New roles of emerging countries in a global economy in crisis

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The increasingly central role of so-called emerging economies is one of the most important features of change in global economy. Their increasingly important position in productive and commercial tasks and their financial and entrepreneurial potential have large geopolitical implications. But these economies are not immune to the consequences of the crisis. Global difficulties can better show the deficiencies of growth factors in terms of solid foundations, such as those referring to institutional quality and sociopolitical mechanisms of social welfare and effective democracy that can appear to be more necessary than they were perceived when managing the expansion benefit in order to share the cost of the crisis.

The increasingly central role of so-called emerging economies is one of the most important features of change in global economy. Their increasingly important position in productive and commercial tasks and their financial potential have large geopolitical implications proven by the fact that it was not the G-7 including the traditional advanced economies that was summoned to create forums to tackle the crisis at international level, but the by now famous G-20, in which also Brazil, Russia, India and China (the BRICs) as well as a second generation of emerging countries including Indonesia, Mexico and South Africa play a role. Emerging countries are increasingly essential players and partners. This means more power but also more (co-)responsibility.

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However, it is also true that these economies are not immune to the consequences of the crisis, against what decoupling theories were suggesting some years ago, by which emerging economies had achieved a dynamism of their own that allegedly allowed them to leave behind their traditional dependence on advanced economies. The 2009 data show how the downward review of growth expectations significantly reaches, albeit quite unequally, emerging countries and forces to reorient some patterns and models. Dani Rodrik said that, with a historical perspective, a change of orientation in China towards more internal demand than so far, when exports used to predominate, could have effects as significant as the very financial crisis. Others indicate how distribution of entrepreneurial and financial power can change during the crisis and turn some emerging countries into emerged ones. But it is also suggested that global difficulties can better show the deficiencies of growth factors in terms of solid foundations, such as those referring to institutional quality and sociopolitical mechanisms of social welfare and effective democracy that can appear to be more necessary than they were perceived when managing the expansion benefit in order to share the cost of the crisis.

The rise of emerging economies in global competition

The role of emerging economies has been acquiring different dimensions juxtaposing in varying proportions according to each country.

Thus, a first perspective, the one initially most present, has been the change of localisation patterns related to given activities or segments of production processes in economies offering advantages in terms of reduced labour costs. The possibility of taking advantage of this cost difference encouraged policies of more openness on the one hand and transport and communication cost reduction on the other, including ICT. All this has allowed to break up production processes into different tasks (of different technological content, with different labour requirements, etc.) and locating or offshoring some tasks –in the words popularised by the studies of Gene M. Grossman and Esteban Rossi-Hansberg (2008)– to emerging and developing economies. These were initially low-skill, labour-intensive tasks, but the most dynamic emerging economies have been recently doing efforts to increase the degree of technological sophistication and labour qualification requirements for the tasks they attract. This way they generate an increase of competitive pressure on jobs and workers in advanced economies.

A second perspective of the role of emerging economies is related to their function as markets with increasing purchasing power, making them increasingly interesting and attractive sales destinations. Many companies not only have the cost reduction incentive to take a position in favour of these economies, but are also close to consumers with a high purchasing potential in different segments: from the wish to improve welfare and consumption patterns of what is called the «new global middle class» (the World Bank expects an increase from 400 million to 1.2 billion people within two decades) to luxury goods addressed to the new elites or, at the other end of income distribution, the potential of the so-called «bottom of the pyramid» that generates low-cost articles such as specific cell phone, computer or even car models. The studies of the Observatori de Mercats Exteriors (OME) examine these changes more in-depth (cf. OME, 2008).

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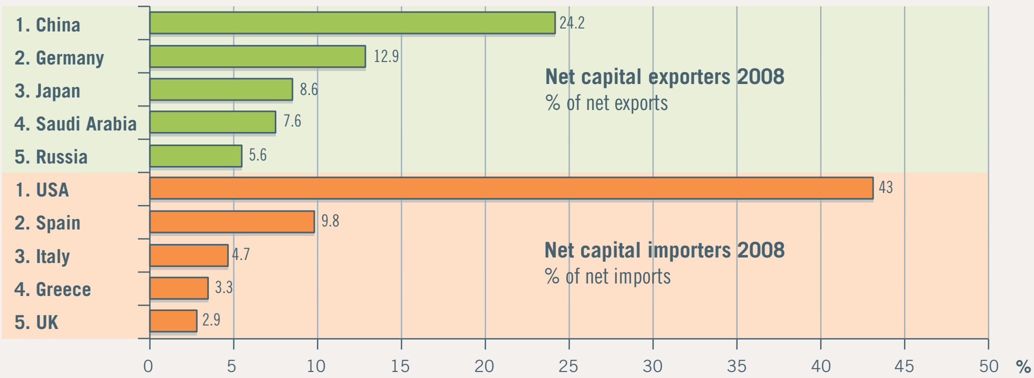
Indicators showing the increasing importance of emerging economies related with these two first perspectives are manifold. Data with a historical perspective of the role of the two most important ones, China and India, in global GDP are shown later. According to a study by the International Monetary Fund (IMF) and the World Bank allowing a more homogeneous comparison between countries, China already ranked second and India fourth in the world in 2007 (the other two BRIC countries were also among the top ten). As has already been said, these positions were achieved with the capacity to attract activities and investment in an increasingly wider product range (both goods and more recently services) on the one hand and with a drive for improving the added value of their contributions on the other. This is well known, as is also its commercial role.

According to WTO data, China climbed to the second position in the ranking of goods exporters (only behind the EU), surpassing even the United States. In 1997, China still was tenth and its export figures have doubled since the turn of the century. Nevertheless, we must not forget that these data also include intra-company trade, in which a considerable proportion of exports include imported inputs. Also, the capacity of emerging economies to absorb imports is not only shown in China's third rank among goods importers achieved in 2007 –according to WTO data– but also in the fact that Russia, India, Turkey, Poland, Brazil and the UAE were in addition to China the countries having experienced an import increase above 20%. Although the crisis will lower these figures substantially, structural change occurred in recent times is obvious.

A more recent additional aspect, deepened in a crisis scenario, is the role of emerging economies with financial capacity. These are economies hosting the headquarters of companies or organisations able to participate in business reconfiguration processes at a global scale, either in the role of purchaser or in achieving powerful positions. In the private sphere, operations that were attention-getting not a long time ago –e.g. the purchase of the IBM PC division by Chinese Lenovo– are now commonplace, with a new role for emerging and advanced economies. Sovereign wealth funds established by countries with a surplus from their profitable trade or revenue from oil and other raw materials are playing an increasingly leading role with the purchase of symbolic assets and shares of companies in industries considered to be strategic in advanced economies (including finance and energy). This phenomenon has become controversial regarding its economic and geostrategic implications. Even principles and practices or codes of good conduct were created –known as the Santiago Principles, established at a meeting in Santiago de Chile in autumn 2008– to counteract reluctance triggered by the lack of transparency and a hardly democratic political situation in some countries with a major financial potential. In any case, the expression «The South goes shopping», coined by S. Garelli from the Institute of Management Development (IMD), describes a new dimension in global competition with complex financial and entrepreneurial aspects.

Graph 1. Main net capital exporters and importers

Data as of 2007: positions and rate on total net capital exports or imports



Source: IMF (2008 b). Appendix.

In 2007, the main capital importers were advanced economies. Among exporters, the leadership of China and the role of oil producing countries is noteworthy.

A significant indicator of the above-mentioned financial and entrepreneurial change is the one described in Graph 1, which shows –based on official IMF data– the main countries with a savings surplus and thus financing capacity (net capital exports) as well as those needing most external financing (net capital imports) in 2007.

China climbed to the second position in the goods exporter ranking, and to the third among importers in 2007.

The fact that the main importers were advanced economies and the dominant role of the United States, Spain, Italy and the United Kingdom are noteworthy, with the discussion this creates about the correlation between such dependence on foreign savings and the depth of the crisis. Among exporters, apart from Germany and Japan, the leadership of China and the role countries benefiting from high prices in oil and other raw materials in recent years is noteworthy. Despite the downward trend of energy prices, these countries play a strategic role, as the gas conflicts between Russia and Europe remind us regularly.

Interrelations between the new financial and entrepreneurial map and the global crisis are deep. A big debate here is to what extent complementariness of strategic interests between the US and China can be challenged by a crisis that poses a limitation to the absorption capacity of advanced economies. This complementariness is based on the US providing China with export markets, high-quality financial assets for savings and technology through direct foreign investment, while China provides labour with various skills and savings complementing reduced domestic savings in the US.

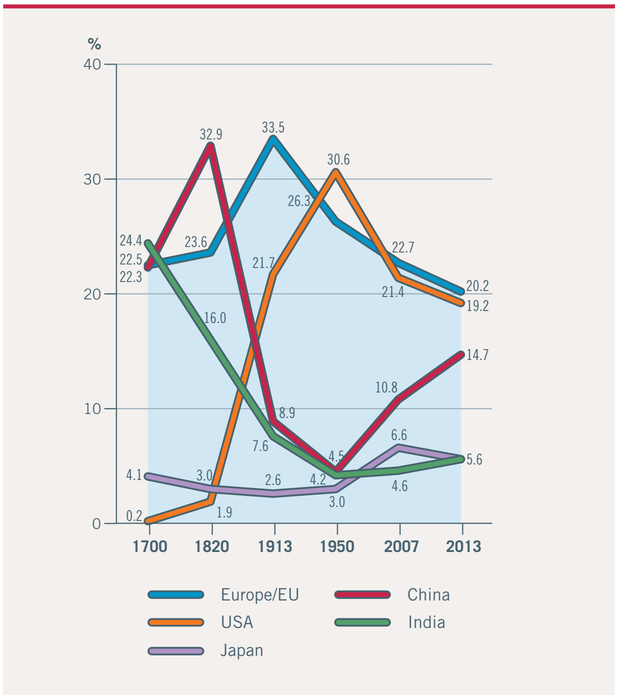
The other point in this debate is how confidence in the capacity of the United States to issue high-quality financial assets will be affected in the light of considerable losses inflicted on some investments of emerging economies in advanced countries due to fraud and toxic assets. These losses may have been one of the drivers of public intervention in some building societies and other US institutions in which China could have large interests, so it could have been geostrategically very painful to allow them go bankrupt. Generally speaking, the situation created when traditional leaders are the main debtors and those aspiring to leadership are creditors is especially delicate and complex during and after the crisis.

Just one comment with a long-term vision: the increasing role of so-called emerging economies takes a different perspective from what we are used to see when placing it in a historical perspective. Graph 2 shows data concerning the distribution of global GDP over different countries or areas after 1700. It combines (on the first columns) data elaborated by Professor Angus Maddison with the most recent IMF and World Bank estimates and projections.

The most commonplace view in advanced countries is that considering only the last three columns. They show how China and India have made progress from virtually marginal positions in the last decades. In fact, the very term «emerging» refers to this evolution. However, a wider historical perspective shows that in the 18th and early 19th centuries, China and India played a role comparable to that of Western Europe but lost their vantage position as they were excluded from the immense benefits in productivity created by the Industrial Revolution. It must therefore be born in mind that from a Chinese and Indian perspective, the current process is not so much about emerging but recovering the position they had historically taken and lost during a certain period out of a little, transitory historical accident. As the configuration of a world order with more items of governance and a more effective and realistic institutional framework requires negotiation –within the G-20 or in any other formal or informal forum– between advanced and emerging economies, it is important that we all bear in mind not only the economic but also the historical and political perspective each group of countries approaches this decisive negotiation with.

***Graph 2.* Evolution of the distribution of global economic weight**

As of global GDP



Source: Historical data: MADDISON (2001). The World Economy: A Millennial Perspective, available at: www.ggdc.net/maddison; 2007-2013 data: World Economic Outlook, April 2008, based on IMF and World Bank data.

▲ In the early 19th century, China and India lost importance as they were excluded from the benefits of the Industrial Revolution.

Is it all gold that shines? Frailties, deepened by the crisis?

The wave of prosperity in recent years in the overall global economy, particularly in emerging countries, pushed back some big frailties that can turn more apparent the weaknesses and undone homework of these economies following substantial reduction of growth rates in times of crisis. Development is not just a matter of quantitative indicators but, as experience with advanced economies shows, also implies social and political, cultural and institutional change, which does not seem to have made progress at the same pace as strictly economic indicators in emerging economies. These mechanisms are especially important to tackle hardship, so the current crisis is a critical period for emerging economies. Given weak foreign demand, will they be successful in attempting to reorient patterns towards internal components, both in consumption and in investment? Following slowdown in growth, which does not allow to create new jobs anymore but rather destroys them, will social and political unrest arise that will test the capacity of these economies and societies to tackle hard adjustments in an efficient way that is perceived as being equitable enough?

Modern growth analysis points out the role of *institutional quality*. This denomination encompasses mechanisms promoting (or not) appropriate incentives to take advantage of a society's whole potential to generate wealth; these mechanisms further allow to solve distribution conflicts in a society in a way considered reasonably efficient and equitable. They include aspects such as safeguard of ownership and the results of effort (as opposed to arbitrary rules and expropriations), reasonable legal security in terms of effective compliance with contracts and appropriate functioning of jurisdictional mechanisms. The latter are especially relevant in case of non-compliance related to investment and intellectual property in order to encourage a framework encouraging investment, know-how transfer and technological projects. Mechanisms of social and political representation are equally important.

As persons and companies having done business in some emerging and developing economies often know out of their own experience, cases in which the frailty of some aspects regarding institutional quality has very harmful effects are not infrequent. Some analysts even find in institutional quality a reserve of comparative and competitive advantage for advanced economies, considering that creating an institutional framework with quality parameters requires a long maturation period and is thus more difficult to be imitated by emerging economies than other aspects related to production or technology.

Some aspects regarding income distribution in emerging economies are not strictly social problems anymore in a crisis scenario, as they also acquire an economic perspective in terms of feasible reorientation of the growth model towards internal demand. Indeed, the capacity of absorption of a market depends not only on its aggregated dimension but also on its distribution and composition. A reference of what we are saying is the so-called Kuznets law, by which times of rapid change –as is occurring in emerging economies now– have an amplifying effect on inequalities at the onset (not all persons, companies or social groups adapt to the new reality and rules at the same pace). But after some time, as adaptation spreads and redistribution measures are taken to ensure social cohesion –and eventually enlarge the internal consumption base– inequality tends to wane.

Emerging economies, most notably China and Russia, have generated large inequalities –first stage of the Kuznets curve– and it remains to be seen if a certain reversal occurs. It is worth pointing out that it is not only a social concern that may affect cohesion of a society, but it is also about efficiency and capacity to generate a model in which internal demand plays a major role. Many observers detect this concern in the above-mentioned countries, even in China, especially as the 2009 growth rate is lower than what is needed to create new job opportunities. Cases like the development in Spain in the 1960s remind that enlarging the middle class base is an important mechanism to widen and consolidate the economic consumption base and the sociological base of transition towards democracy. We already referred to the concept of «global middle class» as a purchasing power potential. However, a turning point in the model towards a more relevant role of internal demand will probably require enlargement of the consumption (which may require further redistribution) and investment base (which may require further stimulation of entrepreneurial capacities in larger segments of the population).

In some countries, especially China, demographic factors associated to rapid ageing due to the one-child policy point towards considerable problems and consequences, not only regarding the productive potential but also social demands, types of needs, migration flows, etc. Therefore, some authors indicate that other emerging economies, foremost India, could have a more promising populational base in the medium term, though putting in all the potential of the new generations could be complicated in the short term, especially in times of crisis.

Finally, but not less important, some other effects of past rapid growth will be felt now in an increasingly visible way. One point to consider is environmental depletion in some countries, especially in areas of recent high, haphazard industrialisation.

Growth models at least as intensive in raw materials and energy resources as those implemented by advanced economies have become a depletion factor of environmental global commons (ozone layer, deforestation and other items related with climate change), which beyond controversies with a further reach than this text, are already affecting human health in some areas.

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