

NOVEMBER 3-5, 2015 TOKYO, JAPAN

---

# EMERGING MARKETS FORUM

---

## 2015 GLOBAL MEETING

---

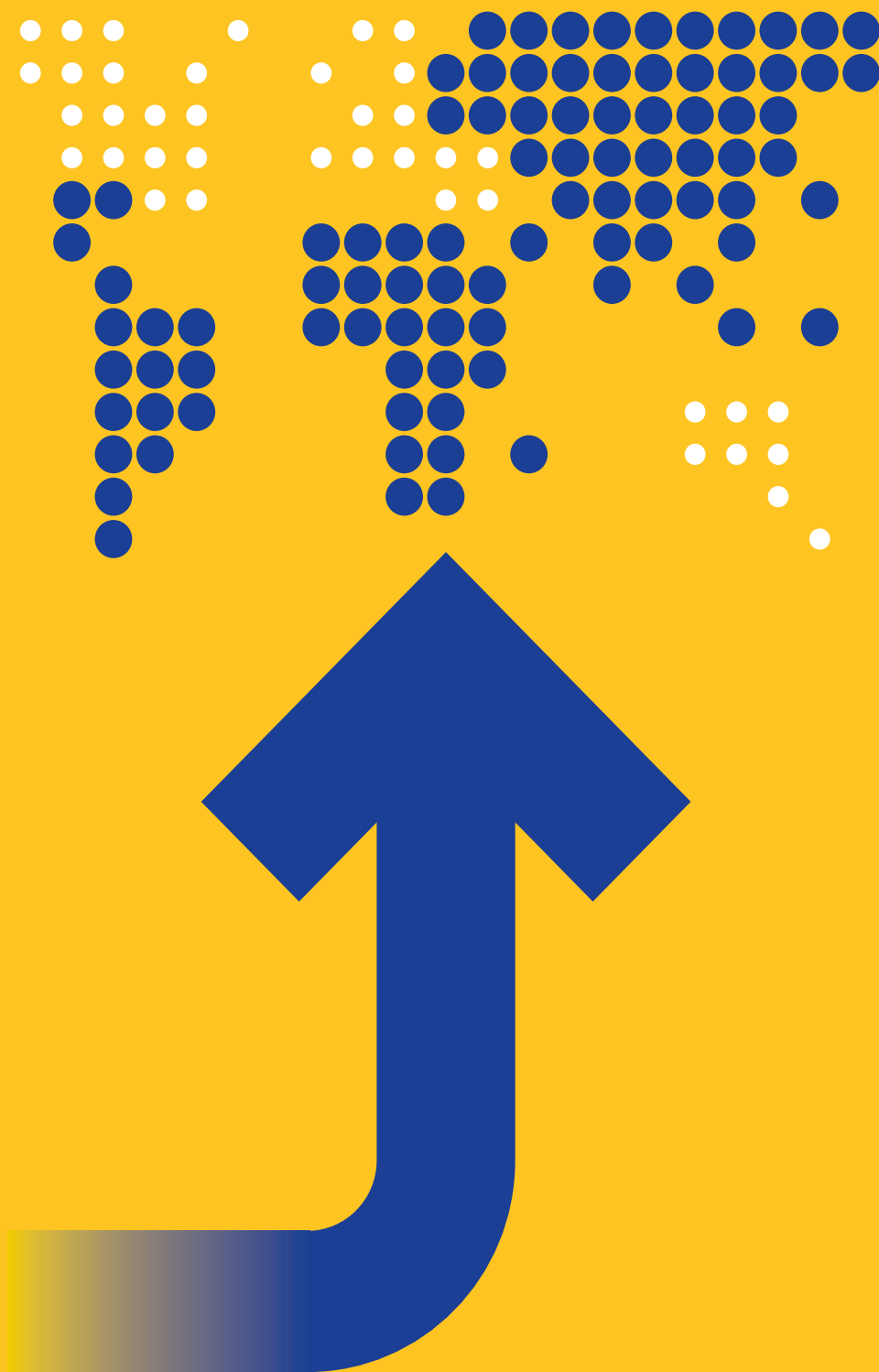
Where will  
emerging  
markets stand in  
global trade?

---

Pascal Lamy

---

Background  
Paper



**Emerging  
Markets  
Forum**

A nonprofit initiative of the Centennial Group





# Table of contents

<b>5</b>	<b>Introduction</b>
<b>5</b>	<b>Shaping factors of emerging countries in global trade</b>
5	<i>Macro-eco consensus on growth and trade volumes</i>
17	<i>Mega-trends impacting the composition of trade</i>
<b>24</b>	<b>Potential disruptions in the intensity of trade and new challenges for the emerging economies</b>
24	<i>Stability of globalisation trends despite de-globalisation or slowdown factors?</i>
27	<i>Potential slowdown risks for the emerging economies within the global economy</i>
<b>33</b>	<b>Evolution of trade obstacles and comparative advantages in global trade</b>
33	<i>Shift from the old trade world to the new trade world</i>
34	<i>Speed and capacity of emerging economies to integrate the GVCs in a time of regulatory convergence</i>
35	<i>Assessing the impact of mega trade deals: possible game changers?</i>
36	<i>The need for collective preferences convergence</i>
<b>37</b>	<b>Conclusion</b>



# Where will emerging markets stand in global trade?

Pascal Lamy

## Introduction

Looking at various sources forecasting trends for emerging markets and developing economies (EMDEs) in the coming two to three decades, there is reason to be confident in their continued catch-up process. The shift of economic power towards the emerging world is on a steady track.

Yet generalising about emerging economies as a whole is misleading. Important disparities exist within this vast category of countries, with an increasing contrast between giants like China and India on one hand, and the rest on the other.

Additionally, and beyond conventional analysis made on the evolution of trade by volume, attention needs to be paid to several factors potentially impacting the intensity of trade. In addition to downside risks, de-globalisation and slowdown factors that could disrupt EMDEs' increasing share of and role in global trade, the increasing importance of new trade obstacles could lead to a fragmentation of global trade patterns. Adequately anticipating these risks requires new thinking.

## Shaping factors of emerging countries in global trade

### Macro-eco consensus on growth and trade volumes

EMDEs have demonstrated their resilience to the crisis, with many bouncing back as soon as 2010-2011.<sup>1</sup> They should remain the primary drivers of global growth in the two next decades, even as they progressively converge with OECD members in the long term. These trends are confirmed by GDP growth rates as well trade growth rates, share of global FDI, and EMDEs' capacity to integrate themselves within global value chains.

1. Their current GDP growth rate remains however below their average annual rate of 7.6 percent seen from 2000 to 2009 which were 4.5 percent higher than the rate seen in rich countries; "Economic Convergence: The Headwinds Return", *The Economist*, 23 September 2014.

## Notwithstanding a deceleration, a growing role in global growth and trade

- EMDEs enter a period of slower growth.

The global economy is expected to pick up speed to reach 3 percent in 2015 and 3.2–3.3 percent in 2016-2017,<sup>2</sup> but should stabilise at around 3 percent per year over the next 50 years.<sup>3</sup>

While advanced economies should reach 2 percent in 2015—first time since 2010<sup>4</sup>—and should keep that pace in the coming decades (around 3 percent in the US and 1.5 percent in the EU), the EMDEs' growth rate should hit 5.4 percent in 2015<sup>5</sup> and should be slightly above 5 percent in the coming decades, and to about half that by 2060.

EMDEs will therefore continue to boost global growth in the two coming decades, despite the long term progressive slowdown of their growth rates, largely driven by the evolution of Chinese growth which is projected to fall to an average 2.3 percent between 2030 and 2060.

- Differences between EMDEs: Asia will remain the growth engine

There are, however, important differences between emerging economies and in the magnitude of the long term slowdown across regions.

East Asia—and most notably China<sup>6</sup>—should remain the engine motor of the emerging world.<sup>7</sup> India's annual GDP growth rate is also expected to soon surpass China's. There are also important intra-regional differences. For example, in Sub-Saharan Africa, some countries (Rwanda, Nigeria, Kenya, and Ivory Coast) should benefit from steady growth supported by consumer-friendly sector diversification.<sup>8</sup>

2. World Bank, *Global economic prospect*, January 2015.

3. OECD, "Looking to 2060: A Global Vision of Long-Term Growth", Economics Department Policy Notes, n°15, November 2012.

4. World Bank, *Global Monitoring Report 2014-2015*, p.4.

5. Ibid, p.3.

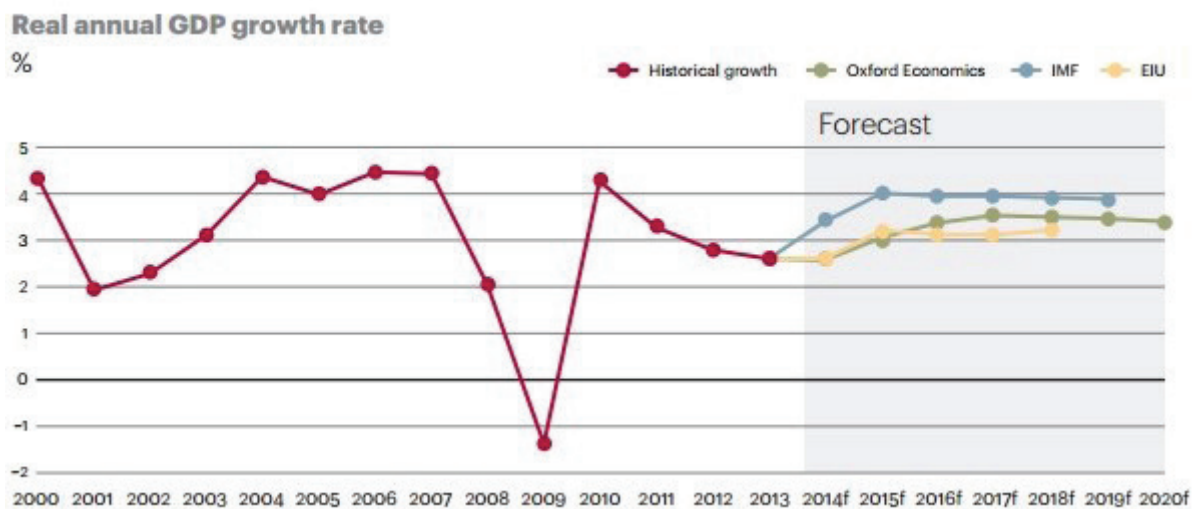
6. If we remove China from the average GDP growth in the emerging world in April 2014, which was around 5.2 percent, then emerging markets only grew at 3.7 percent. World Bank, *Global economic prospect*, June 2014, p.3.

7. IMF, "Emerging Markets in Transition: Growth Prospects and Challenges", Staff discussion note, June 2014, p.9.

8. Coface, "Country Risk Conference", January 2014.

*By 2050, an important convergence is expected between EMDEs, with the exception of China and India which by then are likely to be by far—along with the US—the largest economies in the world.*

**Figure 1: Global growth will stabilize**



Note: Historical growth is an unweighted average of the three sources' GDP data.

Source: A.T. Kearney, *Beyond the Crisis, Sustained Global Economic growth?*, Global Economic Outlook 2014-2020, 2014, p3.

Yet by 2050, an important convergence is expected between EMDEs, with the exception of China and India which by then are likely to be by far—along with the US—the largest economies in the world.<sup>9</sup>

As for global GDP growth trends, the global economic and financial crisis has been a game-changer for global trade growth, not only reducing rates, but affecting the distribution of trade growth unevenly across the world's developed and developing economies.

- EMDEs' share of global trade: modest post-crisis recovery and expansion, but unevenly

When measured conventionally by volume, global trade growth started to bounce back in 2014 with a modest 3.1 percent and could reach a slightly faster rate of 4 percent in 2015, but is not expected to revert to the steeply rising path of the pre-crisis years. However it is forecast to grow

at a robust rate of an average 3.3 percent annually over the next 15 years.<sup>10</sup>

Emerging economies' trade growth will continue to drive world trade growth during the next decades. East Asian economies are currently the most integrated and will continue to outperform developed economies. Of the six economies projected to see the fastest export growth, five are from emerging Asia, with an average growth of 8-11 percent a year between 2014 and 2030.<sup>11</sup> But Africa as well as South America will pursue more regional, continental and international integration which will support continued trade growth, as the economic engine comes from growth but also from multi-localisation (intensity of trade).

9. PwC, *World in 2050. The BRICs and beyond: prospects, challenges and opportunities*, PwC Economics, January 2013.

10. PwC, "What are the prospects for global trade growth?", *Global Economy Watch*, October 2014.

11. HSBC: <https://globalconnections.hsbc.com/global/en/tools-data/trade-forecasts/global>

*Emerging economies' trade growth will continue to drive world trade growth during the next decades.*

**Table 7.1: Average growth rate in trend GDP and trend GDP per capita in USD 2005 PPPs**

	Average growth in GDP in USD 2005 PPPs				Average growth in GDP per capita in USD 2005 PPPs			
	1995-2011	2011-2030	2030-2060	2011-2060	1995-2011	2011-2030	2030-2060	2011-2060
Australia	3.3	3.1	2.2	2.6	1.9	2.0	1.7	1.8
Austria	2.0	1.5	1.4	1.4	1.7	1.2	1.4	1.3
Belgium	1.8	2.1	2.0	2.0	1.3	1.5	1.7	1.6
Canada	2.6	2.1	2.3	2.2	1.6	1.3	1.8	1.6
Switzerland	1.7	2.2	2.0	2.1	1.0	1.5	1.8	1.7
Chile	3.9	4.0	2.0	2.8	2.8	3.4	2.0	2.5
Czech Republic	3.2	2.7	1.8	2.1	3.1	2.6	1.9	2.2
Germany	1.4	1.3	1.0	1.1	1.4	1.5	1.5	1.5
Denmark	1.5	1.3	2.1	1.8	1.1	1.0	2.0	1.6
Spain	2.9	2.0	1.4	1.7	1.9	1.6	1.3	1.4
Estonia	3.6	2.8	2.0	2.4	3.8	3.1	2.3	2.6
Finland	2.5	2.1	1.6	1.8	2.2	1.8	1.5	1.6
France	1.7	2.0	1.4	1.6	1.1	1.6	1.2	1.3
United Kingdom	2.3	1.9	2.2	2.1	1.9	1.3	1.8	1.6
Greece	2.4	1.8	1.2	1.4	1.9	1.7	1.3	1.4
Hungary	2.4	2.5	1.7	2.0	2.6	2.7	2.0	2.3
Ireland	4.7	2.1	1.7	1.9	3.2	1.3	0.9	1.1
Iceland	3.0	2.2	2.4	2.3	1.8	1.2	1.9	1.6
Israel	3.7	2.7	2.6	2.6	1.5	1.3	1.6	1.5
Italy	1.0	1.3	1.5	1.4	0.6	0.9	1.5	1.3
Japan	0.9	1.2	1.4	1.3	0.8	1.4	1.9	1.7
Korea	4.6	2.7	1.0	1.6	4.0	2.5	1.4	1.8
Luxembourg	3.8	2.1	1.3	1.7	2.3	1.1	0.8	0.9
Mexico	2.6	3.4	2.7	3.0	1.2	2.5	2.6	2.5
Netherlands	2.2	1.8	1.6	1.7	1.7	1.5	1.7	1.6
Norway	3.0	2.9	1.9	2.3	2.2	2.0	1.4	1.6
New Zealand	2.7	2.7	2.6	2.6	1.6	1.8	2.2	2.0
Poland	4.3	2.6	1.0	1.6	4.4	2.6	1.4	1.9
Portugal	1.7	1.4	1.4	1.4	1.3	1.4	1.6	1.5
Slovak Republic	4.5	2.9	1.4	2.0	4.4	2.8	1.7	2.1
Slovenia	2.6	2.0	1.6	1.8	2.2	1.7	1.8	1.8
Sweden	2.5	2.4	1.8	2.0	2.1	1.7	1.5	1.6
Turkey	4.2	4.5	1.9	2.9	2.8	3.6		2.5
United States	2.5	2.3	2.0	2.1	1.5	1.5		1.5

Source: OECD (2012), "Looking to 2060: A Global Vision of Long-Term Growth", OECD Economics Department Policy Notes, No. 15 November 2012.

*Of the six economies projected to see the fastest export growth, five are from emerging Asia, with an average growth of 8-11 percent a year between 2014 and 2030.*

**Table 7.1: Average growth rate in trend GDP and trend GDP per capita in USD 2005 PPPs (cont.)**

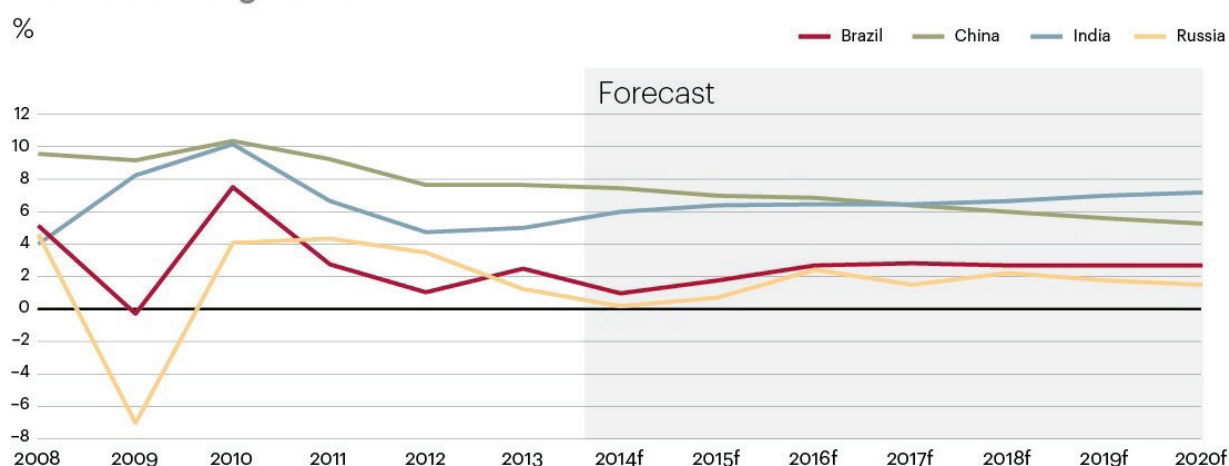
Argentina	3.6	3.6	2.2	2.7	2.6	2.9	1.9	2.3
Brazil	3.3	4.1	2.0	2.8	2.1	3.4	2.1	2.6
China	10.0	6.6	2.3	4.0	9.3	6.4	2.8	4.2
Indonesia	4.4	5.3	3.4	4.1	3.1	4.5	3.3	3.8
India	7.5	6.7	4.0	5.1	5.8	5.6	3.6	4.4
Russia	5.1	3.0	1.3	1.9	5.4	3.2	1.7	2.3
Saudi Arabia	4.4	4.2	2.4	3.1	1.3	2.5	1.7	2.0
South Africa	3.4	3.9	2.5	3.0	2.1	3.4	2.3	2.7
World unweighted average	3.1	2.8	1.9	2.2	2.3	2.3	1.8	2.0
World weighted average	3.5	3.7	2.3	2.9	2.5	3.1	2.3	2.6
OECD unweighted	2.8	2.3	1.7	2.0	2.1	1.8	1.7	1.7
Non-OECD unweighted	4.3	4.7	2.5	3.3	3.1	4.0	2.4	3.0
OECD weighted	2.2	2.2	1.8	3.0	1.5	1.7	1.7	1.7
Non-OECD weighted	6.7	5.9	2.8	3.9	5.6	5.2	2.7	3.7

Notes: Data starts in 1995 or first year available. Aggregate calculations start in 1996, for a few countries, where trend GDP is not available at the beginning of the sample period, actual GDP is used in place of trend GDP. World GDP is taken as sum of GDP for 34 OECD and 8 non-OECD G20 countries.

Source: OECD (2012), "Looking to 2060: A Global Vision of Long-Term Growth", OECD Economics Department Policy Notes, No. 15 November 2012.

**Figure 2: Economic growth in the BRICs**

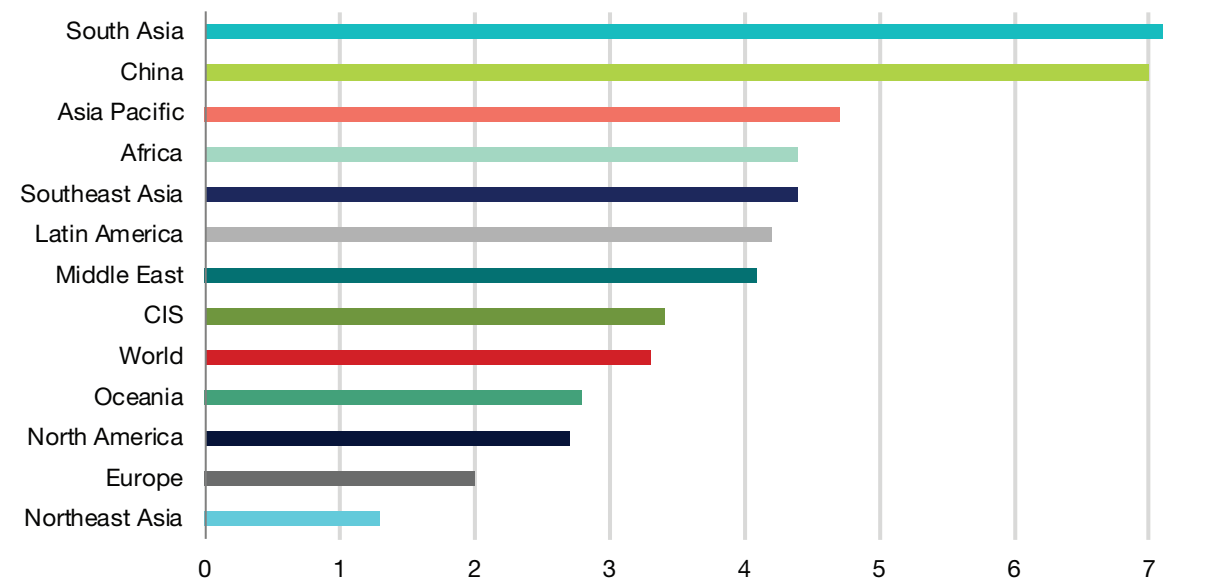
### Real annual GDP growth rate



Source: A.T. Kearney, Beyond the Crisis, Sustained Global Economic growth?, Global Economic Outlook 2014-2020, 2014, p7.

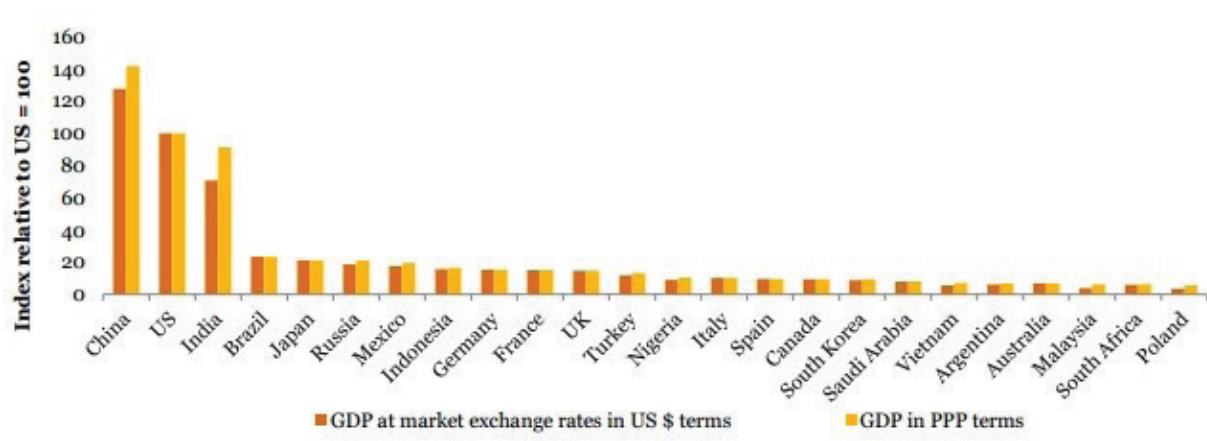
*Africa as well as South America will pursue more regional, continental and international integration which will support continued trade growth, as the economic engine comes from growth but also from multi-localisation (intensity of trade).*

**Figure 3: Projected annual GDP growth (percent), 2011-2030**



Source: Boeing Market Outlook 2011

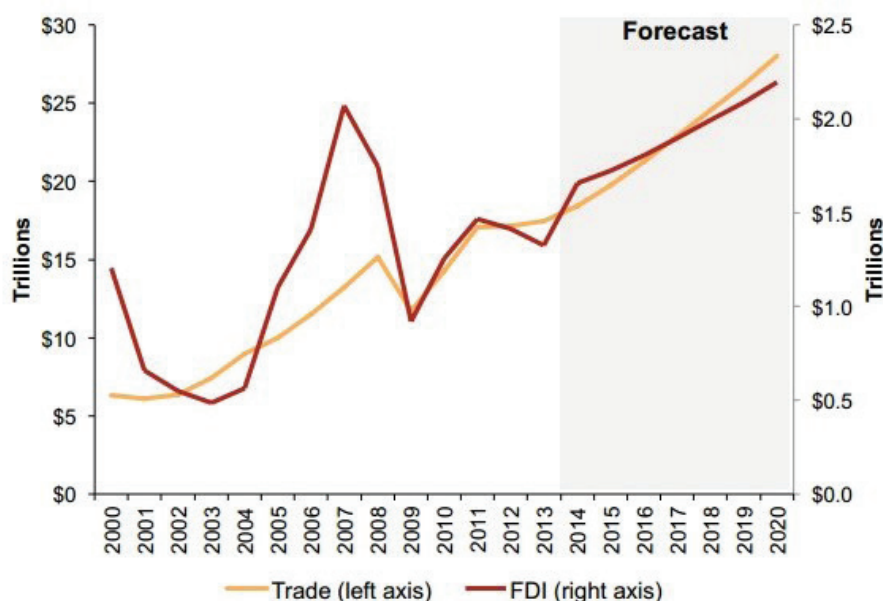
**Figure 4: Relative GDP at MERs and PPPs in 2050 (as percent of US level)**



Source: PwC, 2013, p8.

*The emerging economies' increasing share of global trade will also favour the development of the South-South trade corridor, which has been already particularly resilient to the crisis.*

**Figure 5: Global trade and FDI flows will rebound (nominal US dollars)**



Source: Oxford Economics, A.T. Kearney

**Table 2: Projected average annual growth rate of GDP, exports in goods and exports in services, 2012-2035 (percent)**

	GDP (vol.)		Trade in goods (vol.)		Trade in services (vol.)	
	High	Low	High	Low	High	Low
<b>Developed</b>	2.2	1.5	3.6	1.5	4.9	1.6
<b>Developing</b>	7.1	2.8	8.4	0.4	9.1	3.8
<b>World</b>	4.2	1.9	6.2	1.1	6.7	2.5

Source: "Simulating World Trade in the decades ahead: Driving Force and Policy Implications", Fontagné & alt., WTO Working Paper ERSD, April 4, 2014.

The emerging economies' increasing share of global trade will also favour the development of the South-South trade corridor, which has been already particularly resilient to the crisis.

South-South trade currently accounts for around 25 percent of world trade.<sup>12</sup> With a projected growth of trade between emerging economies at around 6 percent per annum in real terms in the period to 2030—almost twice

the global average rate—its value will continue to converge towards that of North–North trade<sup>13</sup> and the remaining dominant role of developed and advanced economies in world markets will continue to erode.

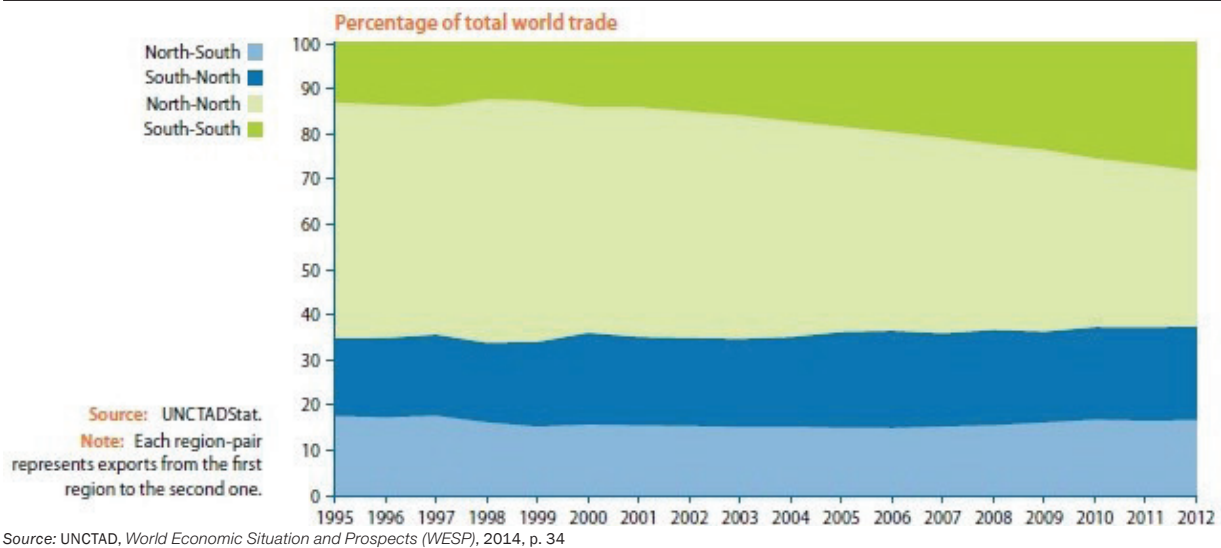
However, the rate of South–South trade has varied across developing regions. Already nearly 50 percent of East Asia trade is currently intra-regional, compared with 20 percent in Latin America and other transition

12. UNCTAD, *World Economic Situation and Prospects (WESP)*, 2014, p.33

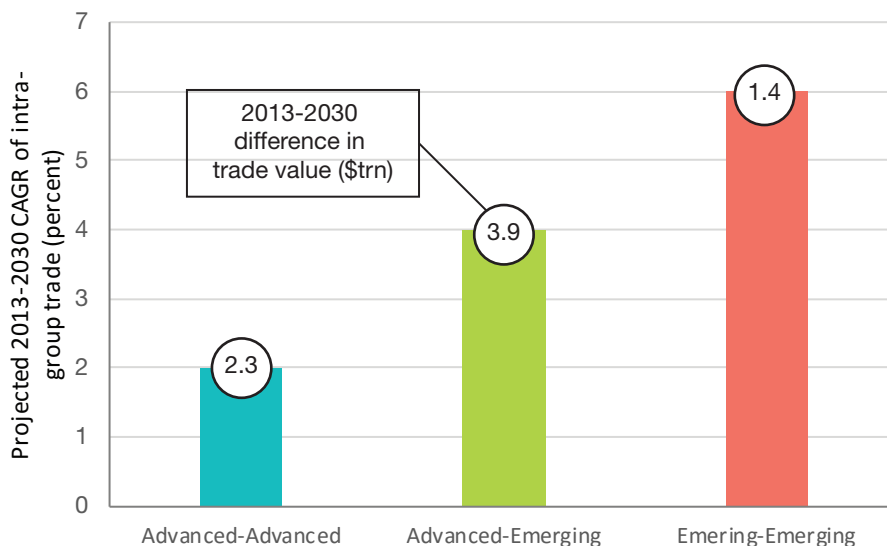
13. UNCTAD, *Key statistics and Trends in International Trade*, 2014, p.12

*By 2030, the trade links between China and India, as well as other South-East Asian economies like Malaysia, Indonesia and Singapore, will become ever more important to global trade.*

**Figure 6: North-South distributions of world trade, 1995-2012**



**Figure 7: We expect goods trade between emerging markets to be the fastest growing bloc**



Source: *What are the prospects for global trade growth?*, Global Economy Watch, PwC, October 2014.

economies.<sup>14</sup> The intra-Asia trade corridor is expected to continue to assert its dominance. By 2030, the trade

links between China and India, as well as other South-East Asian economies like Malaysia, Indonesia and Singapore, will become ever more important to global trade. Of the six

14. UNCTAD, *Ibid*, p.v.

***Emerging economies are also gaining ground in global foreign direct investment (FDI) inflows, related to the localisation of the production processes, and affirming their capacity in FDI outflows.***

countries expected to see fastest export growth between 2014 and 2030, five are in the Far East: China, India, Vietnam, Malaysia and Indonesia – in each of which average export growth is expected at 8-11 percent a year.<sup>15</sup>

### Growing role in global foreign direct investment

Emerging economies are also gaining ground in global foreign direct investment (FDI) inflows, related to the localisation of the production processes, and affirming their capacity in FDI outflows.

FDI global flows have not yet regained pre-crisis levels: after recovering slightly by 4.5 percent in 2013,<sup>16</sup> they declined by 8 percent in 2014<sup>17</sup>; overall FDI levels remain 30 percent below pre-crisis levels and risks remain high.<sup>18</sup> If long-term forecasts for FDI flows for the period up to

2030 are difficult to trace, we can nevertheless expect that, as investment flows are closely connected to international trade, current trends, which have not affected the reorientation of inflows towards EMDEs, will likely persist (see Figure 7).

FDI flows to developing economies proved to be much more resilient than flows to developed countries: in 2012 FDI flows to developing economies exceeded flows to developed economies for the first time ever, with a record 52 percent of global FDI inflows, even as FDI inflows to developed economies fell the same year by 32 percent to \$561 billion, the lowest level in ten years.<sup>19</sup> The same year, 9 developing economies ranked among the 20 largest recipients of FDI inflows in the world, and even 4 of the 5 largest recipients.

Developing economies' global share of FDI inflows had grown to 56 percent in 2014, and is likely to maintain its upward trend along with increasing FDI outflows, which

15. HSBC: <https://globalconnections.hsbc.com/global/en/tools-data/trade-forecasts/global>

16. UNCTAD, *World Investment Report 2013*, p.3

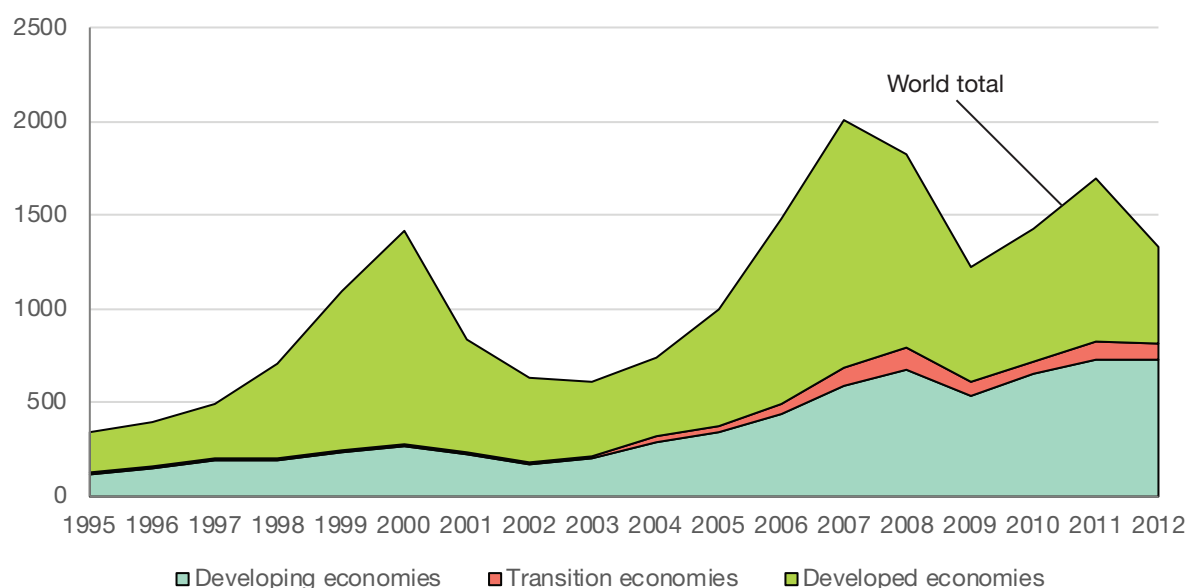
17. UNCTAD, 29 January 2015:

[http://unctad.org/en/pages/newsdetails.aspx?OriginalVersion-ID=920&Sitemap\\_x0020\\_Taxonomy=UNCTAD percent20Home](http://unctad.org/en/pages/newsdetails.aspx?OriginalVersion-ID=920&Sitemap_x0020_Taxonomy=UNCTAD percent20Home)

18. Ibid.

19. Ibid.

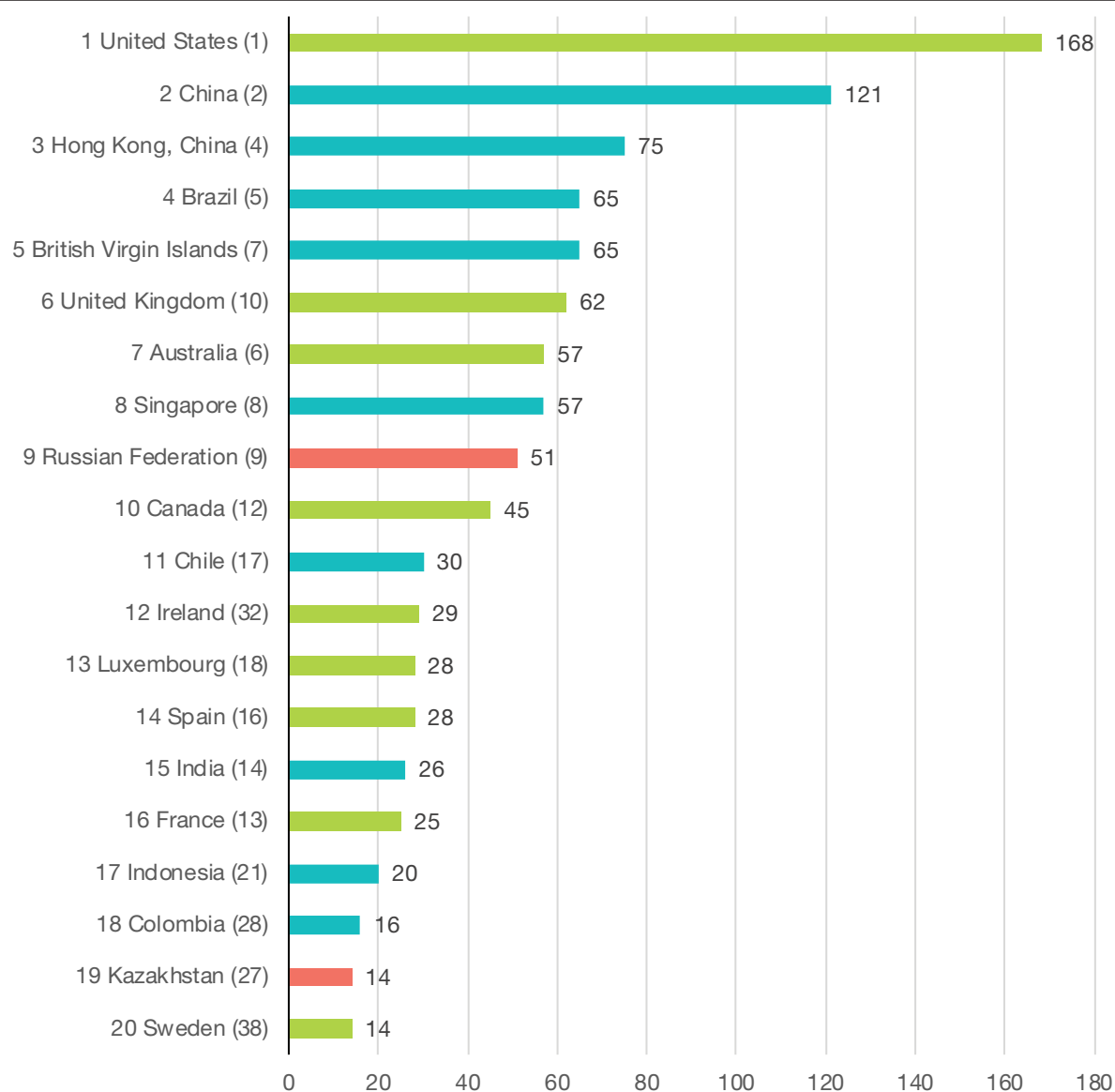
**Figure 8: FDI inflows, global and by group of economies, 1995-2012 (billions of dollars)**



Source: UNCTAD, *World Investment Report 2013*, p.3

*FDI flows to developing economies proved to be much more resilient than flows to developed countries.*

**Figure 9: Top 20 host economies, 2012 (billions of dollars)**



Source: UNCTAD, *World Investment Report 2013*, p.3

***An important driver of emerging economies' global improvement has thus been their integration into those GVCs, including through services exports, as developing economies' total share of global value added trade has increased from 22 percent in 1990 to 52 percent in 2010.***

already represented almost 1/3 of global FDI outflows in 2012).<sup>20</sup> This outflows trend will be supported in particular by the Chinese “go-global” growth strategy.<sup>21</sup>

Among regions, despite weakened growth momentum, flows to developing Asia and Latin America remain at historically high levels. In 2012 Asia accounted for 58 percent of total FDI inflows to EMDCs despite a 7 percent decrease. Inflows went more specifically to East Asian countries.

### Increasing global value chains integration

Part of the increase of trade measured in volume depends on economic growth, while another part depends on the multi-location of production of goods and

services—e.g. the development of the so-called global value chains (GVCs)—which in fact represents an increase in trade intensity.

An important driver of emerging economies' global improvement has thus been their integration into those GVCs, including through services exports, as developing economies' total share of global value added trade has increased from 22 percent in 1990 to 52 percent in 2010.<sup>22</sup> More than half of their total exports in value-added terms are now related to global value chains (GVCs), and South-South global value chain linkages are becoming more important with the share of GVC-based trade between developing countries quadrupling over the last 25 years.<sup>23</sup>

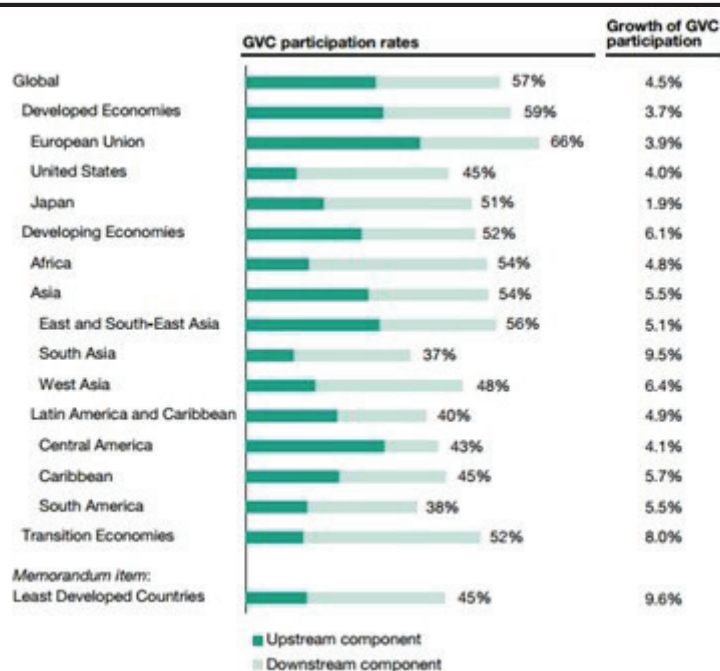
20. Ibid, 2013, piii

21. F. Godement and A. Stanzel, “The European Interest in an Investment Treaty with China”, ECFR Policy Brief, February 2015, p2.

22. UNCTAD, *World Investment Report*, 2013.

23. WTO, *World Trade Report* 2014.

**Figure 10: GVC participation, 2010, and GVC participation growth rates, 2005-2010**



Note: GVC participation indicates the share of a country's exports that is part of a multi-stage trade process; it is the foreign value added used in a country's exports (upstream perspective) plus the value of added supplied to other countries' exports (downstream perspective), divided by total exports. GVC participation growth here is the annual growth of the sum of the upstream and downstream component values.

Source: UNCTAD, *Global Value Chains and Development*, 2013, p11.

*The rapid growth rate of GVCs in the least developed countries is remarkable partly because of a low base in terms of absolute values.*

South Asia remains the lowest-ranked region in terms of GVC participation. Much of the services exports from the region satisfies domestic demand in importing countries and is not used to produce further exports. However, South Asia is also the region with the highest GVC participation growth rate, albeit from a low base.

Transition economies also show faster than average growth. Nearly all developing regions outpace the developed world in GVC growth. The rapid growth rate of GVCs in the least developed countries is remarkable partly because of a low base in terms of absolute values.

As a result, many EMDEs ranked already amongst the top 25 exporting economies with the highest rate of GVC participation.<sup>24</sup> Asia and Africa, in particular, have a central

role, with GVCs participation growth rates progressively approximating developed economies' rates. East and South-East Asia notably remains the region with the highest level of GVCs participation, reflecting its primacy as the most important region for export-oriented manufacturing and processing activities.

Central America (including Mexico) also has a high participation rate in the upstream component, where it equals Southeast Asia. However, it has a lower downstream participation rate, reflecting the fact that it exports relatively more to the United States' domestic market rather than for onward exports.

24. H. Walsh, "Emerging Focus: Global Value Chains—Emerging Markets

Take the Lead," Euromonitor International, 31<sup>st</sup> October 2013.

**Figure 11: GVC participation rate of the top 25 exporting economies, 2010**



Note: The GVC participation rate indicates the share of a country's exports that is part of a multi-stage trade process; it is the foreign value added used in a country's exports (upstream perspective) plus the value of added supplied to other countries' exports (downstream perspective), divided by total exports.

Source: UNCTAD, *Global Value Chains and Development*, 2013.

***China's changing role in global value chains could however be indicative of changing patterns of international production which should also impact other emerging economies' integration in GVCs.***

- The measures of “upstreamness” (distance to final demand) reflect regional and international disparities.

Countries can either be upstream or downstream (depending on their industrial base). Successful emerging economies have become more specialised, moving upstream<sup>25</sup> in GVCs integration (particularly observable in China, Malaysia, the Philippines and Singapore, but also Chile). Asian economies (China, Taiwan, Hong Kong, Malaysia, the Philippines, Singapore, Thailand) have experienced significant increases (over 8 percent increase in value of initial inputs from 1995 – 2008). Countries now seem to specialise in specific business functions and not specific industries per se; country specialisation is thus no longer by industry but by specific functions within the value chain.

- Changing patterns of international production.

Trends in GVC integration should continue despite some contraction of the international portion of GVCs induced by producers switching back to domestic suppliers when faced with decreased trade finance availability and increased perceptions of international risk spread by

25. Countries upstream produce either the raw materials or intangibles involved at the beginning of the production process (including research and design).

the global crisis.<sup>26</sup> This domestic-oriented consolidation of GVCs is consistent with the concept of an “optimal level of fragmentation”.<sup>27</sup> But it is too early to conclude whether GVCs expansion slowing down is cyclical, or indicative of structural change. The apparent resilience of GVCs to the crisis would suggest favourable medium-term growth prospects, particularly as trade intensity increases in continents like Africa.

China's changing role in global value chains<sup>28</sup> could however be indicative of changing patterns of international production which should also impact other emerging economies' integration in GVCs.

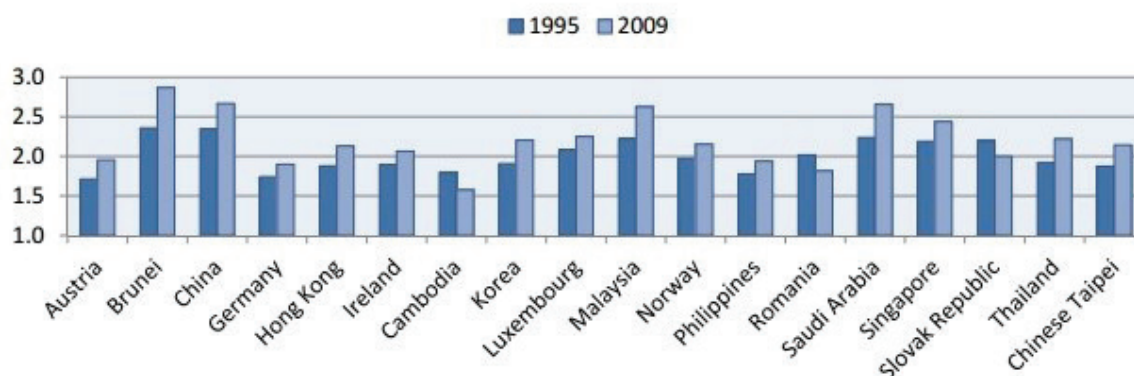
China experienced strong growth in manufacturing exports in the 2000s (with 29 percent growth per year between 2001 and 2008), which involved a rise in both foreign content (intermediate inputs and raw materials shipped from abroad and then processed into exports) and domestic content (domestic factor inputs complementing foreign intermediate inputs and raw materials to produce

26. Trade in intermediate goods, which is at the very heart of global value chains (GVCs), thus fell by 25 percent in 2009. *A global trend to include emerging countries in the value chain*. Coface, March 2014.

27. ECB, *Mapping Global Value Chains*, Koen De Backer and Sébastien Miroudot, Working Paper Series, N° 1677, May 2014, p7.

28. World Bank Group, *Global Economic Prospect*, 2015, p56

**Figure 12: Distance to final demand, selected economies, 1995 and 2009**

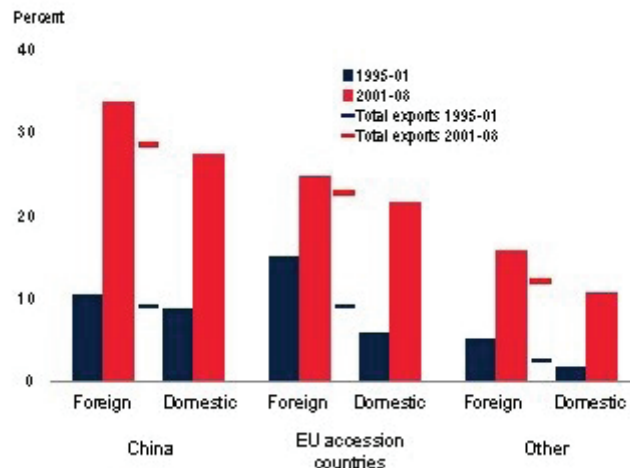


Note: Calculations made using the OECD ICIO model, May 2013 release. The countries represented are those where the distance to final demand increased or decreased by more than 8% between 1995 and 2009.

Source: Mapping Global Value Chains, K. De Backer & S. Miroudot, OECD, Trade Policy Paper No. 159, TAD/TC/WP (2012)6/FINAL, 19 December 2013, p.16.

*As large emerging economies such as China develop greater production capacities, their roles in global supply chains may also change.*

**Figure 13: Growth of foreign and domestic value added of exports and total exports**



Note: Average annual growth for manufacturing goods exports. EU accession countries are Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovenia, and Slovak Republic  
Source: World Bank Group, *Global Economic Prospect*, 2015, p.56.

exports). These grew on average by 34 percent and 27 percent per year respectively, between 2001 and 2008.

The increase in foreign content is partly attributable to China's WTO accession in 2001, which allowed China to expand beyond regional supply chains into global networks; as a result, the share of foreign content from Japan, Korea, and Taiwan in China's exports declined to less than a quarter in 2008.<sup>29</sup> While integrating into global supply chains, China also increased vertical specialisation with increasing domestic value added by Chinese firms, due to substitution of domestic inputs for foreign ones,<sup>30</sup> particularly in knowledge-intensive sectors.

As large emerging economies such as China develop greater production capacities, their roles in global supply chains may also change. These structural changes do not suggest a retreat from globalisation, but they will impact the composition of global trade.

Among the structural factors that should be looked at when assessing development in the modification of the composition of trade in emerging economies, growing middle class and consumption, technological catch-up, increasing natural resources pressures and rapid urbanisation all demand specific attention.

#### **Mega-trends impacting the composition of trade**

Emerging economies are no longer mere producers, but also host a growing middle class of consumers—critical for sustained growth as it drives domestic consumption and demand, and inducing an increase of trade in consumer products and household equipment.

#### **Middle class increase and consumption**

In 2009 the global middle class included 1.8 billion people (664 million in Europe, 525 million in Asia and 338 million in North America).<sup>31</sup> This number should grow to 3.2 billion in 2020 and to 4.9 billion in 2030.<sup>32</sup>

29. World Bank Group, *Global Economic Prospect*, 2015, p.56.

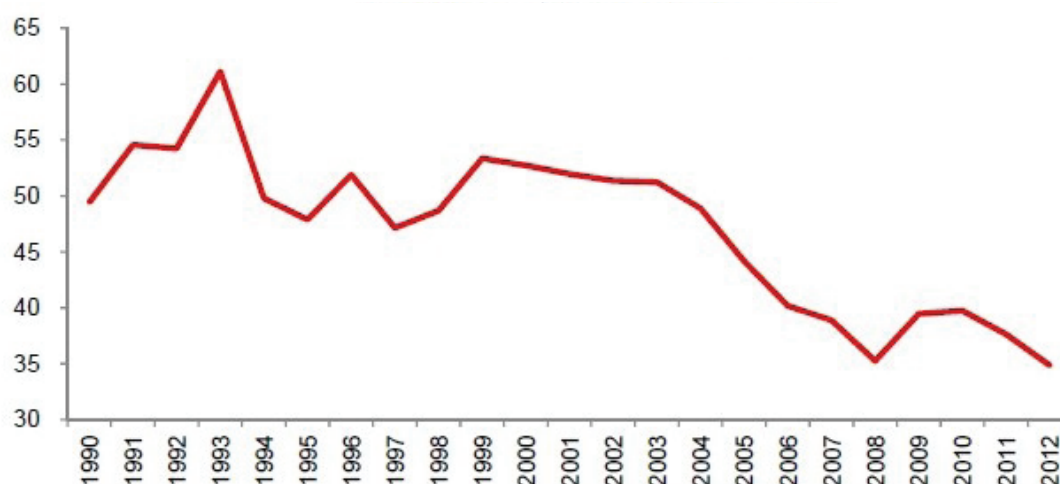
30. Kee Hiau Looi & Heiwai Tang, "Domestic Value Added in Exports: Theory and Firm Evidence from China", World Bank, 2014.

31. National Intelligence Council, *Global Trends Report 2030: Alternative Worlds*, 2012.

32. Ibid, pp. 9–10.

*Since 2012, consumer spending in the seven largest emerging economies ('the E7') has grown four times more quickly than in the G7.*

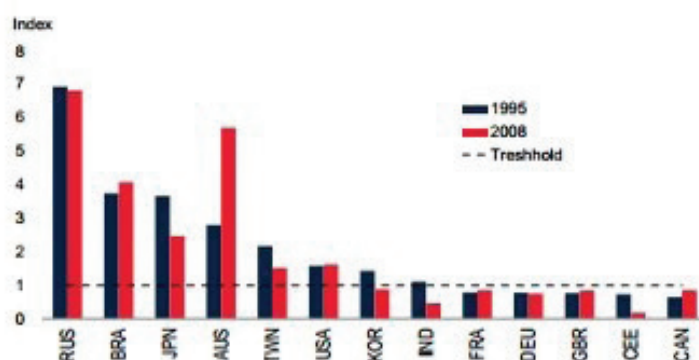
**Figure 14: China's imports of parts and components in total exports of merchandise (percent)**



Note: Classification of parts and components based on UN Comtrade's BEC.

Source: "The Global Trade Slowdown. Cyclical or Structural?", Constantinescu, Mattoo & Ruta, 3rd IMF/WB/WT0 Trade Workshop, 6 November 2014.

**Figure 15: Foreign content in exports**



Note: The index is constructed as a ratio of each country's value added in China's exports to China's value added in the other country's exports. An index value greater than 1 indicates China is downstream relative to the country, while an index value less than 1 indicates China is upstream relative to the country.

Source: World Bank Group, *Global Economic Prospect*, 2015, p57.

Since 2012, consumer spending in the seven largest emerging economies ('the E7') has grown four times more quickly than in the G7.<sup>33</sup> The majority of middle class growth will be driven by Asia, which will represent 66 percent of the global middle class in 2030<sup>34</sup> and 59 percent

of middle class consumption (it represented only 28 percent of the middle class in 2009 and only 23 percent of its consumption).

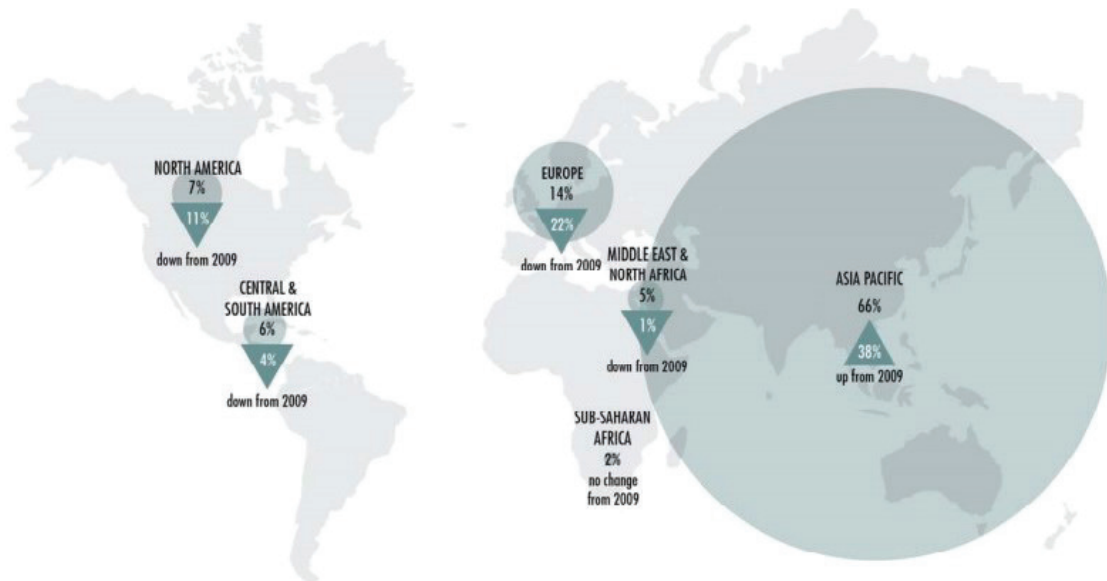
China is expected to be the primary driver of Asian middle class growth; if it makes good on its target of increasing household expenditure at the same rate as GDP, the Chinese middle class will swell, possibly to 75 percent

33. "What are the prospects for global trade growth?", *Global Economy Watch*, PwC, October 2014.

34. H. Kharas, "The Emerging middle class in Developing Countries", Working Paper No. 285, OECD, January 2010, p28.

*China is expected to be the primary driver of Asian middle class growth; if it makes good on its target of increasing household expenditure at the same rate as GDP, the Chinese middle class will swell, possibly to 75 percent of its population by 2030—by which point India's middle class will have surpassed it.*

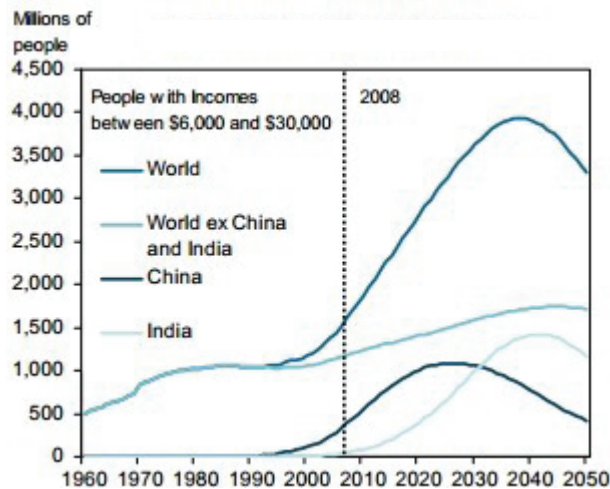
**Figure 16: Asia's role in global middle-class growth: global share of the middle class by region, 2009-2030**



Note: Arrows indicate the percentage increases since 1990.

Source: RAND, *The Rise of a Global Middle Class: Global Societal trends to 2030*, Sam Drabble, Nora Ratzmann, Stijn Hoorens, Dmitry Khodyakov, Ohid Yaqub, 2015, p.15.

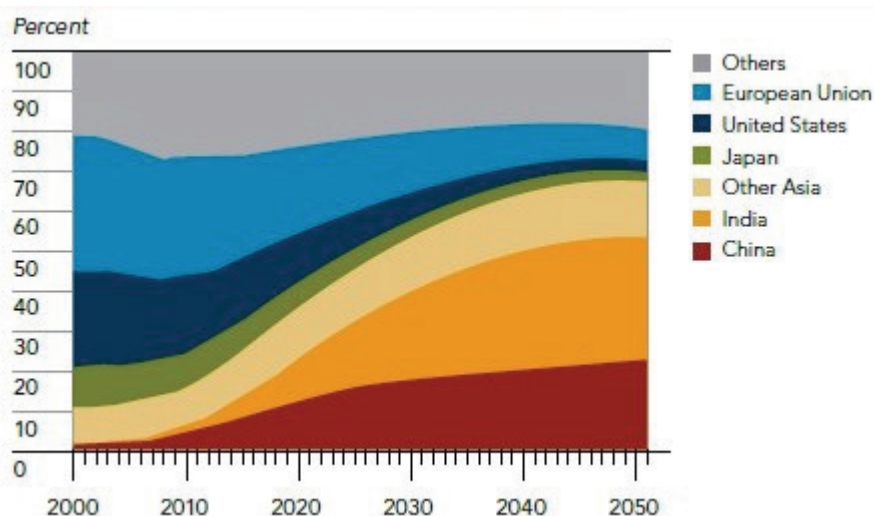
**Figure 17: The expanding world middle class**



Source: "The Expanding Middle: The Exploding World Middle Class and Falling Global Inequality," Global Economics Paper, Goldman Sachs, N° 170, 7 July 2008.

*The rise of the middle class in the emerging economies will increase their appetite for consumer goods and services, as they are likely to desire better health and social system protection, as well as leisure services.*

**Figure 18: Shares of global middle-class consumption, 2000-2050**



Source: OECD, "The Emerging Middle Class in Developing Countries", H. Kharas, Development Centre Working Paper No.285, p29.

of its population by 2030<sup>35</sup>—by which point India's middle class will have surpassed it. Africa's middle class is also expected to grow rapidly, but from a low base.

The rise of the middle class in the emerging economies will increase their appetite for consumer goods and services, as they are likely to desire better health and social system protection, as well as leisure services.

Asia's rapidly expanding consumer appetite will notably have a strong impact on global trade during the next decades, as its middle-class consumption is expected to rise by 9 percent each year through to 2030, while the share of American and European middle class consumption is only projected to rise by 0.6 percent each year in the next decades.<sup>36</sup>

### Technology

The reorientation of global technology's centre of gravity from the West to the East and South will continue.

Among developing countries, the upper-middle income countries achieve today only 3.3 percent of the scientific innovation and invention rate of the high income countries, the lower-middle and low income countries less than 0.6 percent.<sup>37</sup> However, looking at the increase in technological achievement, upper-middle income countries reach almost twice the speed (192 percent) of the developed countries. China itself currently invests 2.0 percent of its GDP in R&D and aims to increase that to 2.5 percent in 2020. By then absolute investment in R&D could be about 80 percent higher in China compared to Germany.<sup>38</sup>

The rate of technological achievement is also still increasing 57 percent more quickly among the lower-middle income countries than in developed countries. Only in low-income countries will the gap in scientific innovation widen relative to developed countries.

Therefore, while the global rate of technological progress is assumed to be around 1.3 percent per year<sup>39</sup> in

35. National Intelligence Council, Global Trends Report 2030: Alternative Worlds, 2012, p9.

36. PwC, 2014, Ibid, p. 10

37. Roland Berger Strategy Consultants, "Trend Compendium 2030", 2011.

38. Ibid.

39. OECD, Looking to 2060: Long-term global growth prospects, Eco-

***Global demand for food, water, and energy is expected to grow respectively by 35 percent, 40 percent and 50 percent by 2030, with global population growing from 7.1 billion today to 8.3 billion in 2030, and reaching between 9 to 10.4 billion by 2045.***

the coming decades, emerging economies are expected to catch up to the developed countries by 2030. By then, some developing countries such as China and India will have become major competitors of the latest technologies and innovations from developed countries. China will continue to actively pursue leadership in areas such as environmentally friendly technologies and alternative energy.

Some developing countries will however remain limited to minimal participation at the global technological frontier. In some cases, (e.g. India, Indonesia and Nigeria), a slower rate of technological progress is expected in the short term, but the pace of catch-up should accelerate in the longer term as these countries strengthen their institutional frameworks and converge to the estimated annual global rate of 1.3 percent of technological progress.

Technology will not only play in emerging economies' rates of convergence and capacity to increase domestic added value, but also in the composition of domestic and international trade. Emerging economies will logically require more advanced technological services sectors, and their consumers will increasingly demand the sort of consumer technology widespread in today's advanced economies.

### **Natural resources**

Global demand for food, water, and energy is expected to grow respectively by 35 percent, 40 percent and 50 percent by 2030,<sup>40</sup> with global population growing from 7.1 billion today to 8.3 billion in 2030, and reaching between 9 to 10.4 billion by 2045.<sup>41</sup>

- While supply of fresh water is already insufficient at current population levels, global agricultural water consumption is expected to grow by 19 percent, and the world's general freshwater needs will have

grown by 55 percent by 2045.<sup>42</sup> Without some sort of mitigating factor, the estimated 450 million to 1.3 billion people who currently suffer from water shortages could grow to 3.9 billion in 2045—roughly 40 percent of the world's population suffering water stress.<sup>43</sup> Fragile states in Africa and the Middle East are most at risk of experiencing water and food shortages, but China and India are also vulnerable.

- In terms of food production, 25 percent of agricultural land is already degraded; however, supply of arable land is supposed to remain roughly constant through to 2045 (with estimates ranging from a 10 percent decrease to a 25 percent increase. Acidification and overfishing will reduce the total amount of harvestable food resources in the oceans. As a result, future food prices are likely to be highly volatile and a general increase is likely. The potential effects of climate change could also increase food prices up to 100 percent of present levels. Such a rise in food prices could lead greater levels of worldwide hunger; global malnourishment could increase by nearly 49 million people by 2045.<sup>44</sup>
- Global energy demand could more than double by 2045, with developing countries being the largest drivers of global demand for energy supplies. While renewables and nuclear are expected to increase, conventional carbon-based energy will remain dominant. However, the growing importance of nuclear could also have knock-on security risks, with increasing availability of fissile material for non-state actors and rogue states. Additionally, the likelihood of developing radical breakthroughs in energy technology through 2045 is unlikely, especially as fossil fuels remain relatively inexpensive.<sup>45</sup>

onomic Policy Papers, N°3, 2012, p.20.

40. National Intelligence Council, *Global Trends 2030*, 2012, p.IV.

41. UK Ministry of Defence, *Global Strategic Trends – Out to 2045*, 30 June 2014, p.XV

42. Ibid, p.45.

43. Ibid.

44. Ibid

45. Ibid.

***The majority of large urban agglomerations are now concentrated in the global South and will develop there.***

Those strong constraints will require important infrastructure equipment and services in emerging economies, impacting the composition of their trade needs.

### Urbanisation

While urban dwellers accounted for only 30 percent of global population in 1950, they now represent 54 percent of the global population (3.9 billion) and are expected to continue on an increasing trend up to 66 percent by 2050.<sup>46</sup> The global rural population, now at nearly 3.4 billion people, will peak over the next few years, then decline and stabilise at 3.2 billion by 2050.<sup>47</sup> In sum, current trends in population growth and urbanisation should add 2.5 billion people to the world's urban population by 2050, for a total 6.4 billion urban dwellers.

The majority of large urban agglomerations are now concentrated in the global South and will develop there.

In cities, one billion people will enter the global consuming class by 2025, with income high enough to become significant consumers of goods and services. Around 600 million of them will live in around 440 cities in emerging market that are expected to generate close to half of GDP growth between 2010 and 2025.<sup>48</sup>

While the Americas and Europe already exhibit high levels of population urbanisation and will be over 80 percent urbanised by 2050; Africa (60 percent rural) and Asia (52 percent rural) are currently the most rural regions—combined, they represent nearly 90 percent of the world's rural populations—but will also be the most rapidly urbanising: these two regions should achieve 56 percent and 64 percent urbanisation of their populations by 2050.

India, China and Nigeria are expected to account for 37 percent of this projected growth between 2014 and 2050: India will add 404 million urban dwellers, China 292 million, and Nigeria 212 million.

Such rapid urbanisation will engender need for infrastructure development, construction, connectivity devices, services and urban management sectors. Major infrastructure projects will be important growth drivers, even as engineering and construction firms are increasingly global. Indeed, construction in emerging markets — including Asia, Latin America, the Middle East and Africa are expected to double within the next decade and become a \$6.7 trillion business by 2020, accounting for some 55 percent of global construction output.<sup>49</sup>

China in particular is likely to have a 25 percent share of urban municipal water demand growth and a share of nearly 40 percent of growth in demand for urban building

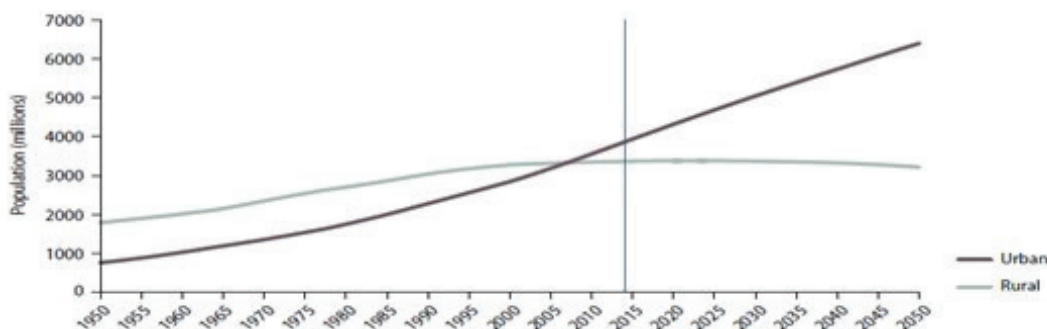
46. UNDP, World Urbanization Prospects Highlights, 2014.

47. Ibid.

48. McKinsey Global Institute, 17 July 2014: <http://gt2030.com/tag/middle-class/>

49. S. Hoover, "Globalization of the Engineering and Construction Industry," FMI Quarterly, Issue 4, 2013.

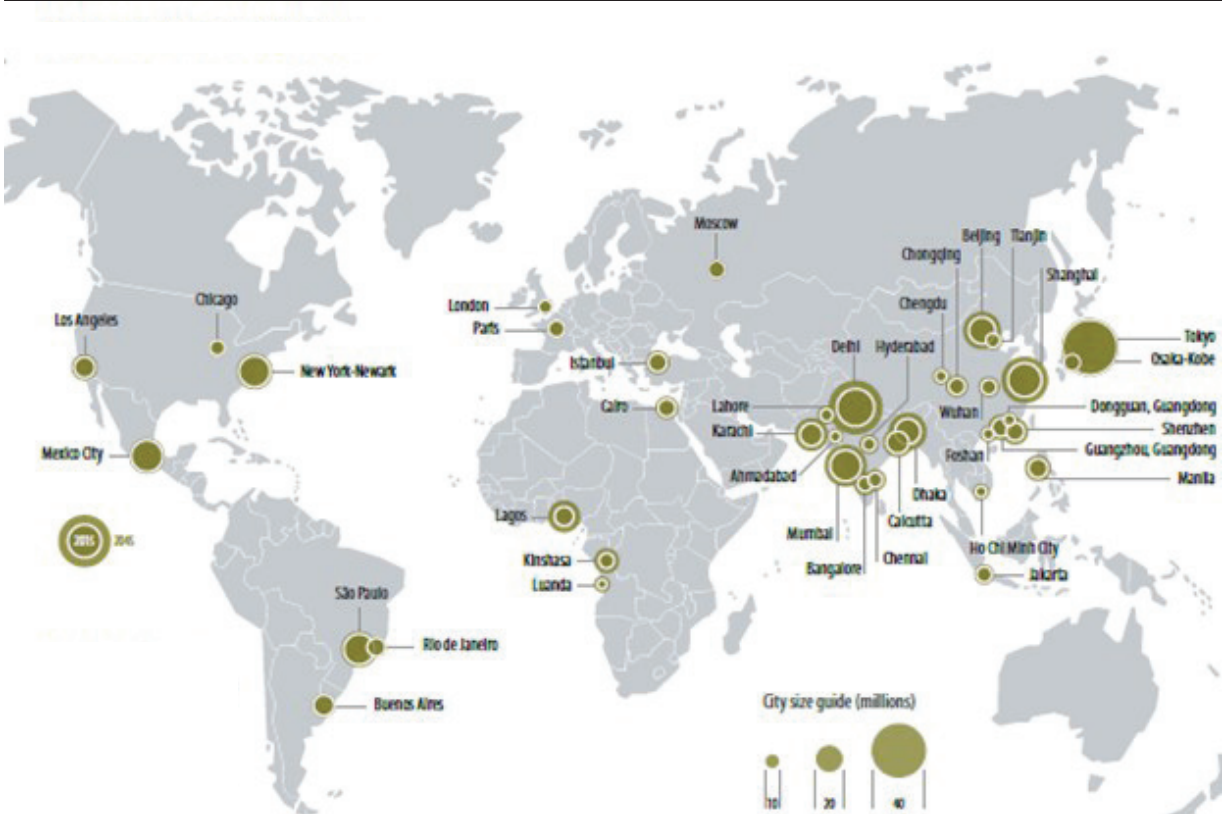
**Figure 19: Evolution and trends for global urban/rural divide**



Source: NIC, Global Trends 2030, 2012.

*Many analysts have nevertheless pointed to possible de-globalisation factors or slowdown risks that could threaten global trade growth generally, and the continued economic convergence of EMDEs specifically.*

**Figure 20: Major centers population in 2015 and 2045**



Note: Shows the top 30 cities by population size in 2015 and 2045 together with those with populations greater than 10 million that are forecasted to increase by more than 40 percent between 2015 and 2045. London is included for comparison.  
Source: UK Ministry of Defence, *Global Strategic Trends – Out to 2045*, 2014

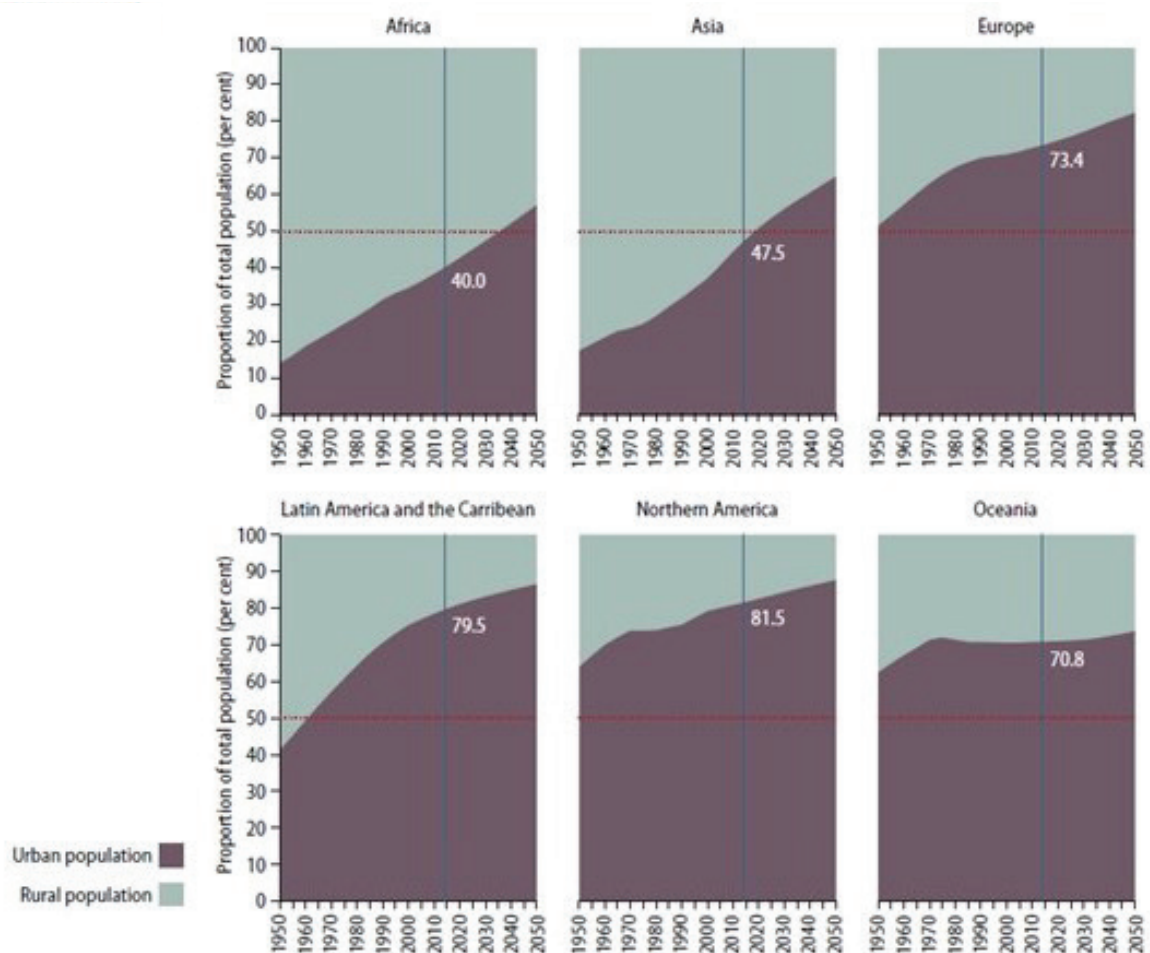
floor space to 2050. Africa and the Middle East will account for almost 14 percent of the global rise in municipal water demand in large cities, almost twice their share of urban GDP growth.

In this first section, we have explored the trends that will shape emerging economies’ continued growing importance in world trade; these trends also help us to understand the probable evolution of world trade’s volume and composition. Many analysts have nevertheless pointed to possible de-globalisation factors or slowdown risks that could threaten global trade growth generally, and the continued economic convergence of EMDEs specifically. Such

observations are correct in a sense—certain factors could well affect world trade growth by volume and its repartition by region and sector. Below, we analyse the potential impact of de-globalisation trends and specific downside risks. However, these trends are ultimately unlikely to derail the intensity of world trade, which will only continue to increase.

*Slower growth in world trade or foreign direct investment sometimes tends to be taken as de-globalisation trends. But they mainly reflect the modest pace of advanced economy growth – notably Europe – rather than a reversal of globalisation itself.*

**Figure 21: Urban and rural populations and proportion of total population, by major areas, 1950-2050**



Source: UN, *World Urbanization Prospects: The 2014 Revision*, 2014, p8.

### **Potential disruptions in the intensity of trade and new challenges for the emerging economies**

#### ***Stability of globalisation trends despite de-globalisation or slowdown factors?***

Slower growth in world trade or foreign direct investment sometimes tends to be taken as de-globalisation trends. But they mainly reflect the modest pace of

advanced economy growth – notably Europe – rather than a reversal of globalisation itself.

However new trends like near-sourcing (favouring production near the consumption of the final product and inducing a reversal of outsourcing manufacturing to low-cost countries) or new automation, manufacturing technologies like additive manufacturing (3D printing) and robotics may be regarded as a potential alternative to

***The speed of the transition and its ultimate impact are uncertain: these technologies could diminish the need for outsourcing by shortening supply chain costs, but it could also replicate the effect of outsourcing by making the supply domestic low- and mid-skilled workers redundant in developed economies.***

global sourcing in order to leverage supply chain responsiveness and economic efficiency.

### **De-globalisation or slowdown factors**

Global production systems have been reshaped over the past two decades by a complex ecosystem of manufacturers, suppliers and logistics companies. But new automation, manufacturing technologies like 3D printing and robotics could reshape work patterns in developed and developing economies alike.

The speed of the transition and its ultimate impact are uncertain: these technologies could diminish the need for outsourcing by shortening supply chain costs, but it could also replicate the effect of outsourcing by making the supply domestic low- and mid-skilled workers redundant in developed economies. However, the rapid adoption of these new technologies in developing economies, particularly Asian ones, will likely stimulate new manufacturing capabilities and further increase competitiveness.

Advanced robotics will also make jump from military to everyday applications:<sup>50</sup> 1.2 billion industrial robots are already in daily operation and new generations of robots are being developed and their functions will span industrial and nonindustrial functionality. If significant advances are made in robots' current cognitive abilities, the need for human labour could be eliminated from some manufacturing environments. The impact of total automation could then be highly disruptive, by reducing overall costs, suppressing wages and reducing employment.

The impact of robotics will not be limited to manufacturing; common service sector jobs like health/elder caregivers may be replaced by autonomous, interactive robots for certain repetitive daily living tasks, which would address some challenges of an aging society. Automation and autonomy in vehicles and transportation systems could help to relieve congestion, solve other urban transportation

problems, and have applications in many sectors including geo-prospecting, mining and agriculture.

3D printing could also be disruptive for GVCs. It can allow producers to avoid high initial costs associated with traditional specialised manufacturing while creating geometrically complex and customised objects. The ability to access 3D object designs online, coupled with relatively cheap productive inputs, could democratise manufacturing and allow individuals or small-companies to make large impacts. Local micro-factories could facilitate consumer access to goods for which transportation costs and delivery times have been high. 3D printing could thus reduce reliance on expensive imports. However, the current production quality is insufficient for widespread adoption, and 3D printing goods may have some functional industrial applications only by 2030.

Those progressive changes in work patterns, which will continue to decisively affect global trade, should impact the volume of global trade and its repartition by region and sector, rather than the intensity of global trade.

Looking at trade measured in value added suggests that, rather than a de-globalisation, we face a structural change in globalisation.

### **Focus on added value rather than cross border trade**

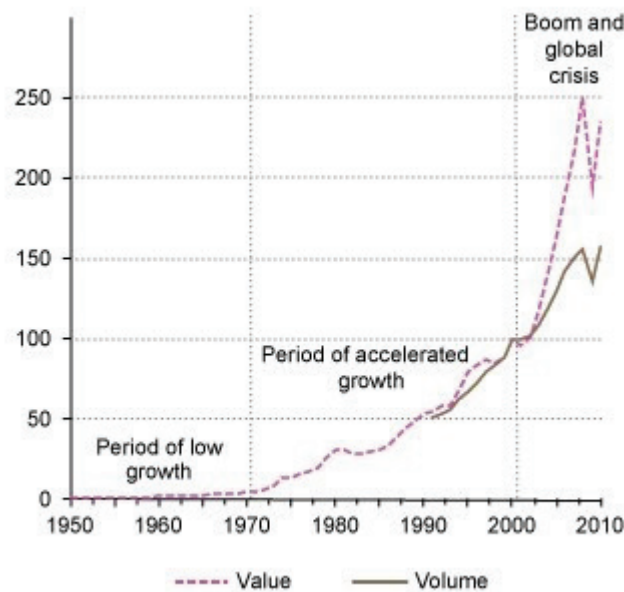
There is indeed widespread confusion concerning measuring trade by volume (measuring the impact of GVCs) and trade in value added (estimating trade as an engine of growth), which is what matters most at the end of the day.

The recent relative decrease of the growth of trade measured in volumes can be attributed to the slowdown of the expansion of GVCs, which may very well not endure, and of the decreasing performance of the reduction of obstacles to trade. But it doesn't tell us much about the impact of trade on growth. It cannot be concluded that the slowdown of global trade—which is in fact a slowdown of the increase of global trade volume—will slow down global growth.

50. National Intelligence Council, *Global Trends 2030: Alternative worlds*, 2012.

*What is at stake for global growth is trade measured in added value: exports-imports compared to the sum of added value represented by the GDP.*

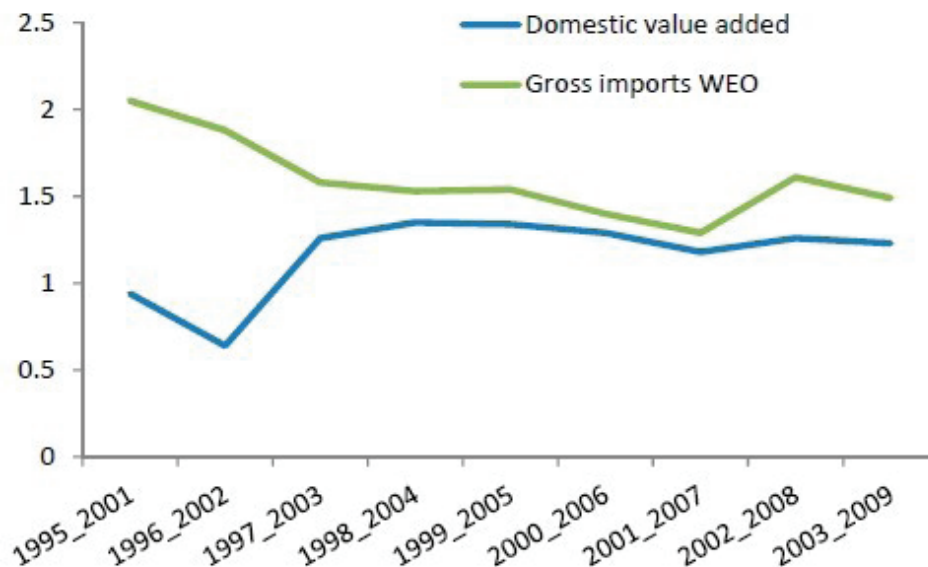
**Figure 22: Long-term trends in value and volume of merchandise**



Note: Index numbers, 2000 = 100

Source: UNCTAD, *Global trade Trends*, 2012

**Figure 23: Lower and more stable estimates of value-added trade elasticities than the gross trade elasticity**



Source: The Global Trade Slowdown. Cyclical or Structural?, Cristina Constantinescu, Aaditya Mattoo and Michele Ruta, Public Policy Research, Working Paper 7158, World Bank Group, January 2015, p39.

***Trade is growing slowly not only because of the slow growth of gross domestic product deriving from the global crisis, but also because of a structural change in the trade-gross domestic product relationship in recent years.***

What is at stake for global growth is trade measured in added value: exports-imports compared to the sum of added value represented by the GDP. Estimates suggest then that trade itself has become less responsive to GDP.

Trade is growing slowly not only because of the slow growth of gross domestic product deriving from the global crisis, but also because of a structural change in the trade-gross domestic product relationship in recent years. According to recent research the explanation may lie in the slowing pace of international vertical specialisation—particularly in two big economies, the United States and China—rather than in increasing protection or the changing composition of trade and gross domestic product.<sup>51</sup> Long term factors would therefore be at stake rather than short term factors.

Yet, emerging economies might face specific slowdown risks. Their resilience to the global crisis has already provoked an active debate. While observers have long questioned the sustainability of EMDEs' growth rates (particularly those of the BRICS nations), there are new signs of slowdown in some of those economies. The principal drivers of recent EMDE growth as well as potential downside risks that could slow continued growth include fiscal and credit risks, the end of a commodity boom, structural under- and unemployment, environmental, social (inequality), and governance and geopolitical risks.

***Potential slowdown risks for the emerging economies within the global economy***

- A less supportive framework for EMDEs' trade growth

External demand and favourable conditions (rising global trade, reflecting expanding supply chains; easy financing conditions driven by low interest rates in AMs; high and rising commodity prices; and marginally higher trading partner growth) were responsible for 25 percent

of the higher growth registered in the average non-commodity EMDEs in the 2000s.<sup>52</sup> These favourable conditions, coupled with continuous trade and financial liberalisation, boosted growth in more non-commodity export-oriented EMDEs and facilitated a surge in capital flows and investment, resulting in higher productivity.

EMDEs' improvement of policy frameworks has also been a positive factor. Many EMDEs used the decade to implement structural reforms, reduce vulnerabilities and build buffers, and to diversify their economic structures, trading patterns, and composition of capital flows. These efforts resulted in lower public and external debt and sovereign spreads, improved international reserve coverage, and more flexible exchange rate regimes in many EMDEs.<sup>53</sup>

But some of those factors may no longer prevail in the coming years. Some large emerging economies have come under market pressure as their growth outlook relative to advanced economies started to look less rosy, advanced economies began to normalise their monetary policy, and external financial conditions started to tighten.<sup>54</sup> Actual growth rates may vary substantially across regions, depending upon geopolitical tensions and the possible tightening of financial conditions.<sup>55</sup>

It has been even suggested that five fragile emerging economies (Brazil, India, Indonesia, Turkey and South Africa) may have realised nearly all of their "catch-up" potential.<sup>56</sup> Structural economic reforms have decelerated. With rapid growth from 2000 to 2012, they didn't keep the pace of the structural economic reforms carried out from 1980 to 2000, thereby reduced their immediate future growth potential and created a potential for economic crises in the short to medium term.

51. The Global Trade Slowdown. Cyclical or Structural?, Cristina Constantinescu, Aaditya Mattoo and Michele Ruta, Public Policy Research, Working Paper 7158, World Bank Group, January 2015.

52. IMF, "Emerging Markets in Transition: Growth Prospects and Challenges", Staff discussion note, June 2014, p7.

53. IMF, "Emerging Markets in Transition: Growth Prospects and Challenges", Staff discussion note, June 2014.

54. Ibid.

55. Ibid.

56. Aslund Anders, "Why Growth in Emerging Economies is Likely to Fall", Peterson Institute for International Economics, 2013, pp.4 – 5.

***Vulnerabilities will persist in several economies if domestic credit and demand were to expand too rapidly in response to increased financial inflows.***

Anders Aslund<sup>57</sup> considers that the governments of many emerging economies have also drawn the wrong conclusion from developments during the Great Recession, considering that state capitalism and industrial policy have proven superior to free markets and private enterprise. In addition, while the opening of developed countries has been very beneficial to the emerging economies, the lack of full reciprocity may push the West to proceed with more selective, regional trade agreements rather than with general liberalisation.

The risks that may impact trade are the following:

- Fiscal and credit risks

Financial and policy adjustments (depreciations, interest rate hikes and other policy measures) imposed since summer 2013 have contributed in the short term to narrow current account deficits and slow credit growth in several of the countries hardest hit by the crisis (India, South Africa and Thailand).<sup>58</sup>

But global financial market volatility remains a risk for developing countries. Domestic price and wage pressures remain strong and current account deficits high in countries like Brazil and Turkey. Vulnerabilities will persist in several economies if domestic credit and demand were to expand too rapidly in response to increased financial inflows. Heightened risks of inflation volatility in one or more of these economies and the spread of country-specific problems could spark contagion to other countries.

- Debt

In contrast to AMs, emerging economies have large foreign reserves and low public debt, hence little funding problems, but in relative terms their reserves have not grown substantially.

Despite fiscal conditions that are generally not worrisome, exceptions exist in developing countries and fiscal balances have deteriorated substantially since 2007:<sup>59</sup> despite solid growth, debt levels have increased by 10 percent (or more) of GDP in more than half of developing countries. In the middle-income countries that combine high inflation and elevated current account deficits, macro policy needs to be tightened. Elsewhere the need to slowly reduce deficits lies on a more prudential argument, as many countries need to anticipate a medium-term environment where debt-servicing costs are likely to rise, and, in the case of commodity exporters, governments revenues are likely to weaken.

- A downturn in credit cycles

Substantial increase of leverage in a number of countries – Russia was 52.5 percent in 2013, while China was 140 percent—suggested growing worry of credit booms, particularly in Asia, where countries like Singapore, Malaysia, Thailand, Taiwan and China have private sector credit to GDP ratios of over 100 percent.<sup>60</sup> The end of the credit boom and higher costs of funding would thus amplify risks—notably profit pressures—for emerging economies.

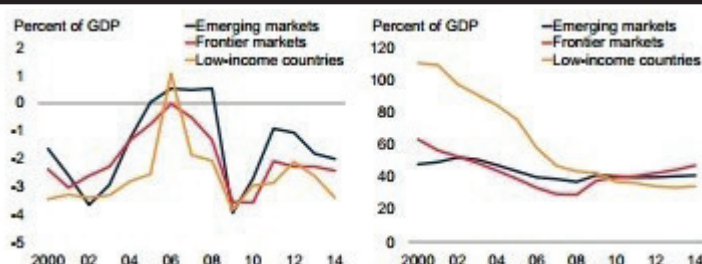
57. Ibid.

58. World Bank, *Global economic prospect*, June 2014, p. 5.

59. Ibid, p. 6.

60. World Bank datas: <http://data.worldbank.org/indicator/FS.AST.PRVT.GD.ZS>

**Figure 24: Fiscal balance (left) and government debt (right)**



Source: World Bank, *Global Economic Prospect*, January 2015, p.14.

***A key risk is thus the pace of deleveraging in China, which by being too slow—or supporting the economy by traditional credit levers—risks a hard landing in the medium term; or by being too fast, would provoke a credit crunch which could in turn intensify existing pressures on the corporate, property and financial sectors.***

Their banking systems require a cooling phase of slower credit expansion.<sup>61</sup>

In China, in addition, a massive residential and construction boom—a key driver of growth in recent years—is cooling and could turn into sharp correction as credit standards are tightened. A key risk is thus the pace of deleveraging in China, which by being too slow—or supporting the economy by traditional credit levers—risks a hard landing in the medium term; or by being too fast, would provoke a credit crunch which could in turn intensify existing pressures on the corporate, property and financial sectors.<sup>62</sup>

This transition will be complicated by the need for China to move from an abnormally high investment cycle to a more normal investment ratio; as its investment ratio has risen from a sound rate of 35 percent of GDP in 2000 to a—hardly sustainable—extreme level of 48 percent of GDP in 2009 and 47 percent in 2012, while Anders Aslund suggests that the ideal developing economy should have an investment ratio of 30 to 35 per cent of GDP.<sup>63</sup>

- The end of a major commodity boom

Indicators suggest that the decline in commodity prices, starting with the price of crude oil, is likely to continue for some time and will have a negative impact on commodity exporting economies. Producers in Latin America (Chile, Colombia), Sub-Saharan Africa (Zambia, South Africa), and Central and East Asia (Mongolia, Indonesia) will be particularly affected by oil, metal and coal prices remaining well below 2013 levels.<sup>64</sup>

Sustained low oil prices will weaken activity in exporting countries, with spill overs to trading partners and recipient countries of remittances or official support. A sharp recession in Russia will dampen growth in Central Asia, while weakening external accounts in the Venezuela or Gulf

Cooperation Council countries may put at risk the external financing support they provide to neighbouring countries. On the other hand, it may be positive for oil importing countries – which are many!

- Structurally high unemployment and underemployment

Labour markets in EMDEs are still not expanding at the same pace of their population growth rate. As 90 per cent of the global youth population is currently living in those countries, this generation is often exposed to unemployment, or to informal employment—thus omitted from statistics and likely cut off from the social benefits and protections of formal employment.

Prospects for younger generation are brighter in high-growth markets, particularly in Asia, where a new middle class is rising. In Africa, where the youth population currently totals 200 million and is projected to double by 2045, sufficient economic opportunities will need to be generated to absorb this growing and increasingly better-educated labour force. Yet the young need to adapt quickly as traditional societies change and new skills are required and skills mismatch remains a particular problem in Africa as well as in the Middle East.

Young people in low-income economies usually cannot benefit from social protection systems. The extent of unemployment and underemployment risks generating social instability, especially in post-conflict settings or fragile states, as evidenced by the Arab Spring. Nearly two-thirds of the youth in developing economies are not achieving their full economic potential, which holds these economies back significantly.

In addition, the rural-urban migration concentrates unemployment risks and vulnerabilities in megacities. The growth of populations and cities puts also pressure on food production, so the prospects for a young generation of farmers also need to be addressed.

However, in some emerging economies, demographic shifts mean the relative supply of labour will be decreasing within a decade or two. In China, for example, the

61. World Bank, *Global economic prospect*, June 2014, p26.

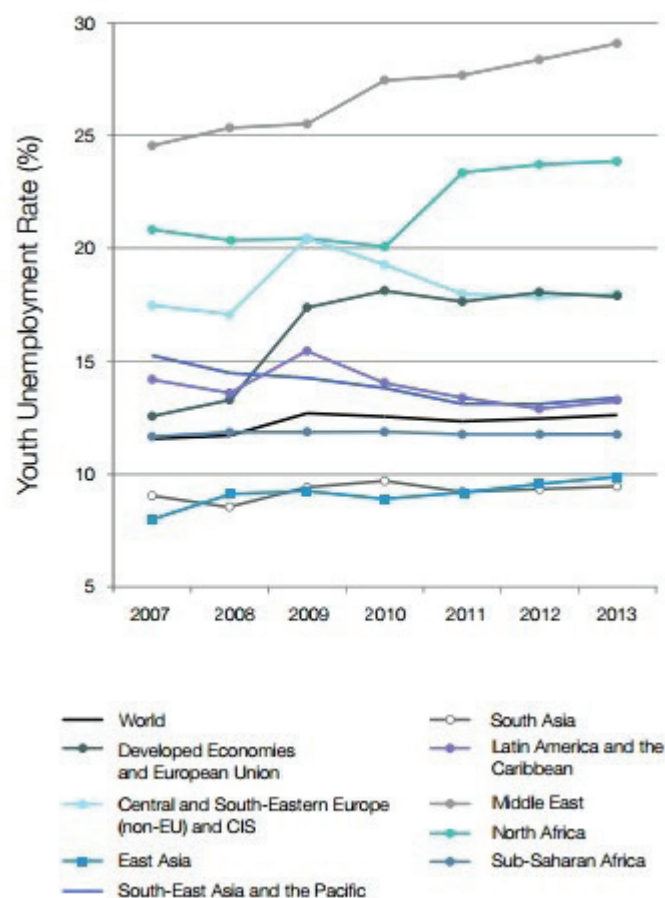
62. Ibid.

63. A. Anders, Ibid, 2013, p.9: Four other large emerging economies (Brazil, South Africa, Turkey, and Russia) have too low investment ratios with 18 to 21 percent of GDP, and most other large emerging economies are neglecting investment in infrastructure.

64. World Bank, *Global Economic Prospect*, January 2015, p15.

*Very quickly, demand for skilled and educated people is expected to exceed supply.*

**Figure 25: Youth unemployment rate by region (2007-2013)**



Source: ILO 2013b

number of university graduates currently exceeds market demand in many regions, but the situation is projected to flip by 2020, with demographic change and the shift from industries to services. Very quickly, demand for skilled and educated people is expected to exceed supply. This will ease the problems of unemployment and underemployment for the next generation, but many in the current generation may remain “lost” in unstable, low-paid and low-productivity jobs in the informal economy.

- Severe income disparity

The extreme poverty rate has fallen from around 52 percent of the total developing world population in 1981 to 21 percent in 2010.<sup>65</sup> But a high level of Gini coefficient, an index used to measure wealth inequality, remains a normal characteristic of an emerging market. And the continuous rising income inequality expected in emerging economies<sup>66</sup> could amount to an overly excessive burden, as it

65. Standard Chartered Bank, *Taming the Gini: Inequality in perspective*, Special Report, 16 July 2014, p7.

66. Ibid, p10.

***Least developed countries will be particularly exposed to the challenges caused by climate change (extreme drought, reduced crop yields, increased energy stresses and water shortages).***

threatens societal gains in life expectancy and quality, and is a source of social and political unrest that can undermine investor confidence and the business environment.

Sustained income inequality has a negative and statistically significant impact on growth in the medium term; specifically, analysts found that an aggregate rise of 3 points in a Gini coefficient over 20 years would lead to an average 8.5 percent cumulated loss in GDP for the same period.<sup>67</sup>

In addition to direct economic impact, persistent severe income inequality could prevent emerging economies from transitioning towards the consumer demand and service sector-based economies that characterise high income countries, effectively trapping them in the “middle-income trap”.<sup>68</sup>

The case of China is particularly worrying as the magnitude of income disparity has gone beyond the warning levels. While it was forecasted that by 2015 over 60 percent of China’s disposable income would be earned by the middle class, by 2025, over half of the income could be earned by the upper middle class.<sup>69</sup>

- Water and food crises

While population grew fourfold in the 20<sup>th</sup> century, demand for freshwater grew nine fold. Indeed, water and food demand are expected to grow by 40 percent and 35 percent respectively by 2030; such growing demand will raise food prices and could potentially ravage poorer and developing economies.<sup>70</sup> Agricultural productivity even risks declining in certain regions, even as population growth amplifies demand for food.<sup>71</sup>

Poor water quality is also an issue and can disrupt global value chains and daily business operations, as well as damage corporate reputations. Despite the need for

regional and global investment packages in water management infrastructure, many emerging countries are not engaging sufficiently in the struggle to properly manage climate variability and water resources.

- Failure of climate change mitigation and adaptation

The cost of climate change adaptation for developing countries is estimated to be up to USD 70–100 billion per year to 2050.<sup>72</sup> Without greater progress and financing to contain global warming, those economies will remain exposed to the systemic risks deriving from increasing incidence of extreme weather events (droughts, floods, super storms, etc). Least developed countries will be particularly exposed to the challenges caused by climate change (extreme drought, reduced crop yields, increased energy stresses and water shortages).

Meanwhile, the conventional energy sources tied to climate change, including coal and hydrocarbons, will remain dominant, but renewables and nuclear should increasingly contribute to the global energy mix. A rise in resource protectionism for water, oil, rare earth elements and other critical materials is likely to continue or increase through to 2045, and could very well lead to increased geopolitical tensions.

The true costs of carbon-based energy use and emissions currently remain external to most mainstream growth models. However, major stakeholder buy-in like the recent Chinese-American “climate pact” suggests that both growth models and global markets should increasingly internalise these costs. Such an internalisation would logically affect real prices in energy markets and would quite likely and significantly reorient global trading patterns and activity. Failure to properly internalise true costs will only prolong half-hearted efforts to mitigate climate change. Nowhere will such failure be felt more strongly than in poor and developing economies. Some studies estimate that the effect of unmitigated climate change is such that average annual growth rate in poor regions is cut from

67. OECD, *Focus on Inequality and Growth*, December 2014, p.2.

68. Egawa, Akio, “Will Income Inequality Cause A Middle-Income Trap in Asia?”, *Bruegel*, 2013, Brussels, Belgium.

69. Ming Wang, Jerome Yen & Kin Keung Lai, *China’s Financial Markets*, Routledge, 2014, p.210.

70. National Intelligence Council, *Global Trends Report 2030: Alternative Worlds*, 2012, p.v.

71. UK Ministry of Defence, *Global Strategic Trends – Out to 2045*, 30 June 2014, p. 21.

72. UNEP, *The Adaptation Gap Report 2014*, December 2014, p.xiii.

***Geopolitical risks ranging from terrorism, resource disputes, failed governance, to organised crime or illicit trade, remain as well elevated; and aggressive foreign policies, whether military or commercial, on the part of global or regional powers could spread profound political and social instability and disrupt global markets.***

3.2 percent to 2.6 percent, which means that by 2100 per-capita GDP is 40 percent below reference.<sup>73</sup>

- Growing risks related to urbanisation

The majority of the almost doubling of urban population by 2050 will take place in middle- and lower-income countries that have more limited capacity to mitigate associated risks. Emerging economies will be especially vulnerable to the chronic instability caused by slums, which currently affect 1 billion people (1/3rd of current global urban population) and which are expected to grow quickly as 40 percent of the world's urban expansion is taking place in slums.<sup>74</sup> Furthermore, urban areas in EMDEs will be exposed to communicable diseases spreading more quickly in densely-populated areas. As interconnectedness of major cities by air link means 3 billion people could rapidly be exposed to pandemics, these global risks could impact GVCs as well.

- Health care challenges

Slower economic growth will make health care funding a defining challenge for all countries over the next 10 years. Ageing populations and the persistent rise in chronic and lifestyle diseases will force both AMs and EMDEs to transform health care provision.

In EMDEs, any failure to create sustainable universal health care systems – a constitutional obligation in Brazil and Turkey, a stated ambition in India, Indonesia and South Africa, and now a reality as in Rwanda or Namibia – may arouse social unrest.

It is likely that EMDEs will pragmatically open up investment opportunities for foreign firms in healthcare and pharmaceutical provision, albeit sometimes in partnership arrangements. Foreign involvement will probably be hampered in areas that are easily managed domestically, such as the production of simple generic drugs, though more complex areas, such as biologics, may well remain open. Requirements for technology transfer and assistance for

local research and development (R&D) are likely to intensify, however – as is apparent in the Russian Federation's Pharma 2020 strategy.

Cost pressures in these countries are likely to lead to the increasing use of compulsory licences, harder scrutiny of pharmaceutical patents and demands for transparency on pricing, as well as controversial pricing mechanisms to lower drug costs. India has already implemented such measures, and similar approaches are anticipated in Brazil, South Africa and possibly China. Rather than taking a blanket protectionist stance, it is likely that governments will target the drugs that cost them the most money, such as those for oncology.

- Geopolitical and governance risks

Political revolutions, natural disasters or military conflicts, which are inherently difficult to predict, can throw countries off their equilibrium growth paths for long periods of time. Geopolitical risks ranging from terrorism, resource disputes, failed governance, to organised crime or illicit trade, remain as well elevated; and aggressive foreign policies, whether military or commercial, on the part of global or regional powers could spread profound political and social instability and disrupt global markets. The American National Intelligence Council underlines that the governance gap could be a global game-changer in that the abilities of governments to adapt to rapid social, political, and economic changes is critical.<sup>75</sup> It is at the domestic level that the governance gap would continue to be most pronounced. Democratic transitions are more stable after the youth-bulge, at which point national demographics smooth out and are supported by advances in health, education and income—which are expected to continue. Rapid middle class growth in many developing economies is likely to create greater desires and pressures for democratic governance, rule of law, and accountability. Established middle classes would also make it more difficult for governments to revert back to autocratic tendencies.

73. Nuccitelli, Dana, "Climate change could impact the poor much more than previously thought," *The Guardian*, January 26, 2015.

74. World Economic Forum, *Global Risks 2015*, 2015, p.31.

75. National Intelligence Council, *Global Trends 2030*, 2012, p.vii.

***We are currently going through a transition phase between the old trade world—based on national production and obstacles to trade protecting the producer—and the new trade world—based on transnational production and obstacles to trade protecting the consumer.***

The NIC considers that there are currently 50 countries in the awkward and risky transition phase between democracy and autocracy; the greatest number being in Africa (23 out of 45 countries), followed by Asia (17 out of 59), and then the Middle East (11 out of 16). Countries in the mid-range transition between autocracy and democracy have a proven record of high instability.

Moreover, the democratic deficit—in which a country's economic development is more advanced than its governance—is evident in Gulf countries and China; despite the fact that they don't demonstrate as much visible vulnerability, their levels of repression and institutional incongruity are certainly risk factors for political and social disruptions. The democratisation of China could potentially increase extant nationalist sentiment in the short-to-medium term, but a process of Chinese democratisation could also put substantial reform pressure on other authoritarian states.

Finally, in terms of global governance, second-tier emerging powers will continue to make their mark as evidenced by the participation of the G-20 (as opposed to just the G-7/8). Some other international institutions need to be updated or re-equilibrated to reflect these shifting balances of powers.

Yet, while all the risks analysed in this section could indeed disturb and impact globalisation in the medium term, they should neither derail globalisation nor emerging markets' increasing role. There is a much more decisive challenge that emerging economies must anticipate, and that is the evolution of trade obstacles. Only those economies—advanced as well as emerging—where policy makers adapt to the learning curve of the new trade world will develop or maintain their strategic comparative advantage in the decades to come.

## **Evolution of trade obstacles and comparative advantages in global trade**

### ***Shift from the old trade world to the new trade world***

#### **The regulatory convergence challenge**

We are currently going through a transition phase between the old trade world—based on national production and obstacles to trade protecting the producer—and the new trade world—based on transnational production and obstacles to trade protecting the consumer.

This change in the nature of the obstacles to trade, with the growing importance of regulations and standards over tariffs, will transform the parameters of the new generation of trade agreements.

What does not change is that opening trade for growth and welfare under some conditions (the Geneva consensus)<sup>76</sup> continues to be about levelling the playing field. But what changes is the way to level the playing field. The purpose has changed with the change of obstacles to trade.

Until now most of the obstacles were measures to prevent competition—e.g. tariff barriers, sectorial subsidies. The old way to level the playing field was to get rid of the measures (trade-offs and negotiations) by reducing—or even suppressing—tariffs barriers. But this mercantilist approach, which considers that exports are better than imports, and which has, for a long time, inspired trade policy in some emerging countries (“import substitution policies”) is ending. Protecting producers no longer makes sense in a world where economies are integrating along global value chains. Classical obstacles to trade are vanishing.

The measures at stake will be less and less about protecting producers and more and more about protecting consumers. These are the so-called NTMs (non-tariff measures), norms and standards adopted to protect the

76. Pascal Lamy, *The Geneva Consensus. Making Trade Work for All*, Cambridge University Press, 2013.

***There remain important differences in emerging economies' respective capacities to integrate GVCs; many of them, which have focused on tariffs or industrial policy, have not yet accomplished domestic market integration in value chains.***

consumers of goods as well of services against many kind of risks and the specifications / certifications processes entailed by this precautionary approach. With increasing living standards throughout the world, the level of precaution will rise and those non-tariffs barriers are expected to multiply.

The new way to level the playing field for production is therefore to remove or diminish discrepancies between those measures (levels and administration of precaution, regulatory convergence process). This is a shift, which has meaningful consequences:

- On reciprocity: it used to be the name of the game for tariff reductions. Engaging in regulatory convergence is entering into a field which is much more sensitive in terms of values because precaution is about risk and demand – it involves ideological control about what is good and what is bad.
- On the political economy of trade restrictions: with tariff reductions, consumers praise lowering prices while producers complain about their protections being stripped away. Things are different in regulatory harmonisation. Producers are excited by the prospect of such measures, which could have serious implications for medicine, food, financial products, vehicles – everything. But they make consumers anxious because they fear it means giving up the precautionary safeguards from which they benefit. We are thus moving from a technical device to a more culturally and ideologically sensitive device.

This new pattern has consequences on the various processes, the purpose of which is to ensure the legitimacy and the eventual buy-in by various stakeholders through transparency, raising awareness, consultation and public debate to address fears and anxieties. It raises important issues for emerging countries as their own domestic standards of precaution are usually not as stringent as those of high income countries, which should be the case under the assumption that the level of precaution is closely correlated

to the level of income per capita. Their producers that wish to reach out to deep/rich markets are confronted with a cost issue: either they will subjugate their production between various norms and standards, at a cost; or they will adopt the “richer” standard at the “rich” market price which they will likely not be able to sell / bill on their poorer domestic markets.

#### **No more room for special and differential treatment**

The traditional area of market access has long been governed in GATT/WTO by the principle of “special and differential treatment” according to which poorer countries were allowed a higher level of protection for development purposes. This materialised in asymmetries in trade openness, whether in multilateral regimes or preferential regimes.

However, in the area of precaution, markets will remain closed to any preferences: while protection of domestic producers can be graduated and import levels adjusted based on an import's country of origin, consumer protection does not tolerate even partial market access to preferential imports. Precaution cannot be “graduated”. Whether a product matches a standard is a question of “yes” or “no”, and not a question of “how much”. In this case, precaution is de facto “MFN”, and leaves no room for discrimination or differentiation as long as domestic goods or services are submitted to the same level of precaution.

#### ***Speed and capacity of emerging economies to integrate the GVCs in a time of regulatory convergence***

As seen above, there remain important differences in emerging economies' respective capacities to integrate GVCs; many of them, which have focused on tariffs or industrial policy, have not yet accomplished domestic market integration in value chains.

A natural bridge between domestic and global value chains is for developing economies trade policy makers to integrate regional value chains. Regional integration serves to expand markets and enhance scalability. Politically, they are an easier bridge to cross and successful

***The on-going transformation in the nature of obstacles to trade, and thus the ways and means to reduce them, raises new issues on the possible relationship between a multilateral, non-discriminatory regime, and bilateral/regional preferential regimes.***

regional value chains based on RTAs have the dual advantage of building strong political and strategic ties along with economic relationships.

To manage integration in GVCs, emerging economies will have to consider specific risks: demand compression in existing markets, ever-changing product and process standards, the emergence of new technologies, changes in labour markets, food security challenges. Robust domestic market conditions can function as an antidote to these risks, but small low-income economies will remain vulnerable.

However, rules (like norms and standards) are often being made by lead firms in a GVC, and multilateral rule-making has lagged behind market realities. In view of the largely market-driven nature of GVCs, multilateral rule-making for emerging economies requires a bespoke approach.

One option is rule-making through a public-private partnership platform, and there are some existing initiatives that can provide such a template.<sup>77</sup> “Principles for Responsible Agricultural Investment that Respects Rights, Livelihoods and Resources,” a joint initiative of FAO, IFAD, UNCTAD and the World Bank, seeks to establish a code of good practices for agricultural investments while respecting local rights and concerns like food security in developing countries. The principles provide a toolkit of best practices, guidelines and governance frameworks for investors and host governments. The Extractive Industry Transparency Initiative (EITI) provides another global standard, based on public-private partnership, for ensuring transparency of payments from natural resources. It is followed in several countries. Such initiatives can create a possible basis for intergovernmental agreements to assist low-income countries in obtaining a fair share of value from GVCs. They cannot, however, be a substitute for basic development work like infrastructural development and capacity building in such countries.

In the meantime, mega trade deals currently under negotiation, if and when they come to fruition, will also affect the emerging economies’ trade.

***Assessing the impact of mega trade deals: possible game changers?***

The on-going transformation in the nature of obstacles to trade, and thus the ways and means to reduce them, raises new issues on the possible relationship between a multilateral, non-discriminatory regime, and bilateral/regional preferential regimes.

The WTO Trade report 2011 considered that recent regional and multilateral initiatives represent complementary aspects of an increasingly complex and sophisticated global trade architecture – one in which bilateral, regional, cross-regional and multilateral agreements coexist and cohere in a kind of “multispeed” or “variable geometry” system.<sup>78</sup>

Yet the development of a new generation of free trade agreements, the so-called mega FTAs, may have a more significant and less positive impact on global trade regulation.

In addition to the Trilateral Agreement negotiated between China, Japan and Korea, various other agreements are currently under negotiation. The Trans-Pacific Partnership (TPP) brings together the United-States plus a group of eleven Asian countries – Australia, Brunei, Chile, Canada, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore and Vietnam. The Transatlantic Trade and Investment Partnership (TTIP) encompasses the European Union and the United States. The EU and Japan are negotiating a bilateral trade and investment agreement. And the Regional Comprehensive Economic Partnership (RCEP) gathers together the ten ASEAN members and six other Asian countries – Australia, China, India, Japan, New Zealand and South Korea.

The specificity of those mega FTAs lies in their size, but more fundamentally on their level of ambition – “deeper”

77. Ujal Singh Bhatia, “The globalization of supply chains – policy challenges for developing countries”, *Global value chains in a changing world*, Elms and Low (eds), WTO – FGI – TFCTN, 2013, p.313 -328.

78. WTO, *Trade report 2011*, 2011, p.54.

## ***Supporting further trade liberalisation via regulatory convergence would thus require a convergence of collective preference.***

integration—which follows the evolution of patterns of production towards global production networks and reflects the relative decrease of the importance of tariff protection.

The TPP and the TTIP are probably good examples of the shift from old trade to new trade. The TPP may be considered the last agreement of the old trade, as it claims the ambition of achieving regulatory convergence but may well end with limited success in that field, because of the large diversity of countries involved. While the TTIP – whose main objective concerns regulatory convergence – may be the first of the new trade age if both the EU and the US succeed in overcoming the bad start of the first 18 months of negotiation, which has provoked strong opposition in public opinions.

Assuming successful outcomes for those new agreements, currently under negotiation, the past synergy between multilateral and regional approaches to trade opening would be less obvious for the future, as there is no more guarantee that bilateral convergence would lead to multilateral convergence: whether intended or not, harmonisation of regulatory standards can have a “preferential” effect if it effectively creates a regional regulatory “block” that has a more constraining effect on outsiders than insiders. Not, as sometimes argued, in terms of discriminations as third party producers will gain in the regulators playing field levelling between their export markets. But more by placing them in a “rule taking” rather than a “rule making” position, which may imply a comparative disadvantage.

In this context, the overlapping membership of the mega FTAs<sup>79</sup> could only be a minor factor of convergence, as the content of their respective agendas differs: regulation-wise the RCEP has a less ambitious scope than the TPP and even less than the TTIP.

Therefore “the risk for the future is that we have a multilateral playing field overshadowed by the proliferation of divergent regulatory regimes”,<sup>80</sup> with the establishment of

“regulatory areas” disrupting global supply chains and leading to trade diversion; in other words scattering the trade regime and undermining the WTO’s centrality.

Supporting further trade liberalisation via regulatory convergence would thus require a convergence of collective preference.

### ***The need for collective preferences convergence***

Two scenarios must be avoided. The first involves a US-EU regulatory block facing a Chinese regulatory block, leading to a new form of global trade fragmentation and its resultant negative impact for other emerging countries.

The second involves the TTIP negotiations reaching a successful conclusion, complemented by two bilateral agreements between Japan and the EU and Japan and the US—through the TPP—which would overall confer a de facto dominant position of the resulting set of norms and standards. This scenario, which would take us back to the 20<sup>th</sup> century dominance of the old industrial countries, would induce an alignment of other trade partners, including the emerging economies, with the leading norms and standards.

A third scenario should be promoted instead: regulatory convergence that would be regulated or at least monitored at the global level for the sake of all. To prevent unnecessary trade tensions and to ensure the world’s growth potential, an update of 21<sup>st</sup> century global trade governance with a common strategy to manage questions of regulatory convergence, would be launched.

To make this last scenario happen, the WTO could be given the competences to organise and monitor the regulatory process in order to foster collective preferences convergence, while recognising that decisions on specific regulations pertain to other international organization/institutions than WTO. To start, it could be given a mandate to supervise and monitor regulatory convergence<sup>81</sup> in order to help bring regulatory convergence within a multilateral framework. This competence should also embrace

79. While the US are involved in the TPP and the TTIP, seven of sixteen RCEP countries already take part of the TPP negotiation and could be joined by additional RCEP partners.

80. Pascal Lamy, *Ibid*, 2013, p177.

81. WTO, *The Future of Trade: the Challenges of Convergence*, April 2013.

***Despite positive long term trends of growth, emerging economies will need to anticipate many potential slowdown risks that lie on the road to sustainable development.***

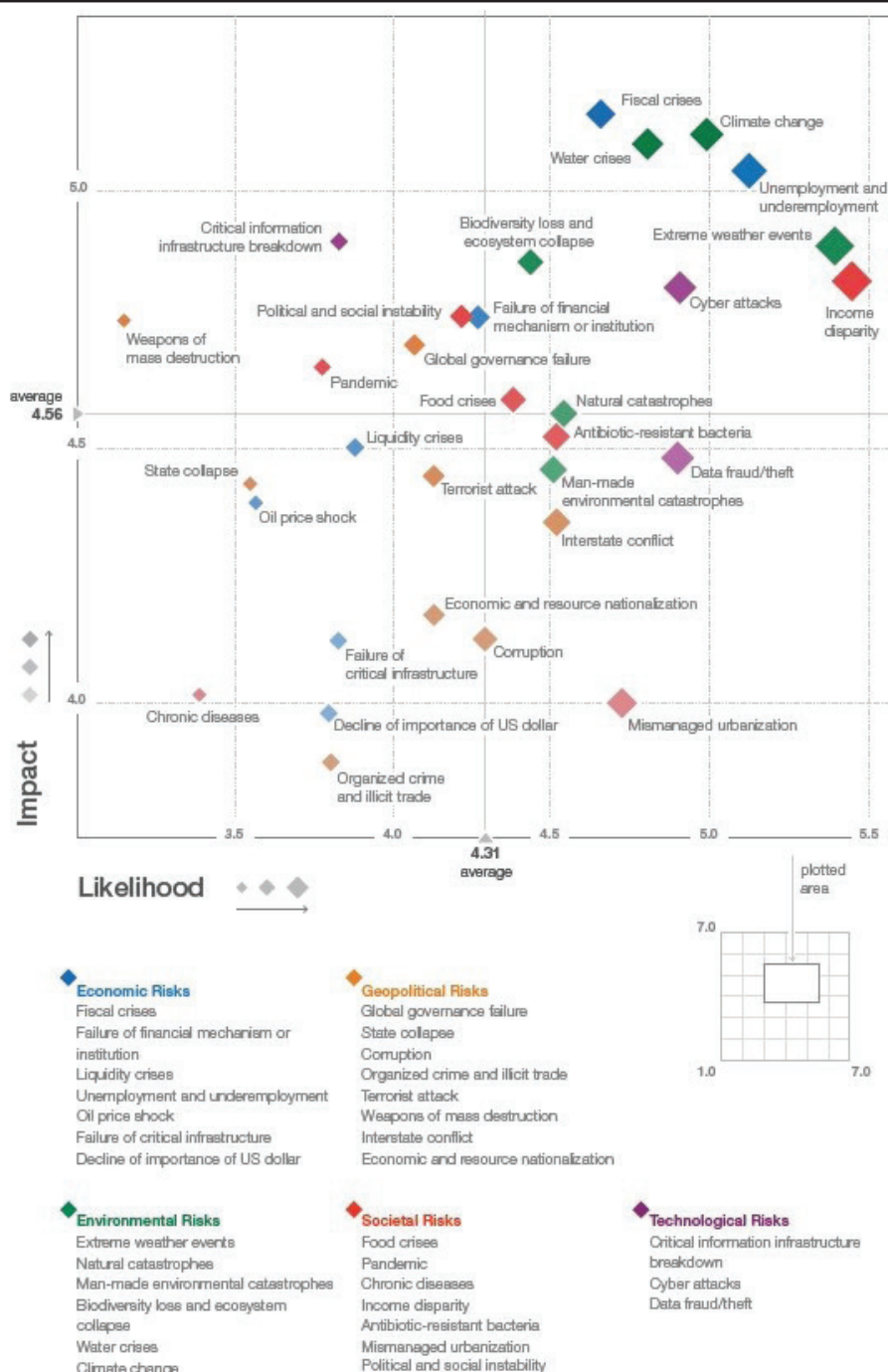
convergence between public and private standards. The WTO has a proven record of being able not only to regulate and enforce hard law but also to monitor this sort of process, as it has done it successfully so far in implementing the SPS and TBT agreements. This is where the challenge lies. A challenge that emerging economies should push for, as it is clearly in their interest.

### **Conclusion**

Despite positive long term trends of growth, emerging economies will need to anticipate many potential slowdown risks that lie on the road to sustainable development. A downturn in credit cycles and progress of new 3D printing and robotic technologies could also induce structural changes in globalisation that need to be well anticipated. Yet the more decisive 21<sup>st</sup> century challenge will be that of regulatory convergence; it is the collective responsibility of emerging and advanced economies to prevent it from generating a new fragmentation of global trade. It is in their common interest to promote a smooth multilateral handling of this process to avoid further substantial imbalances and instability.

*Yet the more decisive 21st century challenge will be that of regulatory convergence; it is the collective responsibility of emerging and advanced economies to prevent it from generating a new fragmentation of global trade.*

Figure 26: The global risks landscape 2014



Source: World Economic Forum, *Global Risks Report 2014*, 2014.



