Economic Growth and the Evolution of Economic Geography

Dong-Eun Rhee

PhD, Head of International Macroeconomics Team
Korea Institute for International Economic Policy

On April 30, the Financial Times published an article with a rather provocative headline: “China poised to pass US as the world’s leading economic power this year.” According to the article, China’s GDP reached 87% of the U.S. in 2011, based on the measure of purchasing power parity or PPPs. The figures were updated for the first time since 2005 which were compiled by the International Comparison Program (ICP), conducted by the World Bank. When measured using the new PPPs, the article states that China is likely to overtake the US in terms of economic size this year. In other words, the U.S. is standing on the historical brink of losing its status as the world’s largest economy to China.

Although it is only a matter of time that China will overtake the U.S. in terms of PPP-evaluated GDP size, it does not simply imply that China already attains similar economic levels to the U.S. When using different measurement, it illustrates a somewhat different picture. Using market exchange rates, China's GDP only stood at 55% of the U.S. total as of 2013. China's GDP per capita in particular remained at 6,747 U.S. dollars, accounting for merely 12.7% of the U.S. Therefore, notwithstanding the rapid growth generated by a population of 1.3 billion, China still has a long way to go in terms of economic development.

Indeed, the rising economic power of the emerging market economies is reshaping the global economic landscape. The fast-growing emerging economies continued to increase their share of the global GDP, while the developed economies experienced sharp slowdowns in the aftermath of the global financial crisis and the European sovereign-debt crisis. For example, based on PPP-evaluated GDP in IMF's economic outlook database, China only took up 2.2% of the global GDP in 1980. However, its share tripled to 7% in 2000, then to 10.8% in 2007 right before the global financial crisis hit. As of 2013, the country represented as much as 15.4% of the global GDP. Not surprisingly, China is not the only the case showing dramatic economic growth. With a population of 1.2 billion, Indiana accounted for 5.8% of the global GDP in 2013, which is more than double the 1980 figure of 2.5%. Thus the BRICs countries hold a combined GDP (PPP) of 26.9%, constituting one-fourth of the global GDP.

On the other hand, the advanced economies are losing ground. The U.S. share of the global GDP stood at 24.9% in 1980 and stayed at 24% until 2000. However, it was dropped to 21.5% in 2007 and falling further in 2013 to 19.3%. In addition, Japan accounted for 8.8% of the global GDP up until 1980, maintaining its status as the second-largest economy in the world. However, after a prolonged period of recession, the country's share of the global GDP decreased to 7.6% in 2000 and further down to 5.4% in 2013. This implies that China already overtook Japan in 2001 based on PPPs. As for the EU member countries, their combined GDP reached 30.9% in 1980, but it has been on a downward trajectory ever since, recording 24.8% in 2000, 22.1% in 2007, and finally 18.7% in 2013.

As such, the gap between the advanced and emerging economies continues to narrow, eroding the dominance of the developing economies. In fact, the global GDP share of the advanced world fell from 69% in 1980 to 49.6% in 2013. In the meantime, the emerging economies' share rose from 31% to 50.4% over the same period of time. Then, what implications can be drawn from this shift in the global economic landscape?

First, with an increase in the voice and representation of emerging economies in international institutions, they have become more influential in the world economy. Back in 1980, about 56% of the global GDP came from the G7 countries; however, the figure stood at only 37.6% in 2013. It becomes more evident that the advanced economies are not the only player the global economy, which implies the importance of cooperation with the emerging economies. In this context, the role of G20 became greater as it reflects the growing influence of emerging economies. In the same context, quota reforms are undertaken by IMF and World Bank in order to increase representation of the emerging world.

Second, the emerging economies should take greater responsibilities on global issues as they possess a potential to have a substantial impact on the global society. For example, the active participation from emerging economies is pivotal to tackle environmental problems in order to achieve sustainable development in the long run. Currently, China and India are the first and the third largest emitters of greenhouse gases. Moreover, a majority of the emerging economies are undergoing rapid environmental degradation. In light of this, the resolution of environmental issues is likely to remain elusive and ineffective without vigorous cooperation between the advanced and emerging economies. Indeed, the tangible outcomes for environmental challenges can only be achieved when responsibility is shared between the advanced and emerging economies.

Finally, the relatively weak fundamentals of some emerging economies can present risks to the global economy. Rapid growth comes with side effects. If left unchecked, these side effects can amplify volatility of the global economic environment. Case in point: the 1997 Asian financial crisis. And in fact, many of the emerging economies fell into the "middle income trap" and failed to join the ranks of the advanced economies. As for China, it is exposed to risks caused by excess investment, shadow banking, and overheated real estate market. Brazil and India are also contending with problems of high inflation and financial instability. The fact that QE tapering in the U.S. raised concerns of a financial crisis in the emerging world is also a good demonstration of this point. Now, more than ever, the emerging economies need to secure macroeconomic stability by drawing on the experience of their advanced counterparts.

The global economic situation in 2014 can be characterized by two evident trends: moderate recovery in the advanced economies, and growth slowdowns in the emerging economies. In the past, softer growth in a handful of emerging economies did not have much repercussion on the rest of the global economy. However, situations have been changed. As emerging economies are almost on a par with the advance economies in terms of size, now they have substantial influence on the world economy. In this heterogeneous world, both the North and the South has been “equally important.” Since the advent of globalization, the global society has experienced issues transcending national boundaries, ranging from economic development to environmental protection. Although there is an ongoing debate over convergence and divergence between the advanced and emerging economies, what matters the most is putting efforts from the both sides. In an attempt to accomplish better outcomes for the future, the advanced economies should better understand the emerging economies’ perspective. At the same time, the emerging economies should not escape from taking responsibilities as their role is crucial to combat global challenges. KIEP