

III. THE CHANGING GLOBAL ENVIRONMENT AND THE RISE OF EAST ASIA

East Asia faces a different global environment than the high-income economies did during their rise after World War II. In contrast to the closed capital accounts, limited flows of portfolio capital, and fixed exchange rates of the post-World War II era, increased volatility in all of these variables is probably one of the most important global challenges today. Moreover, commodity prices are on the rise after a century-long decline.

Yet, developing countries account for a growing share of global output and growth and “South-South” trade is the fastest growing component of global trade. East Asia is at the leading edge of this transformation change. Its companies are becoming increasingly global, and its workforce more innovative. But with increased economic weight come new responsibilities. East Asia’s successful export-oriented growth strategy was based in no small part on a relatively open international trading environment and significant levels of foreign investment -- all made possible by a framework of global rules and supporting institutions. Going forward, it will be in East Asia’s interest not just to benefit from such global public goods, but to actively support and improve them. In addition to the international trading environment, this would also include efforts to improve the international financial architecture and global economic governance and help address the risks of climate change.

The rise of developing countries: opportunities and challenge

Until the early 19th century, China’s economy was the largest in the world and the economies of developing East Asia together were larger than today’s high-income economies combined measured in purchasing power parity terms.³ Over the following century, the share of global output of both China and developing East Asia declined dramatically amid extraordinary disruptions. Starting in the 1960s, however, developing economies led by East Asia began growing faster than the high-income economies, and today their share of global output is one-third at market prices and one-half in PPP terms (Table 3, Figure 35, Figure 36, and Box 4). What is more, the margin between the growth rates of developed countries and those of developing countries has widened in recent years, even as business cycles have become more synchronized. Developing countries are decoupling in trend terms but are becoming more tightly integrated, and therefore more coupled, in cyclical terms.

If developing countries continue to grow at their current rate, their share of the global economy will climb to one-half in current prices in the 2020s, and at about the same time China will become the largest economy in the world. Developing countries will account for as large a share of global fixed investment, trade and investment flows as high-income economies. The role of China will be key: in fact, the rise of China will offer exceptional

Table 3. The share of developing countries in global GDP is rising steadily

	in percent of GDP			
	2010	2030	2030 (current prices)	
			(2010 prices)	low
High income	66.4	52.4	49.1	40
U.S.	23.6	20.5	19.2	15.7
Other	42.8	31.9	29.9	24.4
Low & middle income	33.6	47.6	50.9	60
China	9.5	17.1	18.8	23.6
India	2.3	4.6	5.1	6.7
Other	21.9	25.9	27	29.7

Sources: World Bank, IMF, Consensus Economics, and World Bank staff estimates.
Note: Low appreciation: 0.8 percent a year vs. the U.S. dollar, high appreciation is 1.5 percent a year. See chapter IV.

³ Maddison, Angus, <http://www.theworldeconomy.org/MaddisonTables/MaddisontableB-18.pdf>.

Figure 35. The share of developing countries in global GDP began rising anew in the late 1950s...

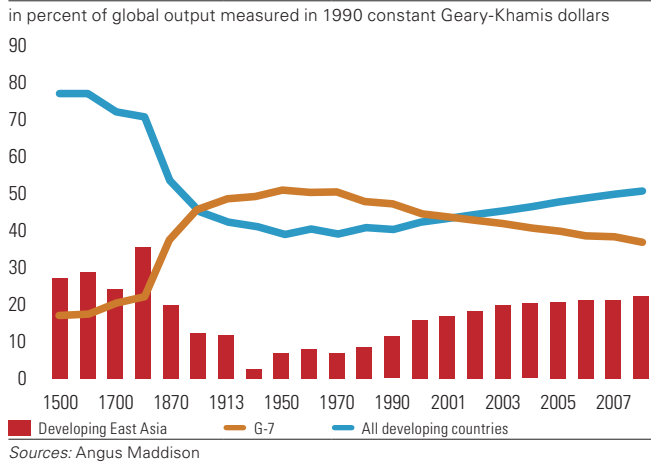


Figure 36. ...as growth in developing economies surpassed that in high-income economies

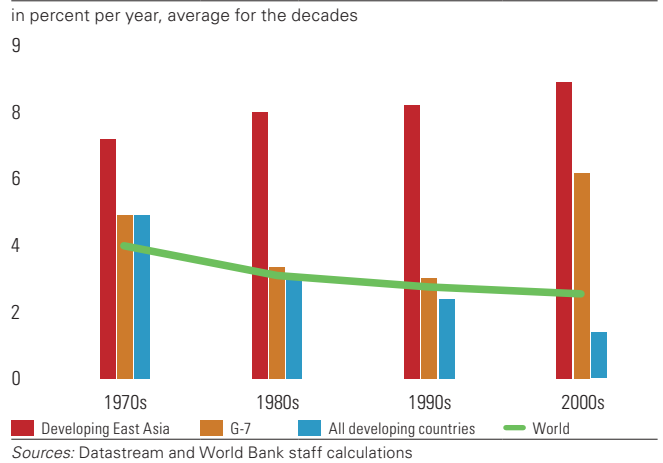


Figure 37. Per capita GDP in constant dollars has risen in all regions on average...

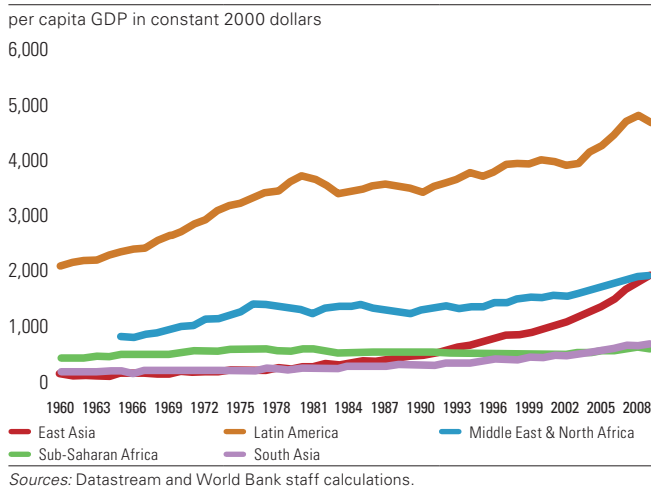
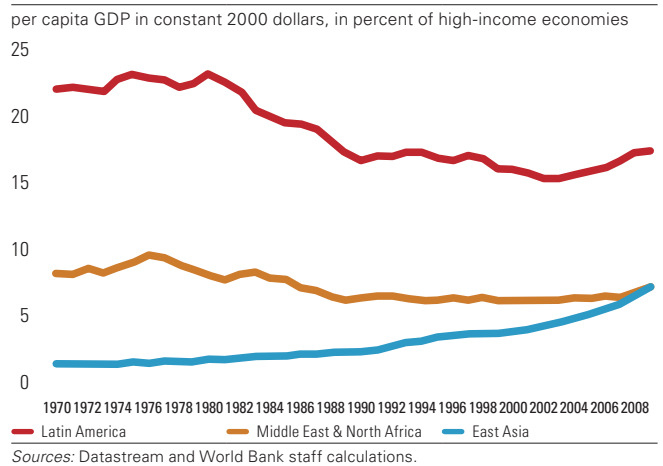


Figure 38. ...but relative to high-income economies, has increased steadily only in developing East Asia



opportunities to other countries in East Asia to upgrade their patterns of growth and move up the value chain. There are also likely to be large spillovers to the rest of the world in terms of growth, capital flows and commodity prices.

The rise of developing countries and the shift in relative global economic power is likely to result in a world without a dominant economic pole. Whether this is a “multi-polar” world, or a “no-polar” world will have profound implications for the global economy. Although a multi-polar world does not automatically mean more stability, such a world may be more likely to sustain a cooperative spirit and adherence to the values that have made recent progress possible is likely to continue. Moreover, the global risks of a substantial growth slowdown in one growth pole will be smaller if there are other powerful sources of global economic expansion. A “no-polar” world, by contrast, will likely be dominated by less cooperative large countries and economic blocks, with a risk of a lapse into regionalism that may turn around some or much of the progress accomplished by globalization over the last half a century.

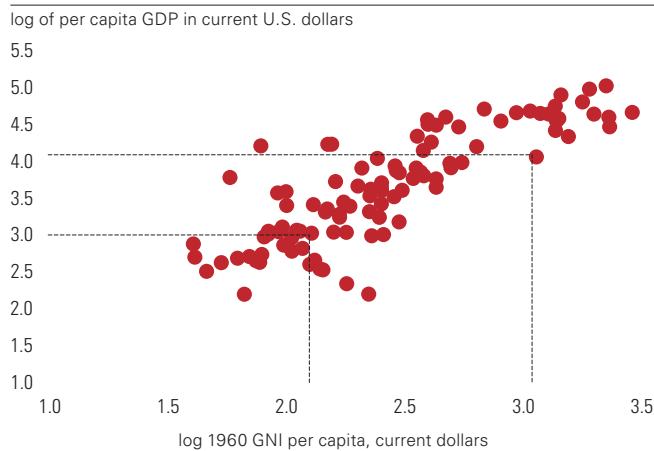
Nevertheless, the U.S., the EU, and Japan will remain the wealthiest large economies in terms of per capita income, but their economic size will have diminished relative to some developing countries. For the first time in modern

history there will be a large disparity among countries based on income per capita on one side and overall economic size on the other. And these imbalances will have substantial implications for global economic relations and global institutions. New governance arrangements will be needed—and the G-20 will be part of these.

While GDP per capita has risen in all developing regions over the last half-century, only in East Asia have average incomes converged steadily toward high-income country levels (Figure 37 and Figure 38). The weight of the developing economies in the global economy is rising, but it appears to be driven almost exclusively by East Asia, notably China. And it is East Asia's demand for changing global economic relations and global governance that are more likely to actively shape the global environment in the decades to come.

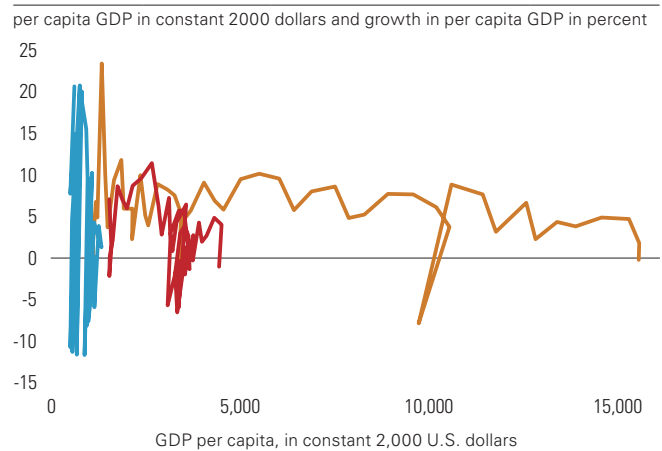
At an even more disaggregated level, per capita incomes in the large majority of developing countries have made little progress towards middle-income status, and even fewer have moved to high-income status. Of the countries that were middle-income in 1960, almost three-fourths remained middle-income or regressed to low-income by 2009 (Figure 39).⁴ Even though many countries have succeeded in achieving strong growth rates over an extended period of time, not all have avoided the “middle-income trap” where wages are too high to compete with low cost producers, yet skills and the innovative culture are not sufficiently developed to propel countries to high-income (Figure 40).⁵

Figure 39. Fewer than half of the middle-income countries in 1960 became high-income by 2009...



Source: World Bank staff calculations.
Note: Dotted lines denote the middle-income and high-income thresholds. The 2009 high-income threshold defined by the World Bank is \$11,905. The 1960 line is derived by deflating the 2009 one with SDR inflation.

Figure 40. ...as they became “trapped” in middle-income status in contrast to Korea



Sources: Datastream and World Bank staff calculations.

Growing economic weight, rising voice

East Asia is becoming more assertive in claiming its rightful seat at the global table. Thus far, its role in the governance of international economic institutions has trailed its rapidly growing economic weight. But this is beginning to change, thanks to both China and ASEAN, which are helping bring the countries of the region and the rest of the world together in a variety of global forums and organizations (Box 5).

⁴ This analysis looks at 1960-2010. The official World Bank classification which started in 1989.

⁵ Indermitt Gill and Homi Kharas first defined the middle-income trap in East Asia Renaissance (World Bank, 2007).

Box 4. Korea: From low-income to high-income in two generations

The Korean economy stands out in its development journey. One of the poorest countries in the world in the early 1950s, Korea is now a member of the OECD. The heavily aid-dependent country became a donor country for the first time. Agriculture as a share of GDP has plummeted, while industry has more than doubled as the export sector has grown rapidly. Korea's industrial strengths include plenty of world-class brand names in, for example, automobiles, electronics, LCD, semi-conductors, and shipbuilding. While this transformation has not been without its share of failures and problems, such as the 1997-98 Asian financial crisis, Korea has demonstrated remarkable resiliency.

Figure 41. Korea's GDP per capita has converged fast to the levels of high-income economies...

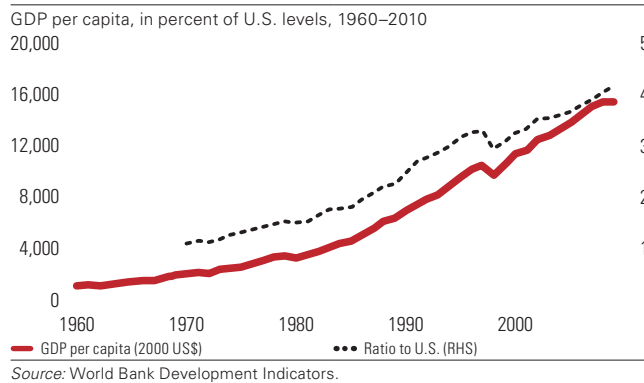
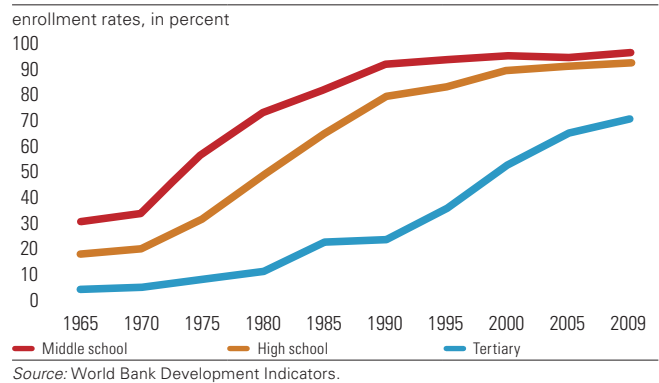


Figure 42. ...reflecting to a large extent a dedication to education and innovation



Korea's impressive economic performance is attributable to a combination of openness, macroeconomic stability, market-based resource allocation, and capable government. More specifically:

- **Building on relatively favorable initial conditions in terms of human resources and institutions, Korea adopted an export-oriented industrialization strategy.** This strategy played a key role in the country's economic development not just by increasing exports but by continuously moving up the value chain through competition and innovation in international markets.
- **This transformation was the result of a government-business partnership.** The government initiated the multi-year development plans and adopted an array of measures that supported business groups, including the sharing of investment risks. In turn, business groups, the *chaebols*, actively engaged in industrial upgrading and technological development. The export performance of private firms was used as a selection criterion for further government support.
- **Korea's outlays on R&D were significantly enhanced initially through government-established research institutes and subsequently through private sector activities.** Korea also expanded access to education, thus helping to train a skilled and creative workforce.
- **Finally, Korea has been ready and flexible enough to change course when it encountered new realities and challenges.** Responding to the increasing complexity of the economy, the government's role shifted from direct to indirect planning. More importantly, Korea used economic shocks and crises to rebalance its strategies to cope with evolving development challenges. The wide range of market-oriented reforms implemented after the 1997-98 Asian financial crisis is one example.

The Korean experience highlights the importance of establishing a well-functioning performance-based reward mechanism in resource allocation. For Korea, export performance in the competitive global market was a prerequisite for government support. Investment in human resources and technological capacity were an integral part of the country's development strategy. Finally, to sustain high growth, Korea was able to adopt new paths and strategies when new challenges emerged.

Source: Prepared by Chul Ju Kim.

Box 5. Taking a seat at the table: The emerging role of East Asia in global economic governance

The East Asia and the Pacific region has not only emerged as a strong economic power but also has initiated shifts in global economic governance. Countries from the East Asia and Pacific region are emerging as strong powers in international financial organizations, such as the Bretton Woods institutions, and in multilateral settings such as the G20. In the aftermath of the global economic crisis, the worldwide recognition of the sheer size of China's economy and its role in the global recovery have led to a wider acknowledgement that the policies adopted in large emerging markets matter for global economic stability. This has made it essential that China be brought more fully into discussions of international economic policy coordination, previously the domain largely of G7 finance ministers.

But while China has been an important force behind the emergence of East Asia in global economic governance, it has not been the only country in the region whose political weight and influence has been enhanced. To some extent, this reflects the ability of other developing countries to play a significant part in the crisis response, both financially and in policy terms. Their contribution took a variety of forms, including coordinated fiscal stimuli, a commitment to avoid imposing trade restrictions that could have derailed the recovery, and direct financial contributions to the crisis response. For example, in response to the G20's call to triple IMF resources, Korea, China, and Singapore were among the group of countries that put in place bilateral lending arrangements with the IMF. China and the Philippines have joined the newly expanded and reformed New Arrangement to Borrow (NAB), which already included Korea, Malaysia, Singapore, Thailand, and the Hong Kong Monetary Authority.

However, emerging markets were not prepared to assume a greater share of the financial burden without a greater voice in formulating the crisis response. The emergence of the G20 as the pre-eminent forum for discussions of global economic policy coordination was one part of the answer. Reflecting the fact that most leading emerging markets (and the largest East Asian economies) were represented in the G20, it became the preferred forum for managing the response to the crisis. The presidency of the G20 passed to Korea in the midst of the crisis, providing the country with a high profile and strategic platform for contributing to the setting of global priorities. The Korean government chose to focus its presidency of the G20 on shared growth built on nine key pillars—infrastructure, human resource development, trade, private investment and job creation, food security, growth with resilience, financial inclusion, the mobilization of domestic resources, and knowledge sharing. Their status as an “emerged” economy added valuable credibility to its efforts to balance the concerns and interests of both high-income and developing countries. At the same time, China has played a major role in launching a debate on fundamental reform of the international monetary system, which is continuing to be at the center of G20 attention under the presidency of France.

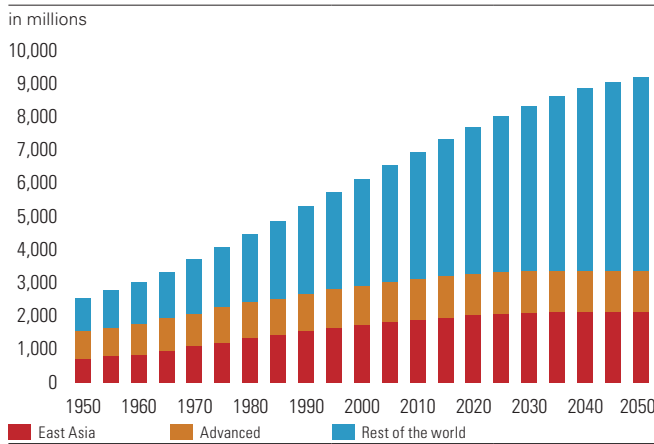
Reforms of the voting system at the Bretton Woods institutions are reflecting a broad acceptance of the need for a more fundamental realignment of voting power. Important reforms of voting power at the World Bank and the International Monetary Fund were adopted in 2010. At the World Bank, as a result of the two phases of reforms to increase the voice of developing regions (2008 and 2010), the voting power of the countries in the East Asia and Pacific region has increased substantially. Increased voice has come with higher financial responsibility to the World Bank. And as the global economic clout of East Asia continues to rise, prospects are good that the political weight of the region is likely to increase. What this means in practice will be determined by the extent to which countries in the region are able to articulate shared policy interests. In this regard, the policy agendas of APEC and ASEAN are likely to be indicators of the broader international policy agenda for which the region will advocate in the future.

Source: Prepared by Jeff Chelsky.

A more populous, more urban, and older world

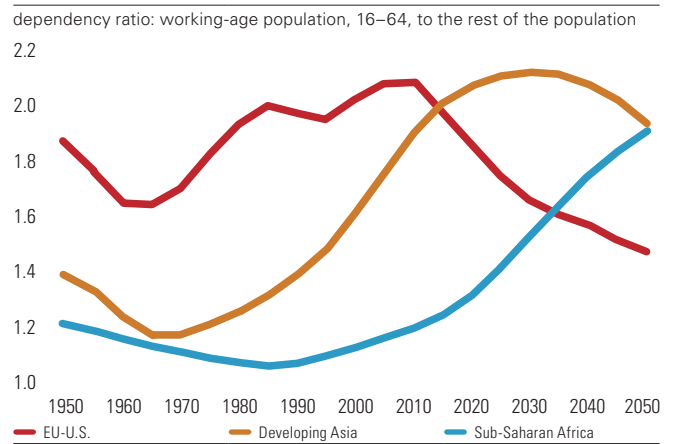
The world’s population is set to rise by another 1.4 billion by 2030, with most of the increase due to occur in the developing world. The population of high-income economies has broadly stabilized, and East Asia’s will plateau by 2030 (Figure 43). It is the least developed countries, in particular those in Sub-Saharan Africa, that will account for the bulk of the global population increase in the long term. The implications of this shift will be profound.

Figure 43. Global population continues to increase, thanks to developing countries outside East Asia 1950–2050



Sources: UN population database.

Figure 44. The demographic dividend is coming to an end, except in Sub-Saharan Africa: 1950–2050



Sources: UN urbanization database.

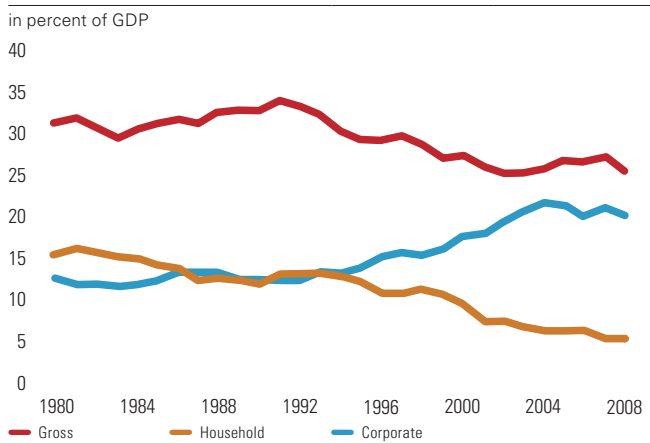
The large and growing size of the working age population in developing countries is continuing for now but is projected to level off by 2030 in all developing regions other than in Sub-Saharan Africa. The rise of the working age population (16–64 years old) relative to the total population—an increase that leads to the so-called “demographic dividend”—results from the well understood and documented sharp decline in mortality before fertility rates decline. This decade will mark the end of the demographic dividend in the high-income economies, with the working age population peaking at about 65 percent of the total population of these countries. The end of the demographic dividend is likely to come in East Asia by 2030 or even earlier (Figure 44).⁶ As will be explored in Chapter VI, this is likely to result in slower per capita growth rates. But countervailing policies to encourage saving, extend working lives, and improve human capital are likely to help offset most of the potential decline.

The experience of Korea and Japan suggest that ageing is unlikely to slow growth because of lower savings rates. Population ageing in both countries does not appear to have resulted in meaningful declines in the national saving rates—even as household saving rates fell (Figure 45 and Figure 46).⁷ And the employment rates in Korea—defined as those of working age who are in the labor force—surged by 3.5 percentage points between 1999 and 2009, largely due to the increased participation of women. The employment of older workers also rose by about 1.5 percentage points.

6 Birdsall, Nancy, Allen C. Kelley and Steven W. Sinding, eds., 2001.

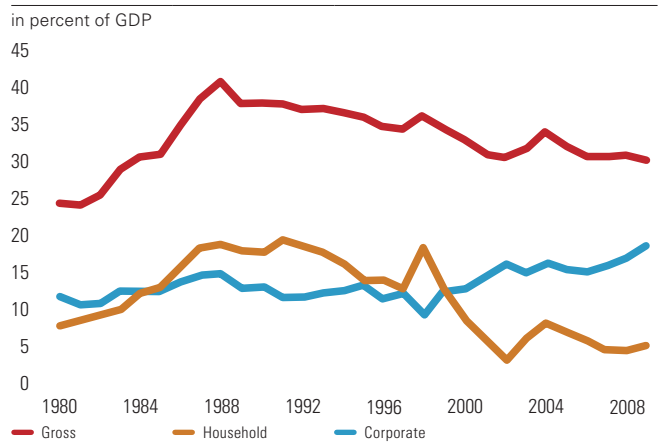
7 Kim, Cul Ju, Eye on East Asia No. 4, “Demographic Change and Household Savings in Japan and Korea: Implications for China,” www.worldbank.org/eapeye.

Figure 45. In Japan, rising corporate saving partly offset falling household saving to limit the decline in overall saving...



Sources: Cabinet Office of Japan, as in Eye on East Asia No.4, Chul Ju Kim, www.worldbank.org/eapeye.

Figure 46. ...as was also the case in Korea

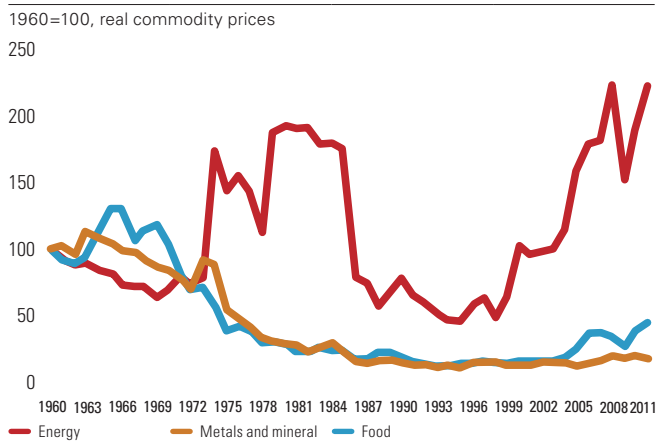


Sources: Bank of Korea, as in Eye on East Asia No.4, Chul Ju Kim, www.worldbank.org/eapeye.

Commodity prices are on the rise

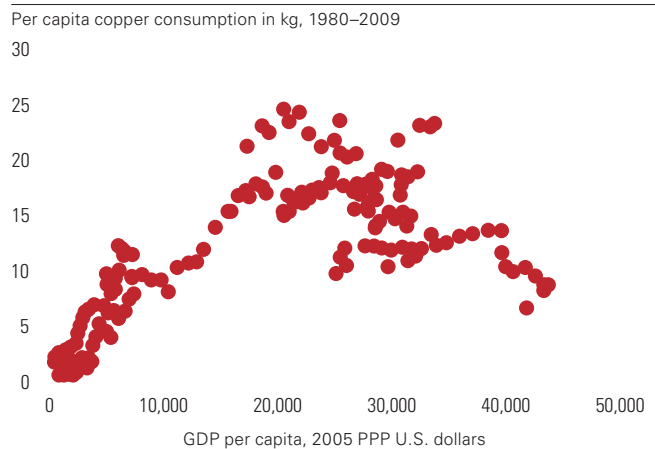
The recent surge in prices for food and commodities, coming two years after the food and fuel crisis of 2008, serves as a reminder that higher prices are unlikely to be a temporary phenomenon. In real terms, deflated by prices for manufactures, energy prices have risen inexorably since 2000, followed at a much more modest pace by food prices (Figure 47). Whether the start of the new millennium marks the end of a century-long decline in real commodity prices has yet to be seen, but chances are better than even that an upward correction is inevitable given the rapid industrialization and urbanization taking place in developing countries.⁸ Since 2000, food prices are up almost three-fold in real terms, oil prices up almost two-fold, and metals have surged by more than half. In nominal terms, price increases have also reflected a decade of loose monetary policy, growing demand for maize and sugar for biofuels, and, at times, speculative buying.

Figure 47. Commodity prices have been on an upward and volatile trend since the turn of the century



Sources: World Development Indicators, World Bank.

Figure 48. Per capita use of copper, aluminum, and other non-ferrous metals appears to peak at about \$25,000 per capita GDP PPP



Sources: World Development Indicators, World Bank.

⁸ World Bank, 1994, Global Economic Prospects, p. 14.

The surge in China’s demand for commodities has been unprecedented. Driven by investment, including in metal-intensive infrastructure and housing, China accounted for almost all of the increase in global copper and aluminum demand during 1999–2009 and more than 40 percent of global oil demand. As a share of global consumption, China now accounts for nearly 40 percent of global copper demand, four times as large as a decade ago. China’s aluminum consumption is up 10 times from 1992.

China’s infrastructure and housing needs are likely to support continued strong demand for metals and other raw materials. China’s demand is likely to be even more front-loaded than international experience thus far suggests. Historically, metal consumption has risen with per capita income and tended to peak at about \$25,000 PPP when the service sector dominated value added (Figure 48). If historical patterns are followed, China (with GDP per capita in PPP terms lower than \$10,000) is likely to dominate global commodity demand for decades. Indeed, China’s demand for commodities could be steeper than precedent might indicate, suggesting at least a decade during which global demand will severely strain production capacity. China’s urban population is about 53 percent of the country’s total, well below the 78 percent level in Mexico. At current rural-urban migration rates, it will take China probably until about 2025 to increase its urban population to 75 percent, which will mean another several hundred million people living in cities with concomitant increases in demand for infrastructure, housing, and durable consumer goods.

Projections for global energy demand show developing countries playing an equally large role, again led by China. Recent projections suggest that China will account for more than one-third of the increase in global energy demand through 2035 and India for another 18 percent, with other non-OECD countries accounting for almost all of the remaining increase.⁹ Even though these projections assume a doubling of the demand for renewable energy to 14 percent, fossil fuels will still account for half of overall demand. How to ensure that there is sufficient energy for development while creating more livable cities that are crucial for sustained growth is a topic that will be discussed in Chapter VIII.

The role of East Asia

East Asia’s rapidly rising economic heft comes with new opportunities and responsibilities. Sustaining solid macroeconomic foundations at home and ensuring the conditions for strong and inclusive growth remain a core part of these responsibilities. At the same time, whether global economic expansion remains robust over the long term will depend increasingly on East Asia’s active role in ensuring that the rules governing global commerce and international economic relations contribute to prosperity for all.

⁹ International Energy Agency, 2010, World Energy Outlook.