

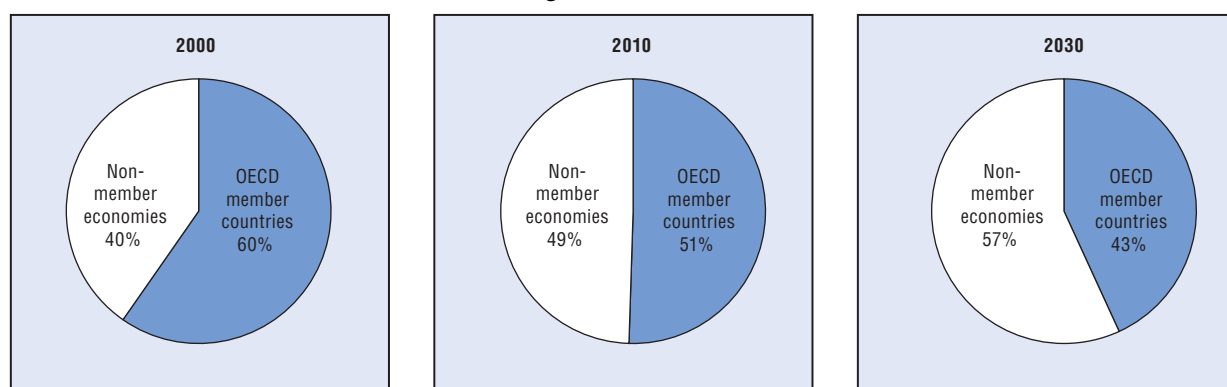
## Executive Summary

In 2009 China became the leading trade partner of Brazil, India and South Africa. The Indian multinational Tata is now the second most active investor in sub-Saharan Africa. Over 40% of the world's researchers are now in Asia. As of 2008, developing countries were holding USD 4.2 trillion in foreign currency reserves, more than one and a half times the amount held by rich countries. These are just a few examples of a 20-year structural transformation of the global economy in which the world's economic centre of gravity has moved towards the East and South, from OECD members to emerging economies, a phenomenon this report calls "shifting wealth".

*Perspectives on Global Development* shows how developing countries have become important economic actors and demonstrates the dynamism of the new South-South economic ties. Although the process has been ongoing for 20 years, the opportunities and risks for poor countries posed by shifting wealth are only starting to be understood.

OECD non-member economies have markedly increased their share of global output since the 2000s, and projections predict that this trend will continue (Figure 0.1). This realignment of the world economy is not a transitory phenomenon, but represents a structural change of historical significance.

Figure 0.1. **Share of the global economy in purchasing power parity terms**  
% of global GDP, PPP basis



Note: These data apply Maddison's long-term growth projections to his historical PPP-based estimates for 29 OECD member countries and 129 non-member economies.

Source: Authors' calculations based on Maddison (2007) and Maddison (2010).

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What does the strong growth of large emerging countries mean for our thinking on development? How can countries capitalise on the intensification of links between the developing world? Can lessons from the emerging countries be replicated for those countries which are still poor? What does the new economic geography mean for global

governance? This report addresses these questions by looking at the process of convergence and its macroeconomic impact; how this is fuelling increased South-South interactions; and the distributional challenges that growth can bring.

### *Shifting up a gear in a four-speed world*

It is no longer enough to divide the world simply between North and South, developed and developing countries. In order to understand the complexity of the shift, this report takes and develops James Wolfensohn's concept of a "four-speed" world. This splits the world into Affluent, Converging, Struggling and Poor countries according to their income and rate of growth per capita relative to the industrialised world. This framework reveals a new geography of global growth, exposing the heterogeneity of the South: some developing countries are beginning to catch up to the living standards of the affluent, others are struggling to break through a middle-income "glass ceiling", and some continue to suffer under the weight of extreme poverty.

Seen like this, two distinct time periods emerge in terms of growth performance. For most developing economies, the 1990s were another "lost decade", hampered by financial crises and instability (Figure 0.2). Two regions in particular failed to rebuild their economic fortunes: Latin American growth responded only weakly to reforms, and sub-Saharan Africa continued to stagnate.

In the 2000s, things moved up a gear and much of the developing world enjoyed its first decade of strong growth in many years (Figure 0.3). The new millennium saw the resumption – for the first time since the 1970s – of a trend towards strong convergence in per capita incomes with the high-income countries. The number of converging countries (that is, countries doubling the average per capita growth of the high-income OECD countries) more than quintupled during this period (from 12 to 65), and the number of poor countries more than halved (from 55 to 25). China and India grew at three to four times the OECD average during the 2000s. Nevertheless, there was a great diversity in outcomes and a group of struggling and poor countries continued to underperform.

Figure 0.2. **The four-speed world in the 1990s**

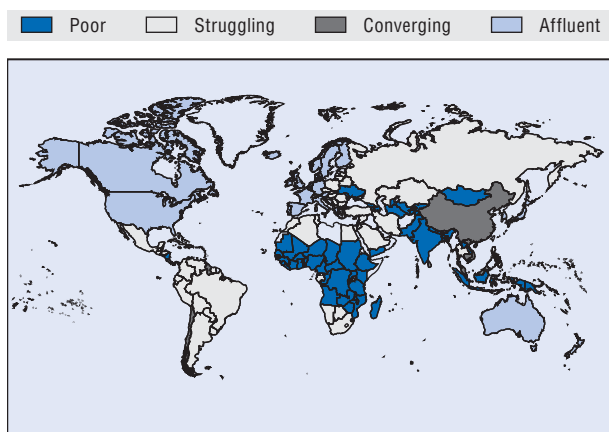
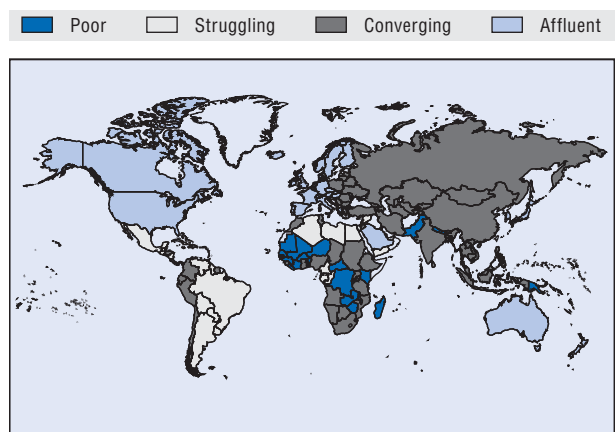



Figure 0.3. **The four-speed world in the 2000s**



Note: See Chapter 1 for a detailed description of the country classification used.

Source: Authors' calculations based on World Bank (2009).

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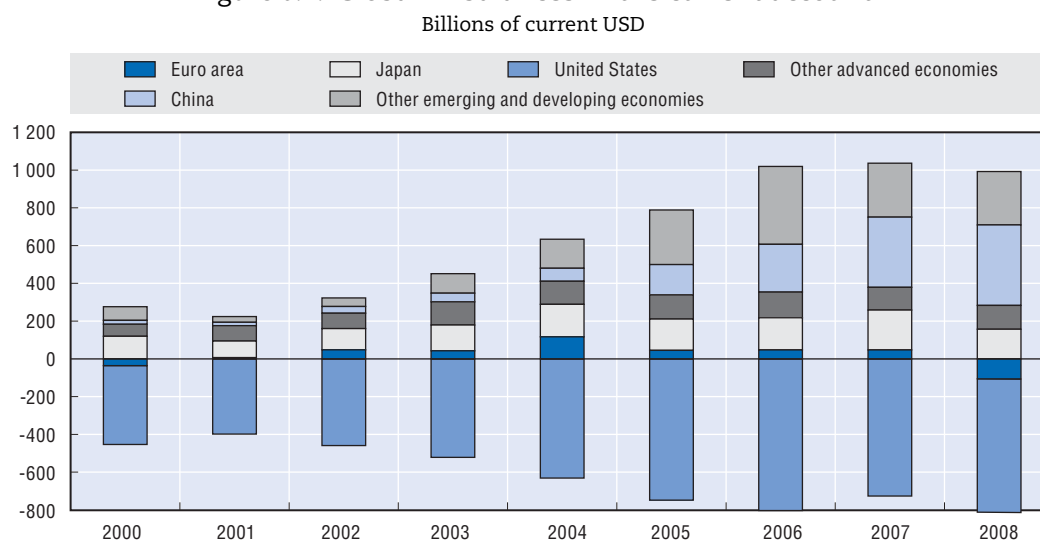
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## Understanding the macroeconomics of shifting wealth

What factors underlie the realignment? First, the opening of the formerly closed large economies of China, India and the former Soviet Union brought a supply shock to the global labour market. An additional 1.5 billion workers joined the open market-oriented economy in the 1990s. This reduced the cost of a range of traded goods and services, and made the take-off possible in a number of converging countries, principally in Asia. Second, growth in the converging countries boosted demand for many commodities, particularly fossil fuels and industrial metals, transferring wealth to commodity exporters and bringing an immediate boost to growth across Africa, the Americas and the Middle East. Third, many converging countries moved from being net debtors to net creditors, keeping US and global interest rates lower than they might otherwise have been.

As these processes accelerated, global imbalances grew sharply (Figure 0.4) which has led some observers to call for an appreciation of the Chinese currency, the renminbi. However, a rapid and premature appreciation may harm Chinese growth and, by extension, some of China's economic partners, including many countries already falling in the "struggling" and "poor" categories of the four-speed world. At a deeper level, the imbalances reflect structural issues and addressing them may require profound social changes in China to boost consumption.

Figure 0.4. **Global imbalances in the current account**



Note: Data for 2008 are estimates (except for Japan and the United States).

Source: IMF (2010).

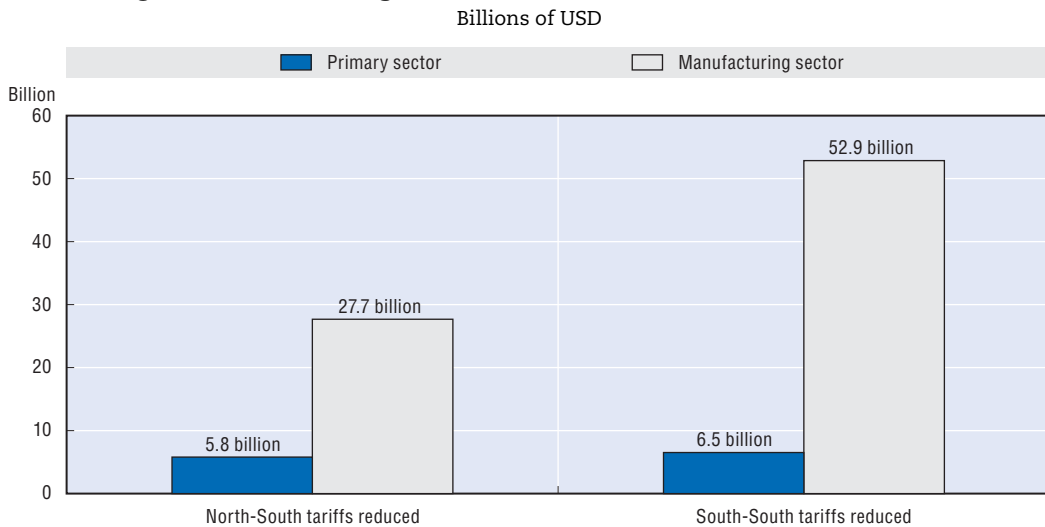
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China, India and, increasingly, other large converging countries matter for policy making as they shape the global macroeconomic context. Development policy will be incomplete without an assessment of their growth, their shifting competitive impact, their domestic demand and the finance that may be available from them.

## The increasing importance of the South to the South


The direct channels of interaction between the emerging giants and poor countries – such as trade, foreign direct investment (FDI) and aid – have been intensifying. This trend is likely to continue. Between 1990 and 2008 world trade expanded almost four-fold, but South-South trade multiplied more than ten times. Developing countries now account for around 37% of global trade, with South-South flows making up about half of that total. This trade could be one of the main engines of growth over the coming decade, especially if the right policies are pursued. Simulations by the OECD Development Centre suggest that, were southern countries to reduce their tariffs on southern trade to the levels applied between northern countries, they would secure a welfare gain of USD 59 billion (Figure 0.5). This is worth almost twice as much as a similar reduction in tariffs on their trade with the North.\*

Figure 0.5. **Potential gains from South-South trade liberalisation**



Note: Non-standard closure, assumes labour surplus in the South. See Chapter 4 for further details.

Source: Authors' calculations based on Center for Global Trade Analysis (2009).

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South-South FDI has also increased. China is the largest developing country outward investor with an investment stock estimated at more than USD 1 trillion. However, the phenomenon is broader, with growing activity from many firms in Brazil, India and South Africa, as well as new smaller outward investors from countries such as Chile and Malaysia. South-South investment has enormous untapped potential for low-income countries. Southern multinationals, for example, are more likely to invest in countries with a similar or lower level of development since they often have technology and business practices tailored to developing country markets.

\* This implies maintaining South-South applied tariffs at current levels, but reducing reciprocal North-South tariffs to the levels prevailing on North-North trade.

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### *Shifting wealth and poverty reduction*

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Shifting wealth has lifted many people in the developing world out of poverty. Poverty in China fell from 60% of the population in 1990 to 16% in 2005. The number of poor people worldwide declined by 120 million in the 1990s and by nearly 300 million in the first half of the 2000s. The contribution of growth to poverty reduction varies tremendously from country to country, largely due to distributional differences within them. In many cases, growth has been accompanied by increased inequality, complicating the challenge of poverty reduction. High levels of inequality could undermine growth and, ultimately, the sustainability of the shift.

Policy makers should pay particular attention to income inequality, both for its own sake and because it strongly influences the “poverty reduction dividend” of growth. Social policy can be a powerful means by which to limit inequality in outcomes.

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### *The growing technological divide in a four-speed world*

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There has been a massive shift of manufacturing capacity from OECD members to the developing world, in particular to East Asia. Some developing countries have participated and profited from this reorganisation of global value chains; many others have been marginalised. Shifts are also evident in the distribution of technological capacity, reflected in the rising amount of Research and Development (R&D) being carried out in the developing world – an activity traditionally concentrated in Europe, Japan and the United States. Attracted by rapidly expanding markets and the availability of low-cost researchers and research facilities, the world’s leading multinationals have increased their R&D bases in low- and middle-income countries. There is even talk of a new business model emerging from the developing world, involving “frugal innovation” – designing not just products but entire production processes to meet the needs of the poorest.

One concern is the growing technological divide between those developing countries which are capable of innovating and those which seem not to be. Innovation is not automatic; countries which have been proactive in terms of implementing a national innovation strategy have generally had more success.

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### *Individual country responses*

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Development strategies in developing countries need to be adapted to harness the opportunities of shifting wealth. National policies should:

- promote South-South foreign direct investment, learning the lessons from successful examples of clusters and Export Processing Zones and using investment links to achieve technological upgrading through national innovation systems;
- ensure appropriate revenue management policies in resource-rich economies and consider using sovereign wealth funds to smooth consumption and channel resources to promote growth and investment in the domestic economy;

- respond to the growing demand for agricultural exports and increasing pressure on arable land by strategies to improve agricultural productivity, through greater support to R&D and extension services, and through South-South technological transfer;
- implement pro-poor growth policies, focusing on providing more and better jobs and improving social protection through further development and replication of institutional innovations such as conditional cash transfers;
- expand South-South peer learning to help design policy based on successful experiences in the South.

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### *Collective responses to shifting wealth*

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The new configuration of global economic and political power means that the affluent countries can no longer set the agenda alone. The world's problems are becoming increasingly global, and if they are to be solved, then responsibility and solutions must be shared. A new architecture for global governance is emerging to reflect changing economic realities. The post-crisis role for the G20 shows how converging powers are becoming increasingly important protagonists in global governance. This is a positive development. Efforts towards making all institutions of global governance more inclusive and representative should be sustained.

In international negotiations, the new configuration of the economy may open up space for new strategic coalitions between developing countries. Many development benefits can be secured by co-operation among developing countries, particularly in the areas of trade and technological transfer.

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### *Shifting wealth: A win-win situation?*

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While many observers might see the trends described here as a threat, this report is couched in quite different terms. Rather than see the “rise of the rest” in terms of the “decline of the west”, policy makers should recognise that the net gains from increased prosperity in the developing world can benefit both rich and poor countries alike. Improvements in the range and quality of exports, greater technological dynamism, better prospects for doing business, a larger consumption base – all these factors can create substantial welfare benefits for the whole world.

That is not to deny the challenges. Environmental sustainability, growing levels of inequality within countries and increased competition are three significant issues raised by shifting wealth. The birth pains of this new economic world order have also been accompanied by enormous global imbalances. These challenges have come to the forefront during the economic crisis, but have been building over the last two decades. Despite these challenges, this report argues that the overall picture is a positive one for development.

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