Economics focus

Why the tail wags the dog

Emerging economies now have greater heft on many measures than developed ones

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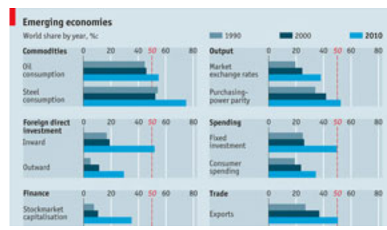
ON JULY 29th government number-crunchers revised downwards America's real GDP figures for the past few years. It now turns out that the country's output in the second quarter was still below its level at the end of 2007. The story is similar in many other rich countries. In contrast, emerging economies' total output has jumped by almost 20% over the same period. The rich world's woes have clearly hastened the shift in global economic power towards the emerging markets. But exactly how big are emerging economies compared with the developed world?



To track the rise of the emerging economies' economic clout over time, see our **daily chart**

Different organisations draw the boundary between emerging and developed economies differently. The IMF, for example, now includes 11 former emerging markets, among them Hong Kong, South Korea, the Czech Republic and Estonia, in its list of developed economies. Such divisions are more than a tad arbitrary: Estonia's GDP per person is only $15,000, whereas the emerging economies of UAE and Qatar have average incomes of $60,000 or so. And if successful emerging economies are promoted to the developed league, the economic weight of the developing world is steadily eroded, understating their rising importance. To appreciate the true shift in global economic power, we have looked at the numbers using the IMF's pre-1997 classification. The developed world consists of the original members of the OECD excluding Turkey*; all other countries, including newly industrialised Asian economies such as South Korea, count as "emerging".

Playing Leapfrog

The combined output of the developing economies accounted for 38% of world GDP (at market exchange rates) in 2010, twice its share in 1990 (see upper chart). On reasonable assumptions, it could exceed the developed world's within seven years. If GDP is instead measured at purchasing-power parity, which takes account of the fact that lower prices in poorer countries boost real spending power, emerging economies overtook the developed world in 2008 and are likely to reach 54% of world GDP this year. Even more impressive, they accounted for three-quarters of global real GDP growth over the past decade.

An analysis by *The Economist* finds that the upstarts also loom larger on many other measures (see lower chart). A landmark was reached last year when emerging economies' exports edged above half of the world total, up from 27% in 1990. Their rising income has also sucked in more imports, which jumped to 47% of world imports last year. Developing countries accounted for more than half of America's exports in 2010.

Emerging economies scored another first last year by attracting over half of all inflows of foreign direct investment (FDI). Foreign firms are increasingly lured by these countries' fastgrowing domestic markets as much as lower wages. Their share of outward FDI was a more modest 29% but it is rising rapidly, thanks partly to China's ample financial resources and its need for raw materials. Commodity consumption is where emerging economies really dominate the world: they consume 60% of the world's energy, 65% of all copper and 75% of all steel. Yet there is plenty of room for growth. Emerging markets use 55% of the world's oil but average oil consumption per person is still less than one-fifth of that in the rich world.

This year emerging economies are likely to account for over half of all capital spending, up from 26% in 2000. China and India have invested a rising share of their GDP over the past decade, in sharp contrast to rich countries. In 2010, America's investment was a paltry 16% of GDP, compared with 49% in China. Emerging economies' share of global consumer spending is only 34% (up from 24% in 2000), but this is partly because housing and services are cheaper than in rich economies. Much more important for Western companies is their 46% share of world retail sales, 52% slice of all purchases of motor vehicles (up from only 22% as recently as 2000) and 82% share of mobile-phone subscriptions.

Emerging economies still punch well below their weight in commerce and finance, but are catching up fast. Almost a quarter of the Fortune Global 500 firms, the world's biggest by revenue, come from emerging markets; in 1995 it was only 4%. Emerging economies' share of world stockmarket capitalisation has surged to 35%, more than three times their share in 2000. They hold an impressive-sounding 81% of governments' foreign-exchange reserves, but the bulk of private-sector wealth still lies in developed countries. Jonathan Anderson, an economist at UBS, estimates that emerging markets hold about a quarter of global financial assets (cash, stocks and bonds), double their share only ten years ago.

Emerging economies' lowest score is on debt: they are responsible for only 17% of all outstanding government debt. Over the coming years, massive debt burdens will be a drag on rich countries' growth. The long-term outlook for emerging economies remains bright, with less debt, more favourable demography and huge potential to lift productivity.

Two decades ago economic models treated the developing world like a dog's tail, wagged this way and that by rich countries but too small to affect them. Now the tail wags the dog. Their greater weight and speed mean emerging markets drive global growth, commodity prices and inflation.

See more data and the list of developed countries on our definition (http://www.economist.com/powershift0811)

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