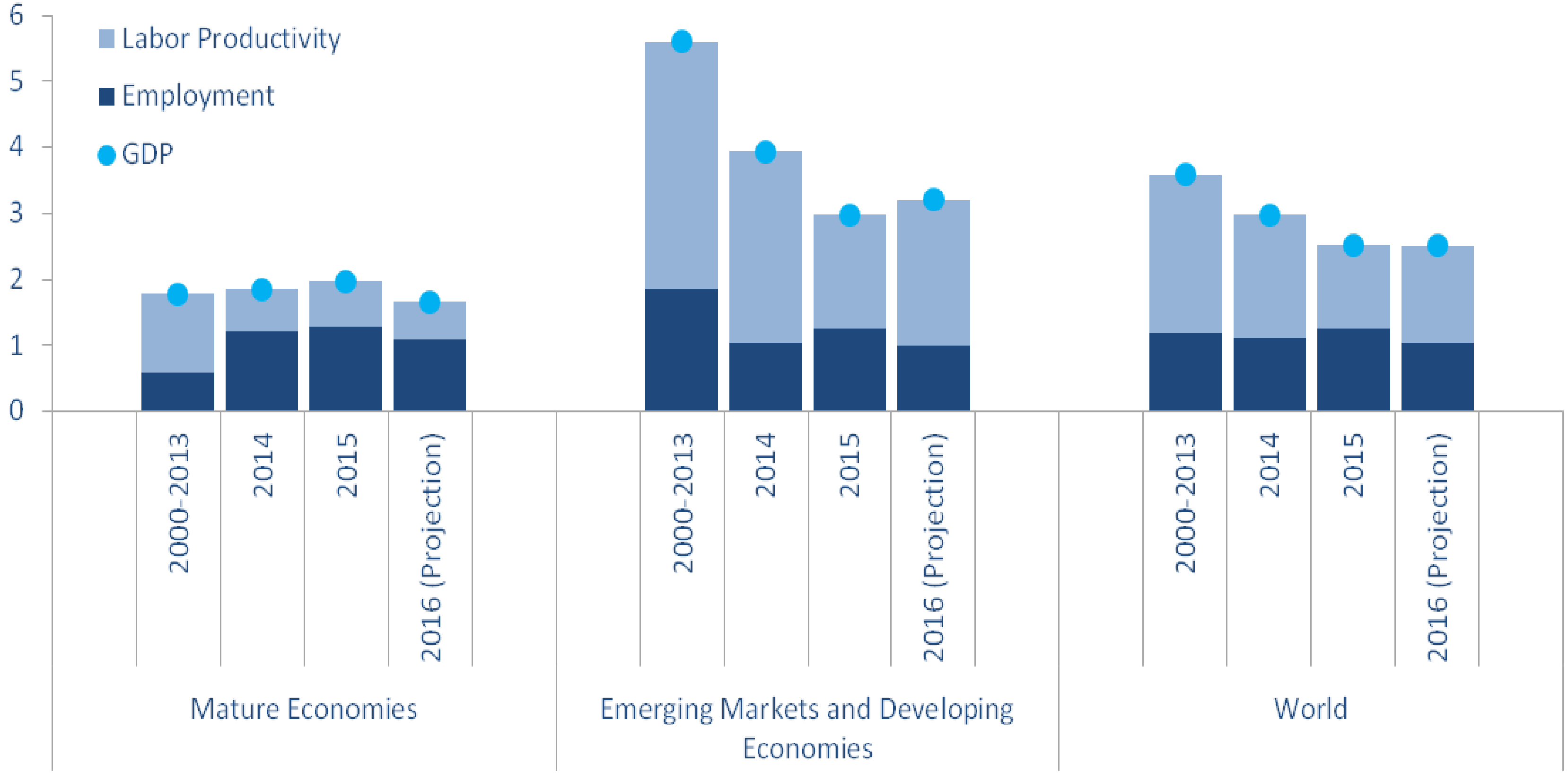
Are Emerging Markets Still Emerging?

Bart van Ark

Since 2014 GDP growth in emerging markets rapidly declined – both employment and productivity are causes

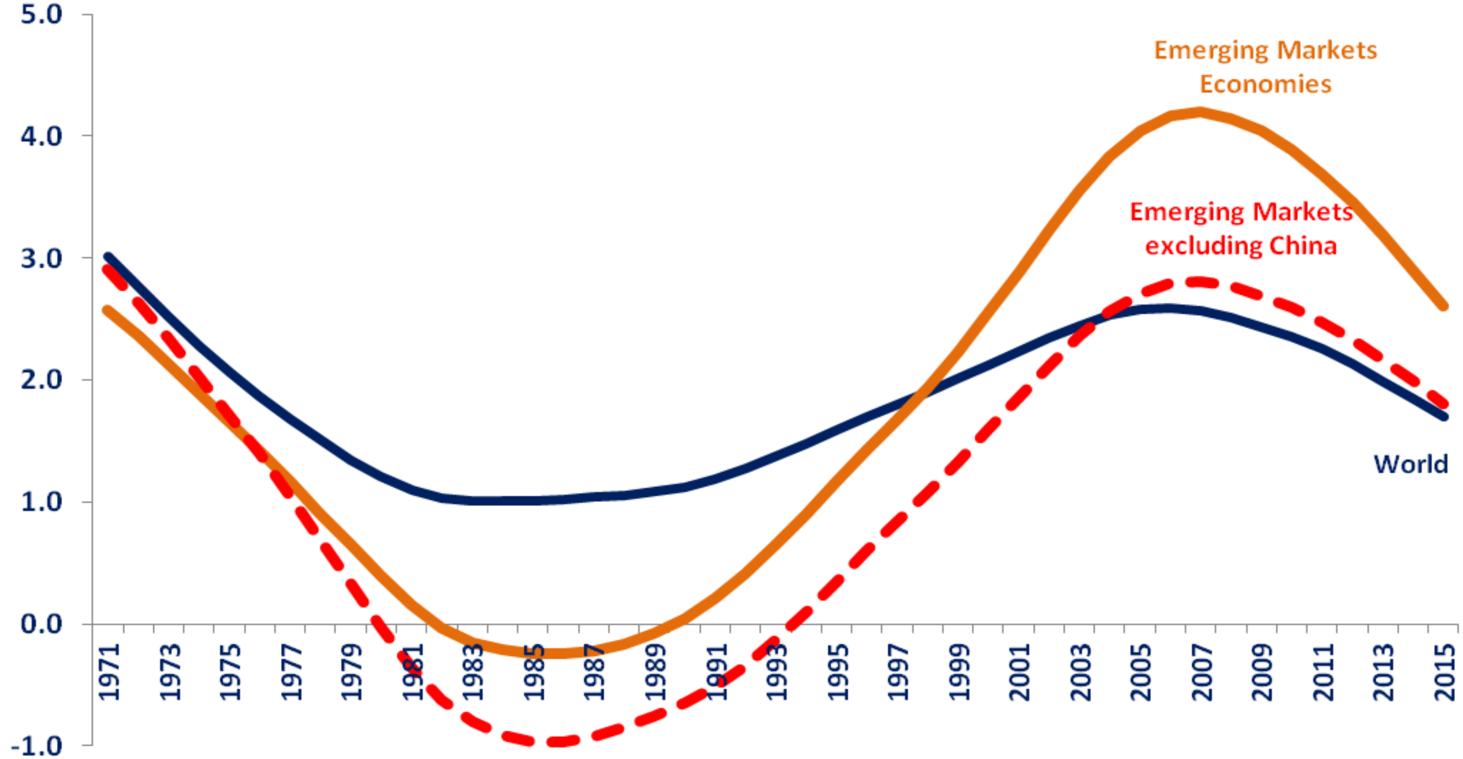
Contributions of Employment and Labor Productivity to GDP Growth, 2000-2016, in % (annual average)



Source: The Conference Board Total Economy Database, May 2016

To some extent this is much about China, but not just China

Trend growth in output (GDP) per worker, 1971-2015, in %

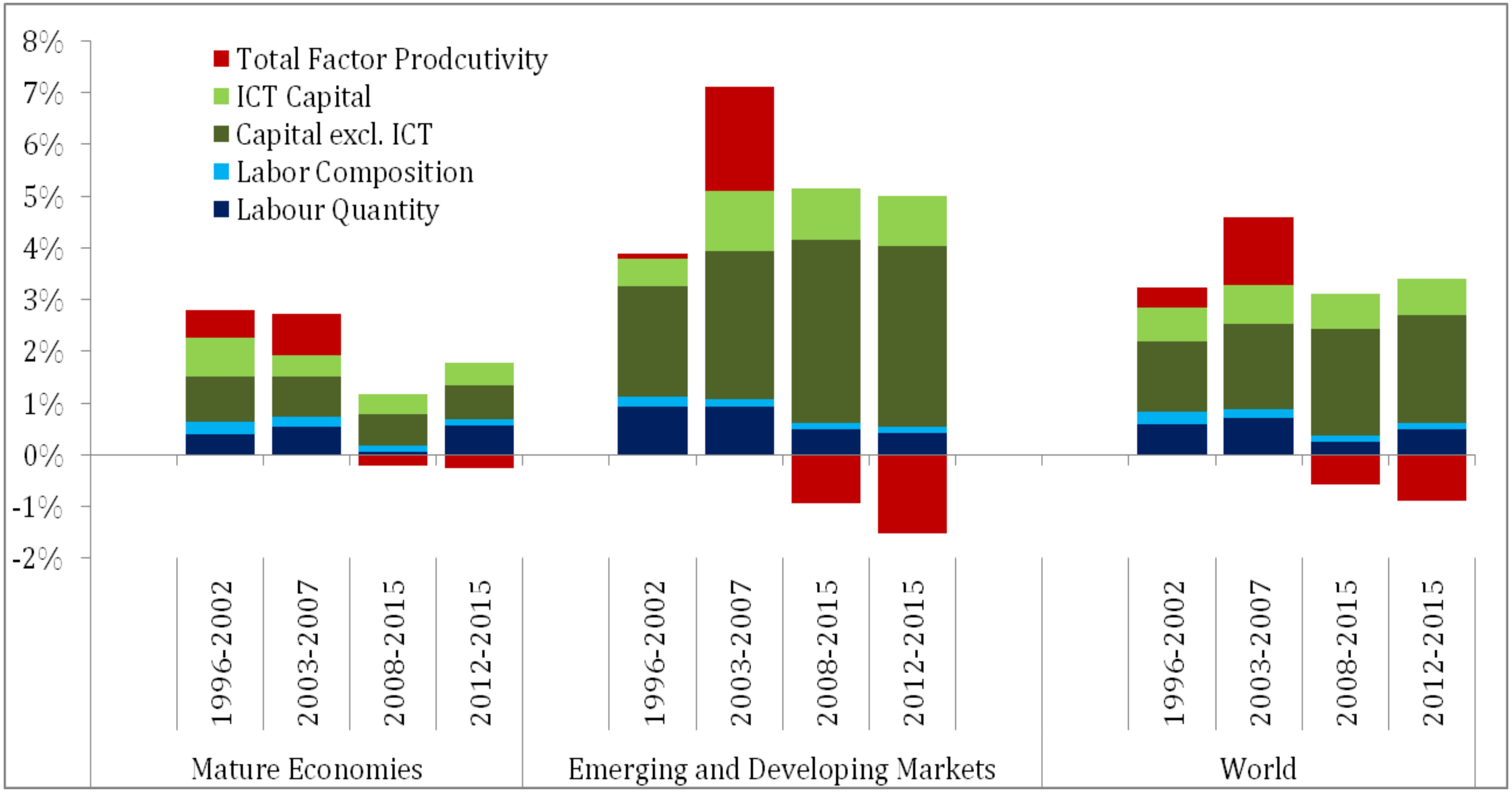


Note: Trend growth rates are obtained using HP filter, assuming a λ=100.

Source: The Conference Board Total Economy Database™, May 2016

While emerging market growth held up after 2008/09 crisis, it was increasingly investment driven with negative TFP

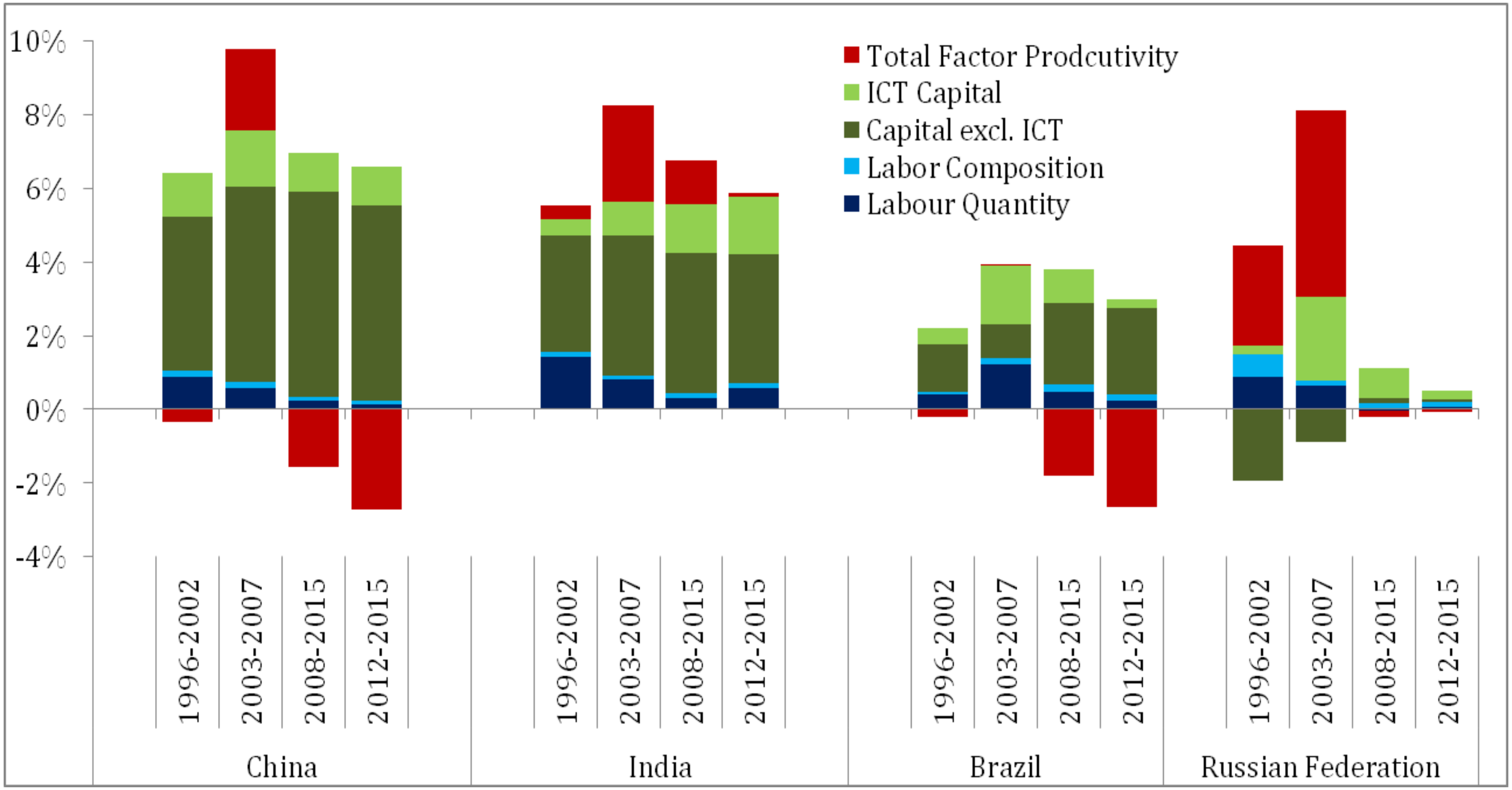
Growth Contributions of Labor, Capital and Productivity, in %



Source: The Conference Board Global Economic Outlook 2016 (November 2015)

The BRICs don't have a lot in common except for recently weakening TFP growth

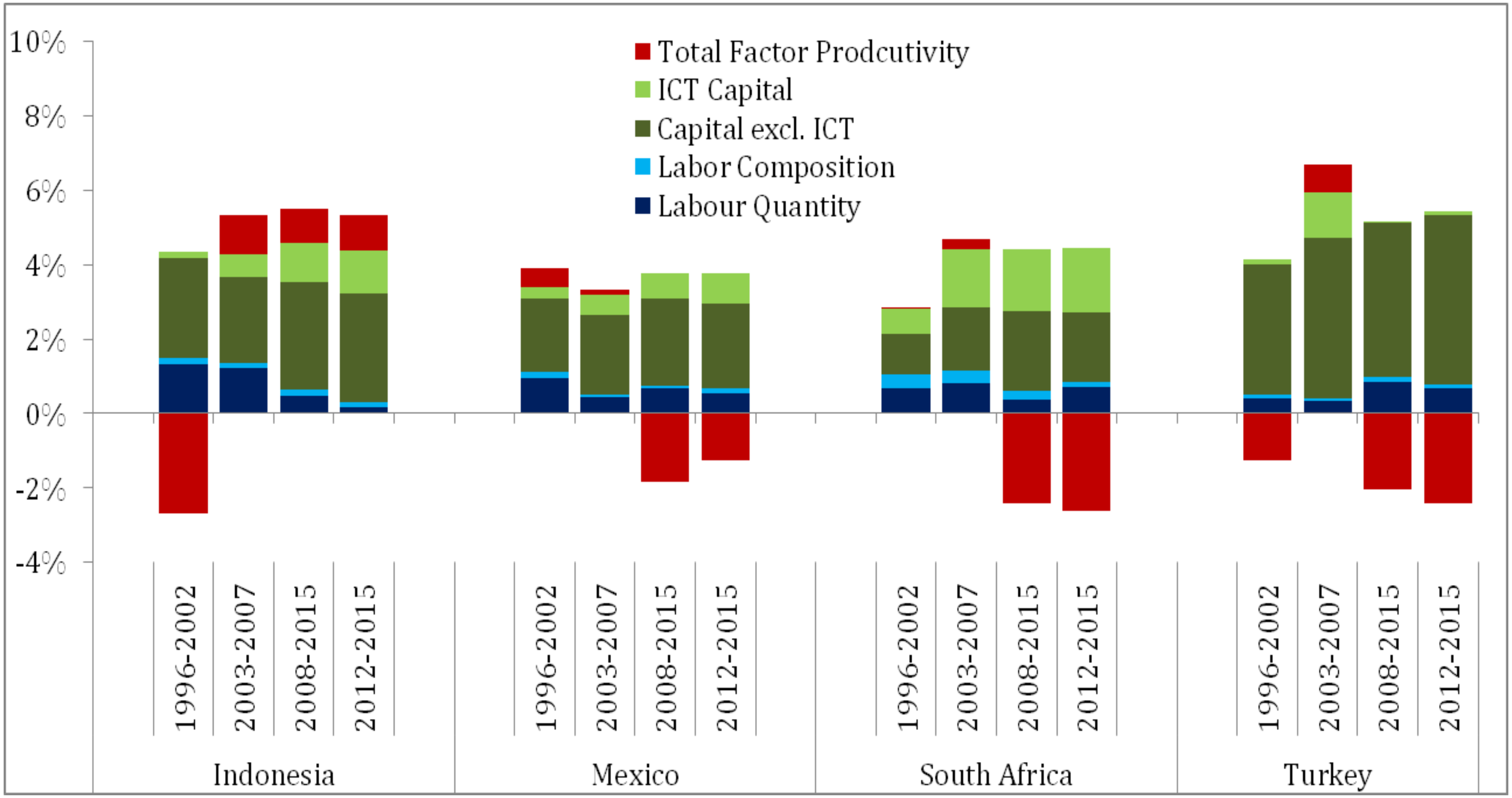
Growth Contributions of Labor, Capital and Productivity, in %



Source: The Conference Board Global Economic Outlook 2016 (November 2015)

The “next” generation of emerging markets shows a similar pattern of mostly capital intensification of the growth process

Growth Contributions of Labor, Capital and Productivity, in %

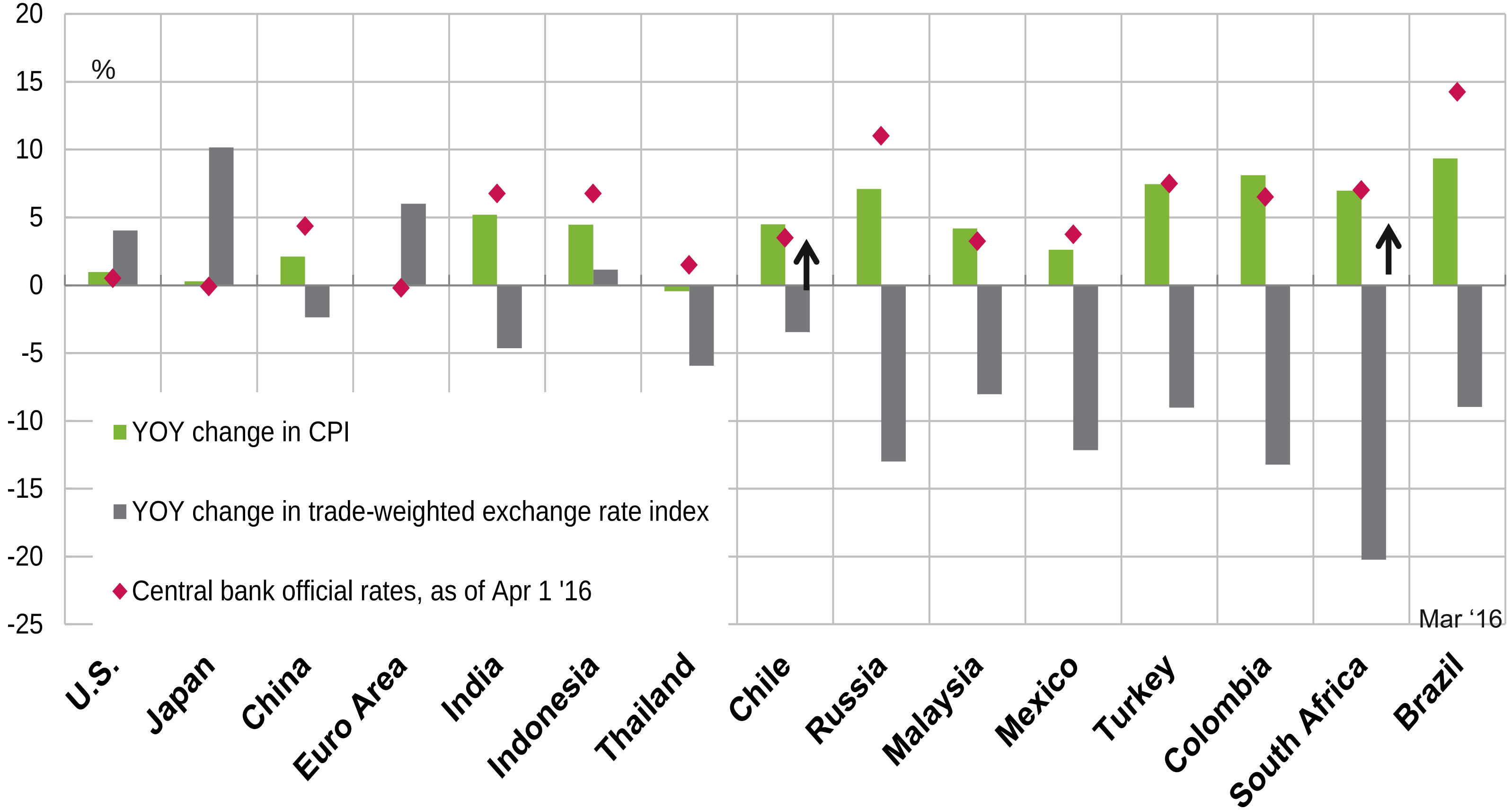


Source: The Conference Board Global Economic Outlook 2016 (November 2015)

Possible explanations for emerging market slowdown

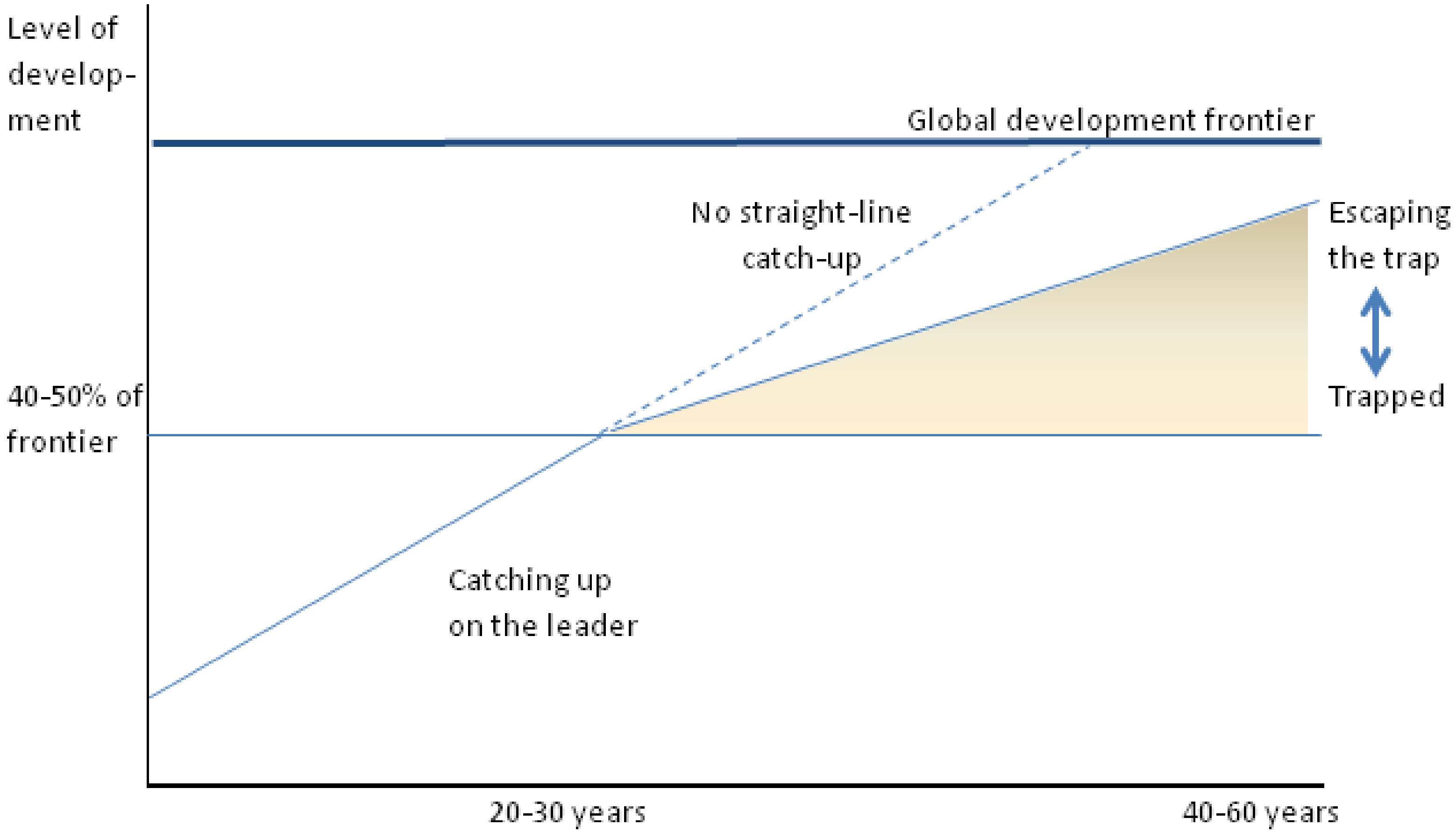
- Short-term:
  - ✓ A temporary dip due to lower oil and commodity prices for resource-rich emerging markets
  - ✓ Fallout of possible monetary tightening in U.S., including depreciations and inflation
  - ✓ Increase capital outflow to regions with higher returns
- Medium-term:
  - ✓ End of catch-up growth and transition from investment- and export- driven growth to consumption and services driven growth
  - ✓ A middle income trap because of increased global competitive challenges
  - ✓ Innovation challenges in globalization V2
- Long-term:
  - ✓ Erosion of demographic dividends
  - ✓ Structural policy issues (regulatory and governance)

Resource-rich economies are tightening monetary and fiscal stance, while net users of resources loosen policies further to support economic growth



Source: Haver Analytics

The middle income trap results from the failure to transition to a slower but sustainable growth path

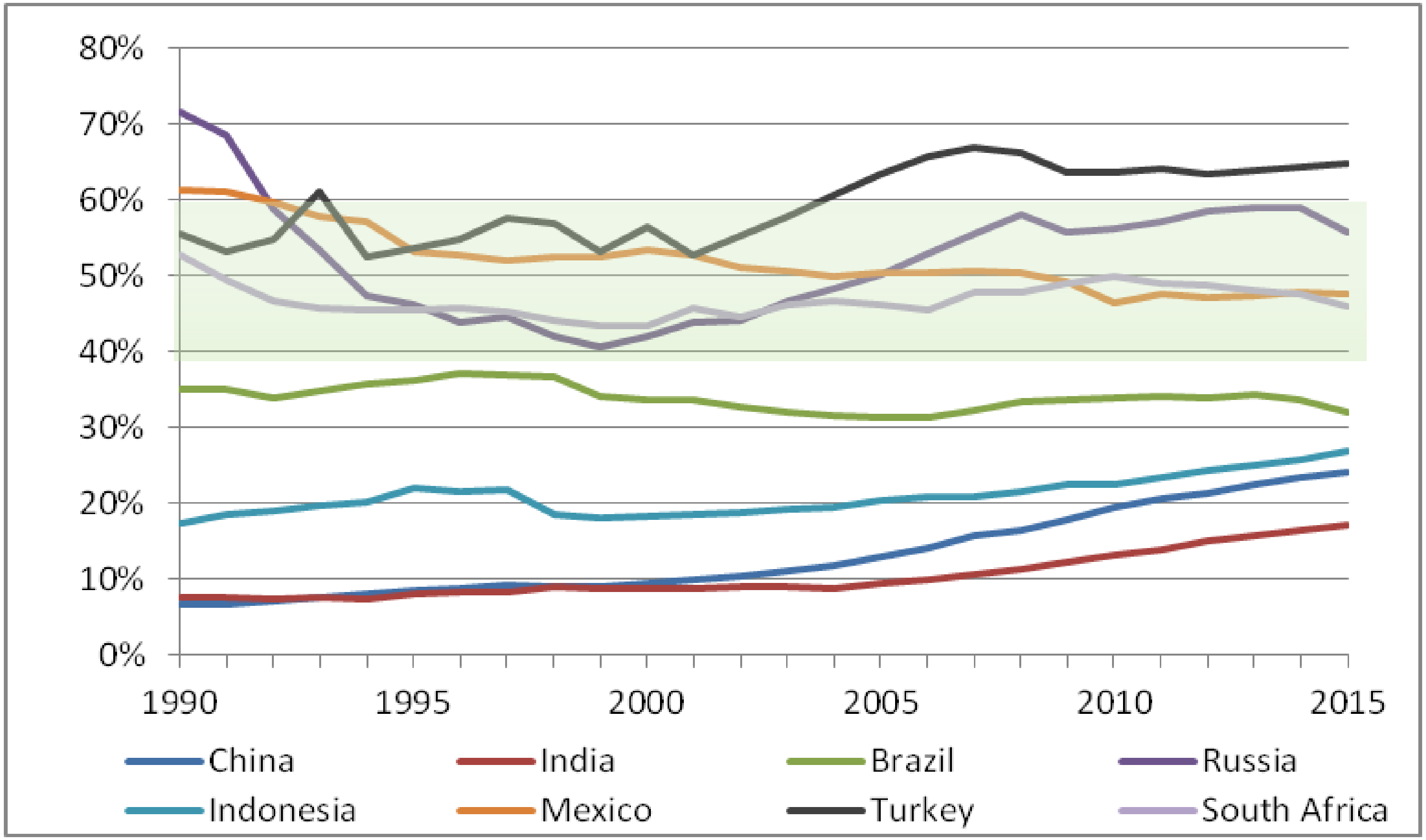


Countries trapped in the middle-income range are characterized by loss of competition in transition process

- Countries that are *unable to compete with low-income, low-wage economies in manufactured exports* and *with advanced economies in high-skill innovations* … such countries cannot make a timely *transition from resource-driven growth, with low cost labor and capital, to productivity-driven growth*. (ADB, 2011)
- Industries that drove the growth in the early period start to become globally *uncompetitive due to rising wages*. These labor-intensive sectors move to lower-wage countries and are replaced by a new set of industries that are *more capital-, human capital-, and knowledge-intensive in the way they create value*. (Spence 2011)
- A large number of countries that receive *too little manufacturing FD*I stay at stage zero. Even after reaching the first stage, *climbing up the ladders becomes increasingly difficult*. Another group of countries are stuck in the second stage because they *fail to upgrade human capital*. (Ohno 2009)

The countries that are "technically" at risk of a middle income trap are all relatively capital- or resource-intensive

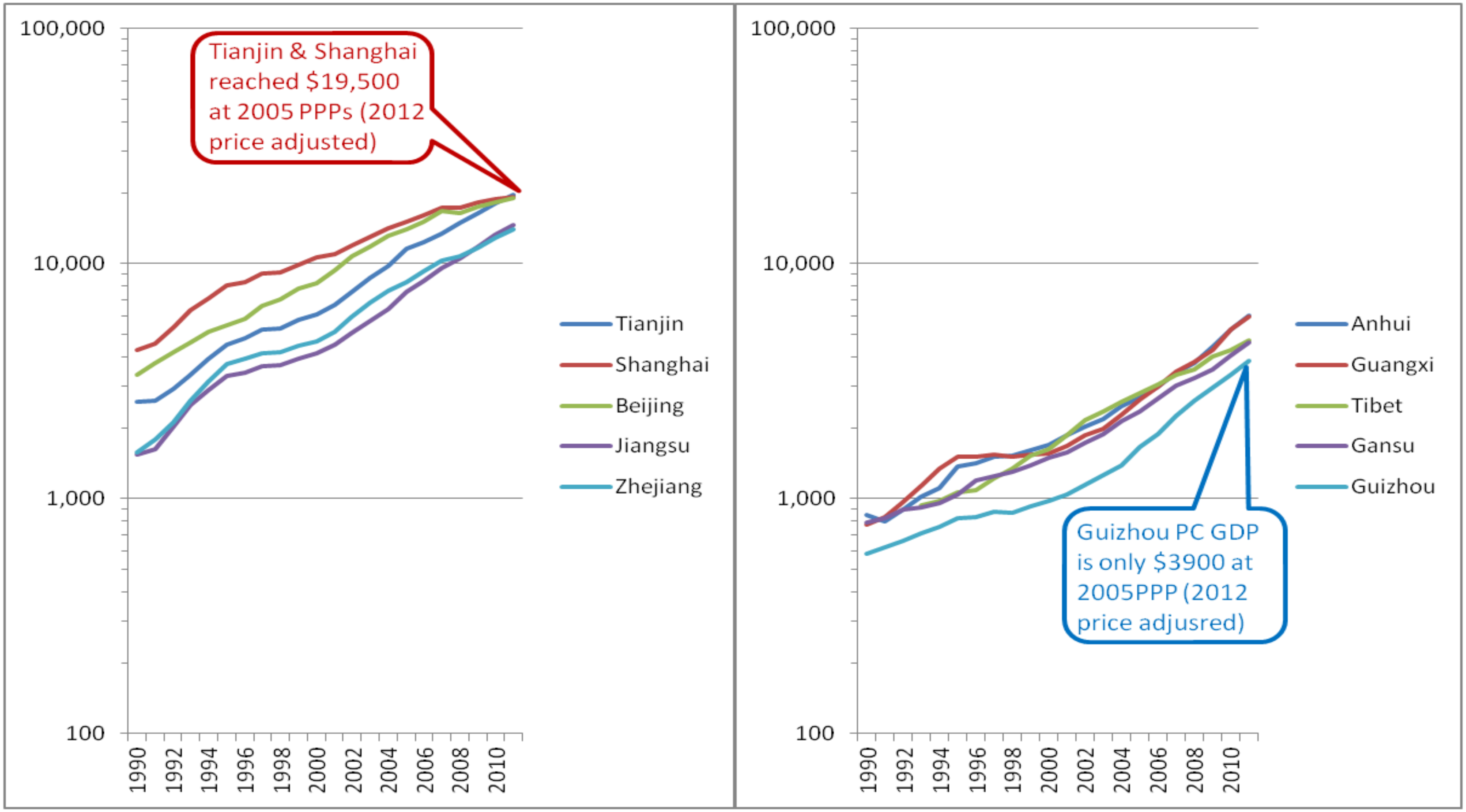
Output per person employed as a % of OECD average, 19902-15



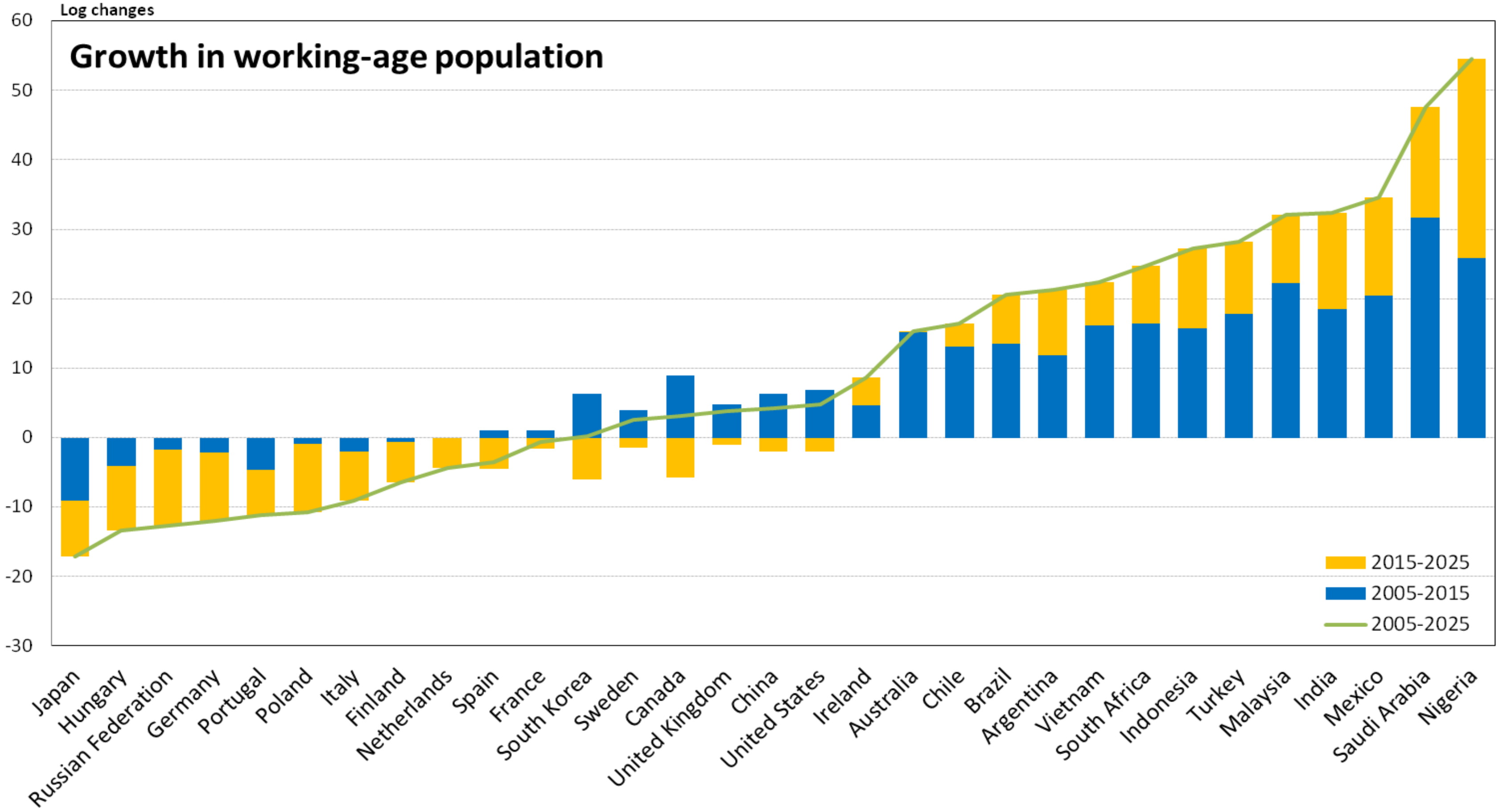
Source: *The Conference Board Total Economy Database, May 2016*

There are still many different “China’s”

Level of GDP per capita (PPP-based) - The richest five vs the poorest five provinces



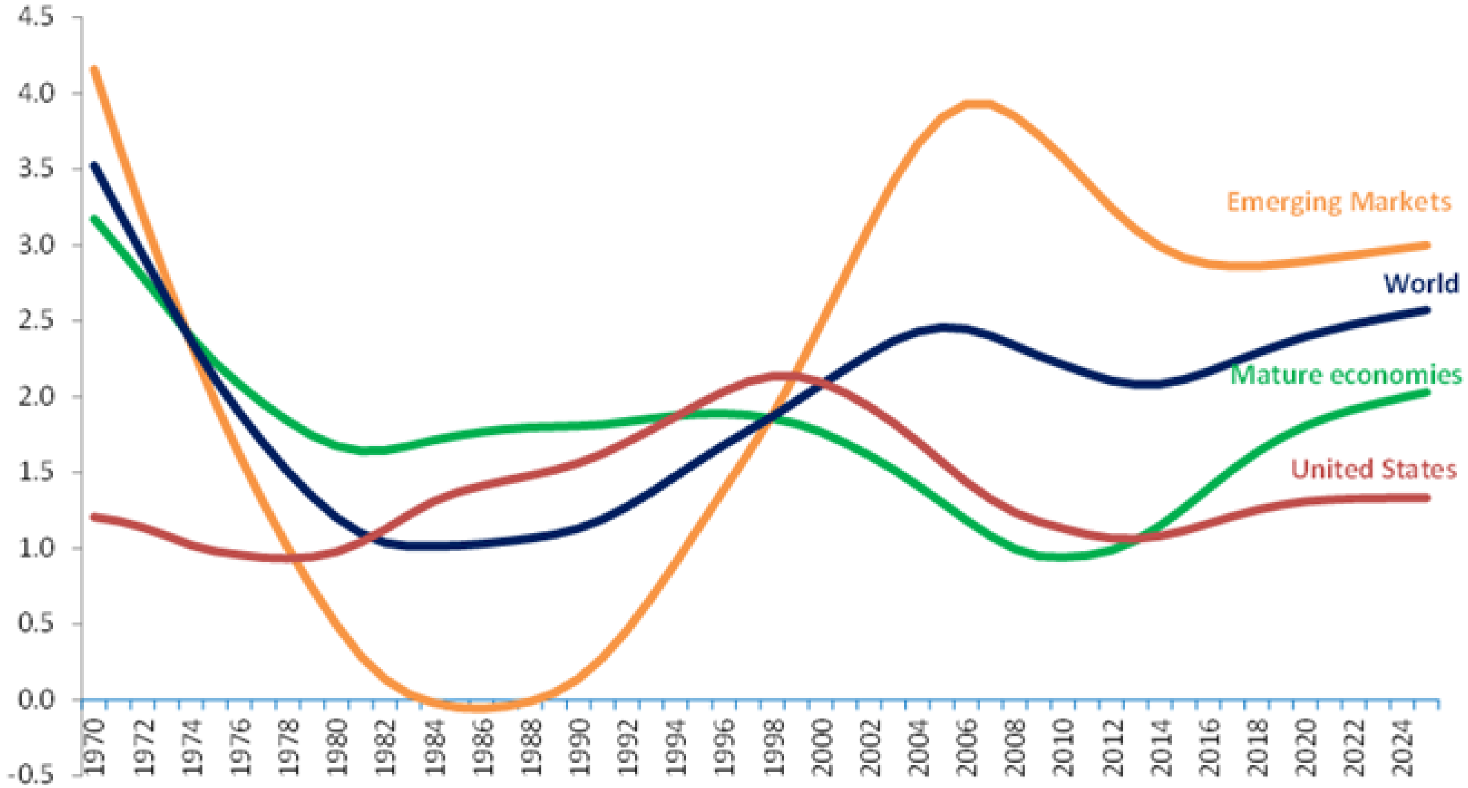
Emerging markets still enjoy demographic dividend but it will slow – higher skills have to make up for it to drive TFP growth



* "Natural" refers to growth in population excluding migration
Source: United Nations Population Division

Productivity growth could see some recovery into 2020s, but will it be enough to offset slowing labor supply?

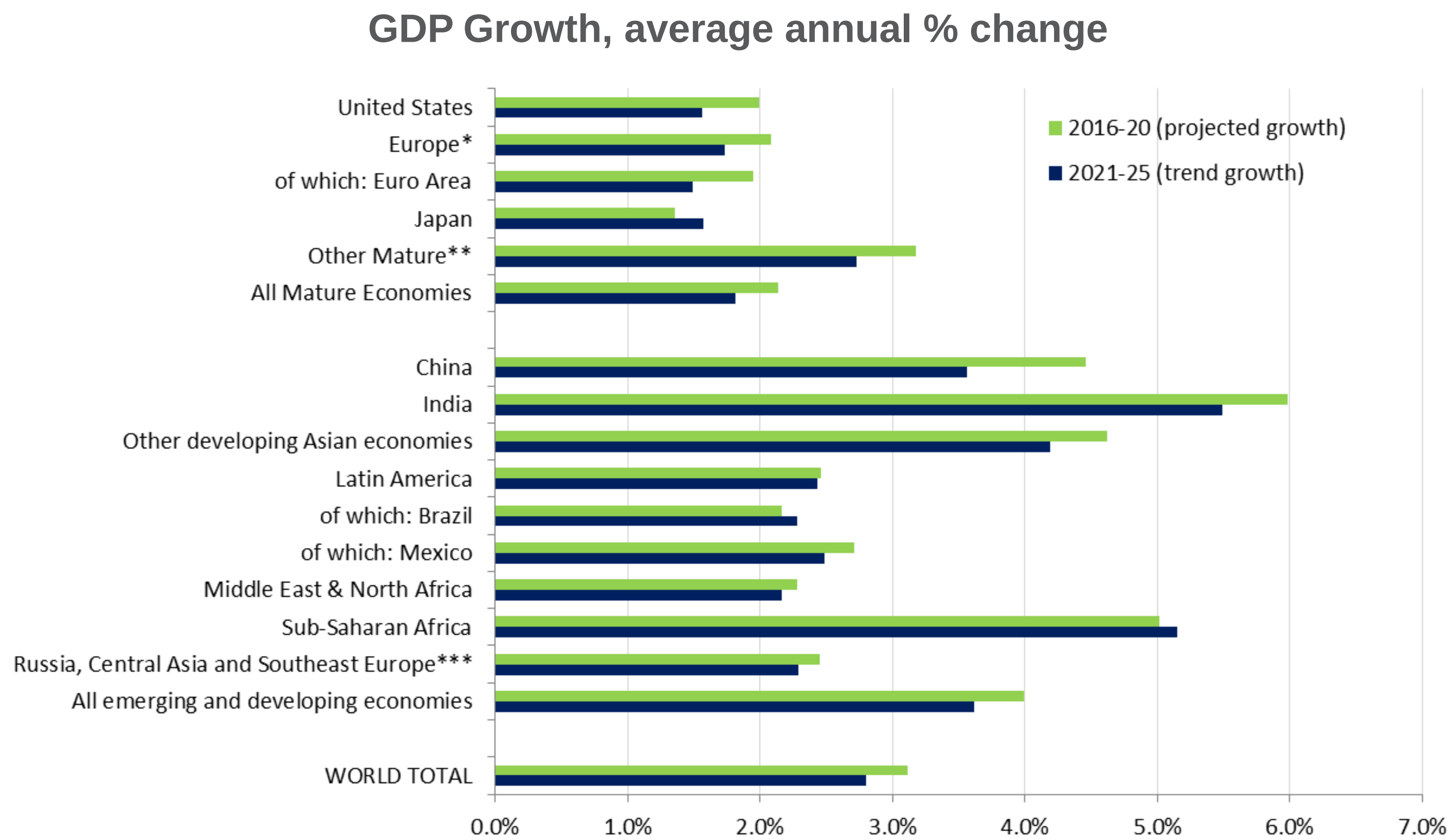
Trend growth in output (GDP) per worker, 1970-2025, in %



Note: Trend growth rates are obtained using HP filter, assuming a λ=100.

Source: The Conference Board Global Economic Outlook 2016 (November 2015)

No !! Growth rates of mature and emerging markets will converge dramatically



**Europe includes European Union -28 as well as Switzerland , Iceland and Norway.
**Other mature economies are Australia, Canada, Iceland, Israel, Hong Kong, South Korea, New Zealand, Singapore, and Taiwan Province of China.
***Southeast Europe includes Albania, Bosnia and Herzegovina, Croatia, Macedonia, Serbia and Montenegro, and Turkey.
Source: The Conference Board Global Economic Outlook 2016 (November 2015)

How to avoid an "exit" for emerging markets? From "accumulation" to "assimilation"

- Despite short-term challenges, the main constraints for emerging markets to sustain growth are medium-term
- The slowing demographic dividend is unlikely to be made up for by faster labor productivity growth
- The rebalancing from (tangible) capital accumulation to skills and innovation will make ongoing catch-up with mature countries possible
- The current slowdown in globalization (weak trade, slow FDI) is a constraining factor
- The nature of current innovation does not reward low-wage economies as a virtue on its own – it depends on returns on human and other intangible capital
- Regulatory and governance issues in an innovation-driven economy are much more challenging

