



# Perspectives by Ruth Lea

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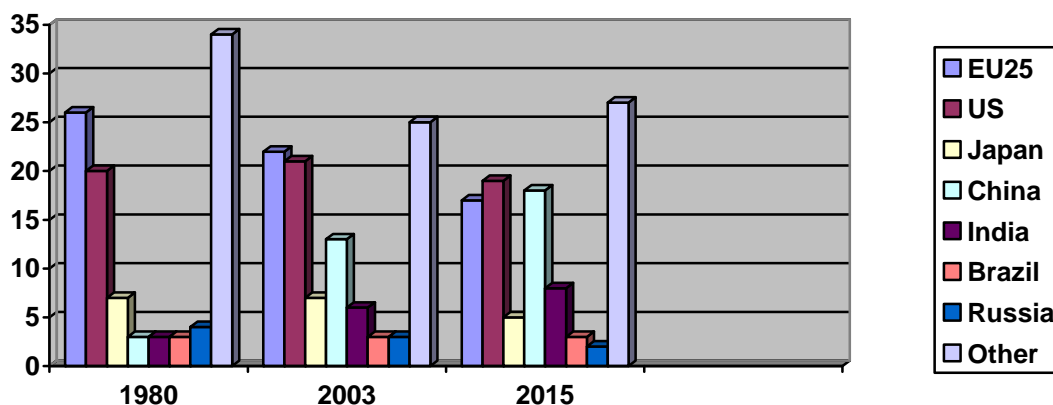


## The changing global landscape: G20 comes of age

The relative shift in economic power from the developed economies to the emerging economies is indisputable. The rise of China and India and the relative decline of European countries have been commented on many times.<sup>1</sup> It is difficult to see how these trends would reverse, especially given Europe's ageing demographics, and it is reasonable to assume that they will not be reversed.

One of the many sets of global projections was published by the Treasury in 2005 and showed that the EU's share of global output fell from 26% in 1980 to 22% in 2003 and was expected to fall to 17% by 2015. The comparable data for China and India (together) were 6% (1980), 19% (2003) and 27% (2015).<sup>2</sup> Meanwhile the US's share of world GDP changed little at around 20%, as shown in chart 1 below.

**Chart 1: Shares of world GDP (%), purchasing power parities**



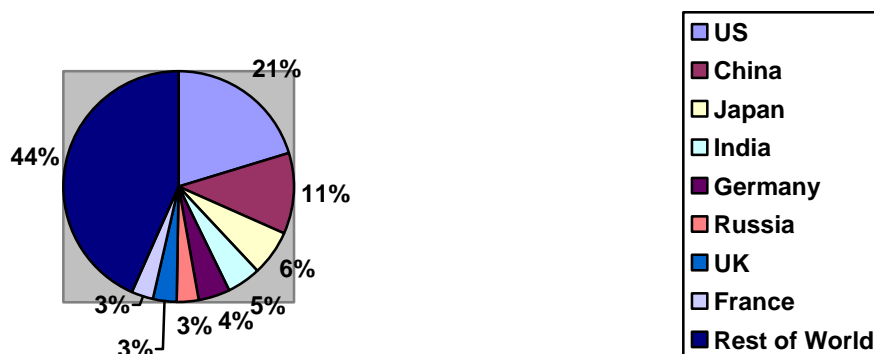
Source: Gordon Brown, *Global Europe: full-employment Europe*, HM Treasury, 2005. The EU data exclude Romania and Bulgaria.

The data shown in the chart above are at purchasing power parities, which take into account differences in the relative prices of goods and services, particularly non-tradeables, and therefore provide a better overall measure of the real value of output produced by an economy compared with other economies than data calculated using market exchange rates.

*Largest economies in 2008: a snapshot*

Chart 2 below shows the comparative sizes of the eight largest economies in 2008, in purchasing power parities. The US is still, without doubt, in a class of its own, accounting for one-fifth of global income (GNI), whilst the Chinese economy is still only about half the size of the US's. Japan, India, Germany, the Russian Federation, the UK and France are the next largest economies. Annex table 1 provides further details.

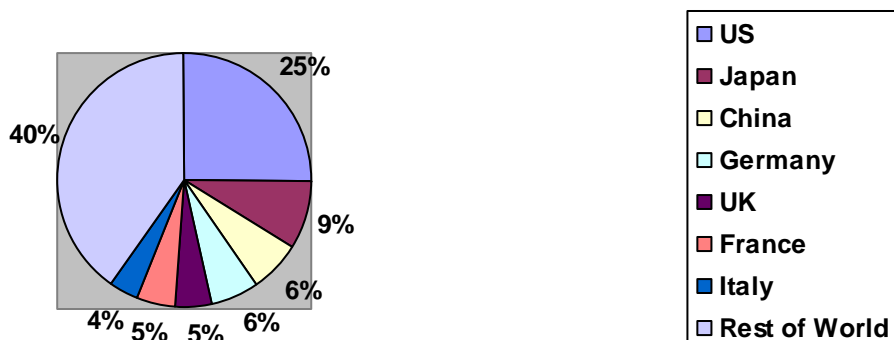
**Chart 2: Gross national income, 2008, share of total (%), purchasing power parities**



Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). There are rounding errors and approximations in the table.

Even though data in purchasing power parities are the most appropriate for judging the relative sizes of the world's economies, data at market exchange rates are nevertheless also frequently quoted. But simple year-to-year comparisons can be distorted by wild swings in exchange rates. The IMF/World Bank therefore use the Atlas method of smoothing exchange rate fluctuations to improve the reliability of the comparisons. Chart 3 below shows the seven largest economies calculated on this basis. The US's lead increases, on this basis, and accounts for a quarter of the world's income. The relative positions of the emerging economies including China and India slip dramatically down the charts – as does Russia - partly, arguably, reflecting the undervaluation of their currencies vis-à-vis the dollar. As table 2 in the annex shows, Russia slips to 11<sup>th</sup> position in the league tables and India to 12<sup>th</sup>.

**Chart 3: Gross national income, 2008, share of total (%), Atlas method, smoothed exchange rates**



Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). There are rounding errors and approximations in the table.

China and India are, of course, very populous countries and when population is accounted for in order to calculate per capita incomes they don't just slip down the league tables – they plummet. The table below comprises selected countries and shows the enormous disparities in per capita incomes, which are very broad indicators of comparative living standards. According to these figures living standards in Luxembourg are over 10 times as high as in China and over 20 times as high as in India. Apart from Luxembourg, the richest European countries are Norway and Switzerland. The data below are purchasing power parity comparisons, disparities at market exchange rates are even more marked. Table 3 in the annex provides more details.

**GNI per capita, 2008, selected countries, PPP basis, \$000**

Rank	Economy	PPP, international dollars (thousands)
2	Luxembourg	64.3
4	Norway	58.5
11	US*	47.0
12	Switzerland	46.5
16	Hong Kong, China	44.0
27	Canada*	36.2
28	UK*	36.1
29	Germany*	35.9
32	Japan*	35.2
34	France*	34.4
71	Russian Federation*	15.6
95	Brazil*	10.1
122	China*	6.0
155	India*	3.0

Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). G20 countries asterisked.

*The eclipse of G7: G20 comes of age*

As the global recession, the “Great Recession”, progressed in 2008 there was a growing acknowledgement that G7 finance ministers meetings were no longer the appropriate international forum to discuss global crises because major emerging economies were absent.<sup>3, 4</sup> Arguably though, the start of the demise of G7 began earlier than this. Some would date the start of the demise as February 2004 when, at a G7 discussion on global trade imbalances and exchange rates, it became increasingly clear that key players such as China and India were not present.<sup>5</sup>

The G7 which, it could be argued, had adequately represented the global economy from the 1970s to the early 2000s, no longer does so. The changing shape of the global economy has made this inevitable. And increasingly the G20 meetings of finance ministers – and the recent meetings of heads-of-government – have assumed greater and greater importance.<sup>6,7</sup>

Following the September 2009 G20 heads-of-government meeting in Pittsburgh, the G20 was billed as the “premier forum” for coordinating policy for the global economy.<sup>8</sup> The G7 finance ministers meetings seem to be doomed. The governance of the world economy is irrevocably changing to reflect global economic realities.<sup>9</sup>

### *The G20's agenda*

As the new “premier forum” for economic coordination the G20 set itself an ambitious programme in September.<sup>10</sup>

Firstly, the G20 leaders agreed to shift the voting power substantially within the IMF towards “dynamic emerging markets and developing countries” and endorsed similar reforms at the World Bank. This amounts to a reform of the global “Bretton Woods” institutional architecture. The G20 meeting agreed to transfer at least 5% of representation to under-represented countries, although it stopped short of specifics.<sup>11</sup>

Setting fairness aside, a reason to reform the IMF is the hope that countries would be more likely to heed the IMF's advice if it is more representative. The IMF's previous attempt to get the big surplus countries together to deal with global imbalances in 2006 was an abject failure. But even with reform, there is still, of course, a limit what discussion can accomplish without a serious willingness on the part of member countries to act on unpalatable advice.

Secondly, and continuing with this “rebalancing of the global economy” issue, was the G20's launch of a “framework for strong, sustainable and balanced growth”. This framework looks extraordinarily ambitious – not least the stated aim to implement and monitor plans for global rebalancing. But, one trusts, the G20 has a real will to act. They understand that a global economy requires global governance. They understand that the problem posed by the imbalances cannot be tackled on the basis of unilateral action and therefore needs coordinated international measures. The difficulty will be to persuade the surplus countries, especially China, to stimulate domestic consumption and revalue the currency and persuade the deficit countries, principally the US, to stimulate its external sector at the expense of its domestic sector. China and the US are the two countries that really matter. But the G20 could not get a reference to China's currency in its communiqué and Beijing again refused to “take lectures” on reducing its trade surplus. This was not auspicious. The history of international coordination of macro-policies yields few happy examples and, whilst coordination is needed to reduce imbalances, the financial markets should not assume it will be forthcoming.

Thirdly, it was agreed to expand the Financial Stability Board, which oversees the coordination of global financial regulation, to include the G20's emerging-market members. But how much clout the developing nations will actually have remains unclear. The G20 also agreed to strengthen financial regulation, via reformed rules of capital adequacy and remuneration of bank employees. Progress is being made along these lines.

Fourthly, the G20 agreed to avoid the “premature” withdrawal of stimulus and plan their exit strategies. More specifically, they agreed “to sustain our strong policy response until a durable recovery is secured”. But the US already seems to be running down some of the facilities it had earlier set up to address problems in the money markets. And Jean-Claude Trichet, ECB President, has said “it is important in our view that it starts as soon as recovery starts”. For the ECB there appears to be no question of waiting until the recovery is seen to be durable, as the G20 undertook to do. The G20 leaders’ agreements over the appropriate time to exit the stimulus measures already appear to be floundering.

In addition, the G20 statement arguably misses a most important point, which is that global activity seems set to slip back even if policy makers make no efforts to implement exit strategies. This is because some of the measures taken to stimulate economies are expiring while the effects of others are fading. In the UK, for example, the standard VAT rate is due to revert to 17.5% in January 2010 from the current 15%. And, more widely, various car support schemes are time-limited or funds-limited.

Fifthly, there were also statements intended to combat supposed man-made climate change including the phasing out of fossil fuel subsidies and reaching agreement in Copenhagen on climate change. And, finally, there was the expressed desire, but slightly forlorn desire, to “bring the Doha round to a successful conclusion in 2010”.

#### *Final comments*

G20 appears to be off to a flying start and, whilst it is all too easy to criticise the realism of its ambitions and the potentially cumbersome bureaucracy surrounding meetings of 19 nations (plus the EU), its *de facto* replacement of the G7 finance ministers meetings as the forum for global economic cooperation speaks volumes.

The 21<sup>st</sup> century economy will be truly global. The post-war western world dominated by the US and Europe (with prosperous Japan as an honorary western developed economy) is over. The economic tectonic plates are shifting. We are living in historic times and the September 2009 Pittsburgh G20 summit was an historic event.

## References

1. Ruth Lea, "Globalisation and demography are changing the world", Arbutnot Banking Group, 31 March 2008.
2. Gordon Brown, *Global Europe: full-employment Europe*, HM Treasury, 2005.
3. The G7 finance ministers meetings (US, Japan, Canada, Germany, UK, France and Italy) began in 1975 in the wake of the 1973-74 OPEC crisis.
4. The G8 refers to the heads-of governments meetings, comprising the G7 countries and the Russian Federation.
5. Chris Giles, "Crisis marks life of a body on its last legs", *FT*, 3 October 2009.
6. The G20 economic meetings comprise the finance ministers and central bank governors of 19 countries & the EU. The countries are Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the UK & the USA. Representatives of the IMF and the World Bank and Spain and the Netherlands also attend. G20 was set up in 1999.
7. The G20 heads-of-government have met 3 times: Washington (November 2008), London (April 2009), Pittsburgh (September 2009).
8. FT leader, "Seats at the table", 29 September 2009.
9. Economist, "Cosmetic surgery? The face of global governance is changing", 3 October 2009.
10. FT leader, "G20 takes charge", 28 September 2009.
11. Alexandra Frean, "G20 leaders agree to bank reforms, but the real test lies in future cooperation", *The Times*, 26 September 2009.

## Annex IMF/World bank data on world Gross National Incomes (GNI)

Notes on the data:

- The data in table 1 are GNI (gross national income) data in purchasing power parities. GNI takes into account all production in the domestic economy (i.e. GDP) plus the net flows of factor income (such as rents, profits and labour income) from abroad. Purchasing power parity (PPP) conversion factors take into account differences in the relative prices of goods and services, particularly non-tradeables, and therefore provide a better overall measure of the real value of output produced by an economy compared with other economies than data at market exchange rates. PPP GNI is measured in current "international" dollars which, in principle, have the same purchasing power as a dollar spent on GNI in the US economy.
- The data in table 2 are the IMF/World Bank's official estimates of the size of economies are based on GNI converted to current US dollars using the Atlas method. The Atlas method smoothes exchange rate fluctuations by using a 3-year moving average, price-adjusted conversion factor. It results in GNI data at "modified, smoothed" market exchange rates (MERs). GNI data measured in current US dollars using annual, market exchange rates (MERs) are not quoted here.

**Table 1: Gross national income, 2008, PPP (billion of US dollars)**

Rank	Economy	GNI, \$bn	Share of total (%)
1	US*	14.2	20.4
2	China*	7.9	11.3
3	Japan*	4.4	6.3
4	India*	3.4	4.9
5	Germany*	2.9	4.2
6	Russian Federation*	2.3	3.3
7	UK*	2.2	3.2
8	France*	2.1	3.0
9	Brazil*	2.0	2.9
10	Italy*	1.8	2.6
11	Mexico*	1.5	2.1
12	Spain*	1.5	2.1
13	South Korea*	1.35	1.9
14	Canada*	1.2	1.7
15	Turkey*	1.0	1.4
16	Indonesia*	0.9	1.3
17	Iran	0.8	1.1
18	Australia*	0.8	1.1
19	Poland	0.7	1.0
20	Netherlands	0.7	1.0
21	Saudi Arabia*	0.6	0.9
22	Argentina*	0.6	0.9
23	Thailand	0.5	0.7
24	South Africa*	0.5	0.7
25	Egypt	0.4	0.6
26	Pakistan	0.4	0.6
27	Colombia	0.4	0.6
28	Malaysia	0.4	0.6
29	Belgium	0.4	0.6
30	Venezuela	0.35	0.5
	World	69.7	100.0
	Euro area	10.9	15.6

Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). There are rounding errors and approximations in the table. G20 countries asterisked.

**Table 2: Gross national income, 2008, Atlas method (billion of US dollars)**

Rank	Economy	GNI, \$bn	Share of total (%)
1	US*	14.5	25.3
2	Japan*	4.9	8.5
3	China*	3.7	6.4
4	Germany*	3.5	6.1
5	UK*	2.8	4.9
6	France*	2.7	4.7
7	Italy*	2.1	3.7
8	Spain	1.5	2.6
9	Brazil*	1.4	2.4
10	Canada*	1.4	2.4
11	Russian Federation*	1.4	2.4
12	India*	1.2	2.1
13	Mexico*	1.1	1.9
14	South Korea*	1.0	1.7
15	Australia*	0.9	1.6
16	Netherlands	0.8	1.4
17	Turkey*	0.7	1.2
18	Switzerland	0.5	0.9
19	Belgium	0.5	0.9
20	Sweden	0.5	0.9
21	Indonesia*	0.45	0.8
22	Poland	0.45	0.8
23	Norway	0.4	0.7
24	Saudi Arabia*	0.4	0.7
25	Austria	0.4	0.7
26	Denmark	0.3	0.5
27	Greece	0.3	0.5
28	Argentina*	0.3	0.5
29	South Africa*	0.3	0.5
30	Iran	0.25	0.4
	World	57.4	100.0
	Euro area	12.6	22.0

Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). There are rounding errors and approximations in the table. G20 countries asterisked.

**Table 3: GNI per capita, 2008, PPP, excluding mini-states**

Rank	Economy	PPP, international dollars (thousands)
	Selected richest countries:	
2	Luxembourg	64.3
4	Norway	58.5
5	Kuwait	52.6
9	Brunei Darussalam	50.2
10	Singapore	47.9
11	US*	47.0
12	Switzerland	46.5
16	Hong Kong, China	44.0
18	Netherlands	41.7
22	Sweden	38.2
23	Austria	37.7
24	Ireland	37.4
25	Denmark	37.3
27	Canada*	36.2
28	UK*	36.1
29	Germany*	35.9
31	Finland	35.7
32	Japan*	35.2
33	Belgium	34.8
34	France*	34.4
35	Australia*	34.0
37	Spain	31.1
39	Italy*	30.3
43	Greece	28.5
44	South Korea*	28.1
45	Israel	27.5
46	Slovenia	26.9
49	Iceland	25.2
50	New Zealand	25.1
	Other G20 countries:	
53	Saudi Arabia*	23.0
71	Russian Federation*	15.6
75	Mexico*	14.3
76	Argentina*	14.0
78	Turkey*	13.8
95	Brazil*	10.1
97	South Africa*	9.8
122	China*	6.0
146	Indonesia*	3.8
155	India*	3.0

Source: IMF, September 2009, available from [www.imf.org](http://www.imf.org). G20 countries asterisked.

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