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Globalization and Catching-up in Emerging Market Economies

1. Introduction

To believe is the privilege of politicians. Economists should *know*. The economic policy makers – who are typically economists put in charge of politics – usurp the prerogatives of both groups and mistake belief for knowledge. What they believe is that, the way the world is made, the poor should be able to catch up with the rich and reduce the enormous differences in the level of economic development. Yet, these differences somehow grow year by year. Today nearly half of the world's inhabitants live on less than two dollars a day, and a billion people – a sixth of mankind – subsist on less than a dollar.

Faith, of course, can help, but knowledge is of decisive importance. What then do we know about the capacity of the emerging, relatively backward market economies to catch up with the highly developed countries? What systemic arrangements and development strategies might lead to this objective? What historic lessons are there to be learned concerning the management of economic growth in the future? How to distinguish the inevitable legacy of the past, which can only evolve in time, from the economic policy options left open? These are the questions that should constantly be addressed, all the more so since the old answers become outdated as the development factors change.

A third of a century ago, in 1969, the United Nations set up an expert group, known as the Pearson Panel, to suggest measures facilitating growth in less developed countries and to level out the differences in living standards. The Panel proposed development strategies which supposedly promised the backward countries (many of which were then in the process of gaining independence after centuries of colonialism) to attain a 6-percent growth over the coming decades. Countries that managed thus to accelerate their economic growth were expected to become – mainly through the expansion of exports – self-reliant partners in the world economy by the year 2000.

The year 2000 has passed. And it turns out that the course of development outlined by the Pearson Panel is a rare exception rather than a rule. The United Nations established, therefore, a new expert group, this time headed by the former President Ernesto Zedillo of Mexico, whose task is to advise on policies aiming to foster economic catching-up and, in particular, to implement the ambitious goals put on the agenda by the UN Millennium Summit

– one of which was to reduce the number of people living in extreme poverty by at least half a billion until 2015. The Zedillo Panel believes that this could be achieved through rapid economic development, if only the rich countries would increase their annual assistance for poor countries to 0.44 percent of their GDP. The trouble is, as we all know, that they would not (although they should) and so development aid lags at a paltry 0.22 percent. Consequently, the numbers of the poor do not shrink, disparities in development level increase, and distances to catch up grow. The year 2015 will soon have passed, too, conceivably, without bringing any noticeable improvement. There will be few winners, many more losers, and all the remaining actors are also likely to be dissatisfied with the way the globalized economy operates and the living standards achieved. Can we do better than that?

This paper deals with the fundamental theoretical aspects of and practical prerequisites to the catching-up process in the emerging market economies. Following this introduction, Part 2 presents the hitherto efforts in this area and the actual socio-economic processes going on over the last decades. Part 3 describes the current phase of globalization and analyzes its influence on the trends in output change and its pace. Part 4 contains a characterization of the young, institutionally immature market economies which seek to boost their growth rate through integration with the global system. The disparities in development level between various countries and regions in the world economy are discussed in Part 5, along with their implications for the catching-up process. Finally, Part 6 is devoted to the policies of systemic reform and to conclusions concerning a desirable development strategy to foster fast, sustained growth in the emerging market economies.

2. Back to the future

The past is gone. And so is the present, because in reality it does not exist, every passing moment turning instantly and irrevocably into the past. Thus all that is left is the future. Which is the most important thing. However, in order to couch our expectations about the future in rational terms, we need a good understanding of the past. Otherwise, we will never manage to forecast future development processes with reasonable accuracy, or to actively shape these processes (which is even more important). For the socio-economic aspects of the future are not only the function of time and some chaotic development processes, but, first and foremost, depend on a conscious development strategy combined with a growth and distribution policy.

Throughout history, **only about 30 nations, with a total population of less than a billion – that is, about 15 percent of mankind – has managed to attain a relatively high**

development level, with GDP per head exceeding $15,000 in terms of purchasing power parity (PPP).[1] Outside North America and Western Europe, this group comprises the member countries of the OECD from the Asia and Pacific region – Australia, Japan, South Korea and New Zealand – as well as Singapore. This level has also been achieved by some oil-exporting OPEC countries (Brunei, Kuwait and Qatar), certain economies with special structural characteristics (like the Bahamas, Martinique and Taiwan), and a few overseas territories of highly developed countries (like French Polynesia or New Caledonia). In 2001, the highest-income group was joint by the first and only post-socialist country thus far – the tiny (2 million inhabitants) Slovenia.[2] Next in line is the Czech Republic, where GDP per head is expected to exceed $15,000 in 2004.[3]

On the other extreme are countries unable to overcome the vicious circle of poverty. Some of them not only fail to close the staggering gap that separates them from highly developed countries, but keep plunging in stagnation and recession, lagging further and further behind not only economically, but also culturally. It happened in the past, and it happens, occasionally, today (Magarinos and Sercovich 2001). No doubt it will also happen in the future. Why? The answer is that only few countries in history managed to catch the train of progress. It was only possible if three favorable circumstances co-occurred.

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[1] "Purchasing Power Parities (PPPs) are the rates of currency conversion which eliminate the differences in the price levels between countries. PPPs are obtained by evaluating the costs of a basket of goods and services between countries for all components of GDP; PPPs are given in national currency units per US dollar." (OECD 2001, p. 13). Because of the relatively higher (in dollar terms) cost of living in the U.S. than in the remaining OECD countries, GDP calculated in PPP terms is, in most of the cases, higher than GDP calculated at the current market exchange rate of a given currency. For instance, with respect to Poland, the OECD estimates the purchasing power parity of the zloty at 1.98 to a dollar. This means that, at the average market rate of 4.35 zlotys to a dollar in 2000, the zloty equivalent of one dollar bought in Poland 2.19 times more goods and services from the representative basket than one dollar did in the United States. In 2001, this proportion decreased to 2.07 because of the appreciation of the zloty by 5.9 percent (the average exchange rate amounted to 4.1 zlotys to a dollar). Only in six countries (Denmark, Iceland, Japan, Norway, Sweden and Switzerland) is GDP per head calculated in PPP terms is lower than GDP in current exchange rate terms. Characteristically, all the European countries from this group remain outside the euro area. These are the "more expensive" countries in the sense that a dollar exchanged for their domestic currencies buys less than it does in the U.S., because of the price differentials. For the inhabitants of these countries, the U.S. is "cheap". In the remaining countries this relationship is reversed, and there is an inverse correlation between this price differential on the one hand, and the relative development level of a given country and the degree of adjustment of its internal prices to world prices, on the other. For example, within the OECD, the spread between PPP-adjusted and current-rate GDP is largest in Slovakia and smallest in the United Kingdom. In the age of globalization – in view of the progressive market liberalization and integration – differences in this field can be expected to shrink gradually. In the United States, GDP calculated at current rates and at PPP is, by definition, the same and amounts in 2002 to about $37,000 per inhabitant.

[2] According to the estimates of the Washington-based PlanEcon (since 2002 DRI-WEFA, Inc.), per capita GDP in Slovenia (in PPP terms) amounted in 2001 to $15,372 (PlanEcon 2001b). By way of comparison, the same source puts Poland's GDP at $8,137. The OECD estimates the latter at 15 percent more, that is, about $9,400. These discrepancies stem from the different methodologies on which the calculations are based.

[3] According to OECD estimates, GDP per capita in the Czech Republic – taking into account the 3.5 percent growth rate in 2001 and another 4 percent or so expected in 2002 – approaches (in PPP terms) $14,900 in 2002, while the PlanEcon forecast for the same year mentions $13,376 (PlanEcon 2001b).

First, economic development always requires technological progress. Without the spread of new manufacturing methods and the implementation of novel technologies that change the organization of production, no innovation is possible – and it is innovation that drives economic growth. Necessary – but not sufficient – conditions of technological progress also include, obviously, high-quality human capital, an adequate level of education and science, as well as efficient system arrangements in these areas (Kwiatkowski 2001).

Second, in order to sustain long-term development trends, it is essential to reform the institutional framework of an efficient market economy. Otherwise, even a relative technological superiority is no guarantee of rapid economic growth, as creative enterprise becomes stifled in such circumstances.[4] Obviously, creative enterprise is even less possible in technologically backward countries. Thus, without the capacity for economic reform, rapid output growth can hardly be relied on.

Third, **a creative feedback between technological progress and economic reform calls for political determination on the part of the political elites, who must be willing to upset the existing balance and to challenge the established position of conservative interest groups**. Only then can the "new" gain the upper hand of the "old", which is necessary for a sustained productivity growth. The fear of the temporary confusion that accompanies this kind of change often paralyzes the authorities, who then begin – through their reluctance to stimulate and institute the required reforms – to hamper rather than facilitate economic progress and socio-economic development.[5]

One needs to reminisce about the past – including more distant past, spanning several centuries – if for nothing else, then in order to realize, at the outset of a new millennium, that history is happening at all times. Now, too, because of the **three momentous processes coinciding today: the current phase of permanent globalization** (Bordo, Eichengreen, Irwin 1999; Frankel 2001; Kolodko 2002a), **the post-socialist transformation** (Blanchard

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[4] In fairly remote times – at the beginning of the 16th century – that was the case with China, which then surpassed Europe in technological advancement. However, the lack of necessary reform and the conservatism of the power structures stood in the way of an economic acceleration – particularly at a later stage, when 18th- and 19th-century Europe took excellent advantage of the subsequent phases of the scientific and technological revolution.

[5] A positive example is provided by the changes in Japan in the second half of the 19th century under the Meiji reform; a negative one can be furnished by Ukraine, which failed to utilize its relatively better position as regards the state of the production facilities and the technology at its disposal in the 1990s. It is important to note that such losses cannot be made up for at a later time. Thus neither contemporary China is making good the losses, despite its impressive growth, nor is Ukraine, even if it manages to hold on to the rapid development path it entered at the beginning of the present decade. This is so because the time that was once wasted is irrevocably lost, and no contemporary (or future) economic growth will offer compensation for this loss, as this growth begins at a lower level than it would, had the past opportunities been appropriately utilized. Today these

1997; Lavigne 1999; Kolodko 2000a), and **the modern scientific and technological revolution** (Raymond 1999; OECD 2000; Payson 2000; Kolodko 2000d). It is in this context that we should perceive modern developments, so as to avoid missing the train of progress once again. Not everyone succeeded in this task in the past: actually, few did. The same thing is being repeated now: some will get on the train, some will be left waiting, and some might even get pushed off the platform.

Incidentally, this phenomenon has already been observed for two decades. This is shown, for instance, by a World Bank report (World Bank 2002a) which distinguishes – apart from the rich economies[6] – two main groups of states. Today the term "developing countries" is less frequently used with reference to these, for the simple reason that some of them are hardly developing. Instead, one speaks about more globalized countries (MGC) and less globalized countries (LGC). This distinction is based on the participation in the international labor division, measured by the dynamics of foreign trade. A third part of the countries where the growth of the proportion of foreign trade volume to GDP in the 1980s and 1990s was steepest has been classified as MGCs, and the remaining two thirds as LGCs.[7]

The group of 24 countries which become more actively involved in the world economy (MGCs) has a total population of nearly 3 billion. The 49 countries less tightly integrated through foreign trade with the world system (LGCs) have about 1.1 billion inhabitants. The characteristics of the two groups differ widely, and changes in output level and dynamics, as well as the living standards, follow different trends in either group (Table 1).

opportunities can only be seen as a more or less distant past, whose promise – if not totally squandered – was at best inadequately exploited.

[6] Interestingly, included among the "rich economies", apart from the initial 24 member states of the OECD, are not only Hong Kong, Taiwan, South Korea and Singapore, but also Chile, whose GDP per head (in PPP terms) is the same as Poland's. In both cases it amounts to about 26 percent of the American income.

[7] "The 'more globalized' – the top third of developing countries in terms of increased trade to GDP between 1970s and 1990s – are Argentina, Bangladesh, Brazil, China, Colombia, Costa Rica, Côte d'Ivoire, the Dominican Republic, Haiti, Hungary, India, Jamaica, Jordan, Malaysia, Mali, Mexico, Nepal, Nicaragua, Paraguay, the Philippines, Rwanda, Thailand, Uruguay, and Zimbabwe. The 'less globalized' are all other developing countries for which we have data. The less globalized group is a very diverse set of countries. It includes failed states whose economic performance has been extremely poor. It also includes some countries of the former Soviet Union that went through a difficult transition in the 1990s. Some of the less globalized countries have had stable but not increasing trade, and positive but slow growth." (World Bank 2002a, p. 51).

Table 1: Characteristics of more and less globalized countries

Socioeconomic characteristics	More globalized countries (24 countries)	Less globalized countries (49 countries)
Population, 1997 (billions)	2.9	1.1
Per capita GDP, 1980 (USD)	1,488	1,947
Per capita GDP, 1997 (USD)	2,485	2,133
Inflation, 1980 (percent)	16	17
Inflation, 1997 (percent)	6	9
Rule of law index, 1997 (world average = 0)	-0.04	-0,48

Source: World Bank 2002a.

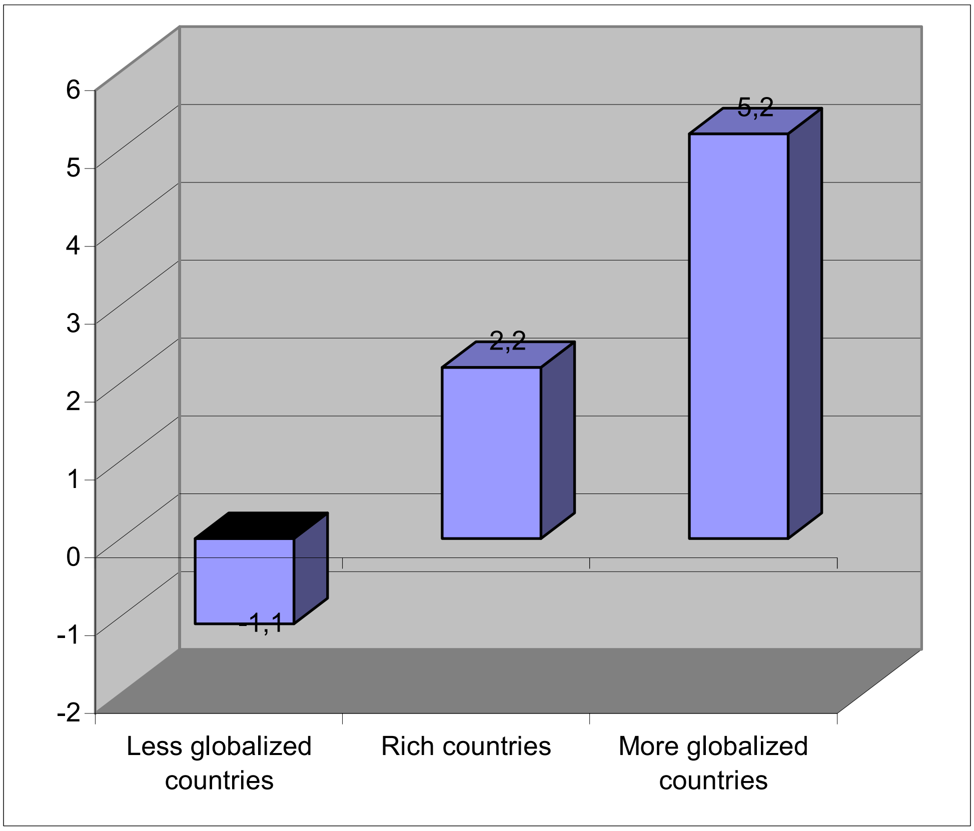
In 1980, GDP per head (in PPP terms) in the MGC group stood, on average, at less than $1,500; by 1997, it increased to nearly $2,500 – that is, by almost two thirds. In the LGC group, the increase amounted merely to about $200, or less than 10 percent. Taking into account just the last five years, the respective proportions become even more striking. While the MGCs have kept developing at an average rate of about 5 percent annually and managed to further increase GDP pre head by almost $400, reaching about $3,100 in 2002, the LGCs have recorded an about 6-percent drop in GDP per head, to about $1,900 in 2002. Thus the difference in this respect changed from about $500 in favor of the LGCs in 1980 to about $1,200 in favor of the MGCs in 2002. These are significant qualitative differences which alter the face of the modern world.

Such tendencies indicate that **within the time span of a single generation, the economies that take more active part in globalization managed to double their real income per head**. Unfortunately, the income of other societies, less involved in the development of international trade, did not increase, on average, at all. If a shorter time span is taken into account, and these processes are viewed solely from the perspective of the 1990s, we will see a 63-percent increase of GDP per head in the MGC group[8] and a drop by about 10 percent in the LGC group[9] (Figure 1).

[8] Per capita GDP in these countries kept growing at increasingly faster rates in the last decades of the previous century: from 1 percent in the 1960s, to 3 percent in the 1970s, 4 percent in the 1980s and 5 percent annually, on average, in the 1990s.

[9] In highly developed countries, GDP per head grew at the average rate of 2.1 percent a year. Thus it increased during the 1990s, in real terms, by another 23 percent, yet in the richest among the major economies – the United

Figure 1: Economic growth in the world economy, 1991–2000
(GDP per head in percent)



Source: Dollar and Kraay 2001.

However, one must not overlook in this context the fact that this general, fairly encouraging picture of change results mainly from the unprecedented progress attained by just two countries. But these were quite special countries, too: China and India, inhabited jointly by some 2.3 billion people. Therefore, their growth rate has an overwhelming impact on the indicators of the entire MGC group.

It is an important and noteworthy fact that both China and India – although they follow different routes and their progressive integration with the world economy and involvement in the worldwide competition likewise takes dissimilar paths – pursue development strategies by no means based on the neoliberal orthodoxy and the classical prescriptions that stem from the so-called Washington Consensus,[10] which has been invoked so often recently in mainstream economics and figured prominently in the recommendations

States – the aggregate growth was over 38 percent (3.3 percent average overall growth, or 2.8 percent in per capita terms).

[10] The essence of this concept of economic policy is presented by Williamson (1990 and 1997). For a criticism of the "Washington Consensus", see North (1997), Stiglitz (1998) and Kolodko (1999b).

given to many countries by the G-7 countries, the International Monetary Fund and the World Bank.

Both China and India are reforming their respective economies at their own, not too quick pace, but with a great deal of consistency and determination. They liberalize capital movements gradually and with moderation, while the exchange rates are effectively controlled by the state at all times. Moreover, their monetary policy is subordinated to the overall national policy, the top priority of which is rapid economic growth. To this end, state intervention is used in both countries more extensively than elsewhere, mainly in the form of industrial and trade policies. Such a combination of structural reform and development policy brings favorable results.[11]

Chinese GDP increased in the 1980s by as much as 162 percent, which amounts to an average real year-to-year growth of 10.1 percent. In the 1990s, growth was even faster, reaching 10.7 percent annually, to produce a cumulative output increase of another 176 percent. In 2000-02, growth rate has somewhat declined, fluctuating around 7 percent. Thus over the past 23 years – within the time span of a single generation – GDP in China has grown by a staggering 780 percent! Given the population growth at the same time, the increase of GDP per head was, at 575 percent, relatively lower, but this too is a giant leap (this time a successful one) in the field of economic catching-up and, consequently, the living standards. Yet the disparities remain enormous. It should be borne in mind that, despite this successful, great step forward, Chinese GDP per head (in PPP terms), still comes up to a mere 12 percent of the USA level.

India, in turn, saw in the 1980s an average annual growth rate of 5.8 percent, which increased to 6% in the following decade. In the last three years (2000–02), real GDP growth has been around 5%. Thus the aggregate output growth within the time span of one generation (1980–2002) has totaled 264 percent, or 130 percent on a per head basis, because of the much higher population growth than in China.[12] Thus when it comes to closing the gap between rich economies and the MGC group, one should remember that if the world's two most populous countries were to be excluded from this group, the picture would be far less optimistic. The

[11] It should be added that a similar observation pertains to some other countries which boast success in attaining relatively higher growth rates and overcoming the development lag. In Asia, for instance, this is true of Vietnam, and in Africa – of Uganda.

[12] Whereas the population of China increased in those years by about 30 percent, India recorded a nearly 50-percent population growth. If the current demographic forecasts prove accurate, the population of these countries should increase by the year 2015, respectively, by 8.5 and 18 percent, reaching 1.41bn in China and 1.23bn in India. Thus every third inhabitant of the Earth will live in one of these two populous countries, whose development level will have an even greater impact than today on global averages.

MGC population would then drop from three billion to 700 million, among which the income growth would be far less impressive.

On the other hand, there exist countries which have been thus far unable to cope. Not managing to reduce the gap, some of them have actually been losing distance. Unfortunately, from the point of view of the attained development level (or, to put it differently, relative backwardness), the latter group comprises nearly all the economies of Central and Eastern Europe and the former Soviet Union, in the midst of a lengthy and complex transition from central planning to free market. This transition is inseparable from the process of successive opening up to foreign contacts that will lead in time to full integration with the global economy (IMF 2000b; Kolodko 2000c).

Characteristically, out of the total number of 28 post-socialist economies, only Hungary has found its way to the more globalized group. All the 15 post-Soviet republics, as well as the remaining 11 countries of Central and Eastern Europe and Mongolia, showed in the previous decade too low foreign trade dynamics[13] to qualify, using the World Bank methodology, to that group.

Of course, this fact by itself does not amount to much. Far more importantly, in the 1990s, the distance between these countries and more highly developed and affluent societies further increased. Whereas GDP in post-socialist countries plummeted in 11 years (1990–2000) in absolute terms by an alarming 28 percent,[14] the seven most highly developed economies of the world – known as G-7 – recorded during the same years a 28-percent increase. Respectively, in the 15 European Union countries, growth amounted to 24 percent and in OECD countries, to some 31 percent.[15] Thus the already enormous gap between the

[13] This pertains especially to exports, whose slow growth creates problems which are fairly typical of the entire region, connected with a high trade deficit and a deficit of the balance of payments.

[14] This indicator differs from region to region and from state to state. In nine economies of Central and Eastern Europe (Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia), economic growth began after just three years of transitional recession, in 1993. As a result, in the year 2000 their GDP reached 107 percent of the 1989 level. In six other states of Southern and Eastern Europe (Albania, Bosnia-Herzegovina, Bulgaria, Macedonia, Romania and Yugoslavia), the recession lasted four years, having begun already in 1989). In that region, as the slump was much deeper, the GDP of the year 2000 reached only 73 percent of the level of 1989. In the CIS area, that is the 12 economies of the Commonwealth of Independent States (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine and Uzbekistan), this indicator came up to 61 percent, partly because these countries, on average, returned to the growth path only in 1996, after five years of recession in 1991–5 (EBRD 2001).

[15] This group also comprises the new member states which joined this organization in the 1990s, including four post-socialist countries (the Czech Republic, Hungary, Poland and Slovakia). However, their relative contribution to the GDP of the entire organization (respectively, 0.5, 0.5, 1.3 and 0.2 percent) is so small that the development tendencies within this group have very little impact on the overall growth in OECD countries. Even if these countries were excluded from the calculation, the GDP growth in the remaining OECD countries in the 1990s – rounded off to the tenth of a percentage point – would amount, on average, to about 2.5 percent annually.

post-socialist region and the most advanced economies was further dramatically broadened. Great as the distance was, now it is even greater.

This is highly significant. After all, **one of the fundamental economic arguments in favor of the post-socialist systemic transformation was – and remains – the conviction that market transition will contribute to greater economic efficiency and will soon lead to higher growth rates, compared not only with central planning, but also with the developed market economies**. Thus far, 13 years into the transition, this is hardly the case. In time, however, these predictions may materialize, although – as the experience of recent years shows – the economic transformation alone is not enough. What is needed is also an appropriate strategy of socio-economic development.

3. The contemporary phase of globalization

Globalization is the historical process of liberalization and integration of goods, capital and labor markets, which have hitherto functioned to certain extent in separation, into a single world marketplace. The qualification "to certain extent" is important, because even seemingly totally separate national or regional economic organisms are somehow interconnected, indirectly or directly, and some economic and financial flows do take place between them, albeit on a limited scale. As regards specific markets, their liberalization and consequent integration differs in scope and intensity.

There are differences between the markets of goods and services, many of the latter being unsuitable, in view of their specific form, to be traded globally, as they need to be consumed on the spot, the moment they are performed. Different still is the market of capital transfers, which follow different rules than the simple movements of goods. Yet another set of differences pertains to labor, whose international transfers have thus far been liberalized to the least extent – for economic, but also cultural and strictly political reasons, although the latter (except for extremist political movements, like Haider's party in Austria or Le Pen's party in France) is rarely publicly admitted.[16]

[16] This can be illustrated by examples from various corners of the world economy – from the openly hostile treatment of the Asian immigrants in Australia and their deportation to South Pacific islands, to the expulsion of illegal Chinese immigrants from Hong Kong back to China, to the introduction of stringent visa requirements for CIS citizens traveling to the formerly "fraternal" countries of Central and Eastern Europe, to tough immigration quotas for the inhabitants of Central America trying to settle in North America. Of course, such restrictions are far less strict – or, indeed, sometimes replaced with incentives – in the case of highly skilled employees who are in short supply in the developed economies. The boom of the so-called new economy in the U.S. is a case in point, where a number of measures were introduced to facilitate the arrival of specialists in the areas of computer hardware and software, as well as Internet technologies, educated elsewhere – mostly in India and China, but also in some post-socialist transforming economies.

To be sure, the scope of market integration has been changing across the historical phases of the globalization process (Frankel 2001). Globalization can be divided into periods in many different ways. Apparently, one can even speak about its permanent character, because globalization – that is, the extent to which particular product markets and regional markets have been liberalized and integrated – has been deepening all the time, although with varying intensity, long breaks or even occasional setbacks, as in 1914–45. In the history of permanent globalization thus construed, three particularly expansive phases can be distinguished:

- **globalization of the Age of Exploration** (16th to mid-17th centuries);
- **globalization of the Industrial Revolution** (mid-18th to 19th centuries);
- **globalization of the Age of Computers and the Internet** (last quarter of 20th century and beginning of 21st century) (Kolodko 2001a).

The World Bank distinguishes three phases of globalization, covering, respectively, the years 1870–1914, 1950–80 and recent times, past-1980 (World Bank 2002a). However, this periodization gives rise to serious reservations, for two reasons. First, it totally ignores earlier (pre-1870) peaks of international economic activity and links between numerous regional and national markets, as well as the ensuing qualitative changes. Second, the years 1950–80 cannot be considered a "second phase of globalization", because, as the World Bank report itself confirms, that period involved only the integration of highly developed capitalist economies, that is, those of North America, Western Europe and Japan. This is quite a lot, but not enough to be considered a "global economy".[17] Remaining outside the scope of those integration processes were some huge areas: both the "Second World" of socialist planned economies, and the "Third World" of underdeveloped countries.

Six characteristics of modern globalization can be distinguished. First, thanks to the significant reduction of customs barriers,[18] the **volume of world trade increases very fast, nearly twice as fast as output**. While the global GDP increased in 1965–99, on the average, at 3.3 percent a year, the volume of exports (and hence, in the global context, also imports) increased at 5.9 percent per annum.[19] Foreign-trade growth was fastest in the MGC group: in

[17] This group of highly developed countries, although inhabited by merely 15 percent of the world population, generates 57 percent of the global income, and its share in the world exports of goods and services amounts to 76 percent. However, in spite of its decisive influence of the global economy, it must not be equated with the world at large.

[18] In the last decade and a half – since the mid-1980s – customs tariffs have been reduced by about 10 percent in the LGC group and by about 33 percent in the MGC group.

[19] This long-term tendency is not undermined by the stagnation of the world trade volume in 2001–02, which is a temporary occurrence, as was the slowing down of growth in 2000–01. The World Trade Organization estimates

the case of the East Asia and Pacific region, it stood at 10.1 percent a year, on average. However, even in some LGCs foreign-trade dynamics exceeds that of GDP growth. As a result, the share of these countries in world trade increased from 19 percent in 1971 to about 30 percent in 2001.[20] Moreover, there have been favorable changes in the structure of these exports. In 1980, merely 20 percent of exports from less developed countries consisted of processed manufactured goods; today this proportion exceeds 80 percent (IMF 2000a).

Second, apart from some temporary disturbances caused by a series of financial crises at the turn of the previous decade, **capital flows have been steadily increasing**. Three decades ago, capital transfers from rich to less advanced countries stood at less than $28bn; in the record-breaking (thus far) year 1997, they were 11 times higher, reaching $306bn.[21] Growth of the transfer volume has been particularly explosive in the case of private portfolio investments: from a negligible $10m in 1970 to a record $103bn in 1996.

Third, there are **population migrations**. Although the modern-time movements are not as extensive as those in the years 1870–1910, when as much as about 10 percent of the world population changed their permanent residence, their economic significance is considerable. Over nearly forty years (since 1965), the number of employees who have found work outside their country of birth has nearly doubled. Interestingly, the scope of migrations is greatest between less developed countries, rather than from those countries to rich ones.

Fourth, one should take note of the **dissemination of new technologies**, and in particular the spreading impact of the scientific and technological revolution connected with information and computer technologies (ICT). We witness the birth and development of a knowledge-based economy, with serious implications for countries seeking to catch up with more highly developed states. Progress pertains not only to the "hard" manufacturing technologies, but also to new management and marketing methods, which greatly boost productivity and hence increase the output.

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that the global trade volume dropped in 2001 by about 1 percent and is likely to increase by about the same amount in 2002, returning to the level attained in the year 2000.

[20] It should be noted that out of the 20 countries with the relatively highest proportion of their foreign trade volume to GDP, exceeding 50 percent, only four are highly developed countries, namely, Belgium, Ireland, Luxembourg and Singapore. This group also includes three post-socialist economies: the Czech Republic, Estonia and Slovakia.

[21] In terms of capital flows, and especially direct investment, post-socialist economies occupy a specific position. In 1990–2001, they officially absorbed more than $150bn, of which the greatest part – almost $60bn – was channeled to Poland. During the same period Poland invested abroad – mainly in the neighboring post-Soviet republics – a mere $600m, that is, a hundred times less. Similar proportions are observed in other countries of the region, except Russia. Another type of emerging markets comprises countries which invest more capital abroad than they absorb from foreign sources, like Hong Kong or South Korea. In post-socialist emerging markets, the scarcity of capital makes direct investment a one-way process: funds flow into these countries.

Fifth, an indispensable element of the current phase of globalization is the **post-socialist systemic transformation**. Indeed, one could hardly speak about globalization without including in this process this huge area, inhabited by more than a quarter of mankind. On the one hand, this transformation acts as a catalyst facilitating market transition in the former centrally planned economies. On the other hand, it complements and completes the globalization process itself. Global economy means global capitalism (Hutton and Giddens 2000) and, therefore, it can only be based on the market. Thus the inclusion of Central and Eastern European countries, the Commonwealth of Independent States, China and Indochina in this process[22] will require the prior transformation of these areas into open and liberalized market economies.

Sixth, the radical transformation of the financial and economic structures and institutions is accompanied by far-reaching **cultural change**. Greater openness to the transfer of not only people, but, first and foremost, ideas – not least through the phenomenal growth of the Internet, which is a medium resistant to bureaucratic and political control – means that the world has shrunk considerably and increasingly acquires the characteristics of a "global village". But at the same time it has also enormously expanded by the creation of vast virtual spaces in which various cultural trends coalesce as if in a giant melting pot, while new forms of economic activity are being born (Kolodko 2000d; Zacher 2000).

Thus defined and characterized, **globalizations seems an irreversible process**. But is it really so? From the point of view of the incredibly accelerated information flow and decreased communication and transportation costs, it is. There is no way to undo technological progress and the explosive growth of the ICT sector – the two factors that have altered within the time span of one generation, right before our eyes, the face of the world.

What is it like then, the world's new face? First and foremost, it is heterogeneous, for not all the consequences of globalization are positive. The persistence or even, in some areas, increase of social inequalities (Dollar 2001), financial crises and their spread to other sectors of the world economy (including some economies based on relatively sound foundations and strong institutions), the dying off of some traditional branches of manufacturing in certain countries due to their low competitiveness, which creates rampant unemployment and poverty – these are but a few of the disadvantages of globalization. Further problems arise not only in

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Obviously, there are exceptions, connected especially with the export and flight of capital, as was the case in Russia in the 1990s or after the fall of the fraudulent pyramid schemes in Albania in 1996–8.

[22] Of course, among post-socialist countries, one should also include Mongolia, to which the above remarks and generalizations also apply, although it is usually left out in the published statistics, because of its minimal contribution to the world economy.

the social and economic spheres, but also on the political or even military levels. As an extreme example, one could point at international terrorism, which, incidentally, can be viewed as a privatization of wars and military conflicts, or as an instance of the world trade in arms running out of control of powerful countries and the international organizations in which these countries play a dominant role, such as the UN or the WTO.

Therefore, the **possibility that the attained progress of globalization will be reversed cannot be ruled out**. It has happened so in the past, for instance, after 1914, when the then achieved level of globalization likewise seemed secure. Thus although technological progress cannot be checked, further liberalization of trade and capital movements – as well as, significantly, the increasingly liberalized transfer of labor – can be brought to a halt. The threat of renewed protectionism is real and cannot be ruled out a priori.[23] That would automatically entail the slowing down of globalization, which would deprive many nations of the chance to catch up with more advanced economies.

We keep looking at the world economy from the perspective of its component countries. This is not only due to the availability of appropriately aggregated statistical data (and hence the possibility to carry out various comparative analyses), but also – and mainly – because of the domination of the traditional way of thinking. Accordingly, although it would be more convenient to speak of the increasingly integrated world economy in terms of various regions, rather than countries and national economies, the traditional, "nation-centered" thinking will continue to hold sway for many years to come. Superposed on it is the perception of the word economy as clearly divided into mature economic systems and "emerging markets".

4. The emerging markets

The notion of "emerging markets" is blurred. It gets a different reading in the countries in which it was coined, that is, highly developed market economies (Mobius 1996; Garten 1998; Gilpin 2001), and in the countries to which it directly applies. The latter is a large, if heterogeneous, group, with a well-defined center and hazy periphery.

It is easier to say with certainty what is *not* an emerging market than what is. One could say that **emerging markets do not include, by definition, either those highly developed market economies which have long evolved mature institutional systems, or**

[23] In a sense, this threat remains a fact all the time. Even the World Bank (2002a) says that, by cautious estimates, the protectionist practices of rich countries alone cost the poorer countries as much as about $100bn a year, that is, double the amount of foreign aid they receive.

those countries which have yet to set out on the path of market development. Thus outside this group are all rich, institutionally mature countries. These comprise all the "old" members of the OECD (except Turkey), and several countries which have attained a high development level in recent decades, acceding wholeheartedly to the world economic exchange and liberalizing their economic regulations.

It remains a moot point whether every relatively rich country can be excluded a priori from the "emerging markets". Should we include in this group – in view of their specific economic system and a certain immaturity of their market institutions, and in particular, barriers to competition and a lack of liberal deregulation – some oil-rich Arab countries which owe their relatively high development level solely to their natural resources? Could it really be that, say, Qatar or the United Arab Emirates, with a PPP-adjusted per capita GDP of, respectively, about USD 19,000 and USD 17,000, are more mature – already "emerged" – market economies than Chile or Hungary? Or do they just happen to be richer than the latter? It would seem, therefore, that – at this end of the spectrum – inclusion in the category of developed markets should be based on the criterion of market-institution maturity rather than level of development alone.

At the opposite end of the list of countries that certainly cannot be included among the "emerging markets" are four types of economies. The first one, rendered totally obsolete by the post-socialist transformation, comprises the orthodox socialist states, like North Korea and Cuba. The second is made up of countries which either by way of their own political preference, or through international sanctions imposed upon them, are largely isolated from broader contacts with the world economy, like Myanmar, Iraq or Libya. The third group consists of failed states with dysfunctional institutions, which are not only unable to take part in global economic exchange, but even internally appear ungovernable, such as Afghanistan and Bosnia-Herzegovina, or a fair number of African countries, like Somalia, Congo (former Zaire), Sierra Leone or Rwanda.

Finally, the fourth group – which is the most important source of candidates for an "emerging market" status – comprises countries which are gradually approaching a stage in structural reforms, opening and liberalization where a qualitative change is about to take place that may soon enable them to take advantage of free global capital flows or international free trade. One can classify with this group some post-socialist countries which have belatedly embarked on the transformation, like Turkmenistan or Uzbekistan, as well as some of the former "Third World" countries now facing profound economic and political reform, like Algeria or Iran, and, finally, countries about to overcome the turmoil of civil war and armed ethnic strife, like, formerly, Guatemala and Yemen and now (hopefully) Angola and East Timor.

Unfortunately, there are processes in the modern world going in the opposite direction, too. Economies whose markets were already "emerging" may be set back in this process. This is particularly true of countries which become entangled – often quite unexpectedly – in destructive political and military conflicts, usually, though not always, of ethnic character. By way of exemplification, one could mention Kyrgyz Republic and Nepal in Asia, Madagascar and Zimbabwe in Africa, or Haiti and Colombia in America. Thus, generally speaking, **what is and what is not an "emerging market" depends on the maturity of its institutions**, that is the rules of the economic market game – the law and culture – and the institutions enforcing the adherence to these rules.

Methodologically, it is also possible to treat as "emerging markets" all economic systems which cannot be considered fully mature. Then one would also have to include in this category Iraq beside China, Belarus beside Poland, Libya beside South Africa, Cuba beside Mexico. Indeed, the classification here is a matter of convention, rather than sharp distinctions based on substantive criteria. This is not really the main point and there is no need to argue whether Singapore and Slovenia still count as "emerging markets", as global investors would have it,[24] or whether Pakistan and Kazakhstan have already attained this status, although not as fast as some transnational corporations and the governments of the most highly developed economies would wish.

Of greater importance is the interpretation of the "emerging market" category, as well as its theoretical and especially pragmatic implications. Does the fact that a country counts as an "emerging market" has a bearing on its socio-economic development, and in particular, on its chances for accelerated growth, which are of special interest for us here? This is one of the issues that the two interpretations of the "emerging markets" – from their own perspective and that of the advanced economies – are concerned with.

From the point of view of (institutionally) developed and (materially) rich countries, the "emerging markets" are treated instrumentally. For these countries, they form yet another segment of the expanding field of economic activity. Thanks to its "emergence", a new region of the world opens up for penetration by creating an opportunity to invest profitably surplus capitals, sell products and acquire resources, including relatively

[24] In some international analyses, certain countries are occasionally included in two groups simultaneously. For instance, Hong Kong, South Korea, Singapore and Taiwan have been treated by the IMF and the World Bank for

cheap labor. In this way an additional demand "emerges" – and becomes globalized – which now can be satisfied, as the political, economic and financial barriers that used to block access to these regions of the world are being torn down. Such an approach emphasizes not so much a commitment to the socio-economic development of an "emerging" market, as the opportunity to increase one's own capacity for expansion and to multiply the wealth of the already rich countries. The development of an "emerging market" itself is only important inasmuch as it favors further expansion of the rich countries in a specific, new sales market. In other words, under the instrumental approach, rapid growth of an "emerging market" is not a self-contained, supreme goal, but only an instrument to further the interests of other, more powerful actors in the global economic game – be it the highly developed countries or the great transnational corporations.

On the other hand, the "emerging markets" themselves – which, incidentally, did not insist on being thus named – have a totally different outlook on this subject. What matters from their point of view is not the additional outlet created in their territory for the capital and goods from other, more advanced countries, but the **rapid maturation of their own economic systems, leading to the emergence of full-fledged market economies**. On this interpretation, the principal goal is not to create a new sales market for others, but to build a new, market system which is institutionally liberalized and progressively opens, much to its own benefit, to an expanding range of outside contacts.

Such a system should ensure a higher level of efficiency and faster output growth, hence also improving the living standards of the societies in countries described as "emerging markets". The object of the game is to have market *economies* emerge, rather than just markets. This distinction is significant, for it emphasizes the main objective, which is rapid growth, to be achieved by the creation of an open, market economy with strong institutions. But the fact that a given country can be classified as an "emerging market" is in itself no guarantee that its economy is growing. If this is to be the case, many conditions must be met.

5. Development gap and catching-up

How, then, are we to understand catching-up? What is it supposed to be like and who is to close the distance to whom? Do we speak about Canada catching up with the United States, Eastern Europe catching up with Western Europe, or perhaps Africa catching up with Southeast Asia? And with Europe, too? What are the prerequisites and implications of

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a couple of years now as advanced economies, whereas investment banks still classify them as emerging catching- up? To answer such questions, it is good to realize first what the starting point is, which the world economy has reached at the beginning of the 21st century. Different regions vastly differ in attained development levels.

So far some economies have been doing better than others. Over the past few decades, some have recorded considerable growth, while others are treading water or even falling behind with their development level. As a result, **huge differences in development levels exist between specific countries and regions of the global economy, and thus the less advanced economies face the task of closing an enormous distance**. In most cases it is plain to see that this distance cannot be made up for. But there should likewise be no doubt that for some emerging market economies, including several post-socialist countries, catching up with the highly developed countries is within reach (Kolodko 2001b and 2002b).

The potential reduction of distances in development levels should be seen in various perspectives. After all, we are not speaking about Sierra Leone catching up with the GDP of the Luxembourgers, who generate within a working week as much output (in terms of value) as the Sierra Leoneans do in two years. Nor are we speaking about Honduras overtaking the United States. But we do want to see Honduras, as well as other countries of Central America and the Caribbean, develop faster than their rich neighbor up north, overcoming in time their backwardness and poverty. The same can be said about Ukraine and Germany, Vietnam and Japan, Sudan and Egypt, or Papua New Guinea and Australia.

Closing the distances should be seen not only – or even not mainly – in the global context, but in a regional one. First one needs to catch up with one's close neighbors who have attained a relatively higher development level. **In the neighborhood of every country there are other, more highly developed economies, and reducing the distance to them should be one of the strategic political objectives.** Especially when these are adjacent countries, like Haiti and the far more prosperous Dominican Republic,[25] Costa Rica, which develops much faster than its neighbor, Nicaragua, Uganda, which does better than Tanzania, or Thailand, which has greatly outdistanced Laos. Such instances, as well as many others, demonstrate that the currently existing differences in development level are not only the function of geographical location and the available natural resources, but mostly result from

markets.

[25] Although the Dominican Republic and Haiti coexist on the same island, the GDP of the former increased in the 1990s by 82 percent and that of the latter dropped by 11 percent (ECLAC 2001).

the unequal efficiency of the respective economic systems and the varying quality of the trade development policy followed by specific countries (World Bank 2002c).[26]

The same observation pertains to post-socialist countries, among which the pre-existing differences in development level changed in various ways over the first dozen or so years of the transformation, because of the varied duration and depth of the transitional recession (Kolodko 2000a; Blejer and Skreb 2001; EBRD 2002). Thus if Poland wants to improve its position, it should first close in on the Czech Republic and Hungary;[27] likewise, Uzbekistan should first attain the development level of Kazakhstan and Russia,[28] to be able to proceed further.

It seems, however, natural from the political and psychological points of view that, say, Turkmenistan looks up mostly to the nearby and culturally similar Turkey, Hungary wants to emulate the neighboring Austria, Estonia compares itself with Finland, Poland with Germany and Macedonia with Greece. The amount of catching-up differs in all these cases. The distance is least pronounced in the case of Turkmenistan, whose PPP-adjusted GDP per head is about 50 percent of that of Turkey. The respective proportion stands at 45 percent between Hungary and Austria, 37 percent between Estonia and Finland, and 35 percent between Poland and Germany. The most severe disparity occurs between Macedonia and Greece, where the ratio in question amounts to a mere 24 percent.[29]

Let us add that we are not concerned in the present discussion with the catching up processes among highly developed economies (which, incidentally, is an interesting problem in its own right). In order to catch up with the U.S. in terms of PPP-adjusted GDP per head, Canada would have to increase its output by 25 percent. But the growth rates in both countries have been very similar in recent years, mainly because of their strongly correlated business cycles. For South Korea to overtake Japan, its GDP per head would have to grow by 62 percent. If New Zealand's per capita GDP were to equal that of Australia, it would have to be

[26] In the long run, the economic system is also shaped by the policy being implemented, although in a short-term perspective it may seriously affect the effectiveness of this policy. Incidentally, this is one of the significant differences between emerging and mature markets.
[27] PlanEcon (2001b) estimates per capita GDP (in PPP terms, year 2000 prices) in Poland, Hungary, and the Czech Republic in 2002, respectively, at about $8,300; $11,800 and $13,400. According to the World Bank, the Hungarian and Czech income exceeds that of Poland, respectively, by 32 and 53 percent.
[28] PlanEcon (2001a) puts per capita GDP (in PPP, year 1995 prices) in those three countries, respectively, at $2,700; $3,550 and $5,625.
[29] The indicators quoted above for the Turkmenistan-Turkey and Macedonia-Greece pairs (pertaining to the year 2000) should be taken with due caution, as the respective per capita GDP figures (in PPP terms) have been calculated using slightly different methods: the OECD methodology in the case of Greece ($16,000) and Turkey ($6,800) (OECD 2001) and the PlanEcon methodology in the case of Macedonia ($3,900) (PlanEcon 2001b) and Turkmenistan ($3,400) (PlanEcon 2001a).

boosted by 35 percent.[30] For Austria to be level with Switzerland, its per capita GDP would have to move 17 percent up, whereas a similar outcome in the case of Portugal and Spain would require only a 12-percent growth.

Yet **even if GDP levels per head were fully equalized, this would by no means eliminate differences in living standards**, because the latter depend not only on the current income stream, but also on the resources accumulated – in some cases over many centuries.[31] This can be illustrated by the example of Finland and Sweden, which has been the more prosperous of the two for ages, partly due the exploitation of its eastern neighbor. Currently – since the turn of the previous decade – Finland enjoys a per capita GDP level (in PPP terms) amounting to 105 percent of the OECD average, whereas the same indicator in Sweden stands at 103 percent. In absolute numbers, this amounted in the year 2000 to about \$24,900 and \$24,400, respectively.

Catching-up has been even more efficient in the case of Ireland, which has managed to exceed the GDP of the United Kingdom (respectively, \$25,060 and \$24,390 at current exchange rates, or \$28,500 and \$23,900 in terms of PPP). However, the consumption level still clearly lags behind in Ireland. These differences remain conspicuous. A trip from London to Dublin is enough to see that it was Britain, and not Ireland, that was for centuries the center of an empire on which the sun never set. The legacy of that period can still be seen both in the regional proportions of income and wealth distribution, and in the functioning of the global economy.

Thus the average income level is greatly differentiated in modern world. The table below compares the ranking of 70 countries where the PPP-adjusted income per head exceeds \$6,000 (or about a sixth of the current U.S. level) with the 20 poorest countries of the world. Among the former group, there are just 12 out of the 32 post-socialist economies of Europe and Asia (including China and Indochina). In the latter group, there is just one post-socialist

[30] As it happens, the Australian economy has been developing faster than New Zealand's over the past dozen or so years, thus increasing the distance between the two: the average GDP growth in Australia in 1990–2002 has reached as much as 4.2 percent, as compared with 3 percent in New Zealand.

[31] Real consumption depends on both current income and the degree of depreciation of the accumulated consumption assets. It should be added that the notion of living standards is far broader than consumption – even if the latter is construed in so-called true terms. It depends on many factors, including the general level of education and culture, health, public security and the state of the environment. Attempts are being made to measure these standards by means of the Human Development Index (HDI), calculated under the United Nations Development Program (UNDP 2001). It should be noted that from the point of view of HDI disparities, the distance between the emerging post-socialist market economies and the rich countries is noticeably smaller than in the case of per capita GDP (Kolodko 2000a). Whereas there are just four post-socialist countries (Slovenia, the Czech Republic, Hungary and Slovakia) among the 50 countries with highest per capita GDP levels (in PPP terms), four other post-socialist countries (Poland, Estonia, Croatia and Lithuania), in addition to the above-mentioned four, are listed among the top 50 in terms of HDI.

country: Tajikistan – the poorest of all the countries undergoing a systemic post-socialist transformation.[32]

[32] According to a PlanEcon forecast, per capita GDP (in PPP terms) in Tajikistan was expected to reach $1,028 in 2002, whereas at current exchange rates it stands at a mere $204 (PlanEcon 2001a). The ratio of per capita GDP between the richest EU member – Luxembourg – and the poorest CIS economy – Tajikistan – amounts to 42-to-1 in PPP terms, but calculated at current exchange rates, it increases to 243-to-1.

Table 2: Countries with highest and lowest GDP per head in PPP (USA = 100)

Highest purchasing power

1. Luxembourg	129.2	36. South Korea	48.7
2. United States	100.0	37. Bahamas	48.6
3. Switzerland	90.1	38. Martinique	46.3
4. Norway	88.2	39. Barbados	43.9
5. Iceland	85.3	40. Guadeloupe	40.6
6. Brunei	85.1	**41. Czech Republic**	**40.2**
7. Belgium	80.6	42. Bahrain	39.5
8. Denmark	80.2	43. Reunion	38.7
9. Bermuda	79.7	44. Argentina	37.4
10. Canada	79.7	**45. Hungary**	**34.6**
11. Japan	78.9	46. Saudi Arabia	34.6
12. Austria	77.1	**47. Slovakia**	**32.7**
13. Netherlands	76.5	48. Mauritius	28.0
14. Australia	74.7	49. Uruguay	27.4
15. Germany	73.7	50. South Africa	27.3
16. France	72.1	51. Chile	26.4
17. Finland	70.8	**52. Poland**	**26.3**
18. Hong Kong	70.7	**53. Estonia**	**25.7**
19. Ireland	70.4	54. Mexico	25.3
20. Singapore	69.9	55. Costa Rica	24.7
21. French Polynesia	69.6	56. Trinidad & Tobago	24.1
22. United Kingdom	69.6	57. Malaysia	23.9
23. Euro area	69.5	**58. Croatia**	**22.8**
24. Sweden	69.4	**59. Russia**	**21.9**
25. Italy	68.9	**60. Belarus**	**21.6**
26. New Caledonia	66.2	61. Brazil	21.4
27. United Arab Emirates	64.5	62. Botswana	20.5
28. Cyprus	59.8	**63. Lithuania**	**20.3**
29. Israel	56.6	64. Turkey	20.2
30. Spain	55.9	**65. Latvia**	**19.5**
31. New Zealand	55.2	**66. Romania**	**18.7**
32. Macau	53.1	67. Thailand	18.6
33. Slovenia	**50.3**	68. Tunisia	17.9
34. Portugal	49.7	69. Colombia	17.5
35. Greece	49.5	70. Namibia	17.5

Lowest purchasing power

1. Sierra Leone	1.4	11. Zambia	2.3
2. Tanzania	1.6	12. Nigeria	2.4
3. Congo-Brazzaville	1.7	13. Congo	2.5
4. Burundi	1.8	14. Madagascar	2.5
5. Malawi	1.8	15. Mozambique	2.5
6. Ethiopia	1.9	16. Chad	2.6
7. Guinea-Bissau	2.0	17. Rwanda	2.8
8. Mali	2.3	18. Benin	2.9
9. Niger	2.3	19. Burkina Faso	3.0
10. Yemen	2.3	**20. Tajikistan**	**3.1**

Source: Economist 2001.
Post-socialist countries – in bold letters.

Reducing the existing differences in development level thus requires that the output growth rate should be high – markedly higher than in rich countries. This is obvious. But it is worthwhile to ask how big the difference in growth rates should be in order to reduce the distance in a perceptible way or, in some cases, eliminate in time the existing gaps.

Catching up is possible when the economic growth in a given country is at the same time:

- **fast;**
- **sustained;**
- **endogenous.**

So when can we say that growth is "fast"? This is a relative matter, for the same absolute growth rate can be in certain cases – in the context of one country or period – considered to be high, while elsewhere it is low. Undoubtedly, the average annual GDP growth of 3.3 percent in the United States in the 1990s was very fast.[33] The neighboring Mexico recorded a similar rate during the same period, but this meant slow growth, because it not only failed to shorten the cumulative distance, but even, in view of the relatively weaker growth dynamics in per capita terms, resulted in an even greater income disparity.[34] In 1992–2001, overall GDP increased in Mexico, on average, by 3.2 percent per annum. But calculated on a per capita basis, growth was merely 1.5 percent annually. As a result, the distance between the two economies and the living standard of their population increased even further.

It should be noted that, from the point of view of growth rate dispersion and catching-up with the developed countries, this is the main difference between the market economies emerging from "Third World" and "Second World" (post-socialist) countries. Let us compare Latin America and the Caribbean with Central and Eastern Europe and the CIS. In the post-socialist economies, overall output grows at the same rate as output per head, as the population, generally, does not change. On the other hand, in the emerging market economies of America, population is increasing steeply. In extreme cases, the spread between GDP growth rate in overall and per capita terms exceeds two percentage points. During the previous decade, it reached 2.6 percentage points in Paraguay (respectively, +1.7 and –0.9 percent), and 2.1 points in Ecuador and Venezuela (respectively, +2.0 and –0.1, and +2.4 and

[33] In the euro area, the annual GDP growth in the same period was just 1.8 percent, thus increasing (rather than reducing) the distance between these 12 advanced economies and the USA to more than 50 percent.

[34] Per capita GDP in Mexico (in PPP terms) amounts to about 25 percent of the U.S. level, but it should be borne in mind that income disparities in Mexico are much greater than in the United States, with the Gini coefficient for these two countries of, respectively, 53.1 and 40.8. If the extreme deciles and quintiles of the Mexican population derive, respectively, 1.3/41.7 and 3.5/57.4 percent of the total income, the respective indicators for the U.S. stand at 1.8/30.5 and 5.2/46.4 percent (World Bank 2002b).

+0.3 percent). In the entire Latin America and Caribbean region, GDP grew on average at 2.9 percent a year, but on a per capita basis, the increase dwindled to a lame 1.2 percent annually, that is, below the social perception threshold. Worse still, in as many as five countries of the region (Ecuador, Jamaica, Haiti, Cuba and Paraguay), output per head was lower in 2001 than 11 years before, although it was only in two of these countries (Cuba and Haiti) that overall output shrank (ECLAC 2002).

Thus if growth is to qualify as fast, it should be qualitatively higher in per capita terms than in highly developed countries. The term "qualitatively" is used here to imply that, in time, the differences in development level will perceptibly diminish. Bearing in mind the disparities existing at the very outset, it might be assumed that **rapid growth presupposes at least double the growth rate of developed economies**. In the last-mentioned group, the average annual growth over the last 35 years has stood at 3.2 percent in overall terms, or 2.4 percent on a per capita basis. Accordingly, rapid growth should amount to at least 5 percent annually in per head terms. At this rate, GDP doubles approximately every 14 years, so within the time span of a single generation it quadruples. If so, even if the starting point was low, qualitative changes for the better take place and the distance to more developed economies is substantially shortened.

What makes this point important is that less advanced economies – both from the MGC and LGC groups – are characterized by faster population growth than rich countries. One exception from this rule is post-socialist countries, where, in general, population does not increase. In the years 1995–2000, as many as 17 out of the 20 countries with the lowest natural increase (which indeed took negative values) were post-socialist countries. According to UN demographic forecasts, this tendency will continue to prevail until 2005. Among the top 20 countries with the largest absolute population decrease during this period there are 16 countries of Central and Eastern Europe and the CIS – from –0.1 percent annually in the Czech Republic, Poland and Slovenia, to –1.0 and –1.1 percent, respectively, in Bulgaria and Estonia. Hence, in these cases overall growth rate can be equated with per capita growth rate.

Unfortunately, situated at the opposite end of the spectrum are many of the world's most backward and poorest countries, including two post-socialist economies which have lost much of their national income to local conflicts: Bosnia-Herzegovina and Cambodia. The average natural increase rate in this group varies these days from 2.8 percent in Cambodia to 3.2 percent in Mauritania and Chad, to as much as 8.5 percent in Rwanda (Table 3).

Table 3: Fastest and slowest growing population, 2000-05
(annual average growth in percent)

Fastest growth

1. Rwanda	8.5	11. Mauritania	3.2
2. Liberia	7.1	12. Gambia, The	3.1
3. Yemen	4.2	**13. Bosnia-Herzegovina**	**3.0**
4. West Bank and Gaza	3.8	14. Congo-Brazzaville	3.0
5. Somalia	3.6	15. Uganda	3.0
6. Niger	3.5	16. Angola	2.9
7. Saudi Arabia	3.5	17. Jordan	2.9
8. Oman	3.3	18. Madagascar	2.9
9. Togo	3.3	19. Singapore	2.9
10. Chad	3.2	**20. Cambodia**	**2.8**

Slowest growth

1. Lithuania	**-0.2**	**11. Moldova**	**-0.3**
2. Estonia	**-1.1**	**12. Romania**	**-0.3**
3. Bulgaria	**-1.0**	**13. Serbia, Montenegro**	**-0.2**
4. Ukraine	**-0.9**	14. Austria	-0.1
5. Latvia	**-0.6**	**15. Czech Republic**	**-0.1**
6. Russia	**-0.6**	16. Italy	-0.1
7. Georgia	**-0.5**	**17. Poland**	**-0.1**
8. Hungary	**-0.5**	**18. Slovenia**	**-0.1**
9. Belarus	**-0.4**	19. Sweden	-0.1
10. Kazakhstan	**-0.4**	20. Switzerland	-0.1

Source: Economist 2001.
Post-socialist countries – in bold letters.

If, then, "fast growth" could be conventionally defined as a real per capita GDP growth of 5 percent plus annually, another question arises: what is "sustained growth"? It could be assumed, also by convention, that **sustained growth pertains to a macroeconomic reproduction process which spans a period of at least ten to twenty years, allowing per capita national income to double at roughly half-generation intervals**. Such criteria of sustained growth are undoubtedly met by China's economic expansion over the last 25 years or the doubling of the GDP by Ireland during the 1990s and its continued growth at about 5 percent annually in the first years of the current decade.[35]

Likewise, the average growth of per capita GDP by 6.4 percent annually in South Korea in 1965–2002 can be labeled both rapid and sustained. Unfortunately, the same cannot

[35] The IMF forecasts that, in 2003, Ireland will remain the fastest growing economy among the rich countries and its GDP will increase by a further 6.2 percent (IMF 2002).

be said about growth in Poland over the last decade.[36] Even though GDP increased in 1994–7 – in the course of the implementation of the policy known as "Strategy for Poland" (Kolodko and Nuti 1997) – by as much as 28 percent, likewise increasing on a per capita basis by 6.4 percent annually on average, this prosperity was too short-lived, being prematurely interrupted by erroneous economic- and especially monetary-policy decisions, implemented since 1998. As a result, the economy was brought down to near stagnation in 2001–2, with a mediocre growth of 1 percent annually. Thus the distance to developed countries began to increase again, instead of being progressively shortened – which, by the way, is still possible (Kolodko 2002a).

The trouble is that few economies indeed are capable of keeping to the rapid-growth path for an extended period. Out of the 20 fastest growing countries in the 1980s, which recorded an average GDP increase of 4.5 to 10 plus percent a year, only eight made it again to the top twenty in the 1990s.[37] These eight countries with fastest-growing output are: China, Vietnam, Singapore, Malaysia, India, Taiwan, Oman and South Korea. It should be noted that the first five countries on this list developed in the 1990s even faster than in the 1980s. It is intriguing or, indeed, fascinating to observe that virtually all of them followed policies which were a long way off the Washington Consensus and monetary orthodoxy, which usually inform the IMF-proposed structural adjustment programs.

What is more, the situation on the opposite pole was going from bad to worse during the period in question. Whereas in the 1980s, there were 11 national economies with a negative average yearly growth – from –6.8 percent in Iraq to –0.1 percent in Mozambique and Niger – the number of such countries doubled in the 1990s, reaching 22. One of the reasons was the post-socialist transformation, intended to boost economic growth. But it turned out that this effect could not be expected at this phase: as many as 16 post-socialist economies saw a negative average annual growth in the 1990s, while by 2002, only seven[38] out of the 28 post-socialist countries have exceeded their GDP levels of 1989.

[36] In Poland, thanks to the reforms of the pre-transformation period, the transitional recession was the shortest in the region, lasting merely three years: from mid-1989 to mid-1992. Growth has thus continued for 10 years, although during the two quarters at the turn of 2001/2, it was brought down to a negligible rate of 0.3 percent (on a year-to-year basis).

[37] There are also cases like Burundi, which maintained in the 1980s an average annual growth of 4.4 percent, placing it among the twenty fastest growing economies, only to end up in the following decade, in the aftermath of a devastating ethnic and military conflict, with a negative growth of 2.9 percent annually, among the twenty slowest growing (or, to be precise, fastest shrinking) countries.

[38] This threshold was crossed, in chronological order, by Poland, Slovenia, Albania, Hungary, Slovakia, the Czech Republic and Uzbekistan (EBRD 2002). The next post-socialist economies to achieve this will be, in all probability, Estonia and Croatia, around 2005.

Finally, there is the third prerequisite of the catching-up process – the endogenous character of growth. It is indispensable in that **only by building, during one phase of rapid growth, the foundations of continued expansion in the following phase, can the self-sustaining character of growth be assured**. The endogenous growth mechanism is thus intimately connected with the market's institutional infrastructure and a high propensity to save and invest. Taken together, these factors should ensure an adequate level of internal accumulation of capital and high efficiency of its allocation.

The average per capita GDP (in PPP terms) in OECD countries will approach $25,000 in 2003. Bearing in mind what has been said earlier about catching-up with highly developed neighbors, this amount should be seen as a long-term goal for countries at a medium development level, including the relatively less developed OECD countries, like Czech Republic, Greece, Hungary, Mexico, Poland, Portugal, Slovakia, South Korea, and Turkey. And, it should be borne in mind at all times, per capita income throughout the OECD, which is composed of 30 countries with a total of some 1.16bn people, runs up to a mere two thirds of the U.S. level. The emerging markets, including all post-socialist economies, will keep lagging far behind that last mentioned country for generations to come. But countries at a lower development level should strive to successively reduce the distance to the next richer group.

From the point of view of the attained development level, the World Bank, as well as some other international organizations, distinguishes in its reports three groups of economies: low income, middle income – further subdivided into lower middle income and upper middle income – and high income. Superposed on these statistics in the two lower-income groups is a geographical division into six regions. Post-socialist economies are included in the Europe and Central Asia group (Table 4).

Table 4: Populations and income level in the world economy, 2000

	Population (millions)	Gross national income per head (in USD)	PPP gross national income per head
World	**6,057**	**5,140**	**7,410**
Low income	2,460	410	1,980
Middle income	2,695	1,970	5,680
Lower middle income	2,048	1,130	4,600
Upper middle income	647	4,640	9,210
High Income	903	27,680	27,770
East Asia & Pacific	1,855	1,060	4,130
Europe & Central Asia	474	2,010	6,670
Latin America & Caribbean	516	3,670	7,080
Middle East & North Africa	295	2,090	5,270
South Asia	1,355	440	2,240
Sub-Saharan Africa	659	470	1,600
Euro area	304	21,730	23,600

Source: World Bank 2002b.

Evidently, the distance to the rich countries that the economies at medium and lower advancement levels should make up for, is truly astounding. In many, or, indeed, in most cases, closing the existing gap is practically impossible – at least in the foreseeable future. Certainly not in this century. And what happens afterwards – we will see. For the time being, let us reiterate, **the point is to have poorer economies develop faster than richer ones**. The focus, therefore, should not be on coming abreast of the richest, but rather on efficiently closing the distance, and gaining on them rather than lagging ever further behind. All the more so since the rich do not intend by any means to stay put. Assuming that their per capita GDP increases at a similar rate as it has in the last 35 years, after two more generations it will rich (on a PPP basis) some $90,000. Even if the less advanced countries manage to maintain a high growth rate – 5 percent annually, on average – most of them will still bring up the rear. In some cases, indeed very far behind the leaders (Table 5).

Table 5: Catching-up in the first half of 21st century

GDP per capita in PPP (in USD)*

Year	2000	percent of high income group in 2000	2012	2025	2050	percent of high income group in 2050
Low income	1,980	**7.1**	3,225	6,705	22,705	**25.0**
Middle income	5,680	**20.5**	9,250	19,230	61,135	**67.3**
Lower middle income	4,600	**16.6**	7,490	15,580	52,750	**58.0**
Upper middle income	9,210	**33.1**	15,000	31,190	105,615	**116.2**
Post-socialist economies**	6,670	**24.1**	10,865	22,590	76,490	**84.1**
High Income	27,770	**100.0**	35,200	50,240	90,900	**100.0**
Euro area	23,600	**85.0**	29,920	42,700	77,250	**85.0**

Source: Author's own calculation.
* GDP per capita in a given year under the assumption that the average rate of growth since 2001 will be 2.4 percent in the case of high income economies and 5.0 percent in the case of all emerging market economies.
** East Central Europe and the CIS.

But it is a well-known fact that many countries – both among the MGC group and, especially, some of the LGC economies, undergoing marginalization – are unable to attain such growth dynamics. This is also true of some post-socialist economies, in the case of which less favorable geographical location combines with a misguided economic policy and an institutional weakness of the emerging market. Some countries not only failed to achieve high growth dynamics in the past, but will be likewise unable to do so in the future. In recent history, only a few countries managed to overcome their age-old backwardness. Among these, one should mention especially South Korea, whose per capita GDP has attained about 50 percent of the USA level, Singapore (70 percent), Hong Kong (71 percent), Ireland (72 percent) or Finland (71 percent), where sweet herring with potatoes is a national dish not because everybody loves it, but for the simple reason that as late as the 1950s many Finns could afford little more.

There is compelling evidence that many other nations have begun to catch up with more advanced economies. This is true of the already mentioned Costa Rica in Central America and the Dominican Republic in the Caribbean, as well as Chile (an 86-percent GDP increase during the 1990s) in South America. Countries doing fine in Africa include Uganda and Côte d'Ivoire (44-percent growth in the 1990s), Egypt (54 percent) and Ghana, where the proportion of population living in poverty had dropped during the 1990s from 53 to 43 percent.[39] In Asia, apart from China, Vietnam and India, mention is also due to Malaysia, which, thanks to its unorthodox strategy, doubled its income in the previous decade, and Bangladesh, which saw a 58-percent increase of its national income in the 1990s.

As regards post-socialist countries, there are grounds to believe that fast growth will continue, among others, in Azerbaijan, Estonia, Latvia and Kazakhstan, and in Europe – in Albania, Hungary and Slovenia. Some other economies, too, especially the countries in the process of integration with the European Union may – although this is by no means automatic – enter the path of fast and sustained growth, kept up by the endogenous mechanism of extended macroeconomic reproduction. It would be unreasonable to expect that all the countries from this group will manage, in the space of a generation or two, to increase their output at a rate conventionally described as fast, but there are many reasons to believe that their growth dynamics will be better than in the richer countries, including the European Union (Kolodko 2001b and 2002b). Alternative growth paths for this group, differing in output dynamics, and their consequences in terms of per capita GDP changes in the current half-century are presented in Table 6.

[39] Oddly enough, this feat was attained despite the relatively low growth rate of 2.0 percent (in per capita terms) in 1983–2001.

Table 6: GDP per head (PPP) in a given year assuming 3, 4, and 5 percent average annual rate of growth

	GDP in 2002	3 percent			4 percent			5 percent		
	(in PPP)*	**2012**	**2025**	**2050**	**2012**	**2025**	**2050**	**2012**	**2025**	**2050**
Slovenia	15 850	22598	33186	65496	25376	42254	104143	28464	53674	164480
Czech Republic	13 380	19077	28015	55290	21422	35669	87914	24029	45309	139169
Hungary	11 790	16810	24686	48719	18876	31430	77467	21173	39925	122631
Croatia	11 500	16396	24078	47521	18412	30657	75561	20652	38943	119615
Estonia	10 900	15541	22822	45042	17451	29058	71619	19575	36911	113374
Slovakia	10 730	15298	22466	44339	17179	28604	70502	19270	36336	111606
Poland	8 290	11820	17357	34256	13273	22100	54470	14888	28073	86227
Latvia	8 040	11463	16834	33223	12872	21433	52827	14439	27226	83626
Belarus	6 980	9952	14615	28843	11175	18608	45862	12535	23637	72601
Romania	6 200	8840	12981	25620	9926	16528	40737	11134	20995	64488
Russia	5 625	8020	11778	23244	9006	14995	36959	10102	19048	58507
Bulgaria	5 570	7941	11662	23017	8918	14849	36598	10003	18862	57935
Lithuania	4 190	5974	8773	17314	6708	11170	27531	7525	14189	43581
FYR Macedonia	3 970	5660	8312	16405	6356	10583	26085	7130	13444	41293
Turkmenistan	3 960	5646	8291	16364	6340	10557	26019	7112	13410	41189
Kazakhstan	3 550	5061	7433	14669	5684	9464	23325	6375	12022	36975
Yugoslavia	3 390	4833	7098	14008	5427	9037	22274	6088	11480	35260
Armenia	3 330	4748	6972	13760	5331	8877	21880	5980	11277	34636
Ukraine	2 950	4206	6177	12190	4723	7864	19383	5298	9990	30684
Bosnia-Herzegovina	2 700	3850	5653	11157	4323	7198	17740	4869	9143	28083
Uzbekistan	2 700	3850	5653	11157	4323	7198	17740	4869	9143	28083
Kyrgyz Republic	2 560	3650	5360	10579	4099	6825	16821	4597	8669	26627
Azerbaijan	2 540	3621	5318	10496	4067	6771	16689	4561	8601	26419
Albania	2 290	3265	4795	9463	3666	6105	15047	4113	7755	23819
Georgia	2 290	3265	4795	9463	3666	6105	15047	4113	7755	23819
Moldova	2 090	2809	4125	8636	3094	5151	13732	3404	6419	21739
Tajikistan	1 028	1466	2152	4284	1646	2740	6755	1846	3841	10693

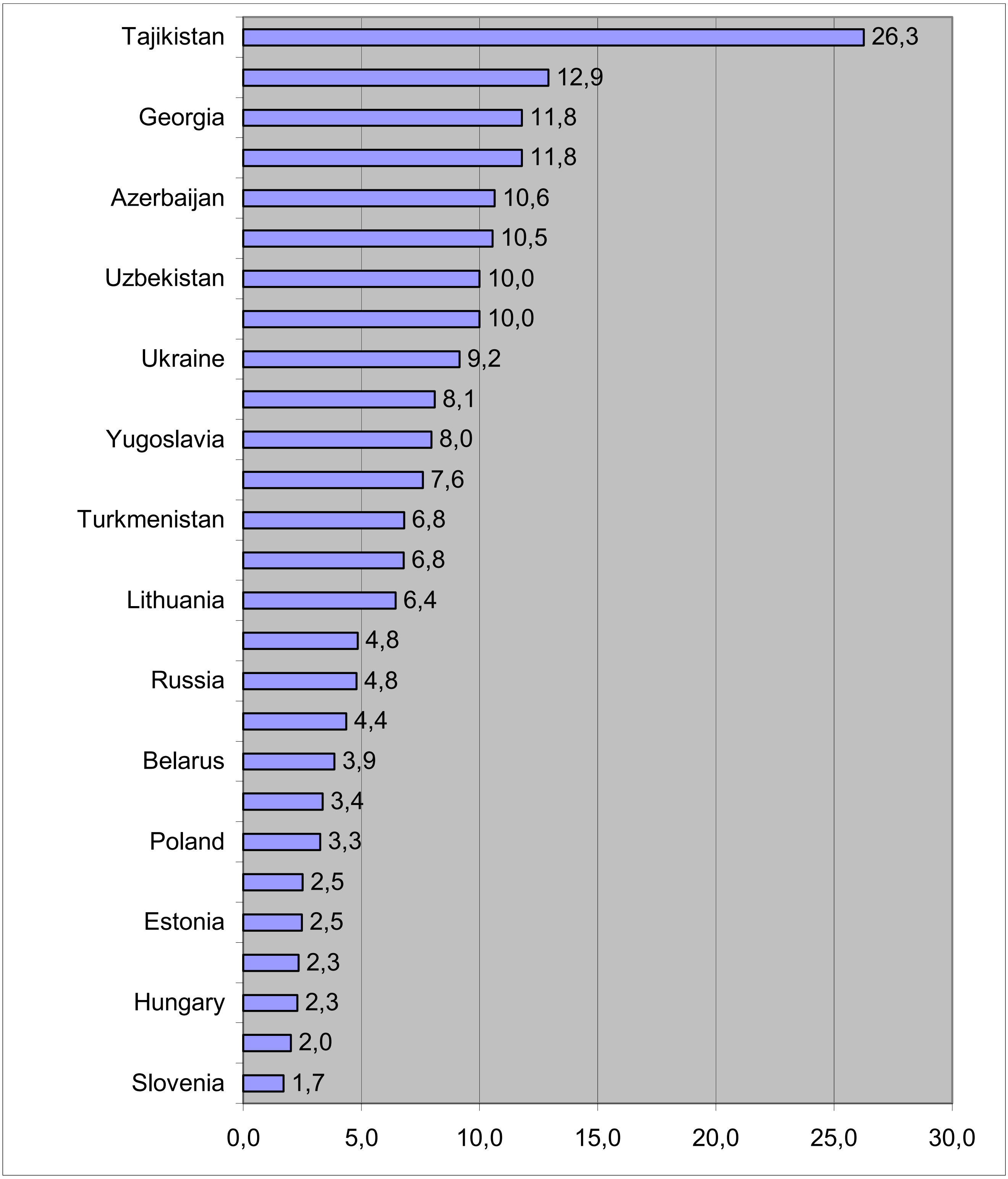
Source: GDP in 2002 - PlanEcon 2001a and 2001b. Growth scenarios – author's own calculation.

* GDP for 2002 - in 2000 dollars.

The distance to the rich countries that post-socialist economies have to make up is in many cases enormous. For Kazakhstan to reach today's income level of the United States, its GDP would have to grow, until 2050, at the average annual rate of 5 percent. This seems hardly probable, although this country does have too the potential for fast growth for ten or twenty years. In the case of poor countries, like Albania or Georgia, whose GDP per head (in PPP terms) stood at about $2,300 in 2002, even if such a growth rate were maintained in the time span of two generations, they would still be below today's income of rich countries. It follows that one should try to catch up with one's neighbors. Albania will need as much as 48 years of an average growth of 4 percent annually to reach today's per capita income level of Slovenia; Georgia in 2025, after 23 years of growth at 5 percent a year on average, will not yet have reached the level then attained by Croatia, even if the latter country were to develop at an average rate of merely 3 percent annually.

In post-socialist economies, the attainment of the current level of rich countries – that is, a per capita GDP of $27,000 – would require its current level to increase by a factor ranging from 1.7 in the case of Slovenia, to more than 26 in the case of Tajikistan (Figure 2). Even if this does happen one day, the rich countries will then be still richer and the pursuit of the moving target will go on (Kolodko 2000b).

Figure 2: Catching-up with high-income countries in emerging post-socialist markets



Source: Author's own calculation.
The coefficients show how many times the country's GDP must multiply to catch up with the income level of a rich country, e.g., 27,000 dollars.

Now, in the 21st century, chances to catch up with more developed countries, although unevenly distributed, are opening up before quite a few emerging market economies. This is a result of the contemporary phase of globalization, which, as we know, also poses numerous threats. While trying to avoid the latter, many emerging market economies can make good use of the new opportunities: Argentina and Ukraine, Brazil and Russia, Chile and Poland, Nigeria and Pakistan, Iran and Thailand, Costa Rica and Malaysia, Mexico and Croatia, Tunisia and Sri Lanka. Half a century from now, some of them will count among high-income countries, while others may even be demoted to the low-income group. It is time to address the question of what this will depend on.

6. Determinants of fast growth

Many growth factors exist, but the current phase of globalization brings some new elements into economic theory and policy. In particular – especially in the case of more globalized countries (MGC) – the relative importance of the external environment, in relation to the domestic market, is increasing. **Demand for goods manufactured in a given country and the supply of available capital increasingly depend on tendencies prevailing in other parts of the world and in the global economy as such.** A national economy may enjoy a long-term growth only on condition that both effective supply and real demand are on the increase. The dynamics of these two flows thus determines the general economic dynamics, with globalization changing the traditional proportions of the internal and external components of their structure, in favor of the latter.

This means that **only those countries can succeed in ensuring fast economic growth which, on the one hand, can stimulate, in a possibly inflation-free way, the increase of internal demand, and take advantage of their increasing openness and international competitiveness to tap the external demand, and, on the other hand, are capable of not only creating their own capital, but also attracting foreign savings and turning them into long-term capital, enhancing their own productive powers**.

On taking a closer look at the mere dozen or so emerging market economies which have succeeded in overcoming the development lag in the last decades, one can notice that this success stems from a combination of two sources: macroeconomic stability and human capital. Without these, no catching-up is possible, either today, or in the future. Only those countries which can take care of these two factors will have a chance for fast and sustained growth. But even this is not enough.

Sustained social development and fast economic growth crucially depend on six factors:

- **human capital;**
- **financial and real capital;**
- **mature institutions;**
- **size of the markets;**
- **policy quality;**
- **geopolitical location.**

The combination of these factors will decide in the coming years about the success or failure in catching-up with the rich countries.

The role of **human capital** is increasing in the current phase of liberalization and integration, which unfolds in the course of yet another stormy scientific and technological revolution connected with the ICT expansion and growth of the knowledge-based segments of the economy. For this reason, the high quality of education at all levels and relatively high spending on research and development (R&D) will increasingly act as growth stimulants.

The trouble is that globalization entails, by definition, migrations, which also involve the educated. As a result, **instead of education, or brain training, we often witness brain draining**. It is felt in many emerging market economies, also the post-socialist ones, from which there is an outflow of mostly highly skilled workforce to more developed countries. In this way, the relative competitiveness and development potential of the countries where these people were educated and trained is adversely affected. This is an aspect of globalization which limits the catching-up potential.

These migrations are paralleled by large-scale movements of poorly educated people. Unskilled labor looks for a new and better place in the global village, thus not only improving their own material situation, but also contributing in a specific way to a reduction of development disparities. By changing the balance of regional and local labor markets, such flows contribute to the relative increase of wages in the countries that people leave (supply of unskilled labor is dwindling so average wages go up) and their relative decrease in the countries in which they arrive (supply of unskilled labor increases so average wages go down).[40] Currently, such dependencies can be observed, for instance, between Mexico and the

[40] During the "second phase of globalization", in accordance with the World Bank periodization, that is, in the years 1870–1914, migrations had an even stronger impact on the changing economic dynamics than did goods trade or capital transfers (World Bank 2002a). In those years, "Emigration is estimated to have raised Irish wages by 32 percent, Italian by 28 percent and Norwegian by 10 percent. Immigration is estimated to have lowered

United States, Algeria and France, Ukraine and Poland, Vietnam and Thailand, Indonesia and Australia, Mozambique and South Africa, or Bolivia and Chile.

Thus if the outflow of workforce – and especially skilled labor – does not favor high growth rates, measures should be taken to avoid it. This is no simple task in a liberalizing world, and is best accomplished by overcoming the vicious circle of low growth rates and population outflow. **The reason why people leave their native land is not the low income levels in that country, but, rather, the lack of realistic prospects for perceptible and speedy improvement in this field.** People do return to their homeland, too – bringing with them their experience, acquired knowledge and savings[41] – if they can view their country's development perspectives with optimism. Feedback thus arises which can be either favorable, or detrimental to development.

Poland, for example, recorded in 1994–7 net (positive) immigration, because of its unprecedented economic dynamics and a significant improvement not only in the current living standards, but also in the level of social satisfaction and optimism about the future. More people were coming back to Poland – quite often equipped with new knowledge and experience gained abroad – than were leaving the country. This tendency was reversed a couple of years later because of the unnecessarily dampened growth rate. In 1999–2001, at least a quarter of a million people, mostly young and educated, left their country for faster developing regions of the world economy. Some of them, regrettably, for good.

Development must be based on **real and financial capital**. For many countries at a medium or low development level, its shortage is the principal barrier to economic growth (World Bank 2002d). Achieving and maintaining such growth requires, in the first place, the formation of domestic capital, while foreign investment and aid can only play a supplementary role. Systematic capital formation requires financial equilibrium and a high propensity to save. Both are difficult to attain in backward countries, especially in the absence of well developed institutions of financial intermediation – the banking sector and the capital market.

Argentine wages by 22 percent, Australian by 15 percent, Canadian by 16 percent and American by 8 percent." (Lindert and Williamson 2001, p. 19).

[41] Of course, one does not have to return home in order to transfer the savings made abroad to one's native country. It is estimated, for instance, that the transfers to India made by Indians working worldwide are six times higher than the entire official aid received by that populous country.

If the low propensity to save is aggravated by capital flight – which is quite often the case in emerging market economies – the problem is hopeless.[42] However, when the banks and other organizations manage to accumulate an increasing flow of savings and turn it into active capital, a great deal depends on systemic regulations which should facilitate efficient capital allocation. Otherwise, the apparent abundance of assets might not be productively employed as capital (de Soto 2000).

Foreign capital, which should increasingly be referred to as "originating from other parts of the global economy", can only supplement domestic capital in the financing of development. A strategy for catching-up with the richer countries cannot be based on the assumption that this process will be financed by capital from these countries. It can only play an auxiliary role. This applies both to foreign investment, especially direct (FDI), and to the aid of the richer for the poorer.

The influx of FDI itself, and, consequently, the increased presence of foreign companies on the market of a given country, is not in itself a guarantee of progress and accelerated growth. Sometimes it just demonstrates that domestic companies are weak and their products are unable to satisfy the demand not only in other parts of the world economy, but even at home. However, foreign capital may contribute to the growth of output and an improved efficiency of the emerging market economies in which it is invested, if four processes take place.

First, the incessant **process of "creative destruction"** of the old firms by new ones must indeed be creative in the sense that the penetration of foreign capital and the influx of FDI result in the disappearance of obsolete (mostly domestic) companies which are uncompetitive and unable to expand on the world market, but this is more than compensated for by the emergence of new companies, offering more competitive jobs and better products. Such replacement processes occur everywhere – also in the most highly developed countries[43] – and constitute the main vehicle of technological progress and microeconomic efficiency improvement, which, in the long run, should translate into faster growth.

Second, **changes in the market and price structure should facilitate competition and foster the economies of scale**. Foreign companies have their obvious interest in driving

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[42] According to World Bank estimates, about 40 percent of African's countries private capital was kept outside the continent in the 1990s. If the poorest continent thus finances, de facto, the development of other parts of the global economy, it is small wonder it remains the poorest.

[43] In the United States, in every five-year period as much as some 35 percent of all companies go into liquidation, particularly in the small and medium-size enterprise sector (Dunne, Roberts and Summelson 1989). But even among large companies, with 250 or more employees, this indicator amounts to 16 percent (Bernard and Jensen 2001).

out domestic firms. Given the unequal power of companies to resist such pressures, this affects especially small and medium-size enterprises. The ultimate impact of this kind of competition on output dynamics depends, on the one hand, on the openness of the market, the extent of protectionism and support for domestic entrepreneurs, and, on the other hand, on the general reduction of manufacturing costs (and relative prices) resulting from the extended scope of production and the accompanying reduction of trade markups.

Third, **foreign direct investment function today as the principal transmission belt for new technologies** – including ICT – being transferred to the emerging markets. The most important thing here is an appropriate proliferation mechanism that will spill-over the technologies to related spheres of economic activity and other enterprises. This is not as obvious as it might seem at first glance, for this type of impact would be in the interest of the recipient countries, but not necessarily of the multinational investors. In fact, these interests are often at cross-purposes here. This is due to the fact that over 80 percent of all FDI originates in just six rich countries – in order of magnitude, the United States, Great Britain, Japan, Germany, Switzerland and the Netherlands – and it is these countries that derive profits from licenses and patent fees, absorbing a total of 90–98 percent of revenues from this source.[44]

Therefore, foreign (global) investors may occasionally hinder, rather than facilitate, the spread of technological progress. But an appropriate development policy response to this threat should not restrict the influx of FDI, but just the opposite, encourage its increase. The greater the number of modern companies (including foreign ones) which apply modern technologies operating on a given emerging market, the faster is its overall long-term growth.

Fourth, the inflow of direct investment involves a constant know-how transfer, resulting in **the improved skills of local employees in the areas of management and marketing**. Quite often it is the lack of basic skills in these areas that hampers output expansion and economic growth. Foreign investment is usually directed to export-oriented sectors – particularly in those countries where the size of the local market is limited – and the penetration of foreign markets requires greater skills. In time, this knowledge accumulates and finds use on the domestic market as well, with all the beneficial effects on productivity, efficient goods trade and growth rate.

[44] It should be added that most of these funds are cross-invested in the richest countries, while the poorest continent – Africa – receives only about 1 percent of the global direct investment flow. There were years when a small country like Ireland attracted more investment than this vast continent in its entirety.

While most emerging markets, regardless of internal capital accumulation, may and should count on private foreign investment to give their rapid growth strategy an additional boost, some countries may also rely on **foreign aid**. These need not be the poorest countries, for transfers of this kind are also a function of geopolitics, regional policy and regional integration processes (Hettne, Inotai and Sunkel 2001). Thus, for instance, foreign aid on an extremely large scale has been directed in recent decades to Ireland, whose success in catching-up with the most highly developed countries would not have been possible without the aid received from the European Union.

Unfortunately, the stream of foreign aid flowing from the rich to the poor countries largely dried up in the 1990s. Despite the UN recommendation, undoubtedly appropriate, as it is, that highly developed countries should bring up the relative amount of development aid to 0.7 percent of their GDP, the actual proportion dropped over the previous decade to 0.22 percent. This resulted from the combination of naïve belief that private direct investment would be more than adequate to compensate for this loss, and reasonable doubts about the ability of some of the poorest countries to absorb the received aid in a sensible way (Easterly 2001).

Rather than to places where capital seems to be particularly needed, FDI is far more prone to flow to areas where growth dynamics is already high and a vibrant emerging market exists. At the same time many instances can be quoted of misallocation of funds directed, in the form of non-repayable aid, to countries in particularly strained circumstances, mainly in sub-Saharan Africa. Undoubtedly, without a substantial **increase of the scale of assistance to the poorest economies** – both in the form of the cancellation of debt of those highly indebted poor countries[45] (which cannot be expected to be repaid anyway) and new funds for the financing of human capital and infrastructure development – these economies will not only be unable to enter the category of emerging markets, but will not even manage to make sufficient progress to join the MGC group, where growth rate considerably exceeds the average.

Mature institutions are of fundamental importance for sustaining a high growth rate. The trouble is that the emerging economies are characterized – by definition – by still underdeveloped institutions and too liquid, as well as frequently opaque, rules of the market game. This affects allocative efficiency and impedes growth. Importantly, weak institutions create relatively greater inefficiencies and waste. Everything – with the possible exception of

[45] In particular, this refers to the 41 economies that make up the so-called HIPC group (Highly Indebted Poor Countries), out of which as many as 35 are located in Africa. In some cases – like Mozambique – they spend

corruption, money laundering and organized crime – functions in such circumstances less efficiently than in institutionally mature economies.

This is why structural reform and successive institution building are so important for the emerging markets (Porter 1990; North 1997; Kolodko 1999b). Today this truth is generally acknowledged and, thankfully, its importance is emphasized by influential international organizations (World Bank 2001), although this was not always the case. The involvement of such organizations in the institution building in the emerging market economies appears to go beyond the direct participation in the financing of various projects. The campaign to overcome the development lag is largely fought on the institutional front, where the framework for the functioning of the young market economies is being strengthened.

The **size of the markets** also has a bearing on growth rate. Under globalization, markets undergo integration, and so they expand in size. At the same time every national economy relinquishes part of its sovereignty over the part of the world market it represents. Thus its capacity to interfere with the market is reduced, which may be a good thing or a bad thing, depending on the effectiveness of the intervention policy. At any rate, a larger market provides a better scope for the proliferation of technological progress and the reduction of manufacturing costs due to the economies of scale. A larger market also stimulates enterprise, as it exposes companies to greater competition from other manufacturers. All this has an impact on the production pace and thus may be able to enhance the capacity for catching-up.

In a closed economy, the only way for a market to expand was through the increase of internal demand (and supply). Now markets expand because liberalization and globalization are in progress. Some of the emerging post-socialist market economies face in this context the integration with one of the largest and best-developed markets – the European Union.[46] This is often expected to lead to a rapid convergence and reduction of development disparities between the Union's old members and the candidate states. It should be clearly pointed out, however, that **integration with the European Union by no means automatically entails accelerated economic growth**.

Unquestionably, the integration does create opportunities for such growth, but if these opportunities are to be utilized, many requirements, discussed above, must be met. Some

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more on the servicing of their foreign debt owed to rich countries than on education and health together. Under such circumstances, there is no chance for development.

[46] The share of the European Union in the global output is estimated at about 20 percent in PPP terms and 27.8 percent at current exchange rates. By way of comparison, the same indicator for the United States stands at 29.9 percent.

countries achieved this feat in the past, other failed to do so (Daianu 2002). When Ireland joined the European Union in 1973, its GDP stood at a mere 59 percent of the Union's average. Now it takes pride not only in having caught up with, but also having overtaken others, as this indicator currently exceeds 120 percent. Greece, on the other hand, joined the Union in 1981 with an income equivalent to 77 percent of the EU average, and now its relative position has eroded, as the indicator in question has dropped to just 66 percent. Similar mechanisms will continue to operate in the future – some actors may succeed, and some may not.

This will depend on the **quality of economic policy**, since membership in the European Union – or in any other integration organization elsewhere, be it NAFTA[47] in America, ASEAN[48] in Asia, or SADC[49] in Africa – does not preclude conducting one's own, national development policy. It does restrict, even more so than globalization does, the members' political – and especially economic – sovereignty, depriving the governments and central banks of the use of certain economic policy instruments previously at their disposal, but this does not render this policy totally impossible. Such a policy should, generally, consist in maximizing the advantages offered to the emerging markets by globalization and in mitigating the inevitable risks brought by globalization.

Besides, of course, one can always celebrate or bemoan one's **geopolitical situation**. Its geographical component is unalterable, but it is possible to endeavor to change the political circumstances for the better. In the long run, some actors even succeed in this task. This is particularly likely when they manage to utilize fast growth to catch up with the economies which made the forward leap a long time ago.

[47] The core of NAFTA, or the North American Free Trade Agreement, is United States. The other members of the grouping are Canada and Mexico. NAFTA has almost 400 millions inhabitants and its GDP exceeds 8 billion dollars, that is about 17,000 per head. Of course, Mexico brings this average significantly down.

[48] ASEAN (the Association of Southeast Asian Nations) was established in 1967 and initially included only five members: Indonesia, Malaysia, the Philippines, Singapore, and Thailand. Brunei joined in 1984, Vietnam in 1995, Laos and Myanmar in 1997 and Cambodia in 1999. The population of ASEAN region counts about half billion people, yet the total GDP of it is less than a tenth of the GDP of the USA or European Union. However, ASEAN is strongly committed to openness and active external economic links (not only due to the export-oriented Singaporean economy), hence it is well advanced into integration with the global economy; more than the other regions. The foreign trade turnover of this grouping are matching its GDP and are hovering around 800 billion dollars annually.

[49] SADC (the Southern African Development Community) includes 14 members from the southern part of continent: Angola, Botswana, Democratic Republic of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Republic of South Africa, Seychelles, Swaziland, Tanzania, Zambia, and Zimbabwe. The entire grouping contributes a half of Africa's GDP, yet a major part of it is coming from just one country, i.e., the Republic of South Africa.

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