1.1 DEFINITION AND SCOPE

How are countries in the world classified, and which part is the so-called ‘emerging market’? These are difficult questions, or so it would seem.

Broadly following the World Bank classification, there are six main types of country:

- Main industrial nations such as the countries of Europe, North America and Japan.
- Smaller industrialized countries such as Australia and New Zealand.
- Countries in transition such as those under the former Comecon.
- Newly industrialized countries.
- Less developed countries.
- Emerging markets, which are countries where there is a great deal of incentive and interest to invest.

No doubt a country can move from one type to another over time.

But classification for countries is not so easy because some of the countries may also belong to other categories at the same time. The ‘less developed countries’ may belong to countries in transition or even newly industrialized countries, all of which are vulnerable to economic cycles.

In fact, in the growing literature on ‘emerging markets’, one can hardly find a precise definition on what it is or ought to be. ‘Emerging market’ is still a vague and dynamic concept, a concept that is frequently in daily usage but one that is rarely defined, or the definition, if any, is not universally accepted. Hence the concept of ‘emerging market’ can mean different things to different people. Ironically, however, this vagueness of the concept does not at all prevent the business community from moving on in their business in emerging markets.

Geographically, emerging markets usually refer to Asia, Middle East, Latin America, Central Europe and Africa. With few exceptions (such as Japan), emerging markets are located in these areas. This coverage implies a wide variety of terms: political, social, economical and financial as well as cultural. By name, ‘emerging markets’ covers markets that are ‘emerging on the horizon’. As such, for many banks the list of emerging markets changes all the time. For example, Poland, Czech Republic and Hungary are gradually off the list in some banks as they are entering the EU.

Many banks try to use GDP per capita as a measurement for being ‘qualified’ for emerging markets. This, however, does have deficiencies because it ignores the potential. Some banks use the concept of OECD and non-OECD countries, which seems relatively easier. However, countries like Turkey and South Korea were once under OECD but they are still widely accepted as emerging markets by many banks.
A well-established and related concept is LDC – less developed countries. Here per capita real income is generally regarded as one of the main indicators of the socio-economic conditions. A comparison of per capita income of less developed countries with that of the developed countries can be striking, as there is a clear difference between the economically developed countries and the less developed countries.

The question is – if the per capita income of the United States and India are considered and assuming that an average Indian earned about 5% of the income of an average American, can we conclude that we may have clear-cut categories for countries? In general, is the problem then settled for country classification? No, not really.

First of all, on what terms is income per capita calculated? The per capita real income concept may encounter the issue of foreign exchange rate. The famous purchasing power parity should work if you want to have a precise income comparison, that is the comparison of income in real terms of purchasing power. That is to say the income level is not on a current dollar basis but should be on purchasing power terms. To judge the standard of living is to consider the purchasing power of a country’s currency over GDP rather than make a simple conversion of domestic per capita income into US dollars at a certain exchange rate. The per capita real income data converted into foreign exchange rate may not always be an adequate index to measure development in a world of floating rates. The expression of per capita real income in terms of official exchange rates may not be meaningful if such rates remain highly overvalued.

More complicated is that although a growth of the per capita income is supposed to contribute to a general rise in the standard of living of the people, it, however, does not really represent the overall quality of life. Per capita real income as a valid index is thus being challenged. In this regard, Kuwait is often quoted. The real per capita income for a Kuwaiti is impressive but the standard of living of an average Kuwaiti may not be the same as that of an average resident of France. This clearly indicates that per capita real income figures may be misleading because an average figure is obtained by dividing the total real income derived from them by the total population. A country’s gross domestic product may grow at a very fast rate but only a small proportion of its population could be the beneficiary of such growth, whereas the masses of its population may not experience any improvement in their standard of living.

What other factors, then, determine the development level of a country? One of these factors is the quality of life. The development level of countries depends on the quality of life and the quality of life is to be regarded as an important index of development. Nevertheless, ‘the quality of life’ is a composite index with factors other than income such as:

- Life expectancy
- Education and literacy rates
- The level of nutrition
- Proportion of infant mortality
- Consumption of energy per capita
- Pollution index for environment, etc.

In 1990, the United Nations Development Programme (UNDP) published a human development index – a new yardstick that provides a broad method by which intercountry and

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intertemporal comparisons of living standards can be undertaken. The human development index according to the UNDP comprises GNP per capita, longevity and education.

Despite the already complicated measurement problems, to quantify human development becomes more complex for political freedom, personal security, interpersonal relations and the physical environment.

On the other hand, the human development index did help to understand in a broader way the development level of a country. At that time a comparison of ranking for countries either under GNP per capita or under HDI was made, which indicated the gap between these two concepts (see Table 1.1).

<table>
<thead>
<tr>
<th>Country rank on HDI rank</th>
<th>on GNP per capita</th>
<th>Global HDI</th>
<th>Global GNP per capita</th>
</tr>
</thead>
<tbody>
<tr>
<td>Japan 1</td>
<td>1</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>United Kingdom 2</td>
<td>3</td>
<td>10</td>
<td>21</td>
</tr>
<tr>
<td>Germany 3</td>
<td>2</td>
<td>12</td>
<td>10</td>
</tr>
<tr>
<td>Republic of Korea 4</td>
<td>6</td>
<td>34</td>
<td>39</td>
</tr>
<tr>
<td>Singapore 5</td>
<td>4</td>
<td>40</td>
<td>25</td>
</tr>
<tr>
<td>Brazil 6</td>
<td>7</td>
<td>59</td>
<td>54</td>
</tr>
<tr>
<td>Saudi Arabia 7</td>
<td>5</td>
<td>67</td>
<td>33</td>
</tr>
<tr>
<td>Thailand 8</td>
<td>8</td>
<td>69</td>
<td>79</td>
</tr>
<tr>
<td>Sri Lanka 9</td>
<td>10</td>
<td>76</td>
<td>120</td>
</tr>
<tr>
<td>China 10</td>
<td>11</td>
<td>79</td>
<td>130</td>
</tr>
<tr>
<td>Cameroon 11</td>
<td>9</td>
<td>118</td>
<td>88</td>
</tr>
<tr>
<td>Tanzania 12</td>
<td>14</td>
<td>126</td>
<td>158</td>
</tr>
<tr>
<td>Uganda 13</td>
<td>13</td>
<td>133</td>
<td>141</td>
</tr>
</tbody>
</table>

Source: Based on UN Human Development Report 1992, World Bank, etc.²

Obviously it is no easy job to define the development level of a country.

From the very beginning, ‘emerging market’ is an unclear concept due to its dynamic nature, and so is the definition of an emerging market country. Nevertheless, we may identify some of the other criteria used for country classification:

- Location of the country, income level by World Bank definition
- Political status and economic performance
- Level of inflation, the rate of GDP growth
- The level of budget deficit
- Size of external reserves
- The trade deficit, etc.

It is widely recognized that the so-called emerging markets mainly have at least three parameters:

- Level of absolute economic development measured by GDP, etc.
- Level of relative economic development measured by GDP growth rate, HDI, etc.
- Market management system measured by the stability of the free market system.

² Based on a table from Subrata Ghatak, *Introduction to Development Economics*, p. 28.
According to Carl Olsson in his book *Risk Management in Emerging Markets*, emerging markets are ‘those countries which have started to grow but have yet to reach a mature stage of development and where there is significant potential for economic or political instability’. Here ‘those countries’ refer first of all to LDCs – less developed countries.

Two useful implications of emerging market may be distinguished here – potential and problem. That is, for the future perspective, emerging markets are those with potential for development. Those without can be calculated as developing countries but not as ‘emerging markets’. In the meantime, emerging markets are markets with problems as well.

Therefore ‘potential’ and ‘problem’ are the key words for emerging market. However, economies like Singapore and Hong Kong are questionable when using this definition, although some banks put them under the category of ‘emerging markets’.

Undoubtedly some of the less developed countries are picked up and labelled as ‘emerging markets’ due to their dynamic nature with development and growth potential.

Despite the fact that it is not easy to define precisely an ‘emerging market’ and that emerging market is a broad and ambiguous term, there is a consensus that the scope of so-called ‘emerging markets’, traditionally, covers the following parts of the world:

- Latin America (Mexico, Brazil Argentina, etc.)
- Africa and Middle East (South Africa, etc.)
- Subcontinents (Pakistan, India, Sri Lanka, etc.)
- Southeast Asia (Asian countries, etc.)
- Greater China (mainland China, Taiwan, Hong Kong, Macao, etc.)

The *Economist* magazine regularly publish data on 27 emerging market economies. They are: China, Hong Kong, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, South Korea, Taiwan, Thailand, Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, Egypt, Israel, Saudi Arabia, South Africa, Turkey, Czech Republic, Hungary, Poland and Russia.

This gives an indication at least as to which are the most ‘active’ economies that are ‘emerging’. Instead of giving various arguments to explain why these countries are put under the category of ‘emerging markets’, we should examine these emerging markets in political, physical, social, economic and financial terms.

### 1.2 EMERGING MARKETS: ‘SYMPTOMS’ AND SIMILARITIES

#### 1.2.1 ‘Symptoms’

Emerging market countries differ widely among themselves, and no single list of ‘typical’ features could cover all emerging markets. Nevertheless, we may well notice some of the emerging market features from our day-to-day work, such as:

- Volatility of macroeconomic environment
- Bubble economy
- Frequent government intervention
- Misleading government policies

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• Booming real estate prices
• Price volatility of stock market
• Significant debt in foreign hard currencies, etc.

As a matter of fact, most of the emerging market countries can be characterized by at least some of the above ‘emerging market symptoms’. We may well identify them by the following similarities.

1.2.2 Similarities

• Political: Politically, the governments in emerging markets are very often labelled as multi-party but the political system is subject to changing factions. Governments in these economies operate with historical legacy. Such legacy is inherited by either colonial past, as many of them were colonies, or by former communist state.

  Transition of power is linked to social unrest, as it is hardly smooth with a potential for violent overthrow. This also implies the danger of war or threat of civil war. In these countries, the government, with the intention to reinforce the ruling party, tends to control or at least influence the public media including the press. In some countries, political power is associated with wealth. Government is operating with corruption scandals, or in the shadow of strong influence of the military. Patronage, cronyism and nepotism are the name of the game.

• Geographical: Geographical characteristics are also worth our attention. Some of the emerging market countries have unfavourable physical environments. These countries, large or small, are located in inaccessible regions or regions where barriers to travel exist. There also exists a distance from developed markets. Some of these emerging markets depend on or have vulnerable to weather patterns – monsoon rains, El Niño effects, hurricane, etc. Sometimes these countries are vulnerable to other natural disasters – floods, earthquakes, tsunamis, etc. Typically their infrastructure – transport, utilities, etc. – is backward or underdeveloped, and their national income, especially hard currency income, comes from a few agriculture and/or primary commodities.

• Social: From a social point of view, problems prevail for language, and population (family planning, health, religion, etc.) due to lack of economic means. In these countries several local dialects coexist but a foreign language (often linked to colony history) is used for international communication. Criminality and ethical problems often hamper foreign investors’ ability to protect themselves. Population growth outgrips the economic growth. Nationwide healthcare by the government hardly exists or exists only in name. This results in uncontrolled spread of epidemics such as AIDS. Illiteracy rate is high and education level low.

• Economic: In the economic field, many of these emerging market countries rely on the ‘visible hands’ for economic development. Government plays more roles in the economy than the market forces do.

  There is a history of extensive direct government control of the economy, including restrictions on international trade, capital movement, etc. State control of large parts of the economy is obvious with limited state sell-out. Government ownership or control of large industrial firms directs government control over internal financial transactions. Governments provide subsidiaries to state-owned enterprises. Prices are under the control of the state and therefore do not reflect the economic costs of producing. Price volatility
is high which results in inflation, sometimes even hyperinflation. The economies depend on primary raw materials exports and/or tourism, and foreign workers’ remittance as a source of foreign exchange income. Some countries even depend on international aid flows. From time to time IMF/World Bank’s support is required.

Due to a lack of competitiveness in the international market, home markets are protected and there is a large ‘underground’ economy. Some of these emerging market countries are also net oil importers and therefore subject to the vulnerability of the price of oil. High unemployment or underemployment exists with no or limited state support. Poor quality/quantity of statistical data leads to lack of transparency for the economic system. Few large conglomerates operate in many sectors – including banking. Standards of corporate governance tend to be low and company law may be inadequate. Contracts are not always honoured, leaving investors unprotected in the event of disputes. There is a lack of legal framework or laws are in place but not enforced. Corruption may affect the judicial process to the detriment of foreign investors. Regulators are often weak and subject to manipulation and pressure from political or commercial interest groups. Budget/trade deficit is high as a percentage of GDP.

- Financial: Looking further into the financial system of these emerging markets, we find that there is a lack of proximity of financial institutions both in geographic and social and cultural terms. The banking industry is usually underdeveloped with many undercapitalized banks, which may suffer occasional illiquidity.

Lack of sound capital markets is another shortcoming in mobilizing surplus of funds to those who may need them. There is only a small-scale stock exchange or no stock exchange at all, while trading in a few stocks heavily influences those stocks that exist. The capital market is thus underdeveloped and a limited amount of stocks stay in the hands of the public. Shallow or nonexistent markets lead to inadequate bond market trading for the government or the private sector to raise funds. As a result there is a lack of markets for hedging risks.

The fiscal situation is nonefficient or primary. Official income for government spending is limited and unstable – tax base is limited and tax avoidance is common either because of loopholes in the tax system or because of a lack of tax discipline.

For the public, there is limited financial literacy among the people, especially the poor. Segregation between financial players is strict, and correlation between economic struggle and financial stability is noticeable. As we know, a financial system performs the essential function of channelling funds to those individuals or companies that have productive investment potential. In emerging markets, the financial system cannot function efficiently and is even disrupted sometimes. The lack of an efficient financial market leads to a contraction in economic activities.

Regarding monetary policy, for the balance of international payments, monetary authorities tend to rely on dollarization – the common use of US dollars in lieu of local currency or the establishment of a more formal link between the two. This will result in two-tier exchange markets – official exchange rate goes hand by hand with black market exchange rate. Thus, to ease the management of currency risk, borrowing by the state and private sector is often done in foreign currency. In these countries a high percentage of exports proceeds is committed to financing debt. There is an obvious lack of hard currency and devaluation is regular, or the currency is under the pressure of devaluation due to speculation against the currency.
1.3 SINK OR SWIM: THE EVOLUTION OF EMERGING MARKETS

Emerging markets are the group of less developed countries that ‘emerged’ on the horizon judged by their development level.

When reviewing the ‘decline and rise of emerging markets’, a couple of development theories and concepts try to explain and analyse the reasons behind. The discussion on why some countries could emerge while others could not throws light on insights of economic development as well as patterns of development.

1.3.1 The 19th Century

Economic development needs capital. In the 19th century when most of the emerging markets nowadays were still colonies of European countries, the capital needed for development originated mainly in Britain, Germany and France. The United States was the then emerging market.

Like the situation for other emerging markets today, the 19th century saw the turbulence in the economic and financial system of the United States. In fact the United States has had a long history of banking and financial crisis in the 19th century – crises occurred almost every 20 years in 1891, 1837, 1857, 1873, 1884 and 1893. Even in the 20th century, there was the so-called Great Depression of 1930–1933.

1.3.2 The 1930s

The Great Depression in US characterizes some of the emerging market ‘symptoms’: bubble economy, price volatility of the stock market and volatility of the macroeconomic environment. The booming stock market in both 1928 and 1929 was followed by a stock market crash in October 1929. By the middle of the 1930s, more than half of the declining stock market had been reversed. There was a continuing decline in the stock market in the middle of the 1930s.

Together with the declining of the stock market followed a sequence of bank collapses from October 1930 until March 1933. One-third of banks in the US went out of business. The loss of one-third of the banks reduced the amount of financial intermediation and the amount of outstanding loans fell by half from 1929 to 1933. The Great Depression was the worst crisis ever experienced in the United States.

After short recovery from the Great Depression, the United States gradually became a major exporter. Together with Europe, the US emerged as a major capital and industrialized product exporter in the 20th century. Countries, especially those in America and Asia, became recipients of capital and finished products, whereas the emerging market countries exported raw materials.

1.3.3 The 1950s and 1960s

In the 1950s and 1960s, the belief was that developing countries could realize industrialization by substituting domestic manufactured goods for imports. Many developing countries tried to ‘emerge’ and accelerate their development by limiting imports of manufactured goods, to foster a manufacturing sector serving the domestic market. This
belief was, however, replaced by the export-oriented strategy in the 1970s. In that period it became increasingly apparent that via exports of manufactured goods developing countries could achieve accumulation of hard currency capital to realize their industrialization.

The countries that developed under this pattern, especially those in Asia, achieved spectacular economic growth. For some countries the growth rate was at more than 10% per year. The World Bank called these countries the ‘high performance Asian economies’. This refers to three groups of country, the ‘miracle’ of which began at different times.

1.3.4 The 1970s and 1980s

First on the list was Japan, whose growth began soon after World War II. In the 1960s rapid economic growth began in four smaller Asian economies, the so-called four ‘tigers’ – Hong Kong, Taiwan, South Korea and Singapore. Finally, in the late 1970s and the 1980s rapid growth began in Malaysia, Thailand, Indonesia and, most impressively, in China.4

Figure 1.1 shows the growth for seven of these economies in the period 1965–1990.

<table>
<thead>
<tr>
<th>Country</th>
<th>% per year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Indonesia</td>
<td>7.1</td>
</tr>
<tr>
<td>Thailand</td>
<td>4.4</td>
</tr>
<tr>
<td>Malaysia</td>
<td>4.0</td>
</tr>
<tr>
<td>Korea</td>
<td>6.5</td>
</tr>
<tr>
<td>Singapore</td>
<td>4.1</td>
</tr>
<tr>
<td>Japan</td>
<td>6.2</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>4.5</td>
</tr>
</tbody>
</table>

The growth was due to a combination of economic policies, which was by far the main factor that contributed to this fabulous performance. These high-performance Asian economies aimed at stability-oriented macroeconomic policies, with the emphasis on low inflation rates and the avoidance of overvalued exchange rates.5

There were ups and downs. In the 1980s, developing countries in emerging markets especially those in Latin America experienced massive bank debt rescheduling. The 1980s have seen the debt crises of Latin American countries.

On 13 August 1982 Mexico unilaterally announced that it could no longer service its $80 billion external debt. Although individual countries like Ghana, Turkey and Indonesia had similar situations in the 1970s, these had essentially been associated with hardly any international attention.

The case of Mexico was different as in the second half of 1982 it became apparent that dozens of other developing countries shared Mexico’s problems.

1.3.5 The 1990s

By the late 1980s, the threat of financial disaster had receded. In the early 1990s, under the concept of ‘Washington Consensus’ many countries had their policy shift to cater free market approach. The ‘Washington Consensus’ was endorsed by the US Treasury and Washington-based international institutions such as IMF and World Bank. Ten particular reform policies made up this ‘Washington Consensus’.7

The focus was the creation of a relatively free market to encourage more capital inflow for emerging markets. Monetary prudence reduced inflation. Fiscal discipline lowered the average budget deficit from 5% of GDP to about 2% and reduced public external debt from about 50% of GDP to less than 20%. Financial liberalization eliminated direct credit controls, interest rates were deregulated and foreign investments were encouraged. Foreign exchange and capital account controls were also removed. More than 800 public enterprises were privatized between 1988 and 1997.8

In the early years of 1990s, with the stimulus of the new free market approach, FDI (Foreign Direct Investment) into emerging market countries soared. The extent of economic reforms in emerging markets was historical but the economic growth in Latin America was discouraging for emerging markets: real GDP growth in the region was low which was substantially below the rates of 5% or more in the 1960s and 1970s.

Public opinion surveys in the late 1990s indicated that Latin Americans thought their economies were not doing well, and that their quality of life was lower than that of previous generations. Many therefore look beyond the ‘Washington Consensus’. Latin American heads of state at their summit meetings in 1994 and then in 1998 broadened their development objectives to include social targets such as poverty reduction, education and good governance. The Mexico peso crisis in 1994 and 1995 brought an unpleasant surprise and the Asian currency crisis later reinforced doubt on this free market approach. Meanwhile, several new emerging economies in Asia such as South Korea, Taiwan, Hong Kong and Singapore attracted attention and they were called as newly industrialized economies or NIEs.

These economies are different in their economic structures: Singapore with detailed government direction of the economy, South Korea with growth via the formation of very large conglomerates, Taiwan with flexible small and medium size family-run businesses and Hong Kong with a policy of laissez-faire for business.

The miracle-like growth of these economies set examples for developing countries to emerge as industrialized countries until the so-called Asian crisis in 1997 – the onset of the Asian crisis witnessed the ‘sinking’ of many newly emerging markets.

A point worth mentioning is the so-called ‘flying goose’ phenomenon, which emphasizes the function of export. It was argued that countries would develop via export expansion by focusing on their ‘comparative advantages’. As a country moves up the ladder of dynamic comparative advantage, the increasing value of its exports contributes all the more to the economy’s development. Beginning initially with Ricardo-type exports based on ‘natural

6 ‘Washington Consensus’ is a loose concept, put forward by John Williamson of the Institute for International Economics. The concept represents the conventional wisdom that liberalization and macroeconomic (notably price) stability are key factors for economic development.

7 (1) The fiscal discipline, (2) public expenditure priorities, (3) tax reform, (4) liberalization of financial marktes, (5) competitive exchange rate, (6) liberalization of trade policy, (7) foreign direct investment, (8) privatization, (9) deregulation, (10) property rights.

differences in labour productivity or Heckscher–Ohlin-type goods based on historical factor endowments, the value added in exports increases as the country moves on to skilled, labour-intensive, capital-intensive and knowledge-intensive exports. This implies that the sources of comparative advantage evolve over time, thereby changing a country’s composition of trade and its position on the ladder of comparative advantage. At the lower rungs, ‘natural’ comparative advantages have a cost-based type of advantage. The higher rungs of ‘acquired’ comparative advantage relate to goods that have a product-based type of advantage.\(^9\)

The evolution of Asian emerging markets explicitly evidenced that less developed countries ‘emerged’ one by one with a ‘leading country’ moving up the ladder and ‘followers’ occupying the vacant rungs. We can readily conclude that export promotion has contributed more to a developing country’s rate of growth income than that of import substitution. This has been mainly due to dynamic gains from trade in practice.

The evolution of emerging markets in Asia is particularly relevant to this pattern and the following is a summary of these three rungs of the ‘flying goose’:

- Japan (R&D and knowledge-intensive; ‘acquired’ comparative advantage, capital-intensive).
- NICs (skilled labour-intensive; ‘natural’ unskilled, labour-intensive).
- ASEAN (comparative advantage: resource-intensive, raw materials, low skilled labour, etc.).

The demolition of the Berlin Wall and the overthrow of Eastern European communist governments in 1989 opened the door to countries that previously had been considered off limits to Western countries. These former communist countries, which were under the category of centrally planned economies (CPE), joined the territory of ‘emerging markets’. Most of those economies were in the process of transition to a market economy. These CPEs include the European (Estonia, Latvia, Lithuania, Belarus, Republic of Moldova, Russian Federation and Ukraine) and Asian parts (Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan and Uzbekistan) of the former USSR, plus other European countries (Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia, Albania, Bosnia, Croatia, Slovenia, Macedonia and Yugoslavia).

In the late 1990s, the concept of ‘social capital’ was first introduced.\(^10\) The World Bank defines social capital as the social relationships, networks and norms that shape the quality and quantity of a society’s interactions.\(^11\) Various types of social capital are relevant for analysis of country development.

For developing countries, the concept is further divided into ‘civil social capital’ and ‘government social capital’. It was noticed that culture plays a role in development as civil social capital relates to values, beliefs, attitudes and norms of behaviour.

Alongside this line S. Gordon Redding in 1993 wrote his book on The Spirit of Chinese Capitalism which examined the fundamental beliefs and values, social structures, relationship rules, rules for action and forms of cognition in the Chinese communities in Southeast Asia.

\(^9\) Those who are interested in this development model for emerging market are recommended to read a textbook on trade theory, such as the one written by Krugman and Obstfeld (2003).

\(^10\) Coleman and Putman have been the most influential in introducing the concept of ‘social capital’ although the concept is used differently by sociologists, political scientists and economists.

\(^11\) www.worldbank.org/poverty/scapital/library
His attempt was to explain so-called Chinese capitalism in Hong Kong, Taiwan, Singapore, Indonesia, the Philippines, Malaysia, Thailand, etc.

Although it is neither the task nor the ambition of this book to label the emerging markets according to their categories, the review of these concepts and models is, however, helpful to understand the evolution of policy changes.

1.3.6 The 2000s

The 2000s saw the young emerging economies growing up in more than one way. The major emerging markets today are so-called BRICT countries: Brazil, Russia, India, China and Turkey, which will be discussed in detail in the next chapter.

Most of these countries have so far embraced market friendly reforms and opened their doors to trade and investment. They catch up quickly by adopting technology and management know-how from the West.

It is nevertheless clear that their development will not be a straight line. It will not surprise us if some of the emerging markets today do sink or ‘submerge’ in the future while others move on. But the interest in the emerging markets is related to the fact that, despite difficulties and setbacks, the emerging market economies nowadays are truly becoming an exciting and alluring place in which to do business. This is because advances in technology especially in communications and transportation have connected business with additional sources of labour and other resources. Imports and exports are fuelled by the accumulation of capital in many countries of the world.

The rationale for emerging markets to attract attention from the business community is simple and straightforward – the market potential of these markets.

1.4 EMERGING MARKETS: THE POTENTIAL

Emerging markets are interesting because they are now doubling their gross domestic product (GDP) roughly every 12 years according to Daniel Riordan from Emerging Markets Solutions group. In the next decade the collective economies of developing countries are expected to account for over 65% of the world’s production as measured by GDP. Add to this growth is a surge in population and continued urbanization. Experts estimate the economic growth will create nearly 50 mega cities in emerging market economies over the next 50 years.

Rapid economic growth in emerging markets also means that their share of the world’s economic wealth is growing. As mentioned in our introduction, the Economist gave more detailed estimation and statistics – the combined output of emerging economies rose above half of the global total in 2005. The message is that, by one measure at least, the dominance in the global economy of the rich countries since their industrial revolution in the 19th century is over. This estimation is based on the IMF’s method of converting national GDPs into dollars using purchasing power parities instead of market exchange rate.

Even when measured by market exchange rates, emerging market economies are also showing growing clout. In 2005, their combined GDP grew in current dollar terms by $1.6

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12 See Trade Finance magazine, America’s Trade Finance report April 2004.
trillion, more than the $1.4 trillion increase of developed economies. This rapid growth will also allow developing countries to narrow the economic gap between the emerging market countries and developed countries. Today, the G7 countries produce about two-thirds of the world’s GDP, feeding 11% of the world’s population. In 20 or 30 years’ time, this world GDP picture will look very different. A relatively small number of countries which are home to half of the population today will be the main drivers of the world’s economic growth during the next 20–30 years. On the other hand, their combination of increased life expectancy and low population growth has created a situation where most developed countries, with the exception of the USA, will be faced with ageing populations and shrinking workforces in the decades ahead. This will put motivation on capital flows around the world, as developed countries with ageing populations seek to maximize returns on their savings by investing in high growth emerging market economies. These emerging market countries – notably China, India, Brazil, Russia, Turkey, etc., will therefore become the focus of economic development.

It is not surprising that foreign direct investment flows to emerging markets also outpaced those to the developed world. In 2004, foreign direct investment flows to developing countries spiked by 41%, reaching an all-time high of $268 billion. In contrast to this, the developed world experienced a 14% decline in foreign direct investment inflows, down to $380 billion – a six-year low. Emerging economies in Asia benefited particularly from this massive shift, taking nearly one in four global foreign direct investment dollars in 2004, compared to only one in 10 in 2000. Asia’s inflows reached $148 billion in 2004, $46 billion more than the year before – an unprecedented increase in the region.14

This response by international investors to emerging markets is impressive. Asia and Latin America have attracted most of the investment community’s attention as compared with Africa. The emerging markets of Asia have attracted almost all the private equity investment from Japan and half of the equity dollars invested in developing countries by the US. Africa and the Middle East remain largely ignored, yet their economies represent around 20% of all emerging markets.15 Today, China and India combined account for 45% of the region’s foreign direct investment.

Foreign direct investments are an important source of momentum for economic development as they create jobs, exports and new industries. They also transfer technology and know-how in ways that have introduced new growth dynamics in these markets and on a scale the world have never seen before. Not only are these emerging markets enjoying robust economic growth, but deep economic structural changes including but not limited to technological transformations that will position them as new emerging centres of future global growth. More interesting is that, some emerging markets, such as China and India, are becoming sources of foreign direct investment themselves.

Together with the shift of wealth comes the rise in living standards in these emerging markets. The rise in living standards naturally implies the rise in purchasing power of the population. This development of new consumer markets provides opportunity for companies as well as for banks. Emerging markets, with both hidden dangers and opportunities, are thus becoming an important and interesting topic to many companies and banks.

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15 See IFC paper, Emerging Stock Markets Fact Book.
On the capital market side, emerging markets are also on the top of the list of the world’s best performing stock markets, although the worst performers happen to be concentrated in emerging markets too.

The increased interest by private equity investors has been accredited to the ‘push and pull’ factors. The push factor is for better profits and more diversification because of the knowledge that investment returns in emerging markets are generally higher than in mature markets, even with adjustments for risks. Increasingly the investment community has recognized a low or even negative correlation of stock markets in the developing and in the developed nations. Therefore investing in the developing world is a means of reducing overall portfolio risk.

The pull factor is a result of wide-ranging reforms, legislative as well as economic, in many emerging market economies. Governments have liberalized or eliminated capital restrictions, improved the flow of financial information and strengthened investor protection thereby earning the attention of the investment community. This helps to attract foreign investment. Investment banks have confirmed that returns on emerging market investments have outpaced those in developed economies.

Emerging markets, at least some of them, are fast growing economies that have benefited from their comparative advantages in low labour costs and corporate taxes and sometimes an absence of red tape.

Alain Bourrier and Plamen Monovski, co-managers of the Merrill Lynch Emerging Europe fund, believe that the central European countries will continue their fast growing trend owing to the convergence with the established members of the EU. Lower interest rates reduce the cost of capital, boost credit growth and the banking sector and raise consumer confidence. ‘The success of these countries is the mirror image of the problems in Germany and France’, Mr Monovski, who himself was born in Bulgaria, commented. Although emerging market economies still have income per capita far behind that of the developed world, and the sustainability of recent development tendency for emerging markets can be argued, the fact is that by a wide range of gauges, emerging markets are flexing their muscles. They are the markets that no businessman can afford to lose.

**SUMMARY**

Emerging market can mean different things to different people. One can hardly find a precise definition of what it is or what it ought to be. It is a concept that is frequently in use for daily work.

Geographically, emerging markets usually refer to Asia, the Middle East, Latin America, Central Europe and Africa.

On the other hand, the concept of less developed countries is well established. People judge the development level of a country by its per capita income, the growth of the per capita income and other measurements such as life expectancy, education level, the level of nutrition, proportion of infant mortality, consumption of energy per capita, pollution, etc. The United Nations Development Program published a human development index under which intercountry and intertemporal comparisons of living standards are to be taken.

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17 Main concerns are: (a) rising commodity price may favour the producing countries such as Russia, Brazil and South Africa; (b) lower interest rates have reduced debt-service costs especially for Latin America; (c) recent booming of export from emerging markets has been due to America’s strong import demand.
Despite these discussions along the development level of countries, the *Economist* regularly follows the development of 27 countries and puts them under the category of emerging markets. These are at least the most active emerging countries.

Emerging markets share a lot of similarities in political, economic and financial terms. There are also common symptoms for emerging markets. The evolution of markets indicates that during the development of many countries they experienced similar stages and similar problems – among which is the twin crisis – (bank crisis and country crisis) – in these emerging markets. But the market potential of these emerging markets has attracted attention both from the business circle and from the academic community.