

The Future of G8

June 2007

Research Centre

 **Analysis**

- G8 currently accounts for 13% of world population and 61% of output.
- We forecast that G8's influence will decline significantly over the next 45 years. In 2050, we expect the members of G8 to account for 10% of the world population and just 34% of output.
- Russia's is the only country in G8 whose share of world output is expected to increase by 2050.
- Our analysis shows that the US will remain the most powerful economy in the world, but the influence of Europe will diminish as that of Asia increases.
- G8 may have to enlarge its membership to include the fast growing economies of China and India, both of which are expected to become major world players in the years ahead.

G8 – the present situation

G7 was initially formed by the 7 largest industrialised economies in the world, with Russia joining at a later date in recognition of its pivotal role in the world economy. Although Russia's GDP, and GDP per capita, is far lower than that of the other G8 members, it was perceived as having an important strategic role to play in maintaining stability in the world's new political order. Germany currently holds the presidency of G8 for the fifth time.

Figures sourced from the World Bank suggest that, together, the present members of G8 produce about 61% of world GDP. The chart opposite illustrates GDP for each individual member, and clearly shows the current dominance of North America, with the US economy accounting for 28% of global output and Canada for a further 2%. Japan, the only Asian member of G8, is currently the world's second largest economy, and accounts for 10% of world output. Western European influence is high, as Germany, France, the UK and Italy are all members of G8 and together these countries account for 20% of world GDP. Russia, the newest member of G8, is also the smallest member accounting for just under 2% of total world GDP in 2006.

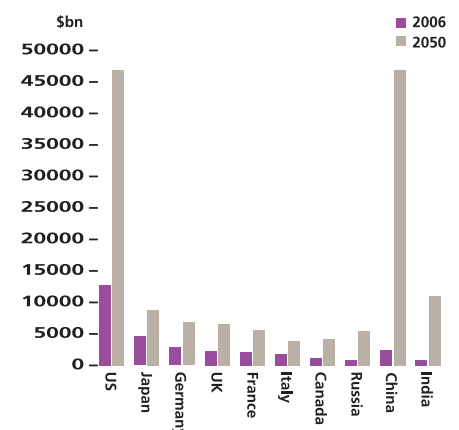
However, in recent years, both China and India have begun to emerge as major economic players. Both countries have huge populations and fast growing GDP.

If present trends continue, Asia will undoubtedly become a major force in the world economy within the next 45 years. This could result in a significant shift in the balance of economic and political power, away from the existing members of G8 in the west, particularly Europe, in favour of some key Asian nations.

Our Forecasting Model

In order to illustrate the potential magnitude of the expected shift in economic power, we have built a forecasting model to predict GDP out to 2050, using data sourced from both the World Bank and the IMF to construct the baseline scenario. Given the extreme difficulty in forecasting over such a long period of time, we chose to keep the model, and its underlying assumptions, as

G8, China and India - GDP in 2006 and 2050



Contact

Shona Dobbie

Head of Research Centre

Alliance Trust PLC, Meadow House,
64 Reform Street, Dundee DD1 1TJ

Tel +44 (0)1382 201700

Fax +44 (0)1382 225133

Email contact@alliancetrust.co.uk

Web www.alliancetrust.co.uk

Alliance Trust PLC is the largest generalist investment trust company listed on the London Stock Exchange. The Research Centre is part of Alliance Trust and was formed to carry out economic and social analysis to deepen our understanding of economies, markets and socio-economic issues.

The views, information and data in this publication are those of the Research Centre and this publication is not a financial promotion or recommendation to make any particular investment. Alliance Trust is not authorised to give financial advice.

The future of G8

simple as possible. We have excluded any significant assumptions about war, resource constraints and technological change, all of which could have a dramatic impact on future growth.

Our model uses our own in-house forecasts of trend rates of growth based on our assumptions regarding long term prospects for consumer spending, business investment, exports and government expenditure. In each case we have identified the major trends which we expect to prevail in the years ahead, and we have weighted these in terms of relative importance to derive a long term trend rate of headline GDP growth. Our model also incorporates population estimates provided from the UN to enable us to calculate GDP per capita in 2050.

The World Economy in 2050

Both China and India are set to emerge as global economic players. We expect both China and India will have overtaken most of the G8 members in size by 2050. Only the US would be larger than China, and Japan would move to fourth position, just behind India. Russia will be the only G8 member which will increase its share of world output over the next 45 years.

What is noticeable in our results, is the extent to which the economic dominance of G8 is expected to decline over the next 45 years. We expect G8's share of world output to fall from 61% in 2006, to just 34% in 2050.

Although North America will remain a dominant region, the US and Canada's combined share of world output is expected to fall from 30% today to just 20% in 2050. We also predict European dominance will decline. At present, Germany, France and Italy together account for around 15% of global output, but our model forecasts that this will decline to just 6% by 2050. The UK's share of world output is expected to fall from 5% to just 3% over the same period. Russia is the only existing member of G8 which is expected to increase its share of world output. We expect Russia's share of global GDP to increase from 1.7% at present to 2.1%, moving it out of eighth position and putting it ahead of both Canada and Italy.

The most striking result of our analysis is the growing importance of both China and India in terms of world output. China already accounts for 5% of global GDP and this proportion is expected to rise significantly to 18% by 2050, which

would place it a very close second behind the US. India presently accounts for 2% of world output, but we expect this to increase to 4% over the next 45 years, placing it well ahead of all of the European members of G8.

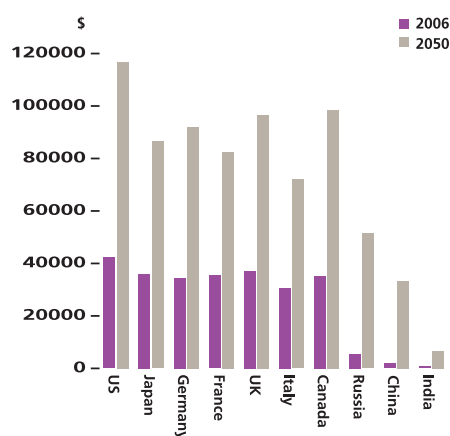
Relative Wealth

GDP per capita is an alternative measure of relative economic well-being, and is generally favoured as a measure of living standards in a country as it takes into account the size of the population. We have therefore extended our analysis to compare GDP per head in the G8 countries plus China and India, both today and in 2050

In terms of GDP per capita, our results are significantly different from those for GDP itself. Our model uses our trend forecasts for both GDP and population forecasts from the United Nations to estimate GDP per head in both 2006 and 2050. Our results suggest that, on this measure, the current members of G8 will retain their leading positions. This is largely because of expected changes in population. Whereas the populations of China and India are expected to grow significantly, which offsets the impact of strong growth on GDP per capita, the expectation of a fall in population levels in Germany, Italy, Japan and Russia enhances the expected increase in GDP per head. The populations of Canada, France, the UK and US are expected to increase but by a lower rate than output growth. This means that GDP per head will continue to expand in these countries.

We estimate that GDP per head for G8 as a whole is \$32,644 which is 4.6 times larger than the equivalent figure for the world as a whole of just \$7,043. This clearly illustrates the higher wealth of the member countries of G8. By 2050, our analysis suggests that GDP per head in G8 will be \$96,139 which is still 3.4 times higher than the expected world level of \$28,373 at that time. Russia's GDP per head is only \$5,572 at the present time, which is 83% lower than the average level for G8 as a whole. We expect Russia's GDP per head to increase significantly by 2050, to reach a level of \$51,336, but this will still be 47% lower than the average for all G8 members. Russia's population is expected to decrease by 25% over the period in question, which will boost GDP per head, while the population of G8 is expected to increase by 6%.

GDP per head - 2006 and 2050



Although starting from an extremely low position in terms of GDP per capita, we expect China to make considerable gains even though it will not overtake Russia. China's population is expected to increase by 7% between 2006 and 2050. Given the expected growth in its population of 44% over the forecast period, India will not make any remarkable gain in terms of GDP per head and could still remain relatively poor, even after several decades of relatively fast growth. Much depends on whether India's birth rate remains as high as expected over the next few years. A small decline in the birth rate could have a dramatic impact on GDP per head.

Conclusions

Our analysis shows that, in terms of headline GDP, China and India could soon develop into major world players, testing the dominance of the present members of G8, particularly those based in Europe. Even though China and India are expected to remain poorer than the present members on a GDP per capita basis, their headline GDP may become sufficiently large to encourage G8 to widen its boundaries to include both of these countries.

Although the US would be expected to remain the dominant member of 'G10', the expansion of membership would probably swing the balance of influence away from Europe and towards Asia. Once both China and India had been admitted, representation from both Latin America and Africa may follow. Only at this point would the forum become truly global in nature.

Sources: World Bank, IMF, UN, Inhouse analysis.