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Analysis of today
Assessment of tomorrow

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How can developing economies maintain a positive trajectory in a changed global landscape?

For many developing countries, the global economic landscape has shifted dramatically in recent years.

Lower growth, disrupted supply chains, reduced aid flows, and heightened financial-market volatility represent significant headwinds.

Underpinning these changes is a fundamental restructuring, driven by the developed world, of the postwar economic and financial order.

Against this background, a handful of factors are becoming critically important for the current and future well-being of developing countries – and for the fate of multilateral institutions.

For much of the period following World War II, the global economic and financial order operated as a core-periphery construct, with the United States at its center.

The US provided global public goods, led multi-country policy coordination, and acted as a crisis manager, in accordance with a widely accepted set of rules and standards.

The end goal was eventual convergence, securing an ever more integrated and prosperous world economy.

But three factors undermined this order. First, insufficient attention was paid to increasingly destabilizing distributional outcomes, leading to widespread alienation and marginalization within politically influential segments of society. Instead of continuing to influence politics, economics became subservient to it.

The US - from a stabilizing force to a source of volatility

Second, the existing order struggled to integrate rapidly expanding large developing countries.

The most notable example is China, whose immense economy but relatively low per capita income created a persistent misalignment between its domestic development priorities and its new global responsibilities.

The world could no longer absorb smoothly the external consequences of China's economic strategy, generating tensions that international governance structures have struggled to resolve.

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Contributing to this development were the 2008 global financial crisis (which originated in the US), the weaponization of tariffs against China in 2018, and the increasing use of payment-system sanctions.

It accelerated in recent years with the failure to ensure the equitable global distribution of COVID-19 vaccines, the "uber-weaponization" of tariffs against friends and foes alike, the dismantling of America's foreign-aid system, and continued indifference to devastating humanitarian crises and repeated violations of international law.

How to maintain positive trajectory?

While the traditional core-periphery model is inherently ill-equipped to handle all this, there is nothing to replace it, resulting in a bumpy journey toward an unclear destination.

Despite this, developing countries have navigated the changing landscape relatively well so far.

Their success can be attributed largely to hard-won policy achievements, including the strengthening of macroeconomic frameworks and institutions in recent decades.

But to maintain this positive trajectory in an increasingly challenging external environment, developing countries must affirm four key policy priorities.

The first is to preserve macroeconomic stability while aggressively addressing any structural and financial vulnerabilities, including shallow domestic financial markets, weak regulatory frameworks, and governance deficits.

The second priority is to strengthen international links that boost resilience, improve agility, and expand optionality.

> Developing countries should prepare themselves to exploit the new opportunities created by innovations

This requires coordinated, multiyear efforts to harmonize regulations, foster regional financial integration, and build trade infrastructure.

Third, developing countries should prepare themselves to exploit the new opportunities created by innovations – from productivity enhancements in traditional sectors to improvements in social sectors where investment in human capital has the highest returns.

AI, in particular, holds immense potential to revolutionize medicine, education, and agriculture, which could help these countries leapfrog traditional development stages.

Building a supportive ecosystem requires investing in digital infrastructure, cultivating a skilled workforce, and developing an innovation-friendly regulatory environment.

Lastly, with many US assets appearing overvalued and US Treasuries becoming more volatile, the small but strategically important subgroup of developing countries with high levels of foreign reserves and substantial financial wealth in dollars is being pushed to reconsider their holdings' traditional US overweight.

This process will inevitably be protracted and complex, and will require careful asset disaggregation, revised asset-allocation methodologies, and new investment mindsets that look beyond conventional safe havens.

Multilateral institutions

Multilateral institutions such as the World Bank and regional development banks have a crucial role to play in helping their members pursue such an approach.

To become trusted advisers, these institutions must get better at compiling and disseminating best practices for new and evolving technologies that can improve health, educational, and productivity outcomes, and they must do more to promote these technologies' uptake.

Multilateral institutions should encourage regional links and projects that facilitate trade, expand cross-border infrastructure, and promote shared resource management - The World Bank

For example, their staff must be equipped to answer questions about interacting with AI agents, leveraging innovations to deliver essential services, and managing the attendant risks.

Multilateral institutions should also encourage regional links and projects that facilitate trade, expand cross-border infrastructure, and promote shared resource management.

And in a world shaped increasingly by frequent shocks, there is an urgent need to enhance contingency-funding facilities, such as by strengthening risk-sharing tools.

Of course, this should not undermine the essential work that these institutions perform in fragile countries.

Given the overwhelming evidence that traditional development models struggle in countries with such serious governance and security challenges, this, too, is an area that requires more out-of-the-box thinking.

AI and other emerging technologies provide developing countries a rare opportunity to unlock new pathways to inclusive economic growth. But exploiting this historic opportunity is far from automatic.

Unless developing countries create the conditions necessary for the efficient and equitable diffusion of such innovations throughout their economies – starting, crucially, with the health and education sectors – they risk falling further behind, causing inequalities within and between countries to deepen, and accelerating the fragmentation of the global order.

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