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## THE RISE OF THE SOUTH AND NEW PATHS OF DEVELOPMENT IN THE 21ST CENTURY

## BACKGROUND PAPER

# SOUTH-SOUTH ISSUES FROM A NORTH-SOUTH PERSPECTIVE

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**BACKGROUND PAPER NO. 2**

**This study was prepared for UNCTAD as a background paper for to the ECIDC Report 2012. The views in this paper are those of the author and not necessarily those of UNCTAD or its member states. The designations, terminology and format employed are also those of the author.**

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## UNCTAD AND SOUTH CENTRE

## MARCH 2012

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# SOUTH-SOUTH ISSUES FROM A NORTH-SOUTH PERSPECTIVE

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## 1. Introduction

With anemic growth in the rich countries of the world, that is, the North, it seems unlikely that they can continue to serve as a growing market for the products of the relatively poorer countries of the world, that is, the South, as it has done in the past. In the words of W. Arthur Lewis (1980), it does not seem that the North can continue being an engine of growth for the South, at least in the near future. Moreover, it can be argued that the Northern engine was not a very effective one in the past, since global growth was unable to narrow the gap between the North and the South and bring about convergent growth.[1] Furthermore, it is arguable that it is not desirable, either from a normative Northern or cosmopolitan perspective that it continue to serve as an engine of growth. Does all this doom the poor countries of the world to stagnation and no significant prospect of embarking on the path to sustained development?

The fact that some countries in the global South have recently experienced rapid economic growth may suggest that there is a global engine of growth within the South. It has been widely heralded that in recent years countries like China, India, Brazil and the Russian Federation – the BRICs as they have been called – have performed very well. Sometimes South Africa is added to the list and called the BRICS. While the real per capita income of the world as a whole as grown at an average annual rate of 1.47 per cent from 2000 to 2010 and members of OECD have grown at 1.02 per cent, China has grown over the same period at 9.64 per cent, India at 5.82 per cent, and the Russian Federation at 5.66 per cent. Brazil and South Africa has not done so well in terms of average growth rates, having grown at 2.49 per cent and 2.14 per cent, respectively, but even Brazil has grown at 6.55 per cent in 2010, and at an average rate of 5.27 per cent for the last four years if one leaves out 2009 when it experience negative growth. Apart from these countries, a number of countries in Eastern Europe and the former Soviet Union (Armenia at 8.07, Azerbaijan at 13.61, Belarus as 7.8, Kazakhstan at 7.61, and Turkmenistan at 12.83), and Southeast Asia (Cambodia at 6.70, Lao PDR at 7.40, Myanmar,

11.46, and Vietnam at 6.00) have also experienced high numbers, but have not attracted as much attention because of their smaller population size (although Myanmar had close to 48 million and Vietnam over 86 million people in 2010).[2] Can these countries collectively replace the North as an engine of growth and development for the rest of the South? Can they grow in a self-sustained manner even without significant Northern growth, and can their growth bring about convergent growth in the world economy, while avoiding the problems that can result from continued Northern growth? Or, at the very least, does their experience show that even without the Northern engine, parts of the South can indeed embark on the path to sustained growth?

These are not new questions. Lewis (1980) asked it more than thirty years ago when, as now, the growth rate of the North was low and the prospects of a strong recovery seemed dim. Lewis argued that it was possible for parts of the South which could sustain Southern growth – he mentioned India as a possibility even though at the time India's growth rate was low, but did not refer to China, since China's growth had just started to accelerate after the reforms were underway – even if the North did not recover its growth. Compared to the late 1970s and early 1980s growth did, however, pick up in the North, although, despite the strong performance of China and some other countries like India, which have a high weight in the South on account of their size, there has been much talk of North-South divergence (see, for instance, Milanovic, 2005). However, they are relevant again, because of the current Northern slowdown which is more severe than when Lewis was writing and because there are some Southern countries which are experiencing high rates of growth. Reidel (1984) criticized Lewis at the time, arguing that Lewis's argument required an engine of growth for the South, whereas, especially because many Southern countries had diversified out of primary production, individual Southern countries were not constrained in terms of their growth by overall Northern growth, since they could gain market shares in the North without requiring the North to grow. So, one can ask whether, even if these Southern countries do not serve as engines of growth, can more countries of the South lift themselves up with suitable policies of their own, because some seem to have done so? Reidel, in fact, blamed low growth in the South to failed import

substitution policies and failure to adopt outward oriented policies, rather than to some mechanical dependence on an engine of growth.

The purpose of this paper is to examine these questions. In particular, it will try to analyze if the improved performance of Southern countries can enable them to become the new engine of global, especially Southern, growth, or whether their experience shows that the future is rosy for the South, only if they emulate the successful countries in terms of sound policies. If so, what are the appropriate policies? These are, of course, very broad and general questions, and because they encompass issues that encompass the whole of not only development economics but also development studies, they cannot be addressed at a general and comprehensive level in a short paper. This paper will address these issues by drawing on the experiences and analysis of North-South interaction in the past, especially the literature on North-South models and to a lesser extent by drawing on the literature on demand-led growth and its consequences for wellbeing.

The rest of the paper proceeds as follows. Section 2 will provide a brief review of some aspects of North-South interaction to discuss the nature of the Northern engine and its effectiveness, and to provide background about the potential and prospects of South-South interaction. Section 3 will discuss the difficulties facing the North in terms of being an engine for global growth and whether it is desirable to have this role. Section 4 will address the performance of the fast-growing Southern economies, examine some features of their experience and discuss whether their growth is sustainable. Section 5 will examine the relation between the countries of the South. Section 6 will conclude.

## 2. North-South interaction

### 2.1 The North as an engine of growth

According to an influential view which followed Lewis (1980), the North was an engine of global growth. When the North grew faster, the demand for goods produced by the South increased more rapidly, and the terms of trade moved in favor of the South and the South grew faster, because the higher profits resulting from the improved terms of trade – with stagnant wages because of surplus labor - allowed it to save and invest more and because it made available

more foreign exchange available to the South which allowed it to import more investment goods produced in the North. Models of North-South trade attempted to formalize this process, taking into account different structural characteristics of the North and the South, and their asymmetric relation in the global economy, including the fact that the North produced investment goods while the South did not (an extreme assumption highlighting the inability of the South to produce a significant amount of capital goods).[3]

Early North-South trade models of growth were developed by Findlay (1980, 1981), Taylor (1981, 1983) and Molana and Vines (1989), among others. These models all assume that the South grows with unlimited supplies of labor as in the Lewis (1954) model of the dual economy, while the North is modeled in alternative ways, in a neoclassical way with fully employed labor by Findlay (1980), with growth being determined by aggregate demand by Taylor (1981), and in a saving-constrained, classical, manner with unemployed labor by Molana and Vines (1989). An analysis which stresses the structural asymmetries between the North and South using alternative assumptions and clarifies the implications of these assumptions for global developing using a common framework is developed in Dutt (1990).

The aptness of engine of growth metaphor is suggested in these models not only by the fact that Northern growth pulls up Southern growth, but that without an increase in Northern growth the South as a whole cannot experience sustained increases in its growth. Suppose, for instance, the South increases its production and growth by saving a higher proportion of its income (especially profits) or because of technological change which allows it to produce more out of its scarce capital. This increases the supply of the Southern good and the demand for the Northern good and therefore turns the terms of trade against the South, reducing profits and the Southern ability to continue investing at a high rate because of the reduced level of saving and available foreign exchange for importing investment goods. The growth rate of the South, at least in the simple models, reverts back to the Northern rate. The deterioration of the terms of trade for the South occurs for a number of reasons which have been stressed in the literature and which have been highlighted in different models: the South's inability to produce capital goods, which must be imported from the North; differences in the market structure of Northern and Southern goods which allow Northern producers with market power to prevent

the price of its product from changing while the price of the Southern good is flexible in competitive markets; and conditions of surplus labor in the South which prevents the Southern real wage from rising to benefit from technological changes, while Northern workers are able to gain from Northern technological changes because of labor scarcity and/or their bargaining power (see Singer, 1950, Prebisch, 1950, and Lewis, 1969).

**2.2 Problems with the Northern engine and uneven development**

The Northern engine, however, was not necessarily a very effective engine, for a number of reasons. First, the Northern and Southern goods have different income elasticities of demand. Early structuralist writers like Singer (1950) and Prebisch (1950) stressed the fact that the Northern goods were typically manufactured goods while the Southern goods were typically primary goods, and that the former had a high income elasticity of demand compared to the Southern good because of Engel's law. As countries in the South graduated to the production of manufactured goods, it was found that they still faced a low income elasticity of demand, because they produced more simple consumption goods rather than sophisticated luxury and capital goods (Singer, 1975). This could be due to actual or perceived differences in quality of the products, due to branding and international demonstration effects (see Dutt, 1988); thus a low income elasticity may be the result simply of the fact that the good or service is produced in the South. Moreover, in the case of many primary products which are exported from the South to the North, technological change which replaces the use of such products with synthetic substitutes as intermediate inputs also result in a reduced demand which yields a pattern similar to low income elasticity (see Dutt, 1996). This implies that if there is balanced trade between the North and the South, if the North and the South grow at the same rate, the terms of trade will deteriorate continuously for the South because the equal rates of growth for the two regions shifts demand away from the Southern good to the Northern good. Thirlwall (1983) pointed out that this implies that the South would have to grow at a slower rate than the North to keep the North-South terms of trade constant. A model of balanced North-South trade with differential income elasticities of demand shows that in fact the global economy will converge to a long-run equilibrium with stable terms of trade and unequal growth, the North

growing at a faster rate than the South (see Dutt, 2002). In addition to a large amount of empirical evidence on individual countries and product, there is some evidence to suggest that the overall Northern income elasticity of the demand for Southern goods is lower than the Southern income elasticity for Northern goods (Dutt, 2003), implying that there is reason to believe that the result of divergent growth due to this mechanisms is likely to hold in the real world given the assumptions of the model.

Second, the pattern of specialization of North-South trade arguably implies that North and South experience different rates of technological change. Early writers such as Singer (1950) and Prebisch (1950) argued that the North produced mostly manufactured goods which result in learning by doing and dynamic scale economies, while the South produced mostly primary products and other resource-intensive goods which involve little processing and hence little learning by doing, so that Northern technology improves over time and Southern technology stays stagnant. Even after some countries of the South became major producers of manufactured goods, since they produced technologically less-sophisticated products which required less processing, the same pattern of divergent technological change continues. If technological change results in higher profits for producers and higher profits result in greater capital accumulation, this implies divergent patterns of capital accumulation as well. Simple models which allow both the North and the South to produce two goods, one implying learning by doing and the other not, suggest that with trade it is possible for the South to be immiserized because it produces less of the technologically dynamic good compared to what it would under autarky, given the North's static comparative advantage in it (see Krugman, 1981, Dutt, 1986), despite benefiting from trade in a static sense. Results like this also emerge in standard neoclassical models of fully-employed resources due to what are called production externalities.[4]

In addition to these problems that arise from the production of many kinds of Southern goods, the fact that many Southern countries are specialized narrowly in the production of one or a few primary goods creates additional problems. First, it implies that the terms of trade for Southern countries with narrow specialization are volatile and affected strongly by business cycles in rich countries. UNCTAD (2011, 4) shows that the higher the share of fuels and

minerals in merchandise exports for the least developed countries (according to the classification used by them), the greater the reduction in the volume index of their exports during the recent economic crisis of 2008-09. This means that the economy will be exposed to a great deal of uncertainty and actual volatility, which hurts their development. Furthermore, growth of the resource-based sector is likely to have an adverse effect on the natural environment of the poor countries due to deforestation, soil erosion and pollution in general.[5] This can cause general environmental problems and also have adverse effects on production, for instance, in agriculture, not to mention resource depletion in the case of exhaustible resources.

**2.3 Capital movements and technology transfers**

It is possible that these inequalizing tendencies can be mitigated by two considerations we have ignored so far, that is, North-South capital movements and technology transfers. Although both can occur with foreign direct investment, it is convenient to discuss them separately in turn. In fact, an increasing amount of world trade and even North-South trade occurs within transnational corporations, so that it is not generally possible to think of trade as being separate from capital flows and technology transfers.

Regarding international capital flows, when capital flows from the North to the South, it augments the supply of saving and the availability of foreign exchange, thereby increasing the rate of capital accumulation and growth in the South. Can North-South capital flows therefore be expected to close the gap between the North and South compared to the inequalizing tendency found it is absence? Models of North-South trade with capital flows do suggest that such convergence is possible at least for a while. However, if the structure of the North and the South do not change, for instance because the income elasticities of demand for Northern and Southern goods remain as discussed earlier, they suggest that if the North and the South grow at the same rate, capital flows and Southern indebtedness as a ratio of Southern production will grow indefinitely even with a constant interest rate, which is not sustainable (see Dutt, 2003).

In fact the models point to some problems that result from international capital flows. First, to the extent that capital flows increase production of the Southern good, it turns the terms of trade against the South, and this reduces the ability of the South to grow at a high

rate. Second, to the extent that profits from the Northern ownership of capital used for production in the South is repatriated to the North, especially if the profits are high due to what have been called imperfections in competition and if the South is unable to tax the profits in an effort to attract more foreign capital, it reduces the net flows of capital from the North to the South. It has been shown that these features can result in the relative immization of the South.[6] However, if foreign investment comes in with new technology, as in the case of foreign direct investment by transnational corporations, it may be the case that the South will expand the production of manufactured goods, even relatively technologically-sophisticated ones, and this may reduce the negative terms of trade effect as inflows increase production of goods that are produced more in the North, which in turn may allow the South to increase exports to the North, and therefore increase the availability of foreign exchange, allowing the South to catch up to the North (see Dutt, 1997). Whether or not this will occur depends on which sectors foreign direct investment goes into, and whether production in sectors using foreign capital also increase imports of intermediate inputs.

Moreover, it is not the case that despite having low wages, the South will necessarily be able to attract Northern capital. The problems of different types of foreign capital can be different. For instance, theories of neoclassical models with asymmetric information suggest that the South may not be able to borrow from the North because Northern lenders may find loans to the South risky because they fear Southern borrowers may default and cannot provide them with sufficient collateral (Gertler and Rogoff, 1990). Even if such capital flows in, the problems caused by their instability in generating boom-bust cycles are too well known to warrant further discussion. Foreign direct investment may not come to the South because despite having low wages Southern productivity may be low because of the lack of infrastructure and education. In fact, endogenous growth models suggest that despite having low levels of capital the return to capital may be low in the South because of increasing returns to capital (see, for instance, Lucas, 1990), and most countries of the South get very little in terms of private capital inflows.

Turning next to technology transfers, it is sometimes argued that the South can benefit from transferring technology from the North, and that this can lead to convergence (see Lucas,

2000). It may be supposed that the South can learn about Northern technology by importing and observing Northern goods, and through the activities of transnational corporations which can bring in advanced technology which can even spread to domestic firms. It has been argued that the rate of technology transfer will be higher the greater the technology gap between the North and the South (Findlay, 1978). The problem is that technology transfers are not as easy at just copying foreign technology: much technological knowledge is tacit and cannot be transferred from blueprints (see Amsden, 2001) even when it can be transferred Southern producers need to know how to adapt the technology to local conditions and overcome inevitable problems and, more advanced technology requires a great deal of technological experience and education to learn (by way of prerequisites, something that was not as essential as in earlier times when the technological frontier was not as advanced). In short, the South needs to build up *technological capability* which allows its firms to do these things, and not just obtain more *productive* technology.[7] Moreover, the protection of international intellectual property rights makes it costly to transfer technology. Finally, transnational corporations often operate plants using simpler assembly processing in the South, keeping more technologically sophisticated production and research and development activity for the North, and often transfer inappropriate and advanced technology from which the South finds it difficult to learn. It has therefore been found that the rate of technology transfer depends not just on the gap between Northern and Southern technology, but on the technological capability of the South to effectively transfer such technology. This may require it to develop technological capability by gaining experience in the production of technologically sophisticated goods – which may be hampered by trade liberalization and specialization in technological simpler goods according to static comparative advantage - and by attempting to transfer somewhat less advanced technology. Trade liberalization, by expanding trade according to static comparative advantage (since domestic producers are unlikely to take into account the future improvements in technology because they may involve externalities and because the gains are uncertain), is likely to increase sectors using relatively less sophisticated technology, reducing the possibility of learning and developing technological capabilities.

This discussion can be used to explain the divergent growth patterns which have been noticed (though not without some controversy) by many observers of the global economy (see Milanovic, 2005). There is also some empirical evidence to suggest that divergence may have been caused by greater interaction between the North and the South (see, for instance, Dutt and Mukhopadhyay, 2005, Baddeley, 2006)

**2.4 Growth in parts of the South**

This discussion of the Northern engine of growth and the problems associated with it in terms of the failure of convergence of the South as a whole is not to imply that it is impossible for some parts of the South to embark on long-run sustained growth. The dependent nature of Southern development – and the problems connected with declining terms of trade imply that there are structural difficulties of the entire South to grow faster than the North, and that uneven North-South development is likely given the structure of North-South interaction, not that some Southern countries cannot break free of this dependence and experience rapid growth by changing their production structures.[8] Clearly, the East Asian economies – South Korea, Taiwan, Hong Kong and Singapore, which were called newly-industrializing countries (which were dubbed the NICs) – did experience rapid growth and transformation. Especially if the relevant Southern countries are relatively small and therefore have a small share as suppliers in the market for Southern goods, growth in these countries does not necessarily imply a significant decline in their terms of trade, and by saving, investing and inducing technological change, these countries can embark on development paths. It is beyond the scope of this paper to analyze the reasons for this (although see section 4 for further comments on this), but it is now generally agreed that in the larger countries a great deal of state intervention – through the spread of education, directed credits, import protection and government support for technological capability creation and even the creation of state-owned enterprises – was involved (see Amsden, 2001, among many others).

Moreover, it was not simply that these countries opted for outward looking policies rather than import-substituting ones that were adopted by the countries that did not prosper, as argued by Reidel (1984) and a whole slew of neoclassical economists and the proponents of the so-called Washington Consensus who strongly support trade liberalization. The argument is

based on gains from trade proposition of standard trade theory, cross country regressions purporting to show that export growth and trade openness result in higher growth, and case studies of a variety of countries. While it is beyond the scope of this paper to provide a full discussion of the issues raised in these contributions, a major failing of the approach is that it does not take into account the possibility of learning by doing and spinoff effects in the imported goods sector which can then – in countries where protection is accompanied by pressures to improve productivity – increase exports. Improvements in productivity and improvements in products can then lead to a growth in exports. The growth in exports then allows an improvement in the foreign exchange position of countries, and allows them to liberalize some imports, so that imports increase. So while it seems that greater trade openness increases growth in these countries, greater trade openness may be the result of export growth induced by strategic import substitution in some industries which experience learning by doing. Studies of the problems with import substitution do not distinguish between the nature of import restrictions – haphazard and intent on reducing imports to save foreign exchange by indiscriminately allowing protection to spread with the goal of self-reliance – and the ability to provide protection and to demand and obtain increases in technology through learning. The findings, because of many cases of import substitution that did not generate quick results, tend to understate the possible benefits of import substituting industrialization.

Conditions in the NICs could not be replicated in many places, although other countries used similar policy packages of state intervention with import substitution and attempts at export promotion. In hindsight it appears that the political economy situation of other countries, did not allow the developmental state to function effectively. As Evans (1995) has argued, in the NICs the state had embedded autonomy. The state was in a relationship with different groups in society which allowed them to work closely with these groups without being "captured" by them, for example to be able to offer business groups the kind of assistance they needed, while insisting on the quid pro quo of their delivering improvements in production efficiency and skill and technology acquisition and export growth. By contrast, other countries were not able to do the same, being overly dependent on the support of different elite and

dominant groups and, perhaps as a result, overzealous to indiscriminately regulate and control the economy.[9]

One can inquire, moreover, what the arguably dependant nature of the South in the global economy implies for the consequence of the growth of a few NICs for the rest of the South. Does it mean that the rest will follow in the footsteps of the NICs, or that the growth of the NICs makes it harder for them to embark on the path to development? An argument which states that there will be a sequence of countries which will take off argues that development in the NICs will raise their wages and induce capital and production to go to other Southern countries where the wage is low, and increase manufacturing production there (see Mainwaring, 1991). However, an opposing argument suggests that if the NICs are able to displace the rest of the South in Northern and world markets, they may make it more difficult for the rest of the South to catch up. Which of these two cases in more likely depends, among other things, whether wages actually rise in the fast-growing Southern countries, on what kinds of goods the NICs export – do they compete more with Northern goods or with Southern goods – and the possibilities of the transfer of production to the rest of the South due to technology transfers from the NICs.

**2.5 Relation to other approaches to international trade**

So far we have examined some major features of North-South interaction and related them to the analytical results of North-South models to examine the mechanisms behind the nature of the interaction. These models are eclectic in that they borrow from a variety of traditions and approaches to capture some features of North-South interaction and the structure of Northern and Southern economies. It is therefore also instructive to relate this discussion to some well-known analytical approaches to international trade and capital flows.

Traditional neoclassical trade theory assumes that the structures of all economies is similar in that constant returns to scale and perfect competition prevail in all sectors and with complete price flexibility, all factors are fully utilized. The Heckscher-Ohlin-Samuelson and other related approaches which assume that factors are immobile internationally typically emphasize the gains from trade between countries due to specialization according to comparative advantage, that is, with rich countries specializing in capital-intensive or skill-

intensive goods and poor countries in labor-intensive or less skill-intensive good, given the abundance of capital and skilled labor in the North and that of labor, especially low-skilled labor in the South. While these models typically emphasize the gains from trade and benefits of trade liberalization, with some additional assumptions they are not inconsistent with some of the results we have emphasized in the preceding discussion. First, with a higher income elasticity of the good exported by the North than the one exported by the South, the approach implies a deterioration of the Southern terms of trade and with this affecting the patterns of factor accumulation with divergent growth patterns (Findlay, 1981). Second, if it is assumed that returns to factors affect their rates of accumulation, trade liberalization can lead to divergent growth patterns: for instance, if it increases the rental rate on capital in the North and reduces it in the South, or raises the skill-premium in the North and reduces it in the South, it will speed up physical and human capital accumulation in the North and reduce it in the South (see, for instance, Stokey, 1991). Third, if the models introduce a variety of "distortions" into them, even the gains from trade are not guaranteed. Thus, if positive production externalities are present in sectors in which the North specializes but are absent in the sectors in which the South specializes, the North can gain from trade while the South may lose.[10] The results are similar to those in which there is uneven development due to induced technological change in the Northern good. Thus, despite the strong assumptions made in mainstream trade theory of perfect competition and full employment, many of the results of other models in terms of uneven development patterns can be reproduced in them.

New trade theories which emerged in the late 1970s and 1980s focused on intra-industry trade, in which trading partners traded products from the same industry with each other (see, for instance, Krugman, 1979, Lancaster, 1980). The assumptions of mainstream trade theory of constant returns to scale, a homogeneous product in each industry and perfect competition were changed to allow for increasing returns to scale, product differentiation and various forms of imperfect competition. These differences explain trade between countries which are very similar in terms of factor endowments and technology, and provide some new arguments for trade liberalization, that is, the gains from benefiting from production at a larger scale and gains due to increasing product variety for consumers and for producers (in the case

of intermediate goods). This approach was initially applied to understand North-North trade, while traditional mainstream trade theory was considered to be relevant for most of North-South trade; nevertheless, the South could benefit from greater intra-industry North-North trade by having access to cheaper Northern goods produced with lower costs and from the availability of a greater variety of consumer goods. With the graduation of many Southern economies to the production of manufactured goods, intra-industry trade has become relevant for the South as well. If we use new trade theory models to analyze at some North-South trade, these models can imply that the South can benefit due to specialization and increasing returns, but this is if they are able to compete with Northern producers. If they cannot, these theories imply that they can from trade restrictions, by imposing trading restrictions to reduce imports, reap the advantages of scale economies by increasing production, and then exporting the same goods (see Krugman, 1984). The result is similar to the models of more than one sector discussed earlier in which trade can slow down technological change in the South by making it reduce the production of skill-intensive goods.

Dependency and structuralist approaches (see Palma, 2008a, 2008b), which did not normally use formal models, emphasized the implications of the expansion of trade and other kinds of interaction between the North and South given the asymmetric structures of the North and South and the nature of North-South relations. They argued that due to a variety of mechanisms the South was condemned to remain in its underdeveloped status. The mechanisms include Southern specialization in primary products and simple manufactured goods which prevent it from experiencing technological improvements, low income elasticities of demand, and surplus transfers by transnational corporations in the form of profits without compensating benefits to the South in the form of linkages due to the enclave nature of foreign-owned sectors. Although some structuralist and other analysts saw import-substituting industrialization under state supervision as a way out of this dependent underdeveloped status, many others argued that such an escape was not possible, and even saw the rise of the NICs as a case of dependent and unsustainable development. While our account is quite consistent with the development of the NICs, the analytical structure we have outlined earlier takes into account many of the problems that have been emphasized by the dependency and structuralist

writers – in fact many of the North-South models were developed to formalize some of these mechanisms to point out the difficulties of breaking out of uneven development patterns.[11]

The flying geese approach to development, was developed by the Japanese economist Akamatsu (1961) to explain the growth of late developers like Japan and which spread to other neighboring the NICs, and then to other countries. According to this approach, the Japanese economy was argued to develop by first importing simple Northern consumer goods, then building the capacity to produce these goods domestically with government support, then learning to produce these better and exporting them, then switching to a similar sequence for more technologically sophisticated capital goods. After Japan developed in this manner, its wage increased, and Japanese firms found it profitable to shift production of simpler goods to neighboring Southern economies with lower wages, bringing in capital and technology. As the technological capability of these countries improved these countries also graduated to other more sophisticated goods, then spreading production to a third tier of Southern countries, and so on, while the earlier developers switched production to increasingly more technologically-sophisticated goods. This approach has some similarities with the product-life-cycle approach (see Vernon, 1966) which, however, focuses more on products rather than the spread of development to countries, and emphasizes the role of standardization of products which allows the South to produce older goods at low wages which is not possible during the period of the pioneering stage of production development. Some Japanese scholars have used the flying geese approach as a paradigm for North-South interaction as a whole, thinking of different Northern countries as the leading goose, which can bring along a larger flock provided they follow the Japanese pattern of foreign investment which promotes trade by allowing the exports of more sophisticated goods to next tier, and importing less sophisticated goods from them, rather than making foreign direct invest substitute for trade by taking over Southern markets (see Kojima, 2000). This approach provides some support to the view that development can spread from newly-emerging Southern countries to other countries of the South mentioned earlier. Some contributors to the approach also argued that it was possible for there to be a boomerang effect in which more recent developers could export advanced

goods to the early developers, which could explain the dynamics of the rise and fall of economic powers (Shinohara, 1996).

The last approach we will mention is the global or international production networks or the global value chains approach, in which trade occurs mainly – though not necessarily only - within firms, but in which components of final goods are produced at a variety of locations, so that it is impossible to identify a good with a particular country or region. This approach involves the recognition of an important empirical feature of trade, rather than an analytical framework,[12] let alone a theoretical model. How taking into account production networks affects the implications of North-South trade and possibilities of Southern development is not very clear, however. It can be argued that the incorporation of Southern countries into production networks is beneficial for their development because it allows them to become more involved in the production of technologically sophisticated goods, increase their export capabilities by obtaining foreign markets for their components, and increasing employment. However, it can also be argued that they may deny Southern countries the benefits of skill acquisition because they are involved in the assembly of inputs rather than producing technologically more sophisticated products, because they increase imports as well as exports and therefore do not have a significant effect on foreign exchange receipts, and because they result in few spillovers to other sectors since they are more tied to the outside world. Recognition of the importance of production networks has led to the criticism of aspects of the flying geese theory on the grounds that unlike some of the earlier tier NICs, later participants in the process failed to benefit from technological development because they were confined to low-technology intensive assembly of seemingly technology intensive products (see Bernard and Ravenhill, 1995).

**3. The North as an engine of global growth and development**

Whatever we think of the need for or the efficacy of the North as an engine of global growth, it seems that it is not in a position to play that role. The countries of the North are experiencing very poor growth to say the least and it seems to many that it is unlikely that they will be able to reverse this in the foreseeable future.

### 3.1 Northern growth

The growth performance of the Northern economies has been poor since the financial and economic crisis of 2007-08, and recovery from it seems to be anemic to say the least. Growth rates of real per capital GDP of some of the main Northern economies are shown in Table 1 and in Figure 1. Although the growth rate of high income countries in the early 2000s was hardly respectable, most of them suffered large setbacks in 2008, and all suffered a huge setback in 2009 during the crisis of 2008-09. Except for Germany and Japan, recovery in all has been quite anemic. For all high-income countries the average growth for the entire 11-year period was 1.1 per cent, and for the high-income OECD group the average was 1.09 per cent. It can also be seen from Table 2 and Figure 2 the growth of high-income countries (HICs) as a whole has been lower than the growth of not only the large Southern countries like China and India, but also the group of low-income countries called the Least Developed Countries (LDCs).

Given the high rates of unemployment of labor and existence of excess capacity in these countries, it is instructive to at least briefly examine the problems afflicting these economies by commenting on the components of aggregate demand, rather than by focusing on supply-side factors such as total factor productivity and its determinants. Regarding consumption expenditure, while in some countries, as in the US, consumption demand was kept high in earlier years by what has been called increases in conspicuous consumption and luxury fever, especially among higher income groups who were also experiencing wealth increases due to an increase in the price of financial assets and real estate, and by increases in consumer borrowing, this proved to be unsustainable after the fall in asset prices and the increase in consumer indebtedness. Given this, as well as consumer expectations, a recovery in the growth of consumption expenditure seems unlikely. Investment demand is low level because of the continued weakness of the financial system and because of the generally low level of effective demand which keeps profits and capacity utilization at low levels. Increases in government expenditure and tax cuts, especially for the rich, have also increased government deficits and the debt, which is now making it more difficult to increase government spending to maintain aggregate demand even in the US which tried to do so. Fears of burgeoning government debt in the US (especially foreign debt) and some countries of Europe and of inflation in Europe

(especially Germany which sets the tone for monetary policy in European Union), together with political antipathy towards government intervention especially in the US and the lack of support by Europe as a hole to support countries with high government debt are likely to prevent expansionary government policy. Finally, except for some countries like Germany, the way out by increasing net exports has been closed because of the slow growth in partner countries and the high level of trade surpluses of countries like China due to technological change and favorable exchange rates. All this suggests that aggregate demand growth, and hence output growth, is likely to be low in at least the near future.

Even if the North could actually increase its aggregate demand to increase its rate of growth, it would arguably be difficult for it to overcome the structural problems caused by the spread of technology to parts of the global South. This is illustrated by the rise of China's trade surplus with the US. Even if other elements of aggregate demand can be increased, this issue is likely to remain a problem, which is likely to lead to bigger current account surpluses for parts of the global South and deficits in the North due to increasing competitiveness in many lines of production. The flying geese or product life cycle approach requires the North to keep developing new types of goods in which it can maintain its competitive edge at least for some time. However, as noted in the previous section, proponents of the flying geese theory pointed out the possibility of the boomerang effect which could depress Northern growth due to imports from the growing parts of the South. Attempts to increase the time during which they can maintain their edge are suggested by increasing Northern pressures to impose intellectual property right protection around the world. However, it is not clear how indefinitely the North can develop new products and new technologies. Efforts by the US to foster the development of green technology, including that in the automotive sector, suggest that this problem is realized by policy makers. However, the problems the US faces due to failed efforts and the deep distrust of government involvement in research and development and industrial policy, point to the challenges of proceeding in this direction. Growing trade deficits can be offset for a while by the holding of dollars and dollar-denominated US securities by surplus countries, as is shown by the willingness of China and other countries to lend to the US, but there is always the problem of the dollar not remaining the favored currency to hold because of its status as

the international currency. Although the Euro does not seem to be immediately placed to emerge as a competitor soon in view of the problems afflicting some of the countries in the Euro zone on account of their international indebtedness, there is no guarantee that the dollar's position will not be challenged in the future, undermining the ability of the US to run large current account deficits, thereby constraining US growth.

**3.2 The desirability of Northern growth**

Even if the North is able to overcome these problems of aggregate demand growth and international indebtedness due to declining competitiveness, it is not clear that it is desirable for the North to continue to grow as in the past.

One obvious problem is the environmental one. Despite the faith that many place in the so-called environmental Kuznets curve which posits an inverse-U-shaped relationship between per capita income and environmental degradation, it is arguable that many aspects of the environment – such as carbon emissions - continue to be adversely affect by continued increases in per capita income in rich countries and, moreover, some of the improvements may have been due to the movement of "dirty" production to the countries of the South (see, for instance, Dinda, 2004, for a review of the literature). Moreover, the debate on global warming in the US suggests that it is not at all clear that environmental regulations will be maintained in ways to curb pollution.

Moreover, despite significant increases in income and consumption in the North, there has been very little improvement in wellbeing by a number of measures. Measures in terms of subjective wellbeing (SWB) suggest that inhabitants of the North show very little improvement in happiness despite the increases in real income and consumption. For both the US and Japan the time series of per capita income and consumption show significant increases while the percentage of people who claim to be very happy show no upward trend (see Layard, 2005). While at low levels of income, increases in income do in fact increase levels of subjective wellbeing, even some cross-country evidence suggests that beyond a certain level of income no further increases in subjective well-being results from further increases in income. The need for continuously increasing per capital income in countries where income is already at a high level can therefore be called into question. The finding that at a point in time in rich countries

individuals with higher levels of income report higher levels of SWB arguably has to do with SWB being related strongly to relative income and not so much to absolute income, at least beyond the point, so that over time, as the average absolute income rises, SWB does not rise significantly in rich countries (Frank, 1999). In terms of more objective indicators of wellbeing, whether in terms of clinical measures or in terms of measures of functionings and capabilities (see Sen, 1999), gains in wellbeing seem to be small or negligible in rich countries when income increases (Inglehart, 1996).

It may still be argued that economic growth in rich countries is good for other reasons, such as their ability to more equitably and fairly share the fruits of their growth. Friedman (2005) has argued that people are more generous when helping the poor and less discriminatory against other ethnic groups, and even towards other countries, when the economy is growing more rapidly than when the economy is stagnating. This relationship is empirically valid in many cases. However, it does not imply that when rich countries are growing faster they will necessarily support policies which distribute the benefits of growth more widely. In the US, for instance, buoyant growth before the recession occurred with increasing inequality as the rich obtained an increasing share of the income, with larger tax breaks for the wealthy. Nor does it imply that when countries achieve high levels of income, it is not unlikely for people to support egalitarian policies which help to reduce poverty and inequality in their own countries and spend more on public goods, making some sacrifices in private luxury consumption for the common good, especially if they find that it improves the quality of their own lives by reducing stress, increasing their leisure time and reducing their negative impact on the environment.

**4. The rising South**

Some countries of the global South have grown at a high rate and have weathered the recent economic crisis much better than countries of the North. As is well known, China's growth has been rapid for several decades, and several other countries in the South, including India, Brazil and some other countries, as well as transitional economies like the Russian Federation, seem to be catching up to the North in terms of income and production, especially after the recent

economic crisis. This section will examine the growth performance of the emerging Southern economies in comparative perspective, comment on some features of their development performance, examine some of their common features, and discuss whether they are in a position to serve as an engine of growth.

**4.1 Growth in the rising South**

As shown in Table 2 and Figure 2 the rates of growth of China, India and the Russian Federation have been impressive in the new millennium with average growths in excess of 5 per cent. Although Brazil has not done as well, it too has had a respectable growth rate since 2007 if one excludes the negative growth year of 2009. All these countries have grown at considerably faster rate than the world as a whole and especially the high-income countries, implying that they have all been narrowing the gap between themselves and the rich countries. Except for Brazil they have on average grown faster than the least-developed countries (LDCs) according to the UN classification, in all but the recession years (see Figure 2 and Table 2). It is not very surprising that they have come to be called the BRICs, following Goldman Sachs's usage of the term,[13] making them sound like successors to the NICs.

**4.2 Some features of the development of the BICs**

Table 3 shows Russia's per capita income in PPP dollars in 2010, at $19,840, was 1.77 times the world average, and those of Brazil, China and India were roughly at or well below the world average. This, and Russia's special status as a major oil producer, puts it at a separate category, induces us to concentrate on the BICs.

Figure 3 decomposes the rate of growth of the BICs in terms of the contribution of private consumption, investment, government consumption, and net exports, all divided by the GDP deflator, where the contribution of, for instance, consumption to growth is measured by the share of consumption in GDP multiplied by the growth rate of consumption. The contribution of a component is greater the greater its share in GDP for a year and the greater its real rate of growth, Since all of the data is not available, investment refers to both private and government capital formation.

The figure shows that consumption has been a major contributor to growth in Brazil and India, and the contribution in Brazil has been rising. Although for China the contribution of

consumption is not low in absolute terms, its share in terms of the contribution it makes to overall growth is low. In several years the contribution of consumption to growth in China is about the same or lower than in Brazil since 2005, despite China's high overall rate of growth. For China and India the contribution of investment is high, and less so in Brazil. For government consumption, except for some negative years in Brazil, the contribution has stayed positive for the three countries, rising somewhat in India and in Brazil in recent years. For net exports, it is generally negative for Brazil and India, and positive for China. However, for China the contribution of net exports has been negative in some years and that of consumption has increased. It is possible to conclude that while for China, the growth of aggregate has been heavily investment driven, more balanced in India, and increasingly consumption-driven in Brazil, with a fluctuating contribution of investment.

Turning next to saving, investment and capital formation, Table 4 shows gross capital formation or investment, domestic saving, and gross fixed capital formation, all as ratios of GDP for the three countries during the last decade. On this count Brazil's performance has been comparatively weak, with these rates generally staying below 20 per cent. India's saving and investment rates have increased to over 30 per cent, and fixed capital formation is generally in excess of 30 per cent. Private investment in both Brazil and India as a ratio of GDP have increased, although full data is not available for Brazil, but India's rate is higher and has increased more. The big difference in investment rates is the higher public fixed investment rate in India. China's rates are astonishingly high, with saving rates in excess of 50 per cent and gross fixed capital formation in excess of 45 per cent. What is particularly noteworthy about fixed capital formation is the very high rate of public investment, which reached close to 30 per cent of GDP in 2003 and 2004. Although this has fallen, it is still above the 20 per cent mark, while private investment has increased steadily, contributing to more than half of total gross fixed capital formation.

It should not be thought that, despite the fact that net exports has a low and sometimes negative contribution to the growth of aggregate demand, foreign trade does not contribute to growth in Brazil and India. Foreign trade exposure may well contribute to increasing production efficiency and increase export competitiveness in all these countries. Moreover, when exports

increase and the foreign exchange position improved, they are able to increase their aggregate demand at a faster rate and grow faster. Table 5 shows some external data for the three countries. For Brazil, net exports as a percentage of GDP has generally been positive, but the current account balance as a percentage of GDP has been more negative than positive. For China both net exports and the current account balance, as ratios of GDP, have been consistently positive and usually at high levels. For India, the level of net exports has been consistently negative, generally around the 3 per cent level in recent years, though rising above 5 per cent in the recession years. The current account deficit has been held down especially by foreign remittances. The reserve to foreign debt ratio now exceeds 5 for China, while it is below 1 for Brazil and just over 1 one for India. Total trade as a percentage of GDP is well less than 30 in Brazil, but much higher in China and India. For China it remained higher than 50 for most of the 2000s, and even reached above 70 before the recession. For India it has increased considerably over the period, exceeding 50 in one of the crisis years. In sum, while China's external balance position is comfortable, Brazil and India's trade balance and current account positions, and especially reserve positions, are much less so. India's position seems a little more problematic because of the high level of trade dependence.

Finally, there are interesting trends in personal and regional income inequality in the three countries. For India, according to a number of indicators income inequality is increasing. Banerjee and Piketty (2007) use tax return data to show that from 1990, when India's liberalization program gathered steam, the share of income going to the top .01 per cent of the population increased rapidly, after falling fairly steady from 1947 to the early 1980s, and roughly the similar trends are seen for the top .1 per cent and the top 1 per cent. During the 1990s the Gini coefficient for consumption expenditure increased for both rural and urban areas and for the country as a whole (see Sen, 2000). More recent evidence suggests that wage inequality is also rising: the top 10% of wage earners in 2011 make 12 times more than the bottom 10%, up from a ratio of six in the 1990s. Among the large developing countries only Brazil and Indonesia have experienced a decline in their Gini coefficients, but for Brazil this is from a very high level, from over .6 to .55 from the early 1990s to the late 2010s. For China it increased from .32 to over .4 and in India from .32 to .38 (OECD, 2011). Interstate income

inequality has also been increasing in India since 1980 and has continued after 1990, and China has been experiencing regional divergence after 1990, as has Brazil (see Shankar and Shah, 2003, Bhattacharya and Sakthivel, 2004, Candelaria, Daly and Hale, 2010).

**4.3 Some common characteristics of the BICs**

It can be argued that despite these differences in the development experience of the BICs, they have some features in common. Two in particular deserve comment, their large size, and the role of the government that their governments have in the economy.

First, these countries are large in terms of population size. China and India, of course, are the two largest countries in terms of population, by far, the only countries having more than a billion people each. In 2010 China had a population of 1.34 billion and India 1.17 billion. Brazil had 195 million (and Russia 142 million). These are among the largest countries in the world in terms of population, ranking first, second, fifth (and eighth) in the world. It is legitimate to ask whether country size has something to do with growth performance and, if so, why. While there is no clear relation between the size of a country and its growth performance, Alesina et. al. (2006) report that larger size – including size in terms of population or GDP – allows countries to grow more rapidly, controlling from trade openness as measured by the ratio of total trade (exports plus imports) to GDP.

There has been some discussion by economists of why the size of a country in terms of population may have an effect on the growth rate. Early ideas were based on Kuznet's (1960) conjecture that larger populations make it more likely that countries will experience a share rate of technological change. The Kuznets hypothesis is based on the assumptions that the number of geniuses in a group will bear a fixed proportion of the total population of that group, that technological change occurs due to the existence of geniuses, that the pace of technological change will be more rapid the greater the absolute number of geniuses and, finally, that faster technological change is associated with a faster rate of economic growth. There are many points in which the argument can be questioned, both for larger countries being more likely to experience a higher growth rate and for smaller countries not enjoying it. Regarding the former, whether or not people are geniuses, whatever that means, is not likely to be purely genetic and independent of economic factors such as education, and it open to

serious question whether innovative activity is the result of the supply of geniuses rather than the economic need for innovation. Moreover, more rapid technological change can lead to greater unemployment rather than a higher rate of growth if there are unemployed resources due to the lack of demand or because of the scarce supply of inputs whose productivity does not rise. Regarding the latter, it is possible that small countries can obtain technology from outside it. Whatever the merits of these arguments, however, the argument has a ring of plausibility in the sense that more people increase the possibility of more development-inducing activities being performed by some people which can have generalized effects and induce growth.

More recently the emphasis in the neoclassical literature has shifted to arguments involving scale economies of some sort, which actually is an old theme from Adam Smith that argues that the division of labor is limited by the extent of the market. The idea has been formalized with models which assume that a greater variety of inputs increases the production of final goods (Romer, 1990), or with standard scale economies (Murphy, Shleifer and Vishny, 1989), or with the use of learning functions which make the rate of learning depend on the stock of such things as cumulative investment or capital (Romer, 1986).[14] All of this analysis, however is based on the assumption that labor is fully employed, and output and growth is determined by the effective supply of labor (in efficiency units), which is arguably of little relevance in economies with large reserves of surplus labor and underemployment for which aggregate demand considerations are more relevant.

Approaches which emphasize the role of aggregate demand may also have an effect on the size of markets, irrespective of scale economies and learning effects. In these approaches, technological change can increase the rate of growth of the economy, not by increasing the effective supply of labor but rather, by directly providing an impetus to investment demand (see Dutt, 1990), by increasing profitability, and by increasing efficiency and external competitiveness and boosting exports (as in Kaldor, 1966) . Three observations can be made about the relationship between population size and aggregate demand. First, the size of population is not all that is relevant, since what is important is a high level of aggregate demand which requires high levels of income as well as population. However, given a particular level of

income, a large population obviously implies larger markets and, moreover, some goods are of the type that each person or family buys one at least at a time, and for these goods population size is important as long as most people can afford to buy the good. Second, high levels of population do not imply large markets for individual firms if there are high transportation costs and communication barriers within a country, which is why improvements in transportation and communication can also increase aggregate demand and investment by particular firms. Third, increasing returns to scale or even technological change are not necessary for large countries to have a higher rate of growth as long as larger size of the market provides a stronger incentive for investment, unlike what is the case with supply-side explanations. However, scale economies and learning effects can also promote higher growth by reducing costs and increasing profitability even in domestic markets (although problems may emerge if this reduces the wage share and reduces market size in what are called wage-led growth regimes) and in export markets, as noted earlier.

It can be argued that the mechanisms regarding country size are relevant only for closed economies. As noted earlier, the empirical results about the importance of size on growth are valid only after controlling for the openness of economies. The theoretical model presented by Alesina et al (2005) shows that a reduction in trade barriers, by increasing trade, reduces the importance of country size in positively affecting the steady state level of income of a country and its growth rate from an initial level of income. It may seem that the small size of domestic markets can be offset by being able to find foreign markets and that this can be achieved by greater openness. Greater openness results from more imports and exports as a share of GDP, and the conclusion drawn from these studies is that trade liberalization is good for growth because it removes the bias against exports due to import restrictions. There are reasons to believe that import restrictions can have an effect on restricting exports, for instance by raising the price of imported intermediate inputs, and by breeding inefficiencies in production, both of which reduce the competiveness of exports. However, the approach also assumes the full employment of resources, that the economy can export any amount it wants to at a given price (the small country assumption) and balanced trade. Under these assumptions the restriction of imports has the effect of reducing imports due to trade restrictions and *automatically* reducing

exports because fully employed resources are transferred from exportable to importable production. There are many problems with this framework as discussed earlier, in section 2.4, and need not be repeated here. Moreover, in addition to explicit trade policy barriers, there may be other reasons why trade (and capital flows) between countries may be restricted by factors such as exchange rate movements, language, lack of information, and difficulties of enforcing contracts, etc. (Helliwell, 1998). These considerations imply that largeness has the advantage that it allows import substituting industrialization because of larger domestic market. Large markets can support large firms to make use of scale economies (allowing even sufficient domestic competition by having several domestic firms) and generally provide stronger investment incentives, even for capital goods producing sectors.

The presence of scale economies in the provision of goods with public goods properties can also have the result of making larger countries experience more rapid growth. There is some evidence that the share of government spending in GDP declines with population (see Alesina and Wacziarg, 1998), which seems to confirm this. Another mechanism is that, if negative shocks which affect different parts of large countries are uncorrelated, these countries are more likely to be able to weather problems caused by these shocks, for instance due to natural factors such as weather conditions or because they specialize in the production of goods for which demand falls, with interregional resource transfers, than smaller countries

Another feature of large countries is that they may be in a better position to benefit from negotiations with other countries and foreign investors. The structure of some international organizations makes it easier to obtain more favorable treatment because of size. For instance, a large country in terms of economic size which is partly the result of population size may place them in a better position in terms of disputes vis-a-vis other countries in the WTO, given the dispute settlement mechanism in that organization relies on bilateral retaliation.[15] Regarding foreign direct investment by transnational corporations, large countries – sometimes just because of their large size and hence markets – are more attractive to foreign direct investors, other things constant. Given this, as suggested by the experiences of China, they are likely to get better terms in their bargains with transnational corporations, for instance, in terms of tax treatment and technology transfer agreements. This advantage is

not guaranteed, however, because national governments may not be capable of bargaining effectively with transnational corporations, especially if the latter bargain with different state governments to get the best deal possible (as, for instance happens in the US). But it can be argued large developing countries of the South can more easily find suitable ways of exercising their greater bargaining power not only to obtain more foreign direct investment, but at terms which translate into improved growth performance than smaller ones.

This is not to say that there are no costs of large size. Larger countries may be more difficult to administer effectively. Larger countries are also likely to be more heterogeneous, in terms of ethnic and linguistic differences for instance, and there is some evidence to suggest that ethnolinguistic fractionalization negatively affects economic performance (see Easterly and Levine, 1997) and also causes political unrest and possibly civil conflict which is bad for growth (Collier and Hoeffler, 1998). Moreover, the large size of a country can be argued to make it more difficult to effectively employ suitable government policies to promote growth and development. In larger countries there are likely to be fewer relationships that are based on common backgrounds and personal knowledge, making it difficult for the government to agree on development priorities, obtain adequate information and ensure compliance with policy initiatives. Some of the advantages that relative smallness brings in terms of governance and political economy have been highlighted in explanations of the development of relatively smaller countries like South Korea where, for instance, many civil servants and business leaders had the shared experience of going to the same university. However, it is possible that such personal relationships can result in unproductive forms of clientelism which are not as conducive to development as other less personalized relationships. Moreover, some of the disadvantages of governance from large size can be overcome with appropriate forms of decentralization in governance, although this is by no means a panacea.[16] Finally, there are many small countries – for instance, those in Africa - with ethnic and tribal divisions.

It is worth noting that in an earlier period the countries of the South that experienced dramatic growth were smaller countries in terms of size. But in these cases special reasons were present. Some were not too small: South Korea in the early 1970s had over 30 million people. Others obtained help in terms of foreign capital and market access, given their

geopolitical significance (see Wade, 1992). A relatively small economy is more likely to obtain market access in the North because of the smaller dislocating effects on employment in the North. Of course, such situations do not always lead to development; other special conditions also need to be present, as discussed in section 2.4 above. Thus smallness is consistent with development only under some special circumstances.

A second feature of these economies is that they have past experience with active state intervention in the economy, and continue to have extended government intervention. A recent special report in *The Economist* (2012) discusses the strong role of the state in the newly-emerging countries of the world, focusing on Brazil, China and Russia. The report leaves out India, although recognizing that there too the state has a major role, reflected by the fact that it has some of the world's largest state-owned enterprises.[17] *The Economist*, as one would expect from their neoliberal stance, argues that this rise of state capitalism is a problem because the world trading system become unfair in consequence.[18] The report notes correctly that these are not quite the dirigiste systems of old which seemed to shun free markets, as in the Soviet Union (for much of its life), China and India, but where the state is "learning to use the market to promote political ends", and they could have added economic ends too. To its credit the report points out that this type of state capitalism is not new, recognizing that "In reality every rising power has relied on the state to kickstart growth or at least to protect fragile industries." They include Britain, much of continental Europe, Singapore, and could have also included the United States and Japan, as well as the East Asian NICs other than Hong Kong (see Chang, 2002).

The new Southern economic model involves the rise of large state-owned enterprises, especially in oil and banking. These enterprises enjoy a certain degree of autonomy (arguably making them less bureaucratized and politicized like some SOEs of the past), although the state exercises control through the ownership of shares, which give the state effective control even as minority shareholders, they are more productive, they have activities abroad, in many cases actively seeking out sources of resources. The state also has close links with private companies in key sectors such as computer and information technology sectors. Governments have developed and managed sovereign wealth funds, some of which actively seek out development

projects in other countries as well as at home, especially in research and high-tech sectors and in infrastructure development at home and abroad, especially in transport and communications. Like some of the NICs, these countries, provide help to many private industries in the form of credit, technology, and import protection, as they have done in the past.

This strong presence of the state is in contradiction with the popular view among neoliberal economists and policymakers that the success of both China and India has been due to liberalizing reforms. Although there is some truth in this, it is more accurate to call the changes that have taken place measured liberalization in a strategic way. The excess of the old license raj in the form of a byzantine licensing system have been considerably reduced, as also the mentality that the country has to be self-sufficient in everything. Policies which dislodged transnational corporations with adverse effects on technology development for India have been reversed. Yet, the state continues to have a major role in both China and India, for instance through public investment, control over the banking system and through restrictions on trade and especially international capital movements. While the earlier strongly dirigiste policies in these countries created inefficiencies, they also provided the basis for developing an industrial and technological base which is now beginning to bear fruit. Neoliberal-minded policymakers in these countries need to carefully assess the costs and benefits of further liberalization keeping these considerations in mind.

**4.4 Engines of growth?**

Can the emerging economies of the South assume the role of engines of growth for the South as a whole? While there are some trends that suggest that this is possible, on balance it appears that apart from China it may be premature to answer definitively in the affirmative.

The main trend, of course, is the impressive growth rate of some of the emerging economies, as described in section 4.1.

Furthermore, this has occurred despite the continued poor performance of the North which, because of its sheer weight and its effect on the rest of the world especially through trade links, has had a dampening effect on the growth rate of GDP per capita in the world as a whole. Econometric time-series analysis suggests that growth in parts of the South has become

less dependent on growth in the North. Hoffmaister, Pradhan and Saimei (1998) use an error-correction model with data from 1967 to 1993 to show that the growth in the North and the South Granger-cause each other. More interestingly for our discussion, if one distinguishes between the North, Asia and the rest of the South, the impact of Northern growth on Asian growth after 1988 seems to have diminished, although this has not happened for the rest of the South. Despite the fact that the two groups of the South in this study are not the same as our groupings – since some non-Asian countries in the South are included in the emerging South, and Korea is included in Asia and it is now not typically considered part of the South – and the shortcomings of causality analysis based on annual time series data, this evidence is suggestive. It would be of interest to conduct the analysis with more recent data and with country groupings more consistent with our discussion to examine whether the emerging South is indeed less dependent on Northern growth and if growth in the rest of the South relies more on these emerging Southern economies and less on Northern growth than in earlier times.

Finally, there is reason to believe that some of the emerging Southern economies no longer fit the pattern assumed in the earlier North-South approach in which the South depended on Northern capital goods for most of its investment needs and where Southern growth, overall, was constrained by the availability of foreign exchange received by exporting to the North. First, while many Southern countries have diversified their production structures away from primary production and simple manufactured goods, some have in fact developed domestic investment goods sectors and are able to produce some proportion of their capital goods domestically. Lewis (1980) noted thirty years ago that already there were a number of countries in countries called the global South, including India, Brazil, Chile, Mexico and South Korea, which were significant producers of capital goods, that is, for which production of capital goods exceeded 15 per cent of their manufactured output. For several countries these ratios have increased, although not necessarily for all, especially in those countries of Latin America where trade liberalization has shifted production towards resource-oriented sectors. Second, due to increases in foreign capital flows due in part to capital-market and financial liberalization in the South as well as impressive growth performance in these countries, these Southern countries are not restricted by the amount of foreign exchange at their disposal or constrained

by the supply of saving. In fact, as we have discussed before, their growth process can be examined in terms of aggregate demand. This is not to say that they foreign exchange constraints are irrelevant for them. However, given that some countries, especially China, has large reserves of foreign currency and foreign liabilities denominated in the dollar, and others have access to private foreign capital inflows, they have more room to maneuver than countries for which the so-called foreign exchange gap is binding in the short run.

However, these trends also raise some doubts about the sustainability of the ability of the emerging South to grow at a high rate despite the slowdown of the North.

First, the high growth rate in some of the emerging southern economies has been helped by capital inflows from the North. These flows increased partly because of low growth and low profitability in the North and because of expansionary monetary policy and low interest rates in the North to deal with these problems, which made Northern investors seek foreign countries in which to seek higher returns (see Akyuz, 2012). Such flows not only came to the emerging South but to other Southern countries as well, and were supplemented by foreign investment from China, in large part from accumulated currency reserves resulting from trade surpluses. The problem on relying on this form of growth is that the outflows depend not only on interest rates in the North, but also on the growth of net wealth in the North looking for profitable outlets for lending. It is possible that continued slow growth in the North can reduce this availability of financial wealth looking for investment outlets, and this can result in reverse flow of capital, even rapid withdrawals resulting in foreign exchange and financial crises in Southern economies, especially if capital inflows lead to complacency and capital account liberalization in countries like India.

Second, as discussed in section 4.2, the emerging South is not free of vulnerabilities. For larger debtor countries like Brazil and India, which hold in large borrowed reserves, the vulnerabilities come from their foreign exchange situation, especially those like India, which have become highly trade dependent in recent years. For creditor nations like China the vulnerability may come from aggregate demand and the overreliance on investment, largely public investment, which can lead to the emergence of large excess capacities. These vulnerabilities can be reduced to some extent with appropriate changes in policy. While this is

not the place to discuss or recommend such policies, which requires careful country-specific analysis, the discussion of this section suggests that for Brazil the priority lies in increasing domestic investment, including public investment, for India (as well as Brazil) to the external balance and in China to increases in domestic consumption and a reduction in the investment rate and its reliance on foreign markets, especially Northern ones.[19]

Particular attention needs to be given to how to reduce inequality and to what improvements in income distribution can do to the sustainability of growth in these countries rather than to eulogies of market friendly one-size-fits-all reforms. Here other countries could learn from the recent policy successes in Brazil, although it should be remembered that Brazil's level of inequality is at extremely high levels. The relation between income distribution, capital accumulation and growth has been studied by some economists in terms of what have come to be called wage-led and profit-led growth regimes which focus on the distribution of income between wages and profits (or the surplus). It is argued that while an improvement in income distribution due to a rise in the wage share increases consumption demand because of the higher propensity to consume from wages than out of profits, which can increase capacity utilization and hence private investment as well, so that growth is wage-led, it is also possible that a fall in the profit share can reduce investment demand through its effect on profitability and, further, that a rise in real wages can adversely affect export competitiveness and reduce aggregate demand, capacity utilization and investment, and hence be profit-led (see Bhaduri and Marglin, 1990). There have been some recent attempts to econometrically determine which developing countries have wage-led structures and which have profit-led ones. Onaran and Galanis (2011) report that both in China and India aggregate demand appears to be profit-led because the positive consumption effect seems to be dominated by the export and investment effects, but argue that a coordinated wage share increase in the G-20 countries leads to an increase in aggregate demand in some of these countries. Short of such a coordinated effort, however, the possibility of improving income distribution in these countries without negative effects on accumulation and growth should be further explored. Improvements and distribution and the consumption of low-income groups can be achieved by increases in "social" spending by the government which do not directly raise the wage in export

sectors and reduce profitability, and by increases in informal sector income by more adequately funding initiative such as India's Rural Employment Guarantee Scheme. Large informal sectors in countries such as China and India imply that the distribution of income in these countries is not so much affected by standard categories such as wages and profits and that changes in informal sector income can have important consequences for saving, investment, tax receipts and import dependence all of which affect the sustainability of growth.[20] Moreover, private investment is influenced strongly by public investment and by expectations, which imply that the parameters of investment functions are unlikely to be stable.

Finally, apart from China, the weight of these emerging Southern economies in the global economy is quite small. After the US, with a 23 per cent share in world GDP in 2010 in current dollars – which are more relevant than PPP figures as far as the influence of these countries on world trade flows is concerned - among developing countries China is at 9.3%, Brazil is at 3.3 per cent and India at 2.6 per cent. As a share of exports the US share is 8.4 and China's is at 10.4 per cent, India's at 1.5 per cent and Brazil's at 1.3 per cent, and of imports, the US is at 12.8 per cent, China at 9.1 per cent, Brazil at 1.2 per cent and India at 2.2 per cent (see Akyuz, 2012). Despite this small size, it should be recognized that the relative size of these economies has been increasing over time, as shown in Figure 4 and 5. Figure 4 shows that the share of high-income countries in world production is close to 70 per cent, but has been falling steadily since 2002, while the share of the BRICs continues to be below 20 per cent, but has been rising steadily during the same period. The BRICs have overtaken the FIGU – France, Italy, Germany and the UK together – and China alone has overtaken Japan. The BRICs are smaller in terms of their share than the US, but the gap is closing. Figure 5 shows the position of the BRIC countries more clearly showing the impressive increases in the share of China and India, and the magnitude China's own share which is approaching 10 per cent. Compared to the LDCs, the BRICs are large.

**5. South-South interaction**

Even if it may be somewhat premature to argue that the emerging South (henceforth, ES) can serve as an engine of Southern growth, it may still be possible for the countries of the rest of

the South (henceforth, RS) to take advantage of the growth of the emerging South by increasing their interaction with them. This section will examine this issue by exploring likely consequences of this type of interaction to see whether such interaction can be of benefit to RS or whether it will simply place ES in the role of the North, reproducing the tendencies towards divergent growth that afflicted some aspects of the earlier pattern of North-South interaction. It will also examine whether such interaction is beneficial to the ES since, in the absence of mutual benefits, the prospects of the deepening of interaction will be dim. Finally, if there are some concerns about the likely adverse effects of greater interaction between ES and RS, can they be attenuated by greater cooperation within RS. The discussion here will concentrate mainly on international trade issues and on foreign direct investment, technology transfer and political economy issues directly related to them, but these issues should be analyzed in the context of cooperation on a broader scale, not only incorporating foreign direct investment and technology transfers, but also financial and monetary, and political interactions.

**5.1 Interaction between the emerging South and the rest of the South**

The consequences of interaction between the ES and RS can be viewed in terms of our discussion of North-South interaction of section 2. Obviously, growth in the ES can serve to increase the demand for products of RS, and result in a higher rate of growth for it as in the case of North-South trade. Moreover, there is the possibility of further positive effects due to capital flows and technology transfers. However, is there the potential for some of the negative effects of North-South interaction which created tendencies towards divergent growth, given the different levels of development of the two regions?

One source of problem is the difference in the income elasticity of demand for the goods exported and imported in the two regions. If the exports of ES to the RS have a higher income elasticity in both regions than those exported by the RS to the ES, uneven development between the two regions could occur. However, this problem may not be as great as that in the typical North-South pattern, especially that for the earlier years. First, the income and technology gap between ES and RS is not as large as the one between the North and the South. There is also a large diversity of goods produced by the ES given that there is a large spectrum of consumers with a large range of income for whom goods are produced in the ES and which

can be exported to the RS. Second, at least part of the high income elasticity for Northern goods is due to the existence of brand names, and the brands produced in ES are not as desirable as those produced say in the US, Italy, Germany or Japan. Third, to the extent that trade occurs in manufactured intermediate goods in international production networks, there is no particular reason to suppose that less will be demanded of a particular component as income and demand for final products grow, or that there will be technological change that reduces the need for specific components. This is unlike the case of final goods with low income elasticities and resource-based intermediate goods like cotton, jute and rubber. Moreover, once producers are a part of a production network they can switch within a range of intermediate goods if they can develop the technological capability to do so.

Second, to the extent that the ES exports manufactured goods to the RS and the latter exports primary resources to the former, the pattern of specialization can create the problems discussed for North-South trade. In particular, the RS can experience terms of trade volatility and environmental degradation due to increasing production for exports. Indeed, in the 2000-2009 period, although the exports of the least developed countries (LDCs) to developing countries other than first tier NICs and the LDCs contributed most to the increases in exports for the LDCs, the increase was mostly due to increases in fuel exports and to other primary products, and to a much smaller extent manufactured goods (see UNCTAD, 2011, 61), while the bulk of the increase in imports of LDCs from these countries was in manufactured goods.

Third, the pattern of specialization can lead to different degrees of dynamic increasing returns and learning effects. This problem can afflict the RS if it exports primary products or if it exports manufactured goods as long as the ES exports more technologically sophisticated goods to the RS. It can happen even if the relationship between the two is through international production networks, if the components that the RS produces are less technology intensive or if they are involved more in assembly than basic production. There may be reason to believe that trade with the ES may be more problematic for the RS than trade with the North because they are more likely to import technologically sophisticated goods that the RS is likely to be able to produce than the far more sophisticated goods that they import from the North. On the other

hand, the RS is more likely to be able to export more technologically sophisticated goods to the ES than they can to the North where they may be little demand for them.

There is some evidence to suggest that exports from Southern countries in general to the South are more technology intensive than those to the North. Dahi and Demir (2008) find that for 28 countries of the South, defining 75 commodities that fall into the "medium" and "high" technology classification of exports according to UNIDO, for the period 1978 to 2005, the median share of manufactures and technology-and-skill-intensive manufactured goods to the South increased, and there was a higher skill content of manufactures in South-South exports than in South-North exports. However, the skill content of manufactures within the South has been increasing at a slower rate than that of South-North exports. Moreover, they show that up to the late 1990s South-South intra-industry trade in technology-and-skill-intensive manufactures, as measured by the Grubel-Lloyd index was higher than in South-North trade, and that South-South intra-industry trade was higher when China and Southeast Asia are excluded. They argue that this suggests that dynamic gains and technology transfers are increased due to South-South trade, and that since South-North intra-industry trade is catching up, and since technology-and-skill-intensive exports are rising in South-North exports, that there is technological upgrading occurring in the South. Moreover, since the sample of 28 countries contain the earlier NICs (South Korea, Hong Kong and Singapore, as well as a number of other Latin American and South-East and South Asian countries and a few Middle East and African countries), to the extent they focus on median share, these results apply to a broader range than a few countries. However, it would be of considerable interest to examine the extent of technology-and-skill-intensive for a broader range of countries in the South, distinguishing between not-only North and the South but also ES and RS, and taking into account the characteristics of production activities for intermediate inputs and not just final goods.

Although they do not examine whether high-tech good exports by these countries actually translate into a higher growth rate due to greater technological upgrading, there is some indirect evidence that this is indeed the case. Hausmann, Hwang and Rodrik (2007) calculate an index of a country's "productivity" level of exports by measuring how weighted its

exports are towards goods which are exported by high-income countries. They show that countries with a higher productivity level of exports by this measure – presumably representing a more high-skilled and high-tech set of goods – grow faster.

The possible benefits to RS from interaction with the ES are obvious. First, RS can depend on exports to ES when the Northern is not doing well, and maintain a higher rate of growth, obtaining more foreign exchange by increasing their exports at a higher rate and being able to buy capital goods from the ES and the North to allow higher growth. The increasing growth of the large Southern economies increases the demand for resources and turns the terms of trade in favor of the resource exporting countries, although this may be a problem for net resource buyers, especially oil importers.

Second, by depending more on exports to the ES, they can be less exposed to terms of trade variations since the growth of the ES may not be as volatile as that of the North. Recent recession shows this to be the case in terms of growth rates. Indeed, as is noted in UNCTAD (2011), percentage decreases in the volume index of manufactured exports for the LDCs in the recent economic crisis (from 2008 to 2009) was less the higher their share of exports to the South in overall exports.

Third, they can export relatively more technologically sophisticated goods to the ES than they can to the North. We have seen earlier that for the South as a whole the skill-and-technology content of exports is higher in South-South trade than in Southern exports to the North, and this is true not just for the NICs and other large high-growth DCs, but also for other countries in the South.

Fourth, they can overcome the problems of small scale production for small countries if they can find larger markets in ES. This may be possible because of the large variety of consumers at different levels of income in these countries, including Brazil, China and India, with high degrees of income inequality. The expansion of consumption demand in China, which may be necessary for sustaining Chinese economic growth, can lead to an increase in the exports of manufactured goods from these countries.

Fifth, RS can obtain foreign investment and technology transfers in return for the benefits that they can provide to ES, especially in supplying resources necessary for sustaining

their higher growth rates (see below). Regarding investment, the bulk of the ES foreign direct investment in LDCs has gone to resource sectors, with arguably adverse environmental consequences and on commodity specialization (UNCTAD, 2011, 64). However, there has been some diversification into other sectors, including those on infrastructure development, banking and telecommunications. It is possible that the benefits to the RS from these investments is likely to be high because they are also likely to be beneficial to the investors who, because they are often closely related to the government in ES are more likely to internalize the benefits to the investors rather than having it diffused to too many other investors. Since the technology gap between ES and RS is not as large as the one between RS and the North, there is likely to be more effective technology transfers, especially through technology transfer agreements and licensing. Since ES employs a large diversity of technologies in terms of the range of technological sophistication, RS can obtain the kind more suitable to them.

Sixth, interaction with states and private entities from ES can contribute to improvements in policy and effective governance by being a catalyst for strengthening and in some cases building what UNCTAD (2011) refers the catalytic developmental state. There are many ways in which this could occur, through sharing ideas, and by affecting how the state in RS interacts with local groups, especially the elite. There are a number of reasons why this may be more beneficial to the RS than advice they get from Northern players and international organizations dominated by the North. First, the faster-growing countries have experience with state formation and policies in situations more similar to those found in the RS than in the North. Second, the types of policies they recommend are less likely to be neoliberal in a doctrinaire way, since their own experience has been very different and more in line with strategic integration in the world economy, making use of both state agencies and market competition in suitable ways. Third, the ES advisors are less likely to kick away the ladder, since they have still not climbed it. Some evidence in support of these two points can be found in the fact that Chinese external lenders to Latin America impose little or no policy conditionalities, unlike the World Bank, for instance (see Gallagher et. al., 2012). What they do impose are conditions which require lenders to buy Chinese products which may in any case more suitable for the needs of these countries and less costly than similar Northern products. Fourth, the

issues are not just of policy advice, but also of domestic political economy with which they have some experience. While they cannot directly change the political economy dynamics within the countries drastically, they can provide useful advice not how to the state can work with different groups in society to pursue development policy goals, and provide loans to governments which are unwilling to pursue market-friendly policies and for which they may be denied other sources of financing (see Gallagher et. al., 2012). RS can in fact choose from the advice they receive from different RS countries, adapting them to best suit their own needs. These kinds of contributions are more likely to occur if the ES finds it to its advantage to have stability and better economic performance in the RS regions, especially in the LDCs, both as markets for their products, investment outlets and sources of inputs in production networks, and even suppliers of resources, to which we now turn.

Interactions between ES and RS can indeed be beneficial for the former. First, they can expand the production of more technologically sophisticated goods which can be exported to the RS. Exports of some ES countries is still largely in low technology intensive goods. For instance, Alessandrini, Fattouh and Scaramozzino (2007) find that low-technology sectors still dominate India's exports and high-technology sectors are prevalent in India's imports, although India is improving in the exports of some high-tech exports. The opportunities to export relatively more high-technology products will increase with trade with the RS.

Second, many countries of the RS are, and can have an increasing role as, suppliers of resources to the ES. As has been noted, the high rates of growth of some of the ES have resulted in a rapid growth in their needs for resources, especially oil, and the resource-rich countries, especially the oil exporting countries are valuable for these countries. This is shown by the rapid increase in primary exports, especially fuels, to these countries, and suggested by the large foreign direct investment these countries, especially China, is making in the LDCs,

Third, ES can benefit from involving RS in cost-reducing production networks if material costs are lower and if wages are lower than in the ES. This can become important if wages countries such as China and India show a tendency to rise. However, since there are large labor surpluses in these countries, as shown by the large size of informal sectors and surplus labor in the burgeoning service sector as well as the agricultural sector, it is not clear how likely this will

be. Here is a potential difficulty in terms of applying the flying geese theory to the interaction between ES and RS, given the large population size of some of these ES countries.

Finally, ES can benefit from its connections with RS as players in global institutions. The fast-growing ES countries have emerged as more powerful members within international organizations such as the World Trade Organization (WTO) and to a lesser extent, in other fora like the G-20. They have been able to translate their rising importance in the world economy to an increase in power in the WTO (Narlikar, 2010). Brazil and India have had a major leadership role in forming and leading developing country coalitions for a while in the GATT and WTO, and after maintaining a low profile on joining the WTO in 2003 China has also become more visible, The three countries have become more visible in the decision-making processes in the WTO, with the old Quad of US, EU, Japan and Canada making room for the three, and the latter, either individually or as a group have on occasion used their veto powers in the Doha Development Round negotiations. These countries have revealed their solidarity with the rest of the South and shown themselves to be less enamored with neoliberal strategies, given their developmentalist stance and their own reliance on a more nuanced development strategy. They have therefore become a stronger voice for the South in terms of agenda setting as well as voting.

The developments brought about by the emergence of these new powers have resulted in stalemate and deadlock. However, the changed dynamics have also increased the possibility of changes in the internal structure of the WTO procedures, introducing greater ability to not only make decisions but also make them more responsive to the needs of the South as a whole. Moreover, greater power in the WTO has not been accompanied by greater power in the World Bank, the International Monetary Fund and the Security Council of the United Nations because of their less democratic structures. The consolidation of the power of the BICs as leaders for the global South within the WTO can eventually lead the way to greater power in these other international organizations. To make all this possible, they would benefit from the trust and support of the RS which can come from greater economic interaction with them.

**5.2 Interactions within the rest of the South**

In addition to increasing the interaction between ES and RS, there is a need for greater intra-RS interaction in the form of preferential trade agreements and other arrangements. Such interaction has been, and can continue to be at the regional level, because of geographical proximity and lower transportation costs, the possible benefits of sharing in the development of infrastructure, closer cultural ties, and local knowledge. However, it need not be confined to regional interaction since, in some cases, there is likely to be great benefit from interacting with countries at the same level of technological development or which allow market access to different parts of the world.

There are many possible benefits to the RS countries from these kinds of interaction. First, by engaging in what Kojima (2000) has referred to as agreed intra-industry specialization in the context of the flying geese approach, they can overcome the problem of small size of domestic markets which prevent reaping the benefits of scale economies. This type of trade can also overcome problems of trade with ES because of technological factors and overcome the problem of overspecialization in resource-based activities.

Second, as noted earlier, especially if they are neighbors, they can reap the benefits of scale economies in the provision of infrastructure and other public goods.

Third, they can improve their ability to negotiate collectively with governments of the ES and especially the North, reducing the possibility of race to the bottom in general and in terms of dealing with foreign investors.

Fourth, their interaction can help to improve their internal political economy situation of these countries. Countries with RS can share ideas, deal with some ethnic problems and have more room to overcome political economy challenges.

One problem with reaping these benefits is that it is not clear a priori which industries to choose and which countries in a group will succeed (since not all may) once a pattern of specialization is agreed upon. These problems, however, are not insurmountable. One method is to sharing resources that come to winners. Another is by participating in production networks so that if a particular product “succeeds” in global markets, a group of countries share in the success. Another problem is that the high degree and growing regional inequality in some of the larger Southern countries, like India and China, suggest that there may be problems of

divergent growth within these groups. However, with more careful negotiations *between* sovereign nations than is possible *within* sovereign nations, these problems may be avoided to some extent.

**5.3 Some challenges and possibilities**

In pinning hopes on these types of interactions it should be remembered that South-South trade remains a small portion of world trade. In 2005, UNCTAD data shows that South-South trade as a percentage of global trade was 15 per cent, compared to over 50 per cent for North-North trade and 35 per cent for North-South trade, with much of the South-South trade being within the more emerging nations of the South. By 2009 South-South trade had increased to 16.9 per cent of which 40 per cent was China's share and 5.4 was India's, with all of developing Asia's being 80.3 per cent Thus South-South trade remains a small part of world trade and heavily concentrated within Asia and heavily dominated by China.

However, the low current levels also imply that there may be a lot of scope for a considerable expansion of South-South trade. There has recently been an increase in preferential trade agreements within the South, especially at the regional level, and this can lead to an increase in South-South trade with agreed patterns of specialization in intra-industry trade.

There are several ways of further increasing South-South trade. For instance, improvement in the financial sector in the South can help to increase South-South trade of the type that can contribute to improved economic performance. Demir and Dahi (2011) find that financial development in the South increases the share of total and technology-and-skill-intensive manufactured exports in GDP, while the same cannot be expected for South-North exports. This suggests either that South-South exports requires more financing than South-North exports (with the North apparently providing the necessary financing) or that the needs of finance are greater for South-South exports on account of their greater technology and skill intensity. Either way, there is scope for positive effects of South-South trade, both increasing it and increasing the skill-and technology intensity of exports for the South. Moreover, the emergence of China as a major source of external loans to Latin America including trade credit

and financing which is paid in terms of exports to China (see Gallagher et. al., 2012), suggests that there is much scope for South-South capital flows increasing South-South trade.

Specific attention needs to be given to intra-African trade. Longo and Sekkat (2004) find that for such trade, infrastructure development, political instability and economic policy management have kept trade at low levels. The expansion of infrastructure, partly with foreign investment especially from ES and partly with greater cooperation within the RS, the reduced levels violence in many parts of Africa, and great policy help from other countries in the South, may allow greater growth in intra-African trade. Moreover, the African economies may have lacked a regional engine of growth, a leading goose as in the flying geese theory. By linking with countries of ES outside the region, they can seek for a lead goose outside the region. There is also reason to believe that the political and economic possibility of forming regional communities has increased in some cases. For instance, for the East African community, early efforts in 1977 may have been hampered by the high economic inequality between countries and the lack of manufacturing sectors in some partners, which has changed in recent years (Kapstein, 2010).

**6. Conclusion**

The slowdown in growth of the rich countries of the world, the global North, accompanied by the better performance of countries in the global South, especially some of the large emerging Southern countries raises the question of whether the development of the South can proceed without the Northern engine of growth. This paper has examined this question from the perspective of the earlier analysis of, and trends in, North-South interactions. In particular, it has examined whether it is possible for the South to develop with the help of engines within itself, that is, the large emerging and other rapidly-growing Southern countries, or to develop without any engines at all, on their own steam, with individual or collective efforts among groups of Southern countries. Our main conclusions are as follows.

First, although some Southern economies have indeed experienced high rates of growth and seem poised to become engines for Southern growth, it may be premature to expect them to have this role, with the possible exception of China. China's share in the world economy is large enough, and its growth performance strong enough to serve in this role. However, the

continuation of China's growth at rates as high as those experienced in the past may depend on China's ability to reorient its growth by expanding domestic markets by increasing consumption, if it is not to experience problems from excess capacity due to very high rates of investment, especially public investment. The shares of India and Brazil in the world economy and in international trade are much smaller, and their growth performance either not strong enough and somewhat fragile, especially on account of low investment and saving rates in Brazil and external positions for both countries, for them to have the same role in the world economy. But this is not to say that they cannot emerge as engines in the future.

Second, there are possibilities of mutually beneficial interactions between the emerging South and the rest of the South, partly because of the need for China and other emerging countries to find markets in the South as the North grows more slowly, and partly because of their large resource needs, and because of what the emerging economies can offer the rest of the South in terms of market access, resources, foreign direct investment and technology transfer, and support in international arenas and institutions as emerging South increases its presence and power in them. For some of these interactions the mutual benefits are likely to be stronger than the benefits of their interaction with the North, but they will also need to continue interacting with the North, especially for technology transfers and markets. However, the rest of the South cannot take it for granted that they will benefit strongly from these interactions, since there are possibilities of repeating some of the problems that arise in North-South exchange, especially in terms of differential rates of technology and skill acquisition from the patterns of specialization and the dependence of some Southern economies on primary production. Some regions may also be left out of the process of integration, as seems to have been the case so far as the East and Southeast Asian countries have stronger links within them, and as seems to have been the case within some of the countries as suggested by growing regional uneven development within their borders.

Third, the rest of the South needs to pursue policies that allow them to strategically interact with the rest of the world, including the emerging South. In doing these things they can learn from the experiences of the emerging South and obtain their help in overcoming some economic and broader political economy objectives. However, they need to redouble

their efforts at increasing their strategic interactions among the other countries of the rest of the South at the regional and other levels, to increase intra-industry trade, develop their infrastructure, overcome political economy obstacles, and improve their bargaining strength both with respect to the North and the emerging South.

The problems of development in the South are difficult to overcome. It would be judicious for countries to do what they can to foster developmental policies at different levels, to look within themselves, to increase strategic links with countries near them and at similar levels of development, and also to make use of the opportunities provided by the emerging South, rather than seek to rely only on the growth engine of the emerging South.

## TABLES

Table 1. Rate of growth of real GDP per capita in selected high-income countries and groups

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2000-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **France** | 2.98 | 1.10 | 0.20 | 0.19 | 1.80 | 1.07 | 1.76 | 1.66 | -0.64 | -3.26 | 0.96 | 0.71 |
| **Germany** | 2.90 | 1.36 | -0.20 | -0.42 | 1.19 | 0.74 | 3.82 | 3.41 | 1.28 | -4.89 | 3.94 | 1.19 |
| **Italy** | 3.64 | 1.76 | 0.14 | -0.79 | 0.54 | -0.09 | 1.46 | 0.74 | -2.08 | -5.79 | 0.81 | 0.03 |
| **Japan** | 2.68 | -0.04 | 0.03 | 1.20 | 2.71 | 1.92 | 2.05 | 2.35 | -1.11 | -6.18 | 4.09 | 0.88 |
| **UK** | 3.54 | 2.09 | 1.72 | 2.39 | 2.43 | 1.57 | 2.16 | 2.03 | -0.73 | -5.50 | 0.67 | 1.13 |
| **USA** | 3.02 | 0.06 | 0.86 | 1.61 | 2.62 | 2.12 | 1.70 | 0.93 | -0.94 | -4.33 | 2.32 | 0.91 |
| **OECD** | 3.33 | 0.74 | 0.87 | 1.22 | 2.45 | 1.88 | 2.23 | 1.87 | -0.52 | -4.53 | 2.44 | 1.09 |
| **HIC** | 3.37 | 0.63 | 0.86 | 1.29 | 2.52 | 1.90 | 2.23 | 1.85 | -0.56 | -4.54 | 2.52 | 1.10 |

Source: World Bank database

Table 2. Rate of growth of real GDP per capita in selected countries and groups

| | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2000-10 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Brazil** | 2.82 | -0.09 | 1.28 | -0.16 | 4.42 | 1.99 | 2.87 | 5.06 | 4.21 | -1.52 | 6.55 | 2.49 |
| **China** | 7.55 | 7.52 | 8.37 | 9.32 | 9.45 | 10.65 | 12.07 | 13.61 | 9.04 | 8.65 | 9.83 | 9.64 |
| **India** | 2.30 | 3.53 | 2.17 | 6.77 | 6.74 | 7.83 | 7.77 | 8.35 | 3.54 | 7.65 | 7.36 | 5.82 |
| **HIC** | 3.37 | 0.63 | 0.86 | 1.29 | 2.52 | 1.90 | 2.23 | 1.85 | -0.56 | -4.54 | 2.52 | 1.10 |
| **LDC** | 1.96 | 3.11 | 2.32 | 2.60 | 4.31 | 4.90 | 5.09 | 5.59 | 4.67 | 2.20 | 3.14 | 3.63 |
| **Russia** | 10.00 | 5.35 | 5.21 | 7.82 | 7.73 | 6.90 | 8.65 | 8.84 | 5.36 | -7.75 | 4.11 | 5.66 |
| **World** | 2.93 | 0.36 | 0.72 | 1.43 | 2.86 | 2.35 | 2.86 | 2.76 | 0.33 | -3.44 | 3.04 | 1.47 |

Source: World Bank dataset

Table 3. Per capita GDP of BRICs, 2010

| | Current US $ | | | Current PPP $ | | |
|---|---|---|---|---|---|---|
| | **Level** | **Ratio of US** | **Ratio of W** | **Level** | **Ratio of US** | **Ratio of W** |
| **Brazil** | 10710.07 | 0.23 | 1.16 | 11210.36 | 0.24 | 1.00 |
| **China** | 4428.46 | 0.09 | 0.48 | 7598.84 | 0.16 | 0.68 |
| **India** | 1474.98 | 0.03 | 0.16 | 3582.48 | 0.08 | 0.32 |
| **Russia** | 10439.64 | 0.22 | 1.13 | 19840.45 | 0.42 | 1.77 |
| **USA** | 47198.50 | 1.00 | 5.11 | 47198.50 | 1.00 | 4.21 |
| **HIC** | 38208.22 | 0.81 | 4.14 | 37290.02 | 0.79 | 3.33 |
| **World** | 9227.95 | 0.20 | 1.00 | 11204.93 | 0.24 | 1.00 |

Source: Author's calculations from World Bank dataset

Table 4. Saving and investment rates for Brazil, China and India

| Brazil | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Capital formation | 18.25 | 18.03 | 16.20 | 15.77 | 17.12 | 16.21 | 16.76 | 18.33 | 20.69 | 16.51 | 19.25 |
| Saving | 16.49 | 16.71 | 17.71 | 18.68 | 20.99 | 19.81 | 19.66 | 19.85 | 20.88 | 16.45 | 18.26 |
| Fixed capital formation | 16.80 | 17.03 | 16.39 | 15.28 | 16.10 | 15.94 | 16.43 | 17.44 | 19.11 | 16.95 | 18.45 |
| Private | | | | | | | | 13.36 | 16.81 | 14.38 | 15.65 |
| Public | | | | | | | | 4.08 | 2.31 | 2.57 | 2.79 |

| China | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Capital formation | 35.12 | 36.27 | 37.87 | 41.20 | 43.26 | 42.10 | 42.97 | 41.74 | 44.05 | 48.24 | 47.78 |
| Saving | 37.53 | 38.39 | 40.44 | 43.40 | 45.81 | 47.63 | 50.67 | 50.54 | 51.76 | 52.65 | 51.70 |
| Fixed capital formation | 34.11 | 34.43 | 36.26 | 39.38 | 40.73 | 40.14 | 40.66 | 39.11 | 40.79 | 45.96 | 45.45 |
| Private | 7.51 | 7.82 | 8.45 | 9.55 | 10.99 | 12.64 | 17.43 | 18.56 | 19.76 | 22.56 | 23.67 |
| Public | 26.60 | 26.61 | 27.81 | 29.83 | 29.74 | 27.50 | 23.23 | 20.55 | 21.03 | 23.40 | 21.78 |

| India | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Capital formation | 24.16 | 24.18 | 25.24 | 26.77 | 32.82 | 34.66 | 35.67 | 38.14 | 34.52 | 36.48 | 34.77 |
| Saving | 23.24 | 23.29 | 24.24 | 25.48 | 31.06 | 31.92 | 32.51 | 34.13 | 29.41 | 31.26 | 31.53 |
| Fixed capital formation | 22.73 | 23.62 | 23.80 | 24.94 | 28.72 | 30.34 | 31.30 | 32.92 | 32.04 | 30.78 | 29.48 |
| Private | 16.27 | 17.13 | 17.52 | 18.49 | 21.80 | 22.99 | 23.39 | 24.87 | 23.47 | 22.35 | 20.78 |
| Public | 6.45 | 6.48 | 6.28 | 6.45 | 6.91 | 7.35 | 7.91 | 8.05 | 8.57 | 8.43 | 8.70 |

Source: World Bank dataset

Table 5. Selected external data for Brazil, China and India

| Brazil | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net exports/GDP | -1.76 | -1.32 | 1.51 | 2.91 | 3.88 | 3.61 | 2.90 | 1.52 | 0.19 | -0.06 | -0.99 |
| Current account/GDP | -3.76 | -4.19 | -1.51 | 0.76 | 1.77 | 1.59 | 1.25 | 0.11 | -1.71 | -1.52 | -2.27 |
| Reserves/Foreign Debt | 13.67 | 15.66 | 16.38 | 20.98 | 24.08 | 28.69 | 44.37 | 75.90 | 73.92 | 86.14 | 83.17 |
| Trade/GDP | 21.72 | 25.68 | 26.68 | 27.06 | 28.97 | 26.65 | 25.83 | 25.21 | 27.14 | 22.30 | 23.30 |

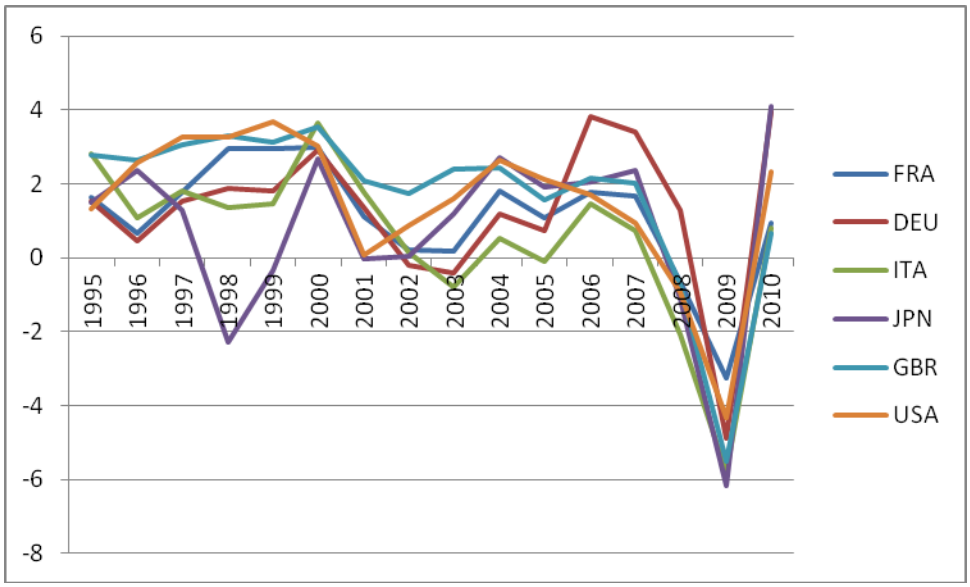
| China | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net exports/GDP | 2.41 | 2.12 | 2.57 | 2.20 | 2.55 | 5.53 | 7.70 | 8.80 | 7.72 | 4.41 | 3.92 |
| Current account/GDP | 1.71 | 1.31 | 2.44 | 2.80 | 3.55 | 5.94 | 8.58 | 10.13 | 9.12 | 5.23 | 5.15 |
| Reserves/Foreign Debt | 118.18 | 119.75 | 161.05 | 201.86 | 253.70 | 293.83 | 334.85 | 414.48 | 517.65 | 567.54 | 531.17 |
| Trade/GDP | 44.24 | 43.08 | 47.70 | 56.91 | 65.35 | 68.63 | 70.57 | 68.03 | 62.24 | 49.02 | 55.23 |

| India | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Net exports/GDP | -0.92 | -0.89 | -1.00 | -1.29 | -1.75 | -2.75 | -3.16 | -4.01 | -5.11 | -5.21 | -3.24 |
| Current account/GDP | -1.00 | 0.30 | 1.39 | 1.46 | 0.11 | -1.23 | -0.98 | -0.65 | -2.55 | -1.88 | -3.00 |
| Reserves/Foreign Debt | 40.96 | 49.73 | 68.32 | 88.01 | 107.38 | 114.64 | 112.33 | 136.29 | 113.91 | 113.88 | 103.51 |
| Trade/GDP | 27.38 | 26.41 | 29.97 | 30.90 | 36.86 | 41.32 | 45.31 | 44.88 | 52.71 | 44.86 | 46.32 |

Source: World Bank database

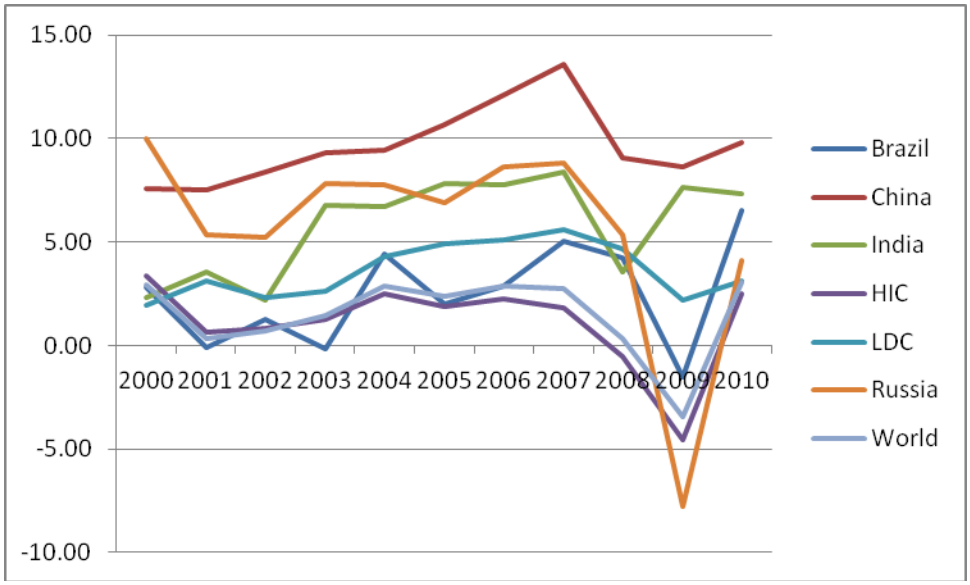
## FIGURES

Figure 1. Rate of growth of per capita GDP of selected high-income countries



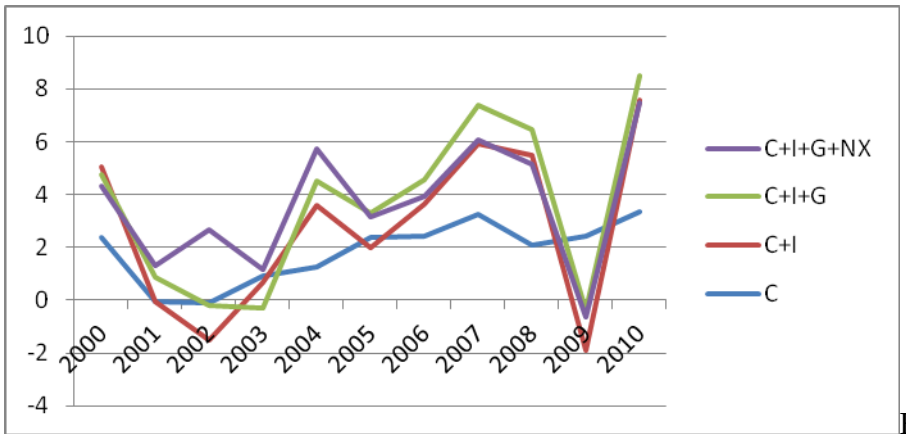

Source: World Bank database

Figure 2. Rate of growth of per capita GDP of selected countries and groups

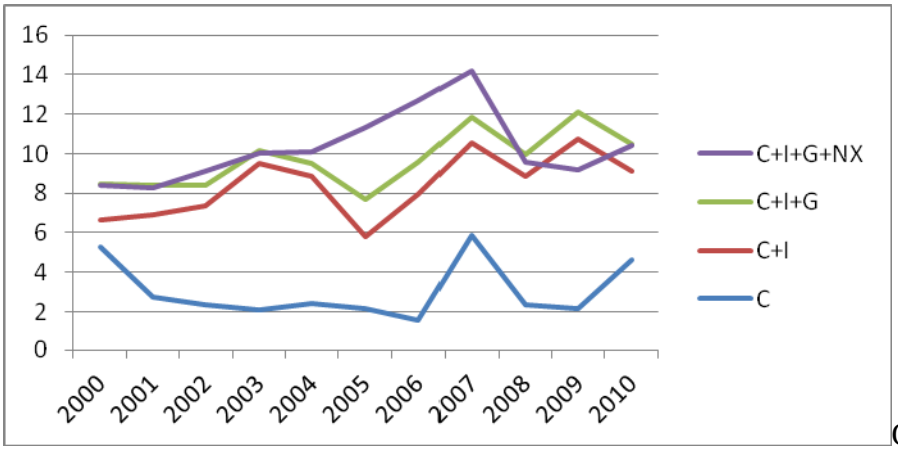



Source: World Bank database

Figure 3. Growth decompositions for Brazil, China and India



Brazil



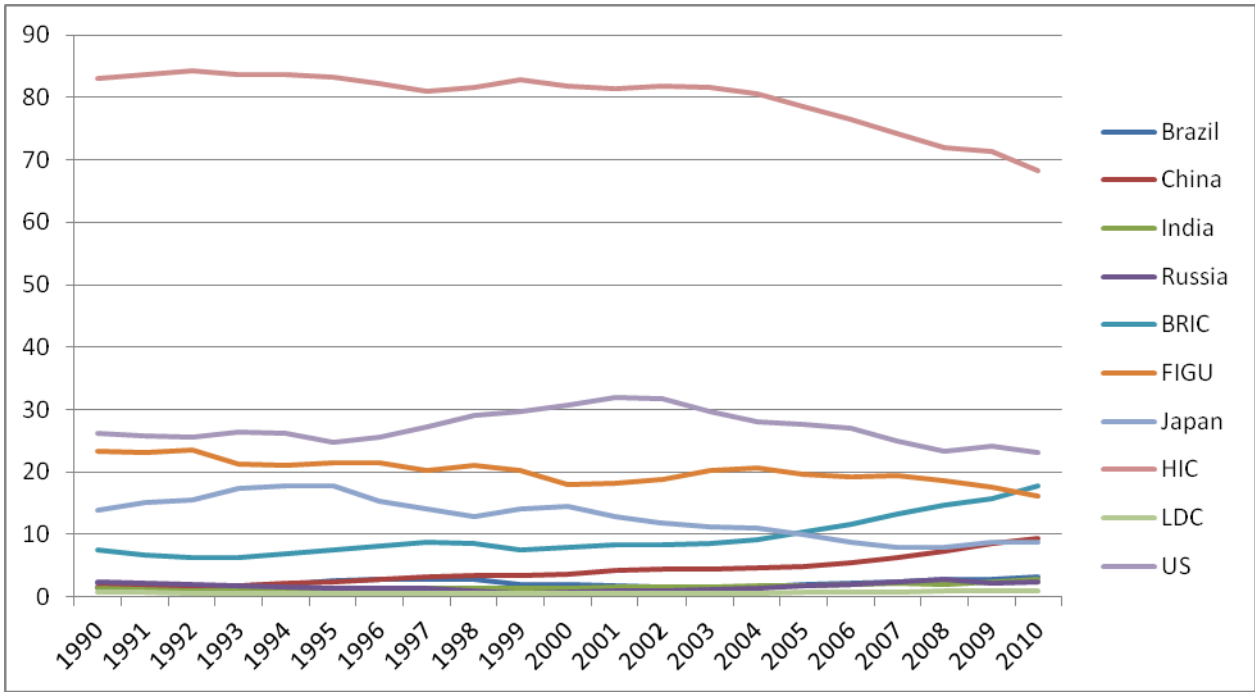
China

India

*The figure shows the contribution of each component as the difference between that line in which the component is included and that prior to its inclusion. Thus, the contribution of investment to growth is the vertical difference between the C line and the C+I line, and so on. In the case of net exports, where the purple line can be under the green line, the contribution is negative.

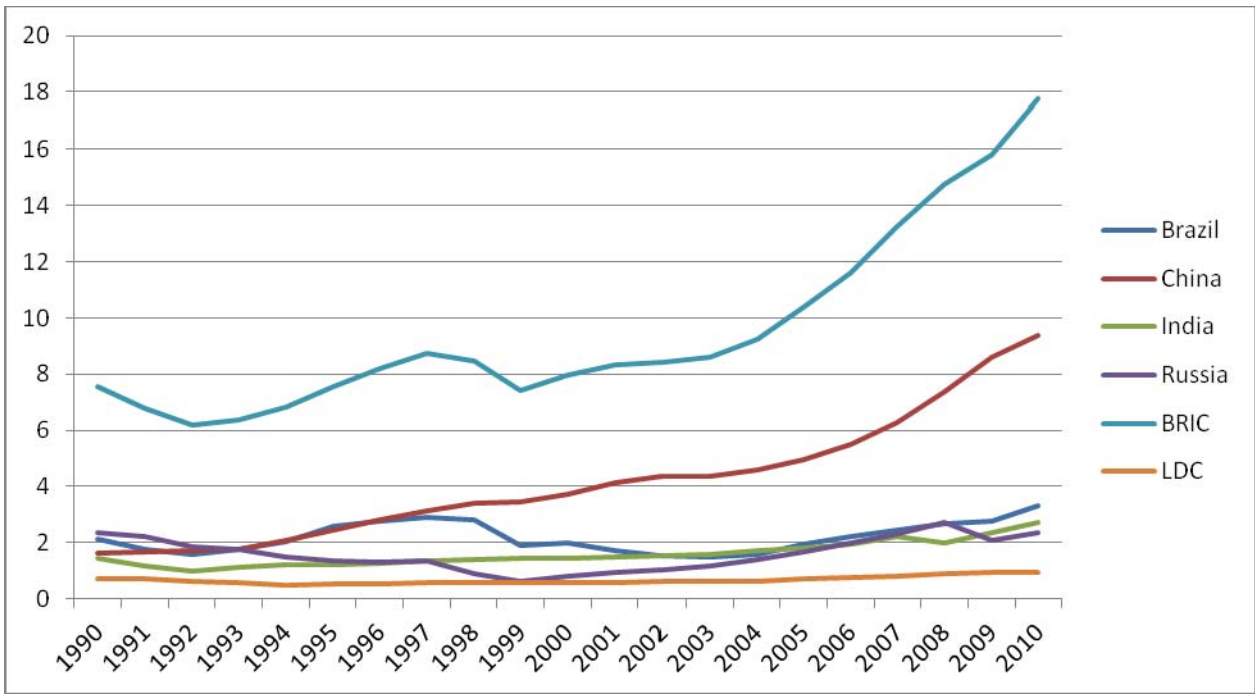
Source: Author's calculations from data from the World Bank Database

Figure 4. Share of world GDP in currency values, selected countries and groups




Source: Author's calculations from data from the World Bank Database

Figure 5. Share of world GDP in currency values, BRICs and LDCs



Source: Author's calculations from data from the World Bank Database

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**NOTES**

[1] This idea was captured early on by Myrdal (1957) who pointed out that the growth of the rich countries could have spread effects on poor countries, for instance by creating a demand for their products as in the engine metaphor, but could also have a backwash effect, thereby resulting in uneven development. While these spread and backwash effects operated within and between countries, convergent regional growth occurred within those countries in which the government transferred resources to poorer regions. Since there was no world government, he recommended transfers from the rich North to the poor South at the global level as foreign aid. Later in his life he was far less enthusiastic about the impact of foreign aid.

[2] These numbers are all calculated from World Bank online data.

[3] It is beyond the scope of this section to provide anything approaching a complete survey of the literature on North-South models. Rather, it will examine some aspects of the literature to analyze the key links between the North and the South which are particularly relevant for the possibility and effectiveness of South-South interaction.

[4] Such a tendency may not continue indefinitely if, for instance, there are spillovers between sectors which result in productivity in the non-dynamic sector rising and raising wages and reducing profits in the dynamic sector, or because with income growth the North increasing concentrates on the production of services in which learning by doing is low.

[5] There is a large literature on the effects of trade on the environment in the North and the South. See, for instance, a book-length treatment by Copeland and Taylor (2005) which follows neoclassical full employment assumptions but shows that trade may do more environmental damage to the South because of the so-called pollution haven hypothesis. Chichilinisky (1994) links North-South trade and environmental degradation in the South especially to the resource-intensive exports of the South because of weaker property rights enforcement in the South. In fact, resource-based trade can result in environmental damage even with, and particularly because of, the imposition of property rights on limited access common property resources, which undermine the earlier norm- and sanction-based systems of overcoming the problem called the tragedy of the commons (Ostrom, 1990).

[6] See, for instance, Burgstaller and Saavedra-Rivano (1984).

[7] See Soete and Verspagen (1993) and Bell and Pavitt (1993).

[8] Lewis (1980), in his discussion of the engine of growth, made it clear that he was talking of the South as a whole, which seems to have been missed by Reidel's (1984) criticism. Reidel's criticism does not recognize the possibility of a fallacy of competition. It does not follow, of course, that there necessarily is a fallacy of composition, which is probably what Reidel was arguing.

[9] See, for instance, Bardhan (1999) and Waldner (1999) for insightful discussions of political economy issues examining the relation between the state and social groups in different contexts.

[10] These results are discussed in the Bhagwati and Srinivasan (1983) text. Note that Bhagwati is a major proponent of trade liberalization in developing countries. He argues that import restrictions are not the best way of solving the problems due to these kinds of distortions. For instance, production distortions involving production externalities are best overcome using production subsidies. This argument, however, is based on the assumption that there is substitution in consumption between protected and unprotected goods and that social desirability is best evaluated in terms individual preferences. Moreover, it does not take into account the resource constraints facing governments in developing countries, which may prevent them from providing subsidies. The argument in favor of protection can be overturned by the possibility of foreign retaliatory protectionism as well.

[11] Taylor (1983) is often referred to as the pioneers of neo-structuralism for his use of formal models to capture some of the insights of the earlier structuralist writers.

[12] Although there have been some attempts to development an analytical approach which emphasizes these empirical features. See, for instance, Henderson et. al. (2002).

[13] The acronym appears to be due to Goldman Sachs, "Dreaming with the BRICs: the path to 2050", Global Economics paper no. 99 (New York: Goldman Sachs, Oct. 2003). It seems to have been first coined by Terence James O'Neill, as chairman of Goldman Sachs Asset Management in a 2001 paper called "The World Needs Better Economic BRICs" (see the entry on Jim O'Neill in *Wikipedia*).

[14] The most popular approach seems to have becoming the learning approach. In this approach, depending on the form of the learning function the rate of growth in new neoclassical growth theory models can positively affected by the size of the population (see Roemer, 1986). If, for instance, labor productivity depends on the stock of capital, the models imply that high population levels imply higher growth: with a full employed larger population, since the productivity of each worker grows according to the total capital stock, the effect of overall productivity growth will be higher. However, if learning depends positively on the stock of capital per worker rather than on total capital, the rate of growth will be independent of population. There has been a debate within the new neoclassical growth theory literature about which of the two formulations is more consistent with data on growth; see Jones (1999).

[15] It is not the case that large countries always have an advantage, because in terms of foreign aid, it is well known that small countries obtain more of it when they are smaller, because they provide a more cost-effective way of getting votes for aid donors in international organizations. But foreign aid may not be as great benefit to countries in terms of obtaining high rates of growth.

[16] For a very useful discussion of the efficacy of, and problems with decentralization in less-developed countries, see Bardhan (2002).

[17] The magazine's reason for excluding India from their report is because it focused on what it calls new state capitalism, and states that for India government involvement is more likely to be leftover from the License Raj of old, rather than a new development.

[18] It asks (2002, 5), "How can you ensure a fair trading system, over or covert, if some companies enjoy the support, overt or covert, of a national government? How can you prevent governments from using companies as instruments of national power? And how can you prevent legitimate worries about fairness from shading into xenophobia and protectionism?". It seems that all this is fine if it happens to Northern companies which are privately owned but supported by Northern governments! It also raises the bogey of authoritarianism, focusing on China and Russia, but overlooking Brazil and by excluding India from the report.

[19] There has been a great deal of attention, especially in the US, on the need to increase consumption in China with a view to reducing US trade deficits and generating a stronger demand for exports of other countries. Apart from the fact that such "rebalancing" is unlikely to solve the deficit problem for the US and significantly increase global demand (see, for instance, Cripps, Izurieta and Singh, 2011), such recommendations do not take into account the foreign exchange problems faced by developing countries – to which even China seems to be sensitive - which can make them vulnerable to destabilizing capital flows. However, some gentle rebalancing towards consumption which, as noted earlier in this section, already seems to have started, may be good for China's own growth prospects, and even for the growth of poorer Southern economies.

[20] See Rada (2010) for an analysis of the cases of China and India which addresses some of these issues.