

## South-South Integration is Key to Rebalancing the Global Economy

**The world economy is seriously out of kilter. Over the last 30 years finance-led globalization has distorted developments in the real economy, triggered a series of boom-bust cycles and fuelled the most regressive redistribution of income in the modern era (see graphs). These trends culminated in a financial meltdown spreading out from the advanced countries in late 2008, and producing the most severe worldwide slowdown since 1945. Imbalances continue to haunt the recovery process, which has been slow and erratic especially in the most heavily financialized and indebted economies, and in the most vulnerable countries in the South, where the economic shocks were compounded by food and energy insecurity and climate variability.**

Fig 1b. Financialization and the Great Equality Reversal

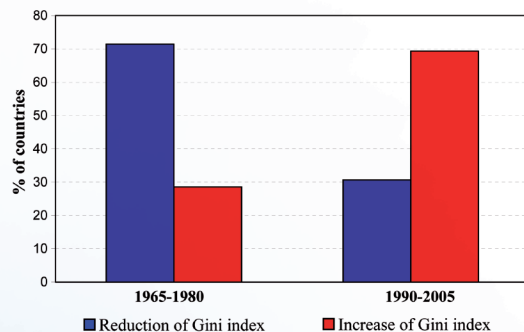
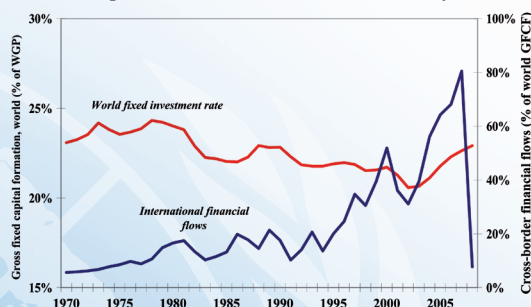


Fig 1a. The Financialization of World Economy



If history is any guide, the adjustment process in key advanced economies will be prolonged and there is a danger that, without a change in policy direction, slow growth, high unemployment and expanding pockets of deprivation will become a more permanent feature of these economies with damaging global implications, including the threat of protectionism. Fiscal pressures may also lead the major donor countries to further reduce their aid disbursements. If this comes to pass, the markets, resources and foreign exchange needed to support the growth of the South may not be found in the North.

On the brighter side, solid economic performance in Brazil, China and India, which were less impacted by the global crisis than most advanced economies, has fuelled speculation that the South can drive global growth, and that these economies can introduce a

new global agenda around foreign trade, investment and aid. China, for example, is emerging from the crisis as a leading actor in international financial markets: the country has become the largest holder of United States government securities, and it controls 29 per cent of global reserves.

Faster growth and increasing economic sophistication in the South has shifted the axis on which the global economy turns. For a simple example, the GDP of the seven largest developing economies, adjusted for purchasing power parities, has grown from 10.5 per cent of the GDP of the OECD member countries in 1980 to 21 per cent in 2010. Recent growth has also involved a tighter integration across these economies, their regional partners, and the LDCs. Between 1996 and 2009, South-South trade grew, on average, 12 per cent per year (50 per cent faster than North-South trade), and it now accounts for 20 per cent of global trade. South-South FDI has also become increasingly relevant; it has grown 20 per cent per annum between 1996 and 2009, albeit from a low base, and now accounts for 10 per cent of total FDI flows. This involves not only the extraction of unprocessed resources but, often, vertical and horizontal linkages which can create manufacturing and export capacity, along with better jobs, in the South.

Unlike the period of convergence during the 1970s, which involved rapid but uncoordinated growth across several economies, the ongoing restructuring of the global economy has been driven by the largest developing countries, and has been articulated across other economies in the South. The world economy has become irreversibly more complex and more integrated: we have moved beyond the 'early' neoliberal globalization, driven by the North, and entered a new phase of globalization in which the South plays a determining and dynamic role. The recent news that China is now the world's second largest economy, and may catch up with the US within a decade, is symbolic of the depth and significance of this shift.

Despite these fundamental changes, talk of a "switchover" in global growth dynamics is premature.



In per capita terms, even the largest Southern economies are likely to remain considerably poorer than the US, EU and Japan for decades, and few Southern economies have managed to escape from the global asymmetry which renders them vulnerable to fluctuations and shocks in the North. This is due to their differential patterns of exports, capital flows and ownership of productive assets, commodity dependence, and the lack of industrial dynamic in many lower income countries. Moreover, it is likely that several economies may have fallen into a “middle-income trap” which can seriously slow down their further advance. There is also a tendency for over-optimistic prognostications of the “rise of the South” to conflate the entire region with the dynamism, the trading patterns and the economic uniqueness of China. Hasty speculations about the ability of the South to drive the world economy could also shift attention away from the responsibility of the advanced countries for driving the recovery and rebalancing the global economy in a more inclusive and sustainable direction, preserving stability and securing a fair distribution of wealth between countries and across regions.

There can be no dispute that the current crisis is due to a systemic, policy-driven environment of financialization and speculation originating in the North, which was, often, foisted upon reluctant developing countries through misguided advice and aid conditionality. The crisis must be resolved primarily through intervention at those levels, rather than through stimuli generated in the South.

Moreover, while faster growth in the South has helped to shift global wealth distribution, there has also been a significant variation of performance within the South. Most LDCs have grown more slowly than the leading economies, and these countries accounted for less than one per cent of world GDP in 2009. Despite the recent growth of Brazil, Latin America’s share of global output has remained unchanged since the 1970s. In addition to this, there has been a significant deterioration in the distribution of income in numerous countries, including in China. In sum, although faster growth in the South points to global convergence at an aggregate level, this process includes a considerable diversity of experiences, and it has fostered heterogeneity and even disappointment in many countries.

A realistic South-South cooperation agenda can help to rebalance the world economy at two levels. First, it can support multilateral arrangements channelling into productive use resources that are currently trapped in speculative financial circuits. Second, it can promote more even, dense and egalitarian global trading relations, which will help developing countries escape from poverty traps.

The emergence of this trading pattern, underpinned by deeper regional trade relationships, builds upon the achievements of the UNCTAD-sponsored GSTP negotiations. It can be enhanced by a global commitment to the development of employment, technology and skill-intensive productive capacities in the South, particularly in manufacturing. These are essential underpinnings for a “high road” of (converging) development based on increasing sophistication of production and South-South integration, supported by regional policy coordination, global trade and investment agreements and the expansion of regional infrastructure.

These policy choices will place a heavy burden upon policymakers in the South, especially in the most resource-constrained LDCs. Confronting this task will require more than individual determination to succeed: it also depends upon bold leadership, focused collective initiatives and a more stable and inclusive model of global interdependence. This is, precisely, at the core of UNCTAD’s vision

of development-led globalization. This new stage of globalization should transcend the current pattern of financial over-expansion and speculation, and foster a better regulated, more equal, and more resilient world economy.

The transition to a new model of interdependence must recognise the structural differences in South-South trade compared to North-South trade, as well as in South-South FDI compared to North-South FDI. For example, North-South economic relations are usually narrowly market-driven, and the ensuing economic asymmetries are reproduced by the power asymmetries between these states. In contrast, South-South economic relations are, generally, not purely or primarily market-driven, and relations between Southern states and firms hold out the potential for more constructive integration.

In order to resource this transition, it is centrally important that Southern balance of payments surpluses are recycled within the South. This can take place through regional and national development banks but more innovative mechanisms may also be needed. This is realistic, since there are multiple opportunities for investment in the South. It is also imperative, because of the insufficiencies which continue to plague conventional sources of funds, including aid, debt, the international financial institutions and Northern FDI. Recycling Southern surpluses within the South could help to stabilize the global economy, remove the financial and balance of payments constraints to growth in the poor countries, build productive capacities in line with national development priorities, support the expansion of domestic policy space, and reinforce the links between economies in the South.

Strengthening South-South economic and political relations can give a significant contribution towards global convergence within a development-led process of globalization. It can also foster a less financialized, better regulated and more resilient world economy. Despite the appeal of this alternative model of globalization, there are no guarantees that a more balanced global growth pattern will secure the elimination of poverty, decent labour standards or the incremental equalisation of the distribution of income and assets within countries. In this respect there is the greatest scope for internal variation, and the greatest need for policy direction.

Development-led globalization depends centrally on the flourishing of national development paths across all the countries of the South, and, in order to implement the required macroeconomic, financial, trade and industrial policies, developing country governments need additional policy space. However, this will not be given by others. Policy space is constructed domestically, and it responds to internal imperatives. UNCTAD is ready to assist in this process. In order to support the exchange of experiences especially around issues where the international community has fallen short, such as industrial policy, UNCTAD is proposing to establish a network of policy-makers across the South.

The agenda of development-led globalization is evocative of firmly-grounded UNCTAD themes around global rebalancing, economic diversification, inclusiveness, and the need for policy space. If South-South trade and financial relations can help to dislocate the most severe constraints to growth in the poorest economies, the ongoing rebalancing of the world economy can leverage the construction of a more sustainable and socially legitimate pattern of development. This new modality of inclusive, cooperative and South-centred global development is sorely needed by a world distorted by a regressive model of growth launched over three decades ago, and currently mired in a crisis which victimises disproportionately the poor, and the poorest countries.