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Evolution of South-South co-operation: Trends in a changing political economic context in the post-Cold War era

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Chapter 1

1.1 Introduction and Aim

The history of South-South economic co-operation[1] has been littered with many failed attempts. However, the broader international economic system is dynamic, and many factors in the calculations have changed considerably since the end of the Cold War. These include the political and economic context within which the World Trade Organisation (WTO) operates.

South-South co-operation therefore has to be viewed within the framework of the wide-ranging and rapid alterations that have occurred in the world economy since the early 1990s. These changes have affected the opportunities for growth and development profoundly, and present new challenges to the developing world (UNCTAD, 2004:1, TD/404). They signal an emerging shift in the balance of the global political economic system, and represent changes in international trading patterns and models of production and consumption (Heine, Mills and Porter, 1998:10).

Even contemporary South-South strategies are different to those articulated in the 1960s when they formed part of the Non-Aligned Movement's attempt to free Third World countries from the stranglehold of imperialist relations. New South-South paradigms are designed to carve out a stronger economic position for Third World countries within the global system. In particular they attempt to provide access to foreign direct investment (FDI), transnational capital, global production chains, cross-border mergers and acquisitions, and greater political recognition.

[1] The term 'South' refers collectively to "the developing countries of the world, most of which were colonies and are in the Southern Hemisphere". The 'North' therefore denotes the 'developed' world, collectively represented by the Organisation for Economic Cooperation and Development (OECD), and includes Japan, the US, Canada, most of Europe, Australia and New Zealand" (McGowan and Nel, 2004:163). However, 'the South' refers less to a geographic location than to a shared political interaction in the economic development of Asia, Africa, South America and the Caribbean. In this specific context, South-South economic co-operation thus refers to trade and investment among developing countries or countries of the 'South'.

This dissertation attempts to answer three questions that are fundamental to the positing of a changing political economic context and the resultant co-operation strategies and trends to be observed among countries of the South.

1) *What structural economic and political factors changed in the post-Cold War era to facilitate economic co-operation between states, particularly between those in the developing world?*
2) *Have these political and economic changes resulted in the emergence of new patterns of South-South economic co-operation in the post-Cold War international system?*
3) *Is there a causal link between the patterns of South-South co-operation and the 'new' knowledge economy?*[2] *If so, what is the link?*

In an attempt to investigate and answer these questions, the writer examines the evolution of South-South associations on initiatives that look *beyond* national or regional borders. It is important to note that co-operation at a regional level has had a critical effect on the Southern dialogue and therefore cannot be neglected. Regional economic and trade co-operation, which includes bilateral and regional trade agreements (RTA), is a mechanism employed by an increasing number of developing countries to expand mutual trade and investment.[3] Regional initiatives similar to the Association of South East Asian Nations (ASEAN), *Mercado Commun del Sur* (Mercosur) and the Southern African Development Community (SADC) are being pursued by Asian, South American and African states respectively, as strategies to encourage South-South co-operation. These arrangements seek to enlarge the region's economic space, attract FDI on better terms, and pool the economic, human, institutional, technological and infrastructural resources and networks of participating countries. The success or failure of each strategy will be explored in chapter.

A further intention of the researcher was to look at economic co-operation in the context of 'new' regionalism, and thus to concentrate on South-South co-operation initiatives that are *not* bound by the regional context. This section examines *extra-*

[2] The definition of the knowledge economy……..
[3] Regional integration by definition is "the process of closer economic co-operation and/ or unification between neighbouring states on a number of policy issues" (Nel and McGowan, 2002: 357).

regional Southern strategies, as possible 'new' patterns of economic co-operation amongst developing countries.[4]

Although economic co-operation at the extra-regional level does not necessarily take place among states that are geographically and hemispherically close to each other, these initiatives also aim to achieve greater efficiency in their use of shared scarce resources, so as to achieve higher rates of economic growth. Increasingly, developing countries are realising the potential of such co-operation alliances and new patterns of trade co-operation among the South are being formed. Through these wider economic alliances each member nation is able to specialise in producing the goods and services in which it is most efficient (Balaam and Veseth, 1996: 221).

South-South economic co-operation has thus taken on a new meaning in the post-Cold War era, influenced by the transforming political and economic variables in the global context. "Previously, the logic behind South-South co-operation was based on the need to widen markets on a sub-regional or regional basis, as a framework for Import Substitution Industrialisation (ISI) reflecting economies of scale. Yet the arrival of globalisation and increased liberalisation has shifted the emphasis from self-contained growth within regional and sub-regional parameters to one of enhancing the capacity of developing countries to participate in the global economy". (Minty, 1999:124)

The model offered by Puga and Venables,[5] *Trading arrangements and industrial development*, was developed in 1996 and will be used in this research paper to explain the role of trade in promoting industrial development among the countries of the global South. This model has significant relevance for understanding the patterns and basic assumptions of South-South co-operation, and is described and analysed in chapter 2. It draws on the theoretical debates about liberalism and dependency on

[4] According to UNCTAD's 2005 report, "65 WTO members were engaged in regional trade agreements that were 'cross-regional' in nature, suggesting that the term 'regional' is, to some extent, losing geographic connotation in the context of this growing number of RTAs of variable configuration" (UNCTAD/DITC/TNCD/2005/6:24).

[5] There are various versions of the original paper written by Puga and Venables on which this dissertation is based (Puga, D and Venables, A. 1996. *Trading Arrangements and Industrial Development.* CEP Discussion Papers. No. 0319. Centre for Economic Performance, London School of Economics). These variations include Puga, D. & Venables, A. J. 1998. *Trading Arrangements and Industrial Development*, World Bank Economic Review, Oxford University Press, vol. 12(2), pages 221-49 and Puga, D and Venables, A. 1999. *Trading Arrangements and Industrial Development*, Policy Research Working Paper Series 1787, World Bank. World Development Indicators, 2003.

which the assumptions of this dissertation are built. These debates will be examined in greater detail in the final stages of chapter 1.

The model designed by Puga and Venables' describes numerous forces that enable and persuade firms to agglomerate[6] in developing markets. It focuses on the location of firms pursuing maximum profitability, and sets out those factors that encourage the concentration of firms in a specific location. These forces, described in chapter 2, include a cheap labour supply, competition among firms, and the proximity of the firm to its suppliers. These variables and others mean that industrial growth is no longer restricted to Northern markets. This in turn has encouraged firms to locate and open operations in developing markets in Southern economies. A good example of this is the production chain patterns in the automotive industry. Although companies such as Volkswagen and General Motors are owned by First World states, in many cases the production and assembly of automotive parts takes place in countries of the South, such as Mexico, Argentina and South Africa.

Chapter 3 and 4 of this research report describe the defining structural features of two eras in the political economy: the post Second World War and post-Cold War eras and their influence on the growth and development strategies of countries of the South. The post World War II global political economy[7] (approximately from 1945–1989) was characterised by isolationist, inward-looking, dependency-inspired policies in developing countries. Analysts argue that this era focused predominantly on a political agenda in terms of which economic integration and co-operation was a policy option and not a prerequisite for development. Public-sector enterprises were a defining feature of this period, which differed substantially from the post-Cold War era which followed. Since the 1990s economies around the world have opened up substantially, in large part owing to the end of the Cold War, the liberalisation agenda

[6] 'Agglomeration' in this context refers to the concentration of a disproportionate share of economic activity in a small set of areas (Combes, P, Duranton, G and Overman,H. 2005:5).

[7] Balaam and Veseth provide us with a useful definition of *International (or Global) Political Economy (IPE)* as being 'the study of a fundamental tension between and dynamic interaction of two spheres of life, which we can variously call 'politics and economics' or 'states and markets'' (Balaam and Veseth, 1996:3). Susan Strange's definition of International Political Economy concerns the social, political, and economic arrangements affecting the global systems of production, exchange, and distribution and the mix of values reflected therein (Strange, 1984).

of the WTO, and the emergence of the knowledge-oriented, technology-driven and private sector-led global economy.

Examples of South-South co-operative, issue-based strategies that were initiated after World War II include the New International Economic Order (NIEO), the United Nations Conference for Trade and Development (UNCTAD) and the Group of 77 (G-77). The writer investigates the political and economic context within which these initiatives were formed, and suggests reasons for their relative success or failure. The focus will then shift to South-South co-operation strategies implemented after the Cold War, namely the South Commission (1990), the Group of 20 (G-20 +), UNCTAD XI and the India, Brazil and South Africa Initiative (IBSA),[8] with the intention of analysing how the structural reforms in the political economy (such as the knowledge economy and the liberalisation agenda of the developing world), have transformed South-South co-operation strategies. In discussion of these more recent initiatives, the researcher pays specific attention to the 'new' economy. The emerging initiatives are described in chapter 4.

The findings presented in chapters 3 and 4 are then analysed according to the Puga and Venables model. This method makes it possible to understand the new patterns and assumptions of economic co-operation among the countries of the developing world in the 'new' economy. Technology transfer and technological change have clearly influenced the indices on which models such as Puga and Venables are based. This model is thus limited in the context of increased interdependence as a consequence of globalisation, and the knowledge-oriented economy – which is rapidly accelerating the inclusion of developing countries in the spatial reorganisation of international and domestic economic activities. Technological factors other than transport costs are absent from this model and are addressed in chapter 4, which awards more attention to the causal link between patterns of South-South co-operation and the new knowledge economy.

Structural changes in the political economy have been widespread, and have affected development all over the world. The rapid growth of technology, especially in

[8] The examples utilized above are representative samples of developing world coalition strategies. These are by no means the only initiatives that exist.

communications, has accelerated the pace of globalisation and has led to an unprecedented growth in services, organisational innovation and specialisation. According to the OECD, "New technologies and their implementation in productive activities are changing the economic structure and contributing to productivity increases in developing economies". The OECD also states that recent trends include the "new interactions owing to the increasing importance of networks, linkages, partnerships and mobility" (OECD, 2005:8).

The model used by Puga and Venables does not accommodate these changes. It has therefore been supplemented in recent years by those of various authors such as Moen (1998)[9], Mayer (2004)[10] and Hur[11] (2001). These authors' contributions to the new economic geography have attempted to illustrate the new agglomeration patterns of industrial activities in geographic space.

Although Puga and Venables assume that all countries have the same relative endowments, technologies, and preferences, this is however not the case, especially in the contemporary political economy, where knowledge-based technology is not evenly distributed. This works to the advantage of the more advanced and industrialised economies. Chapter 5 concentrates on the greatest diversities between the developing countries themselves – some of these being the undeniable beneficiaries of the changes, and others not. Brazil, India and South Africa are used to illustrate this point in chapter 5. The examples also prove that there are new patterns of economic co-operation emerging in the post-Cold War international system. India and Brazil are the long-standing developing country 'big beasts' in GATT/WTO. South Africa, although lacking the economic and political weight of the other two, also exerts considerable power, particularly as the most important trading nation in Africa, ahead of Egypt, Nigeria, Morocco and Kenya (Draper and Sally, 2005:2).

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[9] Moen, J.: 1998. *Trade and Development: Is South-South co-operation a feasible strategy?* Department of Economics, Norwegian School of Economics and Business Administration. pp. 260-285

[10] Mayer, J.: *Industrialisation in developing countries: some evidence from a new economic geography perspectives* in United Nations Conference on Trade and Development. Discussion Paper. No. 174. August 2004.

[11] Hur, J.: November 2001. *Effects of Regional Trade Agreements on Industrial Structure: An Extension of Krugman's Economic Geography Model (1991).*Working Paper No. 0113. Department of Economics, National University of Singapore. pp.1-28.

China has clearly joined this select rank of 'heavy-weight' developing countries because of its accession to the WTO in 2001. In certain instances China has forged links with other developing economies and claims to be an advocate of the South[12]. However, in this research it is regarded as a separate entity and not as a typical example of a developing southern economy pursuing economic alliances with other developing states. Countries that are included under the category of typical emerging southern economies are India, Brazil, South Africa, Mexico, Argentina, South Korea, Malaysia and Thailand.

China has a unique political economic structure that displays characteristics of both First and Third World countries. In its current state of economic growth and development - with a population of approximately 1.3 billion people and an economy of $1.6 trillion - it is virtually incomparable with other smaller economies. Its extraordinary performance has been based on expanding its industrial sectors and focusing on labour intensive manufacturing. Therefore, although it cannot be classed as a typical emerging economy, China's case is worth examination in detail. A full analysis is provided in chapter 6 of this report, along with a brief description of the impact China is having on South-South co-operation statistics.[13]

1.2 Rationale

"Regionalism seems to be on the rise in the post-Cold War era" (Yopo, 1998:16), as part of the substantial efforts being made by the South to incorporate itself fully into the global economy (Minty, 1999:124). The current juncture of international relations imposes greater pressure on developing countries to conform to the dictates of a liberal global order (Le Pere and White, 2005). As a result, new economic patterns of co-operation have emerged among countries of the developing world. According to the findings of UNCTAD's 2005 Trade and Development Report, "there has been a

[12] China has participated actively in a number of Southern coalitions. According to Narlikar and Tussie, China played a leading and committed role in the Group of 20 (G-20) negotiations at the WTO Ministerial in Cancun. "In China's resistance against the EU and US, it captured a great deal of public attention" (Narlikar, A and Tussie, D. 2004:953).

[13] Trade data released by UNCTAD and others are exaggerated, as they include intra-APEC trade when calculating the total percentage of South-South trade. Figures of inter-developing country economic cooperation are therefore unrealistically high.

rapid rise in the importance of South-South trade over the past two decades" (UNCTAD, TDR/2005).

South-South trade accounts for approximately 12% of total world trade, but is growing significantly (UNCTAD, 2003). Intra-developing merchandise trade has grown twice as fast as world trade over the past decade (Australian Commission, 2004:1), and developing countries now account for 32% of total global trade (UNCTAD, 2004). Importantly, over 40% of the exports of developing countries are to other developing countries, and trade among them is increasing at the rate of 11% per year. Imports from other developing countries are even higher, representing 41% of their imports in 2001 compared with 31% in 1990 (World Trade Organisation, 2003). South-South trade in services also offers the South substantial possibilities (Meltzer, 2004:14), and are earning a greater share of output, accounting for 45% of GDP in low-income countries, 48% of GDP for lower middle-income countries and 60% of GDP for upper middle-income countries.[14] *Appendix A* (see p. 88) provides the relevant figures, and charts the changing trade landscape, with emphasis on the increasing co-operation between developing economies. However, the reader should bear in mind that the baseline which these figures have been examined is very low, and is therefore not comparable with the statistics for trade co-operation among large Northern markets**.**

With the shift from dependency to liberalism, developing countries have become increasingly aware of the economic gains to be had from opening up their markets to southern states.[15] Trade and investment between developing economies has been promoted as an alternative to the traditional pattern of North-dependent trade relying on primary commodity exports in exchange for imports of manufactured goods from developed countries (UNCTAD, TDR/ 2005). Rich countries, moreover, have

[14] "To date, most developing country services trade has been with developed countries, in the form of travel and transportation services, information, communications and financial services, and migrant labour" (Autralian Government, 2004:15).

[15] Although the world economy grew by almost 4% in 2004 (recording its best performance since 2000), growth in 2005 is expected to fall to around 3%. Most of this deceleration is attributed to the slowdown in developed economies, although certain Southern economies seem to also be losing steam. (Developing economies are expected to grow in 2005 by 5 to 5.5%, down from 6.4% in 2004). This decelerated growth in the North and its continued trade barriers against products of export interest to developing countries implies that southern economies need to give greater attention to each other's markets to promote export growth (UNCTAD, TDR/2005:128)

maintained tariff rates in areas where developing countries have comparative advantage: agriculture and labour-intensive manufactures. The World Bank claims that "developing countries would gain a lot from better access to each other's markets" (World Bank, 2002:18). South-South trade and investment co-operation has thus become an increasingly important economic alternative for those developing countries that seek to keep abreast of the changing political economy and to prosper and develop in the globalising world markets. According to Le Pere and White, it is also imperative for developing countries to forge closer strategic and institutional alliances in order to improve their chances of increasing material conditions, to fight poverty and foster development (Le Pere and White, 2005).

However, development does not take place evenly, or at the same pace, among southern economies. Certain states on the semi-periphery,[16] such as Brazil, India, and South Africa have reconsidered their trade strategies and are benefiting from coalition-formation with each other. Smaller, less developed states are, however, deteriorating economically because they are unaware of the new opportunities and pattern-formations that are now available.

It is also important to realise that two-thirds of South-South trade takes place in Asia (and significant trade between Latin American countries has also been recorded in recent years). Intra-regional trade expanded faster than trade with countries outside the region in the 1990s (Soko, 2005:5), as already noted This point is supported by UNCTAD's 2005 Trade and Development Report, which explains that "the most important reason for the rapid growth of South-South trade is that output growth in some large developing economies, particularly China, has been much faster than in developed countries" (UNCTAD, TDR/2005:129). However, for several reasons Africa remains the only region that has not benefited meaningfully from the growth of trade among developing countries. Trade between African countries constitutes less than 15% of the region's exports.

[16] A country that is classified as semi-peripheral is both a core and periphery country (Wallerstein, 1986). These countries are generally major exporters of minerals and agricultural goods, and have large manufacturing bases. In this context, countries are classified according to their economic performances in the global economy. States that are semi-peripheral are generally the best performing economies among the developing countries.

With this discrepancy, and with the desperate need to improve development on the African continent in mind, the governments of developing countries need to initiate a self-help mechanism. South-South co-operation has been academically neglected in the past due to the failure of most attempts to bring it about. Consequently, no global overview of South-South co-operation under the changing circumstances has been undertaken. Recently published records that establish the rapid growth of the 'semi-periphery' are not enough as they do not provide information about countries on the periphery, making it difficult for researchers to address this gap. The state of South-South co-operation could be used as a basic reference and is a policy and analytical tool to assess what mutual co-operation can do for the developing world.

The failure of numerous South-South co-operation initiatives has often been attributable to the structural economic and political reforms attempted at the time. It is thus imperative to consider the evolving global context and the factors that are shaping South-South co-operation today. For example, the impact of globalisation and the new economy on South-South alliances cannot be underestimated. The knowledge economy, technological transfer and technological change have clearly improved the possibility of successful Southern alliances by making co-operation strategies more feasible. It is therefore imperative that extensive research is undertaken to establish and verify the link between the new economy, the effects of emerging economic changes, and evolving trends in South-South economic co-operation.

1.3 Methodology

This research report includes qualitative and interpretative approaches from an abundance of secondary sources. Quantitative data such as comparative statistics from the World Bank Indicators, UNCTAD Trade and Development Reports and economic data from the Department of Trade and Industry are applied, to illustrate and substantiate various arguments. Historical-comparative research is used to explain the change in a phenomenon over time, as it "examin(es) the combinations of social factors that produce a specific outcome" (Neuman, 2003). This approach allows the investigation of the changing role of the developing countries in South-South co-

operation (Nueman, 2003: 402), and in mapping the political and economic factors that have shaped Southern alliances.

A substantial amount of secondary literature on the changing political economy in of the post-Cold War era exists. Much research has also been published on the development of new patterns of economic co-operation amongst developing countries that have been made possible by in the context of the knowledge economy. The researcher made an extensive bibliographic search to extract relevant sources of information and analyse them. Various UNCTAD documents proved very useful, particularly the recent edition of the *Trade and Development Report, 2005*, where an entire chapter is allocated to investigating "a new form of global interdependence". This refers specifically to the growing importance of South-South trade and the emergence of "the new geography of trade" (UNCTAD, TDR/2005). The researcher consulted official documents from the World Bank, the WTO and the OECD; the policy documents of IBSA, G-20+ and G-77; numerous discussion papers from the South Centre *(South Centre Bulletin)* and the London School of Economics and articles from *the Cambridge Journal of Economics*, the *Journal of International Affairs, the South African Journal of International Affairs* and *International Studies Quarterly*. The Internet also provided valuable current information, for example the data published on the websites of the Departments of Trade and Industry of numerous countries and the official websites of the WTO and UN. The Internet made it possible to access particular articles with bearing on current events.

Qualitative and quantitative data from various UNCTAD conferences held after 1964 can be compared over a number of years to map those political and economic factors that have influenced South-South co-operation, and altered the role of developing countries in a contemporary context. UNCTAD reports, such as the *New Geography of International Trade: South-South co-operation in an increasingly interdependent world* and *UNCTAD XI- the Spirit of Sao Paulo*, trace the performance in trade of developing countries, and supply accurate quantitative data to support their findings. *UNCTAD Independent Journal* has also been useful in terms of tracking recent events at the UNCTAD conferences, and analysing new forms of South-South consultation and co-operation. In many of the recent documents published by UNCTAD XI, authors refer to the *New Geography of International Trade*, which describes changes

in the traditional pattern of trade, economic development and the international division of labour (Charveriat, 2004; Khor, 2004 and Lavangna, 2004). The *Spirit of Sao Paulo* also emphasises the growing importance of the South in international trade (UNCTAD XI, 2004: TD/404). Although they focus predominantly on the developing world, and at times appear slightly over-optimistic, the UNCTAD documents are valuable in that they do not ignore the role played by the North, and recognise that it will continue to exercise a decisive influence on developments in the world economy and trade.

An important component in this dissertation is the use of quantitative data to measure the increase and decrease of trade among developing countries over a specific period. Statistics can be gathered from *World Bank Indicators (2003),* the Economist Intelligence Unit, the Trade and Development reports from the UNCTAD journals and websites, the *South Bulletin*, the *Trade and Industrial Policy Strategies (2004)* and from the Australian Commission. The researcher charts changes in the political economy by measuring levels of trade and using the statistics provided.

Field interviews were conducted in pursuit of primary sources of information. The South African Department of Trade and Industry and the Department of Foreign Affairs are both valuable sources of information, because they deal with trade–related issues that are relevant to South Africa's role as a leading developing country. The former Trade Project Manager at the Department of Trade and Industry, South Africa, Peter Draper, agreed to provide data for the report, and Lyal White, a senior researcher from a reputable South African think-tank, was approached for comment on various aspects of the research and his views on the future of the WTO and on South-South initiatives such as UNCTAD and the G-20 +. Economists including Phil Alves and Owen Wilcox from Trade and Industrial Policy Strategies (TIPS) also contributed expert opinions on economic aspects of South-South co-operation in a changing political and economic environment.

Another source of valuable data was the IBSA Conference that took place at the Rosebank Hotel in Johannesburg on 15 February 2005, which provided information on the new trade geography of the current decade, and an opportunity to interact with experts from organisations in various developing countries. The presenters included

Cintia Quiliconi from the Latin American Faculty of Social Sciences (FLASCO), Argentina; Mario Marconini from the Institute for International Trade negotiations (ICONE), Brazil; Pranav Kumar from the Centre for International Trade (CUTS), India; and Lyal White from the South African Institute of International Affairs (SAIIA), South Africa. Each speaker provided information specific to his or her specific individual country and evaluations of South-South co-operation initiatives in general, together with the potential of new Southern alliances such as IBSA. (Their contributions are discussed in greater detail in the latter part of the dissertation).

1.4 Literature review

The debate concerning economic dependency versus liberalism are examined in the theoretical analysis provided in this report. Both debates refer to the evolution of the political economy, and both have specific bearing on the economic integration of Southern economies into the global trading system. These theories underpinned the multilateral agendas of the past, and continue to exert a powerful influence on development in terms of today's bilateral initiatives. An abundance of secondary literature exists on both schools of thought.

According to the leading dependency analysts, which include Prebisch, Ferraro (1996) Rourke (1999) and Krasner (1981), Bertelsmann and Mutschler (1997), dependency theory that developed in the 1960s, explained the economic strategies of developing countries through the analysis of centre-periphery relationships. These focused on pursuing policies of self-reliance. Poor countries endorsing interaction only if the terms of co-operation promised to improve the social and economic welfare of the citizenry (Ferraro, 1996). Not only did dependency exist among the North and South, but among countries belonging to the developing world. Sunil Kukreja (1996) describes the economic inequalities that exist among states in the South, contrasting the development of economies in the East Asian region with that of economies in Sub-Saharan Africa to illustrate his point.

However, according to Krasner's *Third World against global liberalism* (1985) that an increasing number of developing countries turned to their membership of

international organisations to foster Third World solidarity and generate a momentum for change in the political economy. This led to the creation of UNCTAD and the G-77. Krasner (1981: 143) argues that vulnerabilities that arose from domestic and international weaknesses at the time provided impetus for Third World demands. International organisations provided the opportunity to realise these goals, the form and unity of which have been shaped by the pervasive acceptance of dependency orientations. Most developing countries explicitly attributed their underdevelopment to the workings of the international economic system rather than to the indigenous characteristics of their own societies. This belief system was not only been endorsed by individual states, but also by such organisations such as UNCTAD and the UNDP. Individual states may reject dependency prescriptions in practice, but even the most conservative cannot offer an alternative.

Although dependency theory still provides justification for the vast economic inequality that prevails today, and gives a realistic interpretations of North-South economic relations in a global context, another theoretical framework has challenged its supremacy. The end of the Cold War brought about the emergence of liberal economic policies and institutions. These are described and defended by numerous authors. Balaam and Veseth (1996), Dos Santos (1970), Neumann and Waever (1997) all contend that the co-operative strategies of today are predominantly liberal in their orientation. According to Nel and McGowan, liberalism allowed international organisations to encourage states to co-operate on functional issues such as trade and economic development (Nel and McGowan, 2002:59). This argument is endorsed by Boris Yopo (1998) in *New regionalism of the South* and by Greg Mills (1998) *in Looking sideways: the specifics of South-South co-operation.* These authors describe the trend towards new regionalism in the South, agreements on regional economic integration and/ or political co-operation emerging in the less developed areas of the South. In the majority of cases, regionalism is viewed as a pre-condition for securing greater competitiveness, better positions in global markets and increased negotiating capacity in the field of international economic and political relations. Yopo argues that development options which emphasize autarchy and national self-sufficiency have been discarded almost everywhere. Expanded markets are also considered to be more attractive to foreign partners, and effective instruments when competing for goods, services and capital in world markets (Yopo, 1998:17).

Yopo's views on regionalism have evolved in response to changing structural circumstances and economic and political ideas. In the past, regionalism in Latin America, for example, was seen as a way to further the process of import-substitution industrialisation in the region, providing sufficiently large markets to satisfy economies of scale. Protective barriers were accordingly raised against competitors outside the region. At that time integration was perceived as an instrument of collective defence against external threats. In contrast, the new integration schemes are based on across-the-board and accelerated liberalisation; reciprocity in the concession of preferences; a search for special trade relations with developing countries; institutional flexibility; and collective leadership by the governments involved, rather than by autonomous technical secretariats (Yopo, 1998:17).

Nel and McGowan in *Power, Wealth and Global Equity: An international relations textbook for Africa* (2002:83), and Balaam and Veseths *International Political Economy* (1996) provide interesting analyses structural factors that have changed the political and economic context since the 1960s. Nel and McGowan provide a detailed critique of the oil crisis, the debt trap and the new international economic order that resulted. They explain how these external factors brought about the South's gradual adoption of the free market system and policies focused on promoting external trade.

In *The Wired Model* (2000) Greg Mills provides insight into other factors leading towards economic liberalisation. Examples are the collapse of many East Asian economies in 1997 and the resultant turmoil in developing markets; and the stagnation and long recession in the Japanese economy. Other authors such as Birdshall and Williamson (2002), Krasner (1985), Gordon (1993) and Rodrik (1999) contribute interesting perspectives, not only on the external forces bringing about changes in the political economy, but also on First World donors insisting on domestic reform in African states as a condition for development aid.

As already noted, the model of development initiated by Puga and Venables (1996), called *Trading Arrangements and Industrial Development* was used by the researcher as a basis on which the argument of this dissertation is founded. This model has been commented on by numerous authors such as Moen (1998) *in Trade and Development:*

Is South-South Co-operation a feasible strategy? and Hur (2001) in *effects of regional trade agreements on industrial structure*.

Jarle Moen describes the linkages between the effect of each country's economic policy on structural features of the world economy (1998:245), and provides valuable insights into the evolution of regionalism and South-South co-operation. His article describes the neo-classical theory of economic development, and then progresses to the new trade theory that superseded it from the 1980s onwards. He distinguishes between the advantages and disadvantages of import substitution and export promotion for the developing economies. Moen's reference to Puga and Venables is particularly relevant as he links their model to South-South co-operation and its feasibility in today's terms.

In *Industrialisation in developing countries: some evidence from new economic geography perspectives*, Jorg Mayer (2004) provides a useful analysis of industrial activity in different sectors that has spread from the developed to developing countries, and is not dependent on linkages with other firms. Mayer concludes that the Southern economies that have an already established industrial base achieved industrialisation before those with undeveloped industrial bases. Mayer explains that only a select group of emerging economies have been the beneficiaries of globalisation; that is, they have managed to incorporate themselves into the global economy. Economies of this sort include those of China, India, Brazil and South Africa.

Other authors refer to the emerging economies of the South, describing the changes both in their roles in international organisations and in the manner in which they interact. These explain the introduction of new South-South strategies such as the India–Brazil–South Africa (IBSA) dialogue forum, initiated in 2003. Lyal White provides an analysis of the IBSA initiative in *South-South co-operation with a difference*, published in August 2004, in which he describes the purpose and intentions of the co-operation strategy. Alden and Vieria in *The New Diplomacy of the South: Brazil, South Africa, India and Trilateralism (2004)* describe IBSA as a 'stepping stone' towards broader co-operation among developing countries.

Although there is an abundance of literature on numerous topics explored in this research report, some gaps remain. South–South co-operation has changed substantially since the end of the Cold War. Developing countries have more weight and are demanding greater preferences in the WTO Ministerial Rounds as well as on the global map in general.

1.5 Theoretical background and existing theory

Dependency and liberalism are both theoretical approaches used to analyse the evolution of the political economy, with specific reference to the trade and integration of Southern economies. Dependency theory has the virtue of explaining the vast inequalities between countries in the contemporary political economy. Nevertheless, the co-operation strategies of today are predominantly liberal in their orientation. In contemporary terms the South pursues a predominantly neo-liberal orthodoxy, in line with the conditions laid down by foreign investors from the more powerful countries. Although liberal norms have been adopted, the South still depends on the North as the latter represents bigger markets, more spending power and greater opportunities.

Therefore, in many instances dependency theory and liberalism cannot be separated. It is true that because of the superior economic and political power of the North, countries of the South have had no other option but to adopt liberalism and incorporate the modern structure of the political economy into their domestic policies.

However, the knowledge economy and an increasingly integrated global economy have added new dynamics to this debate. An analysis of the theories of dependency and liberalism in new regionalism will thus be explored in more detail by the researcher.

1.5.1 Dependency Theory

Dependency theorists argue that the underdevelopment of most countries of the South (the periphery) has been caused by their economic, political and cultural dependence on the rich countries of the North (the core). According to dependency theory, the

poverty and political instability of Southern countries is not caused by their internal characteristics alone, but by their unequal, vulnerable external relationships with the North (McGowan and Nel, 2002:343).

Dependency theory was developed in the late 1960s under the guidance of the Argentinean economist and Director of the United Nations Economic Commission for Latin America, Paul Prebisch (Ferraro, 1996). Dr Prebisch gave expression to the development 'problematique' of the developing countries through his analysis of economic relationships in terms of core and periphery, commodity issues and the terms-of-trade problems of developing countries. In so doing he focused a spotlight on the inherent defects of the international economy and of the global trading system (UNCTAD, June 2004). Prebisch argued that the political economy of the time was characterised by inward-looking trading policies that promoted industrialisation through import substitution. This international trading system, as Prebisch and others contended, reinforces the role imposed on less-developed nations (LDCs) as producers of industrial goods. This international division of labour reinforced the dependence of the less-developed countries on the developed nations, which provided outlets for the primary products of the LDCs (Kukreja, 1996:321). In addition, production specialisation also perpetuated the dependence of the LDCs on the developed countries for capital and technology, each of which make necessary for their economic development.

Dependency was thus maintained through structuring the rules and practices of international economies to benefit the developed countries (Rourke, 1999:400). This economic theory thus entails that the promotion of capitalist norms of trade liberalisation and interdependence is a mechanism by which the North can influence and drive the Third World. Dependency theorists thus believe economic co-operation between North and South can be dangerous.

Presbisch was a keen promoter of UNCTAD. The Declaration published at the end of the first session of UNCTAD in 1964 stated that "the international trade regime should adopt a modified international division of labour which was more rational and equitable, and was accompanied by the necessary adjustments in world production and trade" (UNCTAD I, 1964). The resultant increase in productivity and purchasing

power of the developing countries would also contribute to the economic growth of the industrialised countries as well, and thus become a means of worldwide prosperity (Ferraro, 1996).

According to dependency theorists such as Ferraro (1996), Osvaldo Sunkel, Pedro Paz and Andre Gunder Frank, dependent states, therefore, should pursue policies of self-reliance. Contrary to the neo-classical models endorsed by the Bretton Woods institutions, particularly the International Monetary Fund (IMF) and the World Bank (WB), greater integration into the global economy is not necessarily a good development choice for poor countries. Often reliance is viewed as an endorsement of a policy of autarky. Dependency theorists believe that the failures of neo-classically inspired policies are clear, suggesting that they do not serve developing countries well. A policy of self-reliance would mean endorsing controlled interactions with the world economy. That is, poor countries should agree to economic interactions only on terms that promise to improve the social and economic welfare of the citizenry in general (Ferraro, 1996).

Sunil Kukreja introduces an important angle to the debate by claiming that although dependency theorists focus predominantly on the growing gap between rich and poor nations, one must not neglect the increasing differences in the levels of development of the less developed countries. This haas led to the dependency of LDCs on the more advanced developing nations (Kukreja, 1996:313). In the 1950s and 1960s, LDCs had many similarities including their colonial history and their desire for growth. By the 1990s, however, many of these nations had started to realise economic success. Various Eastern and Southeastern Asian countries had some of the fastest-growing economies in the world, while many others, especially in the Sub-Saharan African region, continued to be beset by widespread poverty and poor standards of living. These variations among regions are further complicated by extreme disparities both regions and within nations themselves (Kukreja, 1996:313). (Inequality among developing nations will be explored in more detail in the final sections of the dissertation.)

Although dependency theory is generally seen as discouraging South-South co-operation, Bertelsmann and Mutschler (1997) describe two recent developments that

strengthen the argument for improved collaboration in the fields of trade and investment across the globe. The first of these has been the economic growth of some developing states, particularly in Asia and Latin America, and signs of economic recovery in certain African states. The foreign policies of these developing states have been altered in order to incorporate fresh strategies to enlarge their markets, thus supporting the entrance into the markets of other developing countries. This means that the fate of the South is no longer dictated solely by the perceptions and policies of the governments of the North. Instead, the leading countries of the South are showing a desire to participate in institutions and negotiations that are inclusive rather than exclusive in nature (Bertelsmann and Mutschler, 1997). The second has been demonstrable progress towards the establishment of multilateral and regional economic groupings that cut across that were First and Third World divisions. This critique of the dependency theory tends to favour liberal norms and ideas.

In similar view, Krasner's *Third World against global liberalism (*1985) [17] illustrates how an increasing number of developing countries have turned to their membership in international organisations as a means to foster Third World solidarity and generate momentum for change in the political economy. This thus led to the creation of UNCTAD and the G-77. Krasner's view is that the dependency orientation fulfilled important functions for the developing states, both internationally and domestically. At the international level, dependency arguments provided a unifying rationale for diverse demands from the Southern bloc. "Calls for special and differential treatment were justified by the contention that the South had been treated unjustly in the past" (Krasner, 1981:144). Existing norms and rules were rejected by advocates of the South as inherently exploitative. This argument underlay the Third World's strategy of using international organisations to promote meta-political and economic goals. In certain instances the countries of the Third World displayed the ability to define issues and control the agenda.

Krasner goes on to explain that dependency theory is a key factor in explaining the unity maintained by the Third World in its quest for a new international economic order (NIEO). Despite the substantial diversity that existed among developing

[17]Krasner, S.: 1985. *The Third World Against Global Liberalism*, University of California Press, Berkeley.

countries with respect to economic and political structures, there have been few outright defections from the G-77. Krasner believes that this viewpoint is widely accepted within developing countries, and not merely voiced at international forums. This which makes it difficult for even highly-developed Third World countries with conservative regimes to break with the rest of the states from the South and endorse the liberal order instead. The South therefore supports transformation of the international trade regime. (Krasner, 1981:145). Although Krasner's book does explain the change in Third World attitudes and introduces an important motive for co-operation and coalition among the countries of the South, his argument is highly controversial in today's terms. Its merits are debated in the section that follows.

1.5.2 Liberalism

The end of the Cold War era brought about the emergence of liberal economic policies and institutions. McGowan and Nel describe liberalism as "the political and economic doctrines stressing individual freedom and responsibility" (Nel and McGowan, 2003:22). Liberalism emphasises the plurality of actors in international relations, and promotes the advantages of co-operative relations among them. Liberals argue that the lowering of barriers between countries encourages interdependence and raises the costs of conflict. They also hold that the strengthening of international law and the creation of international organisations will foster peace and co-operation. It was liberal theory that encouraged international organisations to devise ways in which states of the world could co-operate on functional issues such as trade and economic development. The more areas in which countries co-operate, and the better the sharing of information about each other's interests and concerns, the more opportunities there are for them to sort out their differences peacefully (McGowan and Nel, 2003:23).

Economic co-operation is further supported in liberalist doctrine by the proposition that the international economy is a positive-sum game in which prosperity is available to all (Rourke, 1999:398). Liberals contend that the best way to create prosperity to free economic interchanges from political restrictions and to enhance interdependence. They oppose the use of national economic, such as using tariff barriers or domestic subsidies to distort the free flow of trade and investment, to

dominate trade with other countries. Free international markets are perceived as stimulating industry, encouraging innovation and raising production (Balaam and Veseth, 1996:39). These liberal ideals of economic co-operation originate from Adam Smith's *The Wealth of the Nations* (1776), and have endorsed by authors such as David Ricardo, John Keynes, and by the French capitalist philosophers known as *les Economiste* (Rourke, 1999:463).

Liberalism has been considerably adapted much since these traditional ideals were first set out, because critics argue that critiques these aims are highly optimistic and unrealistic. Stubbs and Underhill (2000) state clearly that a "positive-sum game (does) not exist in the contemporary political economy". Gains by one nation would surely be got at the expense of others, which would result in inequality and unfair advantage for the more powerful nations. Liberals have also come to the realisation that the state has a crucial domestic role to play in equalising income, decreasing inflation and unemployment, and preserving the environment, among other things. This has become a widely accepted viewpoint in political economic discourse, although the desirable degree of state intervention is still hotly contested.

Although dependency theory retains some explanatory power[18], the co-operation strategies of today remain predominantly liberal in their orientation. Nowadays most countries of the South pursue neo-liberal orthodoxy, in line with the principles imposed by the foreign investors of the more powerful countries. However, although liberal norms have been adopted and are being implemented in the South, the latter continues to depend on the North, as it represents bigger markets, more spending power and greater opportunities.

Dependency theory and liberalism are therefore difficult to separate in many instances. Because of the economic and political power of the North, and the dependency of the South, the latter has had no option but to adopt liberalism and incorporate the structure of the modern political economy. Liberalism and dependency both underpin current bilateral agendas, and have substantial influence on development in today's terms.

[18] According to Theotonio Dos Santos (1970:231), the structure of dependency today takes other forms, such as the post-war multilateral corporations.

To provide a context, the reader should remember that differences in relative factor endowments, technology and policy regimes have traditionally been seen as determining the discrepancies in the pattern of economic activities in developed and developing countries. Such explanations have been supplemented in recent years by contributions of numerous authors to the 'new economy geography', which emphasises mechanisms that lead to the agglomeration of industrial activities in geographic space, and show why even initially similar countries can develop very different production and trade structures.

For the purpose of this research, the model presented by Puga and Venables, *Trading Arrangements and Industrial Developments* (1996) was applied. The two authors use this tool to analyse the role of trade in promoting industrial development among countries of the global South, drawing on the liberalist and dependency debates and the new economic geography.

1.6 The Puga and Venables economic model: the role of trade in promoting industrial development among countries of the global South

The Puga and Venables model examines whether firms are likely explores to agglomerate in developing markets. The authors identify the imperfect competition that exists between firms with four forces that determine profitability, and consequently dictate the location of firms.

1) A significant number of manufacturing firms in a single location causes wages to increase and profitability to decrease (increased factor market competition).
2) A large number of manufacturing firms increases supply and drives down product prices (product market competition).
3) Costs are reduced when a number of firms are based in a developed area. Firms have access to specialised intermediate inputs (cost linkages).
4) Profits are increased when firms locate to a developed area because demand is higher, raising the sales and profitability of other firms (demand linkages).

The first two factors (1 and 2) work to disperse activity and to encourage firms to choose locations where labour is cheap and there is little supply or competition from other firms (Puga and Venables, 1996: 224). However, although the firm would benefit from factor market and product market competition effects, it would forgo the benefits of proximity to its suppliers and its industrial consumers. If these forces are great enough, a process of cumulative industrial agglomeration will take place in less developed areas. Puga and Venables suggest that when a development process has started it might become self-reinforcing, and provide a mechanism for the 'takeoff' of an industrialising economy (Puga and Venables, 1996: 222). All of these points assume that there are differences in underlying comparative advantage; that is, that some countries have greater industrial capabilities than others.

The last two forces (3 and 4) describe the cost and demand linkages. These are centripetal forces that work to concentrate industry in a single location. Cost-reducing factors such as knowledge spillovers, access to specialised labour and an increase in demand are added incentives for the agglomeration of manufacturing firms in a subset of countries. Taking these two points into consideration, it is therefore unprofitable for a firm to relocate to a developing country.

Jarle Moen (1998:260) argues that depending on the tension among the four forces causes the equilibrium pattern of location to alter. If the first two forces are more powerful than the last two, then it is generally the case that industry will operate in all locations. In this event, the model does not generate a distinction between the industrial and developing countries. It merely assumes that all countries have the same relative endowments, technologies, and preferences; therefore they should have similar industrial structures and patterns of trade. By changing the attractiveness of their base for manufacturing production, countries can potentially trigger – or postpone – industrial development.

In this framework there are two ways for southern countries to bring about trade liberalisation:

1) The first is *unilateral liberalisation*. This entails either a) an increase in product market competition between foreign firms and a reduction in profits, or b) an

increase in profitability because intermediate inputs can be imported more cheaply. The Puga and Venables model stipulates that option b) dominates, which suggests that unilateral liberalisation will encourage industrialisation. Analysis also shows, however, that although unilaterally liberalising imports of manufactures can promote industrialisation, membership in a preferential trading arrangement is likely to create larger gains.

2) The second is *South-South co-operation*, which also promotes industrialisation, but through the mechanism of increased local demand (Moen, 1998: 261). This explains why firms are reluctant to move to countries with lower labour costs, and shows how trade liberalisation can change the incentives for firms to open operations in developing countries.

Moen analyses the Puga and Venables model to determine whether unilateral liberalisation or South-South integration is the preferable strategy, and came to the conclusion that southern market integration was more beneficial, owing to the creation of a 'larger home market'. When a sufficiently large market size is not achievable, excess production will have to be exported and protection mechanisms implemented. Increased protection will result in an increase in competition, which will then have only a minor effect on profit margins. It is important not to forget that access to cheap imports is still a major drawing factor. Puga and Venables thus predict that in regional groupings where the distribution of industries has been left to market forces, development has tended to favour those regions and states with relatively high per capita incomes or relatively large domestic markets. Puga and Venables therefore describe North-South arrangements as even offering better prospects for participating southern countries, though not for countries that are excluded from the deal (Moen, 1998: 221). This point is re-emphasized by Jörg Mayer in his discussion paper, presented to UNCTAD in August 2004, *Industrialisation in developing countries: some evidence from a new economic geography perspective.* Mayer also concludes that in North-South trade arrangements, the developing countries attract more industrial activity than those countries not party to any other trade arrangements at all. He does, however, point out that this holds true only if the differences in the geographical distance and/or wage level, and/or developing market size do not outweigh the effects of a discriminatory trade policy.