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Changing nature of North–South linkages: Stylized facts and explanations

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Abstract

This paper examines the changing nature of growth spillovers between developed economies, the North, and developing countries, the South, driven by the process of globalization—the phenomenon of rising international trade and financial flows. We use a comprehensive database of macroeconomic and sectoral variables for 106 countries over the period 1960–2005. We consider the South to be composed of two groups of countries, the Emerging South and the Developing South, based on the extent of their integration into the global economy. Using a panel regression framework, we find that the impact of the Northern economic activity on the Emerging South has declined during the globalization period (1986–2005). In contrast, the growth linkages between the North and Developing South have been rather stable over time. Our findings also suggest that the North and Emerging South economies have started to exhibit more intensive *intra-group* growth spillovers.

JEL classification: F15; F42; F43

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> “Emerging economies are driving global growth and having a big impact on developed countries...As these newcomers become more integrated into the global economy and their incomes catch up with the rich countries, they will provide the biggest boost to the world economy since the industrial revolution.”
> The Economist, September 16, 2006

1. Introduction

Profound changes have been taking place in the global economy over the past two decades. First, trade and financial linkages between developed countries, the North, and developing countries, the South, have become much stronger. Second, a number of developing countries have differentiated themselves from the others in the South by growing at an

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extraordinary pace while rapidly integrating themselves into the global economy. Moreover, some of these developing economies have become increasingly important players in the global economy as they have begun to account for a substantial share of the world output.[1]

Understanding the implications of these changes is important for the design of macroeconomic policies and theoretical models. Deeper trade and financial integration between the North and South can generate faster cross-border transmission of macroeconomic fluctuations, and therefore, can have implications for international coordination of economic policies. In regards to the theory, a better understanding of international economic linkages could be helpful in the design of dynamic models that can replicate the changing nature of linkages between the North and South.

In light of these considerations, the objective of this paper is to provide a comprehensive analysis of the changing nature of growth spillovers between the developed economies of the North and the developing countries of the South. In particular, we address the following questions: first, how have the economic linkages between the North and South changed over time? Second, what are the implications of these changes for the transmission of macroeconomic fluctuations across these groups? Third, how have the dynamics of growth spillovers between the North and South been affected by the changes in international linkages?

As we review in Section 2, there has been a growing empirical research program analyzing the linkages between the developed economies of the North and the developing countries of the South. Our study contributes to this research program along several dimensions. First, to have a better understanding of the changing nature of linkages between these two groups, we examine sectoral interactions in addition to the conventional macroeconomic channels of interdependence. The earlier literature on the North–South linkages has mostly focused on the channels of transmission considering fluctuations in the standard macroeconomic aggregates, such as output, consumption, and investment. The sectoral analysis allows us to study the implications of dramatic shifts across industry, service, and agriculture sectors that have taken place over the past two decades.

Second, we employ a comprehensive dataset of 106 countries covering the 1960–2005 period. Considering the changes that have taken place over this period, we analyze the North–South linkages in three distinct sub-periods. The first period of 1960–1972 corresponds to the Bretton Woods fixed exchange rate regime. The second period of 1973–1985 is associated with a number of common shocks, including sharp fluctuations in the price of oil in the 1970s and contractionary (and highly synchronous) monetary policies in major industrial economies in the early 1980s. Finally, the third period, 1986–2005, represents the globalization era where there has been a substantial increase in the volume of trade and financial flows. By opening their trade and capital accounts during the globalization period, a number of emerging market economies have differentiated themselves from other developing countries in the South.[2] This observation is directly related to our third contribution, as discussed below.

Unlike the traditional North–South literature, we consider the South to be composed of two groups of countries, labeled as the Emerging South and the Developing South, based on the extent of their integration into the global economy. In particular, we divide the world (106 countries) into three groups of countries. The North is composed of 23 "core" OECD countries, the Emerging South includes 23 emerging markets, and the Developing South contains 60 developing countries.

In Section 3, we examine how the size distribution of these groups, and the dynamics of sectoral output, trade and financial linkages have evolved over time. Our results suggest that the Emerging South economies have increasingly become major players in the global economy because of their rapid economic growth fueled by the dramatic changes in their sectoral structure and international trade and financial linkages. As a result of these changes, the nature of interactions between the Emerging South and North has evolved from one of dependence to multifaceted interdependence.

[1] These changes have been the subject of several articles in the media, as the quote at the top of this page and following examples show: "The new prominence of emerging markets represent a sharp departure from the flurry of financial crises that tore through Mexico, Asia, and Russia in the 1990s..." (*USA Today*, February 8, 2007); and "the idea that the world economy was being pushed along in an American supermarket trolley was always an exaggeration... The difference now is that the rest of the world is doing more of the carrying..." (*The Economist*, February 24, 2007). In addition, these changes have recently been at the center of an intensive debate about whether emerging market economies can decouple from the slowing of the U.S. economy (see Dées and Vansteenkiste, 2007; Helbling et al., 2007).

[2] The globalization period also coincides with a prolonged decline in the volatility of output in a number of countries in the North (see Kose, Otrok, & Whiteman, in press). In addition, the beginning of the globalization period marks the start of the Uruguay Round negotiations which substantially accelerated the process of unilateral trade liberalizations in many developing countries.