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Discussion Paper No. 2008/02

Southern Engines of Global Growth

Very Long Cycles or Short spurts?

Meghnad Desai*

February 2008

Abstract

This article views the four economies of the South in a long run historical perspective of 1500-2000. It contrasts the history and the initial endowments of the two Northern hemisphere economies China and India which are land scarce and labour abundant with the two Southern hemisphere economies Brazil and South Africa which are land abundant and labour scarce.

It argues for different strategies for future growth and discusses impediments which may come in the paths of these four economies in the near future.

Keywords: China, India, Brazil, South Africa, development, history

JEL classification: N1, O11, F54

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1 Introduction

The emergence of a small number of economies from the ‘South’ or the ‘Third World’ as important players in the global economy has attracted much attention. All the four economies being discussed here (China, India, Brazil, and South Africa – CIBS) were thought to be hopeless ‘basket cases’ within the second half of the last century though for different reasons. India and China were plagued by famines and economic policies, which while radical from a nationalist perspective, were driving their economies into stagnation (India) or excessive political and economic volatility (China). South Africa had the seemingly unsolvable problem of apartheid, and even its economy was highly state owned and corporatist but in favour of the privileged white minority. Brazil had chalked up impressive growth rates in the period 1951-1980 albeit under authoritarian regimes and yet it did not sustain its growth spurt in the later twenty years. There has been some revival in growth in the twenty-first century.

Since the 1990s, their story has changed and we are contemplating their rise in the GDP ranks (PPP yet, but soon actual dollars) in the world. Growth rates have been spectacular in China now for some twenty five years, and in India, since the reform process of 1991, the economy has achieved a growth rate of GDP that on average is double the average of the thirty years between 1950 and 1980, and in the last five years treble. South Africa and Brazil have not had an equally rapid acceleration. They are already middle income countries and they are noticed more for their potential than actual performance in recent years. Brazil’s size makes it a likely candidate as an ‘engine’ and South Africa’s leading position in Africa makes it a country worthy of inclusion in this exclusive club.

2 Some basics about CIBS

The four economies even as they share their status as ‘new miracle economies’ or ‘already emerged economies’ are very different in their nature, their histories and their factor endowments. Two are Southern hemisphere and two Northern ones.

In broad macro terms of area and population, China is the top on both counts with 9.6 million square kilometres (m km^2) and a population of 1.3 billion. Brazil is the next largest in terms of area with 8.5 m km^2 and a population of 184 million. India is the third largest with 3.7 m km^2 and a population of 1.1 billion while South Africa has an area of 1.2 m km^2 and a population of 47 million. China has 136 people per km^2 , Brazil 22, India 297, and South Africa 39. Thus there is a sharp contrast in the people/land ratio as between the two Northern hemisphere economies and the two Southern ones. There are other contrasts as well.

The contrast in initial endowments means that the two pairs of economies have to follow different strategies. Growth theories have normally used a two factor production function with capital and labour. But it may be that if we take a three factor approach with land added to the two standard inputs, one may be able to think out a better growth strategy. Thus for example in land rich/people scarce economies, the real wage tends to be high. They face a labour shortage which is paradoxical in what we think of as Third World economies. But our ideas are shaped by the surplus labour Asian economies and not land rich/people scarce African and South American ones. Given such labour constraint, in order to induce people to take up paid wage work, you have to equip them

with sufficient human and non-human capital to match their productivity to their real wage.

This was the experience of the US economy in the eighteenth and nineteenth century. There the high real wage of 'free' Americans was diluted by slaves whose lower implicit real wage made labour intensive agriculture such as cotton growing profitable. But in the slave free states the growth pattern was capital intensive. Later again in the second half of the nineteenth century migration from Europe softened the real wage constraint, but even then large amounts of capital were required to employ the newcomers.

Brazil and South Africa face the real wage constraint albeit modified by some institutional barriers. During the nineteenth century, in South Africa the policy adopted to attract rural labour into mines was a head tax which had to be paid in money terms. This compelled at least one member of the household to work away from the farm. But this was resisted until the policy became more drastic. In the early colonial period, in Spanish South America, similar inducements had to be provided to make the 'Indians' work for the market economy. In Brazil, it was the import of slaves which kept the local economy relatively free of the labour constraint. At the time of its independence in the early nineteenth century 30 per cent of Brazil's population was slave.

In the twentieth century, apartheid kept the black real wages artificially below the white wages. Now with the new situation, black real wage has implicitly gone up. South Africa witnesses the simultaneous situation of unemployment among the black South Africans especially in urban areas, and complaints that there is in-migration from surrounding African nations whose people are undercutting the South African blacks. The need in such a situation is to enhance the human capital of the black workforce and adopt capital intensive activities that also require high human capital. Brazil has a similar problem with urban unemployment and underemployment. While agriculture and the resource extraction industries provide the mainstay of export earnings, there is still an awful wastage of human capital; puzzling in an economy that faces a labour constraint. But what this implies is that many manufacturing activities which are feasible in land poor/people abundant economies – low tech textile etc. – are not economically viable for the land rich countries. They need to upgrade their labour force, equip it with capital and seek feasible medium tech or high tech manufacturing activities. They could also import labour from labour surplus economies.

The situation of the Northern hemisphere economies is altogether different and much more amenable to the standard analysis. They have abundant cheap labour and lack capital. In this respect China has managed to transfer large parts of its rural population to urban areas thus keeping the effective price of labour low. Capital is generated by the high domestic savings rate plus foreign direct investment (FDI). This has resulted in rapid growth fuelled by exports of manufacture, especially at the low tech end. China's land reforms also helped raise labour productivity on the farms and made the transfer of surplus feasible.

India has not had a successful land reform to the extent of China. Productivity in agriculture both per person and per acre remains low. India has also passed labour laws that inhibit hiring and firing in the organized (i.e. greater than 100-employee firms) sector. This has meant that Indian manufacturing is a medium to high tech niche activity but does not generate large scale employment. India has in effect made its abundant

cheap labour expensive by institutional rigidities. Thus employment in informal urban sector activities and lately in information technology (IT) activities (typically small firms) has grown. The bulk of the population is still in rural underemployment and represents a potential force for extra growth if only reform of the labour laws could unleash it.

The two Northern economies are very old and indeed two of the oldest continuous urban civilizations and were bywords for populous and prosperous countries until the middle of the eighteenth century. Their share of global GDP (given the imperfections of such figures is unavoidable) matched their share of the world population in 1700. They declined during the nineteenth and much of the twentieth century and by the 1960s thought to be 'basket cases' (Desai 2005 for details).¹ If anything their wealth inequalities are lower today than they were, say, a hundred years or two hundred years ago. Recently income inequality in China is reported to have gone up and so has wealth inequality but relative to the Southern hemisphere economies these inequalities are modest (especially since land ownership is not very unequal).

The Southern hemisphere economies are 'younger' in centuries relative to the Northern hemisphere economies. Brazil and South Africa had very small populations before 1500 CE common era and especially a very large resources/population ratio however one may value the resources. Their local populations were overwhelmed by settlers from Europe (Portugal (Brazil) and the Netherlands and later the British (South Africa)) and added to by African slaves (Brazil more than South Africa) or indentured labour (South Africa). South Africa's experience of apartheid was unique in the modern age and has only been overcome in the last dozen or so years.

Both were seen as mineral resource rich areas where the main problem was to generate sufficient labour supply. South Africa was also largely rural with small concentrations around mining towns or ports and very late, i.e. twentieth century, development of urbanization. South Africa was never a 'poor' or 'underdeveloped' country and even today is the richest in sub-Saharan Africa. But it has an immensely unequal distribution of income, wealth (land but also other assets) as well as human development scores. Brazil had a higher level of urbanization relative to South Africa even by the late eighteenth century. Rio, Salvador and Sao Paulo were thriving towns and the bulk of the population was concentrated around the eastern coast. Agriculture was carried out in large land holdings and mining activities were around small concentrations of population. Brazil has always had an unequal distribution of wealth (especially land) and income as well. These inequalities are mapped by race or ethnic origins, though within each ethnic group there are inequalities as well.

Thus, the one major difference between the two pairs of economies is that in the very long run – epochal sense – the Northern hemisphere economies are resuming their rightful place in the global ranks. In 1500, they were the two richest economies – though again in total income terms with a lot of inequality – and indeed up to 1700 continued to be so. They entered a two hundred year long decline as a result of the impact of the rise of the West and Imperial conquest (India) or Imperial domination

¹ Meghnad Desai (2005) 'India and China: An Essay in Comparative Political Economy', in Wanda Tseng and David Cowan (eds) *India's and China's Recent Experience with Reform and Growth*. IMF: Washington DC, and Palgrave Macmillan: New York.

(China). The nineteenth century was better for China than India but in the first half of the twentieth century both stagnated, China did worse than India. In 1975, they were equal pegging in terms of their relative position of income and population shares in the global economy. It is in the last thirty five years that China has outstripped India. Again in the last five years, there has been a growth spurt in India and it is narrowing the distance in terms of growth rates relative to China (Nayyar 2007;² Desai 2005).

One speculative question then is – is there an ‘epochal wave’ that India and China are experiencing and if so will they ‘catch up’ and regain their relative ranking in the global economy, and, if so, when? Of course there are no ‘cycles’ since we can barely observe one wave over three or four centuries. Even Kondratieff cycles with 50 year periods are difficult enough to verify, and there is scepticism about Kuznets cycles of 25 years. But whether a cycle or not, the speculation will not go away. So I would like to pursue that here.

For the Southern hemisphere economies this is not an issue. They were not high in the global league in any case. (The only Southern American economy that was high in the global rank is Argentina. Colin Clark in his pioneering work *The Conditions of Economic Progress* ranked Argentina as one of the top five economies. Unlikely as it seems today, in 1913, Argentina’s per capita income was just under half of the USA’s and even in 1950 about 35 per cent. By 1989, it was under a quarter and of course it has been worse since.) Their share of world income kept pace with their share of world population, which in any case did not amount to more than around 2 per cent each. They are already upper-middle income countries while China is lower-middle income and India is low income. Yet it is useful to carry the Southern pair economies as comparators for the Northern pair.

3 Growth dynamics in a Maddisonian perspective

In very broad (almost Maddisonian) terms, if the Iberian exploration in the last decade of the fifteenth century inaugurated a Global Economy (or World System), then for the first half of around 250 years, it was the Iberian countries – Spain and Portugal – who were dominant powers. They had a lead in naval warfare technology having light manoeuvrable ships that could carry guns for long journeys. Their interest was in surplus extraction and transfer rather than transforming the economies’ production possibilities. Thus it was the mineral exports, especially gold and silver, which were the main activities pursued. Agriculture developed to feed the imported slave population plus the original inhabitants who had been deprived of their means of livelihood. South Africa had only a slight encounter with this phase of the World System. The Portuguese got to Angola in the fifteenth century but for a hundred years were satisfied with only coastal contact. Later in the sixteenth century they traded with interior tribal leaders, slaves for European goods, guns and trinkets. The Dutch began to colonize the Cape region in the early seventeenth century and pushed the Portuguese away. Their interest at this juncture was in farming the somewhat unrewarding but ample land available.

² Deepak Nayyar (2007) ‘China, India, Brazil and South Africa Engines of Growth?’ Paper presented at the UNU-WIDER Conference on Southern Engines of Global Growth.

During this first phase, 1500-1750, India and China were big trading economies. There was extensive maritime trade across the Indian Ocean and South China Sea. The western limits of maritime trade were the Red Sea and the Gulf. Portuguese naval expeditions went around the Cape of Good Hope and opened a new trading route to Asia, thus removing the barrier due to the gap between the Red Sea and Mediterranean which later became the Suez Canal. They came in search of spices but they – and later the British, Dutch, Danes and French – joined the Portuguese to take part in the newly expanded trade. Besides spices they also traded silk and cotton textiles as well as food-grains, both intra-Asia and to Europe. This phase was ‘trade without dominion’ as far as Asia was concerned. There was an export surplus that Asia enjoyed with Europe and this was financed by the treasure from South America. The treasure came either directly from Iberia to Asia or via Western Europe with which the Iberian peninsula also had a trade deficit.

The next phase belongs to North Western European countries who displaced the Iberian countries in Asia and North America. The Netherlands and Britain who led in terms of governance reform, financial revolution, and, later in the eighteenth century for Britain, industrial revolution occupied India and Indonesia (the Netherlands East Indies as it was then called). The French lost out in India but went on to colonize Indo-China (as it was called until recently). It was in this phase, 1750-1950, that China and India lost their leads. In this phase the industrial revolution came as a major shock, displacing the advantage that Asia had in textiles. This phase had trade with dominion and the pattern of trade changed with textiles becoming an import rather than an export item for Asia. The inflow of treasure to finance India’s trade surplus was replaced by an Indian revenue surplus and a triangular trade was set up exchanging Indian opium (a government monopoly) for Chinese tea and the sale proceeds from the tea were sent to London as treasure.

In this second phase of globalization, the pattern of trade, capital and labour flows became restricted to individual metropolis-periphery canals – British, French, Dutch, etc., rather than fully global as before. The direction of capital flows was via London mainly for North America and the white British Empire as well as much of South America and Asia. Labour flows were within the imperial domains, and trade was not free but encumbered by tacit or explicit ‘imperial preference’. The fortunes of India were tied to the dynamics of the British economy. China was tied more to Britain than any other imperial country but its twentieth history was plagued by war with Japan and the breakdown of unified rule from the centre. The stagnation in the twentieth century that both China and India experienced was much due to the slowing down of the British economy after the third quarter of the nineteenth century.

Brazil was under Portuguese domination even after its decline as a European power. Even after independence in the early nineteenth century, it had Portuguese kings until in the 1880s it became a republic. South Africa was settled by the British after 1820 as a colony in Cape and Natal while the Dutch (Boers) moved into Orange Free State and Transvaal. After the Boer War at the turn of the century, the Union of South Africa was born in 1910 which became a republic in 1961. Both continued to be precious metals and mineral exporters and to a smaller extent agricultural exporters. Labour shortage continued to plague them, and immigration either voluntary or as indentured or slave labour continued throughout the nineteenth century.

Thus we have two economies that are long settled with a low resources/people ratio and two with a very high ratio. China and India are relatively labour rich and Brazil and South Africa land rich. But much more than the difference in factor endowments is their history. For India and China, the major drive in the last sixty years has been restoring the dignity of the nation in the international sphere and preserving the territorial integrity of the nation-state. These political goals dominate the economic ones of rising per capita income and poverty elimination. India and China unlike Brazil and South Africa see themselves as potential global players displaced from their rightful place by two centuries of western domination. They are thus much more liable to spend money on armaments and willing to go to war either internally or externally to preserve what they believe is their rightful territorial domain. India has in addition an internal dynamic of inclusion to give social status equality to groups that have been downtrodden for centuries, which is a major objective of its political and economic policies.

4 India and China as growth engines

Much of the growth in China and India has been input driven. Labour productivity has risen mainly by transferring labour from low productivity sectors to high productivity one. Yet total factor productivity growth (TFPG) has been modest. There have been no remarkable innovations coming out of the two countries, which by their sheer size have made a big impact on trade and investment flows (though China is registering many more patents than India and is one of the leading countries in patents ranking). They have taken advantage of the climate for freer trade, reformed their trade regimes to take advantage of market access to developed countries and taken over the manufacture and exports of 'mature' industrial products. There are some differences between the two. China has spread its industrial growth across the spectrum from low to medium and a little high tech while India has focussed on medium tech, skill intensive industrial growth. China has relied on under-consumption, high savings plus a large FDI contribution and export growth while India has relied on domestic consumption growth, low FDI and moderate export growth. In this respect, a crude aggregative calculation would reveal that China gets around 10-12 per cent GDP growth rate from around 50 per cent of GDP invested (45 per cent domestic savings plus 5 per cent FDI) while India gets between 7 per cent to 9 per cent growth from 30 per cent to 35 per cent investment (mostly domestic savings with a small 1 to 2 per cent FDI). China is thus less capital efficient than India. This may partly be due to China's sectoral growth composition with a great amount of investment in infrastructure while India has underinvested in that sector. But the rate of return on equity is also higher in India than in China. Thus the capital intensive nature of Chinese growth pattern is worrying as is its material intensity.

China's population growth is slowing and its population may age faster than India's. China's gender imbalance is worse than India's though it is bad in both countries. India falls behind China in infrastructure, in primary and secondary education and health but has had a relative lead on China in higher education and the ability to use English. Despite many episodes of sub-national revolts across India – Kashmir, Punjab, Assam and Nagaland, India has not experienced a period of excessive political volatility as China did during the Cultural Revolution. The opacity of the Communist Party decision making process makes doing business in China a costly process though its dominance delivers quick results. In India, the decision process is open and slow and reversible under populist pressure (example of special export zones and of the problems faced by the West Bengal government with acquiring land for industrial development in recent

months) and hence any investment once committed can often be worthless since concessions won with difficulty (and a large bribe) can be lost.

In all current discussions, it is taken for granted that this process will continue with the inexorable logic of compound interest rate growth. This may well be so but I wish to spend the rest of this paper on pointing out what could go wrong with such simple scenarios. The 'snags' are external and internal.

4.1 External 'snags'

At present there seems to be a symbiosis between Western capital outflows and Asian need for investment. In return, manufacturing exports from Asia keeps Western inflation low. Western countries have had to restructure their economies away from low tech mature manufacturing products towards high tech R&D intensive products and services. This has led to a massive churning of the labour force with the losers being low skilled and semiskilled manual manufacturing male workers in the developed countries. This process can go on only if the Asian countries buy the goods and services the West has to sell and the debate on China's exchange rate policy shows that there are limits to this process. China underconsumes and accumulates its export surplus. The USA overconsumes and runs a capital outflow to finance its excess consumption. Since China does not recycle its accumulated surplus back into global demand, there is a perception that China is not playing fair. This is the nub of the debate on the exchange rate. As yet the numbers are small in relation to global flows but with the forthcoming 2008 presidential elections in the USA, this 'snag' will loom large as a possible disrupter of smooth growth. China's sovereign wealth fund has begun to recycle some of the accumulated reserves and this will ease the burden a little. This is much needed especially in light of the deep financial crisis of late 2007/early 2008.

On the side of the four emerging nations, WTO negotiations loom large as an example of the lack of symmetry in international trade negotiations. The agricultural subsidies given by the USA and EU and their insistence on the Singapore conditions have held up the resolution of the Doha Round. This is another 'snag' that may hinder smooth developments.

There are geopolitical considerations that also hover in the background. China is seen as the only nation state today that can challenge American supremacy in the near future. On the one hand, in arrangements such as the Shanghai process Russia and China club together, which worries the USA. The USA-India nuclear agreement (yet to go through both countries' parliaments) is a countermove to the Shanghai process by the USA. India and China have an unsettled border dispute though they have agreed to negotiate peacefully. Japan's attitude is ambivalent about the rise of China, and any possible reunification of the two parts of Korea will also influence Chinese perceptions of national security. For China, the Taiwan issue remains unresolved.

India is in a neighbourhood that has many failed or potentially failing states. Sri Lanka has had a civil war raging for 25 years, which has claimed the life of one Indian Prime Minister. Pakistan and India have had four wars and now with both countries having a nuclear capability, one can only hope that future relations will be peaceable. Pakistan itself is under pressure from Al Qaeda and the Taleban militants on its Afghan border. Its transition to democracy is a fraught process as the recent assassination of Benazir

Bhutto has shown. Myanmar on India's eastern border is still a repressive regime with an uncertain future and Nepal has just had a revolution albeit with India's tacit approval.

4.2 Internal 'snags'

India faces the tricky problems of inclusion with its dalits and backward castes, as well as its large Muslim minority. These are struggles for social status equality as much as economic betterment. There is a large and growing army of Maoists – the Naxalites as they are called – which exploit tribal and other marginal groups' discontent with exclusion of the economic processes that could benefit them. One sixth of India's districts have a substantial Naxalite presence. While this is not a long term threat, it is a substantial short and medium term problem. India has also had sub-nationalist movements over the last sixty years – Kashmir, Punjab, Nagaland, Assam – which have had to be dealt with ruthlessly and some of which, such as Nagaland and Kashmir, are not as yet solved.

For China, the lack of the rule of law is a problem. Internal unrest has taken many forms mainly in rural areas where people have found they have lost their property without proper compensation. This unrest is spreading to urban areas as well. There is religious dissent in the form of the Falun Gong and Christian groups who are demanding greater religious tolerance. Again it is unlikely that these threats are likely to cause a serious rupture to the regime but they will grow and not just go away. China may need to relax its underconsumptionist stance and allow greater consumption freedoms to its population much as India has done to divert some of the unrest.

For the other two countries, there are no external snags as such. Their problems are internal, such as the problems of status equality for groups within their populations and the overwhelming problem of inequalities of wealth and lifetime opportunities. In a sense the problem of inclusion that India is tackling through its democratic process is also the problem facing the two Southern hemisphere countries. If Brazil could upgrade the education of its poor people, it could harness the additional human capital for a growth spurt. Similarly for South Africa, eliminating the economic and social distance between the black majority and the white minority will be a growth enhancing policy.

5 Conclusion

The southern engines of global growth are a reality. They herald a new shape to the twenty-first global economy. But one should not take their sustained growth for granted. Each country needs to consciously pursue policies that will overcome some of the internal and external snags that are mentioned above. One thing is certain, that the half millennium inaugurated by the 'discoveries' of Christopher Columbus and Vasco De Gama has now ended. A new millennium will see a new global economy with a smaller disproportionality between populations shares and income shares.