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# Growth in the South: Resilience, Decoupling, Recoupling

**By Yilmaz Akyuz**

Rapid acceleration of growth in developing countries (DCs) and the widening of their growth gap with advanced economies (AEs) before the outbreak of the global financial crisis were widely interpreted as decoupling of the South from the North. In the early days of the crisis, there were also widespread expectations that growth in the South would be little affected by the difficulties facing AEs. In fact, DCs slowed considerably in 2009 as a result of contraction of exports to AEs and financial contagion. However, they recovered rapidly, with growth rates in 2010-11 matching or exceeding the levels seen before the crisis, while recovery in the US has remained weak and erratic, and Europe has gone into a second dip. This has again revived the decoupling thesis, notwithstanding the sharp slowdown in many major DCs over the course of the current year.

This change of sentiment about decoupling reflects lack of sound knowledge and understanding of the evolution of growth fundamentals in DCs and their global linkages. In an earlier IMF Working Paper Kose, Otrok and Prasad (2008) analysed global business cycles and found decoupling between DCs and AEs, but increased coupling within each group. Wälti (2009) challenged this and argued that assessment of decoupling should not be based on actual growth rates but deviations from trend (or potential output). On that basis there is no decrease in the synchronicity between DCs and AEs. Rose (2009) came to broadly the same conclusion, while Yeyati (2009) showed that in fact the 2000s witnessed an increase in the correlations of DCs and G7 cycles.

In a recent paper I argued that a more important question that needs to be examined is whether the acceleration in DCs in the new millennium suggests an upward shift in their trend (potential) growth relative to AEs. After examining global conditions, linking them to policies in AEs and reviewing the evidence regarding some key determinants of long-term growth in major DCs, I came to the conclusion that the unprecedented acceleration of growth in DCs in the new millennium is due not so much to improvements in their underlying fundamentals as to exceptionally favourable global economic conditions, shaped mainly by unsustainable policies in AEs.

Moreover, the only developing economy which has had a major independent impact on global conditions, notably through commodity prices, is China. However, growth in China has been driven first by a rapid expansion of exports to advanced economies and more recently, after the global crisis, by an investment boom, neither of which is replicable or sustainable over the longer term. To maintain catch-up growth, DCs need to reduce their dependence on foreign markets and capital and commodity earnings.

The IMF (2007; 2008) generally subscribed, with usual caveats, to significantly weakened dependence of growth in the South on the North in the early days of the crisis, underestimating the adverse spillovers from the US housing debacle. It has now revisited the issue in its latest World Economic Outlook (Chapter 4) under "Resilience in Emerging Market and Developing Economies: Will it last?"

Lumping together more than 100 emerging market and developing economies (with per capita incomes ranging from $200 to over $20,000) and examining their evolution over the past 60 years, it has found that "[t]hese economies did so well during the past decade that for the first time, [they] spent more time in expansion and had smaller downturns than advanced economies. Their improved performance is explained by both good policies and a lower incidence of external and domestic shocks: better policies account for about three-fifths of their improved performance, and less-frequent shocks account for the rest." Interestingly the Fund does not seem to argue that good policies would be enough to decouple DCs from the North as it cautions that "should the external environment worsen, these economies will likely end up "recoupling" with advanced economies."

"Good policies" found to have improved performance in DCs include "greater policy space (characterized by low inflation, and favourable fiscal and external positions)" created by "improved policy frameworks (countercyclical policy, inflation targeting and flexible exchange rate regimes)." However, the analysis ignores the role of positive external shocks, notably the surge in commodity prices, capital flows and remittances, in creating the policy space in DCs. There is ample evidence from IDB and ECLAC that much of the improvement in the fiscal situation in Latin America after 2002 was the result of the commodity boom while the policy was mostly pro-cyclical. This is also true for improvements in current account and reserve positions (Calvo and Talvi; Ocampo).

All these created space for subsequent counter-cyclical policies in response to fallouts from the global crisis. Even disinflation in countries such as Brazil and Turkey owed a lot to exchange rate appreciations made possible by large inflows of capital. These positive shocks provide a better explanation of the exceptional performance of many DCs in the past decade than "good" orthodox policies such as inflation targeting, single-digit inflation and flexible exchange rates.

Interestingly, the WEO could find no robust links between structural factors – including trade patterns, financial openness and capital flows and income distribution – and the "resilience" of DCs. The Fund staff has clearly spent a lot of time and effort (and hence public money) demonstrating what we all know: that the performance of DCs in the past decade is unprecedented. The analysis sheds no light on how growth dynamics in the South may have changed. Nor does it provide a useful guide to policy over and above what has already been professed.

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