THE RISE OF THE SOUTH

Omar Dahi
and **Firat Demir**

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THE RISE OF THE SOUTH

ESSAYS IN SOUTH-SOUTH TRADE AND FINANCE

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Introduction*

THE RISE OF SOUTH-SOUTH TRADE AND FINANCE

SOUTH-SOUTH TRADE, a generic term used to capture South-South trade in goods services as well as capital and labor flows, emerged as a topic of interest within the global South since early in the 20th century and took on particular importance since the waves of decolonization that swept through Asia and Africa in the post-World War II period. Though interest in South-South trade has ebbed and flowed, it has re-emerged in full force in the last twenty years as a result of several separate yet interrelated processes: the first has to do with the rise of South-South preferential trading agreements (PTAs) that has accompanied the general rise of PTAs, both North-South and South-South as part of the 'new regionalism'. The second is the rise of intra- and inter-regional trade and capital flows, which includes intra-industry

* We are submitting this work in partial fulfillment of the IDEAS South-South grant "Democracy and Empowerment: Contemporary Reality and Emerging Alternatives". As we have mentioned in previous correspondence the work we have done this year has also coincided with a book contract with Anthem Press for a book tentatively titled The Political Economy of South-South Trade and Finance as part of their Anthem Frontiers of Global Political Economy Series. The Anthem Frontiers of Global Political Economy Series contains many impressive works, most notably Kicking Away the Ladder by Ha-Joon Chang. We would appreciate IDEAs support in allowing us to use portions of this research for our upcoming book manuscript with Anthem Press.

as well as capital goods trade in manufactures among emerging markets primarily within South and Southeast Asia and Latin America but also elsewhere, as well as increased foreign direct investment within the global South such as China in Africa and Latin America. The third process has to do with the rise of S-S coalitions within the WTO. Though there are multiple reasons behind the stalemate within the WTO, such as the increased pushback by India and Brazil, the rise of S-S blocs that have disrupted or undermined the power of the Quad (US, Canada, EU, Japan) has also been a crucial factor.

Increasing political and economic integration among the developing countries (i.e. the South) has been a popular idea since mid-1950s when most of them began to achieve political independence from developed countries (i.e. the North). However while there have been various attempts across the years to tackle the subject, there has not been an attempt to systematically and rigorously evaluate the history, trajectory, and achievements of South-South political and economic relations up until today. In this manuscript, we attempt to do just that.

For a long period of time the only examples of South-South relations were independent political organizations or alliances formed by developing States within the context of the Cold War, the most prominent example being the nonaligned movement. Since the collapse of the Soviet Union, however, there have been significant developments towards achieving economic and political integration within the global South. In particular, developing countries have accelerated their integration through their coalitions within multilateral institutions such as United Nations and World Trade Organization as well as though bilateral and multilateral trade and investment agreements. The examples include the G77 within the United Nations, several regional and global Southern blocks (such as G-20, G-33, G90, MERCOSUR, etc.) within the World Trade Organization. Moreover, the number of Preferential Trade Agreements (PTAs) and the share of preferential trade in world trade have increased significantly since the 1990s. At least 197 PTAs were formed during 1990-2010 (accounting for 32% of world trade), exceeding the total number of PTAs signed in the previous 50 years (numbering 23) (Medvedev, 2010; WTO, 2011). Yet, a significant number of these PTAs are actually signed among developing countries, reaching a total of 110 during this period (compared to 78 for South-North and 9 for North-North PTAs). Similar developments took place regarding financial flows as well. In particular, developing countries have emerged as a significant source of FDI outflows during the most recent years, accounting for more than 29% of global FDI outflows in 2010, compared to their 1990 level of less than 5%. Fur-

thermore, within aggregate flows from the South, South-South FDI flows increased significantly, reaching around 63-65% of all outflows from developing countries in 2010 (UNCTAD, 2011; WB, 2011).

Despite the growing importance of South-South integration in global trade and finance as well as the rise of new powers in the international economy such as Brazil, India and China, analyzing these South-South relations has proven to be difficult. There are several reasons for this. First, these examples alone show that the variety of processes included under South-South relations cuts across various fields such as economic growth and development, international trade and finance, transnational social movements, international relations, regionalism inter-regionalism and multilateralism, and international political economy. However, most research in these fields has been built around models analyzing North-North or North-South relations. Second, South-South relations have been viewed through an ideological prism. Depending on the theoretical or political worldview of the analyst, South-South relations are either the answer to the dependency of the South on a domineering north, or misguided and erroneous policies that are remnants of the protectionist era. That is they are either a lofty aspiration or an abject failure. Third, while advocates of South-South relations have consistently highlighted economic integration as an avenue for cooperation, the meaningful economic payoffs have been seen as lacking. This has been particularly true since until the recent decades South-South trade has represented a very small portion of global trade as well as developing country exports despite the numerous attempts at regional integration.

The first attempts at South-South cooperation emerged in the mid-20th century by leaders of anti-colonial or anti-imperialist movements who viewed such integration necessary as a counterbalance to the legacy of the colonial era, which had left the global South underdeveloped, fragmented, economically dependent, and therefore politically weak. The origins of South-South relations are unique in that they were initiated by the energies unleashed by social mass movements for independence. In many cases, these mass movements had articulated radical critiques of the international political order and the global economy. However, South-South relations were consummated by heads of States who were leaders of these mass movements but nevertheless found themselves as the ruling elites of States where they had to balance those energies with a variety of other imperatives. So South-South relations have been undertaken side by side with a variety of other processes taking place within those countries in the post colonial and post war period including the stumbling blocks of nation-building and political consolidation, the difficulties and com-

plexities of economic development, and navigating the treacherous international terrain starting with the Cold War and post Cold War era. In many of those cases, South-South cooperation has been initiated as a response both to the internal as well as the global. For example, political movements from within Syria, Egypt and other Arab countries, advocated pan-Arabism and Arab integration. On the other hand, the Bandung conference and non-aligned movement articulated a response to the global economy and the conflicts of the great powers. At the same time, the work of dependency theorists and structuralist scholars such as Raul Prebisch influenced the countries of the global South to articulate a critique of free trade and the global economy and to push for a voice inside the global institutions leading to the formation of Unctad and the G77 while at the same time advocating regional integration. Therefore, South-South relations should not be viewed as a singular process, nor as a homogeneous set of policies and outcomes. Instead, the various attempts at South-South cooperation have been *a series of processes that the developing regions have initiated to come to terms with economic underdevelopment as well as an overwhelming political and global order.*

South-South relations have had a greater influence on the trajectory of the global economy than is usually understood or recognized. The apex of this period of South-South relations culminated in the launching in 1974 of the new international economic organization (NIEO) program unleashed in Algiers in an Unctad session. The NIEO represented the global South's vision on restructuring the global economy in a way that favors the global south. The NIEO included institutionalized monitoring of commodity prices at the global level (an attempt to replicate OPEC for other commodities), technology transfer to the developing world, industrialization of the global south, democratization of the IMF and the World Bank, restrictions on multinational corporations and foreign direct investment. The NIEO represented both developmentalist visions of the developing countries as well as relative success of South-South cooperation. Even though it seems radical in retrospect, it was in fact a compromise between the more radical and conservative countries within the G77. In many ways, the NIEO also represents both possibilities and limitations of South-South cooperation at that time and the way that the developing countries utilized international organizations to advance their collective cause. As Balakrishnan (2003) has argued, developing countries involvement in international organizations such as the UN helped radicalize the debate in those institutions by advancing alternative economic theoretical perspectives to the debate on the global economy. At the same time, however, this helped legitimate those institutions as

the governing bodies on international economy. Meanwhile the developed countries led by the United States were increasingly exasperated of the inability to control UN General Assembly, which the developing countries had succeeded in converting into a forum for relatively democratic deliberation on world affairs. This led to the formation of the G7, which attempted to provide a forum for economic deliberation exclusive to the advanced economies without meddling influence of the developing countries. The debt crisis of the 1980s provided a fatal blow to the NIEO and the collective bargaining power of the developing countries. The economic policies implemented in a post at crisis can be viewed as the inverse of the NIEO. In many ways, a debt crisis represented the end of a long phase of South-South cooperation that was known as the third world movement. South-South cooperation in the 1980s and the 1990s became minimal. However, this period witnessed the rise of new forms of South-South cooperation. The formation of the WTO represented a major challenge as well as an opportunity for the developing countries. The departure from the GATT treaty into an organization with far more restrictive policies on trade liberalization as well as an expanded mandate, which included services, agriculture and intellectual property rights, severely constrained the policy options of developing countries. It also served to lock in the structural adjustment reforms that have been implemented after the debt crisis and make them difficult to reverse. However, unlike the World Bank and IMF, the WTO also provided on opportunity for developing countries to have an equal seat at the bargaining table. Starting with the Seattle protests of 1999 and for several of the next ministerial South-South blocks emerged within the WTO that advanced, issues negotiated collectively and ultimately attempted to push back against the quad power. The groups formed during this time such as the like-minded group, the African Caribbean partnership, the African Group, and the G99 provided a counterweight that was missing in previous negotiations. However, South-South blocs within the WTO were not the only form of cooperation among developing countries that emerged in the post 1990s. Preferential trading agreements under the new regionalism also began to emerge, most prominent of these is MERCOSUR. At the same time, the rise of capitalism in China, India, Brazil and other countries has increased the linkages between those developing countries as well as increased trade between regions.

In this manuscript, we have developed several essays unpacking the black box of South-South Trade. Our basic approach is one that seeks to examine the 'pay-off' from South-South trade from a sympathetic yet critical developmental perspective. The manuscript is organized as follows. Chapter 1 is a case study of South-South relations

examining two countries, Syria and Turkey, showing how Turkey's role as a regional leader in development approaches is underestimated and then proceeding to show how this particular case of South-South liberalization had destabilizing effects for the smaller developing country (Syria). After that, we develop two cross-country examinations of South-South trade. Chapter 2 asks whether South-South trade matters. Using bilateral trade data in total and technology-and-skill-intensive manufactures for 24 developing countries that account for 82% of all developing country manufactures exports between 1978 and 2005, and using cointegration and error correction methods we examine the effects of South-South (South-North) on South-North (South-South) trade. In Chapter 3, we use bilateral trade data for 28 developing countries that account for over 80% of developing country exports between 1978 and 2005, and we find that trade liberalization in the South significantly increased the share of manufactures and technology-and-skill-intensive manufactures exports in South-South and South-North trade. Furthermore, trade liberalization is found to be favoring the South-North trade more than the South-South trade.

Chapter 1

THE LIMITS OF THE NEW REGIONALISM

SYRIAN-TURKISH ECONOMIC RELATIONS IN A TRANSITIONAL MIDDLE EAST

1. INTRODUCTION

"From now on, Turkey and Syria will continue walking on the same road with a common destiny, history and future" (…) "We are going to walk hand by hand and work altogether to revive our region as a center of civilization, and as a common economic basin".
A. Davutoglu, Prime Minister of Turkey
(Joint News Conference, October 13, 2009).

"When we economically tie the Mediterranean, the Caspian Sea, the Black Sea and the Arabian Gulf we can become the central node of those four seas in investment, and transportation".
Bashar al-Asad , May 2009 (*Al-Hayat daily*, July 13, 2009).

"Should this torture then torment us
Since it brings us greater pleasure?
Were not through the rule of Timur
Souls devoured without measure?"
(Goethe's "An Suleika", *Westöstlicher Diwan*;
Quoted in Marx, 1978: 658).

In the past fifteen years, Syrian-Turkish relations have alternated between tension, alliance, and hostility, since the coming to power of

the Justice and Development Party in Turkey in 2002 alongside the rise of Bashar al-Asad to the Syrian presidency in the year 2000. Since the start of the Syrian uprising in 2011, relations have deteriorated to the point of the Turkish government eventually supporting the armed insurgency against the Syrian regime[1]. Various scholars have explored the trajectories of this relationship using a variety of entry points including domestic politics, Sunni-Islam, Neo-Ottomanism, Kurdish nationalism, and personality traits (Kalaycioglu, 1996; Aras, 2009; Larrabee, 2007; Murinson, 2006; Ozturk, 2009). In this chapter, rather than viewing Syrian-Turkish relations as geographic or historical anomalies we place them within the context of the 'new-regionalism.' We first explore the surprisingly parallel development trajectories of Syria and Turkey, arguing that the 'Turkish model' has more or less served as an example for several Arab countries including Syria long before discussions surrounding it resurfaced in the 2000s. Next, we discuss the dynamics of the relationship between Syria and Turkey since the 2000s and analyze the underlying fault lines that led to its eventual demise in 2011. In the final part of the chapter we also attempt to shed some light on the future trajectories of Turkish-Syrian and Turkish-wider Middle East relationship and whether or not Turkey can play a role model, as suggested by other analysts, in this highly turbulent region.

Syrian-Turkish relations in the past three years have garnered extensive media and scholarly attention in light of Turkey's involvement in Syria's civil war (Ilgit and Davis, 2013). After the outbreak of the Syrian uprising, Turkey has played multiple roles. After initially playing an 'intermediary' role between the Syrian government and opposition, and being caught wrong footed in the Libyan events, then by the early summer 2011 changed course and took a very forward position against the Syrian government. Turkey embraced the Syrian political opposition, especially the Muslim Brotherhood dominated wings. They also became a conduit from which money, weapons, and fighters crossed in the emerging civil war in Syria. When the regime was about to extinguish the uprising, Turkey gave freer hand to takfiri movements which undoubtedly ended up in the hands of groups like Al-Nusra or even ISIS. At the same time, they became a host — and relatively generous one — to the large numbers of Syrian refugees. As the Syrian uprising entered its second and third year, and by 2013, Turkey had become a full-fledged actor in fueling the ongoing con-

1 Notes:
See Ilgit and Davis (2013) on the different roles Turkey has played in the Syrian crisis.

flict inside Syria. The Turkish leadership justified its involvement as principled defense of human rights and in reaction to the atrocities committed by the Syrian government. Though there is little doubt that Turkey's involvement carried other complex dimensions that relate to both Turkish ambitions of regional leadership, sectarian politics and issues related to ethnic and religious groups, particularly the Kurdish question (Malkin and Danforth, 2014; Demirel, 2013). Finally, Turkey's role as a NATO member and in effect one side of the geopolitical battle, which pits the US and EU and Gulf monarchies on one side and Iran and Russia on the other cannot be ignored, though even this division is too neat given the Saudi Arabian-Turkish rivalry and sharp differences, particularly over the question of the coup in Egypt which overthrew President Mohamad Morsi. Nevertheless, Turkey remains in the Western power orbit even if it strays occasionally, and the desire by the West's allies, particularly the Gulf to destroy the Iran-Syria-Hezbollah nexus coincided with Turkey's about face in Syrian relations.

However, our analysis in this chapter is focused on the period of 1999-2010 where there was in fact close relations between Turkey and Syria. Here we make three interconnected arguments. First, we argue that while the policy decisions made in each of the two countries in the past decade were nativists, emanating from within, they have also affected each other. This is true both for the case of Syria whose economic liberalization, which had started gradually in the 1980s, had increased dramatically under Bashar al-Asad, as well as for the adoption by Turkish Islamists of the neoliberal economic model, including its basic tenets of privatization, deregulation, and liberalization. A second argument is that the Syrian-Turkish relationship highlights the contradictions of new-regionalism. That is to say while new regionalism is often understood as a force for, among other reasons, geopolitical stability, it may also lead to instability. In this case, the push for regionalism for the last decade emanated from both sides, though undoubtedly influenced by a changing regional and global context. From the Turkish side, the Islamists under government of the Justice and Development Party (i.e. AKP with its Turkish abbreviation) have substituted Kemalism with a Neo-Ottoman ideology, which incorporates quite a romanticized (and *imagined*) self-image of Turkey with a historical mission to play in the region. This Turkish Neo-Ottoman self-image, which seems to be shared among top policy makers from the President and Prime minister to the foreign ministry, portrays Turkey as a force for good in the region and in the world. On the other hand, the Syrian side pushed for regionalism as a means of escaping its international isolation. The economic

dimension of this was manifested by Bashar al-Asad's famous "four seas" vision that saw Syria as a hub for pipelines, railroads, and other projects between the "East and West", Turkey and the Arab world, the Arabian peninsula and the Caucuses, Iraq, Iran and Southeast Europe. Implicit was a view that economic regionalism coupled with liberalization would play a unifying role.

Third, we argue that the Turkish-Syrian exchange, whatever its political benefits for both sides, was fundamentally unequal in favor of Turkey given that it was contingent on opening up Syrian market to Turkish exporters and industrialists. We hypothesize that this opening played a destabilizing role in Syria and contributed to the economic roots of the current uprising in the country. Therefore, this economic panacea for both countries' internal problems as well as disagreements with each other did not materialize and eventually broke down with the start of the Syrian Uprising. Finally, we conclude that despite the various complications of the current phase, the Syrian-Turkish unequal exchange is expected to continue after the collapse of the Syrian regime with likely increasing domination of the Syrian economy by the Turkish capital, especially given the (mostly Neo-Liberal) economic discourse by a large part of the Syrian organized external opposition such as the Islamist dominated Syrian National council.

The chapter is organized as follows: the next section briefly summarizes the related literature on the 'new regionalism' with a discussion of its (absence) in the Middle East. Section 2 provides a historical overview of the recent development trajectories within Syria and Turkey, highlighting both their similarities and unique features. Section 3 discusses Syrian-Turkish rapprochement as a particular de-stabilizing type of regionalism. Section 4 discusses Turkey's 'regionalism' under the AK Party and Syrian-Turkish economic interaction since the Adana agreement leading up to the current crisis between the two countries. Section 5 comprises the conclusions.

2. THE POLITICAL ECONOMY OF THE NEW REGIONALISM

The 1990s witnessed a vast proliferation of Preferential Trading Agreements (PTAs) that came to be known as the 'new regionalism.' At least 197 PTAs were formed during 1990-2010 (accounting for 32% of world trade), exceeding the total number of PTAs signed in the previous 50 years (numbering 23) (Medvedev, 2010; WTO, 2012).[2] Therefore, a key question for scholars from within the fields of economics and international political economy has become to explain the causes and effects of this dramatic increase in PTAs and trade integration. Ethier's

2 For surveys of the economic literature on PTAs see Panagariya (2000).

(1998) seminal paper argues that the new regionalism has been driven by multilateralism. During the course of last three decades as trade barriers have receded the share of transportation costs in total cost increased, resulting in more regionalized trade. However given that trade liberalization is already quite advanced in most countries (especially since 1995 with the initiations of World Trade Organization, WTO), the way smaller countries move forward for further integration is by attaching themselves to larger countries in the hope of capturing a piece of the regional or global foreign direct investment pie.[3] In contrast, others have argued that the new regionalism is highly influenced by the expansion of US hegemony and neoliberal policies. Cammack (2002) argues that MERCOSUR "today is principally a means to promote 'associated-dependent' development, and in particular to commit its member countries to the disciplines required by global neo-liberalism. MERCOSUR has become primarily a local agent for the enforcement of International Monetary Fund (IMF)-World Bank discipline" (Cammack, 2002: 86). To some extent Phillips (2003) discussing US plans for the Free Trade Area of the Americas (FTAA) in relation to MERCOSUR makes similar arguments: "The FTAA project is less about trade expansion (…) and more about trade disciplines in the region which reflect a set of extra-regional and global interests at least as much as they respond to regional priorities" (Phillips, 2003: 333).

On the other hand, other scholars emphasize a domestic-policy driven regionalism. Kaltenthaler and Mora (2002) in their analysis of the reasons behind the formation of MERCOSUR suggested several other motivations, in addition to economic gains, behind regionalism, including: a) a *security alliance* (against a third, external threat, e.g. European integration towards the Soviet Union); b) a *neo-functionalist* analysis whereby previously hostile countries or rivals integrate in order to alleviate mutual security concerns; c) domestic policy goals that may include *institutionalizing democracy* or *strategic policy*, i.e. trade integration designed to 'lock-in' key reforms desired by the elites (Kaltenthaler and Mora, 2002: 77-80). However, scholars have increasingly abandoned mono-causal explanations for regionalism. In general, they have problematized the relationship between the global, regional and local as much more complex and mutually influential than is otherwise believed.

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3 Ethier (1998) argues that given that liberalization is already quite advanced and marginal trade liberalization under the 'new regionalism' is limited, the classic Vinerian trade diversion and creation are not irrelevant but no longer of primary consideration for theoretical purposes. We believe therefore that analysis of the new regionalism that merely focuses on trade volume is highly limited and can in fact be misleading as to the purpose and results of integration.

Likening globalization to the *Great Transformation*, Hettne (2005) argued that the new regionalism cannot be separated from the same forces pushing for and against globalization, with a greater prominence for non-state actors, and has cultural, security, economic and political dimensions. In that sense-keeping with Polanyian terminology, globalism and regionalism are shaped by a *double movement* of pressures for liberalization and civil society response at the developmental and ecological level. Hveem (2005) argues for the analytical separation between increasing economic interaction within a region (which he labels *regionalization*) and regionalism, which he defines as the pursuit of social actors in shaping a regional construction and organization of power, wealth, and identities. Carranza (2006) has argued that class struggle against neoliberalism in South America gave state elites in the MERCOSUR countries the room to maneuver against FTAA pressure from the United States. Doctor (2007) takes the analysis to a next level by arguing how similar processes allowed MERCOSUR countries to negotiate with both the US and EU leading to a 'failed' EU-MERCOSUR Free Trade Agreement. Read in this new light, regional integration is not a linear homogenous and static process but a constantly changing one by forces from above and below that are constrained by the upper limits of institutional structures. In the case of MERCOSUR, though it is constantly evolving in light of changing external and internal regimes, its usefulness as a tool for regional developmentalism is limited given the 'original sin' of being signed as a Common External Tariff trade agreement.

2.1. THE NEW REGIONALISM IN THE MIDDLE EAST

Since the rise in power and wealth disparities between the Middle East and North Africa (MENA) region and Western Europe, the previous regionalism under the Ottoman Empire was disrupted in return for a new pattern of trade — that essentially remains until the day — of manufactures exports from Europe in return for primary products and raw materials from the Middle East. (El-Anis, 2011; Dahi and Demir, 2008; Owen, 1993). On the surface, the MENA region was considered an anomaly in several respects, as a holdout against democratization (Diamond, 2010) but also as a region that had missed the recent waves of regionalism, particularly since the 1990s. In particular when evaluating the extent of economic integration in MENA, scholarly opinion tended to agree with Aarts (1999: 911) that "economic integration has hardly moved beyond the stage of rhetoric".

Ironically, however, regional integration or 'Pan-Arab unity' has been a prominent topic in the region's history, and has been attempted numerous times economically and politically reaching its zenith with

the formation of the United Arab Republic between Syria and Egypt in 1958. More recently the Greater Arab Free Trade Agreement has been established, with eighteen countries signing the agreement in 1997. As in the general evolution of regionalism elsewhere, the notion of coordinated industrialization and economic development has been abandoned in favor of the simpler idea of liberalization of trade flows (Fawzy, 2003). However, most of the regimes, while outwardly pursuing regional cooperation were in fact interested mainly in political consolidation and State formation. In its recent history, intra-regional trade in MENA has never exceeded 9% of exports, and is the lowest of any region in the world (Galal, 2000; WTO, 2012). In 2011, for example, the share of intra-regional merchandise exports were 71% in Europe, 53% in Asia, 48% in North America, 27% in South and Central America, 13% in Africa as opposed to 9% in the Middle East (WTO, 2012). Finally, some scholars have argued that the availability of windfall rents has allowed the regimes to appease domestic constituencies, and prevent a formation of coalitions pressuring integration or other deep structural transformations (Carkoglu; Eder and Kirisci, 1998). However, as mentioned before, with the proliferation and deepening of the 'new regionalism' various scholars have increasingly discussed its complex and multidimensional nature, which blurs the lines between the economic and political and is both influenced by supra-regional (global) and micro (local) processes. The focus on trade in goods and services, only one type of economic flow, is a misleading measure of integration and hides the existence of a regional system, which featured substantial intra-regional labor, capital and cultural exchange, as well as ideological and political contagion effects, something reinforced by the wave of the Arab uprisings. For example spillover from intra-regional trade in labor has been a vehicle of transmitting economic rents throughout the region, reaching as high as 25% for some countries (Jordan) and around 5-10% of GDP for several others such as Egypt, Syria, Morocco, and Tunisia (Galal, 2000; WDI, 2013).

More importantly, several scholars have argued that despite the lack of formal regional integration along the lines of free trade areas or customs unions, the MENA region were part of a *regional system* that had economic, political and cultural dimensions providing stability to the governing regimes. Pfeifer (2010) uses the Social Structure of Accumulation framework to show how the Arab regimes, both monarchies and republics, initiated public sector led development that allowed a conducive framework for capital accumulation mediated through: a) particular configurations of state-capital and state-labor relations internally that attempted balancing the interests of

capital and labor, b) intra-regional State relations that was marked by both conflict but also cooperation through intra-regional transfer of aid, and labor and capital flows, c) regional state-big power relations that also saw accord and conflict. Pfeifer argues that this regional SSA began to breakdown in the 1990s and was reconstructed in the 2000s along lines more favorable to Gulf oil capital. Hanieh (2011) also points to the rise of prominence in Khaleeji (Gulf) capital at the regional level, making headway to Egypt and the Palestinian territories. Lawson (2012) provides a typology of regionalism to examine the changing roles of the Gulf Cooperation Council (GCC) over the past decades.

However, we argue in this chapter that the case of Turkey has not been adequately considered in discussions of regionalism. We argue that failing to take into account Turkey's increasing role and solely focusing on the Arab Middle East is no longer viable, in particular given its increasingly prominent role in the lead up and aftermath of the Arab Uprisings, and its relationship with Syria is the case in point. Though, before doing so, we shall provide a brief overview of Syria and Turkey's development paths in the next section.

3. SYRIAN AND TURKISH ECONOMIC DEVELOPMENT: A HISTORICAL OVERVIEW

3.1 STUNTED *ETATISM* IN TURKEY AND SYRIA

The main economic model of Turkey starting from early 1930s, despite some flirtation with a more liberal regime in the1950s, was based on the Import Substituting Industrialization (ISI) regime with State Economic Enterprises (SEE) playing a pivotal role in industrial development and, unlike the Syrian case, in substantial private sector creation (Keyder, 1987; Bugra, 1994). With the help of Soviet advisors, the first Turkish five-year plan was developed in 1934, much earlier than many other developing countries (Pamuk, 2008), becoming a model that was imitated by the Arab Republics starting with Egypt and later Algeria and Syria , particularly after the rise of left leaning regimes in those countries (Owen and Pamuk, 1998).[4] However, for a variety of reasons including rent seeking coalitions (i.e. industrialists and labor aristocracy), political instability, and a lack of autonomous state bureaucracy, Turkey, similar to semi-industrialized Latin American countries, and unlike Japan or South Korea got stuck in the first

4 The standard ISI policies including import controls, subsidized credit and foreign exchange policies, and others were used as additional tools to direct private investment projects towards prioritized sectors.

phase of ISI with a lower-end equilibrium producing low value added and low quality industrial products. Furthermore, export performance remained disappointingly low causing serious foreign exchange gaps, which created shortages for imported intermediate and capital goods that were vital for investment and output production (Boratav, 1990; Öniş, 1998; Owen and Pamuk, 1998). The OPEC crisis speeded up the downward cycle and led to a serious balance of payment crisis in 1979. The final demise of the ISI regime took place after the military coup of 1980 that led to a series of tectonic shifts in Turkish economic and its political-institutional infrastructure. The new economic paradigm adopted the export oriented growth model under the guidance of International Monetary Fund (IMF) and the World Bank (WB) and aimed at the liberalization and deregulation of goods, labor and capital markets, and downsizing of the State. The regime switch included a sharp devaluation of the currency, liberalization of the trade regime, cutting of government subsidies, wage suppression and limits on labor's bargaining power, liberalization of domestic financial markets and banking sector as well as later on the opening up of capital account of balance of payments (Demir, 2004; Demir and Erdem, 2010). History repeated itself for a second time after the 1994 and 2001 financial crises, this time under a democratic regime yet again in the direction of further economic liberalization and deregulation.

Economic liberalization and associated changes in economic and political infrastructure including the constitution, labor law, business law, civil rights, public enterprises, education system and so forth proved difficult under a democratic regime. Consequently, the military dictatorship, seeing organized labor and civil society as an obstacle for free-market reforms, imposed strict restrictions over labor union rights and civil society. These restrictions have become institutionalized through the 1982 constitution alongside the accompanying changes in labor law, tax codes and university management.[5] Since 1987 successive democratic governments, both on the left and right have committed to the non-reversibility of the course of the reform program (Cizre-Sakallioglu and Yeldan, 2000: 494-497; Öniş and Webb, 1994: 128-184).

Syria on the other hand, also witnessed an extended period of state-led economic development with the public sector controlling

5 Some of these restrictions include closing the second largest labor union, DISK, dismissal of thousands of university professors and students, establishment of Higher Education Council with draconian powers including the appointment of deans, university presidents, student admissions, course curriculum, etc. For further discussion, see Boratav (1990), Senses (1996), Demir and Erdem (2010).

the commanding heights of the economy in investment, trade and finance. However, again similar to Turkey, Syria also failed to pass the initial stage of ISI to the second stage, which would involve increasing competition, openness as well as increasing sophistication in industrial production and consumer goods — though the overall industrial development has been significantly behind that of Turkey. In both cases, the politicization of the economic bureaucracy played a key role in inhibiting industrial development (Waldner, 1999).

Table 1
Similarities and differences between Syrian and Turkish state structure

	Syria	Turkey
Etatist period	*1960s-1990s*	*1930s-1950, 1960-1980*
Government type	Republican under authoritarian regime	Republican parliamentary democracy (with periods of military takeover) (1923-1950: single party, 1950-: multiparty)
Role of military	Direct intervention in security and politics, marginal intervention in economy	Direct intervention into economy, indirect intervention into politics (except during military takeovers)
International Alliances	Communist bloc during Cold War	NATO
Economic policy	ISI (1963-1986), relatively minimal role for private sector	ISI (1930-1950, 1960-1980), relatively larger role for private sector
Socio-economic base	Workers and peasantry; City-based merchants	State bureaucracy; labor aristocracy; large landowners; large industrialists
Official ideology/ legitimation	Secular, socialist, Arab nationalist; anti-imperialist; anti-Israel/cult of Hafez Asad	Secular, modernizing, Turkish nationalist; anti-imperialist; cult of Mustafa Kemal
Economic development bureaucracy	Politicized	Politicized
Stance towards religious and ethnic minorities	Supportive of religious minorities; anti-Kurdish minority	Anti-religious minorities (particularly, non-Muslim ones); anti-Kurdish and other ethnic minorities.
Stance towards religious freedoms	Strictly secular and anti-Islamist	Strictly secular and anti-Islamist
Liberal era	1990s-2010	1980-present
Changes in government	No political liberalization	Some democratic reforms and political liberalization
Nature of market reforms	Trade liberalization, internal deregulation, loosening restrictions on private sector, some privatization	Trade and financial sector liberalization, deregulation, privatization
Reasons for rapprochement with others	Ending international isolation; economic liberalism and trade as panacea for growth	Turning East after EU disappointments; economic liberalism and trade as means of political consolidation?

Source: Authors.

In Table 1, we present a comparative summary of Turkey and Syria during the *etatist* and liberal eras. The argument here is not a complete correspondence between the two countries, but that they have had more in common at the political and economic level than is recognized despite Turkey being held up historically as the stark contrast to the Arab MENA countries. As Table 1 indicates, despite falling on the opposite sides of the Cold War split (Turkey on the side of NATO, Syria on Eastern Block), in both countries there was and has been a secular nationalist (Turkish/Arab) ideology built around the cult of personality (Ataturk/Asad). Furthermore, both Syria and Turkey's elite ideology (i.e. Baath party and Kemalism, respectively) was hostile and antagonistic to Islamist political movements, and therefore the State worked in various ways to either suppress or co-opt Islamic institutions as well as any other sources of public opposition be that leftist or ethnic originated (such as the Kurdish movement in Turkey). In the case of Syria, while the Ba'ath party emerged out of what broadly can be considered a left wing movement, after 1970 Asad consolidated power by purging radicals in and outside the party, scaling back progressive economic measures and opening up greater space for a conservative merchant class, and establishing alliances with regional conservative regimes such as Kuwait and Saudi Arabia. From 1970-2000, when Hafez al-Asad died there was an uneven process of economic liberalization without an accompanying political opening.

When Hafez al-Asad came to power through an internal coupe within the Ba'ath party, several features of the developmental model were already in place. By that time most part of aristocracy and oligarchy had been destroyed through land reform[6], the State had seized control of major industries and financial sector, monopolized trade, and the State had already developed a large economic and public bureaucracy alongside support for peasants and urban workers in the State owned enterprise sector (Hopfinger & Boeckler, 1996). As Raymond Hinnebusch argues, the rise to power of Asad was an attempt to counter-balance the left-wing of the Ba'ath both in domestic and foreign policy and marked the complete control of the military over the radical intellectuals. Though the State still dominated the economy and infrastructural build up in rural and urban areas continued, the regime forged alliances with the urban merchant class. Furthermore, while limits on land ownership remained, the upper limits on land-

6 The land reform in Syria included both land redistribution and putting upper limits on land-holdings. One third of agricultural land was redistributed to landless farmers. For similar reasons land reform, albeit only on paper, was one of the key proposals of each of the military juntas in Turkey.

leasing were raised and large landowners were encouraged to invest (Hinnebusch, 1982). Employment in the bureaucracy became a major way of building support and political loyalty increasingly became a key element for upward mobility. As Perthes (1997) argued, efficiency was not the criteria by which the value of the bureaucracy was judged. However, since urban workers and peasants formed two important social bases for the regime, the state-led developmental program was meant to protect them from the market rather than subject them to its discipline[7] (Waldner, 1999). The resulting lack of viable manufacturing and industrial sectors signified that most of non-oil trade was concentrated in the production and processing of agricultural products. The regime used its oil revenues for rent distribution to maintain social programs such as free education, subsidized products, and free healthcare.

3.2 RISE OF THE LIBERAL ERA: THE AKP AND BASHAR AL-ASAD

The AKP came into power in Turkey in 2002 after a landslide election, allowing them to capture two thirds of parliamentary seats. Even though the unfair election system with a 10% national bar allowed them to gain more seats than otherwise possible, it was nonetheless a major achievement.[8] While they had a mixed track record, most analysts agree that they have implemented significant changes towards expanding individual freedoms and civilian democracy in the country. The once-all-powerful army is now relocated back to its barracks from the political arena, and there have been major gains on minority rights.[9] Turning to the economic arena, the AKP government fully em-

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7 While it was the same in Turkey regarding the industrial workers, Syrian experience differs in the case of agricultural workers. The Kemalist regime and successive governments under CHP from 1920s to 1940s followed primitive accumulation and used agricultural surplus to support industrial build up (Silier, 1981). As a result, there has always been a popular backlash against Kemalist parties at elections.

8 For example, the AKP received 15% of the votes in Diyarbakir, yet it gained 8 out of 10 seats in the parliament, the remaining two seats being captured by CHP, which received 5% of the vote. DEHAP, on the other hand, which received 56% of the vote in the city, gained no seats as its national average was below the 10% threshold level.

9 Nevertheless, there remained significant problems that yet to be dealt with including Kurdish rights, undermining of secularism and freedom of religion, as well as freedom of speech. In particular, on the individual freedoms and democracy fronts there have been disturbing developments recently, such as the mass arrest of hundreds of Kurdish politicians, journalists and activists, months-long detentions of student protestors, and dismissal of opposition journalists upon pressure from the government. In another example, the prime minister and his cabinet made repeated remarks and threats to journalists and intellectuals who disagreed with their policies (Radikal, 2011; Hurriyet Daily News, 2012, 2013).

braced the neoliberal economic policies and pushed them further. The Prime Minister R. T. Erdogan has made dozens of public statements arguing in favor of deregulation, privatization, and liberalization, and praised the benefits of a laissez faire economic system.[10]

The AKP government has arguably implemented more radical changes towards laissez faire economics including business law, penal code, labor code, environmental regulations (removing or reducing restrictions on construction activities on national preserves, forests, sea shore), health care, education system (supporting private over public schools) and State enterprises than any other government before. More than 80% of privatization revenues ($42 billion) since 1985 were realized during the AKP years of 2003-2010. Thanks to widespread privatization as well as downsizing, public sector employment in SEEs fell significantly, from around 434,000 in 2002 to 220,000 in 2010 despite the fact that Turkish population increased from 67 million in 2002 to 74 million in 2010 (Sayistay, 2006, 2012). The share of personnel expenditures (non-interest payment) in government expenditures steadily fell from above 40% in early 1990s to around 20% in early 2000s, and to below 11% in 2011 (CBRT, 2013). Likewise, the share of public investment expenditure in GDP fell from around 9% during early 1980s to a low of 2.8% in 2011, which marked its lowest level since 1980.

On various occasions, the PM Erdogan and his ministers made it very clear that they fully agree with the IMF, WB and OECD regarding the "costs of labor market rigidities". The AKP government has passed various laws and legislations attempting to increase labor market flexibility and undermine the bargaining power of organized labor in Turkey. While this trend did not start with the AKP and was in place since early 1980s, one can argue that it significantly accelerated under the AKP government which passed labor legislation such as Article 657 and 4,857, the latter abolished job security for more than 94% of employees. According to Article 4,857, labor security is applicable only to those enterprises employing 30 workers or more, which correspond to less than 6% of all enterprises in Turkey. It also excludes part time, temporary or fixed-term contract workers from labor security provisions. Since its amendment, there has been an explosion in subcontracting in public and private sector. While the total number of

10 See, for example, the following: "We will save our country from excess employment [in public sector]. The state is not a place to provide non-productive employment" (Prime Minister R. T. Erdogan; Radikal, 2009). "As there is a free market for everything in the world, there should develop a free market in health care [in Turkey] too" (Prime Minister R. T. Erdogan, NTV, 2009).

subcontracted workers was 20,000 in 2002, it exceeded one million in 2012 (Aydoganoglu, 2011a, 2011b; *Hurriyet*, 2012). During this time period the percentage of employees with union membership fell from 10.6% in 1997 to 5.9 in 2009, the lowest among OECD members where the average was 18.4%. A second major change was the section 4-C on temporary employment (of Article No 657 on public sector workers), devised by the government to provide a solution to workers displaced from privatized SEEs, redefined employment status as provisional up to one year, abolished the right to unionize, and cut wages by 75% while eliminating severance pay and health benefits (Aydoganoglu, 2011a, 2011b).[11] Not surprisingly, the labor strike activity steadily fell from an annual average of 85 strikes (in public and private establishments) during 1991-2001 to 19 strikes a year between 2001-2012, with a low of 7 strikes in 2012, which is the lowest number since transition to democracy in 1987 (CBRT, 2013).

In addition to significant changes towards flexible labor markets, the successive governments since 1980s also kept the labor market supervision to a bare minimum, a trend that continued under the AKP government. According to OECD statistics, Turkey is second to only Mexico in terms of the lowest number of labor inspectors, and this number fell steadily during the 1990s and 2000s (OECD, 2008: 117). According to ILO data, Turkey ranks 5th out of 68 countries and 1st in Europe in the rate of annual average number of fatal work-place injuries (per 100,000 employee) between 2003 and 2008 (ILO, 2013). Yet, the PM Erdogan could still call explain work place deaths with "destiny" and defend his government's increasing use of subcontractors (*Hurriyet*, 2010).[12]

On the public finance side, the tax burden has increasingly become unequal and regressive concentrating on lower income groups with a significant drop in the corporate income tax (CBRT, 2012; SPO, 2010). Being aware of the potential opposition to the rising inequality among the wider population, the AKP government, both central and local, has emphasized the development of social safety nets through

11 In response to this legislation, there was a major strike by the workers of privatized TEKEL, which lasted from November 2009 to February 2010.

12 This attitude stands in stark contrast to some other statements of the PM Erdogan where he argued that Muslim countries have a different capitalist system than the West. For example, he argued that "Wild capitalism and the rapacious drive for profits that is driven merely by personal interests and material gains is not a sustainable economic model (…) We are members of a civilization that does not separate the economy and morals but places morality in the foundation of economy" (R.T. Erdogan, 2011; Hurriyet, 2011).

charity works rather than an institutionalized welfare system.[13] Possibly thanks to such direct and indirect income support mechanisms, there has been a decline in income inequality such that the income gap between the highest and lowest decile of income distribution fell from 18 in 2002 to 12 time in 2010. The Gini coefficient also fell from 0.44 in 2002 to 0.38 in 2010. Overall, the relative economic success in terms of GDP growth, budget deficit reduction, and foreign capital inflows has also helped solidify the AKP's commitment to the neoliberal economic model.

In Syria, the economic policy of the Asad regime led to a second crisis in the mid-1980s, only a few years after the regime shift in Turkey. To solve its acute debt crisis, very much like the Turkish generals in 1980, a faction of the ruling class considered the help of the World Bank and the IMF. Rather than turning to multinational institutions as Turkey did, a decision that might have opened the country to outside interference, the regime that jealously guarded its political autonomy decided to implement its own path of reform. Following a severe foreign exchange crisis in 1986, the State announced an era of economic pluralism (*ta'addudiyya*). It passed policies that allowed the private sector to invest more freely with generous tax exemptions (Investment Law No. 10 of 1991), increased the number of sectors open to liberalized prices and reduced subsidies, and liberalized trade and exchange rates (Sukkar, 1994). Furthermore, the collapse of the Soviet Union and its satellite States in Eastern Europe was understood as the demise of socialist ideology. The Ba'ath party itself as a locus of decision-making and deliberation gave way to the influence of prominent businessmen (Joya, 2007).

On July 10, 2000, Syria held a referendum on electing Bashar al-Asad to President of Syria, where, according to the referendum commission, he won by 97.3% of the vote and was sworn in on July 17th.[14] In his inauguration speech, economic reform was one of the key

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13 For example, free distribution of coal for heating, food baskets and clothing, student stipends, household durables, and even phone cards are some of the common methods of charity work utilized to generate support for the government. In fact, during 2003-2011, the AKP government distributed almost 14 million tons of coal to over 17 million families for free. In recent years, the biggest increase in coal distributions was in 2009, which coincided with the local elections. While only one in 20 families received this aid in 2003, the number was one in nine in 2011 (Licali, 2012).

14 Interestingly, the new Turkish constitution typed by the Junta also received a 91% support in the referendum of 1982. Interestingly, the ballots for "no" vote were printed in blue papers, which made them visible to outsides in thin white envelopes that were used in the referendum.

points of focus.[15] There was little dispute within Syria on the need for a change of direction, but the question was which one to take. Bashar al-Asad's ascent to power came with the promise of political and economic reform- however after brief flirtation with the former only the latter was implemented. The 'Damascus Spring' led to a proliferation of independent periodicals, intellectual forums, and civil society organizations culminating in various statements or manifestos (such as "Statement of 99") which demanded more freedom of expression, rule of law, independent judiciary, abolition of special courts, martial law and emergency legislation.

Since Bashar's accession to power in 2000, the role of the private sector grew substantially. Previously, economic liberalization was done piece-meal and gradually, and largely in response to crises. Under Bashar al-Asad there was a decisive turn (with inspiration and support from the Turkish model) towards the market economy. The economic leadership under Asad decided, and perhaps with good reason, that the old model was unsustainable. However, discarding the model completely represented a dilemma: could the regime afford to completely abandon its key constituents, namely the urban workforce and peasantry? The leadership debated whether aggressive or gradual liberalization should be adopted (i.e. the shock therapy vs. sequencing debate). The so-called "Chinese model" became a mantra of Syrian officials. Over the past decade the government dramatically liberalized trade (e.g. Legislative Decree 61 in 2009) while ending government monopolies on imports, and liberalized agricultural exports through lowering or removal of export duties. Domestically, this has also meant liberalization of prices for most commodities (through the "Competition and Anti-Monopoly Law" of 2008). Private Banks were licensed for the first time and a stock exchange was established. Deregulation of the real estate market, including reversal of decade old tenant laws and allowing landlords to more easily evict tenants in previously rent-controlled housing (Tenants and Real Estate Law No. 6) making Damascus one of the most expensive cities in the world by late 2000s in terms of office space, and laws protecting private property were strengthened. The State withdrew public support from the energy sector (particularly with regard to prices of diesel, gasoline fuel, gas and electricity), and liberalized the prices of agricultural and industrial inputs. Due to a decrease in oil revenues, which were cut almost in half in fifteen years, structural adjustment was finally implemented. The strategy adopted by the regime signified that the public sector was

15 Several of Asad's speeches, including the inauguration one, can be accessed (in Arabic) at <http://www.syria-prins.com/syria.htm>.

to undergo additional marginalization while the private sector and the classes involved in the new economy were given a leading role (Dahi and Munif, 2012).

While the extent of liberalization and rollback of the State in Syria was not as dramatic as in Turkey or others in MENA, such as in Egypt and Tunisia, these were the aspirations, or models Syria was trying to emulate. These steps toward liberalization represented a fundamental change in the economic direction as signaled by major policy documents. In June of 2005 during the Tenth Regional Congress of the Ba'ath Party, the term 'social market economy' was introduced as the new economic model for Syria. Though the phrase 'social' was retained, presumably to signal that aspects of the welfare state would remain, this signaled a decisive shift towards a market economy. However, policy implementation was more 'market' than 'social' and the Syrian State was unable or unwilling to perform the technocratic role needed to guide a social welfare developmentalist regime (Seifan, 2009).

Since Bashar al-Asad's ascension there was an increasing concentration of power within increasingly narrow 'business networks' solidified by a complete alliance and merger between the holders of economic power and political power, the best symbol of which was Rami Makhlouf, the country's top businessman. (Haddad, 2011; Wieland, 2006: 60). Several entities such as Cham Holding and Syria Holding became the markers between those who were included or excluded from the sources of wealth. The concentration of wealth, since the time of the United Arab Republic, has never been as uneven where 5% of the population owns 50% of the wealth. At the same time, the ruling class has been enacting an important but gradual transition from the planned economy to a neoliberal economy that left more than 30% of the labor force unemployed and between 11% and 30% below the poverty line (Wieland, 2006: 63). According to Jamal Barout's (2011) decade long field study, the poverty rate tripled from 11% to 33% (i.e. 7 million people living in poverty) from 2000-2010, the period of Bashar al-Asad's rule.

4. THE NEW REGIONALISM AND SYRIAN-TURKISH RELATIONS DURING THE NEOLIBERAL ERA

On October 20, 1998, Syria and Turkey signed the Adana Agreement. The Agreement marked the beginning of a turning point in Syrian-Turkish foreign political and economic policy relationship that would last until March 15, 2011, the start of the Syrian Uprising. Prior to the Adana Agreement, Turkish-Syrian relations were generally tense and conflictual, a legacy of the initial border disputes following the break-

up of the Ottoman Empire/establishment of modern Turkish republic and then the opposing Cold War alliances, which also included disputes over land, water, and political alliances (Zafar, 2012; Suer, 2008). This was also a legacy of Turkey's turn to Europe and the "Western world", and disengagement with the Middle East and Islamic world after the establishment of the modern Turkish Republic under Ataturk (Danforth, 2008). In this section we show how Syrian-Turkish regionalism, viewed as a panacea in foreign policy, was in fact destabilizing. Rather than solidify Turkey's 'turn East' and project its soft power with its 'zero problems with neighbors' and instead of allowing Syria to emerge from its isolation and find a pathway to Europe it ended up contributing to the grievances that fueled the Syrian uprising.

The most immediate cause of dispute at the time of the Adana Agreement was the Syrian regime's support for the Kurdistan Workers' Party (PKK) through hosting of its guerilla force as well as providing logistical support (Olson, 1998). Syria's foreign policy under Asad could be described as a realism of the weak, forging alliances with external groups that can be assets in its bargaining power with stronger neighbors. Therefore, Syria had at one time or another hosted or allied with Palestinian, Lebanese, Turkish, and Iraqi oppositional or militant groups.

Similar pragmatism was what led to the Adana Agreement. At one level, the agreement was lopsided in Turkey's favor. Syria agreed to recognize the PKK as a terrorist organization, not allow its members to use its land to attack third countries, and use its leverage in Lebanon to push for the same. Contrary to what Syrian newspapers claimed at the time, there was in fact no promise or commitment from Turkey on any issues related to water disputes or the status of Hatay. In other words, it was viewed as a complete Syrian surrender. However, from a wider perspective, the agreement came at a sensitive time in Syrian history in several respects. First, Hafiz al-Asad had been engaged in critical negotiations with Israel, sponsored by the Clinton administration that fell apart when Benjamin Netanyahu came to office in 1996, but the Syrian government could not afford to be negotiating on both fronts simultaneously. Second, the latter half of the 1990s witnessed a gradual decline in economic growth rates following a post-Gulf War boom in terms of oil prices and external aid. After averaging an annual percentage growth rate of 4.9% from 1990-1995, the GDP per capita growth rate was -0.09% during 1996-2000 (WDI, 2013). Third, Hafiz al-Asad was in the process of preparing for his son's succession to power, which included surrounding Bashar al-Asad with new personally loyal military and security elite. All three factors meant that Syria was in a particularly weak bargaining position (Suer, 2008). The result

was that a key feature in Syrian foreign policy was transformed. Economic and political cooperation gradually increased after this point, and this increase was solidified with the coming to power of the AKP in Turkey.

Starting in 2000, mutual visits took place regularly between the two countries' officials and public holidays were occasions for furthering of diplomatic relations. In June 19, 2002, the Syrian head of the Army Hasan Turkmani (notably a Syrian of Turkish origin and with a clear sounding Turkish name had been placed as head of the army) signed a protocol of mutual technical and military cooperation and joint exercises. On January 2004, President Bashar al-Asad became the first Syrian president since independence to visit Turkey. Again, in July 15, 2004, Prime Minister Muhammad Naji al Otari and his delegation visited Turkey and met with the president Ahmet Necdet Sezer and Prime Minister R. T. Erdogan. Both sides started discussions for a free trade zone and expand existing trade and financial links, and promised to remove any remaining blockades for the expansion of their bilateral relations. On August 25, 2004, an oil-industry cooperation agreement was signed, and on December 22, 2004, the Syrian-Turkish free trade agreement was agreed upon during Prime Minister Erdogan's visit to Damascus, finally coming into force in 2007. The free trade agreement was defended by the Erdogan government as a way to encourage further economic, and later political, reforms in Syria. That time period saw numerous agreements in joint-ventures, petrochemicals, manufacturing, transportation, tourism and railroads. The peak point came in October 2009 when they signed an agreement to remove visa restrictions on border crossings and, during that year, both countries established the Strategic Cooperation Council and met in both Gaziantep and Aleppo during that year when 40 protocols and agreements were signed. A major project launched was the natural gas pipeline project, connecting Turkish to existing Arab pipelines (Zafar, 2012). During this period, the Iraqi situation became a major source of agreement, something repeated by both sides, which stressed the 'territorial integrity' of Iraq, that is, the 'threat' of Kurdish nationalism became a key source of joint concern. At the same time, there was an accompanying discursive shift in both countries toward the other: from the perspective of Turkey the discourse of Syrian terrorism support was replaced by the 'joint history' and from the Syrian side the enemy of 'Arab nationalism' and the 'Israeli ally' became the 'strategic partner'.[16] The Syrian Prime Minister even referred to the

16 There was even pressure by the Turkish government on Syria to censor Syrian historical soap operas which had depicted unfavorably the Ottoman soldiers and

two countries as "Shaqiqain" or brothers, a term normally reserved in Syrian foreign policy discourse for other Arab regimes or peoples (Mahfoud, 2009). Previous anxieties regarding the GAP Anatolia development project and joint Israeli-Turkish relations were pushed to the background or minimized.[17]

The public incident between R.T. Erdogan and Shimon Peres on January 29, 2009, at the Davos summit following the Israeli attack on the Mavi Marmara solidified Turkey's image as the new ally of Syria and Arabs in general. A survey of 7 Arab countries (Egypt, Saudi Arabia, Jordan, Lebanon, Syria, Palestine, Iraq) in July 2009 found that 77% of respondents called on Turkey to play a bigger role in the Arab world and roughly the same number thought Turkey would contribute positively to peace in the region. About 61% of respondents saw Turkey as a model for the Arab world (even 55% of respondents in Saudi Arabia) even while 57% thought Turkey should in fact join the EU. In Syria the results were even more dramatic, as 87% of Syrian respondents had a very favorable view of Turkey, more than any other Arab country listed in the questionnaire and second only to Syrians opinion of Syria itself. At the same time, 72% of Syrians "strongly agreed" that Turkey "can be a model for Arab countries" (Akgun, Mensur, Percinoglu and Gundogar, 2009).

On the Turkish side, a key factor in the rebirth of Turkish-Syrian partnership was the "neo-Ottomanist" ambitions of the Turkish PM R. T. Erdogan to make Turkey the leading player in region using its economic as well as political muscles. As a result, the real push for Turkish-Syrian relations came out in 2003 after R. T. Erdogan became the prime minister of Turkey. In fact, R. T. Erdogan, foreign minister A. Davutoglu (who is the architect of Turkey's now demised zero-problems with neighbors policy), and president A. Gul, all pushed for better relations with Syria as a major achievement under AKP government. One may also argue that comparatively disappointing industrialization efforts of Turkey, and increasing export competition from EU (due to Customs Union agreement) and Asian countries also have pushed Turkey to open up new fronts for its business class, mainly in regions where it has a comparative advantage.[18] Historical and cul-

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'occupation' of Syria. From that time period on, the soaps shifted to either ignore Ottoman presence or to fast forward a little bit in the timer period and the struggle against Ottoman occupation was replaced by the struggle against French occupation.

17 The purpose of GAP was to construct 22 dams, 19 Hydroelectric Power plants, and 17 irrigation schemes, which would result in decrease of water flow to Syria (and Iraq).

18 The Gross Fixed Capital Formation (GFCF) as a share of GDP has remained quite low, averaging 16%, 18%, 24%, and 19% during the 70s, 80s, 90s, and 2000s,

tural ties, as well as its industrialists' willingness to put up with higher risks than their developed country counterparts, have allowed Turkish industrialist and merchant class to penetrate in higher risk countries including conflict zones in MENA and Africa.

From Syria's perspective opening a new front for dialogue with the West while at the same time securing a new friend in the face of growing Western pressure on the Asad regime seemed like a strategically desirable goal. According to Wikileaks files, the US embassy in Ankara kept a very close watch on the renewed Turkish-Syria partnership. While recognizing that this offers a "strategic buffer" against Western pressures as well as allowing Syrian regime to repair weakened relations with its neighbors such as Lebanon, Saudi Arabia and Lebanon, it was also seen as a possible way out of the Iran's orbit. It was also reported that ministry of foreign affairs officials discussed the visit with the US embassy and told them their view that Asad's control of the country is too fragile to allow him to initiate a political reform and economic reform is the only possible route against older generation of Baathists, who are against any kind of reform.[19]

4.1. TRADE AND INVESTMENT

The Turkish efforts to prioritize economic cooperation bore fruits, The trade volume between Syria increased from $582 million in 2002 to $2.3 billion in 2010 (see Figure 1), a growth of over 295%. However this overall growth was one sided, Syrian exports grew by 44% while Turkish exports to Syria grew by 592% turning a $48 million (and $182 and $361 million in 2001 and 2000) trade deficit in 2002 into a

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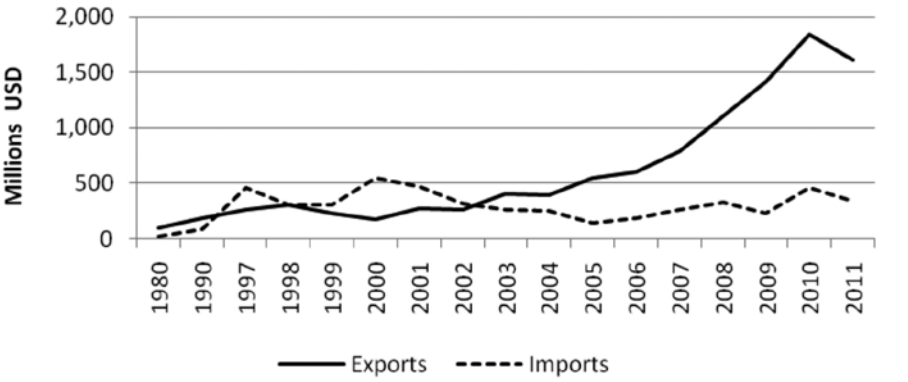
which are significantly below the levels of successful industrialization examples of South Korea with averages of 27%, 30%, 36%, and 29%, or China with averages of 20, 27, 29, 33, and 40%, respectively (WDI, 2013). The share of manufacturing value added in GDP also steadily declined from 24% in 1998 to 19% in 2001 and 16% in 2011 (CBRT, 2013). As a result, UNCTAD (2003) classified Turkey among de-industrializing countries.

19 The following are from the leaked WikiLeaks cables. "The Turks, led by PM Erdogan, FonMin Gul [Foreign Minister Abdullah Gül], and chief foreign policy advisor Davutoglu, are selling improved relations with Syria as a major foreign policy success. GOT [government of Turkey] leaders cast Turkey as a channel of communication for the US and Israel with Syria and as a friend that can support economic reform. At the same time our GOT interlocutors view Assad's control as too fragile to sustain anything but economic reform"; wrote Robert Deutsch, from the US Embassy in Ankara, in a confidential cable on Jan. 18, 2005. Likewise, in another secret cable sent by US Charge d'Affairs Charles Hunter in Damascus stated the following on Oct. 28, 2009: "Turkey's methodical deepening of relations with Damascus offers Syria a strategic buffer against international pressure and a ready mediator willing to help Syria mend strained relations with neighbors, such as Iraq, Saudi Arabia and even Lebanon" (Baydar, 2011).

$1.4 billion surplus in 2010 for Turkey. Nevertheless, the sudden rise in bilateral trade has been followed by a similar decline, reaching a cumulative monthly loss of 432% for Turkish exports and 510% for Syrian exports between 2011:10 and 2012:5, compared to the same months of previous year. At the end of first five months of 2012, total trade volume between two countries fell to one third of its level in the first five months of previous year.

Figure 1
Bilateral trade between Turkey and Syria



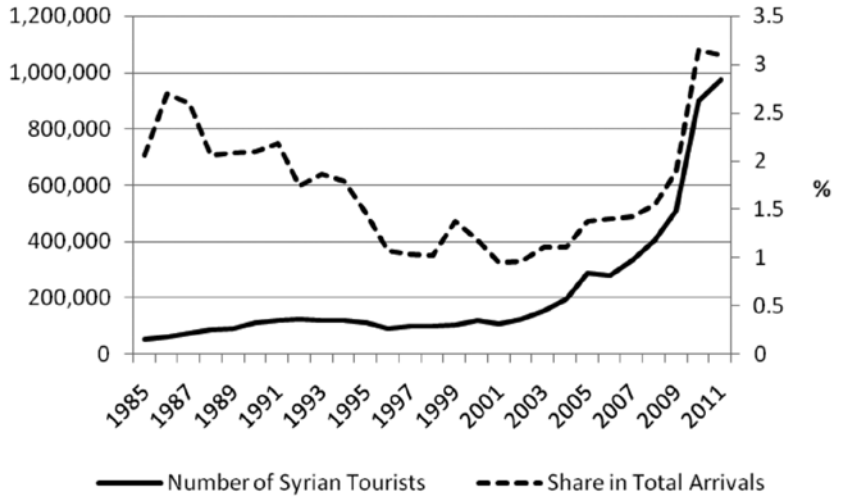
Source: TUIK, Foreign Trade Statistics Database.
Notes: Exports and Imports refer to Turkish exports and imports to and from Syria (in current prices).

We observe a similar development on bilateral tourism figures as well. The number of Syrian nationals visiting Turkey increased by 8 folds from 126,000 in 2002 to 974,000 in 2011. In contrast, the number of Syrians visiting Turkey has been only around 100,000 people a year on average throughout 1980s and 1990s. Its share in total tourist arrivals also increased reaching above 3% by 2011. Likewise, the same figure for Turkish nationals was almost a four folds increase from 468,000 in 2002 to 1.6 million in 2010 (Ministry of Culture and Tourism). According to the data of Ministry of Tourism of Syria, the number of the Turkish tourists who visited Syria in 2010 was 1,664,209, which constitutes an increase more than 100% compared to the 733,132 of the previous year.

Nevertheless, following the deterioration of relations since the start of the uprising in 2011, there has been an equally drastic decline in the number of arrivals, reaching 33% in the first five months

of 2012 compared to the same period of previous year. Similar developments took place with regard to Turkish direct investment projects in Syria. According to some estimates outward Turkish FDI stock in Syria reached anywhere from $700 million to one billion dollars in 2011 compared to almost none from just a few years ago (TUDEP, 2011). By 2010, there were estimates of over 41 Turkish industrial, touristic and other projects in Syria, 15 of which are in Aleppo. These range from autos, machine and machine parts manufacturing, to polypropylene thread production, to olive oil bottling. The largest Turkish project in Syria is the Raqqa cement factory worth roughly $5 million and employing 1,000 workers. Moreover, the Turkish hotel chain Dedeman also has a presence in Syria (Al-Iqtisadi, 2011).

Figure 2
Number and Share of Syrian Tourist arrivals in Turkey



Source: Ministry of Culture and Tourism of Turkey.

A closer look at the Syrian Turkish Association Agreement sheds more light on the dynamics of the economic relationship between the two countries. The objective of the agreement signed under Article XXIV of the GATT, signed in 2004 and coming into force in 2007 was to establish "a free trade area on substantially all their trade over a transitional period lasting a maximum of 12 years". At the time of signing, it

was clear in Syria that industrialists and commercial chambers were not consulted and that the treaty was orchestrated and signed at the highest levels of the Syrian government.

There have not been detailed studies of the economic consequences of the Free Trade Agreement on the Syrian economy, and establishing causality is difficult in their absence. In particular, as discussed above, this time period coincided with a general liberalization of the economy coupled with reductions in government subsidies of fuels which increased the costs of production for Syrian industrialists. Moreover, Syrian manufacturing was already in a downward trend and Chinese exports also hit Syrian manufacturers hard. In a survey of 270 industrial plants and workshops in Aleppo and Damascus found that productive capacity had declined on average by 20%, local sales 20%, exports by 18%, and employment by 14% between 2008 and 2009 (Seifan, 2010).

However, there have been some attempts by Syrian economists to gauge the particular impact of the Syria-Turkey FTA. First, in the years following the coming into force of the Agreement there was a general decline in Syrian manufacturing, in particular in the foodstuffs, textile and clothing, and furniture sectors. In particular, 20% of furniture manufacturers in Syria closed down while about 70-100 textile and clothing factories or workshops have closed or relocated their production outside Syria. At the same time, factories producing grain also suffered as a direct result of the FTA, and 40 factories or workshops are estimated to have closed, since grain production fell under section 2a of Article 3 in Chapter 2 of the Agreement of production at the 1, 1.5, 1.7, 3, and 3.5% tariff rates that were abolished immediately at the time of coming into force of the Agreement. At the same time, Syrian Industrialists often complained about unexpected tariffs in violation of the Agreement, which reaches up to 40% of the value of the export.

The sudden removal of tariffs and quotas and the following deterioration of trade deficit at Syria's expense happened despite the Article 5 of the agreement which allowed gradualism regarding the liberalization of infant industries. In particular, under Article 5 Syria was allowed to increase or reintroduce customs duties in "infant industries, or certain sectors undergoing restructuring or facing serious difficulties, particularly where these difficulties produce major social problems".[20] Furthermore, Article 21 allowed both parties to put restrictive measures for a temporary period in

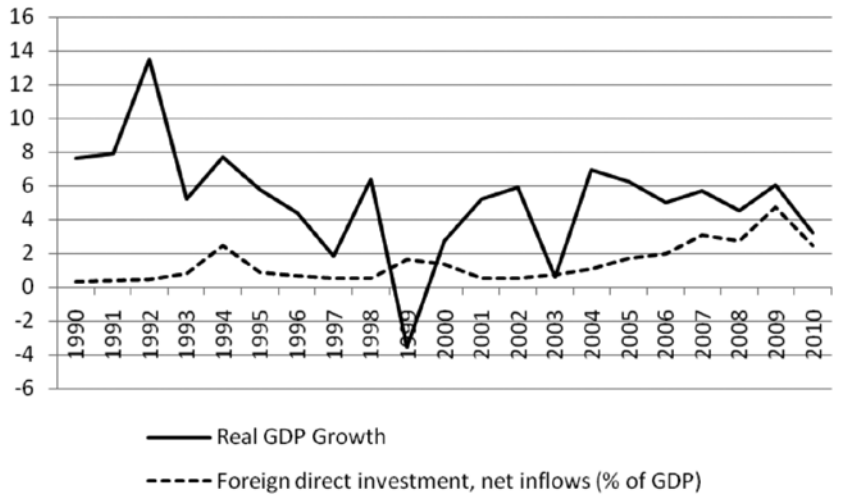
20 The full text of the Agreement can be found at <http://www.ekonomi.gov.tr/upload/DBF45AF3-D8D3-8566-452059879BE3C554/anlasma.zip>.

the presence of "serious balance of payments difficulty or under threat thereof". The fact that neither of these provisions was used, provides support for our earlier remarks on the unbalanced nature of the Agreement. It is also interesting that under Articles 29 & 30, it was stated that Turkey would provide "Syria with technical assistance" focusing "primarily on infant industries, sectors suffering from internal difficulties or affected by the overall liberalization of the Syrian economy and in particular by the liberalization of trade between Turkey and Syria". In Article 33, it was further stated that "the main aim of industrial co-operation will be to support Syria, in its efforts to modernize and diversify industry and, in particular, to create an environment favorable to private sector and industrial development by enhancing co-operation between the two Parties' economic operators". What is interesting with these articles is that Turkey itself has not adopted any such precautions during its liberalization process, and in fact, it is questionable whether Turkey actually had the capacity or willingness to fulfill these promises. Together with the rest of bilateral relations, this agreement also came to a halt in December 2011 with the escalation of conflict between Syria and Turkey.

4.2. RETRENCHMENT AND COLLAPSE

The Tenth Regional Conference of the Ba'ath Party, held in 2005 was seen in retrospect as the consolidation of Bashar al-Asad's power and the decisive turn towards neoliberalism in Syria. Following the declaration in 2004 of the State Planning Commission that Syria will adopt the principles of the market economy by 2010, the Regional Conference announced the launch of the "social market economy", an alleged social-democratic model designed to keep social safety nets while moving towards the free market economy. What it meant in practice was the retrenchment of the State coupled with further trade liberalization as well as deregulation of key internal markets (most importantly real estate). Consequently, the share of government expenditures in GDP first increased in the first years following Bashar al-Asad's rule from around 27% in 2000 to 33% in 2003 before starting a steady decline to a low of 23% in 2008. The same was true regarding the share of public sector total gross fixed capital formation in GDP, which has steadily increased from 11% in 2000 to 15% in 2003 before steadily falling to 9% in 2008 (WDI, 2013).

Figure 3
FDI Inflows and Real GDP growth in Syria, 1990-2010



Source: WDI (2013).

The Syrian government did succeed in some of its primary objectives. It stabilized growth rates and dramatically increased the share of foreign direct investment (Figure 3). However, this came at a price. First, despite attempting to launch infrastructural and developmental projects, most investment was directed towards tourism and real estate, fueling a boom that made Damascus one of the most expensive cities in the world in terms of office space. Second, the loss of manufacturing, in particular the closing down of plants and workshops in the peripheries of Damascus and elsewhere in Syria increased the unemployment problem. Third, the rise of the new rich with ostentatious display of wealth and their increasing visibility coupled with widespread rumors and stories about the monopolization of wealth by Rami Makhlouf and his partners increased the sense of injustice within the country. Fourth, there was a sharp rise in poverty and inequality. Fifth, the majority of wealth and economic activity was increasingly concentrated in the two largest cities of Damascus and Aleppo, increasing the cleavages between the city and countryside as well as medium sized cities. When the uprisings were sweeping through North Africa, the Syrian regime was not far behind. The Turkish government initially followed a very careful approach, encouraging the Syrian regime to adopt reforms and even dispatching advisors to assist the government

to do so. However, as the crackdown in Syria continued, the Turkish government, feeling betrayed or lied to by the Syrian regime, made a major turnaround in policy and started openly backing and providing logistical support to the Syrian opposition while denouncing the Syrian regime. As late as April 2010, the Syrian economic ministry stated that despite Syrian industrialists' objections, Syrian-Turkish cooperation would continue, but that the hope was that joint cooperation will lead to more integration and complementarity rather than just trade.[21] However, relations deteriorated quickly after that, with the Syrian regime unilaterally canceling the Turkish-Syrian FTA and a dramatic shift back in discourse attacking the "Ottomanist delusions and ambitions" of the Turks. Overnight, the discourse returned to the pre-honey-moon phase. Syrian industrialists welcomed the cancellation of the Free Trade Agreement that they said has primarily benefitted Turkey[22] during the time as they were was asking the government to rethink its 'liberal' trade policy.

The first Syrian government formed after the uprising promised a more developmentalist path for the economy, attacking the previous economic ministers' decision at unabashed liberalization and destroying Syrian industry. The public sector Ba'athists thought their time had now come to return to the old model. However, these pronouncements came too little too late. As the Syrian uprising continued and the European Union introduced crippling economic sanctions, the government was forced to scale back its plans and is currently trying to desperately to manage its declining revenues.

By the end of the second year of the conflict, Syria's economy had already suffered devastating losses. GDP losses at the end of 2012 stood at 664 billion SYP (24.1 billion USD), or nearly half of Syria's total GDP in 2010.[23] Since then, the rate of economic deterioration has in fact been growing at an alarming pace. A report estimated that by the end of 2012 Syria's human development indicators had fallen back 20 years since the beginning of the crisis. More than half the population of Syria is now considered to live in poverty, as 6.7 million Syrian citizens fell below the poverty line as a result of the crisis, and 3.6 million fell below the line of extreme poverty.[24]

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21 <http://209.97.213.46/index.php?mode=article&id=7846>.

22 <http://www.syriasteps.com/?d=131&id=79087>.

23 "Socioeconomic Roots and Impact of the Syrian Crisis" in Syrian Center for Policy Research, January 2013: 35. At <http://www.scpr-syria.org/tmpPreLaunch/SyrianCrisisReportEN.pdf>.

24 "The Syrian Catastrophe: A Socioeconomic Monitoring Report" in Syrian Center for Policy Research and the United Nations Relief and Works Agency,

The crisis has tended to hit almost all sectors of the economy.[25] Wheat yields, long a major source of food security, have shrunk over the last several years by 30-50, and livestock and poultry sectors have suffered badly, fueling a rise in the prices of meat, milk, chicken and eggs by as much as 300%.[26]

There are estimates that hundreds of plants, up to 75% of the production facilities in Aleppo, Syria's commercial capital, were no longer in operation in August 2013, either from being bombed, taken over as rebel military centers, or due to the precarious security in surrounding neighborhoods.[27] There were accusations that many industrial plants had been dismantled and sent to Turkey.

Although economic sanctions on Syria did not start with the 2011 uprising, they quickly escalated during mid to late 2011. The precise impact of sanctions is hard to discern, it is clear they played a role in exacerbating the economic crisis.[28] Reports indicated that the sanctions caused 28% (or roughly $6.8 billion) of the losses to GDP in 2011 and 2012, with the worst impacts accruing to the lower social classes who faced higher food staple and heating prices.[29]

The sanctions and economic crisis induced an acceleration of the depletion of Syria's foreign exchange reserves, and the declining value of the lira compelled many Syrians to withdraw their money and convert to dollars. By 2013, data reported by six of Syria's fourteen private banks showed losses amounted to between 40 to 95%.[30] Of course, by then the Syrian Turkish trade relations had been almost completely severed.

First Quarterly Report, January- March, 2013: 21. At <http://www.unrwa.org/userfiles/2013071244355.pdf>.

25 Abboud, Samer 2013 "Capital Flight and the Consequences of the War Economy" in Jadaliyya. At <http://www.jadaliyya.com/pages/index/10617/capital-flight-and-the-consequences-of-the-war-eco>.

26 "Joint Rapid Food Security Needs Assessment – Syrian Arab Republic" in Food and Agricultural Organization of the United Nations (FAO-UN), June 2012. At <http://www.fao.org/giews/english/otherpub/JRFSNA_Syrian2012.pdf>.

27 Putz, Ulrike 2013 "'A Slow Death': How the War is Destroying Syria's Economy" in Der Spiegel International, August 27. At <http://www.spiegel.de/international/world/civil-war-in-syria-destroying-economy-a-918815.html>.

28 "EU Sanctions against the Syrian regime extended" in Council of the European Union, February 28, 2013. At <http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/EN/foraff/135733.pdf>.

29 "The Syrian Catastrophe: A Socioeconomic Monitoring Report" in Syrian Center for Policy Research and the United Nations Relief and Works Agency. First Quarterly Report, January -March 2013. At <http://www.unrwa.org/userfiles/2013071244355.pdf>.

30 Sayegh, Hadeel 2013 "Syria's Banks Brace for Worst as Civil War Batters Economy" in The National, February 19. At <http://www.syrianef.org/En/?p=1048>.

5. CONCLUSION

The Syrian-Turkish rapprochement of the 2000s was built on a new rising social force within Turkey that sought to re-orient its foreign economic and political policy as well as a Syrian leadership that sought to reposition itself regionally and globally. We can identify several features of the integration experiment between the two countries that coincide with established international relations explanations such as those advanced in the previous section. Institutionalizing democracy does not seem to be a credible factor for either side; while on the Syrian side it was a non-starter, Turkey's reforms had preceded the agreement and there were no expected gains on that front to be had from integration with Syria. Nor does alliance against a third external enemy seem plausible. Syria's main declared enemy is Israel, and while Turkish-Israel relations certainly deteriorated during the 2000s, and while Turkish foreign policy was markedly more independent than in the pre-AKP era, Turkey remained a NATO member and an Israeli ally, with significant trade and military relations between the two countries. There was mutual rivalry and hostility between the two countries, previously, and the public declarations of officials from both countries lends credibility to the *neo-functionalist* explanation. Moreover Hinnebusch (2009) has argued that Syria, a small peripheral country in defiance of the global hegemony (the US), has had to make concessions in the post Cold War era (especially after September 11th) while solidifying its 'cards' (alliance with Hezbollah and Iran). Syria's treaty with Turkey fits within the idea of a strategic repositioning that both diversifies its alliances, while taking one step closer to Europe.

It is worth noting that Syria was the only Euro-Mediterranean partner country that had not yet signed an Association Agreement with the European Union (the others are Algeria, Egypt, Israel, Jordan, Morocco, Palestinian Authority, and Tunisia). Having singed the 1977 "Cooperation Agreement" and participated in the "Barcelona Process" that was launched in 1995, it had negotiated and initialed the Association agreement between 1998 and 2004.[31] However, after being stalled first by EU members, it was Syria in 2009 that had held back from signing due to what it labeled unacceptable political interference. By that time Syria had considered itself in a position strong enough to negotiate better terms (Cavatorta, 2011). This demonstrates the premium the Syrian government places on political autonomy. Though the Syrian government faced problems, it was not without alternatives when it pursued negotiations and relations with Turkey. The Syrian-

31 <http://eeas.europa.eu/delegations/syria/eu_syria/political_relations/agreements/index_en.htm>.

Turkish partnership was viewed as therefore much more limited in impact: liberalizing the economy and a pivot in foreign policy while retaining political control domestically.

However as we have argued in this chapter, the promise of an 'economic utopia' whereby economic integration would lead to peace and prosperity for both sides was a key element in legitimating this process as well as a key factor in its development. Though there were many converging worldviews, the place of overlap was the neoliberal economic vision that saw integration into the regional and global economy, foreign direct investment, domestic liberalization, and a free hand to the business class as a harbinger for prosperity and power consolidation.

Despite all the discussions on whether the Syrian regime was or was not following the Turkish model, in fact successive Syrian governments and present regimes had followed the Turkish model on several occasions. Their official ideology and party of mass incorporation were similar, as was their *etatist* government model, their uneasy relationship with Islamism during the *etatist* era, and finally the rise of liberal models were all indicators of a similar trajectory. The Syrian-Turkish experience also shows the limits of the 'new-regionalism'. While there has been a dramatic rise in this process since the early 1990s, and it has been accompanied with euphoric declarations of a new era, the troubles within the EU coupled with the uneven performance of other treaties (such as NAFTA) are causing a rethinking of the conditions under which such integration agreements may be successful. In this case, economic liberalization was a destabilizing factor for the weaker side rather than a panacea.

Of course, there are numerous other fault lines, which made the Turkish-Syrian partnership unstable that we do not explore here. The Kurdish problem and persisting AKP government's attitude to suppress democratic demands of Kurdish people;[32] a quasi-secular government system with Sunni Islam as unofficial state religion; and fragile democracy with Erdogan and his cadre of bureaucrats, judges and politicians replacing the military chiefs and the Kemalist state bureaucracy and judiciary. On the Syrian side, the belief by governmental elites that economic liberalization can be achieved without political liberalization proved incorrect. The increasing liberalism coupled with a corrupt alliance between the holders of political and economic

32 This attitude appears to be changing drastically during the current period as the Kurdish peace talks with Turkey have intensified in early 2013, which can be in part explained by the evolving Syrian crisis in which the Syrian government ceded control from Northern Syria to the Kurdish PYD.

power and their public displays of wealth, along with several crises including a massive drought meant that the Syrian State was full of latent conflict possibility. Externally, top down market oriented reforms to liberalize and deregulate economic systems of undemocratic countries is shown to be unsustainable leading to multiple sources of conflict among different interest groups. It is no coincidence that all three countries that have gone through revolutions in MENA that are Tunisia, Egypt and Syria all had two common elements in the run up to the uprisings: An authoritarian regime and a top down economic liberalization program. In this respect, our study also sheds some light on the issue of relative merits and limitations of different economic transformation strategies, namely gradualism versus shock therapy. As appears, there exist major institutional and political limitations on the ability of state elites/autocrats to carry out top-down economic transition from a centrally planned economic system to a laissez faire economic model. In the end, political, institutional and structural factors shape the transition process and the final outcome. The governments in power during the process of transition has to take into account that fact that powerful groups in society will emerge as losers from this process and therefore can undermine the government's support base.

Last, but not least, the Great Recession (2008 - now) was seen to be a watershed moment that put into question the era of 'neoliberalism' and the deadlock at the WTO has also slowed multilateralism to a halt. The 'new regionalism' itself has been examined from a multitude of perspectives over the past two decades. In this chapter, we argued that Syrian-Turkish relations have been a particular type of the 'new regionalism' that contained high hopes but was ultimately destabilizing. Just as the process of multilateralism is itself non-linear and contradictory with possible advances and reversals, so is the process of regionalism, as discord within the EU attests.

APPENDIX

Text of Adana Agreement October 20, 1998. At <http://www.mafhoum.com/press/50P2.htm>.

Turkey-Syria Association Agreement at <http://www.economy.gov.tr/index.cfm?sayfa=tradeagreements&bolum=fta&country=SY&region=0>.

Chapter 2

SOUTH-SOUTH VERSUS SOUTH-NORTH TRADE

DOES THE DIRECTION OF TRADE MATTER?

1. INTRODUCTION

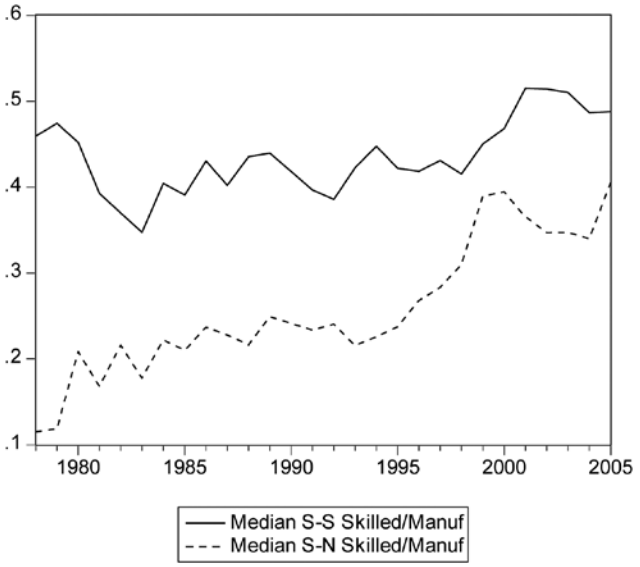
A salient feature of the global economy in the last 25 years has been the increasing economic linkages within the global South. As UNIDO (2005) notes, this has been especially remarkable since it has occurred under the context of North-South trade and policy liberalization. During 1970-2003 South-South trade in manufactures grew at an annual rate of 18.3%, almost twice as high as total world exports and total North-North trade. By 2003, manufactures accounted for over two thirds of South-South merchandise exports compared to 25% in 1965 (UNCTAD, 2005). Likewise, the share of the South in world manufactures exports increased from 5% in 1978 to 36% in 2005 while that of South-South manufactures exports reached 16% from a mere 2% during the same period (COMTRADE). However, the literature on South-South trade has only recently begun examining the implications of these evolving patterns in international trade. Even within this burgeoning literature, a disproportionate amount focuses on the static welfare implications of Preferential Trading Agreements (PTAs) (Mayda and Steinberg, 2007; Venables, 2003; Yeats, 1998). This focus is understandable given the proliferation of South-South PTAs in the late 1990s and the early 2000s. As of early 2008 over 25% of total PTAs reported to the WTO can be considered South-South PTAs. However,

South-South trade is increasingly a global not a regional South phenomenon.[1] Moreover, by 2001, manufactures accounted for over two thirds of South-South merchandise exports (WTO, 2003) and "five out of the top ten products in South-South trade are high-technology manufactures" (UNIDO, 2005: 18). The increased sophistication of these exports along with the growth in inter-regional South trade renders static intra-regional PTA analysis inadequate to understand current trends in South-South trade.

In this chapter, we analyze the dynamic gains from South-South trade through studying the South-South and South-North exports of 24 developing countries that account for 82% of all developing country manufactures exports. Using a cointegration and error correction framework, the main question we try to answer is whether we can gauge dynamic effects from South-South and South-North trade in total, and medium to high technologically intensive manufactures over the time period 1978-2005.

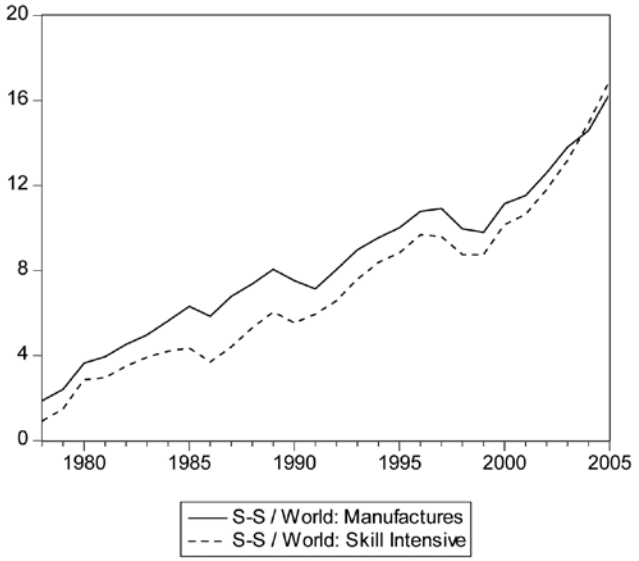
2. WHY CARE ABOUT SOUTH-SOUTH TRADE?

Figure 1
The Share of Skill Intensive Goods Exports in Manufactures Exports: S-S and S-N Trade



1 Notes: Despite the fact that it remains highly concentrated in developing Asia and that Sub-Saharan Africa is marginalized. More on this comes below.

Figure 2
The Share of S-S Exports in World Exports, 1978-2005 (percentages)



Source: COMTRADE and authors' calculations.
Notes: S-S / World: Manufactures and S-S / World: Skill Intensive refers to the share of S-S total manufactures, and technology-and-skill-intensive manufactures exports in World Manufactures Exports respectively.

Table 1
Trends in S-S Trade (percentages)

Year	Share of S-S Exports in Total Southern Exports		Median Share of … Exports of the Sample going to the South		Median Share of Skill-Intensive Goods in Total Manufactures Exports	
	Manufactures	*Skill-Intensive Manufactures*	*Manufactures*	*Skill-Intensive Manufactures*	*S-S*	*S-N*
1978	34	39	27	52	41	11
1979	37	42	35	56	44	11
1980	45	53	45	67	42	17
1981	45	52	50	70	39	15
1982	46	53	46	59	38	20
1983	43	49	44	57	36	17
1984	42	48	40	63	39	22
1985	44	48	41	65	39	21

Year	Share of S-S Exports in Total Southern Exports		Median Share of … Exports of the Sample going to the South		Median Share of Skill-Intensive Goods in Total Manufactures Exports	
	Manufactures	*Skill-Intensive Manufactures*	*Manufactures*	*Skill-Intensive Manufactures*	*S-S*	*S-N*
1986	41	43	37	58	44	24
1987	43	45	37	53	41	23
1988	43	45	41	58	43	22
1989	43	46	38	52	43	25
1990	42	45	38	50	42	24
1991	41	46	41	55	40	23
1992	41	45	40	57	38	24
1993	40	44	40	57	42	22
1994	41	44	42	55	44	23
1995	41	43	43	53	42	23
1996	42	44	46	53	42	27
1997	41	43	44	52	42	28
1998	38	39	41	53	42	31
1999	36	37	39	46	45	39
2000	37	38	42	47	47	39
2001	38	40	42	50	51	36
2002	42	43	43	52	52	34
2003	43	45	45	52	51	35
2004	42	45	47	53	48	34
2005	45	48	50	58	49	41
Mean	41	45	44	57	44	26

Source: COMTRADE and authors' calculations.

The growth of South-South trade is significant for several reasons (Figure 1 and 2). First, in addition to growing faster than total trade over the 1985-2005 period, it did not necessarily follow North-South or North-North growth patterns. As a recent OECD study finds, from the 1985-1990 period, South-South trade grew slower than North-South and North-North trade while growing much rapidly than the other two during the 1990-1995 period: S-S: 20%; S-N: 15.25%; N-N: 5.75% and South-South trade continued to grow rapidly into the late 1990s and early 2000s, when South-North and North-North trade suffered considerable slowdown (Kowalski and Shepherd, 2006). This suggests

that the reasons behind the surge of this trade do not coincide with explanations for trends in South-North and North-North trade.

Second, as noted above, manufactures exports make up a large portion of South-South trade. As Table 1 demonstrates, medium to high technology manufactures represent on average, half of manufactures exports from our country sample to other South countries. Figure 1 shows how this is consistently higher for South-South than for South-North exports. In other words, South-South manufactures exports are more sophisticated on average, than South-North manufactures exports.

Third, despite the general reduction in tariffs worldwide, average tariffs on South-South trade remained higher than those on North-North and South-North trade. According to Kowalski and Shepherd (2006), simple average tariff rates on South-South exports were 11% compared to 9.87% for North-South exports (i.e. when the North is the exporter), and 4.38% and 4.96 for North-North and South-North exports respectively. Moreover, tariff rates are inversely proportional to level of income.

Fourth, tariff escalation implies that many of the South-South exports in sophisticated products are likely to be subject to even higher actual tariff rates than other products (for the same destination) or other destinations (for the same products) (UNIDO, 2005). In other words, trade liberalization within the South cannot be a major reason for the expansion for the growth of such trade.

Finally, while there has been a substantial reduction in North-North and North-South transportation costs in the second half of the 20th century, and in particular the last 30 years, this has not been the case for South-South trade.[2] In fact, Kowalski and Shepherd (2006), using gravity model estimation, show that while a 10% increase in North-North distance reduces trade by 10%, a similar increase in distance reduces South-South trade by 17%, and more importantly, these distance effects are barely different than they were in 1985. This also holds true even for upper and lower-middle income South groups and for that goods that fall into Chemicals and Manufactured goods, as in the case for our commodity group (see Appendix) record "highest sensitivity to [distance related] costs" with a "1% increase in bilateral distance causing trade to drop by around 1.5 to 1.9" compared to

2 Colonial legacy remains an important bias towards South-North and away from South-South trade. This is confirmed in the mainstream literature by the gravity model where dummy variables indicating colonial ties always report positive and significant coefficients. Interestingly, in the Kowalski and Shepherd study, indicators for a colonial past became "more strongly positive" in the early to mid-1990s. This was also the case for common border and, to a lesser extent, common language.

1.7% for overall South-South trade (2006: 19).[3] Taking all these factors into consideration, it makes the dramatic rise in sophisticated South-South manufactures even more remarkable.

The reasons discussed above imply there must be both *push* and *pull* reasons for the increase in South-South trade. *Push* policies include GDP growth, rise of third world multinationals and trade and technological upgrading within the middle-income South countries, while *pull* factors include the use of appropriate intermediate inputs and technological upgrading by countries with similar levels of development and general level of industrial technological know-how, knowledge of regional markets and cultural factors[4] (Amsden, 1987; UNIDO, 2005).

As Tables 1 and 2 demonstrate, the countries in our sample dominate South-South trade both in total manufactures exports as well as in medium to high technologically intensive manufactures. This is a limitation, in the sense that the results here do not hold for the entire global South. However, our main goal is *not* to argue that these results can be generalized to the global South, they clearly cannot; nor is it to argue that South-South trade is a panacea for development, nor that South-South liberalization is a means to achieve developmental goals for lower income developing countries. Ultimately, industrial policy, technological upgrading, along with poverty reduction and other traditional developmental goals are the main channels, as they have been for the East Asian NICs for example (Mehdi, 2008; Amsden, 2003). However, insight into the process whereby these NICs along with lower-middle and upper-middle income countries achieved technological upgrading through development-oriented-South-South-trade can help shed light on what a comprehensive developmental and trade policy for lower income South countries may be.

3. EMPIRICAL EVIDENCE AND THEORETICAL APPROACHES

Trade theory is not extensive regarding South-South trade and discussion of South-South economic exchange has been more often tied to theoretical and political worldview. While this is true for all trade debates, it is especially so for South-South trade because traditionally, scholars advocating this type of exchange view it as a counter to North-South trade liberalization and a critique of neo-classical/ neo-liberal globalization. The views of these scholars were bolstered by the actions of developing countries themselves who through the G-77 and

3 See Kowalski and Shepherd (2006: 7, 17, 18, 41).

4 See Aykut and Ratha 2004 and Aykut and Goldstein 2006 for a discussion of third world multinationals and South-South FDI.

UNCTAD pushed for the establishment Generalized System of Trade Preferences (GSTP) to allow special provisions for South-South liberalization within the GATT, in addition to the already existing PTAs that existed on a regional level. More recently, this desire was restated at the eleventh session of UNCTAD as part of the "São Paulo Consensus" (UNCTAD, 2004). A repeated empirical finding has been the fact that much of South-South trade was based in manufactures or has been capital-and skill-intensive (Havrylyshyn, 1985). Mainstream trade scholars therefore tended to view South-South cooperation as a relic of the ISI era, and saw limited chances for expansion of South-South trade (Greenaway and Milner, 1990 is a good example).[5] As the mainstream theory advocates universal free trade, South-South integration was judged negatively by the Vinerian 'trade creation/trade diversion' criterion, and viewed as a 'stumbling block' towards multilateral liberalization under the literature inspired by Bhagwati on regionalism (Bhagwati and Panagariya, 1996). For example, Venables (1999; 2003) argues that gains from South-South PTAs are likely to be disproportionately in favor of higher income South country and therefore low-income South countries are better off entering into North-South PTAs. However, more recently, the mainstream literature has been more optimistic on the topic, and several multinational development and trade institutions have issued major and often enthusiastic studies on the topic, some of which were couched in Third Worldist politics language (self-reliance, regional industrialization, see: WTO, 2003; UNIDO, 2004; Kowalski and Shepherd[6], 2006). Nevertheless, the more recent literature on South-South trade, while acknowledging the heterogeneity within the South, still does not explore under what conditions would South-South trade be beneficial, and does not focus on the specific pattern or structure of trade. The only effort to

5 Otsuba (1998) divides South-South PTAs between 'market-driven' and 'policy-driven' the former due to GDP size, geography, and pre-existing trade ties, the latter due to political-economic interests of governments. He cited East Asia- example of market-driven regionalism- and the European Union-an example of policy-driven ones- as the only two successful examples of each type. More on the implications of this is discussed below.

6 The shift in mainstream evaluation of South-South trade from the few yet highly critical studies in the 1980s and early 1990s to the more positive today may have several reasons. First, the very increase of South-South trade means it cannot be ignored. Second, the increasing criticisms of neo-liberal development have allowed more discussion on industrial policy and regionalism than earlier. Third however, may be that South-South liberalization is the last remaining obstacle towards multilateral liberalization. Moreover, as Kowalski and Shepherd (2006) note, liberalization by the South yields twice as much welfare gains for the North (28%) than North-North liberalization (14%).

disaggregate South-South trade is done along regional lines. Given the structure of South-South trade, a more interesting approach would be to focus on sub-categories of goods being traded and trace though the impact of South-South trade on those categories.

4. TRADE LIBERALIZATION, SOUTH-SOUTH TRADE AND TECHNOLOGY TRANSFER

In contrast to studies up to that point, Erzan (1989) found "no monotonous relationship, consistent over time, between countries' trade policy orientation and the trends in the proportion of their trade with the South (1989: 25). In other words, South-South trade in capital-intensive manufactures was not necessarily an ISI induced effect. He argued that the growth rate differential between developed and developing countries partially explained long-term trends: the higher the gap, the more South exports went to other South. However, he noted that South-South exports stabilized at a steady increasing level despite the resumption of Northern growth. His study found scope for learning by exporting to other South countries and concluded that given high protection levels against other South countries, and given that North tariffs facing South exporters were already low, there is considerable scope for higher South-South trade through "across the board non-discriminatory liberalization" (1989: 39). That is, across the board liberalization would favor South-South trade.

Fugazza and Robert-Nicoud (2006) develop a theoretical model whereby South-South reciprocal liberalization leads to South-North exports. In their model, only most efficient firms export to world markets and no firms export if cost of intermediate inputs is too high. Substantial entry costs and heterogeneity in firm productivity imply that firms self-select into export markets. When tariffs are lowered, the prices of intermediate inputs fall and producers of final goods gain higher profits, which allow them to cover some of the cost of entry into the international market.

Otsubo (1998) noted that arguments for the promotion of South-South trade can be made under both 'inward-oriented and out-ward oriented' development schemes. The 'inward-oriented' argument relies on structuralist critiques of North-South trade (such as terms of trade, and technologically dependency) as well as alternatives to reliance on Northern growth to increase South exports, and focuses on the role of technology transfer within the South. Otsubo argues that such schemes have been met with little success and claims that the rise of South-South trade can be attributed to "a wave of liberalization — often unilateral" which led to a "more efficient distribution of productive resources spurring both South-North and South-South trade".

In other words, extensive South-South trade is possible only when developing countries move into a stage whereby they are producing "labor-intensive, material-oriented manufactures" which meet the needs of "consumers with similar (lower per capita) income levels (1998: 15-16)". Moreover, Otsubo argues that "foreign exchange shortages, lack of availability of trade-related credits" (1998: 17) have been constraints on South-South integration, therefore an "open framework that accelerates the South's integration with the North will encourage developments in South-South trade if applied universally" (1998: 18).

5. TWO HYPOTHESES ON SOUTH-SOUTH AND SOUTH-NORTH TRADE

Given the existing research on South-South trade, we have two testable hypotheses here:

• *Hypothesis 1:* South-North Trade in Manufactures Increases both South-South and South-North Trade in Manufactures: The literature on the positive effects of international trade is extensive whether through associating the effects of overall country 'openness' and growth (Dollar, 1992; Harrison, 1996; Frankel and Romer, 1999) or more directly through the positive effect of export performance (Greenaway et. al, 1999; Edwards, 1998). Despite the perception of consensus on the robustness of those correlations, they have been subject to continued criticism through scrutiny of the proxies for openness, potential endogeneity of the trade indicators, as well as methodology (Rodrik and Rodriguez 1999). Those critiques aside, this literature also fails to account for the possibility that 'parameter values may vary with level of development' (Darity and Davis, 2005). This last matter implicitly raises the possibility of a divergent impact on countries with dissimilar structures or levels of development that engage in trade, an issue taken up by the North-South literature. Development economics has consistently highlighted the fact that 'not all trade is equal'. Trade structure and patterns of trade carry significant implications for the development and growth process in developing countries. If the export sector presumably has higher productivity than others, then exports in higher technology industries are likely to generate larger spillovers and linkages than lower technology labor intensive ones (Grossman and Helpman, 1991; Feder, 1983). Moreover, knowledge spillovers are expected to accrue by importing such commodities as well as export through various mechanisms (Coe et al., 1997; Katz and Ablin, 1977). The corollary is based on Otsubo (1998) that only once countries have liberalized trade with the North and began producing according to their 'real comparative advantage', i.e. labor-intensive manufactures,

will there be a chance for intra-industry trade within the South. In this case South-South trade is clearly a result and not a cause, therefore there should be no attempts at policy induced South-South integration. In addition, Shiff and Wang (2006) find that the highest impact on total factor productivity in the South comes from the North, *directly* through North-South technology diffusion and secondarily and to a lesser extent *indirectly* through South-South trade.

• *Hypothesis 2:* South-South Trade in manufactures increases both South-South and South-North trade in manufactures at a level that is more than the South-North trade does: The idea that there are dynamic gains from South-South trade has its origins in the Linder's 'preference similarity' proposition regarding consumer demand. According to Linder, inventors, innovators, and entrepreneurs are stimulated by home demand and products are developed according to home market tastes and preferences. Later, exports are destined to those countries with tastes and preferences similar to domestic market (Linder, 1967).[7] Since per capita, income is the chief determinant of such a demand structure and since there are great differences between the demand structures of North and South countries, this has important implications for export-oriented production:

> These [per capita] differences mean that goods in demand in advanced countries are atypical for the economic structure of developing countries; their production functions will be disadvantageous in the latter countries. Goods that developing countries are particularly adept at producing are, on the other hand, not demanded in the advanced countries. Owing to lack of foreign demand [by the North], the developing countries therefore cannot export those manufactures they are most efficient at producing. Generally speaking, they are reduced to trying to export manufactures with which they are unfamiliar to markets of which they have no experience (Linder, 1967: 37).

Logically, Linder (1967) argues that preferential trading agreements should be established in the South as a solution to the problem. Linder argues that when it comes to South-South issues, regional trading agreements' effects are less ambiguous than for developed countries and that trade diversion as a result of those integration schemes is beneficial long as it is trade from the North that is being diverted.

Stewart (1992) attempts to reconcile the results of various trade theories and the implication they would carry for South-South trade.

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7 Linder's preference similarity theory is a main theoretical basis of the highly successful gravity equation empirical model of bilateral trade (Feenstra et al., 2001).

For our purposes here, we focus on those regarding technological transfer and development. Many studies have noted the fact that the South is a technological laggard and hence must rely on inflows of foreign technology and the position of disadvantage that this fact places the South in. For example, Krugman (1979) had pointed out the position of advantage to the North that accrues from constant innovation and monopoly power over new technology. Dutt (1996) presents a North-South model where technical change in the North reduces the North's dependence on a Southern intermediate good and resulting in (?) uneven development. Stewart argues that in addition to the above mentioned disadvantage of being the technological laggard, technological innovation in the North means that the South has to "accept the direction of technological change" from the North which is more capital-intensive and embodies 'high-income' characteristics (Stewart 1990: 81).[8] Stewart argues that these products are therefore biased against Southern preferences and inappropriate in terms of both 'techniques of production" and "product characteristics" that the South accepts due to lack of alternatives. On the other hand, imports from other South countries are more likely to have 'older' technologies more appropriate for South technological development and processes. In many instances these technologies may actually be more beneficial to the host countries than cutting-edge technologies (from the North), which may have been designed for goals that do not match a South country's needs. As Pack and Saggi explain:

> Another potential benefit from the transfer of older technology stems from the fact that the newest processes are often designed to reduce labor per unit of output in response to high and growing wage-rental ratios in innovating country (…). The equipment of older design is the cost-minimizing technique at LDC factor prices. This phenomenon has been observed in the Indian textile machinery sector, which has been unable to obtain licenses to manufacture the newest high-speed European designs. Had they been able to do so, Indian textile mills would not have been able to obtain the cost minimizing technology, which is no longer available abroad (Pack and Saggi, 1997: 91).

8 Following Lancaster's (1971) approach to consumer demand, which posits that consumers desire certain characteristics of goods rather than the goods themselves. Higher income consumers for example might request a high definition television versus a standard television for lower income consumers, thus certain products will have 'high' while others will contain 'low' income characteristics, in this case, corresponding to preferences in North and South, respectively. See Copeland-Kotwal (1996) and Murphy and Schleifer (1997) for example on how quality preferences may affect demand for Southern goods.

Their analysis implies a broader understanding of technological transfer and development than simply treating it as a linear process of factor accumulation. Standard treatment of technological acquisition argues that Southern countries have a wide variety of choices in the 'technology market' and they are free to select and incorporate those technologies with minimal cost. As Lall (2000) states, under the standard treatment

> International technology markets are efficient, these countries can select the best technology and import it without much cost other than the legitimate price. Once acquired it can be used efficiently, again without a major cost or effort. There is no distinction between capacity and capability (Lall, 2000).

Nelson and Pack (1999) however argue that this "accumulation" explanation of technological change ignores the "assimilation" aspect, which instead stresses the centrality of learning in identifying, adapting, and operating imported technologies. This process of 'assimilation' coincides with what Lall is referring to as 'capabilities' approach to technological change. Firms in developing countries have imperfect knowledge of technological alternatives and finding technologies is a difficult and costly process. Once it is imported, its use requires creating new skills and knowledge to master its tacit elements that vary greatly by kind of technology. Some activities are costlier and more prolonged than others requiring selective interventions according to type in order to help firms overcome learning costs and co-ordination problems as different policies can fail. This approach depends more on the national ability to master and use technologies than comparative advantage on factor endowments. Under this conception, the crucial point is that the greater the gap in tacit technological knowledge embodied through the production of capital and producer goods, the smaller the possibility for technological acquisition and a deepening of the knowledge base (Lall, 2000). Amsden (1984) argues that the type of trade that takes place between South countries is such that the learning (and thus capabilities) effects are greatest. In the small developing countries, inexperienced workers may opt for goods of "older design, simpler, more rugged, less specialized, and less automated" than those provided by industrial countries. Older vintages or adapted products are similarly uneconomical to produce in the North because equipment suppliers and their subcontractors have 'forgotten' the older technologies. So for much of these Southern producer and capital goods, foreign technology is imported and adapted to local needs and demands: "descaling, converting from mass to batch pro-

duction, changing from imported to local raw material requirements" (Amsden, 1987: 133). Compared to machine-paced and process centered commodities these are more liable to adaptation in design. They are smaller in scale and less science based (precision instruments, machine tools, etc.). Capabilities in design engineering and production engineering interact and reinforce each other to produce minor 'technological' innovation (Lall, 2000; Lall and Ghosh, 1989; Amsden, 1984, 1987). What this argues is that from a South country's perspective, there is an incentive to both exports to another South country as well as to import from the South, given the similarity in technological development.

Empirical studies along these lines have highlighted the human capital (skill) intensive nature of South-South trade and the potential learning gains involved. Two of the earliest studies noting the difference in factor intensities and direction of trade were based on the performance of the Japanese export sector. Both Tatemoto & Ichimura (1959) and Heller (1976) show that Japan's exports to LDCs are more physical capital and skill intensive than its exports to developed countries, and Heller showed that over time there is a convergence in characteristics to both areas, but that the rate of growth of skill intensive industries was higher than those with the physical capital intensities. Testing for Brazil's manufactured exports Tyler (1984) finds significant skill intensity in exports to other Southern countries than to the North. Lall (1989) finds generally positive and significant results for skill and technological intensity although there are variations among and within regions. In a more micro-level analysis, studying Brazil, India, Korea and Argentina capital goods, Chudnovsky (1983, 1986) find evidence in support of the argument that there is higher learning by doing in South-South exports than South-North. They argue that capital goods exports in those countries can be divided into two categories: "custom-built" exports destined to the South and "series-built" goods that are exported to the North. The former is made in small batches with a long production process, high unit values, with strict customer specifications and design requirements that are high. Basic design is usually imported through licensing agreements but the detailed designs of parts and components are adjusted to local conditions which requires a "complex fabrication technology and requires a skilled staff to deal with the machining operations and the internal organization of the production process" (Chudnovsky, 1989: 225). "Series-built" have, generally, opposing specifications with lower unit value and whose customers are more sensitive to price considerations. Furthermore, Chudnovsky et al. (1983) for Argentina and Brazil, Fransman (1982) for Hong Kong, and Amsden (1984) for Taiwan

point to a progression: from production for domestic market, then to other Southern countries, and finally to Northern countries as products became more sophisticated.

6. EMPIRICAL ANALYSIS

6.1 DATA

The key variables of interest are the bilateral (aggregate) manufactured and technology-and-skill-intensive manufactured goods exports of Southern country *i* at time *t* to the North (high-income-OECD countries) and the South (low-and-middle-income countries). The bilateral trade data in total and technology-and-skill-intensive manufactures are obtained from the U.N. Commodity Trade Statistics Database (COMTRADE). For industrial classification, we used the second revision of the Standard International Trade Classification of Commodities (SITC) because of its broader coverage. The sum of SITC categories 5-8 are used for total manufactures. For the examination of systematic differences in the impact of financial development on S-S and S-N trade in technology-and-skill-intensive manufactures, we selected 75 commodities that fall into the 'medium' and 'high' technology classification of exports based on Lall (2000) and UNIDO (2004) (see the Appendix for the complete list). Accordingly, medium-technology products "tend to have complex technologies, with moderately high levels of R&D, advanced skill needs and lengthy learning periods". Likewise, high technology products are those with "advanced and fast-changing technology, with high R&D investments and prime emphasis on product design. The most advanced technologies require sophisticated technology infrastructure, high levels of specialized technical skills and close interaction between firms and universities or research institutions" (Lall, 2000: 94).

Because of the high variance of the share of manufactures in total merchandise exports and the fluctuations in export prices, we employed real exports (using export unit prices) as a share of real GDP in our regressions. Normalizing with real GDP also avoided distortions created by high inflation experiences of some of the countries in the sample. In the selection of sample countries, the following issues were decisive: a) the presence of a sufficiently diversified production and export structure such that at least 15% of total merchandise exports are in manufacturing, b) data availability since we included only those countries with at least 10 years of continuous data (to avoid non-random entry and exit bias), c) regional balance, that is to say we tried to include sufficient number of countries from each region (Asia, Middle East, and Latin America) to avoid sam-

pling bias. The final sample includes 24 countries accounting for 81% and 79% of all Southern technology-and-skill-intensive, and total manufactures exports in 2005 with overall averages of 85% and 82%, respectively between 1978 and 2005. During the period analyzed, we observe a steady increase in the sample countries' share in total world exports of manufactures and technology-and-skill-intensive manufactures going up from 4% and 2% in 1978 to 29% each respectively in 2005. The 24 countries also account for 77% of total and 84% of technology-and-skill-intensive manufactures exports in S-S trade during the same period that reflect the existing gap between these and other developing countries. The final dataset includes 9 countries from Latin America (Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Mexico, Uruguay, Venezuela), 5 countries from MENA (Egypt, Jordan, Morocco, Tunisia, Turkey), and 10 countries from East and South East Asia (China, Hong Kong, India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, South Korea, Thailand). In the bilateral trade measurement, the North includes high-income OECD countries while the South includes all low-and-middle income countries according to the World Bank definitions.

In terms of the pattern and direction of trade in our sample, we see an increase in S-S trade compared to S-N trade in both total and technology-and-skill-intensive manufactures. Accordingly, the median share of S-S manufactures and technology-and-skill-intensive manufactures exports (in total exports of these goods from sample countries) increased from 27% and 52% in 1978 to 50% and 58% in 2005, respectively (Table 1). From the last two columns of Table 1, we also see a higher skill content of manufactures exports in S-S trade than S-N trade. Accordingly, while the average median share of skill-intensive goods in total manufactures exports is 44% in S-S trade, it is 26% in S-N trade between 1978 and 2005. However, we also observe that the skill content of S-N exports (i.e. share of technology-and-skill-intensive manufactures in total manufactures exports) has been increasing at a much faster rate with an annual average of 4.7% compared to 0.7% in S-S exports.

Furthermore, the median share of manufactures exports to the North in total Southern merchandise exports (and in GDP) increased from around 23% (3%) in 1978 to 30% (9%) in 2005, while those to the South increased from around 9% (1.4%) to 24% (4%) (Table 2). Similarly, the median share of technology-and-skill-intensive manufactures exports to the North in total Southern merchandise exports (and in GDP) increased from around 2.6% (0.3%) in 1978 to 7.6% (1.8%) in 2005, while those to the South increased from around 4.3% (0.6%) in 1978 to 12% (1.4%) in 2005 (Table 2).

Table 2
Sample Summary (percentages)

Year	Medians							
	Total Manufactures				*Technology-and-Skill-Intensive*			
	North		South		North		South	
	Nmnxt	Nmnxy	Smnxt	Smnxy	Nskxt	Nskxy	Sskxt	Sskxy
1978	22.63	2.93	9.03	1.38	2.55	0.33	4.31	0.64
1979	21.06	3.19	11.52	1.49	2.75	0.35	4.46	0.72
1980	14.53	1.39	11.17	1.33	2.07	0.21	3.81	0.42
1981	15.84	1.42	11.22	1.34	1.84	0.09	5.24	0.46
1982	20.12	1.72	13.24	1.23	2.67	0.22	4.91	0.37
1983	20.99	1.48	10.6	1.18	2.36	0.15	4.14	0.38
1984	21.63	1.66	12.13	1.37	2.56	0.21	4.62	0.41
1985	22.9	1.96	12.47	1.53	2.61	0.25	6.03	0.5
1986	23.16	1.96	15.06	1.74	2.86	0.3	6.19	0.45
1987	23.91	2.76	14.66	1.99	3.76	0.37	6.54	0.43
1988	24.49	2.75	16.86	1.95	4.14	0.48	6.13	0.74
1989	27.74	3.29	16.22	1.85	4.34	0.66	6.26	0.8
1990	26.35	3.03	16.8	1.96	4.73	0.74	6.14	0.73
1991	29.53	3.06	18.56	2.39	4.84	0.69	6.56	0.75
1992	29.96	3.7	17.67	2.24	5.01	0.7	6.65	0.8
1993	32.76	3.4	20.39	2.86	5.52	0.71	7.31	1.16
1994	32.04	4.45	20.24	3.05	6.19	0.96	7	1.28
1995	30.75	4.29	20.6	3.37	5.29	0.92	7.09	1.14
1996	27.91	3.92	20.57	3.24	5.25	0.82	8.63	1.16
1997	26.22	4.68	20.41	3.45	5.79	0.88	8.1	1.27
1998	33.44	5.63	21.19	3.43	7.79	1.35	9.95	1.53
1999	44.96	6.22	22.55	2.98	10.85	1.87	10.05	1.33
2000	39.8	6.35	22.23	3.42	11.8	1.82	10.61	1.44
2001	35.12	6.95	24.33	3.85	8.95	1.36	11.49	1.61
2002	36.33	6.94	22.96	3.75	9.26	1.47	12.21	1.57
2003	33.19	8.4	23.34	3.75	8.97	1.4	11.61	1.44
2004	30.62	8.05	24.25	3.86	7.91	1.45	11.88	1.44
2005	30.37	8.76	24.07	4.18	7.61	1.81	11.98	1.85

Source: COMTRADE and authors' calculations.
Notes: *Nmnxt* and *Smnxt* are manufactures exports to the North and South as a share of merchandise exports, respectively. *Nmnxy* and *Smnxy* are real manufactures exports to the North and South as a share of real GDP, respectively. *Nskxt* and *Sskxt* are technology-and-skill-intensive manufactures exports to the North and South as a share of merchandise exports, respectively. *Nskxy* and *Sskxy* are real technology-and-skill-intensive manufactures exports to the North and South as a share of real GDP respectively.

6.2 ECONOMETRIC METHODOLOGY AND RESULTS

We use cointegration techniques and vector error-correction models (VECM) to examine the long and short run interaction between S-S and S-N trade in total and high-end manufactures. We start analyzing the data by examining the series for the unit roots. The tests results from Table 3 show the presence of a unit root that disappears in first differences indicating that all series are integrated of order 1 (I(1)).

Table 3
Panel Unit Root Test

	NMNXY	SMNXY	NSKXY	SSKXY*
Im, Pesaran and Shin W-stat	0.915	0.076	0.485	0.189
PP - Fisher Chi-square	0.489	0.192	0.05	0.281
Levin, Lin & Chu t	0.994	0.06	0.602	0.276
First differenced				
ADF - Fisher Chi-square	0.000	0.000	0.000	0.000
Im, Pesaran and Shin W-stat	0.000	0.000	0.000	0.000
Levin, Lin & Chu t	0.000	0.000	0.000	0.000

Notes: All variables are in natural logs. Results are the p-values for the Null-hypothesis of the presence of a unit root. Tests include constant and linear trends.

Next, we employ the Granger-causality framework to examine the (*non*) presence of a causal relationship between the SS (S-S) and SN (S-N) trade. Accordingly, having two time series, SS trade is said to Granger cause *SN* if the lagged coefficients of *SS* (i.e. β_{2i}) are jointly significant (equation (1)). And, *SN* is said to Granger cause *SS* if the lagged coefficients of *SN* (i.e. ρ_{1i}) are jointly significant. Thus, the null hypothesis is that *SS* does not Granger-cause *SN,* and *SN* does not Granger-cause *SS*.

$$SS_{it} = \alpha_1 + \sum_{j=1}^{n} \beta_{1j} SS_{t-j} + \sum_{j=1}^{n} \rho_{1j} SN_{t-j} + \varepsilon_{1t}$$
$$SN_{it} = \alpha_2 + \sum_{j=1}^{n} \rho_{2ij} SN_{t-j} + \sum_{j=1}^{n} \beta_{2j} SS_{t-j} + \varepsilon_{2t} \qquad (1)$$

Where t and i refer to the time period and the lag structure respectively, and ε_{1t} and ε_{2t} refer to the error terms. In this specification, *SS* and *SN* are stationary in first difference.

Table 4
Granger Causality Tests

Null Hypothesis	1	2	3	4	5	6	7	8	9
Total Manufactures									
S-S does not Granger Cause S-N	0.04	0.48	0.51	0.59	0.08	0.19	0.01	0.03	0.02
S-N does not Granger Cause S-S	0.68	0.14	0.05	0.03	0.03	0.03	0.26	0.12	0.06
High-Skill Manufactures									
S-S does not Granger Cause S-N	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
S-N does not Granger Cause S-S	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

Notes: Variables are in first differences natural logs.

Given the sensitivity of Granger causality tests to lag length, we report the results with up to nine lags. According to Table 4, we see an endogenous relationship between S-S and S-N total manufactures (SMNXY and NMNXY) exports at lags 5 and 9, and at all lags (except lag 2) one of the variables always Granger causes the other. On the other hand, in the case of high-end manufactures (SSKXY and NSKXY) we find a two-way relationship at all lags.

Next, we test whether there exists a stable long run relationship between these variables using panel cointegration tests given that both variables are I(1). Before proceeding to cointegration testing, we first explored the correct lag length using sequential modified LR test statistic, final prediction error, Akaike information criterion, SC and HQ. We also checked for presence of autocorrelation in the residuals at each leg. We finally chose lag 3 and 7 for the total, and high-end manufactures VAR equations, respectively.[9] Using Johansen cointegration test, we find a cointegarating relationship between S-N and S-S trade in both total and high-end manufactures. Table 5 indicates the presence of a long-run relationship between both NMNXY and SMNXY, and NSKXY and SSKXY. Hence, we proceed with our econometric estimation using a vector error-correction model.

9 The lag length selection for VAR models is a critical decision for time series analysis and not to overfit or misspecify the model. Therefore, while choosing the lag length we also took into account the standard diagnostic tests.

Table 5
Johansen Cointegration Test*

Trend assumption: No deterministic trend (restricted constant)				
Hypothesized No. of CE(s)	*Trace Statistics*	*Prob.*	*Max-Eigen Statistics*	*Prob.***
Series: NMNXY SMNXY				
Lag2				
None	61.444	0	54.819	0
At most 1	6.626	0.148	6.626	0.148
Lag3				
None	54.839	0	47.186	0
At most 1	7.653	0.1	7.653	0.1
Series: NSKXY SSKXY				
Lag 7				
None	31.752	0.001	25.737	0.001
At most 1	6.015	0.190	6.015	0.190

Notes: Trend assumption: No deterministic trend (restricted constant).
* Including an exogenous break-point dummy
** MacKinnon; Haug & Michelis (1999) p-values. Variables are in natural logs.

6.3 ERROR CORRECTION MODEL

Based on Engle and Granger (1987), we have the following vector error correction model (VECM) for a cointegrating vector of (X, Y):

$$\Delta X_t = \alpha_0 + \alpha_1 u_{t-1} + \sum \beta_i \Delta X_{t-i} + \sum \beta_i \Delta Y_{t-i} + \varepsilon_i \quad (1)$$

where X is a vector of the first order integrated variables (that are the natural logs of NMNXY, SMNXY and NSKXY, SSKXY), u_{t-1} is the lagged error correction term (ECT) and is the residual from the cointegrating regression of $x_t = \beta_0 + \beta_{1yt} + u_t$ (i.e. the disequilibrium error). Here α_1 is the short-run adjustment parameter that shows the response of the dependent variable to deviations from equilibrium in each period. If the ECT is found to be statistically significant, it implies that there is a long-run relationship between S-S and S-N trade and shows the convergence to the long run equilibrium.

Table 6
Long Run Dynamics: Normalized Unrestricted Cointegrating Coefficients

NMNXY =	4.768 - 1.392SMNXY
SMNXY =	-3.425 - 0.718NMNXY

The cointegrating vectors are given in Table 6. To make economic interpretation easier, we normalized them on left hand side variable. The results after this normalization show the long-run elasticities that are -1.392 for the effects of SS on SN manufactures exports and -0.718 for the effects of SN on SS exports. We can interpret this result such that increasing SS (SN) trade crowds out SN (SS) trade though at a twice-stronger level for the effects of SS on SN trade.

We next turn to the short run dynamic adjustment analysis in Table 7. The error correction term (u_{t-1}) is found to be positive and significant in both equations suggesting that short-term deviations are converging to long run equilibrium for the S-S trade while diverging further for the S-N trade. That is a gap favoring S-N over S-S trade leads to more divergence by increasing the S-N trade even further. The ECT estimate is slightly higher for the S-S exports function suggesting a catching up by S-S trade vis-à-vis S-N. The ECT also indicate that the movement of S-S exports towards eliminating the disequilibrium within one year is very low, that is only 1.4% of the adjustment occurs in one year. On the other hand, the coefficients on S-S and S-N exports in VECM show how the adjustment speeds differ in response to changes in S-S and S-N exports. We find that S-S and SN exports do have a positive effect on S-N and S-S exports respectively, though twice stronger for the former than the latter. Thus, S-S seems to increase S-N exports more than the S-N effect on S-S exports.

Table 7
Vector Error Correction Results for SMNXY and NMNXY

Error Correction:	D(NMNXY)	D(SMNXY)
ECT	0.010	0.014
	[4.200]	[6.736]
D(NMNXY(-1))	-0.051	0.097
	[-1.068]	[2.281]
D(NMNXY(-2))	-0.031	0.027
	[-0.655]	[0.644]

Error Correction:	D(NMNXY)	D(SMNXY)
D(NMNXY(-3))	-0.053	-0.042
	[-1.235]	[-1.113]
D(SMNXY(-1))	0.101	-0.116
	[1.912]	[-2.494]
D(SMNXY(-2))	0.019	-0.032
	[0.383]	[-0.714]
D(SMNXY(-3))	0.046	0.074
	[0.947]	[1.728]

Notes: t-statistics in [ ]. Standard diagnostics tests do not violate any of the standard assumptions. Likewise, the roots of characteristic polynomial all but one lie within the unit circle. Variables are in natural logs. The estimations included break dummies as exogenous variables.

Next, we used an Impulse Response (IR) analysis that shows the dynamic response of the endogenous variables in the system equations to a one-time shock to one of the innovations of the system. As discussed by Pasaran & Smith (1998), we use the *generalized impulses* that construct an orthogonal set of innovations, which does not depend on an arbitrary ordering of the VAR system variables. However, using Choleski decomposition yielded similar results. The results from Table 8 suggest that a one-period shock to S-N and S-S trade have a positive effect on S-N trade, though persistently much stronger for the former. Likewise, a one-period shock to S-N and S-S trade has a positive effect on S-S trade. However, despite the fact that the effect of the shock on S-S is much stronger than that of S-N, its impact decreases through time while the S-N trade's increases.

Table 8
Impulse Response Functions: Response of SMNX and NMNXY to generalized one standard deviation Shock

Response of NMNXY			Response of SMNXY		
Period	NMNXY	SMNXY	Period	NMNXY	SMNXY
1	0.219	0.082	1	0.073	0.194
2	0.217	0.095	2	0.087	0.177
3	0.214	0.093	3	0.090	0.174
4	0.207	0.095	4	0.086	0.184
5	0.209	0.093	5	0.088	0.179

6	0.210	0.091	6	0.090	0.176
7	0.211	0.089	7	0.091	0.175
8	0.212	0.088	8	0.092	0.173
9	0.213	0.086	9	0.093	0.170
10	0.214	0.084	10	0.095	0.168
11	0.215	0.083	11	0.096	0.166
12	0.216	0.081	12	0.097	0.164
13	0.217	0.079	13	0.098	0.162
14	0.218	0.078	14	0.099	0.160
15	0.219	0.076	15	0.100	0.158

Table 9 shows the sums of IR coefficients over 5, 10, 15 and 20-year horizons. The sums can be interpreted as the responses of S-N and S-S exports to a persistent shock to innovations in respective variables. We find that a shock that lasts 5, 10, 15 and 20 years has a positive effect on both S-N and S-S trade. However, the positive effect is found to be stronger from S-N trade towards S-S trade as time goes by than the other way around. Likewise, the self reinforcement effect is also found to be stronger in the case of S-N than S-S trade.

Table 9
Impulse Response Functions: Accumulated Response of SMNXY and NMNXY
to generalized one standard deviation Shock

	Accumulated Response of			
Period	*NMNXY:*		*SMNXY:*	
	NMNXY	SMNXY	NMNXY	SMNXY
5	1.066	0.458	0.425	0.908
10	2.127	0.896	0.886	1.770
15	3.211	1.292	1.376	2.580
20	4.317	1.650	1.895	3.339

In the case of technology and skill intensive manufactures we repeat the previous analysis using a subset of the original sample by dropping those countries whose technology-and-skill-intensive manufactures account for less than 10% of their merchandise exports.[10]

10 We dropped Bolivia, Chile, and Syria.

Table 10
Long Run Dynamics: Normalized Unrestricted Cointegrating Coefficients*

NSKXY =	1.846 + 1.393SSKXY
SSKXY =	1.325 + 0.718NSKXY

Notes: * Includes break and regional dummies as exogenous variables. Among regional dummies of South East Asia, Latin America and Middle East, only the first one (and in both directions) has significant coefficients.

The cointegrating vectors are given in Table 10 where, as before, we normalized them on the left hand side variable. The results show the long-run elasticities that are 1.393 for the effects of S-S on S-N manufactures exports and 0.718 for the effects of SN on SS exports. Surprisingly, the coefficient estimates are almost identical with those of total manufactures with the difference of sign. Accordingly, both S-S and S-N high-end manufactures exports are found to have a positive long run effect on the other, though more so for the former. That is, increasing S-S high-end manufactures exports are found to raise S-N exports more that the other way around.

Table 11
Vector Error Correction Results for SSKXY and NSKXY

Error Correction:	D(NSKXY)	D(SSKXY)
CointEq1	-0.016	-0.006
	[-3.458]	[-1.861]
D(NSKXY (-1))	-0.116	-0.021
	[-2.208]	[-0.566]
D(NSKXY (-2))	-0.019	0.142
	[-0.371]	[3.998]
D(NSKXY (-3))	-0.026	-0.041
	[-0.516]	[-1.152]
D(NSKXY (-4))	-0.021	-0.029
	[-0.441]	[-0.859]
D(NSKXY (-5))	-0.013	-0.035
	[-0.273]	[-1.030]
D(NSKXY (-6))	0.022	-0.021
	[0.461]	[-0.637]
D(NSKXY (-7))	0.059	0.046
	[1.464]	[1.633]

Error Correction:	D(NSKXY)	D(SSKXY)
D(SSKXY (-1))	0.071	-0.043
	[0.920]	[-0.795]
D(SSKXY (-2))	0.031	-0.124
	[0.435]	[-2.500]
D(SSKXY (-3))	-0.039	0.019
	[-0.547]	[0.389]
D(SSKXY (-4))	-0.012	-0.042
	[-0.195]	[-0.942]
D(SSKXY (-5))	0.076	0.011
	[1.211]	[0.258]
D(SSKXY (-6))	-0.005	-0.110
	[-0.081]	[-2.579]
D(SSKXY (-7))	-0.073	0.008
	[-1.237]	[0.201]
D_{Break}	0.118	0.100
	[3.405]	[4.135]
D_{Asia}	0.112	0.138
	[3.848]	[6.851]
D_{LA}	-0.015	0.024
	[-0.439]	[1.048]

Notes: D_{Break}, D_{Asia}, and D_{LA} refer to dummy variables for break-points, and South East Asia and Latin America regions. We next turn to the short run dynamic adjustment analysis in Table 11. The error correction term (u_{t-1}) is found to be negative in both equations (and significant in the NSKXY equation) suggesting that short term deviations are converging to long run equilibrium for the S-N trade while diverging further for the S-S trade. That is a gap favoring S-N over S-S trade leads to more divergence by reducing S-S trade further. The ECT also indicate that the movement of S-N exports towards eliminating the disequilibrium within one year is very low, that is only 1.6% of the adjustment occurs in one year.

Table 12

Impulse Response Functions: Response of SSKXY and NSKXY to generalized one standard deviation Shock

Response of NMNXY			Response of SMNXY		
Period	NMNXY	SMNXY	Period	NMNXY	SMNXY
1	0.276	0.068	1	0.047	0.192
2	0.242	0.068	2	0.037	0.181
3	0.237	0.067	3	0.070	0.165
4	0.225	0.052	4	0.053	0.166
5	0.217	0.045	5	0.039	0.156
6	0.212	0.056	6	0.031	0.153

Response of NMNXY			Response of SMNXY		
Period	NMNXY	SMNXY	Period	NMNXY	SMNXY
7	0.214	0.050	7	0.020	0.130
8	0.224	0.035	8	0.035	0.138
9	0.218	0.034	9	0.031	0.141
10	0.211	0.032	10	0.031	0.136
11	0.207	0.028	11	0.031	0.137
12	0.203	0.024	12	0.028	0.136
13	0.201	0.023	13	0.028	0.138
14	0.199	0.021	14	0.025	0.135
15	0.195	0.016	15	0.025	0.133

The impulse response analysis for the high-end manufactures exports in Table 12 suggest that a one-period shock to S-N and S-S trade have a positive effect on S-N trade, though persistently much stronger for the former. Likewise, a one-period shock to S-N and S-S trade have a positive effect on S-S trade, though the effect of the shock on S-S is much stronger than that of S-N.

Table 13
Impulse Response Functions: Accumulated Response of SSKXY and NSKXY to generalized one standard deviation Shock

Response of NMNXY			Response of SMNXY		
Period	NMNXY	SMNXY	Period	NMNXY	SMNXY
5	1.196	0.300	5	0.246	0.861
10	2.275	0.507	10	0.395	1.560
15	3.279	0.618	15	0.532	2.239
20	4.202	0.656	20	0.638	2.892

Table 13 shows the sums of IRF coefficients over 5, 10, 15 and 20-year horizons. We find that a shock that lasts 5, 10, 15 and 20 years has a positive effect on both S-N and S-S trade. However, the positive effect is found to be quite similar both from S-N to S-S and from S-S to S-N trade. Yet, the path dependency effect is found to be much stronger (as before) for S-N than S-S trade. That is to say, increasing S-N trade is found to be increasing future S-N trade much more than S-S trade increases future S-S trade.

7. CONCLUSION

The empirical results suggest that a disequilibrium favoring S-N trade in total manufactures leads to convergence to long run equilibrium for the S-S trade while further divergence for the S-N trade. Likewise, in the case of high-end manufactures the error correction term is found to be negative in both equations suggesting that short-term deviations are converging to long run equilibrium for the S-N trade while diverging further for the S-S trade. That is, in both total and high-end manufactures trade a gap favoring S-N over S-S trade leads to more divergence either by increasing S-N trade further or by reducing S-S trade.

The impulse response analysis also suggest that while shocks to S-S and S-N trade both have positive effects on trade in the same as well as opposite directions, the size of the impact is much stronger from S-N to S-S and S-N in both total and high-end manufactures. We find similar results from cumulative IR functions as well. Accordingly, a shock to S-S and S-N manufactures trade that lasts 5, 10, 15 and 20 years has a positive effect on both S-N and S-S trade. However, the positive effect is found to be stronger from S-N trade towards S-S trade as time goes by than the other way around. Likewise, the self reinforcement effect is also found to be stronger in the case of S-N than S-S trade. In the case of high-end manufactures, however, we find that the cross effect of S-N on S-S trade and vice versa is found to be quite similar in size. Yet, the self-reinforcing effect of past S-N trade on future S-N trade is consistently stronger than the effect of past S-S on future S-S trade.

We should note, however, that some caveats are in order. First, the experience of these large Southern countries may not be applicable to other developing countries. As discussed above, most of Southern exports are done by few Emerging South countries (which is our sample) while the rest of the South exports predominantly primary goods and low-skill and resource-intensive manufactures. Secondly, our analysis does not address the issue of convergence/divergence debate in trade balances between the South and the North. There is an old debate between the neoclassical and structuralist as well as Marxian analysis of trade on the nature and evolution of North-South uneven trade with the former specializing in capital and technology intensive goods while the former specializing in primary and low-skill manufactures. A complete analysis of this question, however, is beyond the scope of the current chapter, and would require a different empirical modeling involving both the current account and the capital account dynamics.

APPENDIX CHAPTER 2

The exports data from COMTRADE (and OECD for Turkey) are in current dollars. In converting to real values, we used exports price indices

(i.e. unit values of aggregate or manufactures exports depending on availability) from IFS, WDI and central bank and statistical institutes of South Korea and Turkey. The real GDP values are from WDI in constant 2,000 dollars. Merchandise exports are f.o.b. valued in current US dollars (WDI).

List of Technologically Medium to High Skill Commodities SITC Rev. 2

266, 267, 512, 513, 524, 533, 541, 553, 554, 562, 572, 582, 583, 584, 585, 591, 598, 653, 671, 672, 678, 711, 712, 713, 714, 716, 718, 721, 723, 724, 725, 726, 727, 728, 736, 737, 741, 742, 743, 744, 745, 749, 751, 752, 759, 761, 762, 763, 764, 771, 772, 773, 774, 775, 776, 778, 781, 782, 783, 784, 785, 786, 791, 792, 793, 812, 871, 872, 873, 874, 881, 882, 884, 885, 951.

Chapter 3

EFFECTS OF TRADE LIBERALIZATION ON THE PATTERN OF SOUTH-SOUTH AND SOUTH-NORTH TRADE

1. INTRODUCTION

Trade among developing countries has been increasing radically since late 1970s in terms of its share in Southern trade and world trade. The most remarkable aspect of this expansion is its increasingly industrialized nature. Accordingly, the trade among developing countries is more capital intensive with a higher skill intensive (both technological and human) factor content than the one between developing and developed countries. However, several barriers remain blocking further expansion of South-South (S-S) trade. The most notable one is the presence of high levels of trade barriers in developing countries against other developing countries. Still, there is a growing emphasis on the importance of Southern integration as a precursor for development in the South. As a result, unlike the Import Substituting Industrialization era with an emphasis on protectionism for development of domestic industries, the current period is characterized by increasing free trade agreements among developing countries.

Surprisingly, there is no empirical work analyzing the effects of multilateral trade liberalization in developing countries on the pattern of South-South and South-North trade. The chapter, therefore, fills an important gap in the literature by exploring the effects of trade

liberalization in the South on the manufactures and technologically skill-intensive manufactures exports of developing countries.

2. TRADE LIBERALIZATION AND S-S TRADE

The predicted benefits of trade liberalization have long been a contentious issue among trade theorists. Accordingly, trade liberalization is expected to generate both static and dynamic gains through technological externalities (Barro and Salai-Martin, 1997); allocative efficiencies via specialization and competition (Wacziarg, 1997); and increased market size allowing for gains from scale economies. Furthermore, the dynamic gains literature argue that "not all goods are alike in terms of their consequences for economic performance", which suggests that the structure of trade matters for economic development and long run growth (Hausmann et al., 2007: 1). Accordingly, exports in high-technology intensive industries are likely to generate larger spillovers (such as innovation and accumulation of physical and human capital) and linkages for development than lower technology and labor-intensive ones (Balassa, 1986; Feder, 1983; Hausman et al., 2007).

Antweiler and Trefler (2002) using international trade data demonstrate the importance of scale economies for understanding the factor content of trade resulting from industry-level externalities. They also find that output expansion is strongly skill biased with significant implications for endogenous growth. Likewise, in a panel of 86 countries An and Iyigun (2004) find that higher export content of skill-intensive goods generates higher per-capita GDP growth rates. Moreover, Hausmann et al. (2007) for a large panel of countries and covering over 5,000 products find that countries that export goods associated with higher productivity levels also grow faster.

As a result, it is argued that the structure of S-S trade carries the promise of dynamic and long-term benefits. Amsden (1980) and Lall (1989), for example, argue that the factor-content of S-S trade in manufactures is technologically and human capital intensive owing to similarity in technological conditions, which enables appropriate technology transfer. In this respect, increasing trade integration in the South is argued to reduce the cost of intermediaries that is expected to stimulate their export penetration into Northern markets in final industrial goods (Fugazza and Robert-Nicoud, 2006). Myrdal (1956) argued that regional integration in the South helps developing countries overcome local market size limitations during industrialization period. Likewise, Lewis (1980) suggested that S-S trade reduces dependence on Northern growth.

During the last two and a half decades, the S-S trade has grown to be a substantial force in world trade. Between 1978 and 2005, the

S-S exports in manufactures grew more than twice, as fast as global exports with a 14% average growth for the former as opposed to 6% for the latter (COMTRADE). Likewise, the share of the South in world manufactures exports increased from a mere 5% in 1978 to over 32% in 2005 with an annual growth rate of 7% (COMTRADE). Even more impressive has been the increasing Southern share of skill-intensive manufactures in world exports of these goods that reached 31% in 2005 from 2% in 1978 with an average annual growth rate of 10%.

Similarly, the S-S skill-intensive manufactures exports (in constant dollars) grew at an annual rate of 16% reaching 14% of world trade in 2005 from a mere 1% in 1978 (COMTRADE). By 2001, manufactures accounted for over two thirds of S-S merchandise exports (WTO, 2003). In fact, "five out of the top ten products in S-S trade are high-technology manufactures" (UNIDO, 2005: 18). Also in our sample of 28 developing countries, that account for over 80% of developing country exports in manufactures, the median share of skilled goods exports in total merchandise exports is almost twice higher for exports to the South than to the North (Table2).

Nevertheless, despite the remarkable growth in S-S trade and its increasingly industrialized nature, it remains significantly lower than S-N and North-North (N-N) trade. Accordingly, S-S trade represents just under 15% of global trade compared to over 50% for N-N and 35% for S-N trade (UNCTAD, 2005). In addition, the distribution of this trade is highly skewed and is driven mostly by emerging markets. Moreover, production sharing and other triangular trade whose ultimate destination is the North is likely to account for a portion of such trade. In this respect, firms in developing countries seeking to engage in the export of manufactures and, in particular high-end manufactures with other developing countries, face various obstacles. First, average tariffs in the South are much higher on other developing country imports than those on developed countries. Second, similarity in production pattern and resource base can make Southern exports substitutes.[1] Third, infrastructural deficiencies including financial sector development as well as insurance, transportation and other logistical problems limit S-S trade.

In this chapter we focus on the effect of the removal of one of these barriers that is trade liberalization. Given the divergent theoretical views on potential static and dynamic gains from trade, the net effect of trade liberalization on the developing country industrial good exports is an empirical question. Furthermore, given the higher lev-

1 Notes: However, according to UNIDO (2005) and Amsden (1983), this enables appropriate technology transfer.

els of openness in Northern countries, as middle-income developing countries liberalize their trade (and assuming that trade barriers continue to remain higher in other Southern countries), they may start trading more with the North than with the South. In other words, as suggested by Havrylyshyn and Wolf (1983) and Erzan (1989) trade liberalization in developing countries may create a bias favoring trade expansion to the North more than to the South.

3. Methodology

The empirical specification we adopt is as follows:

$$Manufactures_{ijt} = \alpha_1 V_{it} + \alpha_2 Liberalization_{it} + d_i + d_t + \varepsilon_{it} \quad (1)$$

$$Skilled_{ijt} = \beta_1 V_{it} + \beta_2 Liberalization_{it} + d_i + d_t + \varphi_{it} \quad (2)$$

Where: *i=1,…, 28* and *t=1978,…, 2005,* respectively refer to the country and year, and *j* refer to the direction of trade (i.e. *S-S*, *S-N*), and d_i and d_t are vectors of country and time fixed effects, and $\varphi_{i,t}$ and $\varepsilon_{i,t}$ are the error terms.

Manufactures and *Skilled* refer to the log of bilateral manufactured and technology-and-skill-intensive manufactured goods exports of Southern country *i* at time *t* to the North (high-income-OECD countries) and the South (low-and-middle-income counties) as a share of its total merchandise exports.

Liberalization is the trade liberalization measure and includes a dummy variable that takes the value of 1 after trade liberalization. For robustness, we used both Sachs and Warner (1995) and Wacziarg and Welch (2003) trade liberalization measures. Although the reported results are those with Wacziarg and Welch (2003) measure, the (unreported) results using Sachs and Warner (1995) were very similar. Depending on potential gains from trade, *liberalization* is expected to have a positive coefficient in both equations. Yet, given the higher levels of openness in developed countries, it is expected to create a bias favoring trade expansion to the North (Havrylyshyn and Wolf, 1983; Erzan, 1989).

V is a vector of control variables (in natural logarithms) including:

Credit is a measure of financial sector development that is shown to affect the pattern and direction of trade (Beck, 2002). It is measured as the credit to the private sector by deposit money banks and other intermediaries as a share of GDP.

Population is the total population to control for size effects on trade shares.

GDP78 is the initial level of per capita GDP (in 1978) in constant PPP prices.

FDI is the FDI inflows as a share of GDP.

Investment is the gross fixed capital formation as a share of GDP.

GDPGN and *GDPGS*, which are the average logarithmic real GDP growth rates in the North and the South control for demand side developments and cyclical fluctuations (Havrylyshyn and Wolf, 1983; Erzan, 1989).

TOT is the terms of trade to control for price and profitability effects.

HK is the human capital measure from Barro and Lee (1996) measured as the log of one plus the average schooling years in total population in 1980.

4. DATA AND ESTIMATION

The bilateral trade data are obtained from the UN Commodity Trade Statistics Database (COMTRADE) using the second revision of SITC at the three-digit level. For technology-and-skill-intensive manufactures, we selected 75 commodities that fall into the 'medium' and 'high' technology classification of exports based on UNIDO (2004) (a complete list of commodities is available from the authors). All other variables are from the online International Financial Statistics of IMF. The 28 developing countries included in the sample[2] account for 85% of total manufactures and 81% of technology-and-skill-intensive manufactures exports of all developing countries during 1978-2005.

In order to correct for parameter endogeneity in equations (1) and (2) resulting from unobserved country fixed effects and to correct for the reverse causality and simultaneity bias, we use the two-step system-GMM estimation by Blundell and Bond (1998) with the Windmeijer finite-sample correction method. The system GMM technique estimates a system of equations in the first differences and levels and pools (*t-s*) first difference equations with (*t-s*) level equations. In estimation, we employed $2 \leq s \leq 4$ dated variables as instruments, whose validity are tested by the Hansen test of over-identifying restrictions. We also tested the disturbances for the presence of first and second order serial correlation.

2 Algeria, Argentina, Bolivia, Brazil, Chile, China, Colombia, Costa Rica, Ecuador, Egypt, Hong Kong, India, Indonesia, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Paraguay, Philippines, Singapore, Syria, Thailand, Tunisia, Turkey, Uruguay, and Venezuela.

5. RESULTS

The results from Table 1 and 2 show an economically and statistically significant positive effect of trade liberalization on the share of aggregate and technology-and-skill-intensive manufactures in total exports of developing countries both to the developed and other developing countries. The findings, which are robust to different specifications, also suggest an asymmetric effect of trade liberalization on S-S and S-N trade in manufactures, and in particular, technology-and-skill-intensive manufactures. As can be seen from its economic effects, trade liberalization has created a bias favoring S-N trade significantly more than S-S trade. The difference is more pronounced in technology-and-skill-intensive manufactures with a 4-7 times stronger positive effect of trade liberalization on exports to the North than to the South. The results also underline the positive effect of trade liberalization on the changing pattern of developing country exports towards high-value-added manufactures.

Table 1
Effects of Trade Liberalization on S-S and S-N trade in Manufactures

	South-North						South-South					
	(1)	(2)	(3)	(4)	(5)	(6)	(1)	(2)	(3)	(4)	(5)	(6)
constant	-5.73	-3.95	-6.54	-5.42	-2.44	-4.82	-4.14	-2.73	-2.58	-2.65	-3.48	-3.13
	(4.28)	(4.94)	(4.97)	(4.42)	(8.44)	(8.91)	(5.39)	(5.54)	(5.61)	(5.52)	(6.686)	(7.10)
Liberalization	1.01**	0.82**	1.01***	1.00**	1.05***	0.85**	0.72**	0.77**	0.66**	0.58*	0.77**	0.74**
	(0.40)	(0.41)	(0.40)	(0.42)	(0.39)	(0.36)	(0.34)	(0.37)	(0.34)	(0.36)	(0.32)	(0.33)
Credit	0.36*	0.33*	0.39*	0.39*	0.35*	0.36*	0.368**	0.42**	0.38**	0.44**	0.42**	0.43*
	(0.19)	(0.19)	(0.22)	(0.24)	(0.21)	(0.19)	(0.17)	(0.19)	(0.19)	(0.19)	(0.21)	(0.23)
Population	0.36***	0.31**	0.37***	0.36***	0.28	0.32*	0.22	0.19	0.17	0.18	0.21	0.18
	(0.13)	(0.14)	(0.13)	(0.13)	(0.21)	(0.19)	(0.14)	(0.14)	(0.14)	(0.13)	(0.14)	(0.17)
GDP78	0.06	-0.03	0.164	0.03	-0.07	0.24	0.15	0.01	0.08	0.02	-0.18	-0.23
	(0.29)	(0.32)	(0.32)	(0.29)	(0.62)	(0.66)	(0.43)	(0.42)	(0.43)	(0.42)	(0.61)	(0.53)
FDI		3.99						0.53				
		(3.29)						(3.22)				
Investment			-0.10			-0.02			-0.08			-0.13
			(0.40)			(0.61)			(0.36)			(0.44)
GDPGN				0.06**		0.04				-0.01		-0.02
				(0.03)		(0.02)				(0.03)		(0.03)
GDPGS				-0.05**		-0.05**				0.01		0.004
				(0.03)		(0.02)				(0.02)		(0.02)
TOT					-0.12	-0.06					0.19	0.29
					(0.51)	(0.48)					(0.32)	(0.39)
HK					-0.17	-0.73					0.62	0.89
					(1.04)	(1.17)					(0.79)	(0.73)
Economic effect	1.73	1.26	1.75	1.72	1.86	1.35	1.05	1.15	0.94	0.79	1.15	1.08
AR1	0.20	0.16	0.22	0.12	0.19	0.11	0.22	0.27	0.25	0.30	0.27	0.28
AR2	0.13	0.10	0.14	0.14	0.15	0.15	0.18	0.16	0.18	0.21	0.12	0.11
Hansen	1	1	1	1	1	1	1	1	1	1	1	1
Observations	673	673	673	673	656	656	673	673	673	673	656	656

Table 2
Effects of Trade Liberalization on S-S and S-N trade in Technology-and-Skill-Intensive Manufactures

	South-North						South-South					
	(1)	(2)	(3)	(4)	(5)	(6)	(1)	(2)	(3)	(4)	(5)	(6)
constant	-40.59***	-41.14***	-48.59***	-40.65**	-28.69**	-27.89***	-12.91**	-11.42**	-14.01**	-13.84**	-11.34	-11.19
	(14.85)	(16.34)	(16.03)	(16.36)	(13.38)	(8.96)	(5.25)	(5.02)	(5.82)	(5.75)	(8.01)	(7.00)
Liberalization	2.15***	2.09***	2.05***	2.12***	2.53***	2.20***	0.89**	1.03***	0.99**	0.99**	0.96**	0.92**
	(0.62)	(0.62)	(0.65)	(0.61)	(0.68)	(0.67)	(0.45)	(0.37)	(0.43)	(0.41)	(0.39)	(0.43)
$Credit_{-1}$	1.06*	1.00	0.99*	1.03*	1.29*	1.08*	0.60**	0.42	0.53**	0.59**	0.56*	0.52*
	(0.63)	(0.68)	(0.52)	(0.62)	(0.75)	(0.59)	(0.27)	(0.28)	(0.24)	(0.25)	(0.29)	(0.28)
Population	1.28***	1.30***	1.24***	1.29***	1.24***	1.05***	0.40***	0.39***	0.38**	0.41**	0.38**	0.38**
	(0.39)	(0.36)	(0.37)	(0.39)	(0.49)	(0.23)	(0.16)	(0.15)	(0.18)	(0.17)	(0.19)	(0.19)
GDP78	1.76**	1.79*	2.03***	1.80*	1.69*	1.83*	0.61*	0.50	0.62*	0.69*	0.53	0.39
	(0.76)	(1.01)	(0.80)	(0.99)	(0.94)	(0.94)	(0.35)	(0.35)	(0.36)	(0.38)	(0.52)	(0.45)
FDI		4.48						3.52				
		(7.57)						(2.79)				
Investment			2.21***			1.76			0.46			0.37
			(0.82)			(1.39)			(0.59)			(0.65)
GDPGN				-0.12		-0.111				-0.03		-0.04
				(0.16)		(0.17)				(0.04)		(0.04)
GDPGS				-0.001		0.004				0.02		0.02
				(0.04)		(0.04)				(0.03)		(0.03)
TOT					-2.10	-2.62					-0.19	-0.23
					(1.36)	(2.20)					(0.61)	(0.51)
HK					-1.19	-1.49					0.23	0.309
					(1.38)	(1.52)					(0.67)	(0.73)
Economic effect	7.55	7.04	6.77	7.31	11.56	8.06	1.45	1.80	1.68	1.69	1.60	1.51
AR1	0.23	0.23	0.23	0.23	0.26	0.25	0.31	0.26	0.29	0.30	0.30	0.29
AR2	0.24	0.25	0.23	0.24	0.23	0.28	0.17	0.13	0.17	0.16	0.16	0.15
Hansen	1	1	1	1	1	1	1 1	1	1	1	1	1
Observations	666	666	666	666	650	650	666	666	666	666	650	650

Notes: (***), (**), (*) denote significance at 1, 5 and 10% levels respectively. *Economic effect* is the percentage increase in the dependent variable when the dummy variable is 1. It is measured as Exp (Liberalization)-1. *Hansen* is Hansen test of over-identifying restrictions, *AR1* and *AR2* are AR(1) and AR(2) tests. All test statistics are given by their p-values.

6. CONCLUSION

Using a panel of bilateral trade data for 28 developing countries, we find that trade liberalization has a significantly positive effect on the share of total and technology-and-skill-intensive manufactures exports in S-S and S-N trade. Furthermore, trade liberalization in the South is found to be favoring S-N more than the S-S trade. Overall, the results also provide support to the presence of dynamic gains from exports in developing countries. Several caveats are in order: first, the countries studied had higher levels of industrial and human capital development (compared to low-income South) before trade liberalization, thus the results may not apply to other Southern countries. Second, the types of products studied are typically the last to be liberalized, which suggests that liberalization of primary and intermediate inputs first (as also argued by Fugazza and Robert-Nicoud, 2006) might have increased these countries' ability to infiltrate into Northern markets. Third, the use of a de-jure trade liberalization measure has significant limitations. A more appropriate measure would include the use of tariff and non-tariff trade barriers measures. However, given the limited coverage and availability of these data, this is the best we can do at this point. Besides, it is not very clear how to interpret changes in tariff rates. For example, tariff rates may indeed increase after trade liberalization as countries move away from quantitative restrictions to price based restrictions. In addition, trade liberalization is usually phased in over a period of time, which varies across different spectrum of goods and industries.

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