Deutsches Institut für Entwicklungspolitik
German Development Institute
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Briefing paper 9/2007

South-South Cooperation – Opportunities and Challenges for International Cooperation

Since China and India ("Asian drivers") and other "rising powers," especially Brazil and South Africa, began their steady climb, international cooperation has been faced not only with new opportunities, but also with a number of specific challenges. During the political debate new variants of colonial relations have also been identified from time to time. A sober look at South-South cooperation shows, however, that neither hasty condemnation nor euphoria is helpful: what is needed is an objective debate in which all the actors involved in development cooperation participate.

To clarify the role of South-South cooperation, the following subjects are outlined:

- Current tendencies in South-South cooperation (trade, investment, finance)
- South-South cooperation: the role of the Asian drivers in African countries
- Prospects for South-South cooperation and recommendations for international cooperation.

In the past decade South-South trade has expanded more quickly than North-South trade. South-South investment too has shown unprecedented dynamism. Investors from the South often have important regional know-how, use appropriate technologies and prove more willing to take business risks in a difficult political environment.

A further indicator of the increased importance of South-South cooperation is the fact that countries in the South have become an additional source of official development assistance (ODA). The data on the actual scale of South-South development cooperation are still fragmentary, however.

Current trade and investment flows between China and Africa are substantially driven by complementary structures in the two regions: African raw materials for Chinese industrial goods. In contrast, Indian trade and investment flows to Africa largely concern manufacturing industry and the service sector. Recently, however, India has similarly stepped up its foreign direct investment (FDI) in the oil sector. In China, India and most other countries in the South there is in fact no clear distinction between concessionary and commercial flows.

In general, China's and India's development cooperation is well integrated into their foreign, economic and security policies. Conceptually, it is guided by the Bandung Principles, especially that of non-interference in the recipient country's internal affairs. Conditionality along the lines of the OECD/DAC's aid effectiveness concept is rejected by most countries of the South.

While the positive sides of the current South-South dynamism are to be seen primarily in the increased inflows of resources, especially to the benefit of poor developing countries, many African states face major challenges because of increased dependence on raw materials and the greater pressure of competition from Asian countries in the case of light manufactures. The high-level dialogues between the G8 and the five leading anchor countries (Brazil, China, India, Mexico and South Africa) announced during the Heiligendamm process may help considerably to ensure that benefits are derived from closer South-South cooperation and that conceivable risks are discussed openly.

1. Current tendencies in South-South cooperation (trade, investment, finance)

Of late, South-South cooperation has grown rapidly in importance. This is as true of the trend in trade and direct investment as it is of credit relationships between developing countries and of development cooperation (low-interest loans, grants and technical cooperation).

1.1 Development of South-South trade

Over the past decade South-South trade has expanded more quickly than North-South trade. In absolute terms, it rose from US$ 222bn in 1995 to US$ 562bn in 2004. While South-South trade grew by 17.6 per cent from 2000 to 2004, South-North and North-South exports increased by 12.6 and 9.7 per cent, respectively. Total South-South trade accounted for 26 per cent of world trade in 2004.

Currently, most South-South trade is intra-regional, although supra-regional trade is also on the increase. A further indicator of growing South-South cooperation is the rise in the number of regional trade agreements (RTAs) among developing countries. In the early 1990s there were only 50 such agreements. Now there are more than 200.

The growing importance of countries in the South (especially China, Brazil, India and South Africa) and the concomitant increase in South-South cooperation are also plain to see at the level of global governance, and especially of the World Trade Organization (WTO). There are many signs that the emergence of the G-20 (agricultural export countries) has transformed the WTO from an organization dominated by the West to a multipolar-oriented institution.

1.2 Development of South-South investment

South-South FDI has also experienced unprecedented dynamism in the past decade. While it reached US$ 14bn in 1995, its value had more than tripled to US$ 47bn by 2003. The increased FDI flows in the South have thus partly compensated for the decline in FDI from the industrialized countries, which, having amounted to US$ 130bn in 1999, had fallen to US$ 82bn by 2003 (see table 1).

Table 1: South-South FDI flows as a proportion of global FDI flows to developing countries

	1995	1999	2000	2001	2002	2003
Total inflows (1)	90.3	163.5	154.7	159.3	135.3	129.6
from high-income OECD (2)	48.1	95.4	93.7	84.8	55.1	59.4
from high-income non-OECD (3)	28.2	35.0	22.7	24.8	27.2	22.8
South-South FDI (1)-(2)-(3)	14.0	33.1	38.3	49.7	53.0	47.4
South-South FDI (per cent)	15.5	20.2	24.8	31.2	39.2	36.6

Source: World Bank staff estimates

NB The estimates of South-South FDI are based on 35 countries accounting for a total of 85 % of total FDI flows to developing countries.

As much of the FDI from developing countries has recently been confined to the investors' own regions, it is becoming more important for countries at the same or lower level of development. In terms of sectoral distribution, the available data indicate that South-South FDI is largely concentrated on the extractive industry and infrastructure/services. Many transnational businesses in developing countries, however, are also investing in other sectors.

South-South FDI is often encouraged by various government measures. Besides the extensive removal of restrictions on capital exports, governments of developing countries offer tax incentives and other privileges for investment in other developing countries. In some regional arrangements, such as SADEC, ASEAN (Association of South-East Asian Nations) and the Andean Community, provision is also made for special incentives, such as low taxes, tariff reductions and favourable profit-transfer conditions.

The rise in South-South FDI brings new opportunities, but it also poses problems for the recipient countries. A particular advantage is that businesses in developing countries usually have considerable know-how about their region. This is especially true of regional distribution networks and appropriate local technologies and inputs.

Developing countries also benefit from the fact that geographical proximity and cultural similarities facilitate the coordination of operations in other countries, and their businesses also tend to be more willing to take the risk of investing in a difficult political environment or in post-conflict situations. However, the actual significance of these favourable opportunities can be assessed only on a case-by-case basis, since by far the most South-South FDI goes to the extractive industry and to infrastructure projects, where linkage and spillover effects that benefit general development tend to be less pronounced.

As a result of the growth of South-South trade and the dynamism of South-South FDI, many banks in developing countries have expanded their South-South banking business. Like the multinational enterprises in developing countries before them, banks in developing countries prefer to operate in their own region or in a familiar cultural environment with a similar legal system.

As in the case of South-South FDI, banks in developing countries have more experience in difficult environments and are therefore more prepared to take risks than investors in industrialized countries. Low-income developing countries in particular are consequently able to benefit from the cross-frontier activities of developing-country banks.

1.3 Growth of South-South development coopera tion

A further indicator of increased South-South cooperation is the fact that not only the rising powers, but other developing countries too, have become a greater source of ODA flows. The data on the actual scale of South-South development cooperation, however, are still fragmentary.

It would seem that a large proportion of these financial resources is provided by only a few countries and that there is considerable variation from year to year. From 1994 to 2002 almost 60 per cent of concessionary loans were granted by China. Turkey, Russia and Mauritius accounted for a further 30 per cent in that period. Of these concessionary loans, some 70 per cent went to only 15 countries, foremost among them low-income countries. The sub-Saharan African countries received the largest share of the resources (47 per cent), while Latin America and the Caribbean benefited from about 26.5 per cent. Europe and Central Asia accounted for just under 20 per cent.

According to EU estimates, however, there is no doubt that China is now by far the largest donor among the countries of the South. In fact, these data show that development cooperation resource flows from China exceed those of all the other BRICS countries (Brazil, Russia, India and South Africa) combined by a factor of 10.

Like the other South-South resource flows, most concessionary loans (excluding China's) are intra-regional (78 per cent). Thailand, for example, provides 90 per cent of its ODA resources for infrastructure projects in neighbouring countries (Cambodia, Laos, Myanmar and the Maldives). India too focuses its development cooperation on neighbouring countries and its own regional environment: they receive some 73 per cent of its grants and loans (1997–2004). It is noticeable that many rising powers clearly have a particular interest in cooperating with African countries.

2. South-South cooperation: the role of the Asian drivers in African countries

China's and India's high growth rates have not only had a major positive influence on global growth, but also helped to improve the economic situation of African countries. This is particularly evident from the improvement of the terms of trade in the case of mineral and agricultural raw materials (about 14.5 and 7 per cent p.a., respectively).

2.1 Trade relations between the Asian drivers and African countries

Trade and investment flows between Africa and Asia are substantially driven by the complementary structures of the two regions: while Africa's imports from China and India mainly consist of manufactures and machinery, what China and India mostly need from Africa are natural resources, especially energy. The following picture emerges from the available data: 86 per cent of all African exports to Asia are raw materials, with oil and natural gas accounting for 47 per cent. Almost 50 per cent of African imports from Asia are manufactured products. In trade relations between Africa and Asia, China and India play, at 49 per cent, a central role, having now taken over from Japan and South Korea in the region.

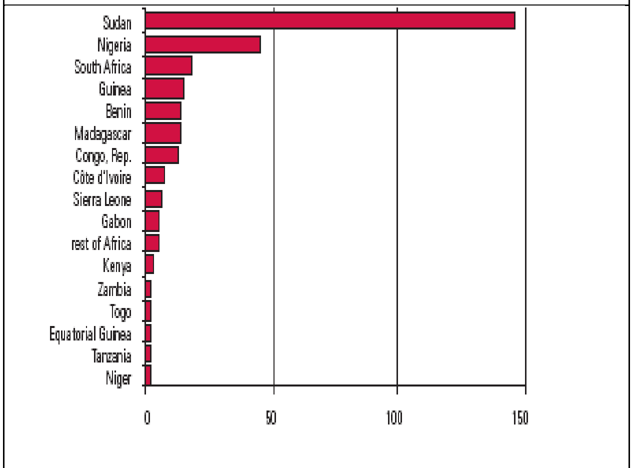
2.2 FDIs by the Asian drivers in African countries

Indian FDI in African countries principally benefits manufacturing industry, Mauritius being the leading recipient country. In the latest globalization offensive India has increasingly sought to use South Africa as the door to the expansion of its automobile industry (especially TATA Motors) for export to the EU. FDI in the raw materials sector, particularly oil, is more recent.

China's latest FDI in African countries, on the other hand, has focused on the raw materials sector (see figure 1).

The fact that a substantial proportion of the investors are state-owned enterprises (SOEs) clearly shows that this investment is not only economic, but also motivated by political considerations. The role of SOEs is particularly significant in China's case. According to World Bank estimates, 43 per cent of China's outward FDI (OFDI) is effected by SOEs.

Figure 1: Current Chinese FDI outflows (2004) to Africa are largely, but not entirely, resource-oriented



Source: 2004 Chinese FDI Statistics Bulletin

2.3 The Asian driver's development cooperation with African countries

In principle, China's and India's development cooperation is well integrated into their general foreign, economic and security policies. Conceptually, it is guided by the Bandung Principles, especially that of non-interference in the internal affairs of the recipient country. The provision of concessionary financial resources is not therefore conditional on adherence to such conditions as "good governance," "rule of law," "market economy" or "respect for human rights." Reporting on development performance is geared to their own categories, unclear though they may be. Consequently, a comparison with OECD/DAC standards is hardly possible in practice.

Africa is **China's** most important development cooperation partner. In 2003 Prime Minister Wen Jibao declared that China had completed 800 projects in Africa. This figure covered projects in the **education and health sectors**, the **secondment of Chinese workers** and cooperation projects in the **security policy sphere**. According to the announcements, **economic relations** are to be expanded further, with FDI in Africa increased from the current US$ 280m (2005) to US$ 1.9bn. To promote further Chinese investment in Africa, a special fund endowed with US$ 5bn is also to be established. Against the background of closer relations, the Sino-African Cooperation Forum was set up in 2005 to promote mutual assistance. In addition, China is assisting African countries with the **implementation of NEPAD** (New Partnership for Africa's Development) and, at international level, within the UN and WTO and also in peace-keeping activities in the region.

Unlike China, **India** focuses its development cooperation primarily on neighbouring countries, especially Nepal, Bhutan and Afghanistan. It has only recently begun to undertake more conspicuous activities in support of development in Africa. The measures it has taken to **support NEPAD** must be seen in this context.

In 2004 India promised a loan of over US$ 200m for NEPAD projects. In 2003 **debt relief packages** were put together for many African countries. As India has to import 70 per cent of its oil, it has developed a Strategy to Secure Future Oil Supplies from Overseas. In this context, special **cooperation and credit models** to the benefit of selected West African countries (Team-9 Initiative) have been devised to finance projects implemented by Indian enterprises through the Export-Import Bank of India. In December 2005 India offered various oil-rich West African countries loans totalling US$ 1bn for power stations, railway infrastructure and refineries in exchange for oil exploration rights. In 2006 a US$ 6bn infrastructure project in the form of a joint venture was completed in Nigeria. African countries are also major recipients of Indian technical assistance. Training programmes in this sphere are provided under the Indian Technical and Economic Cooperation (ITEC) scheme and the Special Commonwealth Assistance for Africa Programme (SCAAP).

3. Opportunities, challenges and recommendations for future international cooperation

The increase in South-South resource flows creates opportunities for poor developing countries in particular, since the investors concerned and the banks are clearly familiar with the technological requirements and actual cultural and political conditions and are far more willing to take risks than investors from industrialized countries.

However, China's and India's presence in African countries also poses various challenges. Although their rapid growth rates and the consequent increase in their demand for raw materials have led to tremendous economic growth in many African countries, the risk is that, as the extraction of raw materials usually proceeds without any major linkages or spillovers for the rest of the economy, enclave economies will emerge or become entrenched. These challenges for African countries appear all the greater when the impending predatory competition, especially with China, in light manufactures is also taken into account.

Against this background, the Heiligendamm process, which has triggered dialogue with anchor countries and, in particular, put development in Africa on the agenda, is extremely topical. The Joint Statement by the German G8 Presidency and the Heads of State and/or Government of Brazil, China, India, Mexico and South Africa on the occasion of the G8 Summit in Heiligendamm provides some useful pointers for creating the conditions for the achievement of the Millennium Development Goals and for sustainable development through the adoption of a cooperative approach, especially in Africa's case.

If the envisaged high-level dialogue on the challenges in Africa is to be launched and the debate is to continue in a structured form, an exchange on the highly varied understanding of development cooperation will be needed. The aim is essentially to achieve a meeting of minds on

- the Bandung Principles (especially the principle of non-interference) and the concept of aid effectiveness or conditionality pursued by the OECD/DAC,
- the data submitted by the OECD/DAC and by the countries of the South on the distinction between commercial and non-commercial resource flows,
- the chances of joint or harmonised standards in development cooperation.

There is also an urgent need for research work conducted jointly by institutes in OECD countries and anchor countries on the following topics:

- the recording and analysis of the effects of South-South FDI as opposed to the traditional North-South FDI;
- the development of strategic options for the environmentally sound and socially acceptable extraction of raw materials in African countries;
- the adjustment of African countries' trade and investment strategies to improve their competitiveness.

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E-Mail: die@die-gdi.de http://www.die-gdi.de
ISSN 1434-8934 (deutsch) ISSN 1615-5483 (englisch)