Development Co-operation Report 2014
Mobilising Resources for Sustainable Development

PART I

Chapter 3

Growing dynamism in South-South co-operation

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South-South co-operation – the exchange of resources, technology and knowledge among developing countries – is increasingly significant for promoting development. While traditional forms of South-South co-operation (trade, investment and technology sharing) are still relevant and growing, new approaches are also emerging that are helping to remodel the development finance landscape. The search for options that can help to end dependence on long-established financial mechanisms is in full swing, including bilateral currency swaps, South-South trust funds and new financial institutions. Such promising developments point to a new era for South-South co-operation involving deeper engagement, especially in the international finance domain, which can only strengthen the ability to deliver sustainable development in the future.

Over recent years South-South co-operation[1] has evolved significantly, with a deepening of engagement across a range of sectors, from trade to investment and technology development. It has also moved beyond traditional government-to-government co-operation to involve the private sector, civil society and other non-state actors. Finally, new approaches to financing are emerging, including currency exchange, South-South trust funds and development banks such as the BRICS[2] Development Bank and the Asian Infrastructure Bank. While the participation of all developing countries in this new wave of opportunity may not be uniform, these initiatives are promoting a growing sense of optimism. This chapter describes the latest trends in South-South co-operation.

South-South co-operation is remodelling the development finance landscape

The rising volume of development assistance from leading "Southern" providers has expanded global development financial flows. For example, Brazil's international development co-operation grew from USD 160 million in 2005 to nearly USD 923 million in 2010 (Milani, 2014; IPEA, 2014). The People's Republic of China operates one of the biggest development co-operation programmes in the South; it has already provided a total of USD 41.08 billion as concessional funding, comprising grants, interest-free loans and concessional loans (Hong, 2011).

China's development co-operation programme is one of the biggest in the South, having already provided a total of USD 41.08 billion in concessional funding.

At the 6th Summit of Heads of State and of Government of BRICS, held in Fortaleza, Brazil in July 2014, the BRICS Development Bank was formally launched as the New Development Bank with initial capital of USD 50 billion.[3] This bank intends to complement other sources of development finance by mobilising resources to support infrastructure and sustainable development projects in the BRICS countries, as well as in other developing countries. The member countries have displayed their willingness to work as a group to promote growth in the South, demonstrating their ability to deliver mutual benefits and collective gains. At present, China and the Russian Federation are the only two BRICS countries able to maintain a healthy current account surplus. Apart from US treasury bonds, they will see the BRICS Development Bank as an option for investing these surpluses. This will not be the case, however, for other countries such as India, which will be investing borrowed resources in the bank (Roy, 2014). The bank's membership and shareholder base will be broad and it will promote equal representation through core principles, such as one-member-one-vote.

The South is not a homogenous group, but comprises countries at different stages of development, moving at varied speeds. For this reason, the structure of the bank will be participatory, encouraging other developing countries to join as equal partners. Each member is expected to hold an equal amount of equity in the bank and if any member invests more of their surpluses, this should be used for lending rather than increasing their stake in the bank. This will also prevent the governance structure from being solely based on the economic weight of its members and maximise the bank's reach, giving it much greater economic influence. Furthermore, the bank will restrict membership to developing countries only – no developed country or multilateral development bank will be admitted as a stakeholder of the institution. Of course, the admittance of developed countries or multilateral development banks controlled by developed countries could give the BRICS Bank superior leveraging power thanks to their attractive rating profiles, but this would be at the cost of significant interest in and control of the new entity by developed countries, which would seriously dilute the branding of the institution as a bank for, of and by the developing world (Roy, 2014).

The Asian Infrastructure Development Bank will have an initial capital of USD 50 billion.

In parallel, China is laying the groundwork for its Asian Infrastructure Development Bank, whose core focus will be on financing infrastructure to enhance regional connectivity in Asia. The bank will have an initial capital of USD 50 billion (Shan, 2014). China claims the bank will not compete with traditional multilateral institutions such as the World Bank, the International Monetary Fund or the Asian Development Bank. While these institutions also have infrastructure development as their top priority, it is expected that the opening up of another channel for developing countries to finance their infrastructure requirements will offer new options and hopes for bridging resource gaps.

Another novel financial arrangement is the India, Brazil and South Africa Fund (IBSA Fund). This fund was established in 2004 to identify new opportunities for contributing to international efforts to combat poverty and hunger (IBSA, 2004). The fund has accumulated nearly USD 18 million. Working in partnership with the United Nations Development Programme (UNDP), the fund supports projects – mostly in Africa – that address both social and economic inequality. The specific objectives of the three countries are reflected in the fund's priorities, which range from promoting food security to addressing HIV/AIDS and improving access to safe drinking water; all aim to contribute to the Millennium Development Goals (IBSA, 2011).

Currency swaps capture new opportunities for mutual benefits

The recent wave of "currency swap" arrangements (Box 3.1 and Table 3.1) is further strengthening South-South co-operation, enabling developing countries to forge new economic relations. Currency swaps help ensure that bilateral trade is unaffected by global financial conditions.

Box 3.1. **What are currency swaps?**

Developing countries are increasingly entering into currency swap arrangements that allow them to promote trade and investment in local currencies. In most currency swap arrangements, countries do business in their local currencies at predetermined and fixed exchange rates, preventing the erosion of domestic currency as a result of trade imbalances. In this way, currency swaps defend against international liquidity shocks and lower the transaction costs involved in bilateral exchanges among domestic firms.

For example, the Indian Ministry of Commerce has prepared a list of 23 countries with which India can enter into currency swap arrangements. The list includes a mix of oil-exporting and non-oil-exporting countries, among them Angola, Indonesia, Iran, Malaysia, Oman, the Russian Federation, South Africa, Thailand and Venezuela.

India also helped Bhutan overcome a currency crisis in late 2013, when a sudden rise in imports from India led to a severe depletion of Indian rupee reserves in Bhutan (*The Economic Times*, 2013). The government of India provided an INR 10 billion soft loan through its credit-line facility to ease the situation. Bhutan also took advantage of the currency swap arrangement that the two countries signed in 2013 to borrow INR 5 billion (Reserve Bank of India, 2013).

Table 3.1. **Some recent South-South currency swap arrangements**

	Bilateral partners	Monetary arrangement
2011	China-Thailand	CNY 70 billion/THB 320 billion
2011	South Korea-China	KRW 64 trillion/CNY 360 billion
2012	China-Malaysia	CNY 180 billion/MYR 90 billion
2013	China-Brazil	CNY 190 billion/BRL 60 billion
2013	South Korea-Malaysia	KRW 5 trillion/MYR 15 billion
2013	South Korea-the United Arab Emirates	KRW 5.8 trillion/AED 20 billion
2014	South Korea-Indonesia	KRW 10.7 trillion/IDR 115 trillion

Sources: Bank of Thailand (2011), "The establishment of a bilateral local currency swap agreement between the People's Bank of China and the Bank of Thailand", *Press Release*, 22 December, Bank of Thailand; *Financial Times* (2011), "South Korea doubles currency swap deal with China", *Financial Times*, 26 October 2011; Bank Negara Malaysia (2012), "Bilateral currency swap arrangement agreement with the People's Bank of China", *Press Statements*, 8 February, Bank Negara Malaysia; Bank Negara Malaysia (2013), "Bilateral currency swap arrangement with Bank of Korea", *Press Statements*, 20 October, Bank Negara Malaysia; Banco Central do Brasil (2013), "The Central Bank of Brazil and the People's Bank of China establish a currency swap agreement", *Press Release*, 26 March, Banco Central do Brasil; Bank Indonesia (2014), "Bilateral local currency swap arrangement with the Bank of Korea", *Press Release*, 6 March, Bank Indonesia; Bank of Korea (2013), "The Bank of Korea and Central Bank of the United Arab Emirates announce the establishment of a KRW/AED Swap Arrangement", *Press Releases*, 13 October, Bank of Korea.

The growth in currency swaps among Southeast Asian countries is largely seen as an outcome of the Chiang Mai Initiative, set up after the 1997 East Asian crisis. The initiative drew attention to the interdependence of developing country economies (West, 2014). It has since evolved into a multilateral currency swap arrangement among the ten members of the Association of Southeast Asian Nations (ASEAN)[4] plus the People's Republic of China (including Hong Kong, China), Japan and South Korea. It draws on a foreign exchange reserves pool initially worth USD 120 billion, which doubled to reach USD 240 billion in 2012.

Increasing South-South investment flows reflect deeper integration

Historically, foreign direct investment outflows from developing countries have been low in comparison to those of developed countries, although this trend seems to be reversing. The share of developing countries in global foreign direct investment outflows has grown fivefold over the past three decades – from 6% in 1980 to 31% in 2012 (UNCTAD, 2013a; and see Chapter 5).

South-South foreign direct investment is growing at an annual average rate of 21%.

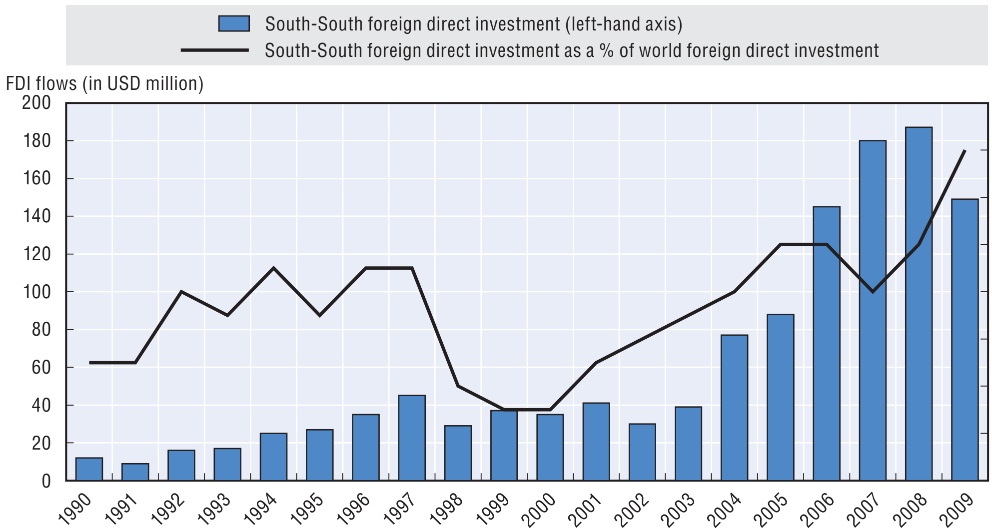
Yet, while the relative volume of foreign direct investment outflows from developing countries remains small, these funds have become increasingly relevant for promoting economic growth in Southern economies. One interesting aspect of foreign direct investment from developing countries is that it is largely destined for other developing countries. In this way, the rapid economic growth experienced by some developing countries has provided opportunities for other Southern countries. South-South foreign direct investment flows are growing at an annual average rate of 21% (Figure 3.1).

The combined value of foreign direct investment outflows from the BRICS skyrocketed from USD 7 billion in 2000 to USD 126 billion in 2012, with nearly 58% being received by developing countries (see Chapter 5). Further, 43% of foreign direct investment from the BRICS to developing economies was intra-regional in character (UNCTAD, 2013b).

South-South co-operation includes skills and trade, not just finance

South-South co-operation takes many forms other than finance. It has helped expand the scale and nature of development co-operation, enabling providers to move beyond concepts of human resource development centred around training programmes alone. In emerging economies such as

Figure 3.1. **Growth in South-South foreign direct investment, 1990-2009**



Source: Author's own calculations based on the United Nations Conference on Trade and Development statistics, *http://unctad.org/en/pages/Statistics.aspx* (accessed 20 May 2014).

StatLink http://dx.doi.org/10.1787/888933121316

Brazil, China, India and South Africa, progress has helped them build their development co-operation efforts, introducing new modalities that have opened up avenues for other developing countries. For instance, in 2008, India announced its Duty Free Tariff Preference for Least Developed Countries, with a tariff reduction spread over five years (2008-12). The scheme is open to 49 of the least developed countries (including 34 in Africa). Both China and India provide preferential buyer's credits to promote investment in the production sectors of their partner countries; these credits create a win-win opportunity for both providers and development partners, as goods, services, machinery and equipment as well as consultancy services are exported to partner countries under agreements based on principles of mutual gain.

This is not to say that programmes for capacity development, training and scholarships are not still important; in fact, they have seen impressive growth. For instance, the Indian Technical & Economic Cooperation Programme (ITEC), India's flagship scholarship and fellowship programme launched in 1964, began by offering 1 400 training slots to students from other developing countries; today it provides more than 10 000 scholarships annually to students from 167 countries. China also provides training to more than 15 000 people from other countries every year. The focus of these programmes – in areas such as computer engineering, statistics, chartered accountancy, industrial surveys, civil aviation, telephone mechanics, fisheries, legislative procedures and textile industrial technology – reflects the new strengths of these countries.

South-South trade grew as a share of world trade from 8% in 1980 to 27% in 2010, while North-South trade was falling.

Trade among developing countries has also helped provide new opportunities for economic growth that bypass trade restrictions imposed by developed countries. South-South trade as a share of world trade grew from 8% in 1980 to 27% in 2010; over the same period, North-South trade fell from 46% to less than 30% (UNDP, 2013).

In the absence of domestic frontiers of innovation similar to those available in developed countries, developing countries previously relied extensively on imported capital goods (e.g. machinery, tools, computers or other equipment used to produce goods for sale). Until the mid-1990s, developed countries were the favoured source for high-skill intensive manufacturing goods; through these imports, developing countries were able to learn and innovate.[5]

Over the years, trade in capital goods among developing countries has climbed steadily (from 35% in 1995 to 54% in 2010).[6] This reflects the strengthening of South-South trade relations since the late 1990s. In particular, developing countries in East and Southeast Asia have substantially strengthened their trade ties with other developing countries, and now import most of their high-tech[7] manufactured goods from this grouping (65% and 55% respectively). Other countries have also reduced their dependence on developed countries for high-tech goods.

In 2010, developing countries exported 62% of their high-tech manufactured goods to other developing countries (see Endnote 6). This rise in South-South high-tech exports can be explained by the combined effect of the technology spillovers from imports of high-tech goods described above, as well as trade liberalisation, lowering of tariffs and removal of quantitative restrictions on imported capital goods. As a result, several developing countries have successfully diversified their production base, reorienting it away from traditional primary exports to manufacturing and services-based industries. This shift, however, is still largely confined to a small group of developing economies.

Civil society is strengthening South-South co-operation

Some Southern civil society organisations (CSOs) are also becoming active players in other developing countries. They have enhanced their expertise in key relevant sectors, ranging from health, water and sanitation, and microfinance to capacity building and training. CSOs work at the grassroots level and often develop innovative approaches that have high impact. The political mobilisation and involvement of civil society in South-South co-operation has increased considerably and Southern countries are now treating civil society as important development actors, not simply as subcontractors.

The emerging Southern providers of development co-operation – including Brazil, China and India – are actively involving their civil society in promoting development for all. For example, India's policy for economic and development co-operation explicitly focuses on bilateral channels, but at the same time recognises the role of civil society as a development actor that should be engaged by the development partner itself (Vaes and Huyse, 2013). In Bangladesh, BRAC (formerly the Bangladeshi Rural Advancement Committee), the largest non-profit organisation in the developing world, places great emphasis on providing medical care to low-income populations. BRAC has evolved a holistic approach to addressing poverty by providing micro-loans, education, health services, jobs and human rights education in countries across the South. Similarly, Brazilian CSOs are increasing their presence and co-operation in Africa. A study of Brazil's international development efforts suggests that "a growing number of Brazilian public national institutions or organi[s]ed civil society, in its diverse categories, have incorporated overseas activities as part of their daily work routines" (Tomlinson, 2013). Brazilian CSOs and social movements also have been important in articulating the demands of smallholders in policy.

South-South co-operation is founded on equity and mutual benefit

South-South co-operation continues to evolve both in terms of magnitude of flows and forms of delivery. Recent improvements in the economies of the emerging economies are allowing them to support the development of other countries and deliver appropriate solutions. In order to spread and sustain this co-operation, partners should continue to embrace the two basic principles of egalitarianism and mutual benefit. Emerging economies, in particular, will need to pay closer attention to the principle of egalitarianism in order to spread and sustain the spirit of South-South co-operation over the long run. It needs to be ensured that these are balanced, win-win partnerships through which the benefits are shared among all the development partners.

Key recommendations

- Continue to embrace the partnership principles of egalitarianism and mutual benefit in spreading and sustaining South-South co-operation.
- Support trade among developing countries as a key way to provide new opportunities for economic growth.
- Enable more developing countries to diversify their production base away from traditional primary exports to manufacturing and services-based industries.
- Recognise the key role of civil society organisations in South-South development.

Notes

1. The exchange of resources, technology and knowledge among developing countries, also known as countries of the global South.
2. BRICS: Brazil, the Russian Federation, India, China and South Africa.
3. The decision to set-up a BRICS-led Development Bank was made at the 5th BRICS summit held in Durban, South Africa in March 2013.
4. ASEAN is a political and economic organisation of ten countries in Southeast Asia: Brunei, Cambodia, Indonesia, Laos, Myanmar (Burma), Malaysia, the Philippines, Singapore, Thailand and Viet Nam. Its aims include accelerating economic growth, social progress, socio-cultural evolution, protection of regional peace and stability, and opportunities for member countries to discuss differences peacefully.
5. Prebisch (1959) was one of the first to argue that developing countries could realise large gains by integrating their domestic markets and building competitive manufactured goods.
6. Author's own calculations based on the United Nations Conference on Trade and Development statistics, *http://unctad.org/en/pages/Statistics.aspx* (accessed 20 May 2014).
7. Used in this chapter to refer to high-skilled, technology-intensive manufactured goods.

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