

**LITERATURE REVIEW OF THE ROLE OF
ECONOMIC POWERHOUSES IN REGIONAL
DEVELOPMENT**

LESSONS FOR SOUTH AFRICA IN AFRICA

Executive Summary

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Background and context of research

The HSRC has been investigating the nature of South Africa's role in the sub-Saharan African region since 2003. This research interfaces with the work undertaken by the HSRC's Corporate Mapping and a political assessment of the role of South Africa's elite on the political dynamics in the region. To further assist the research process, an assessment of the role of regional economic powerhouses in regions *other* than sub-Saharan Africa is considered, on the basis of available secondary research.

This report is intended to engage:

- The HSRC internally;
- Other research organisations and individuals;
- Regional stakeholders, such as the NEPAD Secretariat and the NEPAD Business Group;
- Policy-makers, such as **the dti**; and
- Interest groups, such as parliamentary portfolio committees.

Research areas and methodology

The research is set against the backdrop of globalisation. Trade and foreign direct investment (FDI) integration are prominent features of globalisation, conventionally studied in the instances of the developed economies of Europe and signatories of the North American Free Trade Agreement (NAFTA) nations (excluding Mexico, the only developing-country signatory to NAFTA). Trade and investment integration are increasingly evident in developing economies too, especially in Asia and Latin America, where growing regional powerhouses throw up both positive and negative aspects for regional development. Symptomatically, some 184 Regional Trade Agreement (RTAs) were reported to the WTO by 2003, many of which related to regions resident in developing economies.

Obvious examples of regional powerhouses driving regional growth and integration include:

- The US in NAFTA;
- Brazil and Argentina in the Southern American Common Market (Mercosur);
- Japan and China in Asia (although non-members) in the Association of South-East Asian Nations (ASEAN);
- India in the South Asian Association for Regional Co-operation (SAARC); and
- Germany and France in the European Union (EU).

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Without own FTAs, regions are increasingly disadvantaged in global competition for capital and resources, while multilateral negotiations, which are skewed to favour developed countries, have made little progress in the so-called development (Doha) round of the WTO. At the same time, developing countries have begun to invest increasingly in their own regions – most of the FDI in Brazil, Chile and Colombia is derived from Latin American countries, while almost half of the flows in Asian developing economies is intra-regional.

This paper is divided into the following areas:

- An overarching, economic assessment of the global context in which regionalism has underpinned a role for regional powerhouses in the development of regions, as suggested by FDI trends and the specialisation in production between different countries;
- A discussion of trade agreements and trade blocs and how these underscore the role of regional powerhouses; and
- Consideration of a political model to explain the emergence of regional powerhouses and how this relates to economic factors, as well as consideration of non-economic factors promoting regional integration.

Research findings

Development typologies for regional powerhouses

A pivotal consideration in assessing South Africa's role in regional development is whether South-South relations (that is, developing country partnerships that supersede former colonial relations) are desirable. Based on the literature reviewed in this paper (see sections 4 to 6 of the full report), if the impact of political, trade and economic relations are scored on the basis of available evidence (see Table), a stylised typology suggests that, notwithstanding the drawbacks of South-South arrangements, benefits marginally outweigh costs.

Table 1 – Cost-benefit assessment of South-South relations

Impact	Political	Trade	Economic	Score
Positive	***	*	**	6
	Leverage in multi-lateral fora/ negotiations (G20)	Single-issue lobbying, especially surrounding reform of agricultural subsidies	Increasing levels of investment by regional multi-national corporations (MNCs) – may be less risk averse than other MNCs, encouraging greater levels of efficiency	
Negative	**	***	-	5
	Risk of a self-serving regional hegemon (e.g. India pre-1991)	May be sub-optimal (assuming old data)	May have lower environmental/social standards than other MNCs but a speculative position	

* *Some/emerging evidence* ** *Good evidence* *** *Strong evidence*

From this point of departure, a further debate ensues as to what model South Africa should consider in its regional relations in order to ensure an optimal development impact. While it is cautioned that no model should be replicated wholesale, either on the basis of differing contexts or as a consequence of specific drawbacks that have emerged over time, Latin America's experience of Brazil in Mercosur can be considered the most relevant for South Africa, taking into consideration:

- The level of institutional formality relating to Mercosur, allowing for negotiations and deliberations, unlike the multifarious and loose Asian arrangements;
- The range of institutional objectives (including security, political and economic considerations), as opposed to more restrictive economic models such as NAFTA's; and
- The limited extent of integration, contrasting with that the EU's "deep integration", given the absence of convergence between regional economies.

This is not to suggest that there is not room for improvement, especially in considering smaller country interests where Brazilian dominance may risk hegemony, but rather that it is the most apposite model for South Africa in contemplating its role on the Africa continent.

Table 2 summarises the variations between regional powers giving rise to this recommendation, as an example of a so-called "emerging middle power".

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Table 2 – Regional development models

Region and regional power	Original (and/or dominant) rationale	Development typology	Stage of development	Impact			Applicability to South Africa
				Trade	Investment	Political	
Asia – China India Japan	ASEAN – security, AFTA – economic stability	Ad hoc, with historical <i>de facto</i> domination by Japan	Weak, but strengthening to include sub-regional groupings around China and India	Surpassing other (extra-regional) trade partners and growing in the case of China and India	Significant, even countering global downturns/e xtra-r gional investment	Limited, bilateral arrangements more significant	Inadequate policy and institutional development
Europe – France Germany	Security of access to steel resources	Common market (EU with accession talks for peripheral countries)	Highly advanced in all aspects, expanding in Central and East Europe	Seamless within EU	High, especially in cost-competitive states anticipated to accede the EU	High level of institutional co-operation and joint policy making	Overly advanced – African economies lack institutional resources and economic convergence for emulation
Mercosur – Argentina Brazil	Security (specifically military tension between Argentina and Brazil)	Emerging middle power operating in imperfect customs union	Growing economic links, strong institutional arrangements	Growing, but mixed data on economic value in furthering optimal economic arrangements	High – especially by Brazilian MNCs	Strong – democracy “club rule” for entrance	<i>Most useful model</i>
NAFTA – US	Economic, opening up economic systems to comparative advantage (with some concern surrounding migration)	Dominant trade agreement imposing economic reforms	Advanced economic arrangements	Significant, some quota-jumping investment to enter common market which is sub-optimal for 3 rd parties	High, associated with cost-competitiveness in Mexico	Limited, not the primary focus of the agreement	Too limited in view of political and institutional challenges facing Africa

The Brazilian model of an emerging middle power which plays a constructive role in regional development, adopting a multilateral approach to foreign policy (see section 6 of the full report) suggests that South Africa should not only should accept its role as regional power, but also use it to leverage positive change in the region.

Economic integration and the role of a regional power

Regional powers and their role in the development of their neighbours should be understood as a function of a broader process of economic integration, implying both advantages and disadvantages which apply unequally across countries. The case for globalisation and liberalised economic integration is mixed, but also somewhat impractical in light of failures to reach multilateral agreements on investment, for instance at the WTO.

From an investment perspective, however, it is clear that globalisation presents both opportunities and threats arising from the specialisation of production, as typically harnessed by increasingly significant MNCs – both from developed and developing countries. It can be assumed from evidence on the outcomes of globalisation, however, that globalised production patterns tend to favour the more advanced developing countries, with a mixed outcome for countries across a region. For less developed countries, regionalism – affording some degree of protectionism – may be an attractive policy option.

At an aggregate level, regional economic integration, according to data on FDI flows, is increasingly significant, changing the geography of global investment. Furthermore, an alternative source of FDI flows in the context of closer South-South relations is evident. It is significant to note, however, that regional blocs are not necessarily that significant in ensuring *de facto* integration – it is rather bilateral investment treaties and regional MNCs, as evident in Asia, that play a role in furthering intra-regional investment. What is further apparent, from experience across regions, is that a regional power tends to be a significant source for investment flows, contingent of course, on an outward focus (which has been absent in the case of China and India until recently). This presence, however, is often channelled by MNCs, giving rise to concerns to the inherent impact of FDI and MNCs.

What does this mean for regional powers in fostering development in the regions in which they are resident?

Unilateral liberalisation by developing countries is increasingly apparent, and it is often regional powerhouses that first respond to improved investment conditions in their neighbours, an important signal to international markets.

But from a policy perspective, how do such investments overcome the pitfalls associated with international finance, especially if they are transacted by MNCs?

Regrettably there has been little analysis on the impact of an increasingly evident role of regional powerhouses, but it can be assumed that in order to ensure that intra-regional investment is beneficial for host companies, engagement with major MNCs will be an important tool for development. To this end, in the case of South Africa in its relations with the African continent, a voluntary code for major regional investors should be contemplated. Furthermore, there needs to be, at a policy level, consideration towards how seemingly structural domestic policies can enhance the

capital market credibility of the region – a responsibility which is already apparent in South African policy-making – if contagion effects are to be positive.

Trade integration and the role of a regional power

While there can be gains from RTAs, these are not assured and often weaker, less developed countries are at risk of becoming even poorer due to a RTA, as indicated by a divergence of per capita incomes between members. There is also empirical evidence that South-South RTAs do more harm than good, specifically because of significant trade diversion in member states. This suggests a division between popular sentiment supporting South-South relations and economic reality in the trade sphere. It is important therefore that South Africa thinks carefully about its role in existing and new RTAs, to ensure that membership of RTAs lead to gains and not losses.

It is clear from the case studies of regional dominance, however, that while prominent RTAs are dominated by regional powers, each region is unique. In fact, it seems clear that the RTAs in each region are structured to a greater or lesser degree taking into account the unique characteristics of that region. It is therefore difficult to generalise universal lessons based on this somewhat unique set of characteristics underlying a region's RTA. Having said this, while it is difficult to draw direct parallels between South Africa and other regions in a categorical fashion, it is possible to draw out some broad lessons for South Africa from the experience of other regions:

- A key theme emerging from the case studies is the use of a dominant position in the region to achieve a political goal. While it is well-documented that RTAs are embarked on to achieve the political goal of ensuring security in a region, dominant regional powers have also deliberately tried to keep RTAs weak to ensure their own regional dominance. Examples include Brazil in Mercosur and India in pre-1991 SAARC. However, there seems to have been a growing realisation that political and economic instability is in no country's interests, not only stunting the development of the region, but also resulting in spill-over effects leading to instability that undermines the position of a dominant country. The lesson for South Africa is that increased regional economic integration will lead to political stability and economic growth in the region and also economic gains at home. Arguably this philosophy is already apparent in NEPAD.
- However, the lesson of China and Japan as regional powers in Asia is that economic integration in a region does not necessarily have to flow from a formal RTA. In the case of South Africa, it is possible that a strategic role can be played in building the regional economy without embarking on further formal agreements beyond existing memberships or institutional frameworks.
- An assessment of RTAs dominated by developed countries (that is NAFTA and the EU) and their relevance to South Africa reveals inherent differences between the countries in these RTAs and South Africa, as well as the relationships between member countries and other countries. Although South

Africa can strive to emulate the deep integration of these RTAs (but only over the long term in light of the vast divergence of regional economies) as well as the associated depth of institutional development, it is also important that South Africa be aware of differing contexts.

- Beyond this, there is one very significant lesson for South Africa and other developing countries from the EU's experience. It seems clear that in cases of deep integration, such as the EU, power is far more balanced between members than it is in major RTAs surveyed in other key regions, which tend to be dominated by the most politically or economically powerful nation. The EU's balance of power is enforced through complex governance structures and decision-making bodies representative of all members, working towards regional interests. The lesson for South Africa is that perhaps the use of regional power should be tempered by the use of regional institutional mechanisms to provide regional integration, or by broader regional blocs that include Nigeria. Hence South Africa's role as the regional hegemon could be somewhat tempered through empowered and strengthened regional institutions, assuming that these can build a separate and credible identity.

While these experiences bear relevance to South Africa, perhaps the real lesson for South Africa from other regions lies in the need to structure an RTA (or any regional integration initiative) to reflect the region's best interests. The design of an RTA is key, and again South Africa should be wary of the examples of the many South-South RTAs that were not successful. Often open regionalism is put forward as an alternative to those RTAs that have failed. An important general lesson for South Africa from the previous generation of RTAs is that many of them failed, especially South-South RTAs, because they closed off a region and protected it from competition with the rest of the world. Any new RTA should not only be designed to ensure mutual benefits to all members, but also to minimise the effect the agreement will have on the interaction of the region with the rest of the world.

Political dimensions of regional integration and dominance

Globalisation and the need to respond at a regional or interest-aligned movement level have furthered the leadership as well as economic importance of regional powerhouses, providing an alternative to or at least balancing the locus of economic power to Northern partners. But as already raised by trade relations, regional patterns vary considerably. Furthermore, the role of institutions is often premised on non-financial considerations. That said, there is no assurance that all regional powerhouses will further democratic or governance principles in the regions that they dominate – this depends on the unique circumstances and history of a region, as well as the balance of power and interests that exist in that region.

It is important to consider, however, that for all its stigma, a regional hegemon's economic power (through trade, investment and regional projects) can be an important incentive to ensure compliance with the "club rules" of a region, in support of developmental objectives. President Mbeki's opening remarks at the Non-Aligned

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Mbeki's Durban Conference in 2004 seem to suggest a broad scope of operation for South Africa as a regional power. He highlights as priorities the following:

1. The challenge of poverty and under-development;
2. The continued challenge of peace and stability; and
3. The restructuring of the global exercise of power – this refers to political, economic, social and military power.

Mbeki continues to suggest that through a strengthening of South-South co-operation these challenges will be more realistically met (Mbeki, 2004). The role of a regional power, however, is inherently tempered with the sobering practicalities of self-interest and the need for each individual state to look after lobby groups, securing the best possible deal for their electorates. However, with the rise of the G20 and other developing country groupings, there is good reason to believe that a co-operative attitude among emerging powers, both regionally and between these regions, can have some effect on the global arena, especially with regard to single-issue causes. This effective pooling of sovereignty counters concerns that the role of the nation state is less profound in the globalised context. Arguably, South Africa, as somewhat of a spokes-nation for developing countries, possesses a disproportionate voice for its economic size and status.

While an “appointed” regional power may be the beneficiary of prestige and preferential agreements, for the most part it plays a role beset with the pitfalls, often demanding that leadership make stark choices that depend on the good will and political commitment of other partners in the region. It is important to note that this role may also require a degree of generosity in allowing less developed partners preferential treatment. South Africa's preferential treatment of neighbours is therefore a developmental contribution in diminishing the divergence of incomes arising from open markets.

The Mbeki government seems to have embraced a more idealist school of thought, one that encourages social development and good governance. This suggests that non-economic reasons are more pressing in the region than economic concerns (although political concerns, in turn, support long-term economic prospects). For this reason, the scope of South Africa's involvement expands beyond narrow trade interests and takes on the more complicated role of encouraging fundamental changes in the form of developmental priorities and programmes (as guided by NEPAD). To this extent, South Africa, despite the extensive experience of other regions, is likely to need to forge a unique path that balances national and regional political priorities with economic interests.

Common themes and issues for a South African research agenda

As with FDI, intra-regional trade is increasingly evident and indeed a reality of a globalised economy, requiring a national response to ensure optimal development for both a nation state and a region. This places considerable responsibility on South

African policy-makers, as a regional hegemon, to ensure that trade and investment policies support the political objectives of regional growth and development.

An example of apparent contradictions between these objectives lies in South-South relations. In theory, international trade suggests that trade on the basis of comparative advantage would partner richer nations with poorer, and not poorer with each other, undermining the hype surrounding South-South relations. Evidence (see section 5 of the full report) suggests that this has indeed been the case. This analysis of course takes the position of trade being a static process, locking countries into dependent development paths, and evidence to support this has been based on closed regionalism. Open regionalism presents a model whereby regional developing powers can diminish dependency on Northern partners by providing a dynamic set of complementary products and services for trade for neighbours.

Further focus on recent trade trends in SADC could assess whether regional relations can diminish dependence on Northern trade partners. This research could be pursued in conjunction/co-operation with SAIIA and/or TIPS.

South African policy-makers can also play a significant role in interrogating the micro-economic impact of South African regional FDI. This regional FDI clearly follows the international trend towards intra-regional investment, often prompted by MNC strategies.

*A key project to further the developmental impact of this investment could support the adaptation and advocacy of a code of conduct similar to that of the OECD's. This research could be pursued in conjunction/co-operation with **the dti** and/or the Edge Institute.*

Questions as to the developmental role of FDI arising from international experience to be considered by the HSRC project include an assessment of the extent to which South African FDI in the region facilitates positive outcomes.

Case studies need to consider whether South African FDI has led to:

- *Access to international markets and technology;*
- *Human capital formation;*
- *International trade integration;*
- *A more competitive business environment and enterprise development;*
- *Regional investment projects;*
- *Improved environmental and social conditions;*
- *Responsible corporate policies; and*
- *Investment capacity.*

In assessing these outcomes, it should also be considered *whether these effects vary between target countries* based on varying levels of education, technology, infrastructure, health and financial markets, and *whether these conditions can lead to negative outcomes of:*

- A deterioration in the balance of payments;

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- An absence of linkages with local communities;
- Harmful environmental impacts;
- Adverse effects on competition; and/or
- A loss of political sovereignty.

At a political level, however, it can be concluded that countries coalesce around issues and not regional groupings. The G20 is especially powerful in this regard (as evidenced by the latest lobbying around the selection of Director-General for the WTO), suggesting that geography needs to be understood in terms of hemispherical relations rather than smaller regions. For South Africa, the role of multilateral engagement on issues such as agricultural subsidies is therefore of key significance in furthering the issues of poorly represented regional partners.

A research question arising therefore is what issues get lost in the broader campaigns of debt relief, agricultural access and the reform of multilateral organisations?

*Another question lies in the nature of support of a regional role by South Africa's elite – **to what extent is the role of a regional hegemon feasible and/or desirable?** – a pre-requisite for any of the foregoing issues to take meaningful effect. This question would engage the different regional typologies (outlined in Section 1 of the full report), favouring the Mercosur model that allows for focus on a range of objectives through a well-defined institutional framework.*