



Making South-South trade an engine for inclusive growth

The rise of South-South trade

In the last three decades, there has been a steady growth in developing economies' share of world trade associated with successful outward-oriented growth strategies, particularly in East Asia. In 2006, total exports from the South reached \$4.5 trillion, accounting for 37 per cent of world trade, surpassing the earlier peak in 1950. A prominent feature of this unprecedented rate of trade expansion has been the growing importance of trade among developing countries, at a pace faster than the global average. In 2007, total South-South exports amounted to over \$2.5 trillion, 15 per cent of world trade, up from 11 per cent in 1995. Another prominent feature has been the emergence of large and fast-growing developing economies, notably China, as the principle trading partner of an increasing number of developing countries.

The depth and distribution of South-South trade have been very uneven across developing regions. A good deal of that trade is intraregional, involving a relatively small number of economies from East and South-East Asia (figure 1). In terms of trade expansion, however, Africa's exports to the South grew faster than for any other region between 1995 and 2005, although its share of total South-South trade is still under 5 per cent.

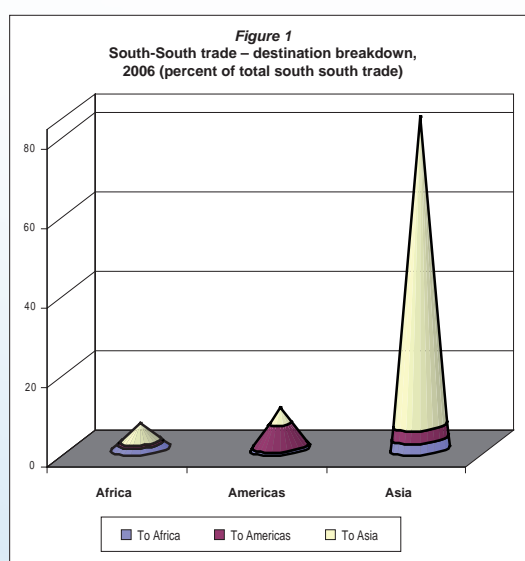
Two important factors behind these broad trends in South-South trade flows are worth noting. First, South-South trade has opened a "vent for surplus", allowing countries to take advantage of formerly underutilized factors to expand output. For example, this has been the case for primary exporters from Africa and Latin America.

Second, South-South trade has allowed East Asian economies to raise productivity through specialization gains, the exploitation of scale economies and learning opportunities associated with the spread of production networks in a small number of manufacturing sectors, most notably electrical and electronic goods, but also clothing and automobiles.

South-South trade and structural transformations

Differences in the composition of South-South trade among developing regions can be seen in figure 2, with manufactured goods dominant in Asia, fuels and other primary commodities dominant in Africa and a more mixed picture in Latin America, albeit with a primary sector bias. Moreover, this pattern appears to have been relatively unchanged over the period 1995–2005. These differences provide some scope for enhanced South-South trading opportunities. Indeed, primary commodity exports from Africa to Asia have been a prominent component in the recent expansion of South-South trade.

In an attempt to better understand the potential gains from South-South trade, recent research published by UNCTAD has drawn on a new concept of the "product space", which maps the varying degrees of linkages across industries in terms of the transferability of capabilities. On the assumption that learning to produce new and more sophisticated export goods depends on how connected is a country's existing "product space", it was found that South-South exports could provide commodity-dependent and low-income



Source: UNCTAD

¹ UNCTAD, South-South Trade: the Reality Check, 2009.

² Bailey Klingler, Is South South Trade a Testing Ground for Structural Transformation?, UNCTAD, Policy Issues in International Trade and Commodities Study Series No.40, 2009



countries with better export opportunities than their exports to Northern markets.

The general pattern is that the poorest developing countries tend to have higher relative South–South export sophistication and connectedness, but countries with higher incomes seem to have convergence in export sophistication by destination, with northbound and southbound exports exhibiting more equivalent levels of sophistication and connectedness.

For example, Guatemala’s leading southbound exports, such as pharmaceuticals and breakfast cereals, are relatively more sophisticated and connected than their dominant exports to northern markets, such as bananas, sugar and coffee. By contrast, Thailand’s exports to the South are not very different from its exports to the North, but the latter is relatively more weighted to sophisticated manufactures (such as electronics goods).

South–South trade and economic cooperation

Linking South–South trade to structural transformation will pose different policy challenges for different groups of countries. For African economies, South–South trade offers opportunities for diversification away from commodity dependence, and perhaps more so than their trade with the North. It also offers some middle-income economies in Asia and Latin American an opportunity to avoid getting stuck producing only relatively unsophisticated manufactured goods. Moreover, new opportunities might be emerging even for developing countries, which export higher value added, technology-intensive products.

The recent financial and economic crisis has forced Northern economies to undertake large-scale adjustments (at the household, government and national levels) and to correct the massive financial imbalances that have built up over the last few years. This has not only slowed down consumption and growth in these economies, but it has also exposed the dangers of relying too heavily on Northern economies as main trading partners. These developments suggest that Southern trade, as both a vent for surplus and a source of diversification and upgrading, might take on even greater importance over the coming years.

Expanding these opportunities will not, however, come automatically, but will depend on renewed cooperation among countries of the South. In this respect, South–South trade should not be approached as a stand-alone engine of growth, but part of a broader set of interdependent challenges involving investment, structural changes and technological upgrading. Three areas will, in particular, need careful attention:

• Market access.

Measured reductions in tariff barriers to South–South trade, particularly if this does not come at the expense of flows to the North, is an immediate policy goal. At the same time, closer cooperation will be required to address regulatory and logistical barriers.

• Policy space.

Greater South–South trade can provide both a vent for surplus and act as a source of structural transformation. However, in both cases, building strong and mutually supportive links between trade and investment depends on the provision of complementary productive capacities and institutional supports. Different combinations of macroeconomic and industrial policies and trade agreements will be needed to meet these challenges.

• Financial mechanisms.

Growing South–South trade will require monetary and financial cooperation to help manage any potentially damaging shocks, as well as provide stable and predictable financial flows, not just to facilitate trade, but also to help catch-up economies converge by supporting a rapid pace of domestic capital formation. But there is no one-size-fits-all approach. In some cases, the focus may be on exchange rate management and liquidity provisioning. In other cases, strengthening regional development banks, and in yet others, new and innovative forms of development assistance, including through triangular cooperation, might be what matters.

Closer economic integration among developing countries looks set to continue in the coming years. This provides opportunities and challenges for policymakers in the South. In particular, the development impact of that trend will depend on more than just the pace of trade and investment liberalization, but on how well longstanding policy challenges can be worked in to new forms of development cooperation that promote inclusive growth across the South.

