

South-South Cooperation through Investment – South African and Chinese Support to Development in Lesotho?

The 4th High Level Forum of Aid Effectiveness in Busan/Korea focused on defining a new paradigm for aid and development and to build a new, all-inclusive, development partnership, sparked by increasing involvement of emerging economies. Emerging economies are promoting an alternative development cooperation model in which economic transactions such as trade and investment play an important role. South-South Cooperation (SSC) has been often compared with the development aid traditional donors have been offering to developing countries for many decades. The emphasis has been thereby on the equivalent to aid. This risks neglecting the crucial role of trade and investment in SSC. This Policy Briefing is based on a study on the role of investment in SSC and, more specifically, the role of state agencies of emerging economies in ensuring that the investments of their nationals contribute to social and economic development in the host country.

South-South Cooperation (SSC) is often defined in contrast to the traditional aid from northern donors to southern recipients. Emerging countries such as China and South Africa, the two countries under study, are not prone to use the term “donor” and emphasise rather the – political – equality of their cooperation with developing countries and the “mutual benefits” of it. However, how different is SSC from North-South Cooperation besides the rhetoric? What are elements of a positive definition of SSC? Since aid is only a small part of SSC, it is not sufficient to only study the similarities and differences between the aid assistance from these emerging economies with official development assistance (ODA) from traditional donors. In the study of SSC, it is important to specifically include trade and investment, and focus on the meaning of the mutual benefits of the economic cooperation. In order to get a better understanding of the role of investment in SSC, this study looked at the role of Chinese and South African state agencies in promoting positive contribution to social and economic development in Lesotho.

The case study: Lesotho

Lesotho is also referred to as “the Mountain Kingdom”, situated in the Drakensberg in the midst of South Africa. Lesotho is a small country in Sub-Saharan Africa with few natural resources and a huge need for development – it is

listed amongst the least developed countries in the world. Being of high interest to South Africa and having diplomatic relations – and thus economic cooperation – with the People’s Republic of China, Lesotho is clearly a case of SSC. During the fieldwork, project sites were visited, and interviews were conducted with government officials and scholars in both Lesotho and South Africa.

This study aims at elaborating on two aspects of SSC: mutual benefits and the close relation between aid and investment. What is the role of investment in SSC and how is it ensured that foreign investment contributes to development in the host country?

SSC-investment here is defined as investment from countries that regard themselves as part of the global “South” (i.e. developing countries) – such as China and South Africa for example – in which state agencies from the country of origin of the investor are involved.

Investments from South Africa and China in Lesotho beyond state support

South Africa and Lesotho started a bilateral commission to identify joint projects that could be economically viable in Lesotho. Potential viable sectors identified by the commission were: tourism, agriculture, propriety and call centres. South African companies’ expressed interest in the

tourist industry in Lesotho, however, this did not result in investment by South African companies in Lesotho yet. Investors name at least two obstacles: Firstly, Lesotho's allegedly strict environmental policy and secondly, the government of Lesotho's reluctance to open this sector for South African companies for fear of South African dominance in the tourism sector.

Beyond any state involvement, both Chinese shops and South African franchisers are prominent in Lesotho's retail sector. Although many Basotho proudly point to the new shopping malls developed by South African investors and filled with mainly South African franchise brands, they express themselves much more critically about Chinese shop owners. According to interviewees in Maseru, Chinese investors were regarded as outcompeting local shops because of allegedly unfairly low prices. Chinese shops are indeed in the low price segment, not least because of their supply and distribution network with direct ties to China, constituting a serious competition to local retailers. Ethnic Chinese constitute less than 0.5 per cent of the country's population; yet, they have become a very successful business community in Lesotho and find themselves in public debate (box 1).

Both the Chinese and the South African governments do not create incentives for their national investors in the retail sector and apparently have a laissez-faire policy towards their national investors in the retail sector of Lesotho. Chinese officials in Africa state it as their task to urge Chinese investors to let the local community of the host country benefit as much as possible from their investments. Yet, the Chinese Economic Counsellor is not tracing every Chinese company operating in the country; in fact, numerous small companies escape the embassy's control. This makes the task of directing and monitoring investment as an element of SSC increasingly difficult and increases the chance of tensions arising between policies and some practice on the ground.

A distinction needs to be made between private investments – investments without any form of state involvement such as in the retail sector – on the one hand, and investment in the context of SSC, the latter usually with the involvement of

state agencies. Such a distinction is currently not (explicitly) made in the policies of South Africa or China.

Examples for SSC-investment with state support in Lesotho

South Africa

Water resources are an important interest of South Africa in Lesotho. Consequently, the Lesotho Highlands Water Project is a key example for SSC-investment. The potential of the water reserves in the highlands were recognised and subsequently developed since the 1950s. The South African authorities were not involved from the beginning, but the drought of the 1970s in Southern Africa changed interests. In order to meet the increasing demand for water in what is now Gauteng province, the South African authorities got involved in the development of water dams in Lesotho. In 1986, South Africa signed a deal for a multi-billion Rand water resources development and management initiative. In order to manage this project, a joint commission between South Africa and Lesotho – the Lesotho Highlands Water Commission (LHWC) – was established. For the use of water, the South African government pays Lesotho royalties consisting of two components: a fixed component and a variable component depending on the quantity of water transferred to South Africa. The monthly Royalties paid to Lesotho's government are on average between R35 – 40 million.

According to the agreement, the Lesotho government had the first say in appointments of 50% of the contractors of this particular project. All tenders were issued from Lesotho. At the individual level, this presented an opportunity for Basotho engineers to work with international engineers, thereby qualifying for later work with South African companies.

A second example of SSC-investment from South Africa in Lesotho is the lending of about ZAR 740 million to Tsepong, a public-private partnership (PPP) consortium, to construct, upgrade and operate a new public hospital at Bots'abelo, in Maseru. The finance came via the Development Bank of Southern Africa (DBSA). Tsepong is a public-private partnership (PPP) consortium led by South Africa private hospital and healthcare group *Netcare*, consisting of Netcare and Bloemfontein-based specialists and general practitioners

Box 1: Public debate over Chinese investment in Lesotho

Press Officer Song Ying of the Chinese Embassy in Lesotho wrote a letter to the Lesotho newspaper *Public Eye* that was published on 30 September 2011 under the title "China Not Colonising Africa" in response to a reader's letter in the same newspaper entitled "Poverty-Made in China?". The reader accused the Chinese for creating poverty in Lesotho and flooding the market with cheap textile products thereby killing Lesotho's own textile industry. In this letter Song takes a market-liberal stance and states that: "The consumers are no fools but the best judges. They know the rule of the market well. No one is forcing anyone to buy products he doesn't like" (Song, 2011). The involvement of foreign investors in the retail sector is publicly debated, especially in having small shops, because that is what the Basotho can do themselves. Many Chinese and South African retailers source their products from their home country. The government of Lesotho is calling on retailers to source products such as eggs and milk locally. The Basotho government thus communicates directly with the investors and does not involve the Chinese and South African representative offices.

Box 2: China's and South Africa's institutional arrangement for SSC-investment

	China	South Africa
Export-credit insurance	SINOSURE China's only policy-oriented insurance company specialising in export credit insurance	Export Credit Insurance Corp., ECIC an initiative of the Department of the Department of Trade and Industry (DTI); offers political risk cover
Concessional loans	EXIM Bank involved in all Chinese government's soft loans; aimed to contribute to development of China and also active abroad, including in Africa; financed by the Chinese government	DBSA aimed to contribute to development of South Africa and the Southern African region; raises capital by approaching potential investors
Taking up higher-risk funding projects to encourage national companies to invest abroad	CADFund designed to "increase investments by Chinese enterprises in Africa, promote economic cooperation between China and African countries, and realize mutual benefits" (CADFund website); it, however, mostly supports the Chinese private sector. Any impact on development in the host country is indirect.	Industrial Development Corp., IDC designed to promote regional economic growth; mostly active within South Africa, it is also expected to play an important role in promoting international development cooperation and outward investment

investment company Afri'nnai, as well as Lesotho-based specialists and general practitioners investment company Excel Health, the investment arm of the Lesotho Chamber of Commerce, D10 Investments and a Basotho women's investment company. The hospital was part of the Lesotho government's health sector reform programme. The new hospital has more than double the number of patients based on the same budget as its predecessor. It is a public hospital and patients pay only a small fee.

China

Most of Chinese SSC-investment to Lesotho can be found in healthcare and infrastructure. Chinese finance in health, however, is mostly aid: Sending medical teams to other developing countries is an important component of China's foreign aid. The first medical team to Lesotho was sent in 1997 and is replaced every two years.

Examples of investment in Lesotho's infrastructure financed by the Chinese state are: a new parliament building, a National Convention Centre, Butha-Butha Industrial Park, a National Library and Archives, and two rural secondary schools (the latter being commitments through the Forum for China-Africa Cooperation, FOACAC). Rumours abound in Lesotho as to returned favours to Chinese actors for their investment. The fact that these stories circulate indicate a lack of trust – and a lack of communication on what is, in fact, done.

At times, Chinese companies are involved in the construction of roads and dams, but work is funded by other sources, i.e. these are not 'Chinese projects'. For example the planned construction of the Metolong Dam, to be executed by Chinese Sinohydro, is funded by the government of Lesotho, the government of South Africa, the World Bank, the Millennium Challenge Corporation and the European Investment Bank. In the past, Chinese firms involved in

similar projects have been accused of not providing enough opportunities for local workers by bringing too many Chinese staff. In these projects in question, no Chinese state agencies were involved; they were purely business activities.

The mix between commercial and state-sponsored activities begs the question of the role of state agencies in ensuring that these investments contribute to development in the host country.

Policies and the role of state agencies

In its SSC with Africa, and particularly with regard to the investment element, China reverts to two institutions, the China-Africa Development Fund (CADFund) (see box 2) and China Export-Import (EXIM) bank. CADFund is not active in Lesotho; this analysis of the case study is therefore limited to the role of EXIM bank.

China EXIM bank is involved in all Chinese government's soft loans. The framework agreement giving the terms of the loan is always intergovernmental, signed by a representative of the Ministry of Commerce (not EXIM bank) and, most of the times, the Ministry of Finance from the African side. All loans from EXIM bank come directly from government; therefore, the projects need to be in line with the government's policy. EXIM bank sends in teams that consult with the local Chinese embassy on the assessment of a project. A criterion in the subsequent feasibility study is whether the project assists the host country's development. Both the Chinese Embassy and the Commercial and Economic Counsellor's Office are meant to coordinate and monitor these projects and report possible misconduct by a Chinese company to Beijing, where a decision is taken on the repercussions for the respective company. While EXIM Bank's English website states that its loans are tied, EXIM bank office in

Johannesburg argues that no such strict stipulations are in place, as two governments negotiate the terms of the loan.

South Africa's cooperation explicitly aims at economic viable and political stable neighbours in order to keep the region politically stable; develop new markets for national companies; and to put a halt to the migration flows to South Africa. The institutional arrangement concerning the promotion of international development cooperation and outward investment of South Africa shows some communalities with that of China.

The role of the DBSA is in some regards similar to that of EXIM bank. Both DBSA and EXIM bank are state-owned enterprises (SOEs) and are set up to contribute to development of their own country; they are also active in (other) African countries. EXIM Bank and DBSA share the common goal of creating a market for companies from their respective nations. However, while EXIM bank is financed by the Chinese government, DBSA has to raise capital by approaching potential investors. DBSA is a not-for-profit organisation, using project profits to build up a small development fund which can be used to cross-subsidise projects that are less economically viable. Practice between South Africa and China apparently differ with regard to tying of aid. State agencies from both countries express a rather orthodox understanding of sovereignty, i.e. matters beyond their interference.

Conclusions

Chinese and South African investment to Africa may have an indirect positive contribution to development in Africa. Whether or not this materialises is to a large part dependent on the attitude, policies and enforcement of law of the host country. This statement is in line with the non-interference policy of the Chinese government and follows the argument that development needs to build on investment rather than aid. Yet, it is a difficult statement if SSC investment is meant for development.

Corporate Social Responsibility and Public Diplomacy are currently much discussed topics in Chinese policy-circles. But how much are officials able and willing to incentivise companies to invest in *the development* of host countries?

The term *mutual benefits* emphasises that SSC is not about providing altruistic aid, but about making a deal that is also beneficial for the investor. The debate remains open on how long-term benefits can or should be and how to strike the balance between investors and the host country. While the citizens of Gauteng – through this cooperation – have

access to sufficient fresh water and pay less for it than they would have done if the project would have been developed in South Africa, benefits to Basotho populations is less direct. The debate is often uneven, as local losses are counted against national gains. The Basotho residents of the project had to move and were not be able to use the river in the same way as they were doing before, because the amount of water downstream had dramatically decreased. They are compensated by the South African government, and the project created jobs for locals during the construction phase. Furthermore, the government receives royalties that can be used for social and economic development in the country. The debate will ultimately have to be political, as there are no technical solutions to striking a balance between groups in development. Even in a business-like understanding of cooperation and with a clear hands-off policy, actors in SSC are supported by states. It is thus important that the deals with all foreign investors are transparent in order to allow citizens of host countries to exert their right to hold governments accountable. Key elements to consider in SSC are:

- ♦ Both China and South Africa should make the distinction between private investments and SSC-investments in their policies. They should only claim control over SSC with other countries where it is exercised;
- ♦ State agencies involved in foreign investments should be open and transparent about the terms and conditions of their deals with other governments so that citizens in the host countries can hold their governments responsible;
- ♦ South African and Chinese embassies and Chinese Commercial and Economic Counsellor's Offices should systematically survey the impacts of Chinese/ South African investment to the local society, economy and environment. *Mutual* benefit implies benefits for both sides; more needs to be done to assure the benefits for the other side; otherwise activities are mere investments rather than SSC;
- ♦ African government officials and civil society representatives for their part should also monitor the aspect of *mutual* benefits. For negotiations, it is important to consider how the benefit of the cooperation is distributed in order to ensure long-term benefits and better development results.

Sanne van der Lugt

Research Analyst
Centre for Chinese Studies
Stellenbosch University



Contact Us

Centre for Chinese Studies
Stellenbosch University
PO Box 3538
Stellenbosch
South Africa

Tel: +27 21 808 2840
Fax: +27 21 808 2841
Email: ccsinfo@sun.ac.za
Web: www.sun.ac.za/ccs
Twitter: CCS_STELL

About Us

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