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A Perspective on Common Industrial Policies for the Member States of the Southern African Customs Union

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Introduction

The Southern African Customs Union (SACU) is a customs union, as defined by having regional free trade behind a common external tariff (CET). This creates a common customs area covering the markets of Botswana, Lesotho, Namibia, South Africa and Swaziland (BLNS). Contrary to the conventional model of a customs union, SACU is also an excise union. Furthermore, with the exception of Botswana, the member states are also organised in the Common Monetary Area (CMA) which effectively integrates Lesotho, Namibia and Swaziland into the South African money and capital market. In the model of linear regional integration, SACU would represent a good example of variable geometry.

The paper addresses the use of industrial policy as a means of encouraging the economic development of SACU member states, the smaller and economically less developed countries in particular. The topic is not only relevant because SACU is a customs union of developing but unequal economies but also because the SACU Agreement of 2002 specifically requires the member states to develop common industrial policies. This makes a close consideration of the rationale and nature of SACU industrial policy a policy and legal imperative.

The way in which SACU currently operates and the challenges the customs union faces in terms of designing and implementing an appropriate industrial policy are intimately linked to the unique nature of SACU and of its development since its establishment early in the twentieth century. To explain this uniqueness the paper commences with a brief overview of the salient developments in the history of SACU with an emphasis on facet of industrial policy followed, in consecutive sections, by a discussion of industrial policy and development strategy in the common customs area.

2. SACU History

The 1910 Agreement – the early years

In 1910 the Cape Colony, Natal, the Orange River Colony (the old Republic of the Orange Free State) and the Transvaal were joined together as the four provinces of the Union of South Africa. This gave birth to South Africa as a country. However, the Union included only these four out of a larger group of British controlled territories.

Before the Union, different customs arrangements existed between these territories. An important development that preceded the Union, and the developments that this necessitated, was the adoption in 1906 of the South African Customs Union Convention.[1] This agreement created a customs territory consisting of the Cape Colony, Orange River Colony, Transvaal, Natal, Southern Rhodesia, North-Western Rhodesia, Basutoland, the Bechuanaland Protectorate and Swaziland. All these territories, with the exception of the Cape and Natal, were landlocked and thus depended on the harbours of the latter two for trade and imported supplies. Customs arrangements, therefore, were a prerequisite for commerce in the region.

Formation of the Union required a major realignment of customs affairs. On 1 July 1910 two customs agreements came into operation. An agreement was concluded between the Union, Southern Rhodesia and North-western Rhodesia providing for the remittance of duties collected on goods in transit to the importing territory, subject to a 5% collection charge. A second agreement established the Southern African Customs Union, the subject of this paper, between the Union of South Africa and the territories of Basutoland, Swaziland and the Bechuanaland Protectorate. The colonial heritage of SACU is clearly reflected in the fact that Lord Gladstone was the only signatory of the agreement, signing four times in his capacity as Governor-General of the Union of South Africa and as High Commissioner of the other three members, referred to as the High Commission Territories (HCTs).

The 1910 SACU Agreement (SACUA) provided for a duty-free flow of goods between contracting states. The common external tariff was a basic *ad valorem* rate of 15%. The revenue generated was administered by South Africa and distributed among the member countries on the basis of fixed

[1] Prior to the establishment of the Union of South Africa, the term 'South Africa' as used in the sense of the Customs Convention was merely a geographic indication and not the name of a country.

percentage shares determined by an estimate of the customs and excise duty content of imports into the HCTs during 1906-8. The shares calculated for the HCTs, which were specified up to five decimal points, left South Africa with 98.7% (rounded) of the revenue pool. The respective HCT shares remained unchanged until 1965 when it was adapted at the cost of Basutoland and substantially in favour of Swaziland and marginally in favour of Bechuanaland.

Tariff management was a task undertaken solely by the South African government. The CET of SACU was actually the South African import tariff. An important factor in this respect is the use South Africa made of the tariff by departing from the basic rate to selectively protect domestic industries. This was done in terms of a strategy of import-substituting industrialisation that, as a distinct government policy, dates back to 1925. This strategy contributed significantly to the industrialisation of South Africa.[2]

The history of SACU up to this point illustrates a number of points that define its uniqueness:

- The customs union was the creation of a colonial dispensation to cope with a number of separate British entities being locked into an economically interdependent region. To a certain extent it could be described in its early years as an interim arrangement since the British government accepted that in the long run it would be impracticable to govern the HCTs from London and hence anticipated their incorporation into the Union.[3]
- The 1910 SACUA was solely a revenue-distribution mechanism that allocated revenue on the basis of fixed shares derived from the distribution of trade flows at a specific point in time. With the exception of the 1965 adjustment no provision was made for any changes over time.

[2] See McCarthy (1988).

[3] The British government suggested to the National Convention convened to design the constitution of the Union, that the constitution should empower the British government to transfer the HCTs to the Union at an unspecified future date, but subject to conditions provided for in the constitution to protect the African inhabitants. Consequently, a section was inserted in the constitution that empowered the King to issue an order-in-council that would transfer the HCTs to the Union, which would subsequently rule the territories subject to conditions specified in a schedule to the constitution. The drafting of the schedule was controversial and led to disputes between the British Government and the National Convention and again between the British Government and the South African delegates who went to London in 1909. But the contents were never implemented and as Leonard Thompson pointed out, when the Union became a sovereign state through the Statute of Westminster, 1931, and the Status of the Union Act, 1934, the schedule ceased to have any legal significance. See Thompson (1971: 343)..

- SACU clearly was not the outcome of a proactive and planned effort to establish an integration arrangement of independent nation states. It was purely a pragmatic arrangement to deal with a colonial regime that reigned in Southern Africa.
- The SACU tariff, managed by South Africa, became an instrument of industrial policy, designed and implemented to meet the industrial development objectives of South Africa.

The 1969 SACU Agreement – dealing with BLS independence

When the HCTs became independent in the second half of the 1960s a need arose for a re-assessment of the SACU Agreement, the outcome of which was the 1969 SACUA. The agreement was concluded on 11 December 1969 and came into operation on 1 March 1970.[4] In the negotiations that led to the 1969 Agreement, independent Botswana, Lesotho and Swaziland (BLS), in contrast to the pre-independence official British view, were particularly concerned that they were not getting a fair share of customs union revenue (Landell-Mills 1971). They were persuaded to hold these views by the growth in their economies and consequently in their imports and by the fact that the fixed percentage shares in revenue under the 1910 Agreement did not compensate for the effects of trade diversion that arose from the protective tariff designed to serve South African industrial development. The SACU tariff in effect represented the subsidisation of South African industry by BLS consumers and simultaneously restricted the fiscal and industrial policy sovereignty of BLNS. Further urgency was given to the revenue issue by the unilateral introduction in South Africa of sales duties as an important source of indirect tax, which, because of close trading ties developed over many decades, could not be avoided in BLS at a reasonable administrative cost.

In its preamble the 1969 Agreement highlighted as objective the maintenance of free trade behind a common external tariff. However, it was envisaged that free trade within the common customs area would be managed in a way that would 'ensure the continued economic development of the customs area as a whole, and to ensure in particular that these arrangements encourage the development of the less advanced members of the customs union and the diversification of their economies, and afford to all parties equitable benefits arising from trade among themselves and with other countries'.[5] Asymmetry in development was anticipated, with industrial development

[4] The revenue-sharing formula, which will be discussed below, was implemented retroactively from 1 April 1969.
[5] Republic of South Africa, Customs Union Agreement between the Governments of South Africa, Botswana, Lesotho and Swaziland, *Government Gazette*, No. 1212, 12 December 1969, p. 9.

concentrating in the high-growth metropolitan areas of South Africa because of the forces associated with cumulative causation.[6]

In its intention at least, it can be said that the 1969 Agreement embodied a spirit of an industrial policy for the customs union as a whole. But from an industrial policy perspective the agreement and the management of the customs union, it could be argued, were flawed, first through problems that were inherent to the structure of the agreement and its implementation and second through operational problems like time lags in the distribution of customs union revenue and issues concerning customs procedures and control measures. In reviewing the development of SACU from the perspective of industrial policy it will suffice to highlight the problems contained in the design of the agreement and the management of the customs union.

First, under the 1969 Agreement the CET remained the South African tariff, managed by South African authorities primarily in the interest of the South African economy. The same applies to excise duties. Although Article 5.1 of the1969 Agreement specified that South Africa 'shall give the other contracting parties adequate opportunity for consultations before imposing, amending or abrogating any customs duty…', consent of the other parties was not required and decisions and implementation were not withheld pending a response from BLNS. Article 5.2 furthermore obviated the need for consultations on interim measures to protect an industry, pending a full investigation by the South African authorities. South Africa could in terms of the 1969 Agreement change tariff levels unilaterally.

This situation was at the heart of the argument that SACU was undemocratic. As Schiff and Winters (2003: 85) put it: 'In the most hegemonic of customs unions, SACU, South Africa simply decided trade policy and compensated the smaller countries for the costs it imposed on them'. The compensation will be discussed below; at this point it needs to be noted that since a customs union is defined by having a CET, it follows that it must also have 'a trade policy that is common in all

[6] Kaldor (1970: 340) in his classic paper referred to cumulative causation in the following words: '(It) is nothing else but the existence of increasing returns to scale – using that term in the broadest sense – in processing activities. These are not just the economies of large-scale production, commonly considered, but the cumulative advantages accruing from the growth of industry itself – the development of skill and know-how; the opportunities for easy communication of ideas and experience; the opportunity of ever-increasing differentiation of processes and of specialisation in human activities'.

respects' (Schiff and Winters 2003: 82).[7] This allowed South Africa, although a member of a customs union, the freedom to adopt SACU tariff policies that were in line with its own particular industrial development objectives. However, a trade-off could exist between using the tariff as an instrument of trade and industrial policy and the role that tariff has as a source of revenue, which in developing countries is more highly regarded than in developed economies. Depending on price elasticities of demand, an increase in tariffs could generate more customs revenue, while a lowering of tariff levels would tend to lower revenue.

This potential trade-off became a contentious issue in SACU where under a regime that had South Africa as the sole arbiter of tariff policy a second problem arose, namely the different perspectives that exist on the role of the tariff. South Africa regarded, and still sees, the tariff as an instrument of industrial policy. Earlier, the tariff was used as instrument to encourage selectively import-substituting industrialisation but since 1994 the South African government for many years has been committed to lowering the tariff, whether within the World Trade Organisation (WTO) system of multilateral trade liberalisation,[8] or through preferential trading arrangements.

BLNS have maintained a different view of the tariff, seeing it in the first place as an important source of government revenue. The irony is that under the earlier regime of protective tariffs a BLNS complaint raised with vigour was the trade-diverting effect of the tariff and the welfare cost this had for their consumers. Because of trade liberalisation this argument lost some of its force. Concern could now have shifted to the impact of liberalisation on the pool of customs revenue, but apprehension was restrained because under the 1969 Agreement's revenue-distribution formula BLNS were guaranteed a minimum rate of revenue return on imports and dutiable consumption and production. Payments to BLNS were enhanced by a multiplier factor in the revenue-distribution formula, stabilised in a way that guaranteed BLNS a 17% revenue rate.[9] The multiplier was justified

[7] The reference here is to 'trade policy', but it will be argued below that it can also be interpreted as industrial policy in the sense of the tariff, conventionally seen as an instrument of trade policy, being used to influence the allocation of resources, which simultaneously makes it an instrument of industrial policy. A preliminary conclusion can therefore be made that a CET that requires a 'trade policy that is common in all respects' implies an industrial policy that is common in all respects.

[8] Between 1988 and 2001 the weighted mean level of the SACU tariff for all products declined from 12% to 5.6% and for manufactured goods from 9.5% to 5.8% (World Bank 2005).

[9] The revenue-sharing formula was used to calculate revenue shares for the BLNS countries, with South Africa's share determined as the residual. The formula provided for a nominal 42% enhancement of the smaller countries' share of customs and excise revenue, but since 1975/6 the introduction of a stabilised revenue rate (the rate of revenue earned

as being compensation for the monopoly that South Africa enjoyed in deciding on trade policy and for polarised development because of being part of a common customs area with a much larger and more developed economy. However, BLNS maintained that there was no proportionality between the distribution of costs and benefits between South Africa and BLNS. As the much larger and more industrialised economy, South Africa benefited from the growth that accrued to its protected producers while BLNS only experienced welfare losses suffered by their consumers that were not adequately compensated for by revenue transfers. Of course, South African consumers also suffered welfare losses from having to pay higher prices for protected, domestically produced goods, but as a society it at least had the benefit of the output and employment growth of the protected industries.

In addition, the 1969 SACUA provided BLNS with the ability to protect their industries against competition from established South African firms and in doing so to encourage the growth provided for in their development strategies of diversifying growth through industrialisation. Exemption from the requirement of free trade within the SACU area allowed the smaller member states to protect industries designated as infant industries (Article 6) or as of special interest to their economies (Article 7).

In order to gain perspective on the challenges that SACU currently faces in managing the customs union as a multinational arrangement and specifically in addressing the industrial development of the common customs area it will be useful to raise a politically sensitive issue that is difficult to substantiate factually. Much can be made of the fact that South Africa has managed SACU in the interest of its particular industrial development objectives, leaving BLS initially and since 1990 also Namibia to benefit from compensatory revenue transfers. As discussed earlier there was no question of collectively managing the customs union as an entity with its own supranational institutions, especially with respect to the determination of the common external tariff. Earlier it was noted that Schiff and Winters (2003) referred to SACU as 'the most hegemonic of customs unions' and that 'South Africa simply decided trade policy and compensated the smaller countries for the costs it imposed on them'.

What comes to the fore when the *realpolitik* of the situation is considered is the possibility that the arrangement politically suited BLNS. Apartheid South Africa was a pariah state, especially in Africa,

on imports and excisable consumption) around a target level of 20%, within a band of 17% at the lower end and 23% as the maximum, the 1.42 multiplier was effectively done away with.

and BLNS – all closely integrated into if not dependent on the South African economy – in all likelihood preferred to avoid close customs union relations with South Africa. In a sense SACU membership for BLNS represented a 'necessary evil'; they had to cope with the reality of economic interdependence while benefiting from revenue transfers without being true partners in managing the customs union. South Africa, in turn, could in a politically hostile environment enjoy a formal arrangement with four independent African states and access to their growing markets while simultaneously pursuing a tariff policy to suit its development objectives as a relatively large and industrially the most advanced African economy.

Explaining the longevity of SACU

From 1910 until 1994, SACU had to deal pragmatically with small national entities that were locked into an integrated economy with the much larger South Africa whose political system until 1994 isolated the country internationally and in Africa in particular. How does one explain the survival of SACU as an integration arrangement, while so many others have failed? Before addressing the 2002 Agreement as the next step in the development of the customs union, this is an important question to address. Two prominent reasons for the failure of regional integration arrangements could help in finding answers to the question. These concern inadequate ways of dealing with, first, the existence of economic asymmetries and consequently the unequal distribution of the benefits of integration, and second, the reluctance of member states to sacrifice control over economic policy, i.e. policy sovereignty, to a regional body (McCarthy 1999).

In the case of the 1969 Agreement the implicit and explicit understanding was that the BLNS would sacrifice important elements of their control over fiscal and trade policy to South Africa who in practice managed these affairs as if BLNS were part of the South African economy. In exchange for this and as compensation for the polarisation effect inherent in being part of a customs territory dominated by a much larger member, BLNS received the beneficial payments built into the revenue-distribution formula. The issue of whether the compensation was adequate or not does not detract from the fact that leaving the affairs of SACU for South Africa to manage, in effect served as a substitute for designated SACU bodies that would have been required to act on behalf of the member states in the common interest of the customs union. A central theme of the paper is that this system of customs union management had evolved historically and was deeply embedded in the

colonial experience of the region and in the subservient position of BLNS. It could also be speculated that after independence this system was a pragmatic and at-arms-length way for BLNS to contend with the politically embarrassing situation of being in a customs union with apartheid South Africa.

Clearly, this arrangement could not be durable in the long run, especially where the 'long run' has brought about a democratic South Africa with whom BLNS could, without hesitation and qualification, associate politically. Hence, one of the first priorities of the SACU members following the political transition to democracy in South Africa was to renegotiate the SACU Agreement, a lengthy and apparently arduous process that culminated in the adoption of a new SACUA in 2002.[10]

3. The 2002 Agreement – collective management of a multinational institution committed to the development of common industrial policies

The outstanding feature of the 2002 SACUA is that the member states set out to establish institutions and operational procedures that are necessary to collectively manage the customs union. Of great importance also was the introduction of a new revenue-distribution mechanism and the provision in the 2002 Agreement for common policies. As far as the latter is concerned, for the purpose of this paper, Part Eight and specifically Article 38 on Industrial Development Policy are highly significant, with links to the SACU institutions and even the revenue-distribution mechanism as will be become clear below.

Since the focus of the study is SACU industrial policy, the discussion in this section will turn the spotlight on this element of the 2002 SACUA, commencing with a review of the relevant clauses in the agreement as an introduction to a subsequent analysis of the broader aspects, challenges and principles that come into play. The argument that will evolve is that a desire for common industrial policies, against the background of the unequal nature of member state economies, calls for deeper integration than trade arrangements. However, the various elements of variable geometry that already exist in SACU as far as labour and financial markets are concerned could be a catalyst for deeper integration, although the politics might prove difficult if not impossible.

[10] The Southern African Customs Union Agreement between the Governments of the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland, 2002.

Commitment to common industrial policies

The 2002 SACUA can be described as a framework agreement, that is, an agreement that defines parameters for the operation of the customs union and a number of agreements on intentions or objectives that will require further deliberations on operational issues that are to be incorporated in annexes to the agreement. One element of these objectives is found in Part Eight of the SACU Agreement that deals with Common Policies. Article 38 on Industrial Development Policy stipulates the following:

1. Member States recognise the importance of balanced industrial development of the Common Customs Area as an important objective for economic development.
2. Pursuant to paragraph 1, Member States agree to develop common policies and strategies with respect to industrial development.

In interpreting this article in an exegetical sense would lead to the following inferences:

- Balanced industrial development can refer to sector developments and to the objective of having an economy that is fairly diversified and not dominated by a single or very few industrial sectors, be it mining or within manufacturing, a subsector such as clothing and textiles. However, considering the unequal distribution of industrial activity between the member states, and cognisant of the statement in the Preamble to the Agreement that member states are 'mindful of the different levels of economic development of the Member States and the need for their integration into the global economy', as well as the objective recorded in Article 2 (e) 'to enhance the economic development , diversification, industrialization and competitiveness of Member States', it is unmistakable that 'balanced industrial development' refers to the objective of balance among member states, and specifically the objective of encouraging the industrialisation of the smaller member states.

- Industrial development is seen as the development primarily of the manufacturing industry in an economy likely to be dominated by activities in the primary and tertiary (services) sectors of the economy. The ambit of the concept can be broadened to include the other branches of secondary industry, thereby also including construction, electricity, gas and water. However,

from a development-policy perspective the emphasis falls on manufacturing, which will include processing activities such as adding value to agricultural commodities and minerals.

- Economic development and economic growth are closely associated but have distinct differences in meaning. Whereas economic growth refers to the growth in output/real income over time and the forces that make this happen, economic development refers to structural change in the economy and the creation of dynamic comparative advantage, the sustainability of the growth process, and the distribution of the benefits of economic growth.[11] Identifying economic development as an important objective for SACU would mean that 'economic diversification through industrialisation' must be the force through which balanced growth in the common customs area is to be sought.

- The member states agree 'to develop common policies and strategies with respect to industrial development'. The way this is formulated implies movement towards the adoption of common policies and strategies and can reasonably be assumed not to be something that will occur immediately or in the short term. This interpretation can also be read in the final objective listed in Article 2 of the 2002 Agreement, namely 'to *facilitate* the development of common policies and strategies' (Emphasis added).

- Difficulties may arise in interpreting what the 'common' in common policies means. It will be argued in the course of this paper that the term cannot logically or in rational terms refer to developing identical or similar policies. Adopting the latter route will recognise neither the differences in potential comparative advantage that each of the member states has nor the fact that each member state starts from a different level of development and economic (market) size.

Having interpreted the meaning and the explicit and implicit intentions of Article 38, important questions need to be addressed. The first is the more general issue of the role that regional integration can play in supporting industrial development, a question that needs to be addressed against the background of the nature of SACU as an integration arrangement of unequal member states. A subsequent question is the following: why must the SACU member states develop common

[11] In the words of Adelman (Undated): 'Economic development, as distinct from mere economic growth, combines: (1) self-sustaining growth; (2) structural change in the patterns of production; (3) technological upgrading: (4) social, political and institutional modernization; and (5) widespread improvement in the human condition'.

policies and strategies for industrial development? The answer to this question has two dimensions: first, an operational reason and second, a broad development consideration. But these questions can only adequately be addressed once a clear perception exists on the definition and policy reach of industrial policy and of the challenges that exist in SACU as an integration arrangement of unequal partners.

Definition and parameters of industrial policy

How does one define 'industrial policy'? This question is pertinent when the geographic distribution of industrial activity within the SACU region is considered and particularly when attention is given to the operational aspects of designing and implementing an industrial policy for the common customs area of a group of sovereign states.

Describing the parameters of industrial policy can lead to a lengthy discussion on the different views that exist in this regard, especially if one starts considering 'industrial' in a narrow or a broad sense. For the purposes of this paper it will suffice to use the working definition provided by the World Bank as 'government efforts to alter production structure to promote productivity based growth' (quoted in Pangestu 2002: 149). One can expand this description by noting that industrial policy, in seeking to alter the production structure to a more productive level, represents an exercise in microeconomic intervention in allocating resources from less to more productive use. This interpretation is implicit in the definition of Pack and Saggi (2006): '… industrial policy (is) any type of selective government intervention policy that attempts to alter the structure of production in favour of sectors that are expected to offer better prospects for economic growth in a way that would not occur in the absence of such intervention in the market equilibrium'.

These definitions are sufficiently precise to establish a common understanding of regional industrial policy. It also allows some broad inferences. First, industrial policy refers to interventionist action by governments. Second, it is a facet of applied microeconomic policy since it seeks to have an impact on the allocation of resources in the region's economy. Third, the objective of the intervention is to reallocate resources from less productive to more productive use in an equitable fashion. To these inferences may be added the general understanding that industrial policy has the ultimate objective of encouraging diversifying and equitable growth through industrialisation.

Considered within the context of a regional integration arrangement, the defining feature of industrial policy as government intervention to bring about a reallocation of productive resources shifts the focus to a delicate and problematical issue, namely the allocation of resources among sovereign states, each with its own national government that to an important extent will have to sacrifice policy sovereignty. But not only is the policy space of national governments restricted; agreement must be reached on regional development goals, the instruments to achieve these and on the institutional arrangements necessary to collectively implement the policy and monitor its progress. The importance of these factors for SACU industrial policy will become apparent as the narrative of the paper unfolds.

The goal of industrial policy, as interpreted in this paper, is industrial development in the sense of manufacturing growth, which, as noted earlier, is clearly the underlying logic of Article 38 of the 2002 SACUA. In this regard, SACU is no different from any other regional integration arrangements in the developing world, a situation described by Mytelka (1973: 240) more than 40 years ago, and which remains true to this day: 'Integration in many developing areas of the world is....a paradigm for industrialization'. But why is industrialisation regarded as crucial? The answer to this lies in the fact that, in the words of UNIDO (2009: 4), 'industrialization is integral to economic development'. Experience reveals the following, according to UNIDO (Ibid.): 'Scarcely any countries have developed without industrializing, and rapidly growing economies tend to have rapidly growing manufacturing sectors'.

However, it is our contention that the development of a particular sector such as manufacturing cannot be seen as a ring-fenced operation, dealing only with this sector. The matrix view of economic activity, as reflected in any input-output table of an economy, summarises the fact that economic activity through linkages is interrelated across all sectors. While the principal agent of development may be manufacturing, the growth of this sector cannot take place in isolation from development in other sectors. One of the most important insights into the operation of the modern economy as derived from research into the extent and depth of global value chains is the importance of the necessary links between sectors. Industrial activity of any particular, say, targeted nature, cannot be sustained without, for example, the existence of crucial services in the fields of commerce, finance, logistics and technical support. The same principle applies when one considers the much emphasised need to add value to primary products, often the source of a developing country's

comparative advantage, be they of a mining or agricultural nature. Adding value through manufacturing and processing to agricultural products, for example, could be a very important source of economic development, which requires suitable conditions not only in manufacturing but also in agriculture and its supporting services.

Since the nature of industrial policy turns on the allocation of resources to more productive use, some thought must be given to the conceptual measurement of 'productive'. Within the context of a regional development policy across national frontiers this issue may be politically sensitive. The gains to make in the more productive use of resources should be considered as the returns that are generated over the long run, similar to the benefits that are incorporated in the classic infant-industry argument. It should further be noted that these returns should extend beyond private returns to firms but should be social returns which accrue to society.

SACU as an integration arrangement of unequal partner economies

Table 1 summarises a selection of indicators for the SACU member states. A perusal of these allows a number of inferences. The first is that South Africa is the dominant economy. It is home to 87% of the SACU population and its Gross Domestic Product (GDP) of US$408.2 billion represents 92% of the combined SACU GDP. South Africa, therefore, although not a large economy by world standards, is by far the largest domestic market in SACU. If the degree of industrialisation is considered, the dominance of South African manufacturing is reflected in its 94% share in SACU manufacturing value added. Even in agriculture South Africa is more advanced when measured in terms of labour productivity since its value added per worker is a significant multiple of the equivalent values in BLNS. The higher level of South Africa development is also reflected in its substantially larger per capita electric power consumption.

Although South Africa has the most developed and largest SACU economy, welfare indicators do not match the economic indicators in a comparative sense. South Africa's per capita Gross National Income (GNI) (expressed in current US dollars) is substantially higher than that of Lesotho, Namibia and Swaziland but lower than that of Botswana. If the per capita GNI is expressed in purchasing power parity terms, the difference between South Africa and Botswana is even more substantial. When the Human Development Index is brought into the picture it is also clear that South Africa falls in the same category as Botswana and Namibia, albeit slightly worse off than these two economies,

and that all three these countries are significantly better off than Lesotho and Swaziland. South Africa's rank position of 123 out of 187 countries, compared to 118 for Botswana and 120 for Namibia, is indicative of the fact that poverty is a serious problem in South Africa. Using 2006 survey data published by the World Bank, more than 8 million South Africans were in the poverty group living below PPP$1.25 a day and more than 17 million people if the line is set at PPP$2 a day, which means that the number of absolutely poor South Africans exceeds the total population of BLNS.[12] Although the number of South Africans in the more affluent groups also outnumbers the total population of BLNS, the fact remains that South Africa, although the most developed and largest SACU economy faces a serious demand for resources to address poverty alleviation.

The extent of the problem of poverty in South Africa creates a politically sensitive issue when the transfer of revenue within SACU is brought into the picture. This problem arises because the common external tariff, as a duty on imports, has a dual function: it serves as an instrument to create for the growth of domestic industry, or in the case of the customs union, industry within the common customs area, and it simultaneously generates revenue. It will be argued below that within SACU there are different emphases with respect to these two functions with BLNS favouring the revenue generated by the tariff.

This paper is not primarily concerned with the distribution of customs revenue among the member states, apart from the fact that the emphasis by BLNS on revenue can have an impact on the way the tariff is perceived as an instrument of industrial policy. As noted earlier, revenue distribution under the 1969 SACUA channelled revenue to BLNS through a multiplier-enhanced multiplier that was stabilised to ensure BLNS a minimum revenue rate of 17% that applied to a revenue pool consisting of both customs and excise revenue. South Africa was not included in the revenue distribution formula but kept the residual after the formula-determined shares of BLNS had been allocated. Under the 2002 SACUA revenue is divided into the two separate components of customs and excise revenue. Customs revenue is distributed among the member states, including South Africa, on the basis of shares determined by each member state's share in intraregional imports.[13] This creates a

[12] See World Bank Africa Development Indicators. [Online]. Available: http://data.worldbank.org/sites/default/files/adi_2011-web.pdf (9 October 2012).

[13] Under the 2002 SACUA the revenue pool is divided into two components, namely revenue generated by customs and excise duties respectively. Each member state's share of the excise component is calculated as its GDP in a specific calendar year as percentage of the total rand value of SACU GDP in that year. For Botswana, the conversion to rand value is done using the average daily pula/rand exchange rate for the relevant calendar year.

bias in favour of BLNS since South African imports from BLNS are small compared to BLNS imports from South Africa. Although customs contribute a small share of South African revenue, compared to BLNS and notably Swaziland and Lesotho that depend for about 60% of recurrent revenue on the customs union allocation, the political pain for the South African government, facing tremendous poverty problems that need to be addressed, of transfers to BLNS is not insignificant.

Table 1: Selected indicators of the SACU member states, 2011

	South Africa	Botswana	Lesotho	Namibia	Swaziland
GDP (billion current US$)	408.2	17.63	2.426	12.3	3.978
Population (million)	50.59	2.031	2.194	2.324	1.068
Manufacturing Value Added (million current US$)	49 270.0	696.5	253.3	959.0	1222.4
GNI per capita, Atlas method* (current US$)	6 960	7 480	1 220	4 700	3 300
GNI per capita PPP (current international $)	10 790	14 560	2 070	6 600	5 970
Agriculture Value Added, 2010 per worker (constant 2000 US$)	3 951	534	215	881	1 213
Trade as % of GDP	58	82	159	84	127
Electric power consumption, 2009 (kWh per capita)	4 532	1 503		1 576	
Human Development Index (rank out of 187 in parentheses)**	0.619 (123)	0.633 (118)	0.450 (160)	0.625 (120)	0.522 (140)

* The Atlas method is used by the World Bank to smooth fluctuations in prices and exchange rates by applying a conversion factor that averages the exchange rate for a given year and the two preceding years, adjusted for differences in the rates of inflation between the country and those of industrialised countries (the Euro area, United Kingdom, Japan and the USA).

** The Human Development Index of the United Nation Development Program incorporates three dimensions, namely life expectancy at birth, knowledge and education (measured by the adult literacy rate and the combined school and tertiary enrolment ratio) and the standard of living (indicated by the natural logarithm of GDP per capita at purchasing power parity).

Sources: World Bank, World Development Indicators 2011, accessed at http://data.worldbank.org/; United Nations Development Program, HDI accessed at http://hdrstats.undp.org/en/indicators/103106.html

Regional integration and industrialisation

SACU, as a customs union of diverse developing countries, remains a union that has survived and developed a particular dynamic that justifies its description and increasingly its rationale for existence as an instrument of development. SACU is not a trade arrangement that in the first place seeks the benefits of trade creation, but aims to realise the dynamic benefits that regional integration can offer by way of creating long-term development opportunities. The latter is expected from having a larger integrated market and a common external tariff, which are to facilitate the development of member states' dynamic comparative advantages and integration into the global market. This much is clearly reflected in Article 2 of the 2002 SACUA where, among others, the objectives of SACU are recorded 'to substantially increase investment opportunities in the Common Customs Area' and, as noted earlier, 'to enhance the economic development, diversification, industrialization and competitiveness of Member States'.

This perception of the role of SACU as a development arrangement is in line with the generally held view that the integration of the markets of developing countries is unlikely to produce net static benefits.[14] For them, the benefits are rather sought in the dynamic impact that results from the larger market for trade created by the customs union. Domestic producers that are complacent in the absence of a customs union, especially if monopolistic competition prevails in a protected domestic economy, must become more efficient to meet the *competition* of other producers within the union. Increased competition is also likely to encourage the development and utilisation of new technology. The end result will be lower production costs for the benefit of consumers. The lower production costs as a result of competition will be enhanced further by the second dynamic benefit, namely the opportunities for *economies of scale* provided by the larger market. These dynamic benefits are of particular importance for developing countries for which the potential competitive gains may be larger than for developed economies.

The popular counter-argument is that small economies do not have to depend on customs union formation for economies of scale. These can be obtained by production for the world market. This is true for high-income, industrialised small economies, but in the case of developing countries there is

[14] To generate static benefits associated with trade creation, that is, the replacement of high-cost domestic goods with lower-cost goods from elsewhere in the customs union, the member states must have competitive economies. This would be economies that produce a range of similar products that can be substituted once regional free trade occurs.

the contention that it is relatively easier to expand export production if the market destinations are partners in the common customs area. Trading 'across the border' within a configuration of neighbouring states with a common external tariff may be perceived as an easier option than the rigour required in building trade relations with firms in distant and advanced markets.

A third dynamic benefit is the possible encouragement of *investment* to take advantage of the enlarged market created by the customs union. This need not be restricted to investment by firms located in the customs union but could be foreign direct investment in which case the enlarged protected market encourages 'tariff jumping', that is, subsidiaries of foreign firms are established in the common customs area to have access to the larger market.

Finally, a larger, integrated regional market facilitates the implementation of policies that can be adopted over a wider spectrum to encourage development in the form of structural change over time. Creating opportunities for industrial growth and a manufacturing sector that expands relative to other sectors would be a typical structural change that could be expected of development-oriented regional integration.

However, in identifying these benefits of developmental integration, an important stumbling block should not be ignored, namely the tendency for South-South integration, i.e. the integration of developing countries, to lead to divergence and convergence. In the developing world the European Union (EU) for many years served as the model for regional integration. Although the eurozone experience of recent years has severely tainted this model, it remains true that the EU has been very successful in its experience with economic convergence, notably with Ireland, Portugal and Spain growing faster than the richer EU member states. According to UNIDO (2009: 77), South-South integration schemes tend to generate divergence. The reason for this is explained as follows:

> ...trade depends on difference. Countries with the highest potential to benefit from global trade are those at the extremes of the distribution of endowments. In the absence of a regional integration scheme, a rich country stands to benefit more from global trade than a middle-income country. South-South regional integration tends to favour middle-income countries relative to countries at the global extreme. Yet at present the middle-income countries are the better off members of the scheme and those at the extreme are the low-income labour-abundant countries: hence divergence. The challenge is to foster South-South cooperation in a mutually beneficial win-win scenario.

For SACU, this view seems to support the contention that the customs union and the way it has been managed has been for the benefit of South Africa, at the cost of the industrial development of the smaller member states. The argument has been, as discussed earlier, that the common customs area is characterised by polarised growth in South Africa's favour and that this is justification for the compensatory transfers inherent in the way the revenue-distribution mechanism was set up to work. Whether in fact SACU has experienced economic convergence or divergence is an empirical question that will be addressed below. However, working on the presumption that the customs union favoured South Africa and that industrial growth occurred along the generalised pattern described by UNIDO above, with BLNS not benefiting from being in a customs union with a much larger and more developed economy, the question is whether there is a way out of this dilemma. On this issue it is useful to return to the UNIDO (2009: 78) report where it has the following to say:

> ...small low-income countries are at a massive disadvantage with regard to industrialization. The problem is not primarily that the domestic market for the output of the industry is small. That can be overcome by focusing on the external market, as indeed African manufacturing is now starting to do. The core problem is that small country size implies a small market from which to purchase all the myriad of inputs and skills that a firm needs.

The size of the domestic market is important when it comes to the competitiveness of manufacturers and while the external market provides firms with the opportunity to escape the constraint of small market size, it is much more difficult to break into foreign markets than to produce for the domestic market. With respect to the latter, economies of scale (positive agglomeration economies) for manufacturing in particular, are determined by economic mass, which is the product of population size and average-income levels, and not by population alone. However, even if population size should be important (for example, as an indication of what economic mass could grow to when incomes increase in the process of economic development) it is clear that BLNS are at a disadvantage. Studies on the impact of spatial concentration on economic growth and development show that city size is an important determinant of economic growth; big cities generate powerful economies of scale. Compared to South Africa with its four relatively large metropolitan areas it is highly unlikely that BLNS will ever develop cities of a scale that would generate substantial agglomeration economies. The total population of each of these countries approximates that of a metropolitan area of a reasonable size, and in the case of Namibia and

Botswana their populations of about two million are spread across countries larger than France in geographic size.

Economic convergence in SACU

Earlier, reference was made to the issue of economic convergence, and the question can be asked whether the customs union has brought about convergence within SACU of the kind found in the experience of the EU. Tables 2, 3 and 4 throw light on the matter but it is clear that an unambiguous answer is not possible.

A first observation is the faltering nature of South Africa's manufacturing growth which saw the contribution of manufacturing to gross value added fall from 22.8% in 1970 to 15.1% in 2009. The industrial giant of the region and the continent has continued its manufacturing slide during the most recent years, with the sector contributing only 13.6% of gross value added in 2010-11 (SA Reserve Bank 2012: S-105). The slide in industrial leadership is relevant to the consideration of SACU industrial policy and will feature again in this paper.

As far as economic convergence is concerned, if growth in per capita real GDP during 1980-2009 is taken as an indicator of recent convergence it would seem that BLNS by and large grew faster than South Africa, which would indicate that convergence has taken place. What is also clear is that BLNS did better in the growth league than Sub-Saharan Africa as a whole. Using manufacturing growth and industrialisation during 1970-2009 as convergence indicators the answer seems to be mixed. Botswana, the fastest growing economy in the customs union had a spurt of manufacturing growth during the 1970s, but subsequent to this, manufacturing growth started to decline with the share of this sector in gross value added experiencing a decline from nearly 7% in 1970 to just more than 4% in 2009. Of course, Botswana's growth has been driven by minerals, primarily diamonds, and this would explain the decline in the relative share of manufacturing in spite of the consistent growth, albeit at a declining annual rate, in manufacturing value added over the whole period.

Lesotho and Swaziland have experienced comparatively fast growth in their manufacturing output and although the absolute size of these sectors in both countries is extremely small compared to that of South Africa, the share of manufacturing in gross value added is the highest of the SACU

member states. The question is: to what extent can their industrial growth be ascribed to their membership of SACU and having South Africa as the dominant economy within the customs union?

To answer this question a number of factors need to be considered. The first is the role of the common external tariff in the investment decision, that is, whether production for a larger market behind the barrier of a protective tariff has been a deciding factor. The 'larger market' at stake here is unrestrained access to the South African market. A historical dimension is also relevant in view of the implementation of the SADC free trade agreement and the significant trade liberalisation that has characterised South African trade policy since the early 1990s at the multilateral level but also through the conclusion of the free trade agreement with the EU (the Trade, Development and Cooperation Agreement). The import tariff became less of a barrier for imports and through intra-SADC free trade it effectively became irrelevant – whether production aimed at the South African market was located in BLNS or in any other SADC member state such as Mozambique. When the impact of a protective tariff is removed through the implementation of regional free trade the existence of a customs union within the wider free trade area, as is the case with SACU within SADC, the influence of the common external tariff as a determinant of industrial location is effectively removed.

However, other determining factors will remain in place. In southern Africa, this would include proximity to the major metropolitan markets of South Africa, a supporting transport infrastructure and the broad range of services required by industry. To this may be added the availability of workers with suitable skills and competitive wage costs, which, combined with productivity, will result in lower unit labour costs. But again these considerations do not depend on the existence of a customs union agreement.

Access to capital and exchange rate certainty can be an important factor in deciding on cross-border investment or foreign investment aimed at producing for the southern African market, and in this respect the Common Monetary Area (CMA) that integrates Lesotho, Namibia and Swaziland (LNS) into the South African money and capital market is a prominent feature. The CMA facilitates the seamless mobility of finance and money, the South African rand being legal tender in LNS with their currencies linked at par to the rand, thus also eliminating the risk of exchange rate fluctuations in investment decisions and trading relations. But again, the CMA, albeit a product of the same political

and economic history of regional relationships, is a separate arrangement from the customs union agreement, as has been illustrated by Botswana having left the CMA's predecessor, the Rand Monetary Area, in 1976.

Table 2: SACU member states' per capita Real GDP annual growth rates (2000 prices, $)

	1980-89	1990-99	2000-09
Botswana	7.6	2.5	3.0
Lesotho	0.3	2.1	2.1
Namibia	-2.2	1.6	3.3
Swaziland	4.1	0.7	1.6
South Africa	-0.8	-0.7	2.8
Sub-Saharan Africa	-0.9	-0.6	2.6

World Bank, African Development Indicators

Table 3 : SACU member states, annual average growth rates of manufacturing value added (%)

	1970-79	1980-89	1990-99	2000-09
Botswana	16.6	11.2	3.4	3.9
Lesotho	6.5	10.7	8.0	8.4
Namibia	2.9	13.7	3.4	4.8
Swaziland	13.7	16.2	2.6	1.0
South Africa	5.2	1.3	1.3	2.0

Source: UN Secretariat (2011: Table 3)

Table 4: SACU member states' manufacturing as % of gross value added

	1970	1980	1990	2000	2009
Botswana	6.9	5.4	5.2	4.5	4.2
Lesotho	3.7	4.6	9.6	13.7	19.8
Namibia	6.5	5.9	16.8	12.6	14.5
Swaziland	14.1	24.7	36.7	37.6	41.4
South Africa	22.8	21.6	23.6	19.0	15.1

Source: UN Secretariat (2011: Table 3)

How does one interpret the industrial growth of Lesotho and Swaziland against a background which on fundamental factors makes no difference whether the country is in a customs union with South Africa or not? Both countries have been successful in attracting investment by South African and foreign firms to produce for the South African market predominantly. An example of investment in which the decision to invest could have been significantly influenced by the existence of the customs union is the building by Philips South Africa (a subsidiary of the Dutch multinational corporation), in partnership with South Africa's Central Energy Fund and a South African firm Karebo Investments, of a plant in Lesotho to produce energy-saving compact fluorescent lamps (CFL). The plant opened in March 2009 producing light bulbs for the southern African region. Although the investment decision has been aimed at supplying the South African market, the region is also important as shown by the fact that the Botswana Power Corporation has launched a national low-energy light bulb campaign in which one million CFL manufactured in Lesotho are to be switched free of charge for incandescent bulbs.

However, it is very likely that proximity to the South African market and the supply of services and intermediate inputs available in the large neighbour, as well as the CMA as discussed earlier, played a role in encouraging the industrial development of Lesotho and Swaziland. Under the apartheid regime in South Africa, sanctions-evading investment also served as encouragement for cross-border investment by South African firms wishing to produce for the export market.[15] In the case of Swaziland, in turn, a relatively rich agricultural (for example sugar and pineapple growing) and

[15] In its promotional work in canvassing investment by South African firms in Lesotho, officials of the Lesotho National Development Corporation actively marketed the benefits of having Lesotho as country of origin as a counter to sanctions.

forestry potential has created the supply base for agro-processing industries that are integrated into the South African market.

If the export-oriented investment in Swaziland and Lesotho is considered in its broader context of selling outside the region, the single most important determinant in driving investment has been the preferential access these countries enjoy in the major markets of the industrialised world. Lesotho, specifically, has been relatively successful in attracting investment in clothing and textiles on the back of the preferential access the country enjoys in terms of the African Growth and Opportunity Act (AGOA). It could be argued that SACU as such has no role to play in this regard but it cannot be denied that the proximity of the more developed South Africa, its infrastructure and the services available are important considerations. Hypothetically, it could be argued that Lesotho would not have been so successful had it been landlocked in, for example, Tanzania or Angola.

Developing value chains to address regional inequality

Earlier, the growing importance of global value chains as a force of industrial development was briefly alluded to. For developing countries it is no longer the sole requirement to be cost competitive as a low-cost producer; linking into a global value chain or trade network has become a condition for rapid industrial growth. Although an imperative, being part of a global value chain is not without its problems.[16] However, these are not fundamental to the theme of paper. What is important is to clearly distinguish, on the one hand, the development of a value chain within a region that is organised in a regional integration arrangement, such as SACU from, on the other hand, a value chain that operates globally.

This distinction is important for regional industrial policy. Becoming part of a global trade and production network is primarily a national policy issue. In a *producer-driven* value chain such as motor vehicle manufacturing, assembly in South Africa for export to foreign markets is the outcome of a production decision by a overseas-based multinational corporation that is likely to have been influenced by the incentives available in South Africa to encourage the development of a domestic motor vehicle industry and has little to do with the fact that South Africa is a member of SACU or SADC. This has little relevance for a policy decision that 'South African companies will be encouraged

[16] For a short discussion of the problems associated with value chains or supply networks see Irfan ul Haque, *Rethinking Industrial Policy*, United Nations Conference on Trade and Development (UNCTAD), Discussion Paper, No. 183, April 2007, pp. 5-6.

to participate ... in integrating *regional* supply chains to promote industrialisation' (South Africa National Planning Commission 2012: 120 –italics added). This poses a crucial question in a customs union committed to the development of common industrial policies: how is this encouragement undertaken at a regional level? It is difficult to escape the impression that at the regional level the proactive development of a particular value chain will require some agreement on where a particular component of the value chain is to be produced. This represents a serious exercise in industrial targeting across national borders within a region, which elsewhere in the developing world has proven near impossible to achieve.

In contrast to producer-driven value chains and their commensurate impact on the regional distribution of investment there are strong indications of the expansion of *buyer-driven* value chains, with the lead firms being South African manufacturers investing in the smaller SACU economies. Staritz and Morris (2012: 10-11) have found in a study of Lesotho's apparel industry that South African apparel manufacturers have since 2005/06 relocated to Lesotho in significant numbers, bringing the current number of South African-owned plants to 15, and increasing Lesotho's apparel exports (HS61-62) to South Africa from R6.25 million in 2005 to R445.24 million in 2011. From the perspective of a regional industrial policy, the primary drivers for South African investment, tightly linked to South African retailers, have been found to be the lower cost of labour, a comparatively flexible labour market, a more compliant union environment relative to South Africa and proximity to the South African market which as part of a customs union can be accessed free of duty (Staritz and Morris 2012: 12). It can also be surmised that South African manufacturers in Lesotho benefited from Lesotho being part of the CMA which through its exchange-rate regime of parity between the rand and the maloti provided these producers not only with the benefit of lower-cost production but also protection against low-cost imports from Asia provided by the appreciation of the rand.

Whether cost-driven value chain investment can be sustainable, should the development of common industrial policies actually materialise, is questionable. Labour market policies are an inherent element of industrial policy and it is difficult to envisage that South African trade unions will accept a common SACU industrial policy that will facilitate a substantial relocation of production and jobs to BLNS. This focuses attention on the viability and appropriateness of developing common industrial policies in SACU, a question addressed in the next section.

4. Common SACU industrial policies – appropriate and viable?

It is reasonable to argue that BLNS industrialisation will in the long run depend on regional integration. Preferential market access is important but is not a basis for sustainable diversified industrial growth. Add to this the fact that the domestic markets are too small to provide as starting point significant economies of scale as a prerequisite for export-oriented growth. Large cities generate economies of scale and in the case of BLNS the total population of each country is lower than what one would expect the optimal size for agglomeration economies to be. Namibia and Botswana furthermore have the drawback of having small populations in countries that in geographic size exceed that of Germany and France. This creates substantial obstacles to the development of infrastructure. For Botswana, the fact that the country is landlocked adds further obstacles to industrial growth. These circumstances lead to the inevitable conclusion that for small African economies regional integration is the most likely condition that will allow sustainable industrialisation, and for BLNS the potential benefit has been and remains their links to the South African economy.

The eminent question remains whether the common industrial policies to which the SACU member states have committed themselves are feasible and appropriate to create regionally balanced growth or is this commitment the outcome of the confused thinking on the part of the architects of the 2002 SACUA?

Earlier, in discussing the history of SACU and its development over time, it was argued that SACU has developed from a mechanistic 'device' to deal with the de facto economic integration of separate political entities (enabling intraregional free trade and the allocation of customs and excise revenue) to a developmental integration arrangement. The adoption of the 2002 SACUA has been a definitive step in transferring the management of the customs union from South Africa to supranational institutions required for the collective management of the arrangement. The management of SACU as a developmental regional integration arrangement has a number of implications for industrial policy.

- The first is to recognise that although unequal in important respects all the member states are developing countries that have to deal with serious challenges of having to increase economic growth and alleviate poverty. This applies to BLNS but, as noted earlier, also to South Africa which faces pressing problems in this regard, problems which in magnitude (numbers) exceed those of BLNS. SACU must therefore serve as a win-win arrangement for all its member states.

- As a developmental arrangement SACU must, as explained earlier, seek to encourage and facilitate the industrial development of all the member states. Industrialisation is the driving force of economic growth and poverty alleviation. The 2002 SACUA makes it clear that cognisance has to be taken of the unequal distribution of manufacturing value added in the common customs area and that the industrial development of the less developed and smaller member states (BLNS) is a priority. However, it would be wrong to argue a case for convergence in manufacturing production (naturally in per capita terms) between South Africa and BLNS at the cost of South Africa's industrial growth. It can be argued at length that a symbiotic relationship exists between a growing South Africa and growth in BLNS and that a stagnating manufacturing sector in South Africa will not serve the mutually beneficial partnership that BLNS may expect from being in a customs union with South Africa. In view of this relationship the poor manufacturing growth record in South Africa is a matter of concern and the need for South African manufacturing to increase its rate of growth and relative contribution to gross value added is an imperative.

- Being a customs union of relatively small developing countries, the SACU market as a whole remains small, a characteristic that has important implications for the broad policy approach to be adopted. In 2011, the total GDP of SACU came to approximately US$445 billion, which allows room for economies of scale in production but is too low to provide the foundation for long-term, sustainable growth. This being the case, SACU will have to do what all fast-growing developing economies and newly industrialised countries (NICs) have done and that is to follow the route of export-oriented industrial growth. Poor countries cannot become developed by producing for themselves, which leaves the export market outside the SACU economies as the inevitable direction to wealth creation, hence, the need to develop competitive production capacities. However, for BLNS this does not exclude significant growth opportunities by producing for the South African market.

- A major difference between South Africa and BLNS is the existence in the former of a strong business community with skills and entrepreneurial talent. South African firms across all sectors have demonstrated their ability to compete internationally, and cross-border investment by South African firms in BLNS has in the past contributed and can increasingly in the future contribute to the expansion of the production capacity of these economies.

The burning question is: what role do common industrial policies have in achieving the aims of SACU as developmental arrangement? Much will depend on what is meant by 'common industrial policies'. Semantically, the term would seem to mean the adoption of similar policies, which from a practical policy perspective is a non-starter. The design of good industrial policy requires more than an adequate identification of goals and intermediate policy targets. Policy instruments are to be selected which in turn will crucially depend on the nature of the economy, including elements like:

- labour market organisation in conjunction with work force characteristics (literacy levels, available skills and wage levels);
- the nature (sophistication and diversification) and size of the business sector, the manufacturing sector in particular, and the availability of a cadre of entrepreneurs;
- the availability of natural resources such as water, fertile land and minerals;
- the existence of required service industries (finance, commercial, industrial and legal services);
- infrastructure;
- institutional factors such as security of property rights and a judicial system that can underpin contractual commitments;
- in general, the ease of doing business in the economy.

Given these considerations it is difficult to imagine that the member states of SACU can have common industrial policies. Hypothetically, 'common industrial policies' can be translated into a collective industrial policy for SACU. If this is an envisaged part of the SACU industrial development agenda, the following UNIDO (2009: 79) conclusion on industrialisation and regional integration in a world of small developing economies is relevant for SACU as well:

> ...for the industrialization of the countries of the bottom billion, regional integration is indeed likely to matter, especially in regions, such as Africa, that are divided into many small countries. Integration may need to be considerably deeper than the trade arrangements. In the end, a form of integration that allows the free movement of goods, capital and people across borders, making them irrelevant to the formation of cities and industrial agglomerations, is likely to be necessary+.

The need for deeper integration is further strengthened by the fact that the customs union agreement as such only allows the use of a single policy instrument, namely the import tariff, which can be expanded to include selective tariff rebates and the use of the tariff as a trade remedy. The latter, in the form of anti-dumping and countervailing duties can support industrial policy but as instruments to ensure fair trade in line with WTO commitments they cannot be seen as a means to enact a particular industrial policy. Because of WTO commitments on tariff bindings even the import tariff has lost much of its potency as an instrument of protection in implementing an industrial policy of selective manufacturing support.

To expand the range of available policy instruments to include more than the import tariff and to target capital investment in a common customs area in which the freedom of capital movements on the basis of the CMA already exists, will require deeper integration. The selective use of fiscal incentives – for example, accelerated depreciation for selected investments – forms part of the standard fare of industrial policy, but this can only be used as a policy instrument if a substantial degree of fiscal integration, beyond the current excise duty and CET regime, exists. This is a building block of an economic union on which disagreement exists even within the EU, the most advanced regional integration arrangement in the world, and it is difficult to imagine that the SACU member states will agree to such a level of deeper integration.

5. South Africa's commitment to the development of common industrial policies

Are there any indications that the member states have serious intentions with the commitment to develop common industrial policies, or for that matter, a unified industrial policy for the common customs area? It cannot be denied that South Africa will have to be an important driving force in moving towards such a policy position. Hence, a perusal of the official South African policy position, as revealed in relevant documents that are available in the public domain, should be informative.

Existing official policy documents that are fundamental to industrial policy and development in southern Africa, and which were accepted after 2002, reveal an absence of a precise and consistent appreciation for the implications of a commitment to common industrial policies. The policy document that gives the most explicit attention to SACU is the Department of Trade and Industry's *South African Trade Policy and Strategy Framework* (South Africa Department of Trade and Industry 2010). SACU is envisaged to be a building block of deeper integration, serving 'as an anchor in the SADC regional project' with the additional role of acting 'as a platform for harmonised engagement in wider global trade relations' (Ibid.: 37). It is acknowledged that to achieve this vision it will be required 'that SACU member states forge common trade and industrial policies', while developing 'a work programme that overcomes current policy gridlock by devising a strategy to build production value chains across all member states in agriculture and industry'. Without such a common policy vision, the document correctly asserts, it will not be possible to strengthen SACU institutions such as the proposed Tariff Board and Tribunal and an effective and well-resourced Secretariat (Ibid.).

In the National Industrial Policy Framework (NIPF), which was introduced in July 2007 the development of common industrial policies is not mentioned at all, even though the document includes in its list of Strategic Programmes one on Regional and African Industrial and Trade Framework. In the Strategic Programme on Trade Policy the following is stated with regard to regional integration and SACU (South Africa Department of Trade and Industry Undated: 24 – italics added):

> Regional integration is a central thrust of our trade policy. South Africa will be required to devote greater attention to consolidating the SACU integration agenda and advance beyond issues of the Common External Tariff to the broader integration agenda to include *cooperation* on industrial, agricultural competition and services policy. Moreover, trade negotiations with third parties will, in future, require regional SACU approaches to all new generation issues.

It is conspicuous that no mention is made of the development of common policies in SACU. Instead the reference is to *cooperation* on policy, which we will argue is a more realistic perception but clearly far removed from the development of common industrial policies.

Where SACU received scant attention in the NIPF it is totally absent in the New Growth Path (NGP) launched in 2010 by the South African Government as an initiative of the new Ministry of Economic

Development. The NGP emphasises the need for South Africa to re-industrialise but in policy initiatives on an active industrial policy, developmental trade policies and African development no recognition is given to the commitment to develop common industrial policies in SACU (South Africa Ministry of Economic Development 2010: 7,10, 24-25). As often happens in South African stances on regional integration, which many would argue is understandable, the emphasis falls on SADC, with the NGP stating that 'South Africa will undertake initiatives to strengthen SADC and connect it with the East African Community and Comesa' (South Africa Ministry of Economic Development. 2010: 25).

The most recent policy initiative by the South African Government, the National Development Plan 2030, prepared by the National Planning Commission, contains a chapter (Chapter 7) on 'Positioning South Africa in the world' with laudable objectives and proposed actions (Ibid.: Ch. 7). The chapter reveals a strong commitment to effective regional integration in Africa and to the pivotal role that South Africa has in contributing to the economic development through regional integration, but, as will be pointed out below, is not quite in touch with the real world of regional integration in southern Africa. Existing agreements are not seen as cast in stone. According to the report (South Africa National Planning Commission. 2012: 220):

> 'To take full advantage of the realignment of global politics and trade, South Africa may need to redefine its existing agreements, starting with the Southern African Customs Union (SACU) and SADC partners. These agreements should be tested for their validity and coherence and, for global bilateral and multilateral partners, affiliations and commitments. This may entail hard bargaining and potential trade-offs involving short-term realignments, gains and losses'.

On the customs union specifically, the Commission notes that the SACU Agreement is under review, stating that '(w)hile the weight of South Africa's economy has effectively reduced potential risks in the customs union, its current structure is not necessarily the best option for South Africa or its neighbours' (Ibid.: 226). The Commission then continues to argue that an immediate priority 'is the development of more effective financial transaction mechanisms to facilitate physical trade' (Ibid.). The Commission would seem to be unaware or at best not appreciative of the role that the CMA plays in effectively integrating Lesotho, Namibia and Swaziland into the South African money and

capital market and of the close financial links between Botswana and South Africa.[17] Add to the this the statement in the report that '(A) trade arrangement also exists between South Africa and SACU, whose members are Botswana, Lesotho, Namibia and Swaziland' (p. 224) and it is difficult to escape the conclusion that the Commission was less than well informed on the real world of regional integration in southern Africa when it drafted Chapter 7.

Nevertheless, the Commission expresses the valid view that policy making should be less concerned with ideology and political solidarity and rather concentrate on a reduction of poverty and inequality in South Africa, while simultaneously working to create supportive institutions and strengthen cooperation in order to encourage the growth and development of all economies in the region (Ibid.: 222). The Commission is aware of the fact that regional integration may entail a cost for the national economy but that regional growth will produce economic benefits. In considering the development of common industrial policies, which are not addressed in the report, the distribution of costs and benefits is embodied in two crucial questions: 'To what extent is South Africa willing to make concessions to protect the interests of its weaker neighbours? Should regional integration place South African interests first?' (Ibid.: 230).

The inevitable conclusion from a perusal of the South African policy documents is that the government of SACU's major economy, on which the development of the region will depend, appears not to be committed to the development of common industrial policies. Whether this is by default or design is impossible to determine on the basis of information in the public domain. However, it is reasonable to conclude that Article 38 of the 2002 SACUA is not a guiding force in the design of industrial policy. It may be speculated that part of the reason for this is a post-agreement understanding that the development of common industrial policies is neither appropriate nor viable because of the substantial differences in economic size, level of industrialisation and national goals between South Africa and BLNS. On national goals, for example, it is unlikely that BLNS will share the concern of the South African authorities not to develop the manufacturing sector to a position of international competitiveness on the basis of low-cost labour, hence the South African desire, consistently propagated by government representatives, to focus manufacturing growth in higher value added industries.

[17] The Commission discusses monetary integration without any reference to the CMA

6. Conclusion

SACU is a developmental integration arrangement, covering both customs and excise duties, which since the conclusion of the 1969 SACUA provided for the unequal nature of the member states in a way that would benefit the smaller member states, BLNS. Under the 1969 Agreement this development effort translated into financial transfers through the revenue distribution mechanism to compensate BLNS for being in a customs union with a larger and more developed economy, South Africa, which managed and used the import tariff, as well as related elements like tariff rebates and trade remedies, as instruments of industrial policy.

The 2002 SACUA put an end to this regime, at least in the intentions incorporated in the agreement, which now provides for institutions to manage the customs union in a collective fashion. One of these institutions is a Tariff Board (Art. 11), which in future is to take decisions and make recommendations to the Council of Ministers (Art. 8) on the import tariff and its related elements. Ten years after the conclusion of the agreement the Tariff Board has not yet been established. The South African International Trade Administration Commission (ITAC) has the delegated responsibility to act as the tariff agency on behalf of all member states. If a regional integration arrangement such as SACU defines its objective as the economic development of its member states it stands to reason that collective decisions have to be taken on development policies and strategies that will make the most of potential dynamic advantages of integration. This will specifically be relevant for the design, implementation and monitoring of industrial policies in support of the goal of developing all member states.

Consequently, perhaps one of the most important changes incorporated in the 2002 Agreement is the provision for common policies, specifically the commitment of Article 38 to develop common industrial policies while recognising the importance of the balanced development of the common customs area as an objective for economic development. The working paper leads to three conclusions in this regard:

- Although 'balanced development' is interpreted as referring to the dominant position of South Africa and the agglomeration economies that benefit its industrial development vis-à-vis that

of BLNS, the serious need for larger scale poverty alleviation in South Africa must be taken into consideration as well as the need to revitalise industrial growth in South Africa, not only because it will benefit South Africa but also because it will enhance the growth prospects of the whole region.

- In view of the diverse nature of the economies of the member states (for example, in terms of market size, level of industrial development, resource endowments and the sophistication, and size of private business) the development of common industrial policies is not appropriate and viable.

- It is clear from official development programmes that South Africa, at least, does not consider the development of common industrial policies as a feature that should be incorporated in national industrial policy. Where the region does feature, it would also appear that SACU is lower on the priority list than SADC.

Article 38 of the 2002 SACUA should be revisited. The success of regional integration depends crucially on the commitment to implement agreements and to the extent that Article 38 represents a legally enshrined commitment that is inappropriate and not implemented has a negative impact overall on the commitment to SACU as an integration arrangement. In an exercise that is concerned with more than semantics the concept and goal of developing 'common industrial policies' should be replaced with concepts such as 'coordinated industrial policies' or 'cooperation in designing and implementing industrial policies'. The word 'common' could also feature in seeking to develop a 'common vision' on industrial development and commensurate policies.

An important feature of SACU2002 referred to earlier is the establishment of a Tariff Board that will make decisions and recommendations on tariff amendments submitted by the National Bodies (Article 14) of the member states. In the real world of tariff decisions these decisions cannot be taken in a policy vacuum but require specific guidelines, which can only exist if a common vision on industrial development exists and if national industrial policies do not operate in an opposing fashion.

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