TRADE & INDUSTRIAL POLICY STRATEGIES

POLICY BRIEF

Industrial policy development in the Southern Africa Customs Union: Ideal approaches

INTRODUCTION

Countries in Southern Africa have only recently begun considering the possibility of jointly developing comprehensive industrial policies under the auspices of regional integration bodies such as the Southern African Customs Union (SACU). Regional co-operation in industrial policy design and implementation has the potential to both identify and capitalise on the productive synergies that exist between states, and to enhance the integrated performance of industrial sectors across borders.

As a means to boost their shared competitiveness and productivity in different industrial sectors, as well as to dramatically increase levels of intra-regional trade, members of SACU have called on the body's Secretariat to develop a Regional Industrial Policy that will be capable of developing "diversified, geographically balanced, and globally competitive" industrial sectors in each member country.

As part of this initiative, SACU members have to determine what approaches are most likely to optimise their chances of developing dynamic comparative and competitive advantages.

What should a region-wide industrial policy look like? What level of industrial regional integration should be pursued? How should policy initiatives be sequenced to produce the maximum benefit for each country at both a regional and global level?

RESEARCH FINDINGS

In the Southern African context, very few industries have emerged with strong and sustainable comparative advantages in key sectors. Uneven levels of industrial development between Southern African countries compound this problem, with manufacturers in South Africa usually being the only regional producers able to compete in a liberalised global market with ready access to working capital.

RECOMMENDATIONS

The SACU member states, while all experiencing some degree of economic growth, possess economies in which industrial sectors are at different stages of development. Consequently, pursuing trade integration by way of immediately scrapping intra-bloc tariffs is likely to do little more than provide further advantages to those countries (and those industries) that already enjoy strong levels of industrial strength – namely, South Africa and its manufacturers.

SACU must rather pursue the three-tier industrial policy approach detailed in this brief, with an emphasis on selecting and nurturing infant industries through protectionist measures, as well as using sectoral policies to promote industrial targets, research and development, and the development of complementary production lines.

SACU countries must also make earnest attempts to achieve some level of macroeconomic harmonisation to eliminate the potential for balance-of-payment, deficit or inflation issues to inhibit growth under a regional integration scheme.

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Other Southern African countries do possess industries that show signs of a "latent comparative advantage", but these industries need sustained policy support before they can be expected to compete on even a regional basis.

Most SACU member states are at stages of industrial development that need the nurturing of infant industries. The introduction of simple and uniform policy measures, such as developing a Common Effective Preferential Tariff Scheme (CEPTS), are unlikely to be wholly adequate in enabling region-wide industrial growth or in generating increased levels of intra-regional trade.

THREE-PRONGED APPROACH

What is needed instead are sets of inclusive industrial policies that deal with the externalities that weak – but promising – industries have to overcome if they hope to gain free access to capital and trade accounts. A three-tiered industrial policy approach may be pursued by regional organisations such as SACU to meet this objective.

This approach should be centred around: 1) selectivity in identifying those industries with real potential to become dynamic; 2) the introduction of clear sectoral policies that set out beneficial market conditions under which these selected industries can grow; and 3) the use of complementary macroeconomic and social policies that help to stabilise emerging markets.

By examining the historical evidence of other regional organisations in their attempts to draft industrial policies, it is possible to note that some degree of region-wide industrial growth can happen regardless of prevailing levels of integration. Whether a regional body forms itself as a free trade area, customs union, or fully integrated common market, the regional co-ordination of industrial policy is a viable objective. Nevertheless, higher levels of integration – including the harmonisation of fiscal and monetary policies between states – is likely to lead to more advantageous outcomes for industrial growth.

Most important, however, are the lessons that can be learned by SACU members from the experiences of other regional bodies in determining which industrial policies to introduce, and how to go about sequencing them.

During the course of its eventual transition into a common market, the European Union (EU) and its predecessor, the European Economic Community (EEC), encouraged stakeholders to actively identify European industries with "latent comparative advantages" that could be counted on to grow into globally competitive endeavours. These industries were supported throughout the 1960s and 1970s with protectionist measures such as tariffs, subsidies and anti-dumping regulations.

Moreover, the EEC and EU introduced a number of sectoral policies, most notably those related to supporting research and development (R&D), which gave nascent industries the opportunity to strengthen their operations. Finally, the EEC and EU introduced a number of harmonised macroeconomic and social policies that established the enabling environment needed for industries to flourish. The resulting impact of this three-tiered approach to industrial policy creation was continuous growth in levels in intra-EEC/EU trade – indeed, levels of exports between member states increased by 64.5% between 1959 and 1970 alone.

The Association of Southeast Asian Nations (ASEAN) and the Southern Cone Common Market (MERCOSUR) undertook similar industrial policy initiatives to the EU. First, member states sought to identify those select industries that would most likely provide member countries with comparative advantages that could be exploited in the future to boost levels of intra-regional trade.

Second, member countries in these regional bodies put in place a number of protectionist and sectoral policies to provide key industries with production and growth targets, as well as setting out ideas on how these sectors could be moved towards a higher degree of cross-border integration over time – namely through the removal of intra-group tariffs, the development of complementary production lines, and the introduction of "local content rules" for the sourcing of productive inputs.

However, whereas ASEAN's industrial policy also called for the introduction of measures geared towards some degree of macroeconomic harmonisation, MERCOSUR members did not undertake complementary macroeconomic policies conducive to regional integration.

As such, MERCOSUR's levels of intra-regional trade, while experiencing an initial rise, eventually declined as member states were forced to cope with differing macroeconomic challenges such as balance-of-payment problems and inflationary pressures. In contrast, ASEAN's levels of trade between member states have remained strong.

DEVELOPING INDUSTRIES: *Sectors and industries that may be targeted for industrial policy measures include fisheries (canning and processing), forestry, textiles and garments, mineral processing, pharmaceuticals, machinery and equipment production and assorted service sectors (business advisory services).*

With the North American Free Trade Agreement (NAFTA), on the other hand, an entirely different approach to industrial policy was pursued.

Instead of allowing the targeting of infant industries for protectionist nurturing over a set period of time, or introducing particular sectoral policies, NAFTA integration moved ahead quickly with the introduction of a CEPTS. Industries were expected to either compete immediately after the introduction of trade liberalisation or to end their operations.

For Mexico, whose industries were at a much lower level of development compared to its NAFTA partners, this inability to pursue industrial protectionism permanently inhibited the country from being able to expand its industrial prowess.

For SACU, the lessons of these case studies are apparent: it is necessary to follow in the path of successful regional blocs such as the EU and ASEAN by pursuing a three-pronged approach to industrial policy that includes the explicit "championing" of particular industries, the introduction of sectoral growth strategies, and the introduction of complementary macroeconomic and social policies between member states.

To follow an approach that prioritises trade liberalisation at the expense of industrial targeting, as happened with NAFTA, or an approach that is not aided by even modest levels of macroeconomic policy harmonisation between states, as happened with MERCOSUR, will lead to sub-optimal outcomes for industrial growth and regional trade integration.

RECOMMENDATIONS

The SACU member states, while all experiencing some degree of economic growth, possess economies in which industrial sectors are at different stages of development. Consequently, pursuing trade integration by way of immediately scrapping intra-bloc tariffs is likely to do little more than provide further advantages to those countries (and those industries) that already enjoy strong levels of industrial strength – namely, South Africa and its manufacturers.

SACU must rather pursue the three-tier industrial policy approach, with an emphasis on selecting and nurturing infant industries through protectionist measures, as well as using sectoral policies to promote industrial targets, R&D, and the development of complementary production lines. Also, SACU countries must make earnest attempts to achieve some level of macroeconomic harmonisation to eliminate the potential for balance-of-payment, deficit or inflation issues to inhibit growth under a regional integration scheme.

When determining which industries to support, an inclusive and transparent process must be undertaken to ensure that industries are supported only if: 1) they possess a strong existing market or show strong potential for growing a regional or global market, 2) they are (or will be) reliant on regional production networks, 3) they produce medium- to high-level intermediate goods with multiple usages, 4) they have the potential to create dynamic comparative advantages in at least two countries within a regional bloc; 5) they have high value-added potential, and 6) they are likely to attract reasonable levels of foreign direct investment (FDI).

The SACU Secretariat should work closely with sector associations to ensure that a strong institutional partnership is in place to ensure that obstacles can be worked out in a consensual manner between regional states

Preliminary indications suggest the sectors and industries with such attributes, which may be targeted for industrial policy measures are: agro-food processing (meat processing), fisheries (canning and processing of fish and fish products), forestry, textiles and garments, leather and leather products, mineral processing (mineral and gemstone beneficiation), pharmaceuticals, chemical production (agricultural and industrial chemicals), machinery and equipment production (packaging materials), and assorted service sectors (business advisory services).

Sectoral policies should be geared around each individual industry and may include measures to enhance the technological intensiveness of select industries; coordinate improvements in product design; put in place a reliable system of product quality control; provide management training at junior, middle, and senior levels; offer marketing support; and support collective region-wide FDI sourcing.

Other sectoral measures may involve assistance with export development; creating network linkages between industries and regional technology centres; strengthening professional associations; promoting industry clustering; strengthening legal and regulatory frameworks; and improving the responsiveness of financial systems to the needs of manufacturers.

The objective of introducing these measures is to ensure that they are industry-specific rather than geared in vague terms to serve overriding industrial sectors. Policies should be specific in their objectives and concrete in outlining the steps required by SACU's regional governments and nascent industries to achieve them.

The protectionist nature of industrial policies within SACU should not be designed to be permanent. As has been done in regional blocs such as the EU, protectionism should be phased out over time in favour of allowing industrial growth to be determined by competition and market forces. However, stakeholders must work to ensure that this protectionism is not abandoned too quickly, and that industries have ready access to capital before the state sets them free to compete on a regional or global basis.

To do this, the SACU Secretariat should work more closely with sector associations to ensure that a strong institutional partnership is in place to establish growth and trade targets, facilitate the analysis and exchange of information, and ensure that obstacles to industrial policy implementation can be worked out in a consensual manner between regional states.

The information in this brief is extracted from the report, *A re-examination of SADC industrial development policies and lessons for SACU,* by William S Mbuta
The full report is available on the TIPS website
www.tips.org.za

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info@tips.org.za +27 12 431 79007