Examples of industrial policy approaches within regional integration initiatives – some reflections for the Southern African Customs Union (SACU)

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This paper forms part of a broader research project TIPS has been involved in around developing common regional industrial policies

Contents

Abbreviations

AFTA	ASEAN Free Trade Area
AIC	ASEAN Industrial Complementation Scheme
AIA	ASEAN Investment Area
AICO	ASEAN Investment Cooperation Scheme
AIJV	ASEAN Industrial Joint Venture Scheme
AIP	ASEAN Industrial Projects
ASEAN	Association of Southeast Nations
ASID	ASEAN Supporting Industrial Database
BBC	Brand to Brand Complementation Scheme (ASEAN)
CEPT	Common Effective Preferential Tariff Scheme
CET	Common External Tariff (Mercosur)
CMC	Common Market Council (Mercosur)
CMG	Common Market Group (Mercosur)
ECC	European Economic Community
ECSC	European Coal and Steel Community
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
IMF	International Monetary Fund
Mercosur	Mercado Común del Sur (Common Market of the South)
MFN	Most Favoured Nation
MNCs	Multinational Corporations
NAFTA	North American Free Trade Agreement
NIEs	Newly Industrialising Countries
OECD	Organisation for European Economic Co-operation
OPP	Ouro Preto Protocol (Mercosur)
R&D	Research and Development
SACU	Southern African Customs Union
SIJORI	Indonesian–Malaysian–Singapore Growth Triangle
SREZs	Sub-regional Economic Zones
SMEs	Small and Medium Enterprises
TAC	Treaty of Amity and Cooperation
TENs	Trans European Networks
TOA	Treaty of Ascunsion
WTO	World Trade Organisation

Examples of industrial policy approaches within regional integration initiatives

This paper considers three examples of how regional integration initiatives have approached collective action in the field of industrial policy: the Association of Southeast Asian Nations (ASEAN), the European Union (UN) and Mercosur (Mercado Común del Sur – Common Market of the South). These examples (which are insufficient to rate as case studies) focus on understanding the drivers and motivation for regional integration in different parts of the world. The paper looks into how integration was supported and directed, and specifically how these blocs deal with issues of common industrial policies. It aims to assist in understanding the supply and demand for deepening regional integration and how integration options and approaches can be designed to respond to highly specific contextual circumstances. None of the examples are posited as blueprints for the Southern African Customs Union (SACU), but the lessons learnt from the experience of how these blocs deal with issues of problem solving and maintaining stability among members may provide useful ideas and learning moving forward.

Best (2007) argues that traditionally, when comparing regional integration processes, there is a tendency to place too much emphasis on the formal organs and structures of the institutional system and not enough on policies and underlying conditions. He argues that rather than comparing formal institutional structures, the real question is to identify relevant institutional capabilities, most important of which are the level of problem solving available and the stabilisation capacity of the regional arrangements. These capabilities will vary as a function of the degree of ambition of the regional project and the underlying conditions of the relationship between participating countries. These complex factors include: "the number of Member States, the relative size of participating countries, different levels of development, scope of coverage, type of impact, time perspectives, degree of real interdependence, political frameworks and shared perceptions, values and norms" (Best, 2007:3). Further, Best cautions that the institutions which embody these capacities must be *appropriate* not only to the real needs arising in a particular region but also to the specific historical, social and cultural traditions within and between the countries involved.

With these cautions in mind, a host of potential examples were considered for inclusion. It was decided not to limit these examples to the 13 World Trade Organisation (WTO) designated customs unions as the SACU 2002 Agreement[1] aims to be more than a traditional customs union, resulting in strict definitional limitations being an unnecessary constraint. It was also decided not to limit examples to those which most closely matched the contextual situation of SACU. This decision was taken because of the unique character of every national and trading bloc context and a lack of transferability and replicability, and also because it is often examples from very different situations that can be most useful to thinking outside the box and initiating debate. Rather examples were chosen based on specific lessons or ideas they contained relative to the debates on industrial policy. The focus within the examples is less on direct industrial policy and more on understanding the underlying conditions that inform and drive integration in these areas, and the capabilities put in place to achieve problem solving and stability with the bloc. Understanding the underlying conditions and context of integration efforts and the design of intergovernmental and supranational structures to direct or implement common activity is far more important for achieving deeper regional integration than the substantive commercial content of

[1] It took six years to negotiate the 2002 SACU Agreement. The output was a framework document, the details of which were to be developed subsequent to its signing. In the eight years since the new SACU Agreement came into force there has been little progress in developing Part 8 of the Agreement, which deals with Common Policies, and specifically Article 38, which deals with Industrial Development Policy. This slow pace of progress should not be construed as tardiness. Rather it is the manifestation of a myriad of complex drivers, motivations, attitudes and substantive challenges which characterise the current SACU context.

integration endeavours. The "how" of common industrial policies is as important a problem area for SACU as the "what" of common industrial policies.

The first example chosen was the EU. The EU was selected firstly because it is one of the few international examples of regional integration with an explicit industrial policy. The policy design is of great interest because of its simple framework structure, which then operates through a series of cascading spillover effects to create a sophisticated, multi-tiered collection of common limitations and opportunities for individual Member countries. This long-term approach to industrial policy is a particularly interesting characteristic of the EU, and one of the reasons underpinning its success and sustainability. The second reason for including the EU was to highlight its decision-making mechanisms and how these mechanisms separate out national interest from common interest, as well as the ability of EU industrial policy to be achieved using predominantly soft instruments and open method co-ordination techniques.

The second example selected was ASEAN, which was chosen for three key reasons. The first appealing characteristic of ASEAN was the acknowledgment of the ambivalence of the individual Members to each other and the association at its outset. How this ambivalence was accommodated and finally reshaped was seen as a highly relevant and interesting exercise in the context of SACU. The second reason was the association's emphasis on extra ASEAN organisations and tools which allow for activities over and above those catered for in the formal agreement of the association. Finally ASEAN was an interesting example because the Member countries essentially produced similar goods resulting in a competitive rather than complementary production scheme regionally. The development of joint production networks, intra-industry specialisation and value-chain development within the region was seen as an approach of potential interest to SACU.

Mercosur was chosen as the third example. Mercosur essentially demonstrates the risks of not getting problem solving and stabilisation capacities right for a given regional context. It is also a strong example of the difficulties of regional integration with a single hegemon and how principles and processes are key in resolving the issues between the hegemon and smaller states. Mercosur is a fitting example of how sustained disequilibrium between the supply and demand for regional integration and the failure to enforce agreements can lead to dysfunctionality and impasse.

European Union

History, structure and framework

The EU is commonly acknowledged as one of the best and most extensive examples of deep regional integration. The EU has followed a linear progression from being a customs union to an economic and monetary union and is making progress on several political union fronts. European integration is viewed as being of great significance in determining the changes in the structure and performance of industry in Europe over the past five decades, an impact that has arisen due to a proactive strategy to consistently: (1) deepen integration, (2) widen the scope integration, and (3) drive to enlarge the size of the union by admitting new Members. Despite the achievements of the EU, common economic policies and industrial policy in particular remain highly contested, highly variable and highly dynamic. Pelkmans writing for the EU Commission in 2006 noted that "there is a great deal of confusion about what industrial policy is, only surpassed by the confusion about what European industrial policy might be" (Pelkmans, 2006:2).

The birth of the EU, signalled by the signing of the 1951 Treaty of Paris which created the European Coal and Steel Community (ECSC), was a direct outcome of World War II. Historical rivalries between France and Germany, particularly over the Rhineland and Ruhr coal and steel, had been one of the main sources of conflict in modern Europe. After World War I France insisted on ruinous reparations from Germany, which are generally acknowledged as helping to fuel the fires for World War II. After the end of World War II France decided to not repeat its mistakes of 1915 and pursue punitive reparation, but to rather attempt to lead Germany into a united Europe through a gradual process of integration starting with the strategic coal and steel sectors. The birth of the EU was thus a political strategy aimed at creating conditions which would guarantee lasting peace in the region.

The Americans played an important role in shaping the EU in the early post war years. First the US was highly supportive of a united Europe and made Marshal Plan aid conditional on such co-operation by making such aid available only through the Organisation for European Economic Co-operation (OECD). In 1950 as the Korean War broke out and tensions with the Soviet Union escalated, the US placed increased pressure on European nations to let Germany rearm itself. Most European nations were unhappy with this idea but understood that it was the price that needed to be paid for continued American financial, political and military support for Europe. The concession of German rearmament was finally made but only with additional guarantees of commitments to increased integration to assure peace within Europe itself. These negotiations led to a commitment of the initial six Member States to creating a common market in Europe, a commitment to deepening integration and the creation of a supranational organisation. Thus in Rome in 1957 the European Economic Community (EEC) was established.

The reason why this history is so important is that initially European integration was a project aimed at delivering peace and political stability. In the words of Wallace (2002:202) "the security order of the Cold war made it possible for the economic integration of Western Europe to develop without directly confronting the most difficult issues of internal balance or of external foreign policy". The significance of this is that economic integration was not called on to do more than it could really be expected to do *by itself;* a point which SACU Members would do well to keep in mind as the debate on Article 38 gains momentum.

The 1957 Rome Treaty created a technical customs union whereby customs and tariff barriers within the community were abolished and a common external tariff applied. The aim, even in 1957, was to deepen this integration into an economic and monetary union, thus the customs union was merely a first step. In 1978 it was acknowledged that "other trade barriers" were hampering the achievement of a common market including: technical norms, health and safety standards, national regulations on the right to practice certain professions and exchange controls. All of these non-tariff barriers hindered the free movement of people, goods and capital. A White Paper, completed in 1985, set an extensive legislative and implementation agenda which would in seven years abolish all such barriers leading to a unified economic area on the scale of the US market.

In terms of institutional conceptualisation, the EU founding Member States were loathe to create supranational structures with too much top down power, as was the case with the ECSC High Authority. Rather they created a Commission and a Council.

- The Commission de facto runs the EU and Members work for a five-year term. Commission Members have to be independent and cannot take instruction from any national EU government. They are the guardians of the founding treaties of the EU and their job is to uphold the **common** interest. They answer to the European parliament. The Commission initiates programmes of work and legislation that further the common good of the union. This work may then be placed in front of the European Council, which is the main decision-making body of the EU and has legislative competency.
- The Council is comprised of one minister from each EU Member State and the minister who attends Council meetings varies depending on the topic being discussed. Binding decisions are taken by the Council based on achieving a majority vote, with each country's votes being weighted by the size of the country.

The important point to note in this set-up is that only the Commission (which is independent of individual Member States) can propose and initiate changes in regulations, new programmes or new policies. Using Best's point above, problem-solving and stabilisation capabilities in the EU are very strong due to the independent nature of the Commission and its mandate to serve the common good. The council, which by its composition is not independent, can vote in favour or against these initiatives but cannot initiate anything itself. Moreover, what the Commission can initiate and propose is highly curtailed by the EU framework and certain key principles of the EU.

The two outstanding principles of the EU common market is an unwavering commitment to the free market and a broadly accepted view by Member States not to imbue the supranational organs of the EU with powerful tools which could steer the direction of the union's economic activity. The second important constraining principle concerning economic and industrial policy is the principle of subsidiarity, which does not allow the Union to take decisions at a community level unless this will be more effective than action taken at national, regional or local level. The principle of subsidiarity arose not only as an expression of a deep belief to establish a market-driven approach to economic activity in Europe, but also on the explicit decision by Member States to limit the EU's power to engineer the future growth path of European industry. With industrial policy, this has resulted in the EU input on industrial policy being "long on analytic aspects and recommendations on how to mend ones ways in industrial markets, but short or relatively soft on concrete actions or the employment of significant funding and other instruments" (Pelkmans, 2006:6).

The EU is an economic and monetary union. At its barest bones the EU consists of the internal market, also referred to as the common market or single market, and a modest set of cohesion policies. The hard core of the union is the internal market and everything flows from this concept and the principles which underlie its development and operation. Pelkmans describes the internal market as "the free movement of goods, services and factors of production as well as the right of establishment across intra-EU frontiers, accompanied by all necessary common regulations and/or policies for this internal market to function properly" (Pelkmans, 2006:5).

To support this internal market, the EU has created framework issues which include: (1) the establishment of the internal market, (2) the proper functioning of the internal market, (3) competition policy, and (4) better regulation of the internal market. The establishment of the internal market essentially pertains to the freedom of movement defined in the definition of the internal market. The proper functioning of the internal market looks at ensuring that no market failures occur and deals with issues related to Member States distorting market signals, lack of standards and common policies and harmful activities. The third aspect of the framework aspects of the EU relates to competition policy, which is the cornerstone of the internal market and indeed the EU's industrial policy. EU Competition policy constrains agreements between firms, funding and aid from public authorities to domestic firms and any unfair monopoly actions which may distort free competition in the internal market. Finally the better regulation of the internal market is a new addition to the original framework design and includes processes by which common regulations are tested for their implications on Members States and individual industries to ensure that new regulation does not negatively affect the proper functioning of the market or cause unjustified harm.

A final introductory remark to make on the operation of the EU in general pertains to cohesion policies, which may be of special interest to SACU Members even though they are not considered in detail in this paper. Cohesion or solidarity policies in the EU are aimed at "correcting any imbalances by means of structural measures to help regions lagging behind or industrial sectors encountering difficulties" (EU, 2010). This may be roughly equivalent to what was in the minds of the drafters of the 2002 SACU Agreement when they spoke of "balanced" development.

The driver behind cohesion policies in the EU is not a philanthropic desire to assist poorer nations but to speed up such nations' economic development to support the completion of the single, internal market. This is a subtle but crucially important point. The Union funds these cohesion policies through an annual budget collected from Member States.[2] There are three broad types of cohesion policies. First, regional policies and aid which seek to "boost development in regions lagging behind, to rejuvenate industrial regions in decline, to help young people and the long term unemployed find work, to modernise farming and to help less favoured rural areas" (EU, 2010). Second, common agricultural policies and third social policies which seek to correct the most glaring inequalities in European society. This programme supported by the European Social Fund promotes job creation and helps workers move from one type of work to another or from one geographic area to another.[3]

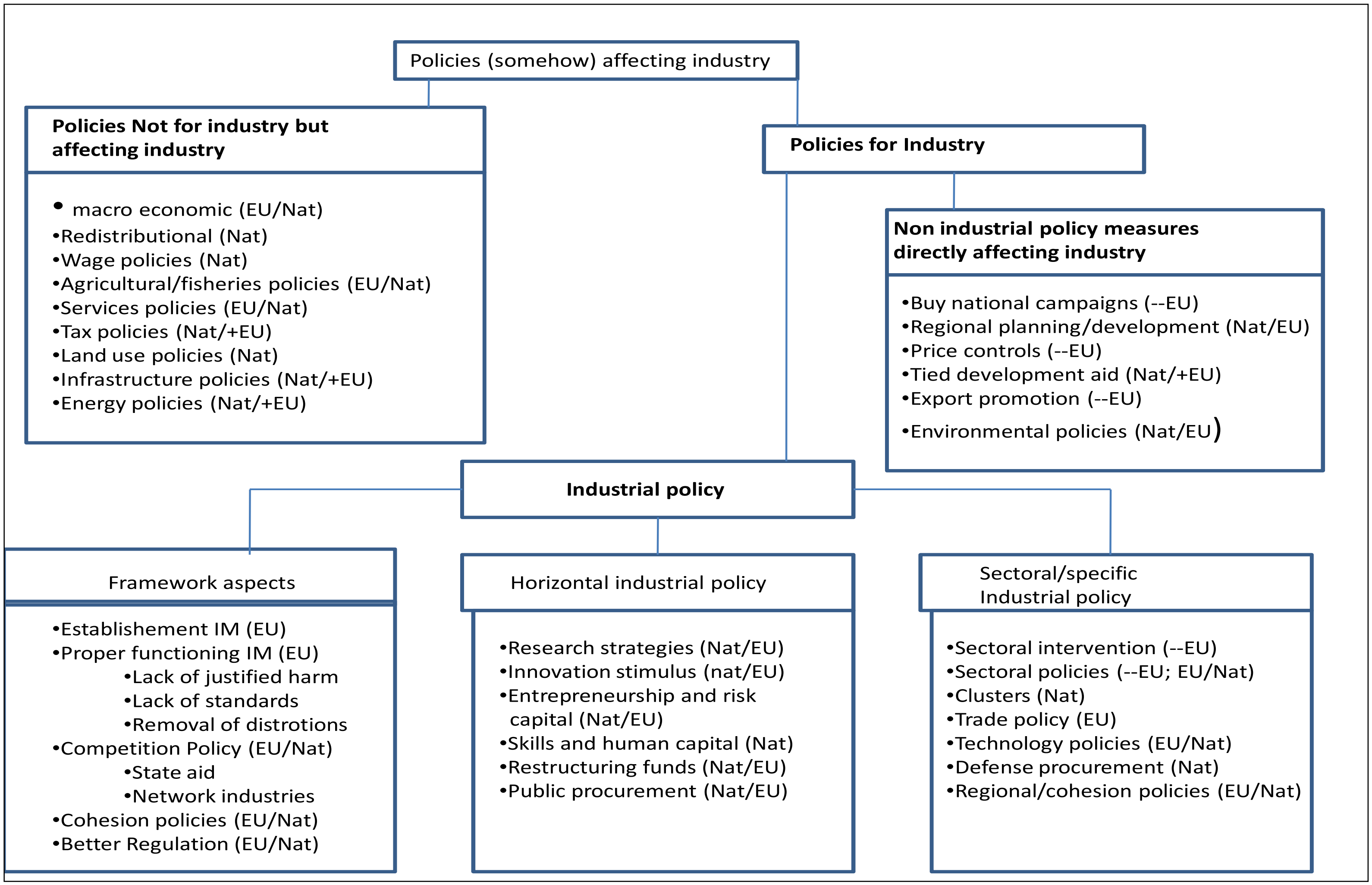
EU industrial policy

Figure 1 is a useful starting point to understand how industrial policy is conceptualised and administered in the EU and where the EU stands on a number of issues. The first thing to understand in this diagram is the legend in which six combinations of power relationships are at work. (EU) denotes activities which are entirely under the control of the EU. (Nat) denotes powers vested entirely with the individual Member States. (EU/Nat) denotes the sharing of powers between the EU and national government of Member States, with the preponderance of power lying with the EU and more limited Member State role. This contrasts with (Nat/EU) where again powers are shared, but most of the power lies at the national level with less power exercised by the EU. Nat/(+EU) denotes an essentially national power with only marginal EU inputs while (--EU) denotes situations where the EU imposes very strict constraints but a little leeway for national government input is allowed.

[2] In 2010 this amounted to 120 billion Euros, a trivial proportion of the EU's collective wealth, a mere 1.2% of combined Gross National Income of all the Member States.

[3] Eligibility for any of the cohesion measures is based upon GDP per capita calculations. If a country in the EU has a GDP per capita of less than 90% of the EU average it is eligible to apply for funding under these cohesion policies.

Figure 1: EU Industrial Policy Overview



Source: Pelkmans (2006:4)

The diagram shows that EU industrial policy includes both universal, broad, horizontal industrial policy elements, as well as narrow, targeted, sectorally specific industrial policy elements. However, the scope of both of these arms of industrial policy is highly constrained by the framework aspects, which control the establishing and functioning of the internal market. The framework aspects of EU industrial policy create systemic obstacles which severely limit acceptable activities in either the horizontal or sectoral agendas. For example, no horizontal or sectoral policies can contravene the framework's competition policy. As competition policies ban any government aid or funding directly to firms, this limits national governments' powers to undertake sectoral policies. Similarly no horizontal or sectoral policies may impinge on the freedom of movement of capital, goods, services or the right of establishment guaranteed under the framework. The only real leeway for national Member governments to pursue sectoral policies is through trade policies in which the EU allows Member States to determine tariffs at a six digit level, although Pelkmans argues that this is rare.

Even though sectoral policy intervention exists in name within EU industrial policy, in reality this type of industrial policy has all but disappeared in the modern free market context and constraints created by the framework resulting in "EU policy having a sectoral slant but only in a non interventionist way" (Pelkmans, 2006:17). Sectoral policies are now limited to encouraging actions such as regulations to support innovation and regulations to support small business development. This approach would not allow the interventions considered by Chang (2009) and Rodrik (2004) to be undertaken and would on the other hand be music to the ears of orthodox practioners such as Lin (2009) and Lerner (2010) who suggest the facilitative role of government only.

Although this is the current formulation of industrial policy within the EU, the debate as to whether the mix is correct and appropriate for the current environment continues unabated. In 2001 Germany and France approached the issue of sectoral industrial policy rather vehemently arguing that the threat of prolonged low growth rates in Europe, the emergence of China and India as manufacturing centres, and the reality that the US, China and India continue to undertake sectorally focused industrial policies all undermined European competitiveness, resulting in delocalisation and deindustrialisation with massive implications for manufacturing sector employment. The EU set these requests aside, arguing that the reallocation of productive resources and structural change are inevitable processes which should not be resisted; however, it did concede that resource reallocation within the common market was impeded by low levels of entrepreneurship and risk taking, resulting in structural change in the EU occurring too slowly and hence creating medium- to long-term threats to the union's ability to compete globally. On the basis of this argument, the EU adopted a sectoral policy aimed at supporting the technology and ICT sectors, although many analysts consider the interventions to be of such a broad nature that they fail to qualify as a sectoral policy. The new ICT policy has created a legal programme, and made some funds available to improve the effectiveness of public support for research and development (R&D), to redirect budgets towards R&D, to improve the framework conditions for R&D, and to support intangible investments in a pro-market fashion related to clean technology, promotion of spinoffs and improved quality. This type of general selective industrial policy adds fuel to the idea that, even in a pro free market approach to industrial policy, industrial upgrading is seen as crucial and it is accepted that sometimes the market pace of change is too slow for the ambitions of a country or regional bloc of nations.

What becomes clear in this short review of EU industrial policy is that some universal and some sectoral targeting occurs and that the mix between the two elements changes as environmental contexts and domestic situations change. In the EU what is crucial is that decisions are taken in the common good, and that the underlying principles of the framework are never contravened.

A final issue to cover in looking at EU industrial policy is to consider the EU's approach to infrastructure and whether the EU should play a role in providing infrastructure to the extent that it impacts on industrial competitiveness.

Infrastructure was taboo in discussions of European integration for a long time and prior to the Maastricht Treaty (signed in February 1992 and which led to the creation of the single European currency) no mention of infrastructure was found in any EU treaties. This is in sharp contrast to the case of the North American Free Trade Agreement (NAFTA) in which the adequate provision of infrastructure between Mexico, Canada and the US was a pre-condition for regional integration. The taboo regarding European infrastructure was finally breached in 1984 when a round table of industrialists listed cross-border infrastructure and infrastructure within certain Member States as an impediment to increased competitiveness (or what they labelled "missing links"). They argued that transiting countries was often needlessly expensive because links were missing or inefficient routing was imposed because of national interests. This applied to road and rail freight but also to network infrastructure in public utilities (which at that time had not yet been liberalised). Later this argument was added to, and industrialists argued that structural changes in industry has resulted in increased congestion, that national governments were under-investing in infrastructure, and that newer (poorer) Members of the union required additional infrastructure investment to allow catch up growth via foreign direct investment (FDI). An interesting point is that the issue was raised by private sector industrialists and not by either Members of the Commission or any individual Member (who can in a limited way initiate issues when they hold the Presidency of the Council).

The EU approached this debate by commissioning a survey, the findings of which showed that in general there was no under-investment in infrastructure among EU Members and that reallocating funds to new infrastructure projects might have the negative effect of reducing resources allocated to the maintenance of existing infrastructure and hence exacerbating the infrastructure problem. The survey also found that the link between additional public capital expenditure on infrastructure and growth was less than argued by the industrialists, thus essentially closing down the debate yet again, but this time on economic analysis grounds rather than political grounds.

A decade after the issue of European infrastructure was first raised, some concession was made in 1994 towards the role of the EU in infrastructure development. An argument was made at Maastricht that if ever the principle of subsidiarity was to apply to economic activity – the provision of infrastructure which allowed for network efficiency and seamless cross-border interconnections with all the externalities and scale which arises from such projects, was such an example. This argument was hesitantly accepted and the Trans European Networks (TENs) programme created. The programme was, however, designed to be weak. No funding was applied to it bar some minor funding for feasibility studies and some minor subsidies. In addition interaction with the programme was entirely voluntary. Pelkmans (2006:21) suggests that "TENs created more disillusions than concrete improvements in European infrastructure ... but that the awareness of the shortcomings of the 'Europeaness' of networks, or the absence of them has undoubtedly increased". Pelkmans and others suggest that in the future this issue will be revisited and the EU position one providing infrastructure will probably strengthen to aid competitiveness.

One point which emerges is that industrial policy within the EU is based on some strong founding principles which are inviolate, but that everything else is subject to debate, re-evaluation and reconsideration as contextual situations arise. The strength of the EU model is not that it is good at arriving at particular answers, but that it enables a process which is flexible and dynamic (within framework limits) and is good at problem solving and maintaining stability among its Member States and the common good. The EU is not characterised by strong and powerful instruments and tools which allow it to control the direction of structural transformation of European industry. Rather it is a set of regulations and frameworks that try to allow the market system to operate as efficiently and effectively as possible such that this system arrives at an optimal allocation of resources within the union. The heart of EU industrial policy is its market principles and processes and not its funding of activities or direct intervention tools. Funding activities are severely limited to cohesion policies and these policies are undertaken to complete the internal market in line with the framework principles and not for development for its own sake. The EU is a study of patience and integration by stealth and open method co-ordination. Steered by a deft and sophisticated touch, its influence and achievements are remarkable and a credit to clever design, process management and long game strategies.

ASEAN

The choice of ASEAN as an example of deepening integration, for a paper focused on co-operation in industrial policy in Southern Africa will appear to most as a highly peculiar choice, not least because of its fundamentally different cultural basis, economic starting point, technical level of integration and (until recently) marked lack of success in most of its endeavours. However, it is precisely this alternative approach to Western style, legalistic, institutionalised integration which is interesting, as well as some highly specific substantive programming and institutional and programme evolution which may be of interest to SACU and its Members. In addition one of the key characteristics of ASEAN which makes it a useful example to consider within the parameters of this paper is the "highly ambivalent attitudes" (Munakata, 2002) of the Member States to deepening economic integration and how the association dealt with this in a slow and gradual manner of trial and error.

The ASEAN Way

ASEAN was created in 1967 with the signing of the Bangkok Declaration. This was a response to a period of regional instability and confrontation following a wave of regional decolonisation, challenges on state legitimacy (Indonesian Konfrontasi) and contested territory (Sabah Province). Beeson argues that a Southeast Asian political space or identity did not exist in the 1960s but that ASEAN "indigenised an existing space that had been given de facto expression by colonial powers" (Beeson, 2008:5). This meant that the character of ASEAN was originally dominated by a lack of intra-regional relations, and was essentially reactionary in nature.[4] The aim of the Bangkok Declaration was "to accelerate economic growth, social progress and cultural development in the region through joint endeavours in the spirit of equity and partnership in order to strengthen the foundation for a prosperous and peaceful community of South East Asian Nations" (Bangkok Declaration, 1967:1).

In 1976 the Treaty of Amity and Cooperation (TAC) was signed and this document created the basis for the "ASEAN Way" as an alternative to "Western multi lateral decision making and liberal cultural values" (Bertorelli, 2008:8). The ASEAN Way incarnates five sets of principles which have been institutionalised by the Association during its history and established the norms and modus operandi of the Association. The foundation principles are:

> "(1) mutual respect for the independence, sovereignty, equality, territorial integrity, and national identity of all nations, (2) the right of every State to lead its national existence free from external interference, subversion or coercion, (3) non-interference in the internal affairs of one another, (4) settlement of differences or disputes by peaceful manner, (5) renunciation of the threat or use of force, and (6) effective cooperation among themselves". (TAC, 1976:2)

These principles led to an association which was intergovernmental in nature, had no legal persona and where no intent or even possibility to cede any sovereign power to any type of supranational or supra-regional organisation existed. This allowed Member States to join ASEAN in the full knowledge that they would be able to build and develop their nations free from institutionalised collective pressure or pressure from individual neighbouring states. Not only was ASEAN explicitly designed to be institutionally weak in accordance with the founding principles, but flowing from principles 1, 2 and 3, ASEAN was to operate on a basis of consensus building and aimed to avoid binding plans, treaties or legalistic rules choosing instead to manage affairs with a minimum of formality, a minimum of confrontation and as much social trust and compromise as possible. Essentially the idea was to develop regional forums on issues of common interest and for ASEAN to act as a benign mediator among Member States.

The ASEAN Way could not have been more different to the EU approach, but in the context of Southeast Asia at the time it was exactly what was necessary and indeed the only option which would

[4] The original signatories were Indonesia, Malaysia, Thailand, Singapore and the Philippines; later expanded to include Brunei (1984), Vietnam (1995), Lao PRD and Myanmar (1997) and Cambodia (1999).

work. The ASEAN approach is a good example of the point made by Best, that institutional structures of integration need to be contextual and support underlying conditions.

To understand the appropriateness of the ASEAN way prior to the 1997 Asian financial crisis it is necessary to understand what was happening politically and economically in the Member States. First, in the 1970s and early 1980s, national governments in the Member States were focused on nation building after independence and domestic political and economic growth issues outweighed regional interests. Nation state formation was a priority across the region and hence the importance of unconstrained sovereignty and self determination. The ASEAN Member States were also highly diverse in economic ideology (including communist and capitalist regimes), political systems (including democratic, authoritarian, totalitarian and military junta members), religion, culture and levels of development and industrialisation. Overall, however, the success of Japan and South Korea created a commonality of the acceptance of a developmental state where state-led growth, based on infant industries supported by massively high protection barriers and strong domestic policies to create both elite and middle-class buy-in dominated. Beeson (2008:8) describes the majority of ASEAN states in the 70s and 80s as "embedded mercantilist regimes" in which powerful domestically orientated political and economic coalitions were able to use their influence to create and sustain policies that protected them from outside competition. Adding these two drivers of embedded mercantilist regimes and nation state formation together it becomes obvious that any regional initiative which limited freedom in either of these areas would have been a deal breaker in the early days of ASEAN.

A second crucially important characteristic of the early ASEAN days is that in the 1970s and 1980s the Southeast Asian Member States were highly ambivalent towards each other economically. The economic structural transformations that were in play were creating economies which were competitors of each other and not complementary. In addition, and because of this, intra-regional trade was not considered important as state-led growth focused on export-led growth to the rest of the world. This creates a context highly different to what occurred in the EU. Within the EU intra-regional trade was a key driver in the establishment of the internal market and the decision to vest powers in a supra-national organisation. In ASEAN the markets of Japan, the US and the EU were seen as crucial to Member State growth, which led to a phenomenon of "talking regional but acting bilateral" (Munakata, 2002:2).

In an economic sense it can be argued that, despite the Bangkok Declaration's intention of supporting economic growth through joint actions, neither the ASEAN Way nor the path of economic development and structural transformation implemented at a Member State level created any real drive, structures, processes or political will toward regional integration if regional integration is understood as formal economic co-operation and economic arrangements of a group of countries to facilitate or enhance de facto regional integration. However, ASEAN Member States did begin to integrate but this was a market-driven process and not a politically-led process. Essentially what happened was that left to their own devises, individual Member States following the successes of Japan and South Korea began to implement economic policies of export-led growth which required some opening up of their domestic markets. Member States began to unilaterally liberalise trade and investment and undertook policies to improve domestic production capabilities in manufacturing based on their low-wage comparative advantage, but supported by strong policies to upgrade technology and upgrade industry as described by Chang and Rodrik.

Essentially in the early days of ASEAN these newly industrialising countries (NIEs) set themselves up to be off-shore production units of mainly Japanese and American multinational corporations (MNCs) and FDI flowed into the region at an amazing rate. The structure of these capital inflows was possibly *the* determining factor in the path of regional co-operation which emerged in Southeast Asia as a region. The MNCs did not make large investments in individual Southeast Asian countries. Rather they set up regional production networks and promoted an intra-regional division of labour through fragmentation of the production process into different sub processes located in different countries based on comparative advantage, relative factor proportions and technological capabilities. These changes, driven by the MNCs, stimulated vertical intra-industry trade in: parts, components, semi-finished goods and finished products, which was supported by bilateral trade agreements where necessary. As Kawai (2005:4) argues "the large flows of FDI to ASEAN Member States have stimulated the regions engagement with trade in a way that reflects the individual Member States economic stages of industrial development and deepened economic interdependence".

In these early days, market-led processes were the key driving force of deepening economic integration and this growing interdependence was facilitated by Member States unilaterally entering into trade agreements with other Member States to support continued FDI flows and intra-industry flows. ASEAN sought to functionally support and add institutional ballast to this process by adding institutionalised elements to an unfolding organic process. This support was housed in extra-ASEAN organisation structures as ASEAN itself was not a legal entity and its principles and structure made such support impossible in-house. These industrial co-operation schemes, as they were termed, were based on the principles of resource pooling and market sharing to facilitate effective exploitation of economies of scale and locational advantages. Participation in the schemes was voluntary, no compliance issues were placed on the table and a minimum of legality was used to achieve their outcomes.

Before discussing these initiatives it is interesting to note that there is virtually no research or information available on the programmes.[5] This is in stark contrast to EU programming for example where copious amounts of research, analysis, evaluation and re-evaluation exist. The reason for the disparity of information is probably a direct outcome of the ASEAN Way where programming is decided in an informal manner based on consensus and not driven by well-capacitated research functions. This is interesting in the context of SACU: the agenda for co-operation in ASEAN arose not from a broad, principled approach to developing and internal market or getting fundamentals right — as in the EU – but simply on problem solving specific issues as they were identified by Member States at a particular time.

The first initiative adopted in 1977 was the ASEAN Industrial Projects (AIP). The aim of AIP was to establish large-scale regional industrial projects which would meet the basic needs of the region and ensure the most efficient use of the regions resources. In this scheme each of the five ASEAN Member States received a first-line project in which the host country would own and finance a 60% share of the equity of the company with the remaining 40% being owned and financed equally by the other four Member States. In some instances it was decided that the countries would jointly seek funding for their equity stakes abroad (mainly from Japan). The initial five projects were: the Urea Project in Indonesia and Malaysia, a rock salt soda ash project in Thailand, a phosphate fertiliser project in the Philippines and a diesel engine project in Singapore.

The AIP projects would enjoy ASEAN-wide marketing preferences as well as pre-agreed purchases, thus ensuring a rapid enhancement of economies of scale. Despite voluntary agreement to the projects, the programme ran into difficulties and only two of the initial projects were finally completed. The first problem with the scheme was that at this early stage in the Member States' economic development, the Members were still reluctant to grant other nations exclusive rights of production in areas which were of national concern. According to Lim (2004:203) "the receipts from a specific AIP often seemed unequal to the apparent sacrifice of individual Member State plans". This led Members to try to limit the scope of AIPs such as when Indonesia tried to persuade Singapore to limit its diesel engine production to engines with more than 500 horse power, when in fact the major market in ASEAN was for engines below 500 horse power. Indonesia's actions resulted in Singapore withdrawing from its AIP. Other problems included: disagreement on the level of protection which should be supplied to these projects, disagreement about funding infrastructure costs associated with the commercial enterprises, and pricing issues, given that non host countries had to guarantee purchases. The AIP was a good idea to solve a specific identified problem but it did not work on the

[5] This is bar broad outlines available through the ASEAN website and odd references in academic papers.

ground. This and subsequent failures were seen as inevitable, given ASEAN's approach of agreeing first and negotiating later.

ASEAN launched its ASEAN Industrial Complementation Scheme (AIC) in 1981 and the Brand to Brand Complementation Scheme (BBC) in 1988. The programmes focused on the automotive industry and sought to promote complementarity between firms in the region. The schemes sought to encourage automotive brand owners to exploit economies of scale of production through rationalisation and specialisation of automotive production units by allowing the exchange of approved automotive parts and components for specific brand models. These parts and components were granted a 50% margin of preference of the prevailing Most Favoured Nation (MFN) rate by the participating importing countries, as well as local content accreditation. This scheme was eventually expanded to cover non-automotive sectors in the ASEAN Industrial Joint Venture Scheme (AIJV) which operated on similar principles. Neither scheme was a great success mainly due to continued sensitivities to domestic industries as well as bureaucratic inefficiencies which made the scheme unattractive to private sector investors, and the fact that the scheme was used unevenly among Member States.

By 1992, ASEAN admitted that its programmes (AIC, BBC and AIP) to date had not been successful and made a qualitative leap forward by creating the ASEAN Free Trade Area (AFTA) using a Common Effective Preferential Tariff Scheme (CEPT). It was agreed that within 15 years intra ASEAN tariffs would fall into the zero to five percent range, but with everything ASEAN this agreement was unique in terms of its flexibility and gradualism. Each Member State could allocate goods under four lists: the inclusion list, the temporary exclusion list, the sensitive list, and the exclusion list. Each list had different tariff reduction deadlines and each country had different deadlines.

Despite its flexibility the AFTA represented a huge shift in ASEAN; it essentially contravened the founding principles of the Bangkok Declaration. The shift to a formal FTA and its imposition on national sovereignty has been attributed to various factors. Munakata (2002) ascribes the shift to the increased maturity of East Asian economies, which after 30 years of some form of regional co-operation had learned to appreciate the efficacy of formal institutional arrangements in their own right as well as their power to provide political momentum to domestic reform. Kawai (2004) argues that the main influence in the sea change was the end of the Cold War and the growing role of China, both of which were seen as threats to the FDI flows which had been crucial to the growth of the region. Beeson (2008) suggests that it was the threat of the growth of NAFTA and the EU, which potentially would lead to the marginalisation of the Asian zone, which finally pushed ASEAN to amend its traditional approach to regionalisation. Irrespective of the motivations the reality is that the gradualism of ASEAN's history since its inception, the creation of trust and the increased real economy interdependence between nations under its stewardship all led to this group of nations to a point where they were able and happy to move towards a formal economic institutional structure which required compliance and some limitation of national sovereignty. In this way ASEAN became embedded in the domestic policies of individual Member States.

The Asian crisis

The Asian financial crisis of 1997 shook ASEAN to the core as it showed that the association had no safety mechanisms or policies in place to protect or rebuild the decimated regional economy after financial contagion had set in. Almost all of the solutions which did emerge immediately after the crisis were put in place either by individual ASEAN Member States or through outside assistance from organisations such as the International Monetary Fund (IMF). At that time critics suggested that ASEAN would likely dissolve. However, ASEAN re-invented itself and put forward a plan for deeper economic institutionalisation and a fundamental strengthening of institutional mechanisms which included: creating formal dispute settlement mechanisms, legal bodies and groups to work on individual protocols and legislation, the inclusion of technocrats in decision-making policy, and increasing the power vested in the ASEAN Secretariat to facilitate efficient processes in extra ASEAN organisations. Ultimately this process has culminated in the adoption of the ASEAN Charter with

ASEAN Members committing themselves to forming a single market where all barriers to trade and investment are ultimately removed.

While the process and blueprints for how this economic community will be rolled out and designed is fascinating reading, in terms of the purpose of exploring ASEAN as a case study of interest for SACU, these developments are not necessarily on topic. What is, however, useful is to consider briefly two specific initiatives forged to support this ultimate goal of economic union — programmes which may be of interest to SACU in spirit if not necessarily in substance. The two programmes are the ASEAN Investment Area (AIA) and ASEAN Investment Cooperation Scheme (AICO). They are interesting not only because of the outcomes they seek to achieve, but also because they incorporate what would normally be regarded as soft tools, dealing with issues of low polity.

The AIA is a framework agreement which seeks to establish a competitive "ASEAN Investment Area in order to attract greater and sustainable levels of FDI into the region and to realise substantially increasing flows of FDI from both ASEAN and non-ASEAN sources by making ASEAN an attractive, competitive, open and liberal investment area". The agreement binds the Member countries to "progressively reduce or eliminate investment regulations and conditions, which may impede investment flows and the operation of investment projects in ASEAN" and to ensure the implementation of AIA within the agreed timeframe. The agreement on the AIA provides three pillars of broad-based programmes for encouraging investment in the ASEAN region: (1) co-operation and facilitation, (2) promotion and awareness, and (3) liberalisation.

Programming for pillars one and two includes: joint promotional seminars and activities to attract foreign direct investment; joint promotion to attract FDI in higher technological-based industries and high value-added activities; joint publications on investment regulations, policies, procedures and opportunities to further enhance the transparency of ASEAN's investment regime; simplification of ASEAN countries' investment procedures; joint training programmes for ASEAN's investment officials on investment promotion; closer co-operation among ASEAN investment agencies through exchange of investment data and information; and updates on any policy changes. Other work programmes include linking ASEAN Member countries' homepages to the ASEANWEB; joint promotion events within and outside ASEAN, joint human resource development projects, joint data collecting, reporting and monitoring systems and joint publications to assist the private sectors in their investment decision-making processes. Three fast tracked priority projects are:

1. ASEAN Supporting Industrial Database (ASID) for supporting industries for manufacturers and suppliers of ASEAN countries;
2. A directory of ASEAN-owned technology suppliers for facilitating intra-ASEAN sourcing of technology, enhancement of investment match-making, promotion of joint venture operations and to provide opportunities to technology suppliers in the region to supply technology to third countries;
3. A compendium on investment policy and measures of ASEAN countries for providing general information on investment policies and measures of the Members.

Finally, ASEAN work groups dealing with the AIA recognised the importance of the private sector. They convened a conference where the ministers of ASEAN countries met with world corporate leaders to encourage private sector companies to interact and to explore the opportunities present in the region. It was also agreed that individual ASEAN countries should also consult the private sectors in their respective countries on what specific measures could be adopted to improve the investment climate. In this connection, they urged the private sectors to participate actively in these consultations.

The second major programme to be launched after the 1997 Asian crisis was AICO, which was a replacement for the AIJV and BBC programming undertaken earlier with minimal success. The purpose of AICO was the "improvement of the competitive position of ASEAN companies in the global and ASEAN markets by providing the means to apply the principles of economies of scale and scope in the manufacturing process, supported by preferential import duties to enhance across ASEAN border transactions, as well as, stimulation of intra and extra-ASEAN investment through complementation of industrial activities and networking as well as the improvement of the overall trade and investment prospects in ASEAN".

The new industrial co-operation scheme was envisaged to operate in a way that would be mutually beneficial and equitable to all ASEAN Members, be private sector driven and be specifically attractive and manageable for small and medium enterprises (SMEs). The programme would be AFTA based and offer incentives other than tariff reductions and local content accreditation as in the old scheme, with these additional incentives being offered by individual Member States. Essentially the programme works by two companies in two separate Member States forming a co-operative AICO agreement to produce and sell either finished goods, intermediate products, components or raw materials to each other in a drive to achieve complementarity in regional production. AICO approved agreements achieve an immediate 0% to 5% tariff rate irrespective of the AFTA timeline for tariff reduction. Further incentives are available on a Member State to Member State basis.

The key to the AICO programme is not that intra-regional trade is increased via this programme but that a deeper integration occurs based on resource sharing and resource pooling. This deepened integration is perceived to occur at three levels.

1. At the level of manufacturing, the architects of AICO hoped that the scheme would promote the exchange and sharing of manufacturing process technology, product development, application know-how, R&D facilities and the appropriate training service. In addition joint production would hopefully allow Member States to use the principles of division of labour and the existing disparity of technical capability to reduce production costs and attain economies of scale.
2. At the second level of deepening economic integration, AICO hoped to support more efficient non-manufacturing logistics. This was to be achieved via the exchange of marketing data and providing local marketing services for the partner company, combining of material requirements into a bulk sourcing and purchasing arrangement, providing local after sales and distribution services for the AICO product of the partner company, and integrated centralised, regional procurement planning including actual sourcing and subsequent distribution to partners in the AICO arrangement.
3. Finally at the third level of integration, which is characterised by corporate integration, it was hoped that AICO would lead to joint ventures, licensing and similar intellectual propriety arrangements, and logistic support arrangements in the distribution, product planning and marketing areas.[6]

In terms of the role of infrastructure in supporting integration, as with the EU, it is interesting to note that ASEAN has also to a large degree forsaken this particular aspect of integration with no formal ASEAN programme on the table to either improve overall efficiency of cross-border trade and physical interconnectedness, nor to deal with the huge infrastructural disparities between its poorest members and wealthiest members. The only momentum on this front has arisen (as in the EU) from industry and the private sector. In ASEAN this has occurred through the development of sub-regional economic zones (SREZs) such as the well known Indonesian–Malaysian–Singapore Growth Triangle (SIJORI) and the Greater Mekong Sub region. These initiatives have attracted substantial private sector investment in infrastructure and, where possible, local and national government investments have been crowded in.

In summary it can be seen that ASEAN's journey towards deeper economic integration through common industrial policies is fundamentally different to that of the EU. Economic ambivalence between Member States, and a strong domestic nation building drive created a non-conducive

[6] To date over 300 AICO associations have been formed and this number is expected to rise as progress is made in the 11 priority sectors identified for fast tracked deeper integration.

environment for the initial creation of ASEAN, and rather than fighting these underlying conditions, ASEAN was designed and structured to roll with these realities rather than to reshape them. This patient and gradual approach paid off over time as Member States matured and learnt to appreciate the value of regional integration allowing them slowly to defer some sovereignty to ASEAN and constrain their national policymaking freedom. The role ASEAN played in these intervening years was predominantly to add institutional ballast or support to an unfolding organic process which was driven by the private sector and large multinational corporations. Despite the fact that many of these support measures were initially unsuccessful and required substantial redesign and re-evaluation, they ultimately succeeded because they improved commercial outcomes and national growth opportunities past what could be achieved by an individual nation acting in isolation or via bilateral agreements. As with the EU, many of ASEAN's instruments are soft and based on open method co-ordination rather than legislative instruments and fiscally intense resource flows. There is no doubt that ASEAN's industrial policy role was largely informed and driven by the reality that the Member States had all adopted similar routes to establish domestic economic growth and development, but the true success of its common industrial policies lay in the understanding of what these policies could and could not achieve. As with the EU, in the ASEAN example common industrial policies were not asked to achieve more than they could legitimately be expected to achieve by themselves. As such the dual lessons from ASEAN must be gradualism and realistic expectations.

MERCOSUR

Mercosur is an interesting example for SACU in so far as it provides a cautionary tale of how regional integration can reach an impasse structurally, politically, economically and commercially. Using Best's criteria of integration models being useful learning tools of how regions resolve common problems and create stability, Mercosur is the poster child of what not to do. Yet in its failures great lessons can be learned from it and, despite years of commentators predicting its demise, the institution is still in existence. The focus in this example is slightly different to that used in the EU and ASEAN examples and focuses less on history, structures and common industrial policy and more on understanding the drivers and underlying conditions of integration performance and non performance.

The story that emerges is that Mercosur is characterised by a disequilibrium between the demand for, and supply of, deeper integration by individual Member States. Whereas ASEAN dealt with a similar initial disequilibrium overtly in its structural design and modus operandi, Mercosur made no such accommodation leading to unfulfilled expectations, resentment, fragmentation and a lack of cohesion. In many ways SACU reflects many of the same characteristics of Mercosur and as such the lessons from Mercosur could be invaluable in red flagging certain issues for SACU moving forward.

History, structure and framework

The birth of Mercosur, as with ASEAN and the EU, was driven by a confluence of economic, political and external factors. The late 1980s, the Southern Cone was characterised by a shift from military rule to democracy and a shift away from import substitution and high protectionism towards more liberalised outward looking economic policies. In 1986 Brazil and Argentina, the dominant economies in the area, signed a Treaty of Integration, Co-operation and Development, which was to create the embryo of Mercosur.

The 1986 Treaty was driven by three motives. First both the new democratically elected Presidents accepted that democracy in the region was both nascent and of a poor quality (Malamud, 2000:4) and that elite led governments were susceptible to popular revolt and back sliding. Against this contextual reality it was perceived that regional commitments to maintaining democratic leadership would strengthen the governments' ability to maintain and develop democracy domestically. Second, secular distrust between Argentina and Brazil was substantial and the signing of the Treaty was aimed to secure mutual recognition and create a basis for improved trust between the two nations. This was particularly important for Brazil, which believed that Argentina often undermined its position internationally and especially with the US in matters of foreign relations. The third driver of the treaty was economic but this was not a powerful determining factor given that bilateral trade negotiations between the two were already well advanced. Nevertheless Argentina was particularly keen to gain greater access to Brazil's domestic market and Brazil did see a benefit in securing a path towards increased liberalisation despite initially low levels of economic interdependence. There is a difference in opinion as to how important these relevant drivers were to the creation of the Argentina–Brazil Treaty but the consensus position appears to be that Brazil's motivation was essentially political and aimed at improving its international reputation and weight in international trade and foreign policy matters, while Argentina's main motivation was based on the prospects of commercial gain and domestic political considerations.

Paraguay and Uruguay, which established democratic regimes after years of military rule in 1989 and 1984 respectively, approached Brazil and Argentina to join their Treaty based mainly on their need to cement democracy in their nation states and the perceived value of access to Argentina, and especially, Brazil's substantial markets. Following the signing of the Treaty of Ascunsion (TOA) by Brazil, Argentina, Paraguay and Uruguay, Mercosur was born in 1991. Bouzas (2008) notes importantly that Mercosur at its outset was an amalgam of different national interests but that because these differences were not incongruent, beneficial arbitrage was possible and a potentially mutually beneficial compromise arrived at[7].

The drivers of Mercosur, from an economic perspective, appear to share more in common with the ASEAN example than the EU example. In both Mercosur and ASEAN the initial level of economic interdependence was low both in terms of intra-regional trade as well as market fragmentation and FDI. The first step for ASEAN and Mercosur therefore was to increase this level of economic interdependence. In the case of the EU the scenario was fundamentally different: since economic interdependence and intra-regional trade was already high, the EU thus sought initially to administer the effects of this interdependence rather than to raise its level.

The Treaty of Ascunsion set out to continue the liberalising trend that was already underway among its Members and to then establish a customs union with a common external tariff. The Treaty was written in just seven weeks (versus the eight years to conclude the 2002 SACU Agreement) and was short and relatively ambiguous on many issues, providing essentially a framework document. The TOA covered five main areas: (1) an automatic and across the board trade liberalisation programme, (2) a general regime of rules of origin, (3) procedures for intra-regional safeguard, (4) a target date to enforce a dispute settlement mechanism and (5) 10 working groups to advance the co-ordination of macroeconomic and sectoral policies. The TOA called for economic development with social justice, but it did not include any compensation mechanism. Distributional effects were to remain issues of national policy and the only concessions granted to smaller states were longer convergence periods.

At the signing of the TOA there was little agreement on the institutional structure, decision-making procedures or specific responsibilities assigned within the agreement and the Members agreed to a transition period from 1991 to 1994 wherein certainty on such issues would be dealt with.

In 1994 the Ouro Preto Protocol (additional protocol) (OPP) was signed which was supposed to provide clarity on how to make Mercosur operational and issues outstanding in the TOA. The OPP was driven by the Members' desire to adopt a strictly inter-governmental approach to regional integration rather than the creation of any supra-national structures. Ostensibly this decision to have no autonomous bureaucracy separate from national administrations was driven by the desire to "prevent the isolation of decision making layers from the national agencies responsible for enforcement" (Bousaz 2008:4), a problem which had been encountered in previous Latin American integration efforts such as the Latin American Free Trade Association and the Latin American Integration Association. Gruegel (2005) suggests that an additional reason lay in the desire to maintain national sovereignty and the role of domestic political and economic elites who believed that they would be more effective in influencing national policies than regional policies. However, a more likely reason for

[7] This is an extremely important insight in relation to the different national interests of SACU member states and the fact that in Mercosur these differences were not incongruent, whereas in SACU they are.

adopting a weak institutional Mercosur structure was Brazil's underlying belief that regional integration with Argentina, Uruguay and Paraguay were unlikely to yield benefits which would outweigh the costs of Brazil forfeiting policy sovereignty.

The OPP, building on the TOA, established a Common Market Council (CMC) made up of top politicians from the Economic and Foreign Relations ministries of the four Member States. The CMC had decision-making authority and the power to further develop rules and institutions. The Common Market Group (CMG) was established as the executive of the CMC and was tasked with enforcing CMC decisions, making recommendations to the CMC and overseeing technical works completed by the third organ of Mercosur, the 10 working groups[8]. In addition, a Trade Commission was established, a joint parliament and an Economic and Social consultative forum to represent non-government actors. Finally, an Administrative Secretary was established to co-ordinate the work of Mercosur. Only the Administrative Secretary had a budget and a small staff. All other organs used Member nation government resources.

This bias towards inter-governmentalism was not viewed as a weakness or sub-optimal option at the time of formation, and the system worked initially. Nevertheless, two structural constraints arose early in the process which would ultimately undermine Mercosur's ability to implement problem-solving solutions and maintain stability among its Members.

1. The first problem in the OPP's structuring of Mercosur was that the system reproduced disagreements rather than creating a framework for resolving them. The 10 working groups and the CMG carried out some sound work in the early years, but when disagreements and problems arose at the technical layer there was no mechanism to resolve such impasses at a political level where decisions were arrived at on the basis of consensus. If consensus could not be achieved the problem reverted back to the CMG and working groups, thus creating a cycle of inaction and impasse.
2. The second problem in the structuring of Mercosur was the notion of incomplete acts. When Mercosur Member States through the CMC agreed to pass an act or regulation these acts or regulations become mandatory for all Members. While technically mandatory, they were, however, neither immediately applicable nor did they have direct effect. This is because Mercosur being a non-supranational entity could not impose acts or regulations on Member States. Rather Member States needed to internalise these through their own national legal system and domestic legislation. Mercosur did not have the power to impose time limits on this internalisation and hence internalisation only occurred if there was sufficient political will to drive such legislative change through; if there was sufficient bureaucratic and administrative power to see change completed; and, if the Mercosur acts and regulations did not contravene to existing Member State national legislation (which they often did). In addition the acts and regulations at a Mercosur level did not come into full effect until all four Member States had internalised said acts or legislation. The result was an institutionally weak integration system which was not rules based and where the gap between agreeing policies and implementing them could potentially be large and destabilising. This led to what Bouzas termed a widening enforcement gap which ultimately led to increasingly negative attitudes towards Mercosur, especially among its smaller members which were often left waiting for Argentina and Brazil to internalise Mercosur acts and legislation.

The period of innovation and success

Mercosur did enjoy some initial success, especially in increasing economic interdependence and increasing the level of economic interdependence. In the transition phase intra-regional trade flows increased substantially and interdependence deepened particularly between Brazil and Argentina.[9] In

[8] On communications, transport and infrastructure, mining, technical regulations and assessment of conformity, financial issues, industry, agriculture, energy, labour, employment and social security issues.
[9] In this period of just four years the intra-regional export to GDP ratio increased over 60%.

line with agreements reached in the TOA, the four Member States removed all tariffs with the exception of those applying to a handful of sensitive products which attracted an automatic calendar of elimination by 2000 and two special sectors (sugar and motor vehicles) which were transitorily excluded from free trade. By 1995 up to 90% of Mercosur trade was free from tariffs. Movement on the reduction of non-tariff barriers, however, failed to materialise despite the two smaller states continually raising such issues. By 1994 Mercosur had also made substantial progress with its common external tariff (CET), which was initially set to equal a weighted average of the national tariffs levied by the Member countries before the formation of Mercosur. The CET ranged from 0% to 20% with a range of 0% to 9% for raw materials and some food stuffs; 10% to 15% for semi-processed goods and agricultural products; and 15% to 20% for textiles, manufactured goods and consumption goods. Across all product types, the average external tariff was originally 12% but this rose to 15% in 1997. Progress on the CET was not, however, straightforward.

The terms of the Mercosur agreement allowed each Member country to maintain its existing national tariffs on 300 specific products which roughly equalled 15% of all types of products (Connolloy, 1999:2) for a period of 10 to 15 years. The Member nations justified these higher tariffs on the grounds that domestic producers of these goods needed more time to prepare for international competition and that productivity gains achieved by trading such goods within Mercosur would allow the space for competitiveness to increase. As such trade policy was closely linked to domestic industrial policy. In 2000 almost 50% of intra-Mercosur trade was made up of products exempt from the CET. The key sectors affected by these exemptions were: capital goods, computer hardware, professional electronics, telecommunications and vehicles. Leipziger et al. (1996), Connolly (1999), Garay (1995) all argue that the protracted continuation of national tariffs in these politically important industries suggests that not only have the changes in structural transformation of production and trade expected from the formation of Mercosur not occurred, but that the de facto limitations which these actions induced dampened the ability of Member States to fully take advantage of world best technology and industrial upgrading – thus limiting their growth prospects. This view would support most commentators' views that the dynamic effects arising from Mercosur were minimal, if not negative.

So, initially at least, the lowering of trade barriers between Member States did result in economic deepening and increased intra-Mercosur trade and economic interconnectedness. The relative size of trade creation and trade diversion, however, remains moot. As a percentage of total trade, intra-Mercosur trade rose from 12% in 1991 to 19% in 1994. Intra-Mercosur exports showed especially high growth rising from 11% of total exports in 1991 to 20% in 1996. The rising share of trade claimed by Mercosur Members clearly came at the expense of non-Member countries and scholars such as Yeats (1997), Garriga (1995) and Michaely (1996) all suggest that substantial trade diversion did occur.[10] At the same time it was also shown that substantial trade creation had occurred. Thus, Leipziger *et al.* (1996:590) still report that "most analysts conclude that trade creation effects dominated trade diversion effects ... suggesting that the welfare effects of Mercosur are probably positive but not very large".

As such, despite a lack of progress in dismantling non-tariff barriers, despite a lack of progress on regulatory and project developments, despite the incomplete nature of the CET and thus the incomplete character of the customs union it is generally agreed that in the transition period from 1991 to 1994, even extending to 1997, Mercosur could be viewed as a success. Many attribute this success to the fact that the initial goals of trade liberalisation were essentially simple from an institutional perspective and not at all contentious from the standpoint of Member countries internal politics. It was once this period of low polity, easy institutional reform was complete that the underlying problems of Mercosur began to be highlighted – issuing in a period of crisis often referred to as a period of de-mercosurisation.

[10] Specifically Yeats (1997:17) comments that "since comparative and competitive advantages were shown to not be the driver of increased intra Mercosur exports .... increased trade arose from the greater level of protection afforded by higher common external tariffs as well as non tariff barriers in those industries".

Period of crisis

Following the transition period, Mercosur's internal agenda shifted focus towards issues not directly related to merchandise trade and the trans-border movement of goods. This agenda was concretised at the re-launch of Mercosur with the signing of the 2000 Agenda in Montevideo, which dealt not only with a host of organisational and rule-making issues but also an expanded commercial agenda including: the desire to harmonise the use of production, export and investment incentives; developing financing instruments to facilitate integration via infrastructure and industrial re-conversion[11]; and mechanisms to avoid the establishment of new barriers or distortions caused by the creation or modification of domestic regulations. The agenda was viewed as a shopping list and entirely unobtainable by all concerned. The reasons behind why the agenda would not be attainable are of greatest interest to SACU.

Dealing with non-trade related issues is always complex in regional arrangements but in Mercosur this tension was heightened by two key factors: the attitude of the regional hegemon Brazil and the size asymmetries between the Member States. The vast gulf in economic weight and size of the two smaller Mercosur Members, Paraguay and Uruguay, versus the relative size and power of Brazil and Argentina resulted in enormous asymmetries of interdependence among them. The smaller countries had greater dependence than the bigger partners on neighbouring countries markets and smaller Members were more deeply affected by the economic policy decisions of the larger countries than the other way round. On this basis different Member States had different incentives to include certain items on the Mercosur agenda. In essence this boiled down to the larger partners having fewer incentives to include issues which would reduce national autonomy in economic policymaking, while smaller Members were in favour of such limitations. Brazil's position on this issue was clear. The regional hegemon believed that "the limits to the integration related cessation of sovereignty should be defined by Brazil's national goals and that such goals take primacy over the goals of the sub region" (Veiga, 2004:6).

The attitude of Brazil was first evident in multiple occasions but most notably when it unilaterally and without consultation devalued its currency essentially wiping out intra-Mercosur exports from Paraguay and Uruguay, and again two years later when it re-embarked on a strongly interventionist sectorally focused industrial policy supported by substantial incentives which rerouted FDI in the region. Goncalves (2002) argues that in the negations with Brazil's Mercosur partners, the national Brazilian development project was systemically expressed as a process of competition and conflict and never as a matter of co-operation. This, he argues, was strongly tied to the Brazilian political and economic elite's view that "Mercosur was a political contingency, one option amongst others" (Goncalves 2002:17). By 2003 Paraguay and Uruguay were seriously considering leaving Mercosur due mainly to the business community questioning the benefits of regional market integration versus global integration. The idea of "enter the world and skip the neighbourhood" (Mondelli, 2007:6) began to take traction domestically especially when the US offered Uruguay a free trade agreement. Brazil and Argentina have managed to hold Mercosur together using presidential diplomacy and a series of bilateral accommodations to overcome specific moments of crisis.

It has been argued that the only reason why Mercosur remains intact is because of the desire of the Southern Cone Member States to remain relevant in the era of globalisation and in the face of trading blocs such as NAFTA, the EU and ASEAN. Smouts (2003, cited in Viega, 2004:6) suggests that "regional constructions ... seem to respond to the perceived need for new political arenas towards which social forces can direct expectations that the nation state is unable to meet". Many believe that Mercosur is now more a political than an economic vehicle, a situation compounded by the inclusion of Venezuela into Mercosur in 2006.

Voluminous literature has been produced suggesting possible routes of recovery for Mercosur and the changes necessary to allow it to achieve the now distant dream of economic growth and development

[11] That is the assimilation of policy changes by agents at a micro level or how firms change their behaviour within a context of changing industry policy and macroeconomic policies.

with justice. What is important in the debates about the experience of Mercosur is how to deal with the hegemon. If a regional hegemon sees little benefit in ceding some of its national sovereignty in favour of common action within the trading bloc, and if such a hegemon places its national development plan ahead of common interests, then, in an agreement based on consensus and inter-governmentalism, common interests might not rise to the top of the policy agenda. If they did they would not be meaningfully implemented. A second important lesson is that if deeper integration is not driven, supported or condoned by the private sector, as it was in ASEAN and the EU, then determining the agenda of the bloc becomes highly politicised, especially when common good mechanisms are absent.

In the introduction of this paper the themes of "what" regional agreements aim to achieve and "how" to achieve the target were raised. In the case of Mercosur the "what" of regional integration and common policies was never meaningfully agreed upon. This would have been acceptable if Mercosur had a strong system for "how" consensus could be established, disagreement overcome, or any type of long game strategy as in ASEAN or the EU. In the absence of clarity on both the "what" and the "how" front, and understanding the underlying conditions that a fundamental disequilibrium existed between smaller states demanding more integration and the larger states willing to supply less integration, Mercosur was always going to be a difficult proposition.

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