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A Re-Examination of SADC Industrial Development Policies & Lessons from SACU

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ABSTRACT

The absence of growth in intra-SADC trade in industrial products since the tariff phase-downs were initiated prompted by the ratification of the SADC Protocol on Trade in 2000 continues to generate interest amongst policymakers and other stakeholders as it appears that removal of market access constraint alone is not a sufficient panacea. While the paper observes that failure to make the factors of production such as labour, capital, enterprises and technology fully mobile across the region has contributed to continued supply side constraints, it is the failure to implement industry specific measures arising from an industrial policy that is the primary reason for poor industrial sector response to market opportunities in the region. Through a review of trade and industrial policies in the EU, ASEAN, NAFTA, MERCOSUR and SADC, the paper makes observations that could be lessons for SACU as it develops its industrial policy.

1. INTRODUCTION AND BACKGROUND

1.1 Role of Industrialisation in Development

The importance of industrialisation as an engine of economic growth and development cannot be overstated. Industrial production creates job opportunities at higher skill levels, facilitates denser links across the services and agricultural sectors, between rural and urban economies and between consumers, intermediate and capital goods industries. Prices of manufactured exports are less volatile and less susceptible to long-term deterioration than those of primary goods, making it particularly strategic in highly commodity-dependent developing countries. In addition, industrialisation is a critical tool in wealth creation, poverty eradication and employment generation. It is, moreover, both a catalyst to, and beneficiary of economic integration programmes (UNCTAD, 2005). Finally, manufactured goods spur technological advancement and innovation.

Wade (2003) has identified two stylized facts around the importance of the industrial sector for development, especially in its initial stages, namely: (i) the share of overall income generated by the industrial sector increases over time, and (ii) the share of workers employed in the manufacturing sector tends to increase. The combination of these two factors leads to an increase in per capita income at the aggregate level as countries industrialise.

Over the past century, a common strategy applied to enhance industrial growth and development has been through preferential trade arrangements between or amongst countries. Preferential trade arrangements occur when countries enter into an agreement which allows imports from amongst themselves to face lower uniform tariffs than imports from the rest of the world (Dennis and Yusof, 2003). Ideally, this is supplemented by adopting and harmonising liberal macroeconomic policies such as monetary, fiscal, exchange rate, trade and investment policies. The countries currently considered as major industrial power houses¹ have all derived great benefits for the industry from increasing integration of their national economies with those of their surrounding counterparts. Through the adoption and application of a Common Effective Preferential Tariff Scheme (CEPTS) efficiency gains are generated by means of improved Total Factor Productivity (TFP) and of reduced price-cost margins at the microeconomic level arising from scale economies and other intra-industry rationalization mechanisms. For some industries, success has not only been through tariff reduction but also by the application of selective measures aimed at nurturing the development of inert comparative advantage to attain competitiveness in a shorter period.

In contrast, Africa's industrialisation history has hardly been one of following the path set out above. With the attainment of political independence, most of the countries in Africa realised that while the extractive industrial sector was well developed, the processing or manufacturing sector and support services were fairly undeveloped. The few manufacturing sectors in place were weak and could not stand the competition of products from foreign developed industries. This was in spite of local latent comparative advantages that could support production of a number of imported products.

However, rather than integrate, countries in Africa started to focus and further consolidate their efforts on developing their economies based exclusively on national resources and synergies with the goal of replacing as many imported tradables as possible while non-tradables such as banking and telecommunication industries were nationalised. A lot of effort was invested in developing an educated human resource, and infrastructure for technology development, energy generation, roads, railways and telecommunication. Soon however, there emerged a realisation of the limitations imposed by inward looking national approaches on the development of the economy in general, and the industrial sector in particular in spite of the heavy investments made in infrastructural development and human resources.

Encouraged by successes in the developed countries, most of the African countries not only began to realise the need to integrate into sub-regional groups, but also reformed their entire economic philosophy by espousing economic liberalisation in all spheres of economic activity with government's role being restricted to macroeconomic

¹ E.g. Germany, France and the UK in Europe; the USA and Canada in North America; Japan, South Korea, Singapore and more recently China in Asia; and Brazil and Argentina in Latin America.

stability, and public goods supply such as infrastructural development, education and training, and other measures that would improve the business environment to facilitate private sector investments and growth.

Out of the recognition of problems of the infant industry case in neo classical economic theory, import substitution industrialisation strategies were reformed to only focus on products with potential for attainment of global competitiveness in the medium to long term. This marked the beginning of industry targeting approaches to industrial development at both the national and regional levels as an instrument for product diversification and export promotion through enhancement of competitiveness shored up by both stabilisation and sectoral policies.

1.2 Motivation for this Working Paper

In spite of its 100 year existence, the Southern African Customs Union (SACU) has only recently considered developing an explicit industrial policy capable of harnessing synergies generated through regional cooperation to enhance an integrated performance of the industrial sector of member states which would ultimately lead to increased productivity and hence competitiveness. The resulting surge in the demand for products originating from within SACU would, on the premise that productive capacities respond accordingly, lead to increased intra-regional trade beyond that provided for by a customs union trade policy. This argument stems from the understanding that under a customs union, the first increase in regional trade occurs when customs tariffs are abolished on trade taking place within the borders of each state. This in turn leads to lower prices for distributors and consumers. However, the elimination of tariffs only enhances the productive capacities of industries that are already competitive globally. Industries with potential to attain competitiveness remain stifled as long as they are not nurtured through explicit industry targeting policies usually provided for under an industrial policy.

Practical demonstration of the impacts of a double strategy over trade and industrial expansion is manifest in the ASEAN Economic Community (AEC). Following the declaration of the AEC as a Free Trade Area in 1992, intra-regional trade flows more than doubled growing at an annual average rate of 10 percent from US\$333.1 billion in 1991 to US\$702.8 billion in 2001 (Leipziger, 1997 and USITC, 2010). However, for a selected number of industry categories, growth superseded the 10 percent average when, in addition to preferential trade arrangements (and influenced by the experiences of the EU), specific policies were implemented to improve the competitiveness and productive capacity of the hitherto infant industries largely from the emergence of regional production and distribution networks.

The Southern African Development Community (SADC) came into effect with the signing of the Treaty in 1992 and, since then, the need to develop the industrial sector as a means towards sustained economic growth, employment creation and poverty reduction in general has taken centre stage. Apart from implementing policies to stabilise the political, social and macro-economy environments, and infrastructure, SADC has also been implementing a number of sectoral policies in support of industrial development. Further, through the SADC Protocol on Trade which came into force in 2000, preferential market access for industries in the region was made possible through tariff phase downs that were scheduled to result in a WTO compliant Free Trade Area by January 1, 2008. This was expected to reduce production costs and hence enhance the competitiveness of, and concomitantly the demand for local products that would ultimately trigger an increase in intra regional trade from 11 percent of total trade to 35 percent by 2008.

Contrary to expectations, intra SADC trade actually declined from almost 11 percent of all trade to 9 percent which was far below the 35 percent target. The lack of response to trade liberalization (which has had more than 99 percent of tariff lines zero-rated) as well as the lack of response to stabilisation and sectoral policies to incentivize accelerated intra regional trade should serve as a point of reflection not only by SADC but also SACU that likewise is in the process of developing a regional industrial policy. This makes a strong case for this Paper to contribute towards the development of an appropriate policy on industry for the SACU region.

1.3 Assumptions and Objectives

The SACU Secretariat is in the process of developing a Regional Industrial Policy within the integration agenda framework which is expected to result in a diversified and geographically balanced, and globally competitive industrial sector.

In this context it is important to recognise that most industries in the Southern African region are in their nascent stages of development, and the fact that the grouping constitutes members with varying levels of development, it is argued that adopting a Common Effective Preferential Tariff Scheme with uniform tariff reductions alone is not sufficient to spur industrial growth and trade thereof within the common borders. Due to the very competitive markets following the liberalisation process, many industries in countries other than South Africa have not taken off and even those operating have not realised their full growth potential. In short, most industries with latent comparative advantage have remained nascent thereby reinforcing the asymmetrical structure of the industrial sector across the region.

The author recognizes that economic groupings where all members are fully industrialised and where industries with latent comparative advantage have been nurtured and are mature, uniform intra-regional tariff reductions and sectoral policies generate well balanced national specialisations and hence efficiency gains which ultimately result in increased intra-regional trade. But, in contrast, for economic groupings with members at varied development stages dominated by industries with unrealised potential, these measures alone are inadequate to spur a diversified, geographically balanced, and globally competitive industrial sector that would lead to balanced production specialisations. The paper therefore argues in favour of a regional industrial policy with explicit measures targeted at nurturing industries that have a potential for global competitiveness but are, due to externalities, too weak to take advantage of preferential market access incentives.

The fact that stabilisation policies, sectoral policies, and industry specific policies have - together with preferential trade measures through the SADC Protocol on Trade - been developed and some implemented so far is not disputable at the moment. What appears to be a concern is that the three tier policy mechanism applied in SADC has not enhanced intra-SADC trade.² Therefore, the following were the objectives for the study:

- i. Conduct an in-depth comparative analysis of trade and industrial policies applied by SADC with those applied in other RECs, clearly identifying the economic objectives and sectoral policy incentives imbedded in such policies;
- ii. Consider regional and international benchmarks of best practices in regional industrial policy development and implementation; and,
- iii. Guidelines on the most appropriate regional industrial policy for the SACU based on its Customs Union Model

1.4 Methodology

This Working Paper essentially seeks to identify and analyse all policies in support of industrial development while focussing on the specific impacts generated by preferential trade agreements and industry specific measures usually contained in an explicit industrial policy.

In order to obtain the required information, and because the study was to be exclusively desk based, research and policy papers as well as books, and opinion and academic discussion papers were consulted. Data gathered included issues on theories of economic integration and also information on the role of industry targeting in the integration process. Case study reports on experiences of targeting and integration were also consulted. The choice of the period was also influenced by the availability of data. To this effect, apart from SADC, other RECs on which relevant information was available included the EU, ASEAN, NAFTA and MERCOSUR. Korea was included because

² In parallel, the same situation can be noted approaches which appear to have succeeded in other regional economic communities (RECs).

though not belonging to any economic grouping, the country has had preferential trade agreements with a number of countries and regions. This is in addition to being one of the successful pioneers in industry targeting approaches.

1.5 Structure of the Paper

This Policy Paper is an attempt to contribute towards the debate on the character of a regional policy on Industry that would support optimal industrial growth in the SACU region. It is divided into five Sections following this introduction which sets out the critical role of the industrial sector. The paper argues that it is possible to grow intra SACU trade to much higher levels if an explicit regional industrial policy based on refined selective intervention approach supported by stabilisation and sectoral policies is developed and implemented.

Section Two discusses conceptual framework for preferential trade arrangements and industrial development policies detailing how each contributes to trade creation. From the trade policy aspect, the paper examines the impact that each level of integration has on trade creation based on tariff differentials while on the industrial policy side, it discusses how a three-tier orientation of industrial policy design enhances broad based growth in competitiveness and productive capacity in the medium and long term.

Section Three examines the historical experiences of countries that have applied the three-tier approach to industrial development, and the impact of such an approach (i) specifically on the efficiency gains of the industries themselves and (ii) generally in terms of boosting trade.

Section Four dwells on the experiences of the SADC region with regard to industrial development policies focussing on the process itself, the impact, the challenges and the prospects for improvement.

Then based on the theoretical framework, the experiences of the other RECs, as well as that of SADC, the paper draws lessons under Section Five that SACU may wish to consider as they prepare their SACU Industrial Policy.

2. ECONOMIC INTEGRATION, INDUSTRIAL POLICY AND TRADE CREATION: A CONCEPTUAL FRAME

Apart from production related constraints, the level of market accessibility and size constitute one of the key determinants of competitiveness of enterprises. From an integration perspective, the level of access to a wider regional market is largely a function of the nature and level of economic integration which is made apparent through the structure of tariffs, quotas, and non-tariff barriers.

Using trade theory, economists have defined integration using the behaviour of prices. Following this approach, they postulate that integration prevails when the prices of similar goods and similar factors in two regions or countries are equalized. This definition sees economic integration as the realization of factor price equalization between two regions or two countries. The factor price equalization theory has argued that, given some assumptions about technology and tastes, free trade can ensure equal prices of goods across countries and equal prices for non-tradable factors as well (Dennis and Yusof, 2003).

There is a strong consensus based on the aforementioned that trade is the embodiment of economic integration and that the basic principle for assessing international economic integration is through the amount of trade that is created.

Trade creation is achieved when trade expands between countries that have joined in an integration arrangement.³ This is achieved when production is shifted from higher-cost non-member countries to lower-cost member countries and trade between participating countries increases. Concomitantly, economic growth is expected to be enhanced with the opportunities that are promised by a larger market size and increasing trade. The level of market and its size is determined by whether the REC is a Free Trade Area or a Customs Union.

³ This is a narrow definition of trade creation that focuses on describing trade changes. The term is not systematically considered here from a Vinerian perspective.

Under a Free Trade Area, member countries remove all trade impediments amongst themselves but each country retains the right to determine their policies in relation to non-participating countries. The agreement usually includes the elimination of tariffs and quantitative restrictions on trade. The “rules of origin” are the basis of the agreement. The rules of origin define that only those commodities that originate from a member state are granted exemptions from tariff. On the other hand, in a Customs Union, member countries, remove all trade impediments amongst the participating countries. In addition, the member countries harmonize their trade policies and, in particular, have common external tariffs on imports from non-participating countries. This means that there is more market access under a Customs Union than under a Free Trade Area.

However, market opening alone has been observed to have its own limitations to trade creation without corresponding growth in the productive capacities of industries in the REC. Therefore, to ensure further growth, RECs usually graduate to deeper integration levels in which Common Markets are created. Under a Common Market, the added feature is that there is free mobility of factors of production such as labour, capital, enterprises and technology, across the participating countries.

Enhancing factor mobility facilitates supply side responsiveness to increasing market opportunities within a REC. Furtherance of market accessibility and of factor mobility is attained when unification of monetary and fiscal policies is made resulting into a single currency under an Economic Union. This is considered to be the most advanced form of economic integration.

In short therefore, a common approach to integration is that of sequencing with liberalization and the opening up of economies otherwise referred to as opening up the trade account coming first and following later with the opening up of the capital account. The integration phasing usually begins with the lowering of trade barriers followed by the lowering of barriers to the movement of labour and capital and moving on to lifting the impediments originating from various regulatory measures. On account of enhanced accessibility to the consumer and factor markets, supply side and demand side constraints are to a large extent eliminated and this facilitates growth in production capacity and efficiency resulting in increased trade creation.

In some cases, rather than take an economy-wide approach, there are other notions of integration which are sometimes used. There can be sectoral integration which covers a specific area of the economy. The European Coal and Steel Community (ECSC), which was created in 1950, is an example of sectoral integration but is in essence a form of cooperation. Another example of sectoral integration is the European Union's Common Agricultural Policy (CAP) which covers the agricultural sector. However, regardless of the integration approach adopted, the expected outcome is enhanced growth in the trade initially facilitated by liberalised tariff and non tariff measures and then followed by liberalisation of the capital account.

While integration improves accessibility to the capital account, quite a number of industries still fail to sufficiently access the capital account on the open market largely due to externalities. This could be in spite of their latent comparative advantage which given some time would be realised by building internal capacities through acquiring capital on the open markets (at least over the medium term). Because of this market failure, there is usually need to develop a number of policy prescriptions that in the short- to medium-term would enable accessibility to these resources at subsidised rate; such interventions would result in improving the production efficiencies to a level that would enable these industries to participate in the open factor market. ***Collectively, these prescriptions are what is commonly referred to as a Regional Industrial Policy.***

Although there is no consensus on what exactly constitutes an industrial policy, there are two prominent schools of thought regarding what it is or is not.

- The first is the neo-liberal position, which places trusts in the market's adjustment mechanisms. It argues from the *laissez-faire* point of view that the “invisible hand” of the market automatically selects sectors and firms, guaranteeing the efficient allocation of the factors of production (capital and labour). In this view, industrial policy provides less than optimal allocation of the factors of production, in contrast to the purportedly optimal allocation achieved by free market mechanisms. This framework advocates for a minimal leeway for the State to act to correct market failures (Leipziger, 1997).

- The second is the Schumpeterian school of thought which provides room for private and public intervention in industrial development. Scholars from this school define industrial policy in ways that emphasise various aspects of state intervention in support of industrialization.

At one extreme, there are those who define industrial policy very broadly and include in it every government policy that affects industrial performance, including macroeconomic, infrastructural, and education policies. Among the scholars of the Schumpeterian school, Pinder (1982) proposes a broader definition that includes all policies designed to support industry, including fiscal and monetary incentives for investment, direct public investment and public procurement programs, incentives for investment in research and development, major programmes for the creation of “national champions” in strategic sectors, and policies to support small and medium enterprises. This definition includes direct support for the creation and improvement of physical infrastructure and social infrastructure (institutions), trade policy, competition policy and measures to prevent the formation of cartels, and programmes to directly support labour-intensive industrial activities.

At the other extreme are those who define industrial policy very narrowly, and equate it essentially with sector-specific ‘targeting’ exercise. Prominent among scholars that believe in such functions of industrial policy is Johnson (1984) who defines industrial policy in a narrow sense, as those “government activities that aim to support the development of certain industries in a national economy to maintain international competitiveness”. Within the narrow definition, Landesmann (1992) makes an original contribution to the definition by underlining the selective component of industrial policy. He argues that an industrial policy is one that discriminates and selects among industries, sectors and agents, and it is designed specifically for each chosen industry and sector within a given geographical space. The discrimination among activities, sectors and agents is based on their potential to boost the overall economy. These scholars take cognisance of the qualitative differences among economic activities in relation to their inert ability to generate and sustain value added and hence industrial growth.

In between, there are those who see the core of industrial policy as targeting or ‘selective’ but include other non-sector-specific policies (or ‘general’ or ‘functional’ industrial policy), such as generalised support for research and development (R&D) or industrial training, in the definition. Reich (1982), who was a great defender of industrial policy in the United States represents this group and defines industrial policy as a set of governmental actions designed to support industries that have major export potential and job-creation capacity, as well as the potential to directly support the production of infrastructure.

In both sides of the Schumpeterian school of thought, one of the most accepted rationales for intervention which is supported by economic theory is the “infant industry” argument. Developed by Alexander Hamilton, it argues that protection from competition is justified during the first stages of development of a new industry, until sufficient scale and technological development have been achieved. However, economists differ about how much protection and when to phase it out.

The premise under which the Paper has been prepared is that optimality in trade creation is the primary goal of every REC and that this condition is satisfied when all industries are able to realise their comparative advantage and increase their productive capacities and efficiencies in response to preferential market opportunities available.

The ability to increase productive capacities and efficiencies in response to availability of preferential market opportunities is anchored on the accessibility of production factors on the open market partly provided through the liberalisation and convergence of the capital account. For a number of developing or infant industries, accessibility to a market driven capital account is almost non-existent. Absence of such factors will normally invoke appropriate policy interventions by way of a regional industrial policy and since infant industries constitute the majority of industries in developing economies, an industrial policy will always be a complementary instrument to enhanced diversification and competitiveness and hence optimisation of intra regional trade in a REC.

Encouraged by the content of both the neo classical and Schumpeterian schools of thought on what constitutes an industrial policy, this Paper adopts a synthesis definition of an industrial policy as one that includes: Selectivity on the basis of Infant Industry; Sectoral Policies on the basis of propping up all competitive economic activities; and General Policies such as stabilisation policies in the political, social and macro-economy spheres, as well as liberalisation for creation of an incentives regime. This appears to be very much in line with the broader guidelines by the African Union (AU) and the Conference of African Ministers of Industry (CAMI) for developing a diversified industrial sector.

3. INDUSTRIAL POLICY PRACTICES UNDER ECONOMIC INTEGRATION

Since the 1960s, the world economic order has increasingly been evolving towards multilateralism with preferential trading agreements taking centre stage. Currently there exists more than 17 preferential trade arrangements the world over most of whom have at least attained Free Trade Area status, Customs Union Status and with some having attained the status of Common Market. The EU has for instance attained the status of an economic union while NAFTA and AEC are Free Trade Areas and so is MERCOSUR. Regardless of the titles applied, all these RECs have not only successfully opened their trade accounts but also capital accounts. However, while the focus of the Paper is to discuss the role of a regional industrial policy within a preferential trade arrangement on growing the industrial production and trade creation, it is outside the scope of this paper to discuss the specific tariff lines opened and non tariff barriers eliminated to attaining this objective.

Arising from limitations on material available, the only industrial policies reviewed were those for the European Union (EU), the ASEAN Economic Community (AEC), the North American Free Trade Area (NAFTA), and the Southern Cone Common Market (MERCOSUR).

3.1 Industrial Policy under the European Union

The use of explicit industrial policies in support of economic integration was pioneered by France and Germany from 1952 when the European Coal and Steel Community was declared as a free trade area in coal and steel. With the establishment of a Common Market in Coal and Steel in 1953, other surrounding countries such as Italy, Belgium, Luxembourg and Netherlands joined the community. By 1957, another institution to run parallel – the European Economic Community was established - whose integration scope would include all economic activities based on sectoral and down to industry level. To this effect, the Treaty of Rome of 1957 identified a number of industries with potential for long term competitiveness including ship-building and earmarked them for support mostly by way of subsidies from the commission for capability development (Alter and Steinberg, 2007).

Since then, a mechanism was established in the EU in which struggling industries with potential for attaining global competitiveness would be identified on a continuous basis for policy support up to the time competitiveness is attained. For instance by 1970, "an entire range of sectors was subject to sectoral European industrial policy of the old variety, in one way or another, via the relaxing of state aid supervision, explicit protectionism, special regulations, anti-dumping, among others". Around 1980, the range came to include cars, aircraft, shipbuilding, coal, steel, textiles and clothing, railway rolling stock, telecoms equipment, consumer electronics, to mention but a few. Picking winners in most of the industries went beyond latent comparative advantage but competitive advantage (Alter and Steinberg, 2007)

By 1990, a number of these industries had become globally competitive resulting in strong arguments for the elimination of direct support. Sectoral interventions were then limited to a few remnants of the past such as lingering but dwindling subsidies in coal, the R&D support for Airbus under the 'Community Interest' clause, subsidies in shipbuilding; and a handful of more explicit forms of industrial protection through trade policy instruments such as a few quotas in steel and aluminium against some former USSR republics (Alter and Steinberg, 2007). All of these continued with close supervision by the Commission with the objective of phasing them out, some faster than others.

Over time, in place of sectoral and specific approaches, EU industrial policy drifted into endeavours to strengthen fundamental determinants of competitiveness, to some degree corresponding to dynamic comparative advantages. Hence since the 1990s, there has been a 'horizontal' emphasis on research strategies, skills and human capital enhancement and a general promotion of innovation throughout industry. Moreover, this was expected to accord well with the deepening of the internal EU market that had been going on, and the consistency of EU competition policy, in reducing distorting state aid and severely limiting the protection on industry arising from new EU regulation, while refraining from a systemic policy reversal.

By beginning of the 21st century, sectoral and specific industrial policy, so familiar from the 1950s, 1960s and 1970s has almost entirely disappeared at the Member States' level. Currently, it is no longer tolerated at the EU level, given that Treaty amendments and accepted supervision policy have become routine. Possibilities for such an interventionist policy can only be supported through trade policy. However, even the latter is said to have lost a good deal of its tools, with the possible exception of anti-dumping action under WTO constraints and tightened EU law.

Furthermore, the EU institutions are reportedly very active in stimulating a better sectoral environment in many sectors but this is no longer done by means of protection, distortive subsidies by way of funds going to adjustment, retraining or research, or permissive competition policy. While policy reversals are not totally excluded if pressures are extreme, competitiveness and hence adjustments still retain overriding importance. The EU has greatly increased technology funding in areas such as new materials, space, hydrogen, health and environmental technologies. Even in this case, the EU level seeks to avoid a 'picking winners' approach by letting technology forums develop where many ideas and applications can flourish.

Many sectors have been subject to such broadly encouraging but largely non-interventionist policies, based on specialized study groups and High Level Panels and with wide consultation of the sectors involved. Such institutions have been established for industry groups which include textiles and clothing, cars, trains (both for new technology and for inter-operability purposes), aircraft, new materials like 'new ceramics' and super-hard fibres, chemicals (culminating in new proposals to transform regulations in such a way that innovation would not be discouraged), biotechnology, shipbuilding, telecoms equipment (especially the attempt to keep the advantages EU companies had acquired with global system for mobile communication, in 3G equipment), and environmental technologies.

The approaches described above are not anymore accompanied by trade protection, or by large subsidies. This is in line with Commission Paper COM (2005) 474 of 5 Oct. 2005 and SEC (2005) 1215, on what it calls a 'new, integrated industrial policy'. The Paper constituted further details which attempt to systematically combine a given horizontal perspective with a detailed screening of 27 sections; it presents initiatives which can be taken to address weaknesses or new challenges at the sectoral level whilst being coherent with the horizontal framework underlying it. Accordingly, good industrial policy in the light of the above is considered as one that is focused on correcting or improving upon market functioning, in particular dynamic efficiency, and as being least-cost (Alter and Steinberg, 2007). Notwithstanding this fact, provision for interventionist approaches by the EU will always be reserved for struggling emerging industries with potential for global competitiveness.

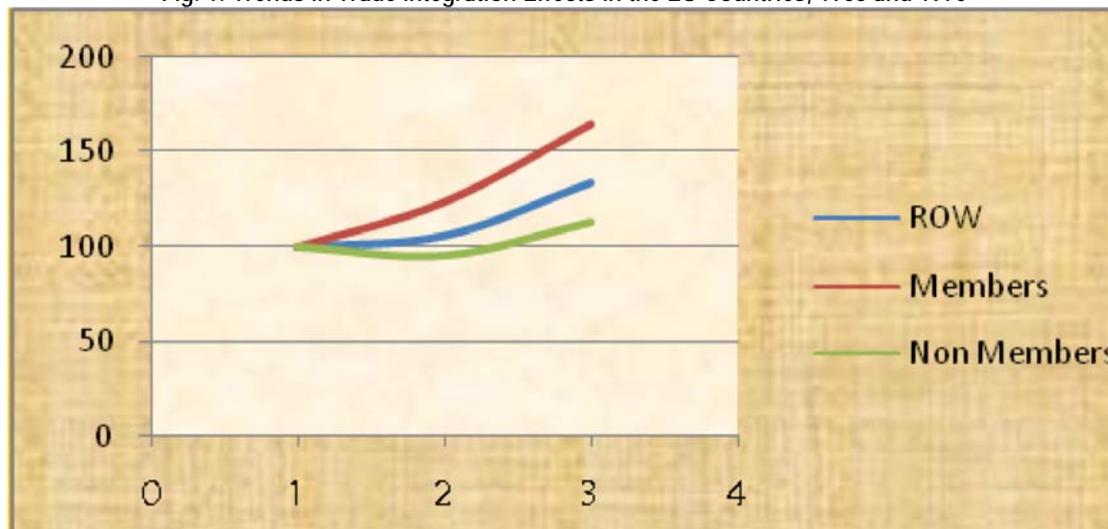
In order to appreciate the high performance levels of the industrial sector occurring in Europe, it is important to reflect and recap on the evolution of the relevant ideology at play. It is a fact that in support of industrial development, the EU started with a customs union in 1957 which witnessed the removal of all trade impediments amongst the participating countries such as intra-regional trade tariffs and non tariff barriers. In addition, the member countries harmonized their trade policies and, in particular, had a common external tariff on imports from non-participating countries. Over time, the deepening of integration continued until the status of a common market was attained in which another feature was added, that of free mobility of factors of production such as labour, capital, enterprises and technology, across the participating countries. By 2002, an economic union was established through unification of monetary and fiscal policies, with the monetary policy managed by a central bank, and the establishment of a single currency - the Euro. In short, running parallel to the implementation of industrial policy in Europe, a free market economic system was adopted to be basis of interaction among all agents. This was also followed by the stabilisation of framework conditions by way of political and social stability through promotion of democracy, in addition to macroeconomic stability. In addition, public goods such as roads, railways, sea ports, airports, power generation stations, general education and training, and R&D were improved upon. of infrastructure

In assessing the impact of the European integration and regional industrial policy the key question is whether there was a net increase occurred in trade amongst the EU Member States and as a region as a whole. Figure 1 below provides an answer to this question. Taking 100 as the base figure in 1959 representing the pre-union period, the figure shows that total EU exports had increased by a modest 5.9 percent by 1965.

Disaggregated figures however reveal that intra-EU exports experienced an exponential growth right from inception. For instance, in the first five years of its formation, intra-EU exports increased by 23.7 percent. Against this background, the share of EU exports to the Rest of the World (ROW) and other European non members experienced

a decline reaching 5 percent by 1965 before starting to recover. By 1970, exports to ROW had increased as well; however, their percentage increase of 13.3 percent was only one fifth of the increase in intra-EU exports of 64.5 percent thus leading to the overall expansion of 33.6 percent in exports. Although exporters to ROW did not suffer losses in the aggregate, the results still demonstrated the strengthening of the ties among EU-countries and decreased reliance on sales to ROW. The absolute changes in 1970 were US\$ 22.4 billion in total exports created, composed of \$17 billion of exports created internally and US\$5.5 billion created externally (Prewo, 1977).

Fig. 1: Trends in Trade Integration Effects in the EU Countries, 1965 and 1970



Source: Author's Calculations based on Prewo, 1975

- * The Number 1 on the Figure stands for the base year, 1959. The first period of analysis is 1959 – 1965 which on the table is between 1 - 2; The second period is from 1965 – 1970 shown by 2 – 3.
- * The term **Non Members** denotes European countries such as Britain and Spain that were not members of the EEC before 1970.

Therefore, the then EEC derived substantial benefits from both the preferential trade arrangements with a strong industrial policy support although there was an absence of information of how much each of the two precisely contributed. This is further demonstrated on a country by country basis in the table below.

Table 2: Distribution of Integration Effects (percent) on Exports by Receiving Country, 1959--1965, and 1959-- 1970

Country	Period	Italy	France	Germany	Net/lands	Belgium Luxembourg	EU	3rd Countries	World
Italy	1959 -1965	-	125.4	111.4	98.8	62	107.1	13.2	39.2
	1959 -1970	-	219.7	163.3	119	84.4	161.4	34.5	70
France	1959 - 1965	38	-	47.5	44.9	0.1	31	-16.5	-1.7
	1959 - 1970	149.7	-	100.8	111.4	42.3	92	-2.3	28.3
Germany	1959 - 1965	25.9	44.4	-	10.8	17.4	23.9	4.2	10.5
	1959 - 1970	111.5	92.1	-	33.6	57	68.1	30.6	43.3
Net/lands	1959 - 1965	89	56.6	38.2	-	-12.6	23.6	-26.3	-4.2
	1959 - 1970	156.2	109.7	94.2	-	-4.7	61.8	-19.4	17
Belgium/Lux	1959 - 1965	2.1	2.7	17.4	-30.1	-	-8.7	-8.9	-8.8
	1959 - 1970	51.4	56.5	54.5	-33.4	-	12.1	-1.3	7.6

Source: Integration and Export Performance in the European Economic Community

The trends in exports that the table exhibits is a further confirmation of the effectiveness of a two pronged approach to exports based industrial growth. In all EU countries, exports to each other, exports to other European countries, and exports to the rest of the world experienced significant growth demonstrating on all fronts. The only exceptions were exports from Belgium and Luxembourg combined to Netherlands that registered declines between 1959 and 1970.

From the comprehensive review of literature on European Integration practices, the following stylized facts stand out that could provide lessons for SACU's experiment with regional industrial development:

- That improvement in social welfare is the intuitive goal of humanity and this is attained in an environment of peace. In Europe, for the most part of the first half of the 20th century, peace has been elusive because of Germany's militarism which was facilitated by the economic advantages derived from the coal and steel competitively produced from its territories. Therefore, objective for establishment of the ECSC was to advance the goal of attaining long lasting peace in Europe by broadening control of the coal and steel resources to a supra Europe-wide political structure from that of Germany alone.

The concept was however modified after six years after realizing that peace can still be attained without a supra continental – wide structure but rather market based economic integration mechanisms, and not only in coal and steel but in all other sectors. The synergies created would not only guarantee peace but also economic prosperity to all members.

- The importance of starting with the most basic form of integration such as the preferential trade areas: Europe commenced with a Customs Union in 1959 called the European Economic Commission. This was graduated into a Common Market 33 years later and attained the status of an Economic Union after 43 years.
- That prior to establishing a Customs Union, each country in Europe had for a long time adopted and implemented horizontal policies that resulted in a well developed infrastructure (transport, telecommunications, power and water, a well educated and sufficiently skilled population, technology support institutions promoting pioneer R&D), and sufficiently developed financial markets. In addition to horizontal policies, members of the EEC had each developed good framework conditions by way of stable political and social environment, well managed macro economic regimes, and supporting institutions such as the legal system able to enforce contracts and property rights efficiently. Therefore, with governments that were broadly supportive of private enterprise, a versatile private sector that had proven to effectively participate in the domestic and exports markets was already in place to provide effective response to the challenges and opportunities arising from the Customs Union.
- That the creation of the EEC meant in practical terms harmonisation of trade policies of member countries by way of removing all tariff and non tariff barriers to goods originating and ending within the Customs Union while putting up a common external tariff on imports from non-participating countries. From the demand side, the objective was to broaden the market for industries in members' countries to the exclusion of those in non members. This was expected to enhance competition and hence efficiency while promoting specialization, and increased production resulting in increased wealth and employment creation. From the supply side, production capabilities had to be enhanced to meet the needs of a broadened market by selecting industries with potential for attaining global competitiveness as the primary criteria. They included industries with static and dynamic comparative advantage as well as those in which competitive advantage can be generated. As a result, almost all industries were targeted for policy interventions with each industry receiving differentiated policy support in terms of type, intensity and time frame depending on the needs and period of maturation.

Meanwhile, the pre-union horizontal policy implementation continued though on a reduced scale and this time at regional level to harmonise and create synergies. As the various industries continued to develop their capabilities and competitiveness, the list of industries for policy intervention began to decline. Over time, when most of the hitherto protected industries attained positions of global competitiveness, Frontier Policies were adopted primarily to sustain competitive positions of the growing number of graduating firms. From its 43 years of existence, most of the industries have since attained global competitiveness which has made the EU to abandon selective intervention policies in preference to those just promoting competitiveness generally. However, selective intervention policies are still being applied for evolving nascent industries though practiced in a very subtle way.

The nexus between tariff reductions (together with removal of non tariff barriers) and industry specific policy measures resulted in a more integrated, diversified, value-adding and balanced industrial sector reliant on resources within the EU and above all an industrial structure responsive firstly to the needs of the EU and secondly to the global markets. This was demonstrated by the consistent increase in exports to both Member States and non members over the period, a trend that has continued and has translated into the attainment of 65 percent share of intra EU trade in total trade and high per capita income.

3.2 Industrial Policy under the ASEAN Economic Community

Although political security was ASEAN's initial focus, economic cooperation grew in the 1970s with agreements on joint industrial projects and preferential trading arrangements. The first substantial step toward integrating the ASEAN market came in 1992 when the ASEAN members agreed to establish the ASEAN Free Trade Area (AFTA). The AFTA provided for the reduction or elimination of tariffs under a Common Effective Preferential Tariff scheme and the removal of quantitative restrictions and other non-tariff measures (NTMs). It also addressed other cross-border measures, such as trade facilitation and standards harmonization.

ASEAN leaders signed agreements to liberalize services trade in 1995 through ASEAN Framework Agreement on Services, (AFAS) and investment flows in 1998 through the Framework Agreement on the ASEAN Investment Area (AIA). By these very Agreements, the trade and capital accounts were liberalised which are fundamental to the removal of supply side as well as demand side impediments to enhanced competitiveness and productive capacity of industries.

In addition to converging and enhancing the two accounts, the AEC developed an industrial policy for the region to further prop up some sectors that under normal market conditions would not have had access to the liberalised capital account. Through this policy, 12 sectors were selected for accelerated integration.⁴ These priority sectors were chosen "on the basis of comparative advantage in natural resource endowments, labour and skills availability, and cost competitiveness, and value-added contribution to ASEAN's economy," and together accounted for more than 50 percent of intra-ASEAN trade (USITC, 2010). In 2004, industry specific policies and strategies by way of roadmaps for each priority sector, outlining the path to full integration, were adopted, and country coordinators were selected to oversee progress.

Within each of the priority sectors, six priority industries were identified and targeted based on each industry's export competitiveness, trade flows, inbound investment, and leading competitive factors such as trade facilitation, logistics services, and e-commerce.⁵ Upon this selection, the industrial policy by way of the ASEAN Framework Agreement for the Integration of Priority Sectors was ratified together with the roadmaps for each priority sector and related industries with specific measures that needed to be implemented, and the broad cross-cutting initiatives such as trade facilitation measures, including timelines for their implementation.

In aggregate terms, there was significant growth in trade for the period 2004 to 2009 largely driven by exports to markets external to ASEAN. These increased substantially by almost 90 percent compared to a 20 percent growth in intra-ASEAN exports.

Sector-wise, the impact of industrial policy interventions has been varied. Starting with Palm Oil, the industry had been recording low volumes in intra-ASEAN trade a trend that continued well into the first two years of policy implementation. However, soon after the policy measures began taking effect, the industry began to record significant growth and even caught up with the growth trends of other mature agro-based industries that did not receive policy support. In nominal value, intra-ASEAN trade in palm oil increased by almost two-thirds during 2004–08 as illustrated in Figure 2, from US\$601 million to US\$1.0 billion, but the value of ASEAN palm oil exports to non-ASEAN markets increased far more, rising 133 percent to US\$20.4 billion (USITC, 2010). The ability of the Palm Oil

⁴ These are agro-based products, air travel, automotives, e-ASEAN, electronics, fisheries, healthcare, logistics, rubber-based products, textiles and apparel, tourism, and wood-based products (USITC, 2010).

⁵ These industries include computer components from the electronics sector, cotton woven apparel from the textiles and apparels sector, hardwood plywood and flooring from the wood based products sector, healthcare services from healthcare sector, motor vehicle parts from the automotives sector, and palm oil from the agro-based products sector (USITC, 2010).

sector to come out of a declining position illustrates the effectiveness of the measures applied through the industry targeting approach adopted.

Fig. 2: Trends in Intra-ASEAN trade: Palm Oil Industry Vs Agro-based Products Sector, 2004–08



Source: USITC Publication, 2010

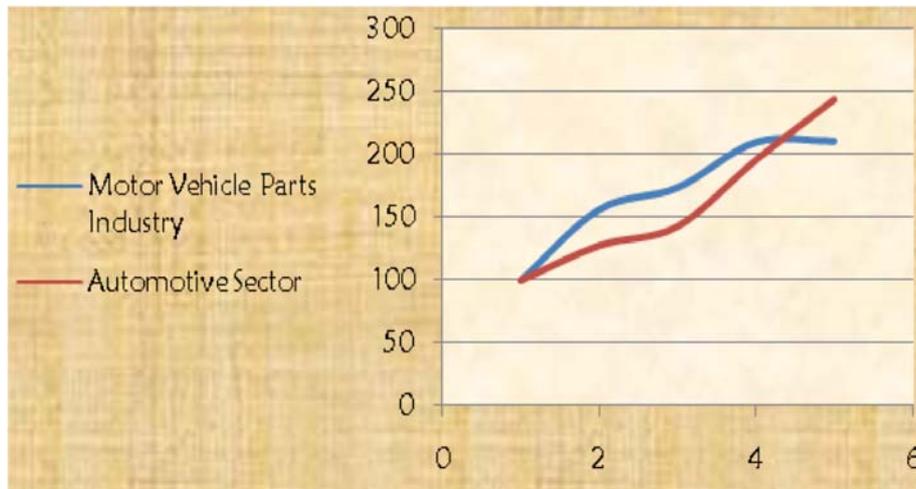
- * The Number 1 on the table stands for the base year, 2004 while 2, 3, 4, and 5 stand for the years 2005, 2006, 2007 and 2008.
- * The decline in intra ASEAN trade for the first two years was against a steady rise in palm oil exports to the external markets. This decline was reversed with the introduction of measures whose effectiveness was only registered during the second year of implementation..

In the case of the Motor Vehicle Parts Industry, intra-ASEAN exports by value increased by 111 percent during 2004–08 compared to 143 percent growth for the rest of the automotive sector that did not receive any industrial policy support as shown in Figure 3. A similar trend occurred with exports to international markets: the Parts industry increased exports by 106 percent from \$3.6 billion to US\$7.4 billion, indicating that demand for these products among ASEAN's external trading partners was growing faster than demand within the ASEAN region. On the other hand, ASEAN automotive sector exports to the rest of the world more than doubled during 2004–08 to \$27.1 billion as shown in Figure 3.^{6, 7}

⁶ The four leading markets—the EU, Japan, Australia, and the United States—accounted for 65 percent of these exports.

Non tariff barriers among including quota limitations were observed as responsible for Parts exports to the region and the fact that most cars produced in the region were destined for the world markets.

Fig 3: Trends in Intra-ASEAN trade: Motor Vehicle Parts Industry Vs Automotives Sector, 2004–08

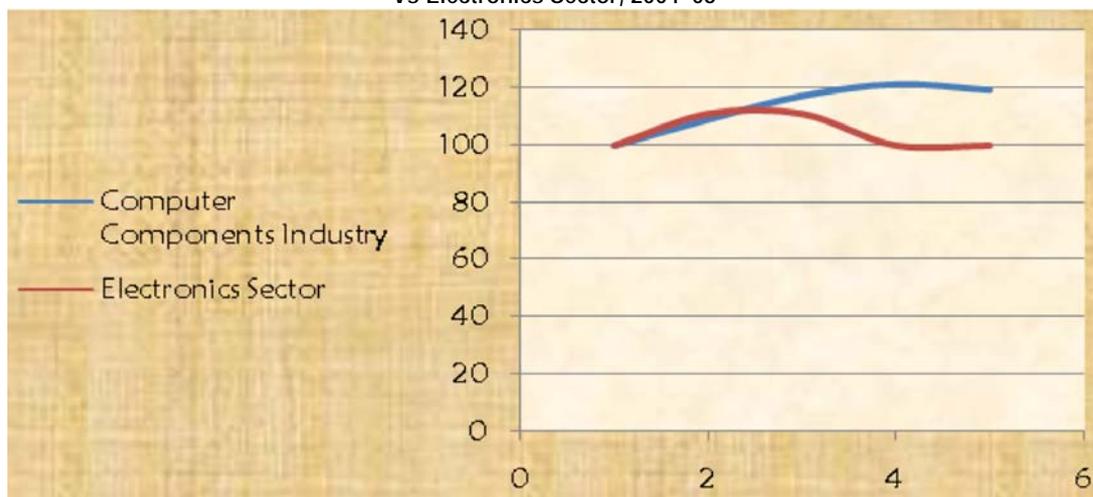


Source: USITC Publication, 2010

* The Number 1 on the table stands for the base year, 2004 while 2, 3, 4, and 5 stand for the years 2005, 2006, 2007 and 2008.

In the case of the Computer Components industry, intra-ASEAN trade lagged behind the rest of the sector in the first two years on policy measures. However, from 2006 intra-ASEAN trade in computer components surpassed that of the rest of the electronics industry reaching an overall growth of 20 percent over the period. This is in addition to the much higher impact on exports to the ROW as these increased by more than 20 percent indicating the critical role that industry specific policy play in promoting growth of intra ASEAN trade in computer components.

Fig 4: Trends in Intra-ASEAN trade: Computer Components Industry Vs Electronics Sector, 2004–08



Source: USITC Publication, 2010

* The Number 1 on the table stands for the base year, 2004 while 2, 3, 4, and 5 stand for the years 2005, 2006, 2007 and 2008.

Trade in the ASEAN healthcare services industry was estimated to be smaller than trade in the four goods industries included in ASEAN's healthcare priority sector. For example, in 2007, the world (including ASEAN countries) imported US\$7.1 billion of healthcare goods from Singapore. In comparison, Singapore's healthcare industry provided services to 348,000 patients, valued at US\$750 million. However, arising from the measures taken at the beginning of 2004, by the year 2006, the growth rate in healthcare services had surpassed that of healthcare goods which was in decline thereby demonstrating the positive role that industrial policy measures on growth of trade in healthcare services in intra ASEAN trade.

Fig 5: Trends in Intra-ASEAN trade: Healthcare Services Industry Vs Healthcare Sector, 2004–08

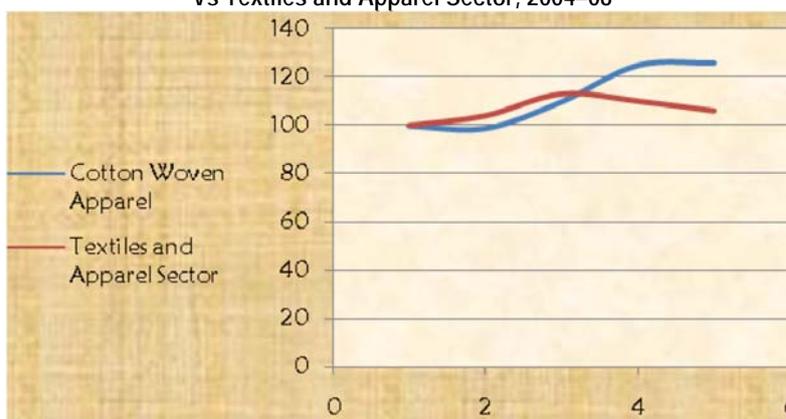


Source: USITC Publication, 2010

* The Number 1 on the table stands for the base year, 2004 while 2, 3, 4, and 5 stand for the years 2005, 2006, 2008 and 2008.

As for the textiles industry, intra-ASEAN trade in cotton woven fabrics, the primary input in cotton woven apparel, increased by 13 percent, from \$168.4 million in 2004 to \$190.8 million in 2008. A performance comparison between the Cotton Woven Apparel Industry and the Textiles and Apparel Sector reveals that the former was able to surpass the latter within three years of implementing the measures in terms intra ASEAN trade (see Figure 6).

Fig 6: Trends in Intra-ASEAN trade: Cotton Woven Apparel Industry Vs Textiles and Apparel Sector, 2004–08

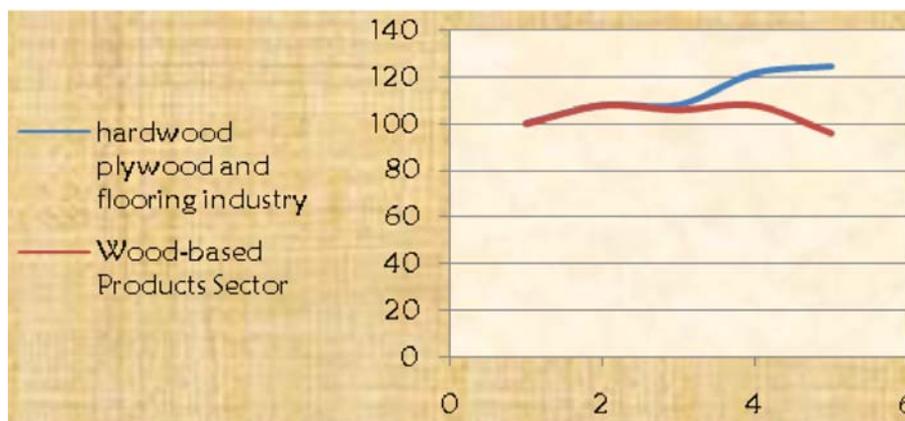


Source: USITC Publication, 2010

* The Number 1 on the table stands for the base year, 2004 while 2, 3, 4, and 5 stand for the years 2005, 2006, 2007 and 2008.

With regard to the forestry and forestry products sector, the plywood production and trade performed generally below other sub-sectors within the sector. The number of operating plywood plants in Indonesia declined from 128 in 2003 to only 25 in 2009 explains the trend together with declining government support, tightening timber supplies, and lost market share in industrialized countries concerned in terms of the legality of wood sourcing.

Fig 7: Trends in Intra-ASEAN trade: Hardwood, Plywood and Flooring Industry Vs Wood Based Products Sector, 2004–08



Source: USITC Publication, 2010

* The Number 1 on the table stands for the base year, 2005 while 2, 3, 4, and 5 stand for the years 2006, 2007, 2008 and 2009.

The findings from a detailed analysis of the six priority industry categories demonstrate that indeed liberalisation of both the trade and capital accounts create impetus for growth of industries. However, optimisation of industrial performance can only occur when industrial policy measures are instituted on specific industries especially those with comparative advantage but still with externalities.

A series of observations emerge on the ASEAN Integration trajectory. First is the fact that each country in the ASEAN region has always perceived itself as a production platform for the markets in advanced countries (especially the EU, the USA and Japan). The ASEAN market has generally been considered as secondary due to low purchasing power and limited market. Therefore, their focus has been on promoting cheaper imports - especially those used as productive inputs - while focused on exporting the finished products. The enhancement of intra ASEAN trade has generally followed this paradigm: increase intra ASEAN imports to primarily serve boost external exports.

Second, the primary motivation for the establishment of the ASEAN in 1967 was to promote regional peace, stability, and security and the prevention of balkanisation as a foundation of economic prosperity. However, the realisation of using regional synergies for collective economic development translated into the establishment of ad-hoc economic projects between and amongst members. These efforts led to the establishment of a Free Trade Area in 1992.

The establishment of the ASEAN Free Trade Area (AFTA) implicitly meant putting in place a Common Effective Preferential Tariff Scheme that provided for the reduction or elimination of tariffs and the removal of quantitative restrictions and other non-tariff measures (NTMs) from imports from the region. It also addressed other cross-border measures, such as trade facilitation and standards harmonization. Three years later, ASEAN leaders signed agreements to liberalize services trade in 1995 through the ASEAN Framework Agreement on Services (AFAS) and on investment flows in 1998 through the Framework Agreement on the ASEAN Investment Area (AIA).

In 2003, the AFTA was transformed into the ASEAN Economic Community (AEC) for the "realization of the end-goal of economic integration ... to create a stable, prosperous and highly competitive ASEAN economic region in which there is a free flow of goods, services, investment and a freer flow of capital, equitable economic development and reduced poverty and socio-economic disparities", and the AFTA, as well as the agreements on services trade (AFAS) and investment (AIA), formed the basis of the AEC. Although the ASEAN is an economic community, it is a hybrid as it contains elements an FTA and a Common Market. Essential elements of a Customs Union and Economic Community are missing.

However, and thirdly, in order to speed up the process of integration beyond that which is allowed by trade policy, an industrial policy based on industry targeting was established. Thus a sectoral approach was adopted to policy development and implementation. To this end, 12 Priority Sectors (agro-based products, air travel, automotives, e-ASEAN, electronics, fisheries, healthcare, logistics, rubber-based products, textiles and apparel, tourism, and wood-based products) were selected on the basis of comparative advantage in natural resource endowments, labour

skills and cost competitiveness, and value-added contribution to ASEAN's economy, above all their high contribution to intra-ASEAN trade. Within each of these sectors, six priority industries were identified and targeted based on each industry's export competitiveness, trade flows, inbound investment, and leading competitive factors such as trade facilitation, logistics services, and e-commerce. Other criteria for selection included: Regional Value chain production networks; Dynamic Comparative advantage; Non Strategicness; Intermediate input level and diversity; Countering the Chinese Influence and lastly Reduced competitiveness. These industries include computer components from the electronics sector, cotton woven apparel from the textiles and apparels sector, hardwood plywood and flooring from the wood based products sector, healthcare services from healthcare sector, motor vehicle parts from the automotives sector, and palm oil from the agro-based products sector.

Apart from trade policy measures, agreements in services and finance were made to liberalise the sector. Following was the agreement to address the development gap between member states through soft infrastructure projects (such as training, technical studies, and capacity building) and physical transport and communication infrastructure projects, and to mobilize funding from international financial institutions and developed countries for support. About 258 projects have been completed to date. In 2004, ASEAN Framework Agreement for the integration of Priority Sectors to spearhead the integration process was signed and the roadmaps were developed for each of the priority sectors and industries. Measures included: Construction of Infrastructure supportive of industry integration, support for Membership in international sectoral groups, adoption of international standards, FDI promotion, local content requirements, Selective high tariff or strategic tariff phase downs, investment incentives, and tax policies, and skills training.⁸

In spite of having started on a lower note than other mature industries, four out of six targeted industries experienced above modest growth in intra-regional trade. Exponential growth was recorded on exports to ROW demonstrating the effectiveness of the industry targeting approach. Intra-regional exports also increased noticeably. All this is a demonstration that the two pronged approach of trade policy and selective industrial policy application are effective in growing the industrial sector.

3.3 Industrial Policy under the North American Free Trade Agreement (NAFTA)

In January 1994, Mexico, the United States and Canada launched the North American Free Trade Agreement (NAFTA) which action created an expanded and secure market for the goods and services produced within the three countries. Among the measures to facilitate the realization of the goals included elimination of barriers to trade in, and facilitate the cross-border movement of, goods and services between the three countries; Promotion of conditions of fair competition in the free trade area; and substantially increasing investment opportunities in the three countries (NAFTA, 1992).

The implementation of the Agreement commenced with the establishment of a Common Effective Preferential Tariff Scheme (CEPTS) which meant that intra-NAFTA imports would face lower tariffs than imports from the rest of the world. It also required that Member Countries lower their tariffs on other intra-NAFTA imports over time by placing items into several lists ' inclusion, temporary exclusion, general exclusion and sensitive.

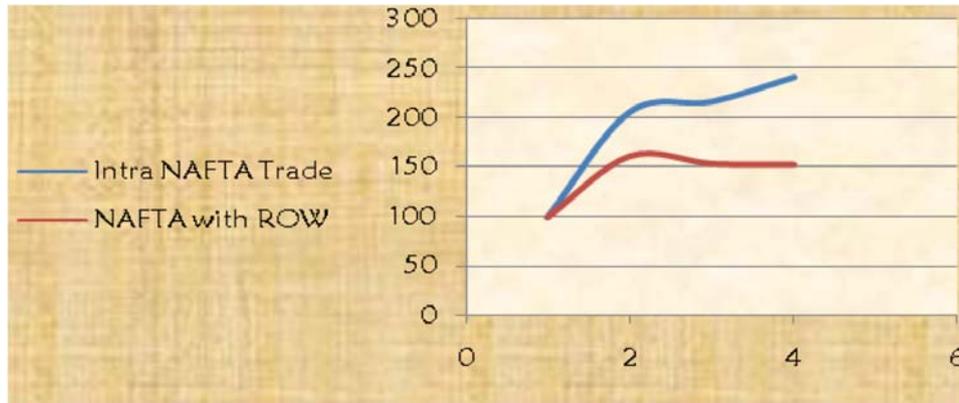
Based on the above, NAFTA brought the immediate elimination of tariffs on more than 50 percent of U.S. imports from Mexico and more than 35 percent of U.S. exports to Mexico in January 1994 (Thorpe and Bulhart, 2001). Unlike the case of the EU and that of ASEAN, the CEPTS did not provide for any other measures especially those relating to targeting of particular industries such as those that could not stand the competition from mature industries located in other NAFTA members. Therefore, whether the industry had potential for being globally competitive in the future or

⁸ The following other measures were also included:

- the implementation of the ASEAN Electrical and Electronic Mutual Recognition Arrangement (MRA)
- Establishment of the ASEAN Electronics Forum (AEF),
- Electronic Trade Exhibitions
- Multiyear tax deferrals or exemptions,
- Free or reduced-price land or buildings;
- Establishment of free trade zones.
- Granting of "Pioneer" status to computer components firms,
- Establishment of in industrial parks

not, as long as it was not able to compete at the time of introduction of the CEPTS, it was let to close down. Industry specializations based on efficiency gains was the only basis for survival. By this very initiative, intra-NAFTA trade experienced tremendous growth. For instance, between 1990 and 1999, intra NAFTA trade grew by 145 percent far above the 50 percent growth in trade with the ROW as shown in Figure 8.

Fig. 8: Trends in Intra-NAFTA trade Vs NAFTA Trade with ROW, 1990, 96 - 99

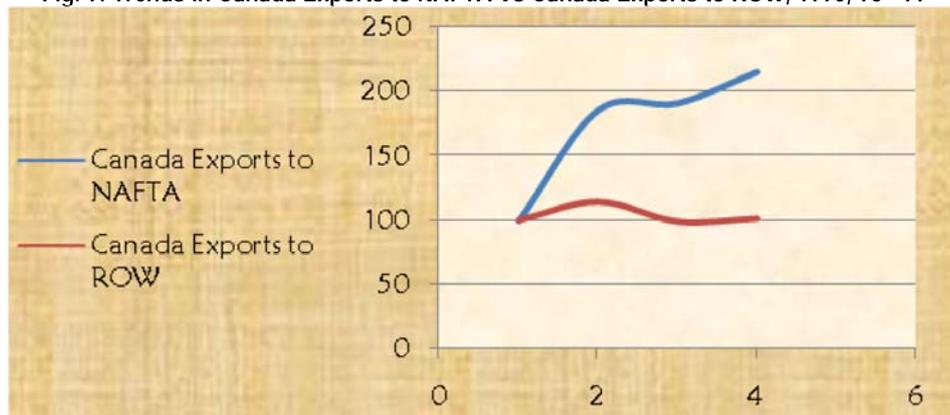


Source: WTO Trade Statistics Website

* The Number 1 on the Figure stands for the base year, 1990 while 2, 3, and 4 stand for the years 1996, 1997 and 1998

Disaggregated data on country basis reveals that Canada contributed significantly to this growth with its 105 percent growth in exports to NAFTA while exports to the ROW stagnated as shown in Figure 9.

Fig. 9: Trends in Canada Exports to NAFTA Vs Canada Exports to ROW, 1990, 96 - 99

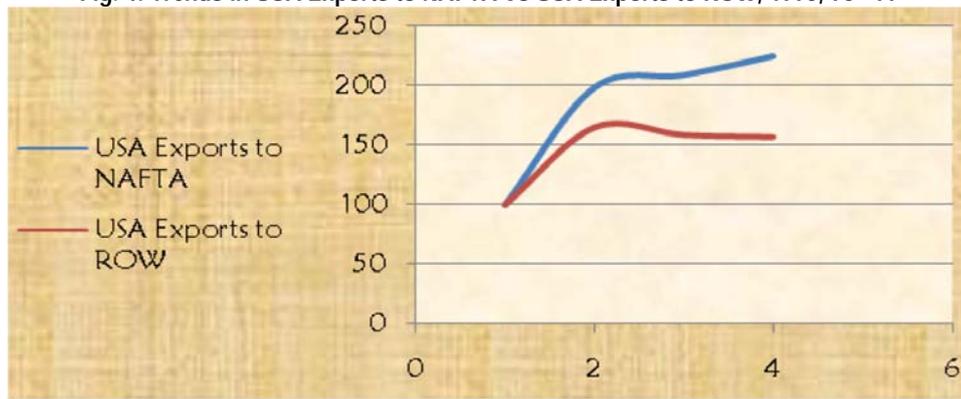


Source: WTO Trade Statistics Website

* The Number 1 on the Figure stands for the base year, 1990 while 2, 3, and 4 stand for the years 1996, 1997 and 1998

In the case of the U.S. exports to NAFTA increased by 120 percent over the nine year period while exports to the ROW only grew by 60 percent (Figure 4). US trade with Mexico increased 113 per cent over 1994-1999, while that with Canada increased 56 per cent.

Fig. 4: Trends in USA Exports to NAFTA Vs USA Exports to ROW, 1990, 96 - 99



Source: WTO Trade Statistics Website

* The Number 1 on the Figure stands for the base year, 1990 while 2, 3, and 4 stand for the years 1996, 1997 and 1998

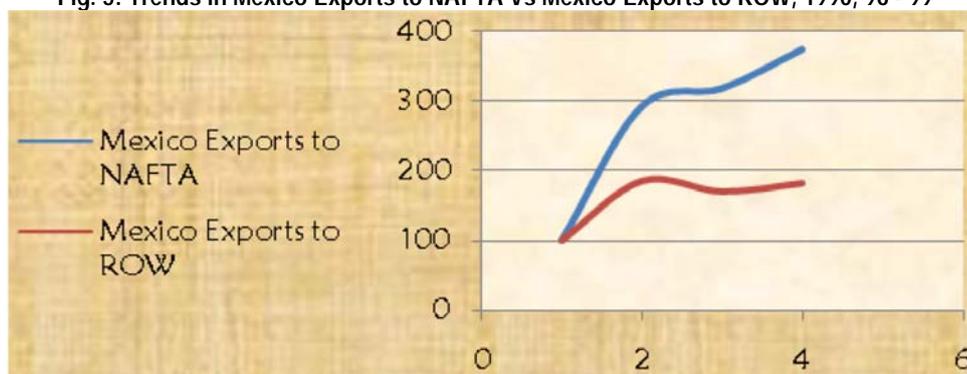
It is necessary to provide some background before assessing the impact of NAFTA on Mexico's trade performance. Of note is the fact that Mexico was the only emerging economy from the organisation of three members; although it had a diversified industrial sector, its industries were fundamentally weak because of the import substitution strategy followed and applied since the 1940s; additionally, Mexico is the only NAFTA member that attempted to invoke industry targeting measures in addition to the measures of a Common Effective Preferential Tariff Scheme to further enhance its intra regional trade performance.

By way of a background, it should be noted that, in the late 1970s, Mexico was basically an oil-exporting economy. Its export drive in manufactures started during the late 1980s, before NAFTA came into force. Therefore, the boom that was experienced in the earlier period was rooted in both the trade liberalization processes that began at that time and also in the sectoral development programs initiated during the previous phase of state-led industrialization.

By 1988, manufactures already accounted for more than 50 percent of the country's total exports in the form of resource based products such as shrimp, coffee, cotton and tomatoes. Nevertheless, the export drive towards NAFTA was to be based on the dynamism of medium- to high-tech manufactured goods.

The establishment of NAFTA opened an unprecedented window of opportunity to export to the US, the largest world market. This opportunity was utilized as Mexico climbed the ladder of major exporters. For instance, from 1985 to 1994 Mexico, ranked fifth among countries with the largest increases in their share of world manufactures exports. During 1994-2001, it moved to second place, just behind China. This positive performance is particularly evident in the evolution of its manufactured exports: In 1994, total exports represented 16percent of Mexico's real GDP; by 2000, this figure had more than doubled, reaching 35.1 percent.

Fig. 5: Trends in Mexico Exports to NAFTA Vs Mexico Exports to ROW, 1990, 96 - 99



Source: WTO Trade Statistics Website

* The Number 1 on the Figure stands for the base year, 1990 while 2, 3, and 4 stand for the years 1996, 1997 and 1998

Notwithstanding the outstanding performance of manufactured exports since NAFTA, reflected in the trade surplus with the US, Mexico systematically registered a trade deficit. Parallel to the export boom in manufactures, the Mexican economy experienced a massive penetration of imports, mainly manufactured goods originating not from its

NAFTA partners but from the ROW. From 1988 to 2003, imports of manufactures grew more than twice as quickly as exports. The trade deficit in manufacturing has thus been widening, putting extra pressure on the overall balance of payments. This concern arises from the fact that traditionally, manufactured goods have always constituted the bulk of Mexican imports. For instance, in 1982, they represented 90 percent of total imports. By 1994 their share was 95percent, a level that has remained constant to date.

The root cause for Mexico's challenges lies in its ideological orientation which was not in consonance with the level of development of its industrial sector. The opening of the economy prior to NAFTA was done with caution and as such some industries that were perceived to have potential for competitiveness continued to receive policy support. However, with the inception of NAFTA, all policy support provided to the nascent industries was dropped and industries were expected to restructure or close. With most of them unable to adjust, closing down became the only option leaving out the very few that had already attained global competitiveness and focused on export markets. Their products included motor engines and auto parts, automobiles, and computers and other electronic equipment.⁹

Therefore, while NAFTA compelled Mexico to liberalise and open its economy totally, and only focus on industries that were already globally competitive, there was no common external tariff to protect and advantage NAFTA producers to flood the Mexican market with their own. Since most of the consumer products from NAFTA were still more expensive than products from the ROW, the latter had to fill the vacuum left by the collapsed industries. This meant that while Mexico made significant gains in its trade with the USA and Canada, against modest gains with the ROW, there was an exponential growth in imports from the ROW that culminated in balance of payments problems.

Therefore, in spite of registering consistent trade surpluses with the USA, a lot of industries collapsed which left a gap for consumer goods. This gap, which had to be filled by imports from other countries, exacerbated the trade imbalance with the ROW. Therefore Mexico's efforts were like 'One step forward and One Step Backward'. Even though it has made great strides with a few industries which specialized and displayed efficiency gains, the gap created has negated almost all benefits accrued from NAFTA.

The poor performance of Mexico in terms of the net trade effect is a manifestation of the over reliance on the trade and capital accounts to the exclusion of a regional industrial policy that nurtures and enforces the participation of the infant industries which are great in number.

3.4 Industrial Policy under the Southern Cone Common Market (MERCOSUR)

Comprising the majority of Latin America's population, land and economic output, Mercosur represents the deepest attempt to date at economic integration in the region. Initiated by the Treaty of Asuncion in 1991, Mercosur began the integration process more or less along the lines undertaken by other RECs. The first initiative involved the liberalization and the opening up of the trade account first through the elimination of all internal tariff and non tariff barriers on the flow of goods and factors of production including implementing a common external tariff, and following later with the opening up of the capital account by way of lowering of barriers to the movement of labour and capital. Additionally, among the integration measures included harmonisation of the numerous macroeconomic and sectoral policies and moving on to lifting the impediments originating from various regulatory measures among Argentina, Brazil, Paraguay and Uruguay.

In an effort to enhance the regional economic integration process in Mercosur, members developed an explicit industrial policy in which they identified some industries that were to be drivers of the process. Market size, latent comparative advantage and high propensity for regional production networks constituted the attributes of important industries which the Mercosur sought to promote through a set of specific policies. In this regard, the automobile industry - among others - exhibited those qualities and hence was selected for policy support.

⁹ Electrical equipment, garments and motor engines combined accounted for 71 percent of all of Mexico's total exports of manufactures.

Among the measures invoked to promote the selected priority industries included a further reduction in tariffs for products made within the common market largely based on local content rules aimed at encouraging local assembly of automobiles and auto-parts production. Other incentives consisted of fiscal incentives¹⁰ and finance.

Regarding finance in Brazil, direct finance for exports was made available for a restricted positive list of goods and services basically focused on capital goods and engineering services. In the case of Argentina the programme involved extending preferential duties to any industry group which agreed to set export targets. This plan, called the Industrial Specialisation Regime, was aimed at facilitating the productive restructuring of companies producing manufactured goods. Under the programme, participating companies were required to increase their exports over those made the previous year in exchange for tariff preferences.

Geographical promotion of industry in both Brazil and Argentina also took centre stage, with programmes targeting the development of certain regions through industry pursued. In Brazil for example, federal tax incentives were only available for investments located in the North-east and Amazon regions, and most states and many municipalities had to compete quite fiercely for new investments, through a mixture of explicit tax reductions and rebates, state's bank loans, as well as through supply of infrastructure services on preferential basis. In Argentina, the programme was backed by legislation that authorised provincial governments to provide incentives for regional economic development in the country's poorest provinces.

As a consequence, both assemblers and auto-part producers began to direct their investments with a view of capturing the Common Market, and setting up complementary production lines in order to reap the considerable economies of scale and product differentiation which characterised the industry. This resulted in rapid expansion of domestic production which was also of a higher quality. Coupled with local content measures were other policy measures related to geographical, finance and technological measures all aimed at promoting the development of the automobile industry.

At a general level, the establishment of a CEPTS within Mercosur led to rapid trade expansion. In 1988 for instance, while trade within Mercosur stood at 9 percent, it grew to 25 percent by 1992. Although total trade with the rest of the world increased in nominal terms (from US\$ 67.8 billion in 1988 to US\$119 billion by 1995), the share of such trade in total trade declined from 91 percent to 80.5 percent between 1988 and 1995 as shown in the table below.

Table 6: Regional and external Trade by Mercosur from 1988 to 1995 (US\$ and %)

	1988			1995		
	Intra Mercosur	ROW	Total	Intra Mercosur	ROW	Total
Value (US\$b):						
Exports	3.02	41.5	44.5	14.5	56.2	70.7
Imports	3.1	20.0	23.0	14.4	62.7	77.0
Total	6.1	61.5	67.6	28.8	118.9	147.7
Share of Total (percent):						
Exports	6.8	93.2	100.0	20.4	79.6	100.0
Imports	13.2	86.2	100.0	18.7	81.4	100.0
Total	9.0	91.0	100.0	19.5	80.5	100.0
Average Annual Growth (percent):						
Exports	-	-	-	25.1	4.4	6.8
Imports	-	-	-	24.8	17.7	18.8
Total	-	-	-	24.9	9.9	11.8
Share of Mercosur GDP (percent):						
Exports	0.7	9.3	9.9	1.5	5.7	7.2
Imports	0.7	4.5	5.1	1.5	6.3	7.8
Total	1.4	13.7	15.1	2.9	12.0	14.9

Source: *Mercosur: Integration and Industrial Policy (1997)*

¹⁰ These came in the form of tax exemptions, tax credits on domestic inputs for export oriented production, a duty draw back regime, tax concessions, and tax exempt export processing zones.

Sectoral variations characterise the performance. Sector specific policies were particularly important in boosting trade in automobiles (including auto-parts). Exports in that sector grew considerably and reached US\$1.14 billion in 1994. Top on the list were Brazilian exports to the Mercosur which reached US\$765.4 billion and imports amounting to US\$375.4 billion. In particular, the industry became critical in raising proportion of intra-industry trade between Argentina and Brazil.¹¹

The foregoing review illustrates that the creation of Mercosur coupled with the implementation of selective industrial policy measures resulted in significant reductions in price-cost margin - especially in the production of goods -. This is the reason why intra-sectoral trade expanded, especially in auto-parts sector, and in some food processing sector. Another good example of the benefits of this integrated – that is combining integration and industrial - policy approach is from Paraguay where substantial modernization of the processed meat sub-sector took place with production becoming more oriented towards the Brazilian market.

In the case of Argentina as the third example, the country found its exports of processed tomatoes and canned peaches falling substantially and being replaced by Brazilian producers able to access the same source of raw material imports as Argentina.

The evidence is clearer with regard to TFP growth. Among a group of Argentinian sub-sectors studied by the World Bank (1996), strong TFP improvements were observed in dairy products, cellulose paste and plastics.¹² In Brazil, rapid productivity increases were posted by industrial firms (approximately 40 percent over the previous 5 years) with surveys suggesting or attributing much of this to TPF gains rather than to capital investment or increased use of intermediaries (Leipziger, Normand and Kharas, 1997).

The general increase in intra-Mercosur trade however could not be sustained because most of the incentives initially implemented could not equally/similar be sustained due to balance of payments challenges that Brazil and Argentina were facing and continue to face. Since 1995, intra-regional trade started to decline and the low level of trade in Mercosur is still one of the principal characteristics of the region. Even in terms of total imports for the block, studies reveal that they constituted less than 8 percent of GDP.¹³ This situation was worse at national level with some members only attaining 1.4 percent of GDP implying that much of the expansion of trade and potential for future growth, both of intra-regional trade and of trade with the rest of the world, was simply to be “catching up with international levels of openness” as the insert below explains.

“Against these relative successes, the sector specific policies had their own pitfalls. For instance, the growth trend in automobiles sub sector could not however continue due to back peddling on a number of incentives due to balance of payments challenges and those related to balancing the budget. In Argentina, the export targets programme, although intended to meet the laudable goal of expanding exports, engendered several economic costs. Among them were foregone fiscal revenue estimated at US\$46 million through 1996, tariff exemptions, and embodied an implied discretionality in approving industries for participation in the regime and penalizing firms which did not comply with their previously committed export quotas.

In terms of geographical policies, among the criticisms are that employment generation and industrial development goals were not achieved as capital intensity increased while profitability without incentives was not attained.

These weaknesses were exacerbated by implementation challenges of the integration process due institutional weaknesses. Mercosur did not define any financing mechanism for regional development, industrial restructuring or reconversion initiatives, or joint R&D projects. Apart from the weak institutional arrangements, the Treaty's provisions for the harmonization of monetary, tax and industrial policies did not specify either timetables or implementation mechanisms for achieving these goals. Still much more work needed to be done as by 2002 to 2005, Mercosur's intra-regional trade had further declined to an average of 15.0percent of total trade while other regions such as the EU and NAFTA had reached 66 percent.”

Leipziger, Normand and Kharas (1997)

¹¹ The intra-industry trade coefficient for the two countries reached 39 percent of total trade for 1993 disaggregated as follows: 51.3 percent for manufacturing trade as a whole and 77.3 percent specifically in the case of the automotive industry.

¹² Further, tradable goods such as food and steel had higher absolute competitiveness (relative to the US) than non tradable goods like banking and telecommunications.

¹³ This is compared to 14 percent for intra-EU imports in 1996.

4. INDUSTRIAL POLICY PRACTICES UNDER THE SADC

4.1 Background

The initial thoughts on improving industrial performance through a regional industrial policy within the framework of economic integration in Africa were mooted in 1971 when the Conference of African Ministers of Industry (CAMI) was inaugurated under the auspices of the United Nations Industrial Development Organisation (UNIDO) as a high-level forum to debate industrial development issues as they affected Africa. Reinforced by the Abuja Treaty for African Integration, the 1991 CAMI put as top priority on its agenda the harmonisation of national policies that facilitate industrial growth on the continent in a way that would reflect the new industrial development ideology of globalisation anchored on diversification and competitiveness as the get way to sustainable growth. This approach to industrial development required nations intending to integrate economically to adopt Free Market Economic Systems as a basis for running the economy. Within this framework, they were then to adopt free trade policies amongst themselves while either maintaining a common external tariff or each nation was free to impose its own external tariff.

Following harmonisation of trade policies, the participating nations were expected to graduate into higher levels of integration to comprise factor market products such labour and finance. While the opening of the trade account and consequently that of the capital account were considered measures sufficient to boost industrial production and trade, this was only applicable to industries that were already competitive with existing capabilities and institutions. For most African economies, there was a growing realisation that a substantial proportion of industries constituted those that could not immediately be competitive in a regional market but would become so with additional support; and new industrial activities that with additional support would conform to the countries' dynamic comparative advantage. For these industries, some of the policy prescriptions recommended by the Treaty included:

- a) The establishment/strengthening of Regional Centres and Laboratory Facilities for standards setting, quality control, assurance and certification to assist African products in meeting technical regulations and international standards as well as to prevent sub-standard and dangerous products from being dumped on the regional market.
- b) Assistance to Member States in upgrading skills and capacities for mastering new technologies
- c) The speedy implementation of NEPAD Infrastructure Projects to enhance productive capacity and intra-regional and continental connectivity
- d) The facilitation of joint cross-border industrial enterprises and intra-regional trade within the framework of value chains
- e) Filling of the current gaps in Regional Technology Development and Adaptation Infrastructure through the establishment of Regional Centers of Excellence in Science and Technology to accelerate scientific discoveries, knowledge production, technology development and innovation in major areas¹⁴ that can trigger Africa's accelerated industrialization avalanche of Africa's industrialization
- f) The establishment of regional observatory of competitiveness and labour employment
- g) The harmonization of investment code

The process of economic integration in SADC has followed more-or-less a pattern prescribed by continental bodies. For instance, by 1992 when the SADC Treaty was signed, all the Member States had adopted free market economic systems and work on developing the Protocol on Trade commenced soon afterwards. In 2000 when Protocol was ratified, it became one of the very early protocols that SADC developed. This paved the way for transforming the region into a Free Trade Area by 2008, Customs Union by 2010, Common Market 2012, and and Economic Union by 2015. Operationally this means all tradable exports to the region where to be zero rated by 2008 and since 2000 when the Trade Protocol was ratified there have been substantial phase downs in trade tariffs. This is demonstrated

¹⁴ e.g. bio-fuels and other renewable energy sources, and industrial energy efficiency, equipment and machinery for processing natural resources, and improving competitiveness of SMEs, etc.

by the fact that except for Malawi, all Member States implementing the Trade Protocol had by 1 January 2008 attained this minimum level.

As of January 2009, the five (5) SACU countries – South Africa, Botswana, Lesotho, Namibia and Swaziland had effectively granted other FTA partners duty-free market access (around 99.9% of their intra-SADC trade). Mauritius, Mozambique and Zambia had implemented their 2009 tariff phase downs while Tanzania and Zimbabwe did not implement their 2009 reductions due to some technical difficulties that were being attended to. Though rescheduled to 2011, a common external tariff was going to be implemented in 2010. By 2012, the factor market was going to be liberalised,

In addition to market opening signified by the Protocol on Trade, a number of other collaboration initiatives to aid the process of integration were put, and continue to be put in place largely to ameliorate supply side constraints of faced by the industries. These are framed by a range of Protocols, Declarations, etc.¹⁵

These agreements, which can also be understood as policies in their specific areas, are there to aid the supply side of trade – the productive sector in general. There is no doubt that these measures have assisted most of the industries that were already competitive to attain higher levels of productivity. However, as noted earlier, these measures are not sufficient to support infant industries as they are not a homogenous group and therefore require industry-specific measures to attain regional competitiveness. These specific interventions can only be addressed through a policy on industry that merges and aligns some aspects of the different protocols to enhance the competitiveness of the infant industry. Therefore, in line with the new approach anchored on regional production networks aligned on sector basis, a study was undertaken by UNIDO under African Productive Capacity Initiative (APCI) in 2003 to identify sectors that would be used to kick-start the regional industrialization process.

Following several meetings at both regional and sub-regional levels, the SADC CAMI meeting adopted the following *sectors* for prioritization of policy efforts UNIDO (2003):

1. Agro food processing
2. Fisheries
3. Forestry
4. Textiles and Garments
5. Leather and Leather Products
6. Processing of Mineral (metallic and non-metallic) products
7. Pharmaceuticals and Chemicals
8. Machinery and Equipment
9. Services

In addition to identifying the broad sectors reported above, in its dossier of concrete proposals to transform the APCI from Vision to Action, the CAMI directed that first of the fourteen actions to be undertaken was "To identify priority sub sectors or industries". While not explicitly stated, a review of the industrial policies for individual African countries, as well as a review of other literature from experts and UNIDO reveals that priority sectors and industry groups were identified using the following criteria:

- a) Comparative advantage
- b) Exportability
- c) Regional production networks
- d) High local content
- e) High value added

¹⁵ Among these are: the Protocol on Politics, Defence and Security Cooperation; the Protocol on Finance and Investment; the Protocol on Science, Technology and Innovation; the Protocol on Competition; the Protocol on Transport, Communications and Meteorology; the Declaration on Agriculture and Food Security; the Declaration on HIV and AIDS; the Declaration on Information and Communication Technologies; the Declaration on Productivity; the Memorandum of Understanding on Macroeconomic Convergence; the Protocol on Agriculture and Food Security; the Protocol on Fisheries; the Protocol on Forestry; the Protocol on Health; the Protocol on Mining; the Revised Protocol on Shared Watercourses; the Protocol on Transport, Communications and Meteorology; the Protocol on Energy; the Protocol on the Facilitation of Movement of Persons.

To this effect, from the nine priority sectors identified, Member States resolved to select 20 industry groups that best fit the above criteria as priority industries on which the SADC Industrial Policy was to be focused. Based on the priority sectors identified in the industrial policies of the Member States, the following were selected as priority *industries* (including their value chain stages) for the SADC region:

1. Meat Processing
2. Dairy Products
3. Bakery Products
4. Soft Drinks
5. Minerals & Gemstones Beneficiation
6. Manufacture of Building Materials
7. Processing of Raw Hides; Manufacture of Leather Goods
8. Pulp and Paper Products
9. Furniture & Assorted Wood Products
10. Canning, Preserving & Processing of Fish
11. Medicinal & Pharmaceutical Products
12. Fertiliser Manufacturing
13. Agricultural & Industrial Chemicals
14. Ginning, Spinning, Weaving & Finishing of Textiles
15. Tailoring & Garments Production
16. Agric. Transp. Capital Machinery and Equipment; Spare Parts
17. Electrical & Electronics Equipment; Cables, Wire & Wire Products
18. Packaging Materials and Services
19. Installations & maintenance Services
20. Business Advisory Services

Following the identification of the nine priority *sectors*, the 12th meeting of the SADC Special Committee of Ministers responsible for Trade Matters (CMT) held in March 2003 in Cape Town, Secretariat was given the mandate to involve UNIDO in the preparation of a regional industrial strategy addressing the identified priority sectors. This was reiterated in October 2006 during the extraordinary summit meeting. Subsequently, an Expert Group Meeting on Improving Industrial Performance and Promoting Employment in SADC was convened in conjunction with UNIDO from 6th to 8th December 2006, in Midrand, South Africa with the objective of preparing policy prescriptions and strategies for enhancing competitiveness and product differentiations in each of the 20 priority *industries* of the 9 priority *sectors*.

Based on presentations from experts, policymakers, the private sector, academia and other stakeholders, extensive discussions were held on the challenges and prospects for each of the identified priority industrial sectors in SADC. Specific strategies were identified under these sectors such as SMEs Development, Infrastructure Development, Market Access Development, Industrial Governance, Quality and Standards, Capacity Building and Skills Development, and Research and Development, among others. Encouraged by the diversity and detail of the deliberations of the EGM, the IDF considered the record of the EGM as a guide for development of the SADC Industrial Policy. Taking cognisance that the meeting made recommendations on how to implement the policy measures and strategies, the IDF then directed SADC Secretariat to engage UNIDO to develop the Industrial Upgrading and Modernisation Programme for that purpose.

On January 25th 2007, UNIDO received a request from SADC Secretariat to assist in the formulation of an Industrial Upgrading and Modernization Programme for removing supply-side constraints to foster regional integration. In response to the request from SADC, UNIDO developed an integrated restructuring and upgrading programme to support the process of restructuring, competitiveness, integration and growth of industries and employment and to facilitate access to the regional and international market in the context of economic and trade liberalisation. For industries and enterprises it involves two goals:

- Competitiveness in terms of price, quality and innovation;
- Ability to follow and assimilate the development of technologies and markets.

The programme was developed over a two year period by UNIDO and was unanimously adopted by the 21st Meeting of the CMT. The integrated programme, based on flexible modular system and on close coordination between the main actors that include the state, support and assistance institutions and private operators, comprises three main components organised according to the respective beneficiaries: the Ministry of Industry, Support Agencies, and industries and enterprises. Some of the activities under the programme components entail short- and medium term activities.¹⁶

For the enterprises, Modernisation of Enterprises entails:

- i. Strengthening competitiveness by improving technology, design, planning, maintenance and quality control;
- ii. Training;
- iii. Management and Marketing Support;
- iv. Foreign Direct Investment (FDI), Collective and Targeted Promotion (Match-making);
- v. Export development;
- vi. Promotion of financial services (Financing of long-term loans, loan guarantee system, Venture capital funds);
- vii. Modernisation of machines and tools

On the other hand, Upgrading of the Industrial Sector entails:

- i. Creation of a network linking information centres for enterprises and technology centres;
- ii. Establishment of a network providing information to enterprises at the national level, consultancy services and international links;
- iii. Strengthening of the capacities of professional associations;
- iv. Creation of groups of industrial enterprises;
- v. Promotion of the national quality system (national approval system, establishment of certification bodies, promotion of national standards).

In terms of policy capabilities, the programme is expected to provide to Industrial and related sectoral Policies support by way of:

- i. Strengthening and modernisation of the Ministry of Industry and Technology;
- ii. Modernisation of industrial policies;
- iii. Sectoral studies
- iv. Strengthening of the legal and regulatory framework;
- v. Improving the finance and banking system.

The Programme of Industrial Upgrading and Modernization (IUMP) is expected to have a significant impact on industrial sector and overall economic performance of SADC countries. More specifically, the Programme will contribute to the region's development by:

- (a) Strengthening the managerial capacities and marketing skills;
- (b) Improvement of productivity, reactivity and flexibility;
- (c) Mastering and cutting down the production costs;
- (d) Improving the quality and sanitary standards;

¹⁶ E.g., summarised:

- i. Redefining and reshaping the role of the administration and of the regulatory, monitoring, promotion, quality, analysis and support institutions;
 - ii. Strengthening support agencies, especially technology centres, the Central Laboratory, Institute of Standardisation and Quality, and the Industrial Development Agency.
 - iii. Strengthening vocational training facilities and establishments
 - iv. Renovating existing industrial zones and developing free zones
 - v. Stimulating the economic, trade and technological information market.
 - vi. Improving competitiveness through skills development and quality management;
 - vii. Acquisition of new technologies;
 - viii. Strengthening enterprises' financial structure.
-

- (e) Recovery and re-launch of suspended productive activities;
- (f) Strengthening capacities of the informal sector companies with their subsequent integration into the formal environment;
- (g) Building capacities of the technical support institutions, business advice and consultancy centers;
- (h) Development of exports capacities and imports substitution;
- (i) Creating employment opportunities directly in industries and in agricultural sector and services, indirectly;
- (j) Development and strengthening of the local expertise in order to extend its services to other sectors not directly affected by the Programme.

Specifically, the programme is expected to result into the following:

- (a) Increased annual value added by 12 to 15 percent;
- (b) Increased annual employment by 10 percent;
- (c) Increase in the cash flows from exports operations (including intra-regional trade) of beneficiary countries by 10 percent per year.
- (d) 10 percent of the companies not able to export before the Programme, should start to commercialize abroad.
- (e) The local and regional expertise capacities are expected to be reinforced forming the core of 30 experts by country with the total army of 350-400 experts for Southern Africa.
- (f) A considerable improvement in capacities of professional education institutions and training of 3000-4000 artisans, technicians and specialized workers are expected throughout the region.

The IUMP has been designed to implement a number of aspects of the policy over a six year period with a budget amounting to Euros 218 million. In spite of its adoption 18 months ago by the CMT, implementation of the programme could not commence as the SADC Secretariat is still engaged in mobilising resources. Therefore, while stabilisation and horizontal policies continue to be implemented through other initiatives, industry-specific policies which are targeted at infant industries and which form the majority of all enterprises are yet to be implemented. Unless they are implemented, attainment of a competitive, diversified and integrated industrial sector envisioned by the Abuja Treaty for African Integration and the SADC CAMI may not be guaranteed.

5. THEORY AND PRACTICE OF REGIONAL INDUSTRIAL POLICY - LESSONS FOR SACU

Trade volumes display a positive correlation with economic growth and social welfare of citizens. Manufacturing and national GDPs have grown through increased trade flows in all the five RECs reviewed above.

Trade can be enhanced through intra- or extra-regional trade. Yet, the growth of intra-regional or extra-regional trade is dependent on the type of regional integration adopted. For instance, it is widely argued that under a Free Trade Arrangement, there is less preferential access to the regional market by producers from within the REC than under a Customs Union, especially if most of the inputs for production are imported. Likewise, producers located in a Common Market exporting to international markets may be less competitive than would be the case under a Free Trade Area, especially if they rely on imported production inputs on which a CET is applied.

In the RECs reviewed, it has been established that the AEC prefers to remain a FTA because it has developed its production capabilities and capacities to satisfy a variety of products beyond the regional demand. Further, the region has identified itself as a production hub whilst relying heavily on external imports. To be globally competitive, the costs of inputs must be kept low and, therefore, national flexibilities on import tariffs are needed by ASEAN members.

In addition to preferential market opening, growth in trade is also a function of the responsiveness of industry by way of adjustments in the production capacities to the unfolding opportunities. The rate of flexibility is driven by the availability of capital. Capital accessibility under a REC is enhanced if the region is a Common Market; this stage allows free mobility of factors of production such as labour, capital, enterprises and technology, across the participating countries. The EU in 1992 provides the best example of this.

It has been observed that even when factors of production - such as finance – are mobile, most industries, especially in developing countries such as those in Africa, are affected by externalities. These prevent (investors and)

producers from accessing the capital market, even in the presence of latent comparative advantages. These may constitute the bulk of producers involved with the majority of locally consumed goods. These may require nurturing by way of subsidies before attaining a certain level of efficiency which would enable them to utilise resources from the open market.

In all stages of integration, there exists no provision for addressing supply side constraints to a particular group of industries based on their efficiency levels. Through industry specific instruments within industrial policy, a number of measures can be made available that would, over time, result into the growth in the productive capacity and efficiency of such infant industries. Therefore, where industrial policy measures have not been invoked sufficiently, to complement market based trade and capital accounts, the overall trade created has declined. This has been the case for Mexico in NAFTA and the experience of most countries in the SADC region. To optimise trade growth, therefore, an explicit industrial policy must be established to deal with market failures for the infant industries.

The review further observes that developing and implementing an industrial policy is not an end in itself. It is rather about developing an appropriate industrial policy. Of the three types of industrial policy highlighted in the paper, the study reveals that an industrial policy with tailor-made policy measures for each category of industry (including infant, and *not* sector) is the most effective strategy. This has been shown in the case of accelerated trade growth experienced by the six priority industries in the AEC compared with other industries within the same sectors. This was reflected in MERCOSUR and in the EU. In fact, these RECs experienced growth in the range of products exported. In contrast, Mexico which went into NAFTA with policies in place for infant industry protection experienced drastic reductions in the range of industries resulting in a much narrowed production base.

The study also observes that selection of priority industries was focused as follows:

- i. Industries with a substantial existing and growing regional (and/or global) market
- ii. Industries reliant on regional production networks
- iii. Industries producing medium to high tech (intermediate) products with multiple usage
- iv. Industries with static or dynamic Comparative Advantage in at least two countries
- v. Industries whose products have high value addition
- vi. Industries with a propensity to attract FDI

Some scholars have attempted to create formulae for determining the most optimal attributes for ranking and prioritising industries and determining their impact on trade expansion. However, such efforts are not yet been extensively tested. This does not rule out exploring for a more scientific approach. Similarly, the study reveals that each category of the priority industries possessed qualitative differences in terms of their ability to generate industrial growth and export growth. Therefore, deciding on the typology, intensity, constitution, duration, timing and velocity of policy measures was varied based on relevant differences.

Included among the lessons is the fact that for a regional industrial policy to be effective, it needs to be supported by a well capacitated institutional arrangement that includes all stakeholders and capable of setting and implementing targets as well as gathering and analysing of information, reviewing of targets, making decisions and implementing plans and in exchanging information on the market prospects, and in removing the bottlenecks and in finding solutions. This was very elaborate at the inception and over the years of the EU existence. The same occurred in the AEC as it established a strong Secretariat and implemented industrial programmes; this was moreover done in close collaboration with Sector Associations.

The study has also revealed that the application of industrial policy on the selected sectors followed a dynamic approach especially as it pertained to the role of government, that of the market and of the private sector such that as the infant industries became more competitive. In turn, the role of market forces and competition among enterprises was increased and the importance of targeting and the amount of subsidies was gradually reduced.

Determination of the efficacy of a targeting measure is clear only ex-post. To make decisions is an ex-ante process involving trial and error. Making mistakes is not an argument for the lack of intervention in all circumstances or for providing all industries with the same incentives. Taking action always involves risks entailed with making some mistakes. One who does not act, does not make mistakes. Nonetheless, not to act is, by itself, the worse case scenario.

The study also reveals some failures with industrial policy implementation. In the case of MERCOSUR, the growth in the selected priority industries could not be sustained as the subsidies or incentives were discontinued due to budgetary constraints arising from poor governance of the macroeconomic policies. In the case of SADC, the implementation of the industrial policy was planned to be implemented with donations and loans from the EU and other multilateral organisations to the exclusion of member states. There was a clear lack of political will.

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