



**SOUTH AFRICA &
SOUTHERN AFRICA:**

**REGIONAL INTEGRATION
and
EMERGING MARKETS**



The South African Institute of International Affairs

SOUTH AFRICA AND SOUTHERN AFRICA
REGIONAL INTEGRATION
AND EMERGING MARKETS

edited by

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with the assistance of
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Foreword

Jack Spence

The current debate on the scope and substance of South Africa's foreign policy, where its key interests lie and how best to define and assert them has, at least, produced consensus on the critical importance of the Southern African region. No state can ignore its hinterland and the relationship between Pretoria and its neighbours - past, present and future - has produced over the years a wealth of analysis and fruitful speculation about the shape of things to come. The subject has obvious relevance for South African scholars as they wrestle with the relevance of traditional integration theory to the region's development, the need to redefine security in a Southern African context, and how best to translate President Nelson Mandela's injunction to treat neighbouring states with 'sensitivity and restraint'.

The South African Institute of International Affairs, therefore, deserves congratulation for arranging a conference on *South and Southern Africa: Lessons from Emerging Markets*, and the published version of its deliberations will assist the theorist and the practitioner to come to terms with the complex realities of the Southern African scene. The editors, Ms. Antoinette Handley and Dr Greg Mills, have assembled an impressive range of expertise, and what makes this collection especially valuable (and possibly unique) is the emphasis on the experience of regional integration elsewhere.

Moreover, the impact of global forces compels governments to recognise the incentives and constraints of inter-dependence and fashion appropriate institutional means for achieving the long term goal of closer union. If - as many commentators claim - the building blocks of a future 'new world order' are to be regional groupings, in varying degrees of economic and political integration, the Southern African states will have to co-operate effectively if their peoples are to prosper. Thus the more we understand the dynamics of transnational change, the better placed our political masters will be to carry the enterprise to a successful conclusion - acknowledging, of course, that as institutional structures follow the substance of co-operation, the process remains open ended.

The hope must be that an emerging pattern of co-operation will be firmly based on local experience and skills drawing on overseas counterparts whenever and wherever relevant. This volume, *inter alia*, makes a superb contribution in that regard.

Preface

Greg Mills

The rapidly evolving process of global integration and liberalisation has posed a number of key economic challenges for South and Southern Africa. This process, known commonly as 'globalization', has resulted in a rapid acceleration of economic activity across borders, an increasing mobility of knowledge, and a situation where geographic location and time-zones no longer prove to be obstacles.

Globalization has, *inter alia*, manifested itself in:¹

- increasing capital mobility, where over US\$1 trillion is traded on a typical day;
- increasing trade. In 1963, world exports stood at US\$154 billion. This has grown to over US\$2.5 trillion today, and it looks set to expand further as the 132 member WTO's tariff reductions kick in;
- the increasing importance of stockmarkets world-wide in the search for higher returns. Today about 14% of American holdings of foreign equities (some US\$50 billion) is invested in emerging markets. Estimates show that around US\$300-350 billion from the US alone could move into foreign stocks by the year 2000, with 25% going to emerging markets;
- the increasing use of a common language (English) and international media sources; and
- growing consensus as regards economic policy, particularly in emerging markets.

Globalization, by its very nature, illustrates continually that the world's economies now have a shared interest in stability and growth. This will increase rather than diminish as emerging stockmarkets become critical to developed countries in the search for higher returns, particularly as ageing populations make such returns on investments all the more important. In a world characterised by increasing capital mobility and trade, and an emerging consensus on a recipe for economic success including deregulation, privatisation, fiscal austerity and currency exchangeability, there has been a new emphasis, too, on regional groupings in Europe, Asia, and Latin America as well as Africa.

But in Africa these groupings face seemingly peculiar challenges. For instance, the small size of African economies does not create an imperative for these states to engage with each other, whereas links with developed countries apparently offer access to larger, and potentially more lucrative markets. Moreover, Southern Africa would appear to suffer from unique circumstances: the devastation wrought by thirty-something years of conflict coupled with poor post-colonial governance has left behind a difficult legacy. South Africa's relative economic giantism - where in GDP terms its economy is roughly four times larger than those of the remaining 13 members of the Southern African Development Community (SADC) lumped together - has had a marked influence on Pretoria's official relations with the sub-continent after 1994.

Yet clearly South Africa now shares its greatest interests with Southern Africa: a common understanding and appreciation of democracy, human rights, the rule of law, market economics, and stability and peace are prerequisites for growth and development.

With this in mind, the South African Institute of International Affairs (SAIIA) convened a conference on *South Africa and Southern Africa: Lessons from Emerging Markets* in July 1997 to examine some of the questions that arise concerning regional integration in Southern Africa. For one, what is the state of play with regard to formal integration schemes in Southern Africa, and what can these hope to achieve? How can such schemes manage South Africa's regional economic dominance, and what are the areas that they should focus on? Most important, how can South Africa affect positively what happens beyond its borders?

Africa's biggest problems today hinge around effective governance, the provision and utilisation of skills, and, with young, job-seeking populations, demography. Experience has taught us that Africa, littered with failed grand integration schemes, should hone its current focus down to the nitty-gritty of co-operation. If the much-talked-about South African-inspired 'African renaissance' is to become a reality, there is a need for Pretoria's foreign policy to be informed by economic and business interests.² The presence of big companies assists the process of normalisation and stabilisation crucial for Africa's economic recovery. It is also no coincidence that those African nations that have exhibited better recent economic performance (such as Ghana, Uganda, Tanzania and a number of the Francophone states) have made efforts to put in place an attractive policy terrain. Southern Africa will have to follow this example.

Certainly Southern Africa is blessed with great advantages in its attempts to co-ordinate regional policies. The integration of its rail, road and, increasingly, air networks reflect its colonial history, and this facet is currently being supplemented by the realisation of ambitious schemes such as the Trans-Kalahari and Maputo Corridor links. Trade and investment ties are also burgeoning.

In this regard, South African businesses have taken full advantage of the end of both apartheid and Africa's Cold War xenophobia, directed against foreign involvement. As Rob Davies, the Chairman of the Parliamentary Portfolio Committee on Trade and Industry, has pointed out in this volume, South Africa's exports to SADC (R26.6 billion) outstripped those to the European Union (R26.4 billion) in 1995.³ The SADC figure was R20.5 billion the previous year. Further afield, South African companies will invest around one-fifth of the US\$500 million that will be expended on mining exploration in Africa in 1997. With current South African-Southern African trade levels heavily skewed in the Republic's favour (South Africa imported just R1.44 billion's worth of goods from SADC members in 1995), it is crucial for South Africa to attempt to even out this imbalance through investment, on the one hand, and potentially through asymmetric regional trade schemes on the other.

The requirement that existing trade and investment links should be strengthened is pivotal to the process of broader Southern African co-operation. One reason is that, worldwide, those regions that are most integrated economically are the least likely to be embroiled in disputes and conflict. Where there are areas of regional tension, little inter-state mercantile contact exists. The cases of Israel and its Arab neighbours, India and Pakistan, Ecuador and Peru, and North and South Korea all sustain this argument. The success of Latin America's Mercosur (Southern Common Market) illustrates perfectly the stabilising role of integration and economic growth.

In the security realm, regional armed forces have a part to play in providing the general framework within which co-operation and development may take place. Regional structures can provide mutual reassurances as to the future behaviour, particularly of South Africa, concerning which there is still much sensitivity, on account of its past role. This demands co-operative security endeavours focused, for example, on enhancing and supporting democratic efforts through the promotion of appropriate roles for the armed forces and by providing security against common threats and vulnerabilities.

These changes pose a number of related challenges for South African diplomats and statesmen and women.

First, the global economy militates against turning inward: you cannot advance South African interests by lowering the South African flag. Foreign policy thus requires a co-ordinated grand design and not short-term reflex responses to domestic, continental and world-wide issues and problems. It is no longer appropriate to attempt to maintain a highly-compartmentalised approach which in practice appears to differentiate between aspects of policy (trade, political, military), government departments and business.

Second, foreign policy has to be geared to allow the greatest possible manoeuvrability in the global economy, in an ever more competitive search for markets and products. There is a need to drop the distinction between domestic and foreign policy, which has occurred by default through globalization anyway. The Growth, Employment and Redistribution (GEAR) economic strategy in this sense *is* South Africa's foreign policy, given that the country's international role hinges on its economic well-being.

As Professor Jack Spence has observed, the contemporary diplomat has thus to be something of a 'polymath', not only coping with, as EM Forster put it, a world of telegrams and anger like his or her predecessors, but with a world simultaneously undergoing rapid social and economic transformation.⁴ The juxtaposition between commercial and foreign policy thus demands: the co-option and/or recruitment of mid-career diplomats with experience in business and from a variety of cultural and language backgrounds; the calibration of the scale of diplomatic representation according to the scale of perceived benefit; the establishment of bilateral commerce commissions and special commercial centres with key states (particularly the so-called Big Emerging Markets); the broadening of participation in trade missions and the targeting of South African companies where they might have interests; and the assigning of a greater number of commercial officers to South Africa's overseas missions. A rough survey of missions in 1997 shows the ratio of commercial to political-military officers to be around 1:6.⁵

There is also a need for government to create expertise capable of implementing and sustaining, and not just articulating, aggressive commercial diplomacy. Canada's Department of Foreign Affairs and International Trade (DFAIT) provides a useful template in this regard: in its 1996 report, the DFAIT lists all of the specific successes it has had in the trade and investment promotion area, detailing even the deals struck and the firms involved.⁶

It is clear, too, that in Africa, South Africa's foreign policy cannot afford to be exclusively focused on trade promotion. With the most advanced, productive and balanced economy in Africa, with a vibrant democracy and with a potent military force, South Africa has to take a broader view of its African role. This role will have to link in with efforts to improve respect for human rights, safeguard the environment and deal with criminal and other policy issues, but it should nonetheless be founded on the day-to-day realities and needs of the continent rather than high-flown principles. Here the need to improve conditions, systems and institutions of governance and assist leadership is paramount. This assistance has to take practical forms, such as the provision of frameworks for tax regimes, intellectual property rights, stockmarket operation and regulation, anti-corruption measures, corporate governance skills, an independent judiciary, and so on.

It is said that if foreign policy is about what to do, diplomacy is about how to do it. Yet it is important to recognise that diplomacy is an indivisible mix of substance and process, where how to do it may to a large extent determine what to do.⁷ In the global economy it is particularly crucial to take cognisance of the centrality of commerce in foreign policy and to think about such policy as a sum of South African rather than competing interests.

The conference and this volume were the result of many able efforts, including those of Laurie Boulden, Caroline de Pelet Abraham, Antoinette Handley, Patricia Jacobs, Anne Katz, Pippa Lange, Claudia Mutschler and Pauline Watts. The SAIIA is most grateful for financial support for the conference from the Brazilian Embassy, The British Council, Eskom, Friedrich-Naumann-Stiftung, the Royal Netherlands Embassy, and the Standard Bank. Please note, however, that nothing in this book should be taken to represent the views of these bodies, nor of the SAIIA and its members.

Endnotes

1. Herbst J, 'Developing Nations and Global Integration: Between Bilateralism, Regionalism and Globalism'. Paper given at a conference on *South Africa and Southern Africa: Lessons from Emerging Markets*, the South African Institute of International Affairs, 16-17 July 1997. See also Garten J, *The Big Ten*. New York: Basic Books, 1997, p.37. Garten's work illustrates the need for a close working relationship between business and government in the conduct of modern diplomacy.
2. This concept of an 'African renaissance' was first publicly used by South African Deputy President Thabo Mbeki at a speech to the US Corporate Council on Africa in April 1997. See *Sunday Times*, 27 April 1997.
3. See Davies R, 'South Africa and Southern Africa'. Paper given at the conference on *South Africa and Southern Africa: Lessons from Emerging Markets*, the South African Institute of International Affairs, 16-17 July 1997.
4. See his preface in Marshall P, *Positive Diplomacy*. London: Macmillan, 1997, p.xii. Marshall's work is highly recommended as a text on the needs and practices of the modern diplomat.
5. I am grateful to Alan Begg for conducting this informal survey.
6. See *DFAIT Departmental Plan*. Supplied by the Canadian High Commission, Pretoria.
7. See Marshall, *op cit.*, p.1.

South Africa and Southern Africa: Introduction

Antoinette Handley

The question how developing countries like South Africa can best situate themselves to compete in the global economy is one that, for decades, has been answered by recourse to regional economic co-operation. Certainly in Southern Africa, first the Southern African Development Co-ordination Conference (SADCC) and its successor, the Southern African Development Community (SADC), have long been touted as the answer to the region's economic woes. But how effectively have developing countries, and African states in particular, dealt with the challenge of organising regionally? Can regional integration on its own offer such states a viable path to sustainable economic development? And what particular model of regional organisation will be to the best advantage of these states? Closer to home, a further set of questions relates to the implications of developments in the rest of the world. How, for example, will SADC be influenced by the renegotiation of Lomé? And what about developments within GATT and the international trading system more generally?

The International Context for Regionalism

The primary focus of this collection of papers is on the economic dimensions of regionalism. It is, however, impossible to isolate these discussions from a broader consideration of the political context within which these developments occur - and from the experiences of other economies, elsewhere in the world, who find themselves in a similar position to our own.

What then is the international context within which regionalism in general, and SADC in particular, has to operate in the late 1990s? It has been argued that 'both the international and the domestic context of the 1990s is much more favourable [for the success of regional endeavours] than that of the 1960s'.¹ Analysts have identified two parallel developments in the international sphere, namely *globalization* accompanied by ever greater *regionalisation*. On the one hand, it is argued that trade, investment and information flows are increasingly internationalised; on the other hand, there are growing concerns that the world is being inexorably divided up into three rigid, exclusivist trading blocs, clustered around the economic poles of North America, Europe and East Asia.

One of the GATT publications, for example, contends that in 1990, over half of all world trade was conducted within trading blocs² - and such figures are frequently employed to argue that if an economy does not fall within such a trading bloc, it runs the risk of being marginalised. In this environment, it is important to define exactly what is meant by regionalism, to ask critical questions about the extent to which the world is becoming more regionalised and to examine what challenges this poses for the Southern African region.

Two 'Waves' of Economic Regionalism

Wyatt-Walters presents a useful definition of economic regionalism as 'the design and implementation of a set of preferential policies within a regional grouping of countries aimed at the encouragement of the exchange of goods and/or factors between members of the group'.³ Two dimensions emerge from this definition as important: firstly, the process is non-coercive and voluntarily undertaken by states; secondly, the process, by definition, involves movement towards the creation of a larger political and economic unit. Both of these imply the sacrifice of a degree of national sovereignty over particular areas of policy making.⁴ The tension between regional co-operation and decision-making, and a stress on national sovereignty is commonly cited in discussions on regionalism.

Likewise, in any discussion about economic regionalism there is frequently an important distinction drawn between trade *creating* regionalism and trade *diverting* regionalism. Trade creation is generally considered to be more likely to occur where states in a region are 'natural' trading partners in any case, and where the lowering of tariffs which accompanies the regional process simply facilitates higher levels of trade (both with the region and elsewhere) and the purchase of the most competitive goods. By contrast, trade diversion occurs when regional tariff barriers divert a country's trade away from the most globally competitive sources and compel states to purchase these goods from their regional partners instead. Trade diversion is commonly thought to result from processes which bind states into a 'closed' regional model, and is opposed by both liberals and many main-stream economists because of the way in which it can impede global trade.

Since the late 1980s, observers of international affairs have noticed a discernible revival of regionalism, alongside ongoing globalization: 'the number, scope and diversity of regionalist schemes have grown significantly since the last major "regionalist" wave in the 1960s'.⁵ Schemes which form part of this 'new wave' include both new and revitalised organisations such as Mercosur, APEC, NAFTA, the Arab Maghreb Union and the Andean Community.

This development appears to echo a similar movement in the 1960s, when 'the world was indeed filled ... with proposals for NAFTA, PAFTA, LAFTA, and ever more'.⁶ Is there

anything that distinguishes the latest wave of regional experiments from their earlier 1960s incarnations? A further and perhaps more crucial question may be whether the current round of regionalisation is likely to be more durable and ultimately more successful than the last.

For the developing world of the 1960s, amidst a heady environment of popular calls for a New International Economic Order, organising regionally was viewed as one important weapon available in an arsenal directed - without significant success, it must be said - against a skewed and unjust international trading and economic system. The Non-Aligned Movement, UNCTAD, the OAU, and the G-77, while they differed in the specifics of their agendas and memberships, shared a concern to organise 'Southern' or Third World states in order to improve their economic lot in the global order. Such groupings represented an attempt to build solidarity on the basis of their developing status, which solidarity was to be harnessed to challenge the South's marginalised or dependent status.

Most commonly, such organisations were grounded in the economic wisdom of the time, that is, that Import Substitution Industrialisation (ISI) represented the optimal route to sustainable, autonomous economic development. ISI in turn was based on the notion that industries should be developed behind protective national or regional tariff barriers, and that these industries would, in time, grow strong enough to be able to compete internationally.

While the strategy achieved some successes, the protectionism implicit in the model gave rise to industries which grew ever more complacent as they were safe-guarded from - and hence unaccustomed to - global competition. In other instances, internal markets were not sufficiently large or diverse to facilitate the development of globally competitive industries. ISI lost credence in the 1970s, accompanied in many instances by the decline or stasis of the regional models which had been grounded in it.

Alongside these economic developments, the intensification of the Cold War meant that a number of regional organisations became a playground for superpower tussles between the superpowers. A number of regional initiatives, distracted by the ideological and bipolar nature of the conflict, barely managed to contain the localised skirmishes that ensued. Those, like the Organisation of African Unity (OAU), that endured and survived these divisions were nonetheless paralysed by them. For these and other reasons, many of the South's regional initiatives stalled, failing to meet the hopes held so high at their inaugurations.

It may be that it is precisely the failure of so many of these earlier attempts and the drastic reduction of their collective bargaining power - the 'end of Third Worldism' - since the late 1970s, that has inclined so many of these states to look, in the 1990s, at 'alternative regionalist scenarios'.⁷ Since the late 1980s, a shift away from broad, ambitious coalitions towards

much smaller, geographically tighter organisational structures has been evident. A number of factors has impacted on the shape of the 'new' regionalism - and the renewed vigour of the hopes held for its success.

For states in the developing world, the 'ever closer union' of the European Union (EU) following the Single European Act in 1986, the ratification of the North American Free Trade Agreement (NAFTA), and the dramatic growth evident in many of the emerging markets of East Asia have given rise to a profound fear of 'being left behind' and of economic marginalisation in an ever more 'regionalised' world.

The end of the Cold War and a decline in the number of sub-conflicts of attrition that accompanied it, have opened up new possibilities for regional co-operation. The same period has also witnessed a series of important economic changes, perhaps most significantly the emergence of the so-called 'Washington consensus'. While certainly not universally or uniformly implemented, even by its adherents, from the late 1980s there has been growing international convergence on the appropriateness of certain base-line strategies for economic success. These are: an outwardly oriented and internationally competitive economy, conservative macro-economic policies, and de-regulation of the investment regime within a substantially liberal trading framework. The incremental liberalisation of the international trading environment, in response to developments within GATT, the Uruguay Round and the WTO have also served to create a rhetorical prototype of the notion of free trade, even if it is one that is implemented rarely in practice with quite as much unequivocal enthusiasm as the rhetoric may imply. These trends were reinforced by the apparent success of the East Asian tigers alongside dramatic evidence of the chaos and costs of the former centrally planned economies.

This broad shift in economic thinking has been evident in the new wave of regional arrangements which aim to create common markets.

As far back as fifteen years ago, one of the most eminent writers in the field of regional integration, Ernst Haas, argued that, of all issues and policy areas, the commitment to create a common market is the most conducive to rapid regional integration and the maximisation of what he called 'spillover' (the spillover of joint and regional policy- and decision-making to new areas, previously outside the region's mandate). Organisations with an economic mandate short of creating a common market or free trade area apparently have greater difficulty in influencing the policies of member states.⁸ Given the focus of the new economic regionalism, this has created considerable enthusiasm for the potential offered by the current round of regionalisms.

How to Make Regionalism Work

Observation of regional developments over decades has established a number of empirical generalisations that can be proffered about attempts at regional organisation, both in the developed and developing world.⁹

- Firstly, it is evident that the parties to such an attempt are likely to evaluate any such process negatively if there is a perception either that the process is costing them more than it is benefiting them, or that costs and benefits are not being fairly distributed among the regional partners.

For this reason, particularly at the outset of any regional integration attempt, it is considered important to make integration appear relatively costless by carefully planning the strategy of the initial steps. Where visible costs are low, it is easier to reach agreement on the first steps. Over time, costs are likely to rise and become more visible, but it is hoped that the regional dynamic will be sufficiently advanced at that stage for actors to have an interest in safeguarding the progress.

Nonetheless, with the passage of time, the broadening of the arena of participants is likely to be accompanied by growing controversy and conflicting visions of common interests - which may be settled or not. Reaching decisions may grow more difficult and involve a wider range of forces. The important question here is timing, namely whether this happens before or after there has been sufficient growth in the distribution of benefits and hence support for the process.

- Uneven levels of economic development among regional partners may aggravate such tensions, unless the stronger economies in the region are able (and willing) to provide some form of 'pay-off' to the weaker. When such payoffs are not provided, inequality appears certain to hinder integration.¹⁰ As integration proceeds, it is likely to affect the distribution of welfare, status and power between and within member states, with some groups benefiting to a greater extent than others. This problem is particularly acute in less developed areas.

On balance however, redistribution need not be entirely negative for an integration process; conversely, it can serve as an incentive for actors to push for further integration.

- There is some evidence of the need for strong support from the ruling élites for the notion of regionalism in the affected states, and what is described as 'élite value complementarity' or consensus among those élites on the basics concerning political and economic governance.¹¹ In the 1990s, this is commonly assumed to be agreement on the value of a market-driven economy and multi-party democracy.

Preferably, the efforts of these élites should be supported by a regional constituency who can serve as allies, lobbyists and channels of information for regional bureaucrats.

- Finally, it appears universally evident that the growth of any regional process is shaped by the capacity of member states to respond - and here it begins to be evident that there are particular challenges and difficulties posed for developing countries (as opposed to those belonging to the industrialised world). Governments in such countries are frequently weak in a number of areas, and the competing demands on the attention of decision-makers posed by internal instability may hinder the capacity of states to 'hear' messages from their weaker regional partners - or to respond to them.¹²

The Regional Context for Developing Countries

As Joseph Nye remarks:¹³

Considering the value of regional economic integration for less developed states and the frequent attempts to achieve it, there are remarkably few successful cases.

Why is this? Are processes of integration in the developing world so different from those elsewhere that we need different guidelines and considerations?

Certainly, the political and economic context for regional integration schemes involving developing states is substantially different from those of industrialised economies. Distributional issues, for example, are likely to be more acute for the former. In addition, the available evidence appears to demonstrate that the lower the income and level of industrialisation in an economy, the lower its tolerance to (both domestic and regional) asymmetries and the more sensitive the problem of equitable distribution of benefits. Certainly the resources available for compensation for redistribution are in shorter supply.¹⁴ Perhaps the most serious obstacles to regional economic integration, however, may lie in the structure of developing economies, and the nature of their trade with each other.

Chapter Outline

Part One: Regionalism in Africa

While the history of regional integration attempts in Africa is not an encouraging one, this has not appeared to unduly affect the creation of new initiatives:¹⁵

Modern Africa has experienced the creation of more than 500 intergovernmental organisations. Today, well over 200 of these organisations still exist, and new ones are continually emerging, many of which have only slightly different objectives, names and memberships compared with the old and already existing organisations.

Part One of this collection focuses on the continent's historical and prospective regional efforts.

It would appear that there *are* particular considerations that pertain to developing countries - and to African attempts.¹⁶ The first of these has to do with process: as Ernst Haas points out, the history of failed regional integration attempts in Africa graphically demonstrates the danger for such a process when members' expectations are prematurely politicised, thus preventing the kind of incremental bargaining on relatively noncontroversial shared objectives which is considered so essential to progress. In addition, bargaining with reciprocal benefits becomes all the more difficult because of the highly restricted and limited nature of available resources.

The second consideration concerns the weak political nature of many African states and the highly contested claims of their leadership and their territories, which means that many African countries are likely to make poor partners in a regional integration process. There may be a reluctance on the part of insecure leaders to further undermine their control at home.

Additionally, inequality between economic partners, and the political tensions and rivalries that result, have been the downfall of a number of prior regional integration attempts, on the African continent and elsewhere. This collection begins with a paper by Christopher Clapham, which outlines the large number of such attempts in Africa and analyses why so many of them have come to nought. He argues that, due to the low levels of trade that existed between African states, such attempts have, in the past, provided only slight economic benefits, as they tended to result in trade diversion rather than trade creation.

Jeffrey Herbst's paper forms Chapter Three, in which he sketches out the international environment within which African states and African regionalism are forced to operate. These states function in a highly competitive global environment, in which the consistent

and sustained implementation of the 'Washington consensus' is increasingly coming to be seen as a prerequisite for economic success, and certainly for international investment. In such an environment, the significance of regional co-operation, he argues, does not lie primarily with trade, but with building credibility for, and by facilitating adherence to, economic reform programmes. In this sense then, regional organisations are useful to the extent to which they assist a region to become a global economic player.

Part Two: South Africa and Southern Africa - The Specifics of Regional Co-operation

Part Two of this book examines the specifics of regional co-operation in Southern Africa. Chapter Four, by Rob Davies, provides an overview of the state of regionalism in Southern Africa. He warns of the inherent dangers - for both South Africa and the stability of the region as a whole - of the acute inequalities and imbalances evident in the region, and how these could be exacerbated by the widening gap between South Africa and its regional trading partners.

Chapter Five by Timothy Thahane provides an authoritative review of *Financial Sector Co-operation in SADC*. In Chapter Six, Talitha Bertelsmann considers the issues raised for the region by the negotiations over a potential Free Trade Agreement between South Africa and the EU. Crucial to any consideration of trade issues is an understanding of South Africa's own macro economic strategy, GEAR, and what the regional dimensions of such a strategy are. Chapter Seven by Stephan Malherbe argues that South Africa's labour regime is crucial for the successful implementation of GEAR, and that this has implications for the region as a whole. South Africa appears bent on the pursuit of a high value-added, high wage growth path. At first sight, this strategy appears congruent with the low labour costs and flexible labour markets evident elsewhere in the region. Yet South Africa continues to protect its industries from the low wage sectors in neighbouring states - and is encouraged in this regard by organised labour here. There is thus little cohesion on economic policy for the region as a whole.

Part Three: Lessons from the 'New' Regionalism in Latin America

Many of the frustrations and obstacles experienced in Southern Africa are not unique to our region, but have been experienced by other developing states. In this regard it is instructive to consider, in particular, regional economic initiatives in Latin America. Many of these states resemble South Africa in important respects. Politically, we share a history of colonialism, of authoritarian rule and more recently, of transition toward democracy. Economically, these states, like South Africa, experimented with ISI models in the 1960s

and 1970s. The economies of Latin America, like our own, continue to display many of the features characteristic of developing states: high levels of inequality and unemployment, a reliance on the export of primary and unprocessed materials to developed economies, and the import of manufactured /processed goods from the same. Nonetheless, many of the Latin America states, having embarked on rigorous and far reaching economic reform programmes, have begun to experience a remarkable economic turnaround. Hyper-inflation has, in many instances been tamed and growth rates compare favourably with South Africa's paltry two to three percent. Perhaps most striking however, has been the (in most cases) unilateral liberalisation of trade in the region, leading to the emergence of *de facto* free trade areas and a new, open and outward-looking model of regionalism.

Part Three concentrates on the lessons which may be learned from this region's experiences. Chapter Eight by Jorge Heine focuses on one of the most successful reformers, Chile, and considers *The Benefits of Tariff Liberalisation*. Southern Africa, consumed by the question of how to accommodate South Africa's relative economic giantism in a region populated by some of the world's poorest states, could do worse than look to the experiences of Mexico in NAFTA. Cassio Luiselli's paper (Chapter Nine), *Coping with the Regional Hegemon: Mexico's NAFTA Experience* shatters many of the assumptions about the 'inevitable' outcome of an agreement which hitches the economic fortunes of Mexico, a developing economy, to the world's largest single economy (the US).

The collection concludes with José Botafogo Gonçalves' succinct summation of the characteristics and processes that have contributed to the success of Mercosur.

Regionalism and Emerging Markets

It seems that the most common tension in any regional or multilateral initiative remains the age-old collision of interests between the regional dynamic and a stress on national sovereignty. This conflict is almost invariably present, but appears to be more manageable under certain circumstances. Conventional regional integration theory tells us that a regional integration project is most likely to succeed:

- the greater the proportion of goods imported from the region and from member states in particular, and the smaller the proportion bought from outside this area;
- the larger the internal market;
- the greater the diversity of production structures among member states; and
- the lower the costs of transport among states.

Beyond these factors, however, there are a number of more explicitly political considerations which must be borne in mind. Prime among these may be the necessity to contain a hegemonic power. Some analysts argue, for example, that the perceived need to contain the large, powerful German state in the aftermath of two World Wars impelled Europe toward the process that ultimately led to the EU. The economic size and political stature of South Africa within Southern Africa have complicated its relations with its region, and this dilemma is mirrored by the position of Brazil in Mercosur and the US in NAFTA. These political dynamics can spill over into political rivalries. Consensus on basic political and economic values, such as democracy and the importance of trade liberalisation (as in Mercosur), can ease some of these tensions, but they are likely to persist.

At bottom, tensions may relate to regional inequities of power between small and large states. Small states frequently feel threatened by their larger neighbours, while larger states are unlikely to accept being dictated to by small states. Central to the resolution of this problem is the distribution of regional risks, costs and benefits - and perceptions of how 'fair' this distribution is. It is, therefore, in the distribution of costs and benefits that regional organisations must labour to win legitimacy - and they can do so only by treading the fine line between a collective increase in benefits and a not-too-burdensome distribution of costs.

The importance of the structure of an organisation, and the size and functioning of its secretariat are emphasised in some of the papers in this volume. Several of the contributors argue for modesty in the size and ambitions of regional initiatives. Certainly, the lesson from Mercosur seems to be to start small and build on your successes; let the organisational structure follow from your successes, rather than having your programme dictated by a pre-determined structure.

Are These Factors Evident in Southern Africa?

Sadly, it appears that many of the structural factors which are apparently necessary for successful regional integration are absent in Southern Africa. The region exhibits the following general characteristics:

- a shortage of value-added products tradeable between states;
- a low level of industrialisation;
- a heavy dependency on imports and foreign trade, in particular with advanced industrial countries;

- a relatively low level of trade within the region; and
- small economies, both in terms of population size and GDP.

It needs to be said, of course, that these considerations do not render regional integration an impossible mirage - but they do indicate why it is likely to be a difficult, even a fraught undertaking.

Despite the advent of democracy in South Africa in 1994, the country's relations with its neighbours continue to be dogged by ambiguity. On the one hand, the region's economic hegemon has been accused of protectionism by its neighbours and pressurised to conclude unilateral trade deals with the larger economies in the region, like Zimbabwe and Zambia. On the other hand, the small economies and its SACU partners accuse the country of pushing too hard for commitments to the liberalisation of regional trade, directly under the Free Trade Protocol, and indirectly by means of a proposed FTA with the EU.

These conflicting concerns raise the question of what role a regional organisation like SADC can reasonably be expected to play to assist South Africa and other states in the region to integrate, on as favourable terms as possible, into the global economy.

What Can a Regional Organisation in Southern Africa Achieve?

It is clear from even a cursory glance at interstate relations in the region that there is a need to resolve the tangle of trading relationships and disputes among the region's states. Unilateral trading agreements fit uneasily with South Africa's ongoing multilateral negotiations. These are occurring on at least three fronts: with the EU over the conclusion of a proposed FTA; with its SACU partners over the restructuring, among other things, of the revenue sharing formula; and with other SADC states over progress on the Free Trade Protocol. Alongside the technicalities lie the vital questions of how to deal with regional trade imbalances, and how best to promote equitable regional development and trade.

There are those who argue that the solution to South Africa's trading woes are to be found in substantially increasing its trade with its regional partners - and that this focus should form the nub of SADC's work. Such analysts are wont to argue that South Africa could save hard currency and correct the current imbalances of trade by importing (for example, more food and beverages) from neighbouring countries.

In addition, the recent Department of Trade and Industry (DTI) Global Economic Strategy Project in its Trade Potential Index for South Africa listed two SADC states in its top ten ranking - a good showing given the region's relative global insignificance. The project

emphasised the importance of value-added exports to the South African economy, and pointed out that value-added goods form a higher percentage of exports to developing markets than they do to its traditional trading partners in the developed world.

Certainly, prospects for improved trade with South Africa's neighbours are looking up: in 1996 there was a six percent growth in GDP in Southern Africa and in the same year, South Africa's exports to SADC jumped 39.9% to R12.7 bn (compared with R8.2 bn in 1995). In fact, the Rand was one of the weakest currencies in the SADC over 1996 and the first half of 1997.¹⁷

Given the fact that, all things being equal, neighbours tend to trade more with each other than with other countries, and the healthy trade surplus (R10.6 bn) that South Africa enjoys with its neighbours, the arguments for a trade-driven SADC begin to look quite compelling for the hegemon. But this may be to fly in the face of certain local political realities and international economic developments.

South Africa certainly enjoys a considerable trade surplus with its neighbours, but the point of SADC, surely, is to reverse this - to assist our neighbours to develop, argue the naysayers, and not just to export greater amounts to them at ever more favourable rates for itself?

Herein lies a clue to a second, perhaps more compelling, rebuttal: just what would Southern African states trade with each other? A cursory examination of current trade within the region reveals that most SADC states do not export the kinds of goods that South Africa imports - for example, industrial goods, machinery and chemicals.

Furthermore, despite their improved economic growth rates and prospects, the SADC states remain solidly in the strata of low income states, most citizens earning an average annual real GDP *per capita* income of US\$1,871¹⁸ per year, suggesting that the big money is not going to be made by trading with Southern Africa. Wyatt-Walters puts it rather bluntly: 'Most trade in the world economy is driven by income: the biggest importers are the richest countries'.¹⁹

As in so much of the rest of Africa, the existing regional infrastructure in Southern Africa is hardly conducive to inter-regional trade, or even to quick, efficient and cost effective transport out of any one country. Consequently, some have argued that one of the most valuable functions that SADC can serve is the co-ordination of regional infrastructure development. Examples of important regional initiatives which are already under way or in the planning stages include the Trans-Kalahari highway project, the Maputo corridor, Mozambican-South Africa co-operation on the Cahora-Bassa hydro-electric dam project, the Lesotho Highlands Water Scheme and the proposal to install power turbines on the Inge River for the generation of hydro-electric power.

The latter example raises a further issue, namely the uneven distribution of water resources in the region, and the benefits which could accrue from a regional approach to water. Regional preparation for drought in the region can only be of benefit to Southern Africa, many of whose states, even in a normal year, receive relatively little rain. This need is thrown into stark relief by the recurrence in 1997 of *El Niño*. It may be that SADC's food scarcity early warning system will be put into operation much sooner than people had hoped would be necessary.

There are already early attempts under way to develop a regional strategy for water. In 1996 SADC countries made a commitment to co-operate in shared water basins to integrate the development of water supply with power generation, domestic water supply and other factors. Should this agreement make a real contribution to drought management in Southern Africa, it could provide a role model for the 'new' regionalism.

The Setting for Regionalism has Changed

It is evident that not only the content, but appropriately also the designated functions and structure of regionalism for developing countries have assumed a very different face in the global economy of the 1990s. Any analyst of the international economic environment will swiftly discern that the environment for regional initiatives has changed profoundly in the last 20 years. The closed regionalism of the 1970s, intended to assist the South to develop by protecting it from interaction with the North, has been replaced with a more open model, aimed specifically at the better integration of emerging markets with the world economy. This has circumscribed the options available to regions - and to states. Clapham's analysis of the history of regional integration in Africa demonstrated much that was wrong with the old regional model, despite the considerable benefits won by the application of a model of ISI.

Yet, as Thahane pointed out, international competitiveness will compel us to look to our regional markets. The frequently made argument that it will little benefit South Africa to develop as an island of wealth in a sea of poverty provides an additional set of imperatives. What, then, must we bear in mind when trying to move towards a successful and dynamic region?

New Roles for Regionalism

As suggested by Herbst and others in this volume, the value of regional initiatives in the global economy of the 1990s may not lie principally or exclusively with the traditional concerns about trade, although for small economies who seek to escape their dependency on the whim of other states such initiatives can serve to secure their access to larger economies.

What regional co-operation can realistically achieve is a rejuvenation of the regional infrastructure, in particular the transport and information technology infrastructure. Thahane's paper demonstrates, for example, the importance of a regional monetary/financial data base. Speaking more broadly, regional co-operation can make a contribution to the building of solid political and social institutions through the development of a regional consensus on norms and priorities. Regional co-ordination can also assist, as outlined by Luiselli, in the rejuvenation of particular industries. The precise nature of this rejuvenation will differ from country to country and industry to industry.

Most crucially perhaps, regional organisations, which are built on an outward-looking model, can serve to build credibility for domestic economic reform programmes. This function is closely linked to a further potential role for regional agreement, namely assisting the region as a whole to come to terms with the 'market' and with the strategies that are necessary to lay the basis for export-driven growth. Some of the experiences of Chile, as outlined by Heine, speak of the dangers of excessive, unilateral tariff lowering, but the country's experiences as a whole also demonstrate the benefits to be had from a considered integration with the world and regional economies.

Finally, and less easy to pin down, is the role that regional organisations can play as a voice for their regions. Africa and Southern Africa urgently need a clear, coherent voice in the world. One hopes that SADC is able to be that voice.

In conclusion, it is important to recall that the demand for international competitiveness frequently leaves very little room for the evening out of regional disparities, and that these disparities can ultimately cause the downfall of any attempt at regional co-operation. South Africa needs, therefore, to consider ways to compensate peripheral states and to draw them into the regional process as potential beneficiaries and stakeholders. One way to do this may be to allow labour from these markets access to the bigger economies.

The movement of people is central to any discussion about regionalism, and labour mobility is undoubtedly here to stay. One can engage in academic discussions about the potential comparative advantage for the region (excluding South Africa) of their lower labour costs and the response to this of the trade union movement regionally. Ultimately however, as

Luiselli pointed out, the point of regional integration is surely to export more goods and fewer people.

South Africans frequently view this emotive debate through the lens of fears about the loss of jobs. It is instructive here to consider the experience of NAFTA and concerns about the 'great sucking sound' of jobs being lost to the poorer South which failed, ultimately, to materialise. In a region which often worries excessively about the impact of market-driven integration, it may be useful to hold before us Luiselli's image of *La Frontera*. Rather than dwelling on the nightmare scenarios we hear outlined so frequently at present - of floods of jobless people and of the smuggling of guns and drugs - it may be worthwhile to look anew at the underpinnings of our regional integration process, concentrating instead on the potential in our own region for a dynamic, thriving border area.

Endnotes

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12. *Ibid.*, p.214.
13. *Ibid.*, p.226
14. *Ibid.*, p.228.
15. Soderbaum F, *Handbook of Regional Organisations in Africa*. Uppsala: Nordiska Afrikainstitutet, 1996.
16. Haas, *op.cit.*, pp.14-15.
17. It was reported that from January 1996 to July 1997, the Rand lost 20% of its value against the Malawi Kwacha, 11% against the Mauritius Rupiah, 17% against the Mozambican Metical and 73% against the Angolan Kwanza. It should be recalled, however, that key to this (under) performance was the Rand's dive in 1996, when it lost 25% of its value against many currencies.
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Regional Integration in Africa: Lessons and Experiences

Christopher Clapham

Introduction

The history of attempts at regional economic integration in sub-Saharan Africa since independence, nearly forty years ago, has been one of virtually unbroken failure. Failure in the past does not necessarily mean that any future attempt at integration must be similarly unsuccessful; but this record derived, not from mere misfortune or the personal inadequacies of the individuals concerned, but from structural features of African states and economies which cannot easily be changed. At the very least, then, any project for integration which does not take into account the lessons of past failures will be fortunate not to repeat them.

This chapter will therefore briefly survey the experience of attempts to form African regional economic communities over the last four decades, and suggest some of the reasons why these have had such very limited success, while seeking to account for the limited successes that they have achieved. It will then go on to draw some lessons for future attempts at regional integration, under the rather different economic and political conditions that have characterised the continent in recent years.

Experiences

The record of failure noted above contrasts sharply with the almost universal expectation at the time of independence that integration provided an essential and practicable route to economic development - an expectation summed up in the title of a book which perfectly expressed the aspirations of the period: *Unity or Poverty: The Economics of Pan-Africanism*.¹ The reasons appeared to be so obvious as to be virtually incontestable. For a start, the economies of individual African states were so tiny that only by joining together could they even hope to reap benefits from the advantages of scale. The creation of larger internal markets would provide a basis for industrialisation, and encourage foreign investments which would scarcely be attracted to individual states. In at least some cases, complementarities could be expected to result from the linking together of factors of production that were currently dispersed between neighbouring states. Africa's

highly mobile labour forces would be freed from the constraints imposed by colonial boundaries. Equally, integration would give African states greatly improved bargaining power in dealing with the powerful industrial economies, both in helping to maintain the prices of their export products, and in counteracting the 'divide-and-rule' policies that could be expected to result should foreign corporations be able to play off one small African state against another.

Green and Seidman's title also points to the political agenda for integration. Artificially created colonial territories had given rise to states whose frontiers were often arbitrarily drawn, and whose peoples were generally indistinguishable from those just across the border. Integration would help to knit together African peoples who had been split asunder by alien rule, and - given the evident practical problems of immediate continental union - provide at least a 'stepping stone' or a 'building block' in the progress towards eventual unity. Though there was some dispute within the Organisation of African Unity (OAU) over the issue of whether regional integration at a sub-continental level might obstruct rather than facilitate the eventual formation of a 'union government', on the whole the consensus favoured such intermediate progress. It could likewise readily be assumed that integration among states that had no long-standing 'national' identities, and were united by a powerful ideology of pan-Africanism, would be far less problematic than in a continent such as Europe, with its entrenched nation-states and bitter memories of recent warfare. Indeed, it could be argued that if even the long-established states of Western Europe were convinced of the need to sink their long-standing differences in a search for regional integration, then the case for such integration in Africa must be even stronger.

Regional organisations were correspondingly formed in large numbers after independence, and on very different political bases. Some, like the East African Community (which linked Kenya, Tanzania and Uganda), or the *Union Douanière et Economique de l'Afrique Centrale* (UDEAC), which comprised the former states of French Equatorial Africa with the addition of Equatorial Guinea, were essentially colonial creations that were relaunched at independence and already possessed important elements of integration such as a common currency. Others, like the Ghana-Guinea-Mali Union or the Mano River Union (initially of Liberia and Sierra Leone, subsequently joined by Guinea), linked small groups of like-minded states across the former colonial divide. The formation of the Economic Community of West African States (ECOWAS) in 1975 was intended to create a single economic bloc, extending across 15 contiguous and heavily populated states, and backed by the political and economic clout of oil-rich Nigeria. Most ambitious of all, the OAU's 1980 Lagos Plan of Action promised to bring about an African Common Market by the year 2000, a target date subsequently put back to 2025. None of them worked.

What went wrong? For a start, the economic benefits of integration for tiny open economies were actually extremely slight. The integration schemes launched in the decades after independence were overwhelmingly guided by the assumption that development required the 'liberation' of African economies from the exploitation to which they had been subjected as an inevitable consequence of colonialism. It was the direct economic equivalent of political decolonisation, designed to reverse the centuries-old experience of forcible incorporation into a European-dominated global economic order. As expressed in pseudo-Marxist works such as Kwame Nkrumah's *Neo-Colonialism: The Last Stage of Imperialism*,² integration was intended not only to link economies within Africa, but to cut them off to a significant extent from economies outside. Elements of this approach, justified by 'dependency' theories of underdevelopment imported from Latin America, continued into the Lagos Plan of Action. African economies were, however, ineradicably locked into north-south patterns of trade, which were unaffected by the shift from colonialism to independence. No African state or group of states was in any position to cut itself off from the global market and seek to industrialise by mobilising its internal productive resources, in the manner sought - entirely counterproductively - by Burma or the Khmer Rouge's Kampuchea. The scope for complementarity was negligible, because few African states produced much that neighbouring states wanted to buy, while the minimal level of industrialisation left few opportunities for integrating the factors of production from different states into common productive processes. The costs of cutting Africa off from the outside world were far greater than any possible benefits to be achieved by integration within the continent. Nor did such integration offer any significantly increased bargaining power in dealing with the developed industrial economies. Prices for African primary products, which were determined largely by global demand, and especially by the economic cycles of developed capitalist states, could scarcely be affected by the attempts of African states to manipulate supply.

Nor did the attempt to create regional 'unions' or 'communities' actually foster the growth of African 'unity' in the way that its proponents expected. Instead, the attempt to integrate readily intensified differences between the would-be partners. It is central to any consideration of regional integration that the benefits produced by the creation of a larger and more powerful bloc have to be achieved by a reduction of autonomy for individual actors within that bloc. The loss of autonomy on the one hand, and the creation of benefits on the other, are moreover inevitably unevenly distributed, with an inherent tendency for the more powerful, developed and centrally located members to gain a disproportionate share of the benefits, and for the weaker, less developed and more peripheral members to suffer the greatest loss of autonomy. In straightforward economic terms, the benefits accruing to the grouping as a whole, through trade creation, have to be set against the benefits which accrue to some members at the expense of others,

through trade diversion. The classic analysis of this process, applied to the Central African Federation 30 years ago, showed how the benefits of integration amongst the three then territories of British Central Africa accrued almost exclusively to Southern Rhodesia (Zimbabwe), while the costs were borne very heavily by Northern Rhodesia (Zambia) and in some degree Nyasaland (Malawi).³ Though the political problems of the Central African Federation were greatly exacerbated by the fact that its dominant member was under white minority rule, its discriminatory economic impact operated independently of specific political arrangements.

Any attempt to mitigate the effects of trade diversion brings economic issues directly into the political arena and is likely to increase the opportunities for rivalries and resentments between the partner states. Dominant states will seek to use the community to foster their aspirations to regional hegemony in ways which peripheral states will correspondingly resist. Industrial policy provides one example. The obvious location for almost any industrial project will be in the largest, most developed and most centrally placed state: in Kenya for the East African Community, in Zimbabwe for the states of former British Central Africa, in Nigeria or Côte d'Ivoire for West Africa, and so forth. External investors will almost invariably wish to locate themselves in this 'hub' economy, and its government will encourage them to do so. If, under pressure from its less favourably placed members, the union seeks to promote integration through an industrial policy designed to encourage development at the periphery, this will both discourage investors and induce a feeling in the hub state that an industry most economically situated in their own territory has been 'given away' to a regional rival.

By far the two most sensitive issues, however, are those of revenue and labour migration. The revenue problem arises from the fact that underdeveloped African states generate a very high proportion of their government income from taxes on foreign trade, whether directly in the form of customs duties, or indirectly through such devices as royalties on mineral production or the profits of government commodity trading monopolies. Any threat to these revenues, of a kind that is almost necessarily posed by any effective regional integration scheme, in turn threatens the freedom of action - and potentially the political survival - of the incumbent regime. The direct loss of customs duties on trade between member states is normally only a fairly minor element, since such trade is in any case usually slight. Transit trade is more important, since many African states (and especially, of course, the landlocked ones) rely on ports in neighbouring states, and if customs barriers between states are dismantled, complex and potentially contentious arrangements will be needed to regulate the allocation of duties collected at the port of entry to the community as a whole.

These specific issues are however no more than the tip of the iceberg. Free trade between member states would, for example, enable farmers to seek the best markets for their

produce, in the process evading taxes payable to their national governments. Parastatal organisations, a useful source of patronage and control for governing élites, would implicitly or explicitly be opened to external competition. Most important of all, a common currency enormously increases the ease with which entrepreneurs of every kind can evade state control: the introduction of national currencies after independence was one of the most important mechanisms through which African governments (with the significant exception of the CFA states, where French support compensated for the loss of state autonomy) sought to police their economic frontiers.⁴

The labour migration issue is even more sensitive. African labour forces are exceptionally mobile, and workers of all descriptions - from unskilled labourers to academics - readily move to wherever the economic opportunities are greatest. In this respect - in contrast, for example, to the European Union (EU), where labour migration between states is slight - African economies are ideally suited to integration. That is precisely the problem. On one side of the boundary, the less prosperous states see the most skilled and enterprising members of their work force abandoning the national territory to seek employment elsewhere. On the other side, the citizens of more prosperous states see 'their' jobs being taken by foreigners, to whom every social evil, from crime to the spread of sexually transmitted diseases, can then be ascribed.

Two characteristics of African economies and societies tend to exacerbate the problem. The first is the boom-slump cycle induced by the volatility of primary produce prices. During the boom period, outsiders flood in to take up readily available jobs, often those for which there are not enough suitably qualified nationals, or which are too menial and ill-paid for nationals to want anyhow. Come the slump, when employment is scarce, the expulsion of immigrants is an obvious and politically popular (if economically dubious) way to create jobs for nationals. The temptation to resort to such expedients is especially great for elected regimes that are looking for a quick and easy source of popular support. For example, the newly elected Busia government in Ghana in 1969 sought to meet popular expectations by expelling foreigners, most of whom were Nigerians. Fourteen years later, the Shagari government in Nigeria, seeking re-election, did exactly the same thing, most of the expelled foreigners being Ghanaians.

The second, and social, characteristic is that despite the mobility of African populations, African personal identities are overwhelmingly defined by descent, and it is correspondingly extremely difficult for immigrants to assimilate themselves into local societies: who you 'are' depends on who your parents were, rather than on place of birth or residence, culture or personal allegiance. Immigrants are also normally heavily concentrated in particular residential areas, where even those who are born in the country of immigration are readily identified as 'foreigners' and targeted accordingly.⁵

The supporters of regional integration in Africa have often accused national leaders of lacking the 'political will' to pursue integration schemes, as though the problems were simply ones of leadership personality. Certainly, the high (and sometimes extreme) levels of personalism in African government have considerably enhanced the difficulties of integration. African leaders have often been deeply sensitive about any restriction on their personal powers, and any constraint coming from abroad - whether in the form of rival leaders among their regional colleagues, or still more insidiously through domestic rivals with potential regional support - has characteristically aroused intense suspicions. Given the high degree of dependence in any successful regional organisation - not least, for example, the European Union - on the successful mediation of differences between national leaders, and the consequent importance of personal relationships between them, the often prickly personalities of African heads of state can form a significant barrier to conflict resolution. The breakdown of the East African Federation, for example, became all but inevitable once Idi Amin had ousted Milton Obote in Uganda and established an irreconcilable breach with Julius Nyerere in Tanzania. The problems of regional integration in Africa nonetheless go well beyond those of mere personality. African rulers, intensely and understandably concerned about their own personal survival, cannot afford to act irrationally when that survival is threatened. When such threats lead them to abandon the largely chimerical benefits of regional integration in favour of the vital necessities of domestic political control, it is because they would be foolish to do otherwise.

When African regional integration schemes have achieved a measure of success, indeed, this has been far more because they have contributed to regional (and notably leadership) security, than because of any actual or potential economic benefits. The region has been one of the critical arenas within which the security of African states and their leaders has been threatened, and within which they could equally be protected. In those cases where regional organisations have amounted to more than rhetorical creations, this has been because the region constituted a 'security complex', in Buzan's terms,⁶ within which the organisation could serve as a security community, rather than as a development one. In Southern Africa in the era of *apartheid*, the security role was effectively performed through the informal meetings of the heads of the Front Line States, which provided a far more effective decision-making forum than its developmental equivalent, the Southern African Development Co-ordination Conference (SADCC). The creation of ECOWAS reflected an attempt by Nigeria, born of the confidence engendered by its size, its oil wealth, and the federal government victory in the civil war, to achieve the role in West Africa to which its leaders felt that it was entitled. It had no viable pretensions to cut across the north-south economic linkages which were reinforced, in the very year that ECOWAS was founded, by the first Lomé Convention between African states and the European Community; but it did have pretensions to establish a regional security community, of a kind that was subsequently exemplified by the West African Economic Monitoring Group (ECOMOG) force in Liberia.

The security element was equally evident within smaller regional groupings. The most explicit of these, the Senegambian Confederation, was the expression in political terms of The Gambian government's dependence on the Senegalese army to reverse the attempted *coup d'état* of July 1981. The formation of the Mano River Union between Liberia and Sierra Leone correspondingly derived from the insecurities of presidents Tolbert and Stevens, and its extension to Guinea reflected the use of Guinean troops to protect the regimes in both Freetown and Monrovia.⁷ Where regionalism in Africa has amounted to anything more than a formality, this has been because it has served the cause of state and regime survival.

The same could, of course, be said for regional economic groupings elsewhere in the world, from the Association of Southeast Asian Nations (ASEAN), which implicitly though never explicitly linked the capitalist states of the region against the threat posed by communist China and Vietnam, to the European Union, (which likewise promoted the integration of Western Europe at least partly against the threat from the East). Whereas these threats, however, were directed against the political community as a whole, and the social and economic structure that it represented, threats to African security were more likely to be directed against the personal survival of individual leaders, or perhaps - as in Liberia, for example - against a narrow ruling clique. Regional integration schemes which actually serve to promote the tenure of particular regimes are always likely to be fragile.

In this as in other respects, comparisons with the European Union, which has provided a siren song for the promotion of political and economic integration schemes throughout the developing world, are thoroughly misleading. The EU states not only share very similar domestic political systems, and have complementary economies whose integration promotes massive levels of trade between them; they also - especially among the core states of continental West-Central Europe - share a political rationale for integration that is enhanced as much by the memory of past conflicts as by the awareness of current commonalities. It has actually proved far easier to promote integration among old states with highly developed economies, than among new ones with uncertain internal identities, unstable domestic regimes, and a high dependence on international trade in primary commodities.⁸

Lessons

This deliberately downbeat appraisal of African experiences in regional integration is intended to provide a suitably sobering backdrop to a consideration of where Africa can go from here. For a start, it has to be recognised that the political and economic setting, both global and continental, within which African regional integration may (or may

not) take place has changed dramatically since the first three decades of African independence. These changes, while undermining many of the specious assumptions on which earlier integration schemes were based, and in particular destroying the delusion that African states could only develop by insulating themselves so far as possible from the exploitative tentacles of an alien capitalism, have nonetheless enhanced the prospects for effective integration.

For a start, there is now for most purposes only one practicable model for economic development on offer: one which accepts (and indeed welcomes) the triumph of global capitalism, and seeks to promote development through the encouragement of external investment and through close integration with global markets. This model is not an entirely homogeneous one. In particular, there is still room for substantial disagreement over the role of the state in promoting economic development, and East and Southeast Asian countries in particular have made a strong case for the need for a 'developmental state', which - in opposition to Anglo-American economic liberalism - makes an active contribution to domestic economic management.⁹ In contrast to previous eras, when for example the East African Community was divided between conflicting development strategies pursued by a capitalist Kenya and a socialist Tanzania, strategies dependent on central planning and state ownership of the major means of production are now both ideologically discredited and practicably unsustainable. Though successful developing states, including many of those in eastern Asia, have found means of promoting exports while discouraging imports of consumer goods, industrialisation for a domestic market behind high tariff barriers is no longer an option: if goods are not competitive in the global marketplace, they are scarcely worth making.

This change has had a dramatic impact on what regional integration is about. Some aspects of it have positively encouraged economic regionalism. In particular, the imposition of currency convertibility has greatly weakened the capacity of African states to police their own economic frontiers, and encouraged the flow of goods and other resources across state frontiers to wherever the opportunities are greatest. A substantial element of economic integration in Africa has thus been imposed, ironically, by the World Bank. At the same time, such regionalism can only exist for the purpose of promoting the development of clusters of states within a global framework. The relationship between globalization and regionalism is a complex and important one. Some authors, for example, have suggested that the emerging world economy is leading to an effective division of the planet between three core areas of industrial production (East Asia, North America, and Western Europe), and their respective economic peripheries.¹⁰ Given the high levels of interconnection between these three regions, this scenario seems considerably exaggerated, and to derive in large measure from a largely domestic political debate in the United States. It is nonetheless the case that globalization has been accompanied by the intensifying levels of regionalism represented, for example,

by the North American Free Trade Agreement (NAFTA), Mercosur, or the Single European Market. The point about these organisations is, however, that they represent attempts to create effective means of participating in a global economy, rather than to create separate regional economies. The problem about regional economic integration in Africa, given especially the continent's exceptionally weak position and the problems of integration identified above, is whether there is any plausible prospect of creating any equivalent dynamic for regional participation in a global marketplace.

One major obstacle to regional integration within a global setting is that the demands of international competitiveness must necessarily override those of internal equality - and indeed, as many would put it, of justice. Perhaps the single most important debate within the European Union is about whether it is possible for member states to preserve the complex and expensive structures for social security that were devised during an era when these states enjoyed a far more dominant position in global markets than they have now. In the case of African states whose competitive position is far weaker, the scope for diverting resources into non-productive but socially desirable uses is very limited indeed. This is, of course, a major problem within many states, where it operates quite regardless of any formal mechanisms for regional integration. But insofar as it is also a problem between states, it must exacerbate tensions of the kind that have already been identified.

It could be argued that the only way out of this problem is to accept inequalities as a necessary feature of any regional integration scheme, and then to use markets rather than inter-governmental regulation as a way of compensating for them. In essence, this amounts to the acceptance of a 'deal' between the stronger and more favourably placed 'core' state or states of the economic community on the one hand, and the weaker 'peripheral' states on the other. Core states, as already noted, are generally in a position to reap the greatest benefits from integration. Industrial development in particular tends to concentrate in areas where different industries can feed one another, and where transport and other infrastructural facilities are strongest. Any regional development policy that seeks to counteract this tendency - such as those that, in many parts of the world, have led to the placing of large industrial projects such as steel mills in completely uneconomic locations - is out of the question. But having accepted the benefits of their relatively favourable global market situation, core states must then be prepared to make those benefits as available as possible to neighbouring states, rather than putting up the shutters against their regional 'partners'.

One fairly obvious form this would take is that markets in the core states would have to be completely open to products emanating from peripheral ones. On the whole, open markets are in the interests of core states, since they are best placed to profit from them; but there may well be specific sectors in which peripheral states have competitive

advantages that enable them to challenge protected industries within the core state, and they must be allowed to exploit these opportunities. The 'gigantic sucking sound' that Ross Perot predicted as United States jobs were lost to poorly paid Mexican workers with the introduction of the North American Free Trade Area has remained conspicuously unheard. But where regional integration takes place between states with widely differing *per capita* national incomes - a problem that the European Union will face with the incorporation of former Soviet bloc economies - there will certainly be areas of comparative advantage in which the poorly paid workers of peripheral states can compete successfully against those of the core. It is likewise essential that companies in the core states should be free to export their capital to the peripheral ones, where this is justified in economic terms, rather than being obliged by their own governments to invest 'at home'.

The potential political problems created by free markets in goods and capital are nothing, however, compared with those of a free market in labour. It is difficult to see how any regional integration scheme can work if the state that draws the greatest benefits from it seeks to restrict those benefits to its own population, by denying the opportunity to participate (and, in the process, to compete with its own workers) to the populations of the peripheral states. Even though the Nigerian government, for instance, was at pains to point out that its expulsion of alien West Africans in 1983 was (technically, at any rate) legal within the terms of the ECOWAS treaty, this action nonetheless spelled the end of any pretensions that ECOWAS had about forming a viable economic community. At the same time, there is no underestimating the resentments that are created by large-scale immigration into societies whose own members are intensely aware of their own deprivation, and who can readily be induced to regard 'foreigners' as the source of all their problems. While it would be an impertinence to say what any government or group of governments should decide to do under any given circumstances, free movement of labour is in fact the key criterion by which any regional integration scheme - especially in Africa, where labour is exceptionally mobile - is likely to stand or fall.

The story, however, does not end there. The forces of globalization, within which any modern attempt at regional integration must take place, are too strong for any government to hold at bay. Insofar as integration amongst neighbouring states is taking place as part of the creation of a global economy, it will continue to take place entirely regardless of whether individual states want it to or not, or of the particular institutional arrangements through which they seek to control it. The flow of capital is represented by the staggering quantities of money which are daily converted from one currency to another, and which defy any attempt at regulation. The flow of goods is most strikingly illustrated by a massive international trade in narcotics, which takes place despite all the efforts of national governments (most of them, anyhow) to prevent it. The flow of information is transmitted by satellite, twenty-four hours a day. The flow of labour takes the form of

the unceasing efforts of Mexicans, Moroccans and Mozambicans to creep across national frontiers into states more wealthy than their own.

Governments everywhere are finding it increasingly difficult to maintain their own autonomy in the face of these developments. African governments, whose control over their own territories is in any event generally weak and often non-existent, are especially at risk. Very few frontiers can be effectively policed. In quite a number of states, warlords or guerrillas run their own little empires, generally funded out of the profits of formally illicit foreign trade, in narcotics, diamonds or whatever. They have no trouble finding buyers for their produce, or in finding suppliers for the weapons that they purchase with the proceeds. Big companies spread their networks through alliances either with formally recognised governments, or else with private operators.¹¹ In this sense, economic integration is unstoppable. In short, if formal schemes for regional integration are not devised to regulate these processes, within a framework that recognises that regulation can achieve little when it runs counter to the inexorable pressures of the market, then informal mechanisms will arise that do much the same job, albeit in a different and vastly less desirable way.

Endnotes

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Developing Nations, Regional Integration and Globalism

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In its sixty-sixth ordinary session held in Harare in May 1997, the Council of Ministers of the Organisation of African Unity (OAU) met for the first time as the Council of Ministers of the African Economic Community (AEC). The AEC, which was established in 1991 and came into force after being ratified by two-thirds of the OAU's member states in 1994, is the latest effort in a thirty-year struggle by African countries to try to create pan-African economic structures. The aim of the AEC is to create a continental market based on the following regional building blocks: the Southern African Development Community (SADC), the Common Market of Eastern and Southern Africa (COMESA), the Economic Community of West African States (ECOWAS), and the West African Monetary and Economic Union (UMOE).¹ In common with other attempts at constructing pan-African institutions, the AEC comes with an extraordinary organisational infrastructure. The treaty envisions creating or including an Economic and Social Commission; a Pan-African Parliament; a Court of Justice; and several specialised technical committees including a Committee on Monetary and Financial Affairs, a Committee on Trade, Customs and Immigration Matters, and Committees on Industry, Science, Technology, Energy, Natural Resources and Environment.²

The creation of regional institutions has long enjoyed both African and donor support. Demands for pan-African unity were especially notable in the early 1960s when Africans realised that the independence of more than forty states might institutionalise divisions imposed by the colonialists. However, the Mali Federation, the East African Federation, the aborted Ghana-Guinea-Mali Union, and 'Senegambia' either did not get off the ground or crashed rather quickly because they challenged the domestic authority exercised by political élites.³ Africa is littered with the carcasses of failed economic unions (like the Economic Community of West African States). The volumes written planning putative continental organisations that were never realised, are legion. For example, the 1980 Lagos Plan of Action, the apotheosis of the OAU's desire to create pan-African institutions, asked for the creation of an African Economic Community, supported by an African Monetary Fund and an African Mutual Guarantee and Solidarity Fund.⁴ Of course, none were ever created and the Lagos Plan became synonymous with failure to bring about African economic unity.

Donors have had much the same motivation for supporting regional institutions. For instance, in a 1961 memo by the Policy Planning Council in the White House, US African experts noted that the extremely small size of many African countries denied the possibility of any real autonomous domestic economic development. Should these countries try to industrialise, they argued, 'scarce resources will tend to be misdirected into parallel and overlapping investments; and the possibilities of attracting private capital from abroad will be reduced'. Therefore, they suggested (undoubtedly influenced by the extraordinary success of US support for the European Economic Community) that American foreign policy should be devoted largely to promoting regional economic integration so that economies of scale could be achieved through relatively large markets.⁵

Similarly, in the late 1980s, donors began to reiterate that regional integration in Africa should become a priority. While the 1981 Berg report did not mention regional integration,⁶ the subject was given substantial attention by the World Bank's 1989 long-term study *Sub-Saharan Africa: From Crisis to Sustainable Growth*.⁷ With the transition in South Africa, many governments, including that of the United States, are hoping finally to overcome the long list of failures and promote some form of regional integration by concentrating on Southern Africa. Endorsing regional integration is also an easy way for American and multilateral officials, tired of enduring endless criticisms about structural adjustment, to advocate something that Africans actually like.

While the historical and organisational impulses to provide support for the seemingly endless variety of African regional and continental economic organisations are understandable, these efforts seem at odds with current trends in the international economy. Sub-Saharan Africa has an average *per capita* income of only US\$490, the second lowest regional average in the world (higher only than South Asia). Indeed, the only region with a *per capita* income less than double that of Africa is East Asia at US\$800. Even Latin America has an average income of US\$3,320. High income countries average a *per capita* income of US\$24,930. Put another way, it would take, on average, 49.8 Africans to aggregate the same income as one person in the high income countries. In fact, there are 902 million people in the high income countries and only 583 million Africans.⁸ Even the prosperous parts of the developing world have macro-economic aggregates that dwarf those of Africa. For instance, the whole of Africa imported in 1995 about as much as Malaysia did (US\$77,574 million). South Africa alone accounted for about 38% of those goods.

While Africa has recently posted some positive statistics, growth figures suggest that these shocking disparities will not be ameliorated soon. Africa grew at a rate of only 1.4% annually between 1990 and 1994, the second worst record after Europe and Central Asia. The rest of the world grew, on average, by two percent during the same period. Indeed, the recent statistics citing a five percent African growth rate in 1995 and 1996,

while certainly an important improvement on the recent past, are highly misleading. These statistics are unweighted: the growth rate of Senegal (population 8.5 million) or Benin (population 5.5 million) count as much towards the continental average as Nigeria (population 111 million). In fact, Africa's three largest countries, Nigeria, Ethiopia (56 million) and Zaire (perhaps 43 million), which together account for roughly 36% of Africa's population, are all in serious economic trouble.

The question, then, is: why go through the effort to try to have a relatively small number of extraordinarily poor people trade with each other when the world economy is larger, more populous, and growing faster? In fact, there are few reasons beyond sentiment to develop regional organisations unless they are used to institutionalise openings to the international economy. To say otherwise is to not understand how the global economy is developing and, paradoxically, to underestimate the opportunities available to African countries.

The Changing International Economy

The international economy has changed in powerful ways in the last 15 years. Certainly, the most dramatic illustration of the revolution has been the explosion in the worldwide foreign exchange market. It is estimated that turnover in the three largest markets (London, New York and Tokyo) increased threefold just between 1987 and 1993, and now amounts to an astounding one trillion dollars a day. As a result, currency traders are now able to mobilise 'runs' on currencies of perhaps one hundred billion to two hundred billion dollars in a week, far more capital than any central bank has access to.⁹

The explosion in the foreign exchange markets is just one symptom of the global revolution. Perhaps even more important are the huge increases in international portfolio investment due to financial liberalisation in a host of countries, the revolution in computer technology and the concentration of savings in the hands of institutional investors (notably mutual funds and pension funds) in Europe and the United States. It is estimated that total gross cross-border equity holdings in the US, Europe and Japan increased from US\$800 billion in 1986 to US\$1.3 trillion in 1991. Total cross-border ownership of tradeable securities is estimated to have risen to US\$2.5 trillion.¹⁰ This figure will increase in the future as stock markets, especially in developing countries, allow foreign participation and institutional investors in the industrialised world to further internationalise their portfolios in order to escape low domestic yields. For instance, the assets of the Fidelity Emerging Markets Fund increased from US\$15 million in February 1993 to US\$3.6 billion spread over three funds a mere nine months later.¹¹

Indeed, after the long capital drought caused by the debt crisis, more loans and equity investment are flowing back to the Third World. The World Bank estimates that in

1990-92 such flows increased by 250% to more than US\$100 billion. Most of the money is going to a few developing countries such as South Korea, Mexico, Indonesia and Malaysia, which have managed their economies well and now offer lucrative opportunities to investors.¹²

Even in the countries that have received record amounts of foreign investment, the nature of the flows has changed to make capital much more mobile at the expense of the state. First, more money is going directly to the private sector. Firms and individuals in developing countries received just 16% of external finance at the height of the debt crisis in the mid-1980s. The figure has now increased to 30% due, in part, to the wave of privatisation. The private sector's share of bond finance alone increased from four percent in 1989 to 47% in 1992.¹³

Also, the nature of foreign direct investment has changed. While countries have always competed for foreign investment, it used to be that once the decision was made to invest, a government gained considerable leverage over the foreign firm. The classic case was mining, where a company had to devote a tremendous amount of capital to (quite literally) sunk costs and therefore had no choice but to stay with that investment for decades, no matter what the policy of the government. Further, investors had to go to certain countries where the minerals were. Now, proportionally, far less money is invested in fixed projects like mines and much more in services which can be rapidly moved to any country with an expanding economy. For instance, in 1975, petroleum and mining accounted for 31% of total US foreign investment, while finance and insurance accounted for only 12%. By 1992, petroleum (mining was no longer disaggregated) accounted for only 11% of total foreign investment, while insurance, banking, real estate and services broadly defined accounted for 35%.¹⁴

Finally, international trade, propelled by unparalleled success in global trade liberalisation, is also growing quite quickly. The World Bank projects that international trade will increase at an average rate of 5.9% annually through the year 2003. The G-7 countries are expected to grow by only 2.7% a year during the same period.¹⁵ Indeed, international trade has now developed a robustness that stands in stark contrast to the uncertainties of domestic economic and regional growth, especially in Africa where economies are still hostage to sudden changes in the weather or the price of a few export commodities. To achieve high rates of growth, developing countries will simply have to take advantage of international trade, the most dynamic part of the international economy.

What Regionalism Cannot Do

The implications of the global economic revolution and its consequent shift in the power balance between investors and governments are manifold and it will take time understand them fully. Certainly, the shift to greater export orientation, freer markets, privatisation, concern with government deficits and the general scepticism about the state becoming an economic actor that began with the election of Margaret Thatcher in 1979, can now be seen as not simply an extreme movement of the pendulum, but as a more or less permanent fact of life. The international environment has become averse to countries that do not foster competitive economies. For instance, when Nelson Mandela stated, shortly after he was released from prison in February 1990, that he was still in favour of nationalisation of the banks and mines in South Africa, De Beers announced that it was moving part of its operations to Geneva. This dramatic example, and the gradual realisation that capital was under no obligation to stay in South Africa, has greatly contributed to the evolution of thinking in the African National Congress away from nationalisation and toward a dynamic private sector and fiscal discipline.

It would, therefore, be a mistake to see regionalism as being able to shield African countries from the global economy. The forces operating in the international economy are simply too powerful for the grouping of a few poor countries, or even a large number of poor countries, to make much of a difference. The forces described above are causing powerful changes in, among other countries, Indonesia, Mexico and Thailand, each of which have economies that are almost as large, if not larger, than the African continental economy. Even a vastly increased and robust trade within and among Africa's regions will not be able to insulate those countries from the profound pressures generated by the international economy. The statistics are simply too stark. Indeed, significant efforts at developing regional trade risk diverting African efforts into trying to achieve trivial gains (given the size of the continent's markets), when the real money is to be made on the global market.

Of course, the realities of the international market have not prevented some from dreaming that regionalism will somehow save developing countries from global Thatcherism. For instance, Jorge Castañeda, who has written as good a guide for the left as is to be found in the Third World, pins his hopes on Latin American countries integrating with each other and not with the major financial powers, notably the United States.¹⁶ This view simply ignores the way the world works today. Latin America's economic resurgence is due, in good part, to a resumption of financial flows from the developed world. Mexico is not going to get rich on investment from Guatemala. Similarly, Africa will only begin to grow again if it opens itself to the financial and trade flows from the world economy.

Finally, there is little precedent in the experience of developing countries that would suggest that significant regional integration is either important or particularly necessary. Both Korea and Taiwan, the two most successful developing countries of the post-war period, grew by trading with distant countries, particularly the United States. Indeed, neither Korea nor Taiwan was particularly integrated with the other economies of the region and both were cut off from what should have been one of their largest markets - China. Similarly, inter-regional trade has not been a particularly noticeable aspect of the development of Indonesia and Thailand, despite the fact that economic activity in the surrounding area is many times greater than that of Southern Africa. Both of these Southeast Asian countries still send more than 60% of their exports to developed countries outside Asia.¹⁷ The World Bank's major study of Asian success (*The East Asian Miracle*) makes no mention of regional trade, stressing instead that Asian countries have succeeded largely because of good domestic economic policies.

What Regionalism Might Do

The contribution that regionalism might make to globalization (where the real money is) lies mainly in the political arena, especially in promoting credible policies. An important aspect of the global economic revolution is what can be termed the search for credibility. It is not enough for governments to announce that they are going to liberalise policies, favour the private sector or adopt conservative macro-economic policies. If investors and owners of firms do not believe that the government has made a credible commitment, they may not invest. Indeed, reforms not backed by government credibility may be worse than nothing, because firms may take advantage of liberalised capital controls to export money out of the country or of liberalised trade restrictions to simply import as much as possible over a short period of time.¹⁸

As a result, governments have sought to convince the private sector that they are serious about enacting good policies by stripping power from politicians who are potentially susceptible to populist pressures. The most widespread attempt at gaining credibility has been what Paul Volcker, in his Per Jacobsson lecture, has tentatively called 'the triumph of central banking'.¹⁹ For instance, then Chancellor of the Exchequer Nigel Lawson, in his minute to then Prime Minister Margaret Thatcher arguing for an independent Bank of England, suggested that such a reform would 'enhance the market credibility of our anti-inflationary stance, both nationally and internationally'.²⁰ Similarly, countries as disparate as France, Chile and New Zealand are attempting to devolve more power to their central banks so as to convince markets that their future monetary policy will be based largely on a desire to preserve the value of the currency. Even the African National Congress, not noted for its previous allegiance to neoclassical precepts, has sponsored a constitution that it is committed to the independence of the South African Reserve Bank.

However, national attempts at reining in politicians are obviously problematic, especially in Africa and elsewhere in the developing world, where institutions are so weak and the incentives for leaders to try to enrich poverty-stricken followers so great. As a result, there has been a global search for international mechanisms to lock in the domestic reforms enacted by countries and to convince potential investors that leaders have made a credible commitment to end 'business as usual' practices. Most notably, despite all of the rhetoric uttered by proponents and opponents, the North American Free Trade Agreement (NAFTA) is not really about trade. Rather, its fundamental purpose is to lock Mexico into its current economic policies so that its leaders can argue credibly to domestic and foreign investors that they will never again be swayed by populist sentiments that seek to punish the private sector. Similarly, the International Monetary Fund and the World Bank have signed restrictive conditionality agreements with poor countries, especially in Africa, for whom they are essentially lenders of last resort. These conditionality agreements, which on paper are more restrictive than those for loans given out by the Fund in earlier decades,²¹ reflect the fact that poor countries have fewer and fewer options in the face of the increasing mobility of capital and that it is desirable for them to be able to show investors that they have a real incentive to follow pro-private sector policies. Finally, the fundamental purpose of the World Trade Organisation (WTO) is to bind countries to the trade liberalisation commitments they have made.

Regional organisations in Africa can play a similar role in binding governments to their commitments. Of course, the most successful instance of regional co-operation in Africa, the CFA-Franc zone in West and Central Africa, already does that by the rather ham-handed method of using a common currency linked to the French Franc. The CFA does make francophone countries more credible to outside investors, because, as the individual countries do not have control over their own monetary policies, there is no fear that governments can pursue inflationary monetary programmes. Essentially, the French treasury sets monetary policy for them. Outside investors are also assured that the francophone countries will have a convertible currency with a predictable value. Of course, the Franc zone came about because of peculiar historical circumstances and its experience cannot be duplicated. Indeed, Europe is currently discovering just how difficult it is to harmonise currencies.

However, there are other, less dramatic, ways in which regional organisations can improve the credibility of individual governments. The first is to set benchmarks - be they the rate of growth of the money supply, statistical reporting or the time necessary to get an electrical hookup - for a wide variety of government operations and then report on how individual nations are doing. One of the more bizarre aspects of economic reform in Africa is that the World Bank often publishes more valuable evaluations of individual country performance than the government concerned does. Such posturing has to end, as it suggests, rather plainly, that the government does not feel that ownership of the

economic programme is a high priority. By having regional organisations develop benchmarks for government operations, African countries can assert ownership over their own programmes and put some distance between themselves and the international financial institutions.

The establishment of such performance criteria would be a natural follow-on from the important technical exchanges and sharing of information that goes on in some, but not all, of Africa's regional organisations. No attempts to enforce the benchmarks should be made for the time being, because that would be too complicated and politically problematic. However, simply by making commitments at a regional level and by allowing for public reviews of efforts to reach stated goals, African countries would be taking an important step forward. Setting benchmarks would also be a relatively low-cost way of developing useful regional bureaucracies as opposed to the myriad useless committees that seem to grow up around current regional organisations.

Another useful step that regional organisations can take is to develop common foreign investment policies and regulations governing foreign company operations, including the remittance of profits. Foreign investors are often concerned about policy instability, fearing that the rules of the game will change once they have made their investments. This is especially true regarding the sometimes complicated question of remitting profits. Indeed, studies have repeatedly shown that the stability of the business environment is more important to foreign investors than the inducements and concessions that are currently central to the efforts made by so many countries to attract foreign funds. Investors know that such concessions can be withdrawn after they invest or be rendered meaningless by changes in other government policies. By agreeing on common codes, African countries can assure investors that there will not be sudden changes in government policies that will threaten the viability of their businesses. As a side benefit, joint approaches to foreigners can help prevent African countries from competing against each other by offering ever-greater concessions and side-payments to attract individual investment. Such a 'race to the bottom' usually does not change the determination of a company to invest in a particular country, but may transfer significant resources from Africa to the shareholders of the multinational corporations.

Finally, there is a significant role for regional organisations in Africa in assuring the completion of regional infrastructure systems. One of the great uncertainties that foreign investors have about African countries is their ability to plug into regional and global networks. Indeed, even if a country develops the right domestic infrastructure, it is still highly dependent on regional systems for access to the world. This is an especially important question in Africa given the large number of countries that are landlocked. The SADC has been (mildly) successful in promoting regional infrastructure, especially transportation corridors in Mozambique, but much more needs to be done. It is telling,

for instance, that the most important organisation in promoting regional telecommunications in Africa is probably AT&T, which is currently encircling the continent with a fibre optic ring that will greatly improve intra-African communication. Africans simply must take a more dynamic role in developing telecommunications, electrical, road and rail networks, and regional organisations are in the right position to get the job done.

Regional institutions in Africa might be particularly useful in promoting credibility because of the 'democratic deficit' often created by attempts to place certain policies beyond the reach of politicians. Part of the current backlash against the European Union was prompted by the fact that leaders were too far in front of their populations in terms of the amount of sovereignty that they were willing to cede to Brussels under the Maastricht Treaty. African leaders have experienced similar problems because they have relied too heavily on the World Bank and the International Monetary Fund to try to ensure credibility. It would obviously be far easier for African populations to accept a role for regional organisations created by their own leaders in helping ensure economic credibility than it has been to accept the manifold interventions of the international financial institutions. Thus, at least part of the pan-African ideal of greater self-reliance can be realised, not as an end in itself but as part of a process of joining the world economy on a more equal footing.

Conclusion

All of the efforts described here, and of the many others that could be implemented, point in the same direction: good bilateral and regional relationships in Africa are no substitute for becoming completely integrated into the global economy. Rather, properly functioning regional organisations can make it possible for individual African countries to enter global economic exchange more confidently and, critically, with much greater credibility. If, as a result, Africans can also improve trade with each other, that is all to the good. However, significant efforts to improve intra-African trade that do not have promoting full entry into the global economy as their goal are, given the rather stark arithmetic of Africa's poverty, at best futile. Arguably, such efforts represent a significant diversion of time and resources from what must be done to enable countries on the continent to grow quicker.

Of course, the measures suggested here are more mundane and certainly not as glamorous as rhetoric commending an African common market with the associated panoply of committees and institutions. However, the enumeration of routine tasks undertaken here reflects the direction Africa needs to take. It is necessary to construct basic institutions and assure investors that they will be treated fairly because, so far, many domestic African

institutions have been highly dysfunctional. The 35 years between the early sixties and the late nineties have demonstrated the futility of organising highly ambitious continental and regional organisations from the top down, before basic foundations have been laid. Africa's regions now have the opportunity to create those foundations in the hope of constructing more enduring structures in the years to come.

Endnotes

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South Africa and Southern Africa

Rob Davies

Three years after South Africa took its place as a full partner in the region, Southern Africa is on the threshold of important decisions which could take the region to much higher levels of co-operation than hitherto. While regional co-operation is occurring (or is possible) in many sectors, several of the most important pending decisions and new departures lie in the area of trade. The adoption of a protocol on trade at last year's summit of the Southern African Development Community (SADC) in Maseru signalled the community's intention to establish a free trade area (FTA) in the region within eight years. The 1997 summit will be faced with important decisions on how to push forward the process of tariff reduction negotiations envisaged in the protocol. The re-negotiation of the Southern African Customs Union (SACU) agreement, which has made only slow progress over three years, is also reaching a critical stage. It is therefore an appropriate moment to reflect on lessons from other 'emerging markets'.

Strategic Significance of Southern Africa for South Africa

Southern Africa has often been proclaimed as top priority in South African foreign policy. It is worth reminding ourselves of the reasons for this.

First, it is based on a recognition of the reality that South Africa has long been part of a region that has meaning in much more than a merely geographical sense. South Africa may be a newcomer to some of the institutions established in the region, but not to the region itself. Since the third quarter of the nineteenth century at least, the country has been part of a Southern African regional economy characterised by deep-seated economic ties between most current SADC member states as well as by a significant degree of economic integration among some of them. Involvement in the regional economy, whether as providers or recipients of migrant labour, transport services, hydropower or in trade has historically been of considerable significance both to South Africa and most other SADC member states. For over a century, South Africa has been a member of a customs union with four neighbouring countries, as well as part of a monetary union with three of these.

The priority attached to the region is based, second, on the fact that the overall regional atmosphere is of considerable significance for efforts to promote growth and development

in a democratic South Africa. It has often been said that South Africa cannot hope to become an island of prosperity in a sea of poverty. This reflects the reality of deep-seated negative inter-dependencies in our region. Migration and unrecorded trade are long-established facts of life in Southern Africa, and crisis and social disintegration in neighbouring countries can, as evidenced in recent years, become a spur to increased undocumented migration as well as cross-border arms and drugs trafficking.

Third, as a number of studies carried out shortly before the installation of South Africa's first democratic government established,¹ greater involvement in regional trade, sectoral co-operation programmes and joint development of regional resources and infrastructure can make a great contribution to efforts to promote growth and development in both South Africa and the rest of SADC.

The strategic significance of Southern Africa for South Africa is evident at a number of levels. It can be illustrated by looking at trade patterns. Though it is seldom recognised, the SADC countries are, in fact, South Africa's biggest export market. This is partly obscured by the fact that officially published trade statistics refer to the trade of the SACU with the rest of the world, and thus mask the significance of the trade that takes place within the Southern African Customs Union itself. A calculation by the Department of Trade and Industry of South African exports to other countries, including those in the SACU (reproduced at the end of this chapter), shows that while total trade with the European Union (EU), exports and imports, was greater than that to SADC, exports to SADC in 1994 and 1995 were larger than those to the EU.

Figures based on the conventional calculation of SACU trade, also included at the chapter's conclusion, show that exports to non-SACU members of SADC have been growing particularly rapidly, in fact almost doubling between 1993 and 1996. An examination of the composition of these exports indicates, moreover, that they have a disproportionate significance for South African manufacturing industries. Figures for 1994, for example, show that the non-SACU, SADC group was the destination of over a third of total SACU exports of machinery and appliances, of more than a quarter of vehicle exports, and of 21% of exports of chemical products, 39.1% of plastics and rubber products, 16.9% of foodstuffs and beverages and 13.8% of textiles and clothing.² Trade with the region is thus of very great significance for precisely those sectors that current industrial policy seeks to prioritise in promoting an export-led contribution to economic growth and employment.

Recognising the economic and strategic significance of the region for South Africa does not mean concluding that it can be seen as some alternative to engaging with the realities of a globalizing world economy. Government's evolving trade strategy is certainly not based on any such view. On the contrary, the government holds the view that there

are many opportunities for an export-led contribution to an overall growth strategy by developing new trade relations with 'emerging markets' in Asia and Latin America, as well as by expanding and restructuring trade with established partners in 'the north'. What the above figures do indicate, however, is that the region has an economic significance for South Africa that is much greater than a simplistic comparison of relative GDP size would suggest.

While recognising its significance, South Africa cannot ignore the fact that the region is characterised by acute imbalances, unevennesses and inequities. Not only are the sizes and levels of development of the economies of the various countries very different, but the historical pattern of interaction in the regional economy has been very uneven. Essentially, the main poles of accumulation were located in South Africa, while the economies of the other countries were incorporated in subaltern roles as providers of migrant labour, services and as 'captive markets' for higher priced South African exports. These imbalances were exacerbated in the years of conflict and destabilisation that characterised the late apartheid period. Not only did war and destabilisation result in an appalling loss of human life and material loss estimated at US\$62.45 billion,³ but established patterns of economic interaction in the regional economy were disrupted in ways that impacted negatively on member states of the then Southern African Development Co-ordination Conference (SADCC). Invisible earnings from migrant labour remittances, hydro-power exports and the use by South Africa of transport services in neighbouring countries all declined significantly over the course of the 1970s and 1980s.

South Africa's current regional policy stance is based on the recognition that inherited patterns are not only undesirable, but also unsustainable. An examination of the trade figures included in the chapter will again illustrate the point. The figures show that while normalisation (that is, South Africa's acceptance as a full and legitimate trading partner) has led to a rapid increase in exports to the region, imports from the region have remained remarkably flat. The gap in visible trade has accordingly widened. The tensions that have already been evident between South Africa and its SADC partners highlight the reality that sustaining export volumes in these markets will simply not be possible unless steps are taken to provide opportunities to SADC partners to increase their visible and invisible earnings from economic interaction with South Africa.

All of these factors and considerations underlie the fact that South Africa should work together with its neighbours to restructure regional relations along new equitable and mutually beneficial lines. This commitment was underscored by two organisational decisions taken relatively soon after the installation of the democratically elected government in 1994: to affiliate with SADC (taken in August 1994) and to re-negotiate the SACU (taken in November 1994).

SADC and Development Integration

South Africa joined SADC at a time when the community itself was undergoing change. The organisation came into existence in 1980 as the Southern African Development Co-operation Council (SADCC). One of its major objectives at the time was to reduce the dependence of its members 'particularly but not only on the Republic of South Africa'. It sought to do this by promoting 'genuine and equitable integration' among its members,⁴ but at the time did not place emphasis on promoting conventional trade integration. Its original programme has been described as 'integration through project co-ordination' or 'functional integration', based on the view that the main barriers to intra-regional trade among its members were not tariffs or non-tariff regulatory barriers, but underdeveloped production structures and inadequate infrastructure. Its programme of action, accordingly, focused on co-ordinating efforts to jointly promote infrastructural development.

The adoption in 1992 of the Windhoek 'Treaty of the Southern African Development Community' reflected an important new departure. The treaty gave SADC a stronger legal basis by replacing the Memorandum of Understanding it had operated under since its inception with a formal treaty. It also committed SADC to widening its agenda by negotiating protocols of co-operation in a number of areas where it had hitherto not been particularly active. These included trade and security.

Other documents produced by SADC at the time⁵ indicated that the organisation had come to see a need to move beyond 'functional integration' to embrace a programme of 'development integration'. Development integration was seen to be the appropriate approach in a region of developing countries in which, indeed, there were countries with economies of very different sizes and levels of development. Essentially, proponents of the development integration approach argued that while an integration programme would have to address issues of tariff reduction and the removal of non-tariff regulatory barriers, it could not afford to be indifferent to the potential for polarisation, nor the need to continue to address the barriers to intra-regional trade arising from underdeveloped production structures and inadequate infrastructure. A regional programme was envisaged that would combine sectoral co-operation, policy co-ordination and trade integration, in a way that was realistic and feasible under prevailing concrete conditions. More specifically, proponents of the development integration approach envisaged trade integration measures being complemented by:

- efforts to promote co-ordinated regional industrial development, through the establishment of regional industrial policies;

- measures to give less developed members greater preference in access to regional markets and facilities and a longer period to reduce tariffs through asymmetrical trade agreements; and
- some co-ordination of macro-policies at a relatively early stage, particularly in relation to fiscal incentives for investment.

South Africa's Approach to Regional Trade Negotiations

One of the major issues that has faced both South Africa and SADC in the period since 1994 has been how to structure a new regional trading relationship that promotes equitable and mutually beneficial development integration. As indicated earlier, Southern Africa is seen by South Africa as a market of major strategic significance, with growth potential in precisely those manufactured export commodities which South Africa needs to prioritise. However, expanding such exports is acknowledged as being unsustainable unless the needs and demands of neighbouring countries are accommodated in terms of access to the South African market, and recognition is given to the need to work towards more equitable trading arrangements in the region.

Willingness to work towards a new regional trade arrangement was proclaimed as a goal of the new South African government at an early stage. A strategic choice had to be made as to whether the new trading relationship aimed at should have a bilateral or a multilateral basis. The new government found itself bombarded with proposals from several individual SADC countries to either re-negotiate existing, or negotiate new, preferential bilateral trade agreements. At the same time the SADC secretariat, which had for some time been working on a regional trade protocol, had, even before South Africa's accession, tabled a draft protocol to establish a free trade area in the SADC region.

South Africa's preference was to work towards a multilateral, regional agreement with some flexibility to accommodate bilateral specifics. Several reasons appeared to underlie this choice, including the desire to avoid duplication, an expressed commitment to reinforce efforts to promote regional co-operation and integration and a sense that the new rules created by the Uruguay Round of the Global Agreement on Tariffs and Trade (GATT) could pose problems for a purely bilateral route.

Having decided in favour of working towards a viable multilateral framework, the next question that had to be confronted was what kind of multilateral agreement to work towards in the region. The draft protocol prepared by international consultants commissioned by the SADC secretariat envisaged a rather mechanical timetable for tariff phase-downs, leading to the establishment of a free trade area. According to the

proposal, countries were to be divided into categories according to the existing levels of overall tariff protection. Those with higher incidences of overall protection were to phase down more rapidly than the others. This formula was criticised as taking no account of the variations in capacity of the individual countries, nor of concrete conditions in specific industries or sectors. The proposal was also vague as to whether the region should move towards literal free trade (that is, remove duties on all intra-regional trade) or a World Trade Organisation-legal (WTO) free trade area, which requires only the removal of duties on 'substantially all' trade - a formulation subject to broader interpretation, and certainly allowing for significant exclusions.

A 'quick and dirty' study by staffers of the South African Industrial Development Corporation on the potential distribution of costs and benefits suggested that the introduction of literal free trade would exacerbate rather than reduce polarisation. The study calculated that the SACU countries (and mainly South Africa) would benefit to the extent of a 1.1% increase in GDP, a 4.6% increase in total exports and an eight percent increase in manufactured exports from the removal of all tariffs within the SADC area. It concluded, however, that the resulting increased competition from South African imports to domestic manufacturing industries would have a net negative impact on the GDP of four of the remaining six SADC countries.⁶ What appeared to follow from this study was a point that had been made in several policy studies undertaken before 1994, namely that further South African access to the markets of other SADC countries would need to be carefully structured and phased. On the other hand, the study identified a range of agricultural and industrial products (including textiles and clothing, footwear, furniture and ferrous products) produced in the non-SACU, SADC member countries that would be competitive in the South African market at lower tariff rates.⁷ All of this suggested the need for an asymmetrical arrangement (which could nevertheless qualify as a WTO-legal FTA), in which South Africa opened up its market to a greater extent than would be required by other countries, and which operated on a somewhat differentiated basis country by country.

South African negotiators suggested that instead of specifying some mechanical formula for tariff phase-downs, the SADC trade protocol should focus on defining a *process* of negotiating a new regional trade regime, taking account of some of the above points. They argued that a distinction needed to be made between the tariff regime prevailing within the region and that applied towards the rest of the world, and called on partners in the region to identify products for which they wanted better access into the South African market, rather than engaging in sterile debates over whose average tariff level was lower than whose. This was, however, seen by several other countries, especially those that cut tariffs most under the impact of structural adjustment programmes, as mere prevarication. They saw themselves as having 'progressed far in liberalising markets and opening up [their] economies', but felt that this had not been matched by the strongest economy in the region.⁸

Negotiations having been bogged down in such debate for many months, agreement was finally reached on a SADC Trade Protocol during 1996. The protocol itself was signed at the SADC summit held in Maseru in August.⁹ It essentially provides for a process leading to the establishment of a free trade area in the SADC region within eight years. The precise definition of the FTA and of the tariff phase-downs required to reach it was left to be determined in various 'rounds' of negotiations in a Trade Negotiating Forum. The protocol thus takes up the South African proposal that there should be various 'rounds' of negotiations, similar in concept to the GATT rounds, but with a much shorter timetable, in which countries make offers and requests. By focusing on process, the protocol creates space for a significant element of asymmetry to be incorporated, both in the timing of the implementation of obligations and in the final outcome, provided that the SADC FTA broadly conforms with the WTO requirements that the process be completed within a maximum of ten years and that it results in the removal of customs duties on 'substantially all' trade. The protocol also calls specifically for 'the establishment of a linkage' between trade liberalisation measures, industrial policy and 'other areas of sectoral co-operation' within the SADC programme.

Discussions preceding the adoption of the protocol, and subsequent statements by officials from various countries, have made it clear that a major feature of the negotiations envisaged by the protocol is likely to be demands by SADC partners for improved access to the South African market, and that a significant element of asymmetry is envisaged favouring the smaller and more vulnerable SADC economies. South African government officials have indicated that a South African offer is expected by the end of 1997, and that the negotiations will be approached from a holistic perspective that focuses on the overall patterns and dynamics of regional trade rather than the demands of specific sectoral interests. The government has also said that it regards implementing the SADC trade protocol as a top priority, and that any reciprocal concessions that may have to be made in extra-regional trade negotiations (such as with the EU) must be phased in such that SADC countries enjoy greater preferential access to the South African market.

A recent workshop organised by the SADC Parliamentary Forum highlighted the fact that some differences continue to exist about how the negotiations should proceed. One question that generated more heat than light was at what point the protocol should be ratified by member states' parliaments. Some countries, notably Mauritius and Tanzania, have already ratified the 1996 Maseru protocol. Others, including South Africa, have not, arguing that ratification can only take place when there is some substance, such as when tariff phase-downs have been negotiated and agreed. Whether and in what way the process should be asymmetrical is also a matter over which a diversity of views is evident.

There is also a link between the SADC FTA process and the SACU re-negotiation, which appears to be moving much more slowly. Contrary to earlier expectations that the revenue sharing issue would be the main 'hot potato', agreement on a simplified approach to the revenue sharing formula was reached in October 1996. This essentially proposed abandoning a search for mathematical formulae in favour of an agreement freezing South Africa's share of the pool at current levels. The main outstanding issues remain processes of decision making on the SACU common external tariff, linked to evident differences between member states about what this should be.

A critical series of questions raised by the SADC FTA process relating to SACU are: who should make the offer to SADC - South Africa or SACU? If South Africa is to make a more generous offer to its SADC partners than it expects from them, should this also apply to its SACU partners? If not, how can this be structured in such a way that the integrity of the customs union is maintained?

Conclusions: The Challenges Ahead

After a fairly long delay, the essential frameworks for restructuring regional trade relations appear at last to be settling into place. The challenge now is to give real content to these frameworks.

South African government officials have repeatedly stated that they are committed to making the SADC trade protocol and re-negotiated SACU agreement key mechanisms to bring about a more equitable, mutually beneficial and thus sustainable pattern of regional trade. A revised bilateral agreement with Zimbabwe, and a possible new bilateral agreement with Zambia are also on the cards as short-term measures to be incorporated into the SADC trade protocol within three years. All of these processes, it is recognised, will - if they are to be meaningful - need to have as their main content, in the short run at least, the accommodation of demands/requests by SADC and SACU partners for greater access to the South African market. Maintaining a holistic and a regional perspective against inevitable special pleading by sectional interests in South Africa will, however, be a major challenge.

While promoting a more balanced pattern of visible formal trade will be an important part of creating a more integrated and more equitable regional economy, the overall distribution of costs and benefits needs to be considered in terms of the whole of the balance of payments account, including invisible earnings from service provision and the capital account reflecting investment.

The deficit in visible trade many countries in the region had with South Africa was, historically at least, partly financed from invisible earnings arising from service provision. The provision of water, hydro-power, transport, tourism and other non-traditional services to South Africa have all been identified as having the potential to boost foreign exchange earnings rapidly for neighbouring states. In several cases, these are precisely the sectors that were most seriously affected by destabilisation policies. SADC has programmes run by co-ordinating units or commissions in all of the relevant sectors. While they have a mixed record, it would be wrong to conclude that they have become irrelevant as the region moves towards trade integration. On the contrary, boosting SADC sectoral co-operation programmes, through addressing in a frank and self-critical way such thorny questions as the performance of the various sectors, the degree to which the Programme of Action has been aid driven, and what institutional development and reform within SADC are needed, will become even more essential.

One of the major challenges will be to promote investment, both within and into the region. Several projects have been initiated by South African companies in neighbouring countries, perhaps the most important being Gencor's recent decision to establish the Mozal plant in Maputo. Most firms have, however, not broken the mould of limited involvement in traditional sectors - mining, hotels and tourism, forestry and building/engineering contracting. The major new initiative that seeks to move beyond this is, of course, the Spatial Development Initiative or 'corridor' programme. This programme, which is one of the flagships of government's infrastructure development and industrialisation strategy, aims to promote decentralised industrial development through providing transport and other infrastructure in partnership arrangements between the state and the private sector. The first such project, significantly, is the cross-border Maputo corridor project. This involves directly road, rail, harbour and telecommunications projects with an estimated value of just over R1 billion. However, the Department of Trade and Industry has announced that 135 'bankable projects' have been identified with an investment potential of US\$5 billion. These, it is estimated, could create 100,000 new jobs.¹⁰ While these figures refer to the whole programme, including that part being undertaken in South Africa, transport minister Mac Maharaj has said that his department believes the project could double the Gross Geographic Product of Southern Mozambique within five years.¹¹ A feature of the projects being undertaken under this initiative is their financing. Most of the infrastructure projects are put out to tender on a Build, Operate, Transfer (BOT) basis under which private sector consortia tender to build and operate toll roads and other facilities, and public money accounts for less than 10% of the total.

It is hoped that this chapter has provided a broad overview of some of the major processes under way to promote greater regional co-operation and integration, and of South Africa's role and approach to these.

Figures and Statistics

SA Trade with SADC and EU (Rbn)		
	1994	1995
Imports EU	35.0	43.00
Exports SADC	20.5	26.60
Exports EU	19.5	26.40
Imports SADC	1.4	1.44
Source: Department of Trade and Industry		

SACU Trade and Non-SACU Trade within SADC (Rbn)				
	Jan-Dec 1993	Jan-Dec 1994	Jan-Dec 1995	Jan-June 1996
Exports to non-SACU SADC Countries (Rbn)	5.4	6.1	9.7	5.5
% Increase	-	12.9%	53.2%	13.4%
Imports from non-SACU SADC Countries (Rbn)	1.0	1.4	1.5	0.8
% Increase	-	40%	7.1%	6.7%
Ratio Exports: Imports	5.4:1	4.4:1	6.5:1	6.9:1
Source: Republic of South Africa, 1993, 1994, 1996, Absa Bank, 1996.				

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Financial Sector Co-operation in SADC

Timothy Thahane

Introduction

The globalization of markets for commodities, trade, finance and services, the revolutionary changes in information technology and the increasing deregulation and liberalisation of national economies in the last decade and a half have given strong impetus to the formation of regional arrangements and the growth of cross-border transactions. Driven by market as well as political and social imperatives, regional groups will play important roles in shaping the interdependent global economy of the 21st century. They will also provide frameworks in which policy co-ordination and harmonisation can take place.

Building on their common historical experiences, and influenced by the forces of globalization and integration, participants in the 1996 Heads of States Summit of the Southern African Development Community (SADC) set themselves the challenging objective of establishing a common market by the year 2004. To achieve this objective within the agreed time frame, several important building blocks, including infrastructure and institutional arrangements critical for effective policy co-ordination and harmonisation, will have to be put in place across a wide spectrum of sectors and activities. One area in which significant progress in co-operation has been recorded since 1995 is the financial sector.

This chapter focuses on the practical programmes of co-operation which the Committee of Governors of the Central Banks of SADC have embarked upon. These comprise first, the important functional co-operation which has been the hallmark of SADC to date in building co-operation among member states of SADC; second, the objectives of the SADC Treaty and of South Africa; third, the characteristics of a robust financial system, which forms the basis of the projects that the Governors have embarked upon in financial co-operation; and finally the main financial co-operation projects implemented by the SADC Committee of Governors. The conclusion highlights some of the challenges that lie ahead.

The Importance of Functional Co-operation in the Development of SADC

While many historical factors have contributed to laying strong foundations for regional co-operation in Southern Africa, the most important one is the struggle against British and Portuguese colonial rule and later against apartheid. The various liberation movements in Southern Africa benefited from common languages, shared cultural experiences, common strategies and tactics. After independence, Southern African countries co-operated within organisations such as the Organisation of African Unity and the Commonwealth. Following the independence of Angola and Mozambique, co-ordination of and co-operation in political, military and economic strategies and tactics against the Unilateral Declaration of Independence (UDI) in Rhodesia and apartheid in South Africa took place in the informal grouping of the Front Line States: Angola, Botswana, Mozambique, Tanzania and Zambia. The Front Line States promoted the formation of the then Southern African Development Co-ordination Conference (SADCC) in 1980, which was later transformed by the 1992 treaty into SADC.

Drawing on the experiences of many unsuccessful regional economic co-operation initiatives in Africa, the Front Line States encouraged SADC to adopt a pragmatic and functional approach to co-operation. This involved giving each member state a stake in the organisation, and accountability to other members for the management and co-ordination of that sector. As a result, SADC decided to allocate to each country responsibility for co-ordinating a specific sector, around whose development SADC could hold discussions with their international co-operating partners. Sectors were allocated according to countries' perceived or potential competitive advantages in specific areas.

The main advantage of this approach was to compel each country to designate SADC officials in its administration who would be responsible for the sector. Secondly, the officials would have to contact and get to know their counterparts in other SADC member states in order to put together plans for the sector. Thirdly, a Council of Ministers was established to meet annually, to review sectoral plans and to identify opportunities for sectoral co-operation. The council meetings put pressure on individual ministers and their officials to take their SADC responsibilities seriously.

Initially, preparations for council meetings were made by a single official in the Office of the President of Botswana. This was done to avoid establishment of a huge bureaucracy in the form of a secretariat, and the associated demands for financial contributions and assessments to fund it. However, a small independent secretariat with an Executive Secretary at its head was later established to plan and co-ordinate the increasing activities of SADC.

This functional approach to regional co-operation has contributed substantially to the development of SADC and the removal of psychological, political and administrative barriers to co-operation. Consequently, the potential opportunities that could result from effective co-operation among the member states of Southern Africa have been made available to many in the region.

Objectives of the SADC Treaty and the Position of South Africa in SADC

When SADC's forerunner was formed in 1980, it was recognised that without apartheid, South Africa could play an important role in the development of the region. In anticipation of South Africa's membership in SADC, the summit meeting of the Heads of States in August 1992 revised the treaty. The revised treaty included, among its main objectives, the following economic goals:

- to achieve development and economic growth, alleviate poverty, enhance the standard and quality of life of the peoples of Southern Africa, and support the socially disadvantaged through regional integration;
- to promote and maximise productive employment and utilisation of resources of the region; and
- to achieve sustainable utilisation of natural resources and effective protection of the environment.

In pursuit of these objectives, the SADC treaty prescribed that SADC shall:

- harmonise political and socio-economic policies and plans of member states;
- mobilise the peoples of the region and their institutions to take initiatives to develop economic, social and cultural ties across the region, and to participate fully in the implementation of the programmes and operations of SADC and its institutions;
- develop policies aimed at the progressive elimination of obstacles to the free movement of capital and labour, goods and services, and of the peoples of the region generally among member states;
- promote the development of human resources;
- promote the development, transfer and mastery of technology; and
- improve economic management and performance through regional co-operation.

The Heads of States also set themselves other political, social and cultural objectives which, although providing a supportive environment, do not have a direct bearing on promoting financial co-operation in the region.

After the 1994 national election and the installation of the Government of National Unity, South Africa joined SADC. In line with SADC's functional approach to co-operation, South Africa was allocated co-ordination of the Finance and Investment Sector. South Africa accepted the challenge enthusiastically. It established a Sector Co-ordinating Unit in the Ministry of Finance, and with the approval of other ministers of finance, established a Committee of Central Bank Governors to pursue co-operation in the monetary sector. The South African Reserve Bank was given the important role of co-ordinating the functions of the central banks in the promotion of SADC's overall objectives. The bank immediately set up a small secretariat to co-ordinate the activities of, and to provide administrative assistance to, the Committee of Governors.

The selection of South Africa to co-ordinate the Finance and Investment Sector took account of South Africa's large and sophisticated economy, financial sector and stock markets.

Development of Sound Financial Systems in SADC

All SADC countries have embarked on various programmes aimed at economic transformation, liberalisation and deregulation in support of the development of market-based economies. They recognise the importance of sound macro-economic policies and robust financial systems in accelerating growth and creating jobs. More importantly, the SADC governments accept that a sound and stable financial system cannot exist in an environment of macro-economic instability.

The overriding objective of the Committee of Central Bank Governors is therefore to establish a robust financial system that will not only be less susceptible to systemic crises, but also more resilient when economic disturbances in the real economy erupt. Such a system forms the basis of the proper functioning of markets for goods, finance, services and commodities. In such a system, effective regional trade, payments and settlements can take place timeously and efficiently.

Key features of the robust financial system which the SADC countries would like to see in place include, among other things, *flexibility* to continue to allocate financial resources efficiently, even if structural reforms in the underlying fundamentals take place; and second, *resilience* to function and effect payments and settlements among the users reliably and expeditiously, regardless of changes in the economic environment or changes in the real economy. These features will vary from country to country depending on the degree of:

- development of institutional and market infrastructures;
- functioning of the markets; and

- regulation and supervision of the system to ensure compliance with prudential requirements in order to avoid systemic risks.

The capacity of the financial system to carry out financial transactions efficiently requires the existence of good infrastructural building blocks, including legal and judicial frameworks and accounting and information systems that will provide accurate and timely information to individuals, market operations and supervisory authorities. Underdeveloped institutional and legal infrastructures cannot deal effectively with fraudulent and detrimental practices that rob poor citizens of their hard-earned savings nor can they track down large fund transfers that sometimes emanate from illegal transactions.

Sound payments, clearance and settlement systems are critical to the smooth operation of market-based economies, giving individuals and corporations the confidence that their payment instructions will be carried out timeously, expeditiously and to finality, and also permitting the supervisory authorities to monitor inter-bank exposures.

Finally, a robust financial system enables supervisory authorities to formulate and enforce prudential rules and standards of behaviour on the various players. In globalized markets for finance, the rules and standards for supervision must be consistent with, or the same as, the international standards because they provide confidence and known rules of the game to international investors and traders.

Financial Co-operation in SADC

The governors of central banks of the SADC countries recognise that they must establish a sound and robust financial system that will facilitate trade, investment, tourism and development of information technology throughout the region. However, to build such a system, important infrastructure and building blocks must first be put in place. Accordingly, in developing their work programme, the Governors, who meet twice a year, have adopted a bottom-up approach.

At its first meeting in November 1995, the Committee of Governors developed terms of reference, which were subsequently approved by the Ministers of Finance and the SADC Council in July and August 1996, respectively. Guided by these terms of reference, the Committee focuses its activities on:

- establishing closer co-operation among the member central banks through a regular exchange of views on the philosophies, structures, functions, objectives and strategies of central banking;

- comparing and analysing the basic differences in the organisational structures and legal frameworks, internal administration procedures, accounting and financial management practices and relationships with governments and exploring ways and means of achieving comparability and compatibility in these areas;
- developing a centralised and readily accessible data base including macro-economic, monetary and financial statistics of member states;
- exchanging views on the main objectives and efficacy of monetary policy and the monetary policy instruments used by members, with a view to better co-ordination, co-operation and harmonisation in the future;
- examining the role of central banks in the establishment of sound and well-managed banking institutions, including the responsibilities for cross-border bank licensing, regulation and supervision, and direct participation in private banking and other financial activities, where applicable, with the view of promoting harmonisation and co-operation;
- defining the role central banks should play in the development and operation of money and capital markets;
- exploring the involvement of central banks and determining areas of possible co-operation in international financial relations, such as the management of foreign reserves, exchange rate regimes and exchange controls and conditions for currency convertibility, with a view to closer financial co-operation in the region;
- investigating the present structures for the repatriation of bank notes and coin within the SADC region, in order to eliminate any shortcomings;
- co-ordinating the development of national clearing, payment and settlement arrangements with a view to facilitating financial transactions among SADC members;
- promoting training and public education in the fields of central banking and financial policies and systems by *inter alia* making use of facilities of institutions within the region; and
- co-ordinating ways and means to combat money laundering and other cross-border banking and currency frauds.

In pursuing the above-mentioned terms of reference, in the 18 months of its existence

the Committee of Governors embarked on seven formal projects, in which commendable progress has been made. A brief synopsis of these projects follows:

- (i) *Development of a monetary and financial statistical database for SADC countries:* The Secretariat of the Committee of Governors in the South African Reserve Bank has established close contact with statistical departments in SADC central banks, and a comprehensive statistical data base has been developed. Efforts have been made to make variables in the database comparable among countries. The database will shortly be published on the Internet as the first of its kind for SADC countries.
- (ii) *Review of the structures and policies of SADC central banks:* A comprehensive document called *SADC Financial Systems: Structures, Policies and Markets* was compiled. Starting at the end of 1997, the document will be published, and updated, annually.
- (iii) *Development of payment, clearing and settlement systems in SADC countries:* The aim of this project is to develop the payment systems of SADC countries to enable them to cater for the demands of modern and integrated economies. Payment systems are developed on a national level, but on a compatible basis, so that they can eventually be integrated relatively easily. For South Africa a new Real Gross Time Settlement System, which will facilitate intra-day settlement among banks, will come into effect early in 1998 and be fully operational later in the year. Other SADC central banks are moving in the same direction with their own systems.
- (iv) *Determine the impact of exchange controls on the cross-border flow of goods, services and capital:* Apart from Zambia and Mauritius, all SADC member states still apply exchange controls to a greater or lesser degree. These controls obviously have an inhibiting impact on regional financial co-operation. A Subcommittee on Exchange Control was established to determine the specific extent of each country's exchange control regulations, and to make proposals to the Committee of Governors on how the inhibiting effects of these can be reduced.
- (v) *Repatriation of banknotes and coin:* Partly as a result of exchange control, some problems are experienced with the repatriation of banknotes and coin among SADC countries. The Committee of Governors is addressing this problem.
- (vi) *Co-ordination of training of central bank officials in SADC:* Cognisant of the critical need for training of central bank officials in the SADC region and the limited resources available for such training, the Committee of Governors has embarked on a project to co-ordinate and rationalise training efforts in order to ensure the optimal utilisation of training facilities and resources in the region. The South African Bank Training Institute is taking the lead in this regard.

- (vii) *Co-ordination and development of information technology*: The various central banks have their own information and technology systems. To ensure compatibility and facilitate the sharing of data, information technology staff have held meetings to identify the gaps in the systems and to develop a plan of action and co-ordination, including training and learning from each other.

In addition to the above-mentioned formal projects, the Committee of Governors is also involved in other *ad hoc* initiatives, including co-operation in developing a common approach to illegal banking and money laundering.

Challenges Ahead and Conclusion

SADC has achieved much in regional co-operation since its creation in 1980. In the area of financial co-operation, progress gained momentum after South Africa joined the organisation in 1994. SADC has progressed to the point where the goal of achieving a common market by the year 2004 is within its grasp. Governments, the private sector and all stakeholders must now formulate time-bound and monitorable plans. Political mobilisation to build consensus support will be needed to achieve a common market by the year 2004.

Equally important is the need to review and rationalise the work methods and processes that have been followed to ensure that they will lead us to the agreed-upon goal. SADC can play an important inter-linkage role between Association of Southeast Asian Nations (ASEAN) and South America's Mercosur, and the Indian Ocean, the Indian sub-continent and Africa.

Formation of an economic community by the expected date means that movement in the reduction tariffs among SADC members ought to be accelerated. Political and public consensus are essential in all member states for momentum to be sustained in this area. In this context, the Southern African Customs Union and the Common Monetary Area Agreements constitute important building blocks.

In the financial sector, co-operation in SADC is moving at a fast pace among the central banks, the stock markets and the banking associations. Private capital for investment is beginning to move across the borders from South Africa to other SADC countries. The potential for more investment is large. The commitment and determination of the governors to build a robust financial infrastructure that will facilitate regional integration of the markets and policy harmonisation later is unwavering. Hopefully the private sector will adopt the same vision of a region that can provide the preconditions for acceleration of growth and improvement in the living standards of all the peoples of Southern Africa.

The SA-EU Free Trade Agreement and Southern Africa

Talitha Bertelsmann

For the first time in its trade history, the European Union (EU) has proposed a Free Trade Agreement (FTA) with a country as far away from Europe as South Africa. Yet negotiations have been cumbersome and have dragged on since 1994. In addition, neither party seems over-enthusiastic about the agreement, and the proposed deal between South Africa and the European Union has provoked serious criticism from the Southern African region. In the first half of 1997, the negotiations appeared to be heading for deadlock. However, the most recent round of negotiations in mid-1997 saw a positive proposal being made by South Africa, which renewed hopes that a deal will be in place towards the end of the 1997.¹ The question remains, however, whether a mutually beneficial agreement can ultimately be reached.

It should be understood that, whereas the focus of the negotiations in the media is almost exclusively on the talks surrounding the free trade area, South Africa and the EU are currently talking about a multifaceted relationship of which the FTA is only one part. This relationship is set to cover all aspects of co-operation in the social, political and economic field. The trade aspect of the agreement could, of course, have the most far-reaching influence on South Africa's (and the region's) development. The agreement is also of utmost importance to South Africa, as the EU is both its - and Southern Africa's - biggest trading partner, accounting for 40% of South Africa's exports, and serving as the destination of between 26% (Malawi) and 79% (Mauritius) of the exports from countries in the Southern Africa Development Community (SADC).² Some 33% of South Africa's imports originate in the EU and, importantly, more than 50% of the country's foreign direct investment (FDI).

The process of reaching a comprehensive, long-term agreement on co-operation between South Africa and the European Union was initiated in 1994, shortly after South Africa's transition to democracy. The EU wanted to reverse its policy of isolation and discrimination against the old apartheid regime and to assist the fledgling democracy as best it could. It therefore proposed, in Luxembourg in April 1994, to lift all sanctions, to provide support for the first democratic election, to grant South Africa Most Favoured Nation (MFN) status and, in the long term, to negotiate a trade and co-operation agreement.

This chapter examines the positions of South Africa and Southern Africa within the negotiations. South Africa, as a single state, is currently negotiating a comprehensive trade agreement with a 15-state region. Consequently, questions regarding whether the EU is strengthened by its numbers, and whether South Africa's independence from other states in the region is beneficial are raised. The argument given in this chapter is that these negotiations should not be viewed in isolation, neither from a European nor a South African perspective. The EU is currently fundamentally restructuring its relationship with the entire developing world, while South Africa is attempting to increase SADC's participation in the world market in a number of ways. The chapter therefore also considers the influence these objectives might have on the negotiations.

The European Proposal

The structure of Europe's proposed long-term trade and co-operation relationship can most easily be understood if it is seen to be resting on three pillars. The three pillars are:

- several agreements on co-operation in a number of fields: science and technology, wine and spirits, and fisheries;
- South Africa's partial accession to the Lomé Convention, which governs relations between 70 African, Caribbean and Pacific (ACP) countries and the EU. Apart from development aid, the members of Lomé receive preferential, non-reciprocal access to the European market with certain quotas being placed on some sensitive products; and
- a trade and co-operation agreement to cover all aspects of the relationship not addressed in Lomé.

Co-operation Agreements

Whereas the EU's relationship with the ACP group rests on 'partnership', its relationship with South Africa rests on 'co-operation'. The relationship between South Africa and the EU was, therefore, also initiated on a basis of co-operation. During South Africa's transition to democracy, the EU provided generous funds for voter education and indeed for the whole election process. After the elections, funds were directed towards the Reconstruction and Development Programme (RDP) and other development projects. Unfortunately not all of these funds were effectively used, as the Sarafina *débacle* proved. On a more strictly contractual basis, the two parties signed a co-operation agreement on science and technology. Similar agreements on wine and spirits, and fisheries are in the process of being finalised.

On 5 December 1996, the first mutual co-operation agreement between the two parties was signed. The agreement provides for scientific and technological co-operation between South Africa, the European Community and its member states. A joint Science and Technology Co-operation Committee will be established in order to administer the agreement. In South Africa, the Department of Arts, Science and Technology, in conjunction with the Department of Finance, is responsible for the implementation of the agreement.

Within the Fourth Framework Programme adopted by the European Parliament, South Africa has been classified as a 'developing country', which will enable it to benefit greatly from the modalities of the programme, including:

- visits and exchanges of research workers, engineers and technicians;
- participation by experts in seminars, symposia and workshops;
- scientific networks and training researchers; and
- exchange of information on practices and programmes.

As a 'developing country', South Africa will be encouraged by one programme to target three initial areas, namely sustainable management of renewable natural resources, sustainable improvement of agricultural and agro-industrial production and health.³

Partial Accession to the Lomé Convention

History of the Lomé Convention

The Lomé Convention administers relations between 70 African, Caribbean and Pacific countries, all former colonies of the members of the European Union. Most of these countries are in Africa. Lomé evolved out of the Yaounde Conventions, but under Lomé, the ACP enjoy more benefits. Founded in February 1975, the Lomé Convention has grown from 46 initial member states into a 70-state instrument of North-South co-operation. Apart from receiving development aid from the EU, the member states also enjoy preferential access to the European Union markets. The Convention offers unrestricted, non-reciprocal and duty-free access for industrial products (including coal, steel, textiles and clothing); duty reductions; and quantitative access for agricultural products.

South Africa and the Lomé Convention

South Africa rejected the EU's proposed partial accession to Lomé and a separate free trade agreement, as it was intent on the pursuit of full participation in all the institutions of Lomé. This approach was a contentious one from the start, as South Africa's economic situation is unique. All of the participants in the Lomé Convention are classified either as 'developing' or as 'least-developed' nations. In contrast, South Africa is classified as an 'economy in transition', making it neither developed nor developing. Whereas South Africa is widely perceived to have a dynamic economy that is also the powerhouse of the Southern African region, it presents a high degree of duality. The economy displays a relatively high GDP *per capita*, but continues to exhibit large inequalities of income; it has a diversified production base, but one that is still highly dependent on mining (50% of export earnings); it possesses an infrastructure base better than any other country in sub-Saharan Africa, but an industrial sector which is uncompetitive in many areas after years of protection; and it suffers an acute shortage of skilled labour alongside burgeoning unemployment.⁴

Although the EU recognised the 'developing' nature of South Africa's economy, it barely considered full participation in Lomé as an option for South Africa, citing the country's economic sophistication in comparison to the economies of other ACP members. It felt that, whereas the developing nature of South Africa should be addressed within a framework of aid, its developed nature should be accommodated in a reciprocal trade agreement.

The European Commission offered additional reasons for rejecting South Africa's full Lomé participation, including:

- the effect it might have on the other ACP countries;
- the interests of other members of the World Trade Organisation (WTO);
- protection for vulnerable EU sectors; and
- the promotion of South Africa's integration into the global economy.⁵

In 1995, South Africa's exports to the EU were equivalent to more than a third of total ACP exports and it was felt that South Africa would overshadow other ACP economies. In addition, other countries, currently on the same level of development as South Africa, could (and would) rightly then demand access into the Lomé Convention as well. For the same reasons that 39% of South Africa's agricultural products are currently excluded from the negotiations, the EU feared South African Lomé participation: some South

African products may have a comparative advantage and could damage European products if allowed into the market completely tariff free.

By contrast, South Africa has argued that only a small percentage of its current and potential exports to the EU could provide competition to the ACP. South Africa has only a very small agricultural export mix, and the EU should therefore have nothing to fear. In a move which seemed at the time to be an effort to sway the EU and to emphasise its claim to be seen as a developing country, South Africa strengthened its ties with the SADC states, which are all members of Lomé. Pretoria identified the Southern African region as its priority, aiming at co-ordinating trade policy with its neighbours. South Africa also signed a Free Trade Protocol with SADC, which intends removing tariff barriers in the region within eight years of implementation. Equivalent levels of access into the European market for both South Africa and other SADC states would have facilitated this process. However, the EU remained adamant that only political participation in the Convention would be considered for South Africa.

The negotiations tend to demonstrate that the position of the EU is strengthened by its number. The EU has repeatedly stated that it cannot deviate from its mandate, as the document was drawn up by the 15 member countries; any deviation would have to be rediscussed and renegotiated with all members. In parallel, although South Africa could not achieve full SADC integration within a couple of months, it had hoped that in a similar way the Trade Protocol would have strengthened its position significantly in the negotiations. Whether this was successful remains debatable.

However, partially due to South Africa's persistent request for full Lomé participation, the Lomé negotiations were de-linked from the overall trade and co-operation talks. This de-linking fell outside the European mandate, which created the impression that the mandate might not be cast in stone. It remained, however, a minor concession by Europe. After de-linking, South Africa's partial accession was finalised swiftly, despite protest from Spain, which feared South Africa would abandon the FTA negotiations after having achieved its main goal, Lomé. South Africa's accession to the Lomé Convention was ratified at a joint ACP-EU ministerial conference on 24 April 1997.

South Africa's accession to the Lomé Convention can be seen as a political accession rather than an economic one. The main economic benefit will be the ability to tender for European Development Fund (EDF) projects in all ACP countries, which could have important economic benefits for South Africa and the region as a whole, as it will enable these countries to tender for contracts worth R45 billion. In addition, South Africa will benefit from the Cumulation of Origin clause. South Africa will further participate in Lomé projects on technical, cultural and social co-operation; regional co-operation; industrial development; and investment promotion and protection. It will not, however,

be eligible for non-reciprocal trade benefits and will receive development aid separately from the Lomé Convention.⁶ The special protocols on bananas, rum, beef and veal, sugar, and coal and steel products will also not be applicable to South Africa.

The form which South Africa's accession to Lomé eventually took, was exactly as proposed within the European mandate, except for the de-linking from the overall talks. The finalisation of the Lomé issue could therefore even be seen as a negotiating defeat for South Africa: it gained nothing more than it had been offered, it no longer has a bargaining chip on the table to use during forthcoming trade negotiations and, in addition, with its persistent call for full accession to Lomé, it signalled to the world that it considers itself to be a developing country in need of aid and not a stable country deserving foreign direct investment.

SADC and the Lomé Convention

SADC should, however, be able to benefit from South Africa's partial accession to Lomé. Apart from indirect gains from South Africa's access to the Cumulation of Origin clause, South Africa could prove a useful ally during the renegotiations of Lomé. The Convention is set to expire at the turn of the century and, in preparation for the renegotiation (due to start in September 1998), the European Union released its *Green Paper* in November 1996.

Why is Lomé expiring?

There are several reasons for wanting to change the Lomé Convention. In recent years, the ACP countries have been demonstrating increased economic diversity. One can no longer place Mauritius and Niger, or Mozambique and Fiji, on a par and, therefore, one would expect the economic needs of these countries to differ as well. The importance of the ACP to the EU is also on the decline.

In addition, the EU has a host of internal problems that need immediate and exclusive attention, such as the nearing of the deadline for the Euro, internal economic difficulties and the expansion of the community eastward. The new countries that are joining the EU have no colonial past and therefore lack any feelings of guilt towards the Third World. These developed countries increasingly feel that development aid is being wasted, as recipient countries are not responding adequately. With growing unemployment throughout Europe and the decline of the welfare state, it is felt that the money previously pumped into the Third World could be used more appropriately to address internal budgetary problems.

Due to its non-reciprocal nature, and the fact that only a few ‘least-developed’ countries are included in the Convention, the Lomé Convention is also not WTO compatible. Lomé discriminates between and among the least-developed countries of the world, which is not accepted by the members of the WTO. It also violates MFN status, as concessions made by the EU to the Lomé participants are not granted to every WTO member country. Although the Convention currently enjoys a waiver, this is due to expire at the end of 1999.

The Options in the Green Paper

Within the *Green Paper* the EU sets out a number of possibilities for the future relationship between the ACP and the EU. For the general Convention, Europe proposes four options for improvement:

- maintaining the *status quo* with a few adjustments;
- reaching an overall agreement supplemented by bilateral agreements;
- splitting up the Lomé Convention into regional segments; or
- reaching specific agreements for the least developed of the ACP countries.

As to the Convention’s agreement on trade arrangements, Europe also proposes four options. The Union feels that not all ACP countries have been able to take advantage of the full range of opportunities offered by the special preferences granted under the Lomé Convention, and therefore suggests:

- maintaining the *status quo*, supplemented by co-operation activities;
- applying the Communities Generalised System of Preferences (GSP);
- reaching an agreement of uniform reciprocity (after a transitional period to phase in reciprocity to eventually comply with WTO rules); or
- reaching an agreement of differentiated reciprocity.⁷

However, there are several reasons why many of these options are simply not viable, and why only minor adjustments to the current Convention should be considered.

Status Quo

The attraction of the *status quo* lies in the fact that it is a known entity with which all participants are familiar, although it has not been a roaring success. To change the whole structure would result in considerable administrative costs in all of the countries. The continuation of the Lomé agreement would also maintain the contractual nature of the relationship. Additionally, it would ensure the best preferences for the ACP group. The group would hold on to its political strength and unity, and in this way preserve its voice in the world arena. The obvious disadvantage of continuing with the Convention is that this requires an annual WTO waiver, and that relationships with other least-developed countries remain difficult to foster. A further message that the ACP group would be sending to the world, if they were to continue their participation in Lomé, is that they still consider themselves to be least-developed countries, in need of special preferences and aid from the rich. This image creates problems in fostering the sense of security necessary to attract foreign direct investment and to encourage trade.

Integration into the Generalised System of Preferences

The EU offers GSP to a number of developing countries. The GSP is a system developed within the United Nations Conference on Trade and Development (UNCTAD) to encourage the expansion of manufactured and semi-manufactured exports from developing countries by making such goods more competitive in developed country markets through tariff preferences. Each industrialised nation determines its own system of preferences, specifying the goods that would benefit from preferential treatment. The advantage of granting GSP to all members of Lomé lies in the fact that a uniform policy towards the entire developing community could be formulated. In other words, it would create a level playing field for all of the least-developed nations of the world. The disadvantage lies in the fact that GSP is not a negotiated deal. Preferences can be withdrawn unilaterally by Europe, leaving the ACP to face a closed European market. GSP would also reduce drastically the preference margin currently enjoyed by the ACP within Lomé, would permanently dismantle the Lomé package and would fundamentally weaken the partnership that forms the cornerstone of EU-ACP relations.

Uniform Reciprocity

In contrast to maintaining the *status quo*, uniform reciprocity would be allowed by the WTO and would create a secure environment for foreign direct investment. In contrast to GSP, uniform reciprocity would also be able to continue the partnership approach taken within Lomé and would certainly entail a negotiated deal neither party could back

down from. It would also create a level playing field with the EU's other associates in the developed world. However, there would be no scope for differentiation between states, and the current level of development of the ACP group therefore renders this proposal not viable. If one considers that South Africa, which has a much stronger economy than any ACP member, expresses doubts about accepting the proposed FTA on the grounds of the adverse effects the agreement might have on its economy, it becomes clear that no other ACP country will be able to implement an FTA with Europe either.

Differentiated reciprocity

Differentiated reciprocity would provide the same benefits as uniform reciprocity, except that it might not be accepted by the WTO. This kind of differentiation is attractive because each ACP sub-region could negotiate a deal best suited to itself and its level of development. This could also facilitate the integration process between the ACP and other countries on a similar level of development. However, the group would have to sacrifice its ACP integrity. Differentiation would create problems for countries that are not part of a sub-region. It is clear that the benefits under differentiated reciprocity would be fewer than under Lomé. The Protocols on rum, beef and bananas would be lost, as well as the EU's Common Agricultural Policy (CAP) preferences. The feasibility of this proposal is also questionable, as South Africa is currently having difficulty negotiating an agreement that virtually amounts to an example of differentiated reciprocity. Once again the negotiating ability of the ACP group remains doubtful.

None of the above suggestions would adequately address the perceived failures of the Convention, while simultaneously preserving the positive elements. The most viable option would, therefore, seem to be to continue with the current Lomé structure as an umbrella organisation and then develop a menu of trade arrangements within the Convention, from which the participants could choose the best possible trade arrangement for themselves. This possibly would allow for other developing countries to join the ACP fold. The option therefore remains for SADC to choose an agreement with Europe that would best suit the Community's needs and facilitate the regional integration process.⁸

Free Trade Agreement

Faizel Ismail, Chief Director of Foreign Trade Relations, has said that the South African negotiators are diplomats in the service of development. The future trade relationship between the EU and South Africa will be the most important aspect of the relationship and will possibly have the most far-reaching effects on South and Southern African

development. For this reason, South Africa rejected the European FTA proposal. Its objections are based first, on the proposed exclusion of 39% of South African agricultural products; second, on the fact that South Africa will have to lower its tariffs far more than the EU; third, on the brief asymmetrical implementation period; and finally, on the adverse effects the agreement will have on the Southern African Customs Union (SACU) and on SADC.

The South African government proposed a Trade and Development Agreement (TDA) instead after a series of consultations with various sectors in the country. The proposal focuses on a strategy for sustainable development in South Africa and the region, and proposes a phasing-in period asymmetrical in both content and time. According to the European interpretation of WTO rules, the South African proposal does not seem WTO compatible. However, the South African government has been arguing that WTO rules are not specific with regard to free trade agreements in general, and also not specific concerning FTAs between a developed and a developing country. It also argues that WTO rules do not stipulate that the percentage of trade has to be the same on either side.

An analysis of the reasons for South Africa's rejection of the European mandate brings South Africa's position regarding the European Union and its neighbours into clear focus.

The 39% Exclusion of South African Agricultural Products

The European Commission's current proposal for the agricultural sector envisages the elimination of duties on 95% of all EU agricultural exports to South Africa within ten years, whilst allowing the elimination of duties on only approximately 55% of South African agricultural exports to the EU. The EU is thus envisaging an asymmetrical liberalisation process in the agricultural sector, with South Africa having to liberalise far more, although rather more slowly, than the EU.

Apart from excluding sensitive products from the FTA, European agricultural products are also protected by the EU's CAP. The CAP has come under serious criticism by various countries throughout the world and also by its own members. Although currently still allowed by the WTO, it is often criticised for its incompatibility with WTO standards, and also for its effect on developing countries. The policy, formulated in the 1950s and in full operation since 1969, aims to elevate farmers in Europe to a status equal to industrial workers while protecting them from an increasingly competitive world market. The initial objectives of the CAP were laid down in the Treaty of Rome. They included five aims:

- to raise agricultural productivity;

- to ensure a fair standard of living for the agricultural community;
- to stabilise markets;
- to assure availability of supplies; and
- to ensure that supplies reach consumers at reasonable prices.

The policy may be criticised in many respects, but arguably its main failure has been in establishing reasonable prices. Most products on the European market can be bought at a much lower price on the world market. However, European consumers are forced to pay increased prices in order to sustain the living standard and commercial viability of the farmer.⁹

The CAP fixes prices of agricultural products at a certain threshold beneath which European prices are not allowed to fall. The EC Farm Fund buys up all the supplies once the price falls to this level. According to the agricultural policy, it is obliged to buy everything of standard that is offered. By contrast, world prices are fixed in the relatively free global market. Without the CAP, European farmers would have to compete with these prices. However, European farmers remain unaffected, as they sell at the prices set by the Community. In return, the EU sells the supplies it has bought from the farmers, for a loss, at the world price.

It follows that the price fixed by the Community raises the import tariff on products from outside the EU. Although foreign producers generally export at a much lower price, the fixed European price means that importers cannot undercut Community suppliers. For years some EU products have been twice as costly as world products.

Third World countries are especially hard hit by the CAP. The policy has had adverse global effects on poorer countries, whose farmers find themselves in an even more vulnerable position than their European counterparts. Third World farmers are not able to develop their exports significantly, due to the unfair European competition. Even though many of these countries receive preferential access to the EU market through the Lomé Convention, they remain incapable of competing in products that still need development.

New GATT rules oblige the EU to dismantle the CAP by some 30%. However, due to pressure from agricultural lobbies within the EU, cuts made to agricultural aid are being replaced by social subsidies. This effectively means that no real cuts in aid are being felt by the European farmer. Farmers building blockades in the streets of Paris show just how remarkably strong the agricultural lobby still is in European politics: the list of exclusions is a direct result of the power it wields.

The 39% exclusion of South African agricultural exports is not a serious problem. South Africa enjoys a comparative advantage over the EU in these products - but, in order to make a larger profit, any exporter would like to see zero tariffs on every exported product. The existing tariffs have not, and will not, prevent entry into the market, as reasonable profits are still to be made. It is even argued by the European Union that South African *producers* will not benefit from lowered tariffs. Once tariffs are reduced, the *exporter* will gain in the first year, as he need not pay a tariff and can sell his product at a lowered price, making a greater profit than the previous year. During the second year of lowered tariffs, the consumer on the European market should respond to the lowered price with a higher demand for the product. However, the case with many South African agricultural products is that already they have almost reached production capacity, due to a South African water shortage. The producer therefore cannot increase production in response to increased demand, and the net benefit will remain with the exporter. If this argument is true, then the European negotiators should also realise that there is no need to exclude these products from the negotiations.

The principle of protectionism, however, forms the hub of the problem. The EU is by far the stronger party in the negotiations. Its true commitment to the development of the Southern African region appears doubtful when such a large number of South Africa's primary exports is excluded even from discussion. The EU is perceived to be selfishly protecting its own sensitive products without giving much thought to its relative strength or the vast amount of subsidies that support these products. If South Africa were to adopt a similar attitude and draw up a list of its sensitive products, it could well end up by excluding all European agricultural exports and it would be impossible to reach a WTO-compatible agreement.

There are some advantages in the present form of the proposed FTA with the EU, although only in the export sector. The 39% exclusion, however, reduces even the attraction of exporting gains. Fears exist that as soon as European products enter the South African market duty free, domestic production will no longer be able to compete. Turkey provides a good example: after concluding an FTA with the EU, its agricultural sector was swamped by subsidised European products and today Turkish agriculture finds itself in a very precarious position. South Africa could travel down the same road.

The red meat industry provides a striking illustration of the possible effects of the proposed FTA on South African agriculture. Some of its products are being excluded from the FTA negotiations, meaning that no preferential access to the EU red meat market will be gained. Currently South Africa is a net importer of red meat, as it can supply only approximately 90% of its red meat consumption. It is also expected that within the next two decades South Africa will increasingly struggle to supply its population with red meat. Population expansion is expected to increase much faster

than red meat production. A relative increase in wealth could also result in a consumer trend away from white meat to red meat. South Africa will therefore have to import red meat increasingly, especially low quality meat, from exporting countries. Ideally these exports should come from our neighbours, as this would increase regional co-operation and development.

Studies done by the Red Meat Producers' Organisation (RMPO), however, show that the European Union could export red meat to South Africa at under R6.00/kg, well below local production prices. Each kilogram would be supported by some R16.00 in EU subsidies. Even the current 40% tariff on red meat imports might not be enough to protect local producers. Under the FTA, the European Union expects South African tariffs to be lowered, even below the 40% threshold, which could result in serious problems for local and neighbouring producers.¹⁰

Lower European Tariffs

Currently 80% of South Africa's exports enter the European market duty free. By contrast only 44% of European products enter the South African markets without paying a tariff. South Africa is bound by GATT obligations to reduce tariffs on 54% of EU exports by the year 2000, and Europe is obliged to let 83% of South African products enter its markets duty free. According to WTO rules, 'substantially all' trade has to be included in an FTA, which is most often interpreted as meaning more than 90% of traded products. Under an FTA, the EU would need to eliminate duties on only seven percent of currently traded goods, while South Africa would need to eliminate duties on 36% of currently traded goods in order to reach the 90% target set by the WTO rules. Although the EU is proposing the exclusion of 39% of agricultural products, this amounts to only about four percent of total trade, which would allow the FTA to remain WTO compatible. It is therefore clear that South Africa will have to lower a greater number of tariffs, despite being the weaker party.

The Short Time Frame

According to WTO rules, a free trade agreement is allowed to contain an asymmetrical adjustment period of ten years. The period can be extended by another two years for products of extreme sensitivity. When the European Union negotiated an FTA with Israel, however, the adjustment period was determined at 15 years and South Africa would like the same concession. It should, however, be remembered that in 1974, when Israel signed an FTA with Europe, there was no World Trade Organisation that laid down rules for these agreements.

During a subsequent round of negotiations in mid-1997, South Africa proposed that all products be included in an FTA with an adjustment period of 12 years. This proposal is not only aimed at prolonging the time frame, but is also aimed at the agricultural exclusions. According to all reports, the proposal was received sympathetically.

The Negative Impact on SADC and SACU

The negative impact which the proposed FTA might have on SADC and SACU has been the main focus of the South African negotiators. South Africa is aware that without a economically stable neighbourhood, South Africa will itself not be able to develop adequately. It has repeated its loyalty to the region time and again. As discussed earlier in this chapter, South Africa's participation in the Development Community appeared at the time to be a ploy to win full Lomé participation, or at least to secure a deal more suited to a developing nation than a developed one. However, African refugees, illegal immigrants, a continent which seems to remain in political turmoil and a massive trade imbalance with the region are real worries to South Africa. It cannot afford a deal with Europe that, according to all estimations, will initially have a negative impact on itself and may have a far worse effect on the region. Such an economic setback to the region would only increase the problems currently experienced by South Africa.

The situation in SADC is evident from the following statistics: South Africa has a GDP of \$2,902 in comparison to its immediate neighbour Mozambique (\$80). South Africa accounts for 82% of the total GDP in the area, and Zimbabwe, the next strongest economy, a mere eight percent. Primary commodity exports dominate the exports of SADC, with an average of 82%. Once again South Africa dwarfs its neighbours in both imports and exports, accounting for 62% of total imports and 70% of total SADC exports.¹¹

South Africa is therefore taking a multifaceted approach to its trade relations with the world and the region. In order to harmonise trade with the region, it is currently negotiating a free trade agreement, renegotiating the SACU formula and participating, although only partially, in the Lomé Convention. To increase its participation in the global market and to develop a tariff regime attractive to foreign direct investment, South Africa is negotiating a trade agreement with Europe, its biggest trading partner, and participating as a full member of the WTO.¹² The lengthy nature of the EU-SA negotiations can be explained in part by this approach. Although these negotiations do not have to follow one another, they have to proceed concurrently. Whereas the EU would like to finalise all the negotiations, South Africa first needs clarity on the SACU and SADC negotiations before it can make a final offer to Europe.

SADC

Given their focus on achieving political liberation, political stability has for years been the focus of Southern African regional organisations. The transformation of the SADCC into the SADC in August 1992 heralded a new era for the regional body. Political stability had been achieved in most member states, and the focus shifted to developing those member countries which had been stricken by war, poverty and natural disasters over the past few decades. The Community was also strengthened by the accession of South Africa in 1994, and by Mauritius the following year.

Since its inception, SADC has had a number of successes in the area of political co-ordination, and it is hoped that it may be the first African regional organisation to achieve some permanency. In order for this to be achieved, SADC is attempting to harmonise economic and trade policy through a free trade area. The argument that South Africa signed the Protocol in order to have a stronger claim on Lomé seems, therefore, unfounded. However, the Protocol remains vague, and to date only Zambia and Mauritius have ratified it.

South Africa argues that there is no real need for it to ratify the Protocol, as it is dedicated to the process. Entering into negotiations on the finer details of the agreement will be sufficient ratification. The Department of Trade and Industry is currently discussing the exact offer it will be making to the region, but it is expected that it will offer lower tariffs to SADC than it will to the EU.

In future the Protocol may present South Africa with difficulties. The very clauses that brought SADC indirectly to the EU-SA negotiating table (Articles 27 and 28) could make it more difficult for South Africa to negotiate trade deals with third countries. These articles stipulate that most favoured nation status should be granted to every member country, and every benefit granted to a third country should also be extended to all SADC members. Trade agreements should also be concluded in consultation with the SADC states. This effectively means that South Africa is actually negotiating on behalf of the entire community. Although in some situations it will be beneficial for South Africa to stress its link with SADC, its real needs differ tremendously from those of the developing countries, and in most cases it may find SADC to be more of a burden than a help.

Tariff liberalisation has generally been accepted in South Africa as a difficult but necessary measure leading to economic development and prosperity. The rest of SADC is, however, not entirely convinced. Whereas many participants in regional organisations view regional bodies as necessary and auxiliary steps toward participation and competitiveness on the world market, most members of SADC look to the community for protection from global movements.

Critics have attacked the Protocol on a number of grounds, including:

- its failure to provide for differential treatment for least-developed countries;
- its emphasis on tariff barriers to trade when they are not the main obstacle to intra-regional trade;
- the absence of provisions to address supply-side measures;
- the call for the immediate national treatment of goods and services traded within the region;
- its attempt to create policy harmonisation when this is not required from an FTA;
- the treatment of relationships of member states to other regional groupings;
- inadequate provisions to foster equitable industrial development in the region;
- the absence of compensatory mechanisms; and
- its failure to adequately address prevailing trade imbalances in the region.¹³

However, the finalisation of the SADC trade agreement is not the only reason why South Africa's affiliation with the region is hampering its negotiations with the EU. South Africa fears that the fragile industries in the region will suffer once it enters into an FTA with Europe. Border controls are weak, so cheap European products could filter through to SADC countries. In addition, South Africa could 'steal' foreign direct investment away from the SADC countries. With its stronger and more stable economy, South Africa will become even more attractive once an FTA is implemented. It is argued that the massive trade imbalance that currently exists between South Africa and its neighbours will be increased when South Africa can buy cheaper European products. The SADC's Lomé advantage over South Africa on the European market will also be diminished once South Africa can export freely.

South Africa therefore demands that the EU provides a guarantee that the region will not suffer. As no guarantees can be given in the agreement itself - the real effects of an FTA are difficult to predict - South Africa would like the EU to set up a fund to compensate the workers in SADC who lose their jobs due to the agreement, and to provide investment where businesses are closed. However, the EU remains adamant that it is not even considering the proposal and that South Africa should deal with this problem itself. After all, the members of SADC are currently still receiving generous funds under the Lomé Convention.

SACU

SACU, which comprises South Africa, Botswana, Lesotho, Namibia and Swaziland (BLNS), is one of the oldest custom unions in the world. Under SACU, as negotiated in 1969, South Africa administers duty collection and distributes shares of the common revenue pool to the other four countries according to a revenue sharing formula. More than 46% of Swaziland's national budget in the fiscal year of 1994/1995, and more than 50% of Lesotho's budget and 24% of Namibia's was derived from the union revenue pool.

In a trading world where tariff reductions and free markets are the order of the day, fiscal dependence on a customs union is no longer viable. Each SACU member concurs that the present agreement has certain shortcomings, but instead of abandoning the union completely, the BLNS countries want a revised formula to be phased in so as to avoid a precipitous fall in their income. In December 1994 the revision process was initiated, but due to the lack of consensus, there is still no new deal in place. Although there seems to be agreement on a new revenue-sharing formula, there is still no clarity on the new set of institutions and policies to underpin the formula; and although it is accepted that the BLNS should receive compensation from South Africa for the effects of industrial polarisation and fiscal disruption, the scale of the compensation has not yet been agreed upon.

Under a free trade agreement between South Africa and the EU, the BLNS countries not only stand to lose fiscal income due to a diminishing tariff income, but unemployment is also likely to rise. A smaller revenue pool will mean that fragile industries may be destroyed and infrastructural development curtailed. The SACU countries will in all probability have to compete with European agricultural and manufactured products which, under an FTA, would arrive duty free in the Customs Union. The BLNS would be unable to compete. Losses incurred would not be adequately replaced by aid from Europe, as prospective losses would be eight to ten times the amount of European aid previously granted to the SACU countries.

Due to the nature of the customs union, all trade deals involving South Africa should in fact be concluded with the SACU as a whole, but this has proved too much for SACU to handle. Had the other members of the union become co-negotiators, several of their industries would have been qualified as 'most sensitive' and would possibly have been excluded from an FTA. Such exclusions would have resulted in high transaction costs, for example for policing to ensure that goods imported by South Africa from the EU did not percolate across their borders without having paid the full customs duties.

There are very few options available to SACU to replace lost income from a possible SA-EU free trade agreement. Alternative taxes could prove fatal to investment incentives. Such taxes would have to be simple, fair and based on the ability to pay. Looking to South Africa for compensation would prove fruitless. South Africa, with its own dedication to its RDP, would most certainly not be willing to pour further tax revenues into the common revenue pool.¹⁴

The future of SACU remains unresolved. It is undisputed that the BLNS countries will be the worst hit if South Africa should enter into a free trade agreement with Europe and, so far, no viable measures to cushion their markets from the impact appear to have been found.

Conclusion

Although many negative reports have appeared in the media regarding the trade negotiations, it should be remembered that the trade aspect is only one, although a very important, facet of the negotiations. Progress has been made on a number of issues, and the negotiations should be nearing a conclusion by the end of 1997.

The difficulties surrounding the trade issues do, however, raise concerns. The EU has not deviated from its original negotiating mandate. It is hard to believe that a different proposal from South Africa on trade relations will be accepted. However, South Africa's proposal on including all trade within 12 years in an FTA was received with optimism. Should the EU, however, turn its back on these negotiations, South Africa would be left with the GSP to regulate its access to the European market. As explained earlier, although GSP might look attractive for its element of non-reciprocity, it should be remembered that the GSP is something that the EU grants. It is not a negotiated deal. Preferences can therefore be withdrawn unilaterally, leaving South Africa outside a closed European market.

If negotiations on an FTA are abandoned, the prospects of re-opening the negotiations will be slim. South Africa has an opportunity to sign a deal with Europe now that will have a series of negative impacts on some industries within the region, but which should prove beneficial in the long term. It is therefore hoped that a deal with the EU will be set in place towards the end of 1997.

In conclusion, the EU has significant power due to its 15 members, and this is the reason most often offered for its inability to change its negotiating mandate. Although it is a dangerous thing to do, South African officials have spoken of the EU as an example for Southern African integration. These aspirations are reflected in South Africa's approach to the negotiations: impressed by the EU's unrelenting attitude towards its

mandate, South Africa is turning towards its neighbours for similar support. However, it remains a debatable issue whether South Africa or Southern Africa's position is strengthened or weakened by this approach. Safety could lie in numbers, but when these numbers include some of the least-developed countries in the world, it might weaken a country's position in a highly competitive trading world.

Endnotes

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4. European Commission, 'Commission launches a New Framework for EU-SA Relations', *Port Parole* (Press Release), 1995.
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12. Currently South Africa is still ahead of GATT obligations on tariff reduction.
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GEAR and Southern Africa¹

Stephan Malherbe

If one excludes South Africa, there are about 500 million people in sub-Saharan Africa (SSA). On average, they earn just more than a one-hundredth of what their counterparts in the world's wealthiest countries earn. Compared to SSA's richest nations – Gabon, Botswana and South Africa – the unfortunate half-a-billion earn one-tenth the income of the citizens in those three countries. Admittedly, valuing some of what they consume like foodstuffs, accommodation and personal services – at what they cost in rich countries would help a little: it would perhaps push their income up to three or four hundredths of the wealthiest societies' *per capita* incomes. On the other hand, life expectancy at birth hovers around the fifty-year mark; 250 million people do not have access to safe drinking water; and one in every ten children dies in or shortly after birth. In the worst countries, one in five children dies before the age of five. A far larger percentage of young children, maybe 40%, suffer from stunted growth caused by malnutrition. Imagine the inner life of a perennially hungry child. Low school-enrolment and literacy rates certainly do not help.

These well-known facts are repeated for two reasons:

- to remind the audience that the intensity and scale of destitution faced by the rest of SSA belongs to an order of magnitude far removed from that experienced inside South Africa, (even though some regions inside South Africa, like the Eastern Cape and the Northern Province, have social indicators that are more like the rest of SSA than other provinces in South Africa); and
- to point out that there is nothing automatic about economic prosperity. While the post-Second World War miracle of growth transformed societies across the globe and all but erased poverty in a number of developing countries, African *per capita* incomes slid, and with them, living conditions.

Two moral imperatives run parallel to each other:

- South Africa's position of relative strength, its historical ties and geography give it neighbourly obligations, and
- these obligations can only be properly discharged with an understanding of how

economies grow, and the limited number of growth possibilities available to African economies in the world.

Fundamentalists Versus Mystics

John Page, the author of the World Bank study on the East Asian Dragon and Tiger economies, *The East Asian Miracle* (1993), divides growth theorists into mystics and fundamentalists. The mystics and fundamentalists are united in one thing: they have noticed that societies grow at greatly differing rates such differences leading to the vast disparities in incomes noted above and they want to account for these differences.

Mystics point out the deep-seated differences in economies between fast-growers and slow-coaches. Religious (Protestantism *versus* Catholicism, monotheism *versus* polytheism), linguistic (phonetic *versus* pictographic alphabets), climatological (the tropics *versus* temperate zones; alluvial plains) and geographical differences (land-locked *versus* coastal) each have been given much weight, as have differences in habits of work (rice-growers *versus* cattle-herders) in explaining these differences.

Where there is a mystic, there is often a cynic, but the mystics have two arguments in their favour. First, such deep-seated characteristics offer persuasive explanations for many ancient economic milestones, such as the development of writing and the first cities. There is nothing trivial about that, or about the long line of 'mystic' thinkers, from Ibn Khaldun through Max Weber to Jeffrey Sachs. Sachs believes that the 'wrong' climate (tropical), geography (little or no coast-line) and geology (an exploitable one) can take one percent of GDP growth per year off SSA, and low life-expectancy (related to the tropics) another 1.3%. Add to that another factor that is not particularly malleable, initial *per capita* GDP, and the built-in handicap can amount to as much as three percent per year for some countries. That may not sound much, but take two countries who at the start have identical output: after little more than a generation (in fact, 37 years) the country growing three percent per annum faster, will have an economy three times the size of the other one.

Yet the mystic approach may be wrong. Its woollier adherents have a lot of explaining to do. At the turn of the century, experts theorised that the 'rice-culture' rendered Asians unsuitable for capitalism; now books explain how the same 'rice-culture' engenders work and savings habits that will vanquish those who grew up in less arduous surroundings. A similar *volte face* is shown with regard to Confucianism: first it presented an insuperable obstacle; now it is considered a secret weapon. There is something touching about these speculations. During the Meiji Restoration, Japanese sent their children to school in white sailor-suits and took up ball-room dancing on the off-chance that Britain's industrial revolution might have sprung from those activities. These culture-

specific explanations for individual productivity can amount to a covert racism. In the South African policy discourse the use of Asian examples is dismissed by South Africans of all colours because 'Asians are different/more hard-working/cleverer than us'. This kind of self-inflicted inferiority is both unjustified by the facts and damaging to good policy making.

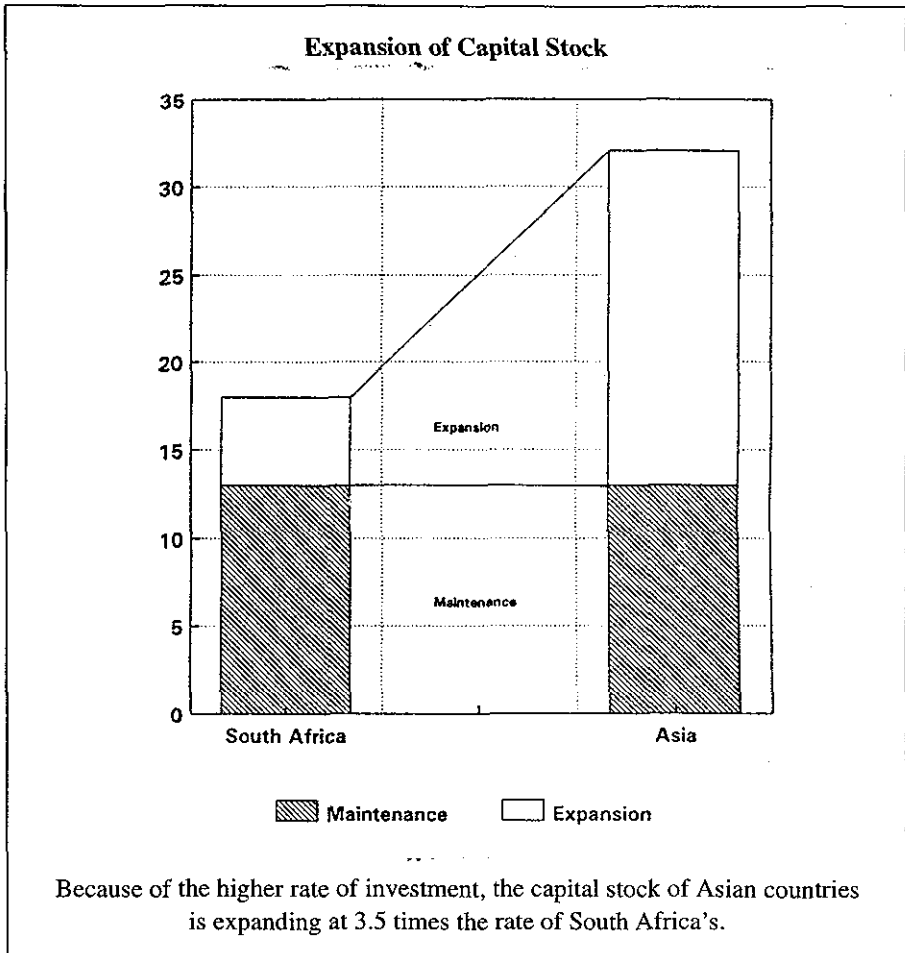
The Sachs brand of mysticism is harder to deal with, because it is partly right. No doubt in the past human and animal disease, over-land travel and heat placed enormous burdens on individuals and societies, and impeded the kind of specialisation from which *per capita* growth springs. The Sachs analysis is not wrong about the past; but it may well be wrong about the future. Technological advances can reduce the costs of distance, can cool working environments and can protect humans against microbes. By citing the economic success of tropical cities like Hong Kong and Singapore, Sachs admits as much. But an ancient example is all we need. The domestication of the camel around 1500 BC enabled Eurasian trade routes to stretch across deserts (and supplanted the use of the wheel), thus changing the course of economic development.

Rather than analysing ultimate causes of economic performance, *fundamentalists* prefer to focus on the proximate requirements: the quantity of resources dedicated to productive uses (or capital); the quality and quantity of labour; and the efficiency with which these are used: productivity. Mystics often claim that the cultural attributes they have isolated enhance productivity; fundamentalists leave the maximisation of productivity to competition so a fundamental tenet of this approach is ensuring the maximum degree of competition, usually by opening the economy.

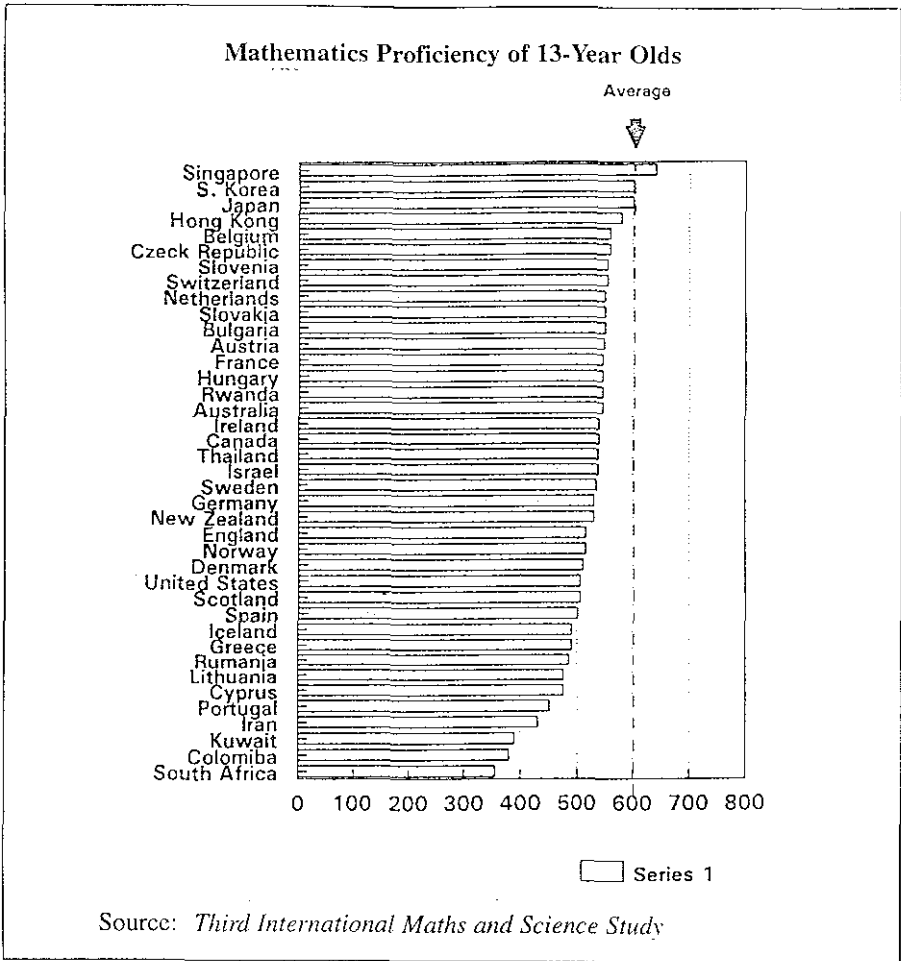
Within a competitive setting, the more capital, the higher the growth. So fundamentalists are concerned with releasing resources in the economy for addition to the production base, or capital stock, of the economy. This addition is known as Gross Domestic Investment, or GDI. This requires additional savings, either by individuals or by the state on their behalf. Alternatively, these resources can be borrowed from abroad, which does not require cuts in consumption at home, hence the fundamentalist pre-occupation with a policy stance that will encourage foreign inward investment.

It is important to note that a part of Gross Domestic Investment is used simply to maintain the capital stock at its previous level, as this is continually diminished by obsolescence and wear-and-tear. Although the amount of depreciation is difficult to estimate precisely, assuming that 13% of GDP is required to cover that is reasonable. This means that of South Africa's 1995 investment of 19% of GDP, only six percent of GDP was used to increase the productive base of the economy. Compare the 1995 investment rate of about 34% of GDP for the Asian fast-growers; using a similar depreciation assumption of 13%, one can infer that net additions to the productive base in those countries amounted

to 21% of GDP, more than *three* times the rate in South Africa. Is it any surprise that those economies were growing at about three times the rate?



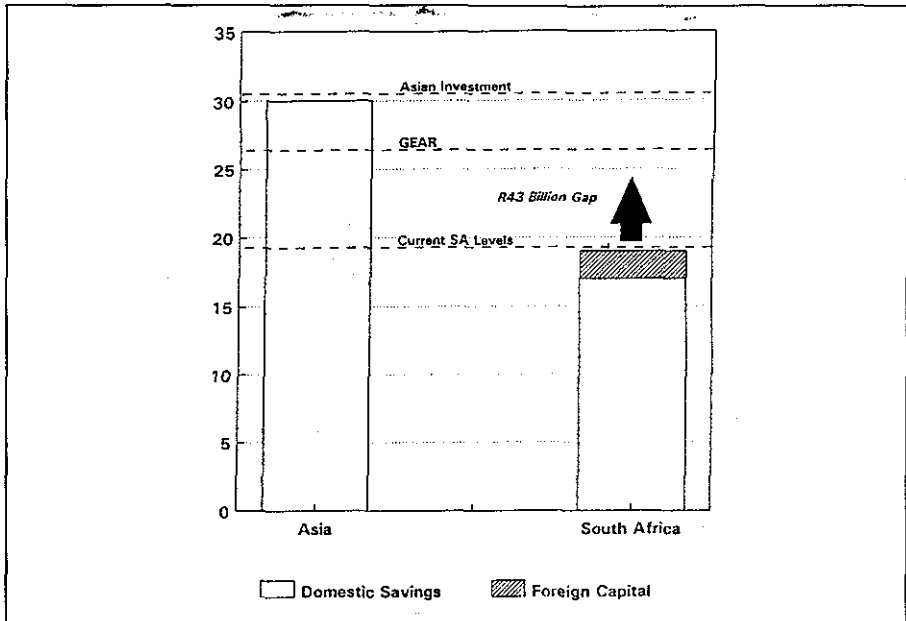
The fundamentalist worries about labour inputs in two ways: Firstly, is the labour market sufficiently flexible to allow job opportunities for all at the world price for their labour? Secondly, is the quality really, the level of knowledge and ability to learn new things of labour as high as it can be? Because inferior schooling, or its truncation, can generally not be rectified fully later in life, schooling performance levels like the one shown below are of great importance. The top four positions in this regard are taken by Asian fast-growers, the bottom position by South Africa.



GEAR is a Fundamentalist Document

The emphasis on increasing savings and attracting more foreign inflows in order to increase levels of investment lies at the heart of the South African government's Growth, Employment and Redistribution (GEAR) strategy. The main device for increasing savings particularly for private investment is through a phased reduction of the budget deficit from 5.1% of GDP to three percent over three years.

The objective is to increase investment by seven percent of GDP to 26%. This implies that an additional R43 billion either has to be saved domestically, attracted from abroad or some combination of the two.



But that is only one part of the equation. Increasing savings without increasing actual flows into investment opportunities will merely result in a current account surplus. A dramatic increase in the number of bankable projects is needed. This, in turn, requires an adjustment either to productivity levels, to factor costs or to tax rates. It is at this point that GEAR is at its most vulnerable. The programme's main stratagem to improve returns to investors is through a reduction in the cost of non-tradeable goods in the South African market through the real exchange rate devaluation of about 20% which preceded its publication.

Over-reliance on Depreciation

There are risks to relying on a real devaluation to bear the full adjustment to competitiveness of factor prices. Firstly, it is open to reversal upon an improvement in sentiment, which has already occurred. Secondly, in a labour market where collective action by employees is effective, the increased return available to investors will be eroded gradually through wage increases. Thirdly, because the devaluation increases the rand cost of traded goods, it causes inflationary pressure. To counteract that, the Reserve Bank may be constrained to keep real interest rates high. The second and third points together imply that regular depreciation would be required to maintain competitiveness, but that, in turn, would require interest rates remain high.

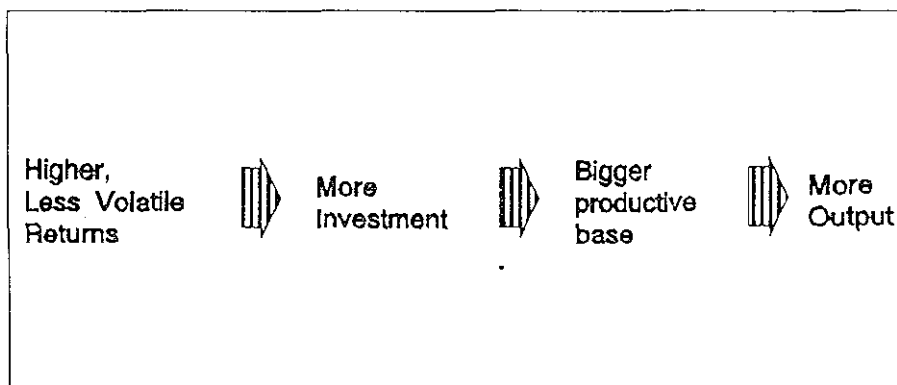
This policy stance would be markedly improved by increasing labour market flexibility, so that wages could adjust downwards to meet the unit labour cost standards set internationally (over the medium term, rising employee productivity would reduce the competitiveness gap). That would decrease much of the inflationary pressure. In GEAR, labour market flexibility is paid lip-service, an impression recently confirmed by Finance Director-General Maria Ramos, paraphrased as saying that the labour market section [in GEAR] was brief and vague so that the labour department could develop its own policies.² The role of labour policy in GEAR and in the South African polity is of supreme importance to South Africa's neighbours, and to their prospects for growth.

In the absence of labour market reform and tax concessions that are competitive with those offered by other investment destinations, exchange rate management and its corollary, inflation management, become very important. A less expansionary fiscal stance reduces demand for goods and services in the economy, easing the need for high interest rates to reduce demand, and with it upward pressure on prices. However, it remains very difficult to maintain competitiveness through the exchange rate alone, and complicates the management of the economy in the case of either positive or negative external shocks.

GEAR is an explicit response from the South African government to the challenges of an open global economy. But perhaps due to an incomplete understanding of the implications of the global economy the response will not bring South Africa to its potential growth rate, or to the rates projected in GEAR.

Investment in a Borderless World

GEAR, then, is a programme based on the following simple logic:



GEAR works by increasing the returns, adjusted for volatility, of investing capital in South Africa: interest costs and the dollar costs of non-tradables are lower, and taxes are in some cases lower, which is one of the reasons why capitalists like GEAR. They must be careful, of course: the trade element of the GEAR package creates a filter that allows these higher returns only for firms that have internationally competitive cost bases. But the fact remains: GEAR is aimed at improving the return on investment (ROI) to projects based in South Africa. The structural adjustment programmes in other African countries follow the same logic.

To understand how to increase the ROI for projects in a particular location, one has to understand which elements of a project are rooted, and which ones are not. *Mobile factors*, which can easily cross borders, are not a source of competitive advantage to countries; *rooted factors* that do not easily cross borders, are the true determinants of the location of a particular investment, and therefore the sources of one country's competitiveness relative to other investment destinations.

Mobile Factors

Mobile project components can easily be brought into a country, and therefore are not critical in the decision of where to locate investment. These factors are:

- project, product and production design;
- technology;
- very senior management;
- market access (in a global economy);
- capital (for foreign investors); and
- market information.

The mobility of these factors explains why countries can, within a short space of time, enter and dominate what for them are entirely new industries, if the input costs are right. The most famous example of recent times is the computer memory chip industry in Malaysia. However, by their very nature, these factors do not explain why Motorola and Texas Instruments elected to put their chip factories in Penang, and not in Pietersburg. That decision was made on the basis of rooted factors.

Rooted Factors

These factors are particular to a country, and the only way individual investors can change these is by changing country. These components are:

- security of property rights and legal remedies for breach of contract;
- stability of macro-economic prices (real exchange rate, domestic price stability and domestic interest rates);
- physical infrastructure;
- cost of labour inputs (wage levels, quality and risk of stoppages); and
- procedural barriers to adjusting production to competitive pressures (work organisation, supply chain flexibility and staffing).

Threshold Rooted Factors

Some of these rooted factors, the protection of legal rights of property and contract, macro-economic stability and tax rates depend on fairly direct government levers. Hence they are not difficult to fix. These three are threshold requirements for which increasingly there will be international norms to which all countries hoping to attract investment will adhere. Only rarely perhaps with tax will they be a decisive source of competitive advantage rather than just an entry requirement. The same reasoning applies to infrastructure: there are now so many countries with suitable transport and communications links at acceptable costs that these things will rarely on their own clinch an investment decision (except, again, in the negative: it is unlikely that South Africa will attract any of the mushrooming internationally outsourced back-office service business because of its high telephone charges).

Decisive Rooted Factors

Peremptory norms in property rights, macro-economic stability and tax levels shift attention to the other rooted factors, like the cost of labour (relative to productivity), mediated through labour market rules governing wage setting and adjustment in staffing and work organisation. These components of unit labour cost become the decisive element as countries start approximating international norms in other respects. Once basic economic and infrastructure policies are in place, a country in essence consists of its people. And, in a world without trade barriers, those people matter as workers, not as consumers, which is why GEAR's credibility is undermined when its labour prescriptions are 'short' and 'vague'.

Labour Costs and Economic Growth Paths

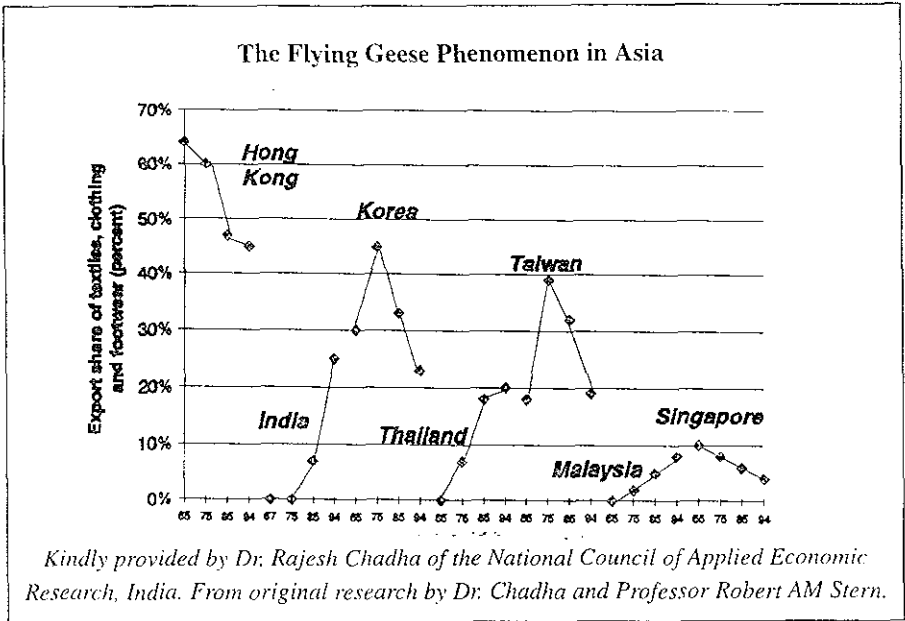
It is because of the centrality of unit labour costs in so many investment decisions in the modern world that labour policies have become a contested area of development strategies. In a sense, Asian countries, lacking large internal markets and natural resources, were the first to be thrust into a world where the only real asset they had was their labour. And as far as labour is concerned, each of these countries followed a very similar growth path.

These are the elements of the Asian labour model:

- labour costs were kept at market clearing rates through a combination of tax and labour policy;
- work stoppages were minimised;
- managers had complete freedom over work organisation;
- a large part of remuneration was incentivised in the form of productivity bonuses; and
- in the context of variable pay and temporary workers, some employers provided job security to their 'permanent' workers.

This policy attracted foreign and domestic investment into labour-intensive industries aimed at the vast global markets in goods like shoes and clothing. On the basis of this comparative advantage, the typical country's production of labour-intensive goods (as a percentage of total exports) rose swiftly. As a result, employment in manufacturing soared, often as much as four times in two decades. These employees, having been brought into manufacturing, improved their own productivity; soon, full employment was reached. At this point, wages began to rise significantly, and entrepreneurs and workers started migrating to higher value-added activities, where growth now took place. This pattern was repeated in every high-growth Asian economy (this is shown in the 'Flying Geese' graph).

This pattern is referred to as the 'Flying Geese Phenomenon' because of the pattern of the graph, and because unskilled labour-intensive activities would migrate from one country to the next as full employment was reached, and workers shifted to higher-value added activities.



Implications for South Africa

These patterns provide an interesting backdrop to the growth path proposed for South Africa, as well as to future policy interaction between South Africa and its African neighbours. Essentially, South Africa wants to skip the first, labour-absorbing, phase of the growth path, and move right to the second, high value-added, high-wage phase. The benefit would be that low-wage sweatshops would be avoided. The problem with this plan, however, is three-fold:

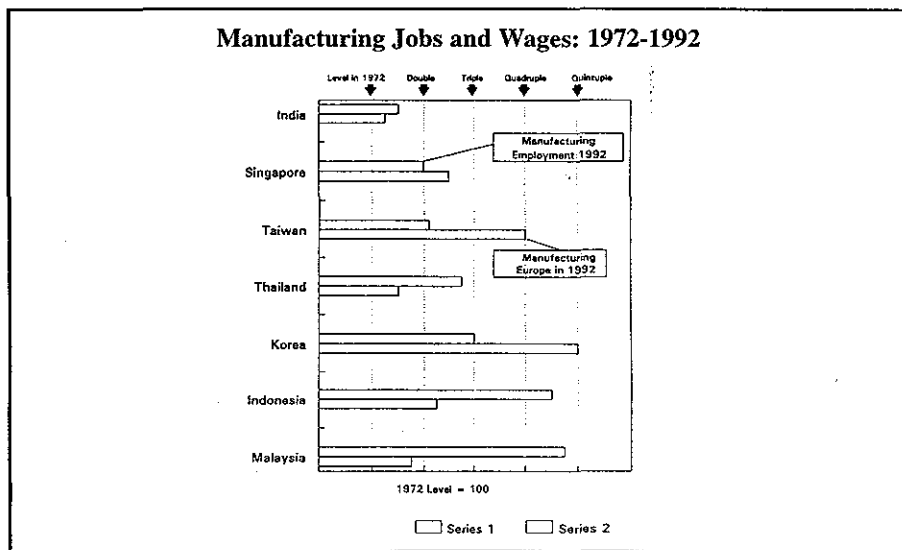
- The lost people:* Between one in three and one in four workers in South Africa do not have a regular job in either the formal or the informal sector. Many of these workers, despite being fairly young, have been unemployed for a number of years. They are effectively shut out of formal employment and the chance to acquire productive habits of work and acquire shop-floor skills by the high-wage route. Because many of them are concentrated in particular regions, such as the Northern Province and the Eastern Cape, these regions would be permanently depressed.
- The time gap:* Even for employed workers, there is a problem when capital stock has to be renewed. Current high wages that are fitting for skills levels, will be acquired only in future and thus create a time gap between costs and revenues

for firms. This renders renewal of investment unprofitable in South Africa. A recent example is the wholesale export of a bus factory from the Eastern Cape to India.

- *Barriers to productivity:* Even though South Africa has, for now, adopted the high-wage approach, its labour regime is unsuited to this. Firstly, swift and continuous improvement to work organisation needs to be put within the unambiguous ambit of management. Secondly, pay must be bound to production incentives, which has proven very difficult in South Africa's wage-setting institutions. If high wages are aimed at, it is essential that they be correctly structured.

Implications for African Countries

The choice South Africa has made to eschew its place in the flying geese formation, and to 'skip' unskilled labour-intensive production, is a dubious one. However, for other African countries such a choice would be unthinkable. Apart from the vagaries of a tropical climate and the dubious advantages of natural resources, African countries have one major card to play in the global economy: a massively under-utilised labour force. If Africa wishes to attract foreign capital, know-how and market access in any area outside mining and tourism, it will have to price its labour surplus attractively. Politically tough as that choice might be, the pay-offs in the long run are great, as shown in the next chart.



The win-win situation shown in the above chart for the high-growth countries reflects the impact of the two phases of growth: in the first phase, manufacturing employment absorbs all surplus labour (the increase in manufacturing employment); in the second phase, wages rise as productivity improves.

Can South Africa and Africa's Growth Paths Co-exist?

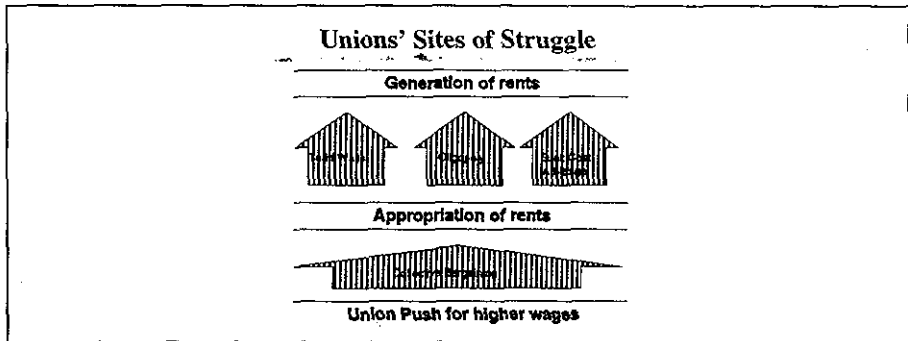
On the face of it, South Africa's decision to focus on high value-added, high-wage activities and abandon unskilled, labour-intensive production dovetails perfectly with the labour-absorbing policies that African governments will pursue. South Africa has to import those goods from somewhere, and it would be mutually beneficial in a number of ways if the source were to be from neighbouring countries:

- South African capital and expertise could be used to set up these businesses, which would mean remittances to South Africa and capital and skills for neighbouring economies;
- Instead of citizens of neighbouring countries crossing the border to sell their labour in South Africa, they could sell it in the form of manufactured goods. In this way migration pressures would be eased. These considerations were one of the motivations from the American side for the conclusion of the North American Free Trade Agreement with Mexico and Canada; and
- South Africa's sophisticated financial services sector could service the new regional firms.

However, life is never so simple. Basic contradictions in South Africa's labour policy stance reveal that even our policy makers do not fully believe in their high-wage/high-productivity/high-employment vision. Although the rational choice within the chosen approach would be for South Africa to open its markets to cheap labour-intensive goods, it protects those industries assiduously. To understand this, we must focus on the particular interests of workers currently employed in vulnerable sectors. Unions seeking to increase wages essentially do so by appropriating rents (profits) that would otherwise have gone to the owners of the firm. But in the absence of rents, there is nothing to be passed on to workers, no matter how effectively they exercise their collective power.

So unions really have two 'sites of struggle': one, during collective bargaining, seeks to *appropriate* rent. The second area of effort seeks to *create* rents in the first place. This can be done in three ways: by tariff barriers, by reducing competition (which unions support in public sector settings) and by sunk cost arbitrage. Simply put, sunk cost

arbitrage exploits the fact that it is expensive to close businesses, even if earlier return thresholds are not being met. However, that strategy leads to a depreciation in capital stock over time.



This analysis yields a firm prediction: that unions will oppose significant opening of trade to Africa in any area where African firms would have a comparative advantage relative to South African firms.

The Impact of Union Stance on African Economies

The union stance is tantamount to denying a man the right to work in the only job he can do. It becomes very difficult for him to pull himself up by his bootstraps if you take away his bootstraps. This approach will hamper African economies at a critical and vulnerable point in their recovery.

Conclusion

For the first time in decades, the SSA economy as a whole is growing faster than its population. People are becoming better off, but still at such a slow rate that it will be decades before the region as a whole escapes low-income status. From the fundamentalist perspective, these modest growth rates have two causes:

- *Investment is too low:* Gross Domestic Investment for SSA excluding South Africa (in 1995) amounts to 19.7% of GDP, but for the developing world as a whole, GDI runs at 26.5% of GDP. This depresses the growth rate by a few percentage points.
- *Investment is inefficient:* Even for SSA's modest investment levels, growth ought to be higher. Incremental capital output ratios are troublesome measurements at the best of times, but those for many African countries tend to be consistently low.

The causes of this are complex, but two factors play an important role. First, an unusually high proportion of investment is mediated by the public sector. Using financial statistics, the author estimates that 44% of investment for SSA is affected. In the developing world as a whole, the corresponding figure is 10%. (Ideology can take a back seat here: a government that cannot run an effective revenue service is unlikely to be much good at picking investment winners.) A second reason for the low returns to investment is the lack of competitive stimulus: until recently most of those economies had a fairly autarkic existence.

Investment Flows Low, Non-Private		
% of GDP	Sub-Saharan Africa	Developing World
Gross Domestic Investment	19.7%	26.5%
Official Inflows	8.7%	1.2%
Non-Tax Resources Mediated by the State	Half	One-Tenth
Non-Tax Resources Mediated by the Private Sector	Half	Nine-Tenths

Consequently, two of the prerequisites for turning Africa's tentative turn-around into a long-term expansion are:

- ensuring that the approximate ten percent of GDP inflow from official sources is replaced by sustainable flows, preferably private; and
- shifting the bulk of investment activities to the nascent private sectors in these economies.

For the reasons explained earlier, the key to foreign investment will be the opportunity to utilise Africa's vast labour pool - but that utilisation has to start somewhere. Integration through free trade of the African labour pool with South African capital, expertise and market demand would make a giant step towards placing Africa on a sustained growth path.

Endnotes

1. Thanks to Gavin Keaton for stimulating and instructive conversations in 1996 and 1997. Special thanks to Richard Ketley for a tutorial on the implications of IDA loans on national accounts.
2. 'Finance not undermining labour', *Business Day*, 14 July 1997, p.5.

The Benefits of Tariff Liberalisation: The Chilean Experience

Jorge Heine

Introduction

A particularly difficult and challenging academic and public policy conference on European Union (EU)-Chile relations was held in Brussels in October 1989, just two months before the 11 December elections that were to bring to an end almost 17 years of military rule in Chile. Organised by the Madrid-based Institute of European-Latin American Relations (IRELA), and generously funded by the European Community (EC), it brought together some 30 Chilean politicians, business leaders and economists with their counterparts from the European Commission, the European Parliament and many member countries, to examine the future course of relations between Europe and post-authoritarian Chile.¹

From a diplomatic point of view, the whole project was extremely delicate: At that point, the Chilean government was still headed by General Pinochet, and it was his ambassador who represented Chile at the EC. Yet the whole purpose of the exercise was for the EC to signal to the then-opposition forces led by Patricio Aylwin (who most observers thought would easily win the December elections and then form a government in March) that the EC was not only ready to do business with a democratic Chile, but that it saw Chile as an emblematic case in Latin America's transition from authoritarian rule and was prepared to cooperate generously with that process - a situation not unlike the one existing between the EU and South Africa in 1993-94.

By definition, any such gathering had to be as inclusive and representative as possible, and at least a third of the Chilean participants, although committed to the democratic transition, were strong supporters of General Pinochet and the policies he applied. The net result was that the deliberations quickly heated up, and, quite predictably, turned to the size of the public sector and the role of the state in the new democratic dispensation.

This was by no means a minor question. The parties forming the centre-left coalition led by Aylwin had a background of statist, private sector-hostile policies, applied both under the government of President Eduardo Frei Montalva (1964-70) and that of President Salvador Allende (1970-73), and the question as to what would happen to private investment from 1990 onwards was a critical one. Despite the large restructuring of

industry that took place in the 1970s and 1980s as a result of the pro-market, liberal policies applied by the military government's 'Chicago boys', the business community threw its support behind authoritarian rule and viewed with some apprehension the transition to a new dispensation.²

On the other hand, if there was one thing the future government did not need, it was the sort of massive disinvestment that had taken place in Chile in earlier periods and had made it so difficult for its democratic governments to achieve their objectives. To enjoy the confidence of business was central for the *Concertación de Partidos por la Democracia's* game plan.

Just as the discussion of the appropriate size of the public sector was turning ugly - with some arguing that its wholesale dismantling ought to continue in the democratic government, and others saying that enough was enough and no more privatisations should take place - Sergio Molina, subsequently President Aylwin's Minister of Planning, and later Minister of Education to current President Frei, cut through the fog of the increasingly tiresome and repetitive debate. 'Whatever the size of the state', he said, 'our government programme is unequivocally committed to an open economy. Certain things, and a certain economic discipline follow from that'.

As if a magic wand had been used, this statement immediately cleared the air and allowed the debate to move forward to specific policy issues, enabling participants to discover more common ground than they had anticipated when the conference started. The rest, as they say, is history.

Patricio Aylwin went on to win the December 1989 elections with some 56% of the popular vote. In June 1991 he cut Chile's uniform external tariff from 15% to 11%, and during his four-year term economic growth averaged 6.5% a year. Eduardo Frei was elected in December 1993 with 58% of the vote, and his government has witnessed similar growth rates - an average of 6.6% a year during 1994-96 - and has announced another tariff cut, from 11% to eight percent, to be enacted in 1997.

Needless to say, there is more to Chile's remarkable economic performance than tariff liberalisation - but the commitment to an open economy has been central to this performance and has allowed policy-makers of a wide range of perspectives to move the country forward through the often rocky waters of the world economy. The purpose of this brief chapter is to examine a number of critical aspects in which, in today's world, the commitment of a centre-left government to an open economy can be instrumental, both in fostering healthy economic growth and in providing the budgetary resources needed to fight poverty and create greater opportunities for all. Throughout, the perspective will be that of political rather than technical economics.

The Nature of the Problem

Chile's economy - with an average of six percent annual growth during the 1986-96 period, was the fastest growing in the West, and the fourth-fastest in the world - and the progress it has made as a result - *per capita* income doubled to US\$5,100 in 1997, and the number of people under the poverty line has declined from 5 million in 1990 to 3.2 million today - has generated a great deal of literature about what a recent article in the *Latin American Research Review* referred to as 'the political economy of the Chilean miracle'.³

As President Frei has pointed out, far from being a miracle, Chile's performance is the result of a lot of hard work on the part of many Chileans.⁴ The opening of the economy (achieved by measures including the lowering of tariffs) that took place from 1973 onwards has been an important, albeit not the only, component of this process. Different observers have read very different, often contradictory conclusions into the Chilean experience. While some have argued that economic restructuring can take place only under dictatorship, others have concluded that only free-market policies and an ever-diminishing role for the state hold the key to economic prosperity. A third group, comparing the 6.5% growth rate of Chile during the 1990-96 period with the less than two percent growth for 1973-89, affirms that it is only under democratic rule that countries can provide the sort of stable and predictable environment that investors seek.

The broader point, though, is a fairly straightforward one: it *is* possible for a middle-income, developing country marked by high social inequality and an economy based largely on the exploitation and processing of natural resources to leave behind the boom-bust economic cycles of the past and set the economy on a path of high, yet steady growth that cuts down the unemployment rate from an effective 30% in 1983 to 6.5%, while bringing inflation down to 6.6%, boosting the savings rate to 25% and the investment rate to 28% of GDP, and running a fiscal surplus. And, contrary to the 'jobless growth' syndrome so evident in today's Europe, job creation is by no means lagging behind in Chile: 42,000 new jobs were created in 1994; 59,000 in 1995; and 72,000 in 1996.

Contrary to the received wisdom, the process leading to the present situation has by no means been driven simply by an ever-diminishing role for the state. In fact, public policies have played, and continue to play, a key role in creating Chile's present economic conditions. The remainder of this chapter is devoted to an examination of these public policies emphasising the central importance of the opening of the economy and dwelling on the implications that Chile's success holds for other emerging markets.

The chapter has four sections. The first analyses the change from the Import Substitution Industrialisation (ISI) approach to economic development, to one based on export-led

growth. The second dissects the policy of 'open regionalism' that has been the hallmark of the international economic policy of the Aylwin and Frei administrations, as opposed to the 'go-it-alone' strategy of the military government. The third evaluates the role played by foreign investment in today's Chile, both in terms of foreign direct investment (FDI) in the Chilean economy and the increasingly significant role of Chilean investment abroad, especially in Latin America. In the conclusion, the dilemmas and alternatives faced by countries such as Chile in today's world economy are discussed.

From ISI to Export-Led Growth

Starting in the late 1930s with the creation of the *Corporación de Fomento de la Producción* (CORFO) - the equivalent of a Ministry of Industry but with greater administrative autonomy - Chile's economic development strategy relied on ISI. CORFO laid the foundations for the development of Chile's steel industry, its hydroelectric sector, its oil refineries and much of what constitutes the core of the country's industry. It thus played a key role in moving the country forward from an economy largely based on a few key minerals and highly traditional agriculture to one resting on a more diversified basis.

This mode of development, of course, was by no means limited to Chile. Starting in 1948, the United Nations Economic Commission for Latin America and the Caribbean (ECLAC), based in Santiago, gave its full support to ISI as the preferred economic strategy for the region, and most of South America (and Mexico) applied it in one form or another.

Whatever its virtues in helping create a Latin American manufacturing sector that was largely non-existent until the 1930s, most observers would agree with the proposition that, by the 1960s, ISI had run its course. In the Chile of 1973, the average tariff was 105%, with the highest being 220% (largely for consumer durables). As if that was not enough, 'previous deposits' were required for imports and all sorts of quotas were in place, as well as a system of multiple exchange rates.⁵

As *Table 1* indicates, over the next six years, the average tariff was lowered to close to 10%, quotas were eliminated and a single exchange rate was adopted.⁶

Table 1: Effective Rates of Protection, Selected Years, 1974-79

Sector	1974	1976	1978	1979
Food Stuffs	161	48	16	12
Beverages	203	47	19	13
Tobacco	114	29	11	11
Textiles	239	74	28	14
Footwear	264	71	27	14
Timber Products	157	45	16	15
Furniture	95	28	11	11
Paper Products	184	62	22	17
Publishing	140	40	20	12
Leather Products	181	46	21	13
Rubber Products	49	54	26	15
Chemicals	80	45	16	13
Petroleum and Coal	265	17	12	13
Non-Metallic Minerals	128	55	20	14
Basic Metals	127	64	25	17
Metallic Industries	147	77	27	15
Non-Electrical Machinery	96	58	10	13
Electrical Machinery	96	58	19	13
Average	151.4	51.0	19.7	13.6

Source: Velasco A, 'The State and Economic Policy: Chile 1952-92', in Bosworth B, Dornbusch R & R Labán (eds.), *The Chilean Economy: Policy Lessons and Challenges*. Washington DC: The Brookings Institution, 1994.

During this period, Chile's trade policy was based on a unilateral lowering of tariff and non-tariff barriers. By 1981 Chile was one of the most open economies in the world. Far from leading to an export boom, this produced a veritable flood of imports, which increased fourfold from 1975 to 1981. The indiscriminate manner in which the lowering of tariff and non-tariff barriers took place and an exchange policy that led to a severe overvaluation of the peso opened the doors for heavy external indebtedness and severe difficulties for local producers. Chile's trade deficit reached US\$2 billion in 1981 - 50% of the value of all exports that year, which were only 17% of GDP. Exports in fact fell by 16.8% in 1981 and by 7.8% in 1982.⁷

The severe 1982 recession triggered by the international debt crisis, in which Chile's GDP fell by 14%, marked the end of this 'free-for-all' period, and the start of a second phase, in which a much more fine-tuned approach to export promotion was used. Tariffs were initially raised to 25%, and later even to 35%. This 'included protection for traded goods whose export was supported by tariff and exchange rate policies that favoured exporting companies'.⁸ As a result of these more targeted policies, exports reached 30% of GDP by 1986, and Chile's export boom was finally under way. Over the next ten years, exports grew from US\$4.1 billion in 1986 to US\$16 billion in 1995.

There is little doubt that Chile's impressive growth rates have, to a large extent, been export-driven. From 1986 to 1995, exports have grown systematically at a higher rate than GDP. Between 1990 and 1996, exports have grown at an average of 10% a year, and foreign trade has reached 55% of GDP. Whereas copper provided close to 80% of all export revenues in the early seventies, today it has declined to 40%.

Whereas in the mid-seventies Chile exported to 50 countries, in 1997 it does so to 152. In this twenty-year period, the number of exporters has grown from 200 to 6,000, and the number of exported products from 500 to 4000. At the same time, Chile's export markets are highly diversified. In terms of the structure of Chile's foreign trade, Asia represents 24% of overall trade, North America 22%, Latin America 23% and Western Europe 24%, thus moving away from the dependence on one or two markets that is the bane of so many developing countries.

At the same time, its concentration on the export of natural resources, either in raw form or with some degree of processing, has been pointed to as a source of concern.⁹ Of Chile's US\$16 billion in exports in 1995, 40.4% derived from copper, 10.8% from wood pulp, 8.9% from fish and fish meal and 6.4% from fresh fruit. Needless to say, given such a structure of products, a long-term growth rate of 10% in exports is bound to raise questions, not only about its sustainability but also about its environmental impact.

The first point to be made in this regard is that a country's natural resource endowment, both renewable and non-renewable, is an important asset that should be used to enhance its development and the standard of living of its population. Not to deploy such a resource would seem to be an unforgivable sin of omission. Countries like Chile and South Africa, lucky enough to be rich in natural resources while blessed with vast open spaces and low population density, should try to make the most of this favourable equation.

A second point is that, far from limiting itself to the primary tasks of digging up minerals, cutting logs, making fishmeal or growing fruit, Chilean industry is well on the way toward what has been called 'the second phase of export development' - one in which, building on its comparative advantages, it is able to add greater value to its exports,

while making less intensive use of natural resources. In the fishing sector, the enormous growth of salmon exports, which has grown from zero to some US\$500 million in 15 years, is a good example.¹⁰ In agro-industry, wine exports have grown by a factor of 20 in the last ten years, from US\$12 million in 1986, to some US\$240 million in 1996.¹¹ Other areas in which exports are increasing are printing, ceramic and leather goods, electrical and transportation equipment and software products.

A third consideration is that, precisely because of its relatively small internal market (a population of 14 million), and as a result of an open economy, an 'export culture' has come to the fore, in which many goods and services have to be of 'export quality' to be produced in the first place. The net result is much more stringent, if informal, quality controls than in the old days of high-tariff protectionism.

A key element here has been the existence of a uniform tariff of 15% until 1991, and of 11% since then. A straightforward norm for all products avoids the 'jostling for position' among different sectors and the possibility of lobbying for preferential treatment from those with special access to the authorities.

Towards an Open Regionalism

As mentioned above, the international trade policy followed by Chile from 1973 to 1990 - that is, the years of military rule - was one of 'going it alone'. In 1975 Chile formally left the Andean Pact, of which it had been a founding member in 1969. The reason was that Chile was 'integrating itself into the world' through a unilateral opening of its economy and therefore felt that it did not need to be part of any regional integration schemes. The export boom that took place from 1986 to 1990 and the steady diversification of Chilean export markets would seem, on the face of it, to justify this policy choice.

Yet, starting in 1990, with the advent of the Aylwin administration, a significant shift in this approach started to take place. Although Chile did not rejoin the Andean Pact, and was not able to join Mercosur in 1991 (which would have meant, among other things, raising its uniform tariff), it developed a unique path towards greater integration with the rest of the Americas. By signing a variety of free trade agreements (FTAs) with countries such as Mexico, Venezuela and Colombia; by joining Mercosur as an associate member in October 1996; and by signing an FTA with Canada, Chile has left behind the 'going it alone' policy and has once again put the Americas, and especially Latin America, front and centre in its international economic relations.¹²

What are the reasons for this policy shift? Far from being limited to Latin America, regionalism has had an international resurgence in the nineties. As one observer has put it:

The end of the Cold War and the decline of the Soviet Union are ... encouraging the emergence of regionalism by reducing the incentives for superpower intervention, by eliminating the pattern of global Cold War alliances that cut across regions, and by creating more autonomous 'regional spaces' freed from the distorting impact of the East-West confrontation.¹³

But it is in Latin America that this 'new regionalism' has been especially dynamic, reversing the earlier pattern of the sixties and seventies. The 1991 creation of Mercosur, and its considerable success is, of course, the most significant example of this trend, but this sub-regional scheme is only part and parcel of a much broader trend throughout the Americas.¹⁴

In this context, the notion that a small economy can thrive solely on the basis of the right economic policies is somewhat misguided. Bilateral FTAs have the advantage of guaranteeing access to a market, in a world in which obstacles to trade grow increasingly (as in the grey areas of 'anti-dumping' mechanisms, compensatory rights and technical norms with protectionist objectives).¹⁵ Both salmon and wood exporters from Chile are facing 'dumping' complaints from their US competitors, which underlines the perils faced by Southern producers as soon as they achieve a significant share of Northern markets. In consequence, creating conditions that will prevent such obstacles to free trade becomes a key objective.

On the other hand, much as has happened with South Africa in Africa, Chile soon discovered that the fastest growing market for its manufactured products was its own continent. In 1991, for example, 38.3% of its industrial exports went to Latin America, relative to only 18.2% to the United States, 15.2% to the EU and 2.5% to Japan, a not insignificant consideration given the imperatives of the 'second phase of export development' mentioned above. Yet, from 1991 to 1996, Chile was the only country in Latin America that was not part of one regional integration scheme or another.¹⁶ If this situation had continued, Chilean producers would have found themselves quickly shut out of neighbouring markets. As one of Chile's leading economists has put it, 'Unilateral lowering of barriers has a number of benefits, but the opening of foreign markets is not one of them'.¹⁷

Also, to continue lowering tariffs after many years of steady low-tariff policies means that ultimately one reaches a point of diminishing returns. The resource allocation and structural adjustment provoked by the opening has already taken place. The additional benefits to be derived from even further reductions as tariffs approach zero get smaller and smaller.

Transport cost differentials between different markets also have a bearing on the complex choice between unilateral tariff reduction, and bilateral or regional FTAs. These differences imply that certain goods can be only exported to countries that are geographically proximate, whereas others can be sold worldwide. In the former case, a reciprocal elimination of tariffs between countries trading those goods is preferable to a unilateral opening.¹⁸ The relevance of this to South Africa's trade policy goes without saying.

Chile has opted for FTAs as opposed to the more cumbersome customs union agreements because they are considered more flexible and quicker to implement than the latter, and to avoid getting into the intricacies of a common external tariff. In the end, the multiplication of bilateral FTAs, though not as orderly a process as one would like, may do as much as anything else to move Latin American regional integration forward.¹⁹

An additional advantage of the more comprehensive type of FTAs (that is those including commitments in relation to foreign investment, intellectual property rights and other such matters) is that they offer governments an opportunity to enter into long-term commitments that will be difficult to break, thus providing significant guarantees to foreign investors - a subject which leads to the role played by foreign investment in the Chilean economy.

FDI in an Open Economy

One of the great turnarounds in the Chilean economy over the past two decades has been the shift from its traditional foreign-exchange scarcity to what could be described as an overabundance of it - the country's reserves have reached US\$15 billion, one year's worth of imports. Part of the reason for this has to do with the export boom. Another is foreign investment, which has been especially dynamic in the nineties - almost doubling from US\$1.4 billion in 1990 to US\$2.7 billion in 1993 and more than doubling again by 1996, when it reached US\$6.2 billion.²⁰

The bulk of this has occurred in the mining sector, which over the past decade or so has attracted more than half of all foreign investment. Anglo American, through Minorco, has played a key role, with an authorised investment of US\$1.5 billion in what is the single biggest copper mine being developed in the world today, *Santa Inés de Collahuasi* in Northern Chile, and the single largest foreign investment project in Chile ever. As a result, South Africa is the third largest foreign investor in Chile after the United States and Canada.

As of 1996, however, an interesting change has started to take place in the structure of foreign investment, with half of it going into the service sector (US\$2.3 billion out of a

total of US\$4.6 billion in FDI), and US\$813 million into manufacturing (compared with US\$886 million in mining), thus mirroring the changes in the Chilean economy as it modernises and moves away from primary activities such as mining and agriculture, diversifying into secondary and tertiary ones.

With FDI contributing close to eight percent of GDP, this has given a significant boost to the fixed capital investment rate, which in 1996 for the first time reached 28%, in a country that until 1990 had historically not invested more than 20% of GDP. Critically, however, these high rates of foreign investment are being supplemented by high domestic savings (25% of GDP) and an important contribution from the public sector - whose savings in 1996 reached five percent of GDP.

Concomitantly, there has also been a considerable increase in Chilean investment abroad. Although estimates vary, and the first six months of 1997 saw the outflow of an additional US\$3 billion. As of December 1996 the total amount of Chilean investment abroad, almost of all of it materialised during 1990-6, had amounted to some US\$12.18 billion in 726 projects in 38 different countries, thus contributing to projects with a total value of US\$23.34 billion.²¹

This investment is particularly concentrated in South America, especially Argentina, Peru, Colombia, Brazil and Mexico, with Argentina receiving nearly half of it - US\$5.6 billion. Some of the reasons behind this increasingly significant trend, which has Chile investing a larger share of its GDP abroad than the US or Japan, are the relatively small size of the local market, the upsurge in privatisations in Latin America and the knowledge of other national markets arising from previous experience as exporters to them are.²²

This expansion has been largely of a horizontal nature - that is, Chilean businesses invest abroad in the same sectors in which they have been involved at home, thus helping to ensure good managerial performance. The energy sector (electricity and gas) has taken the lead in this regard (and is currently actively involved in bidding for the electricity firms being privatised in Brazil), with some 38.7% of total investment abroad; manufacturing has attracted 26% of Chilean capital abroad, banking 9.5% and commerce 4.1%.

Although there are no restrictions on individuals or non-financial sector firms investing abroad, Chile has not totally liberalised its capital controls. This has led to some criticism from free-marketeers, but has avoided dangers such as the December 1994 crisis of the Mexican peso. Even dollars can be too much of a good thing, and to avoid the extreme volatility of billions of dollars flowing in and out of the country at the flick of a computer switch, there is a one-year-permanency requirement for the principal of any single FDI project, albeit no limitations on the repatriation of profits. For portfolio investments, there is a 30% reserve requirement, as there is on foreign loans and credit lines. This

means 30% of the amount invested has to be deposited in an interest-free account in Chile's central bank for one year; alternatively, the financial cost of this deposit can be paid to the Central Bank. A transfer tax of 1.2%, previously applied only to domestic loans, is also applied to loans in foreign currency for less than one year.²³

The combination of this mandatory reserve period and the transfer tax has imposed no cost on medium- and long-term loans, but has affected short-term ones. The basic objective of these controls is to discourage the influx of speculative capital. As Velasco and Cabezas have pointed out,²⁴ this objective can be disaggregated into three different ones:

- to partially cut the link between internal and external interest rates, giving somewhat greater freedom to monetary policy;
- to reduce the total amount of incoming capital, thus avoiding the dangers of currency overvaluation; and
- to change the composition of incoming capital, creating the incentives for short-term flows to transform into medium- and long-term ones.

An open economy means both low tariffs and relatively open capital accounts. Small economies, however - and this is especially true for those in developing countries - are very vulnerable to short-term capital flows, and the benefits of a measure of control over the latter would seem to outweigh the costs.

This has led to a vigorous debate within the economic profession in Chile, with some arguing that the failure to open up totally the capital accounts and eliminate all exchange controls will stand in the way of Chile becoming a major if not the financial centre of Latin America. Yet the experience of Chile in the 1990s, in which it has continued to attract an ever larger amount of foreign investment without incurring the risks of financial instability caused by short-term speculative in- and outflows, would seem to vindicate this heterodox approach to capital controls.

Conclusion

The commitment to an open economy, a common thread throughout the various economic policies that have been applied in Chile over the past 25 years or so, has undoubtedly been central to the remarkable performance of the country's productive structures over the past decade. Lowering tariffs, freeing prices, deregulating many activities and privatising others have been core components of the course towards leaving behind underdevelopment and setting the country on the path to steady, self-sustaining growth. While Chile has doubled its *per capita* income during the 1986-96 period, it hopes to do

so again by the year 2005, thus reaching the US\$10,000 *per capita* income level that is one of the dividing lines between developing and developed economies in today's world.

An open economy generates a discipline among economic players that cannot but have a potent effect on exports, foreign investment and growth in general. At the same time, while it can be argued that it is in many ways a necessary condition for small economies bent on achieving high growth rates in today's world, it is by no means a sufficient one. It is one thing to open up an economy; it is quite another to get the policy mix right. The two recessions which Chile experienced (1975-76 and 1982-83) while in the process of opening up, are a clear reminder of this.

Chile's export boom, the engine that has driven the country's economic growth, did not really start until 1986. It did not do so ten years earlier because such things do not happen by themselves. They need to be carefully nurtured through the appropriate exchange and tariff policies, as well as suitable export-promotion tools. Whereas in the mid- and late seventies Chilean policy-makers naively believed a deregulated, control-free environment was all that was needed to make the economy thrive, the 14% drop in GDP of 1982 rapidly disabused them of that notion. Having assimilated that lesson, the years 1983-86 witnessed a more carefully calibrated approach to macro-economic management, one that provided much better results.

Interestingly enough, something similar can be said about capital controls. Although Chile has an open economy which provides iron-clad guarantees to foreign investors and has no barriers to the repatriation of profits, the existence of some controls to discourage short-term, speculative capital inflows has been remarkably successful, and has even received the endorsement of the World Bank. This has avoided the twin dangers of excessive currency appreciation - and the ensuing losses to exporters - and of financial instability. Foreign investment in Chile, which has only started to reach significant levels in the nineties, has by no means been discouraged by these controls.

To achieve its development objectives, Chile has once again put Latin America front and centre in terms of its foreign policy priorities. The key principle here is 'open regionalism', an outward-looking, fresh approach to international trade, in which Latin America is not seen as a market to be protected from other trading partners, but, rather, as an extension of the national market, thus providing 'trial-run' opportunities to national producers before they take on the more severe challenges of more distant markets.

A natural extension of the enormous growth of Latin American regionalism in the nineties would be the creation of inter-regional agreements with entities like the Southern African Development Community (SADC), which are facing many comparable challenges. But that would (and should) be the subject of another conference.

Endnotes

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Coping with the Regional Hegemon: Mexico's NAFTA Experience

Cassio Luiselli

Introduction

This chapter is concerned with the role that the North American Free Trade Agreement (NAFTA) is playing in Mexico's new economic outlook. Although it does not provide a direct comparison with South Africa, the Southern Africa Development Community (SADC) or any other regional integration scheme, it will not be difficult for the reader to draw relevant comparative conclusions.

This chapter is written in support of the NAFTA - with all its costs, problems and defects (which can, and should, be corrected). NAFTA is a powerful (and perhaps even unavoidable) vehicle for Mexico's economic modernisation and the best way for it to engage the increasingly competitive and globalized world economy.

A description of the genesis of NAFTA and the complicated process that led to its implementation on the 1 January 1994 is followed by a section on the main features and implications of the accord and a preliminary assessment of the effects terms of trade, interdependence, and the border economy, among others.

A reflection on the paradox of 'deeper' integration that NAFTA faces leads to some suggestions, from the Mexican point of view, about ways to overcome that paradox, stressing particularly the need to reinforce Mexico's links with its natural region, Latin America, and other emerging economies of the so-called 'New South'.

The Genesis of NAFTA

The Long Way from Latin America

Before NAFTA, Mexico had attempted integration with other Latin American countries, without much success.

Until the late 1980s, Mexico resisted any consideration of liberalising trade with the US. Besides the suspicion that had always marred the extremely complex relations between Mexico and the US, the economic nationalism of the import substitution era played a major role. So Mexico attempted integration with its peers in Latin America first, despite its geographical distance from the other major economies of the region and the proximity of the US.

The ideal of a strong united Latin America is as old as the desire for independence from Spain and Portugal. Yet the noble and visionary ideas of *Libertador* Simón Bolívar, whose passion for Latin America is deeply rooted in its collective soul and historical memories, have not been realised. The actual attempts to integrate in the calamitous decades after independence in the early 19th century, were few and futile. During the first hundred years of independence, Latin American countries were concerned mostly with the formation and consolidation of their singular nation-states. And - in the case of Mexico - the aim was to keep the country intact, threatened as it was by the expansionist appetite of the young US as expressed by the Monroe Doctrine.

It was only in the aftermath of the second world war, when the post-war order was shaped and Europe started to integrate after the Treaty of Rome in 1957, that Latin America attempted to integrate in a more formal manner.

In the early 1960s, Mexico belatedly signed the Treaty of Montevideo and became a member of the Latin American Association for Free Trade (ALALC, from the Spanish acronym). After almost two decades of frustrating negotiations and minimal progress, ALALC tried to reinvent itself in the late 1970s and changed some of its provisions to accommodate a wider, more encompassing integration. It became the Latin American Association for Integration (ALADI, from the Spanish acronym), but to no avail. The results were again disappointing. The failure of these attempts can be traced to the real reluctance of the major economic players in the region (Brazil, Mexico and Argentina) to make any meaningful trade concessions. In reality, Latin America was still immersed in the inward-looking import substitution development paradigm of the time. But during those years, experience slowly revealed the obvious: Mexico's trade was increasingly occurring with the rich and enormous market of the neighbouring US, and the South American countries either had more trade among themselves or were attempting to diversify their then modest foreign trade.

The ALALC-ALADI experience nonetheless had some positive results. Trade increased and the Latin American region gained more knowledge about its own capabilities, weaknesses and potential. A vision of a united Latin America emerged. After all, thanks to ALALC-ALADI, entrepreneurs and bureaucrats developed a first-hand knowledge of their fellow countries' situation. A feeling of regional belonging emerged and Latin

America achieved co-ordination and a sense of economic identity. This served the region well during the debt crisis of the early 1980s when, thanks to the Cartagena Accord, Latin America co-ordinated its claims and policies to face the debt crisis in what is now considered a fairly positive and successful manner. All of the countries adjusted their economies and made painful reforms that allowed them to negotiate a way out of the crisis.

But along with the end of the Cold War and the ensuing market-driven 'globalization', came massive deregulation and privatisation. Following Chile's remarkable turnaround and sustained economic success, the whole region turned to the free market credo and began to abide by a strict package of macro-economic measures now known as the 'Washington consensus'.

By the mid-1980s Mexico had already attempted not only macro-economic adjustment but deregulation and economic opening (it joined GATT only in 1986). The pace of reform accelerated very dramatically during President Carlos Salinas' administration (1988-94). By the early 1990s Mexico had one of the most open economies in the world, and its privatisation programme was among the most advanced in Latin America. In this environment, a group of young, US-educated technocrats under Salinas' leadership proposed a new economic deal aimed at increasing trade and investment with the US. In a few months the bold idea of a trade pact took shape. For Mexico, this was a major step away from the Latin American-centred and protective vision. The time was ripe for a more realistic and immediate set of policies, targeting - for the very first time - Mexico's immediate neighbour to the north: the US. Thus the idea of a North American Free Trade Association or 'NAFTA' began to take definite form. It was originally a Mexico-US accord, but Canada (which already had free trade with the US) joined soon after.

The winds of change swept through South America too. At more or less the same time that the idea of NAFTA began to materialise, Brazil, Argentina, Uruguay (the inspiration and base of ALALC-ALADI) and Paraguay advanced the idea of a real common market with all the benefits and the costs it entailed. This idea materialised very rapidly and Mercosur was born after the Treaty of Asunción in Paraguay in 1991. Since then Mercosur has proven to be a tremendous success. It is rapidly advancing to a more mature stage of deep integration, and other countries of South America are approaching Mercosur, especially Chile and Bolivia who now have associate status.

Will all of this necessitate a realistic but otherwise regrettable 'long good-bye' between Mexico and its brother countries to the south? This issue will be addressed in full in another section of this chapter, but it is important to say at the outset that this is not the case - not for Mexico, nor for South America. Besides the all important political and cultural links that tie all of Latin America together, the new economic realities reveal that reciprocal trade between Mexico and the Mercosur countries is actually growing

fast. Brazil is Mexico's sixth-largest trading partner with total trade (exports plus imports) estimated to exceed US\$2 billion for 1997. Total trade with Argentina is at its highest ever and will be around US\$870 million for 1997. And of course Mexico enjoys full free trade with the two South American associates of Mercosur: Chile (bilateral trade is soaring at US\$1.1 billion for 1997) and Bolivia. Moreover, the old ALADI pact is alive and well, albeit transformed into a strategic linkage and forum to foster wider pan-Latin American integration among the different sub-regional trade blocs. The countries that belong to the un-renounceable family of Ibero-American nations are living in a healthy and realistic transitional period of sub-regional economic integration and consolidation.

The Long Way to North America

The tumultuous and complex joint history of Mexico and the US has seen sustained improvement of the relationship since at least the 1950s. There is no question that many unresolved issues and major discrepancies remain. But since shortly after the second world war increasing interaction, dialogue and good will have prevailed in the many divisive issues which, objectively, the two nations face.

There are not only forces that divide two such diverse countries and cultures, but also many factors which bring them closer together. The unavoidable relationship expresses itself on *La Frontera* (the Border) where the economic dominance of the Americans encounters the influence and resilience of the Mexican culture. The Chicano nation in the making is perhaps the synthesis of this unique relationship between Mexico and the United States.

Mexico City, secluded in a mountainous valley far away from *La Frontera*, with the harsh memories of the interminable conflicts with the *Yanquis* for most of the second half of the 19th century and at least the first 40 years of the present one, traditionally adopted a defensive and suspicious attitude towards Washington. Yet the steady progress towards a mature, positive relationship that was initiated around 1950 has been enormously accelerated by the demise of the Cold War and the major economic realignment of the past 15 years or so. In fact, economic *rapprochement* started with the De La Madrid administration when debt restructuring and a very broad 'Framework Agreement' to consult and to liberalise in trade matters were agreed.

At the beginning of President Carlos Salinas' administration, the focus of policy was to renegotiate the external debt successfully and to continue with sweeping liberalisation and deregulation measures. Some voices in his government advocated the convenience of securing access to the American market by some sort of free trade agreement in the fashion of the US-Canada or even the US-Israel trade agreements. But these early

advocates were defeated because it was considered too risky, and potentially unpopular. Besides, although both presidents Reagan and Bush had expressed interest in a free trade agreement - 'Free trade from the Yukon to the Yucatan' in Ronald Reagan's phraseology - there was no formal signal of intent from the US Government.

President Salinas changed his earlier view and, by the spring of 1990, declared that he was 'ready' to propose free trade to the US. The reason he advanced was that Mexico was in critical need of foreign investment (and the embodied technology that accompanies it) and secured market access. Besides, Salinas declared that both the European and the Japanese were very much concerned with their own regions and thus hesitant to take major initiatives in a region that was considered to be of vital interest to the United States. It was the era of a pre-occupation with 'trade blocs'. Mexico perceived that it was at risk of becoming isolated and marginalised from these big blocs. For this reason, President Salinas was the one who first proposed to President George Bush that the two governments negotiate a free trade area. Mexico thus became the country which took the bold initiative. The reaction of President Bush was positive but cautious because of the prevailing protectionist mood in the American Congress. On 10 June 1990, the two Presidents issued a joint statement endorsing the idea, and expressing their willingness to advance free trade between Mexico and the US. The two administrations began to prepare for talks and negotiations. By September, Salinas had dispatched a formal request for negotiations and Bush had informed Congress of his intention to negotiate a free trade agreement with Mexico.

Canada joined the process in February 1991. Presidents Salinas and Bush and Prime Minister Brian Mulroney announced the initiation of formal trilateral negotiations to create a North American Free Trade Agreement. In March, Bush requested a two-year extension of 'fast-track' authority to negotiate without congressional interference and was granted this authority, not without difficulties caused by powerful Democratic, pro-labour congressmen. Formal negotiations started on 12 June 1991.

By August 1992 the three parties had finished the negotiations and announced that they had reached an agreement on NAFTA. On December 17 Salinas, Bush and Mulroney each signed NAFTA in their respective capitals. By then Bill Clinton was President-Elect, and he met with Salinas on 8 January in Austin, Texas, where they confirmed their intention to proceed with the ratification and implementation of NAFTA. The ratification process was relatively simple in Mexico since the ruling party, the PRI, enjoyed an ample majority in both houses of Congress. In Canada there was also little opposition. But in the then-new Congress in the US, the situation was more difficult. Nevertheless ratification was eventually approved by a slim margin in both houses. In order to encourage approval, NAFTA was born with two appendages or 'parallel' or 'side agreements', one dealing with environmental standards and the other with labour

norms and related issues. The environmental pact, known as the 'North American Agreement on Environmental Co-operation', as well as the bilateral Environmental Commission for the Border and a binational (US-Mexico) bank, the North American Development Bank (NADBank), were concerned mostly with environmental projects in the border area.

It is worth noting that besides NAFTA, Mexico has negotiated free trade agreements with several Latin American countries: Chile (1992), Colombia and Venezuela (which form the 'G-3' with Mexico), Bolivia and Costa Rica. Exports to Chile, for example, have increased from US\$124 million in 1991 to US\$668 million in 1996. Similar statistics apply to trade with Mexico's G-3 partners and other Latin American countries.

The Conceptual Underpinnings and the Negotiations

Although the theoretical apparatus in support of a free trade area is robust, doubts in this regard were raised on the grounds of the substantial economic disparities between Mexico, the United States and Canada. In fact, NAFTA was the first major integration exercise involving both the largest economy on earth and a developing economy. Although this fact *did not* contradict the theoretical rationale for NAFTA (quite the opposite), concerns were raised about Mexico's ability to compete in the early stages of the agreement, and about the effects on labour and other related transitional costs. In the US, fears were also expressed about labour standards and wages. But indeed, this experience is not far removed from the differences between integrating Germany and Greece, for instance. According to the World Bank's *World Development Report 1996*, the German economy is 26 times larger than the Greek, whereas the American economy is more or less 22 times the size of the Mexican. In *per capita* income the difference is more favourable: Greece has one-fourth of the *per capita* income of Germany versus one-sixth in the case of Mexico. (By the way, South Africa's advantages in this respect over its SADC partners are even more striking).

In any case, at a conceptual level there was no major debate among professional economists, since NAFTA's principles are rooted in one of the most enduring laws of economics, the venerable principle of 'comparative advantage', which argues that each trading partner should benefit through specialising in what it does best, *comparatively*. Besides, the theory of custom unions, developed in the 1920s by Jacob Viner, argues that if a free trade area is creating more trade than it is displacing, it will maximise the Ricardian benefits of free trade. (Actually this argument is a bit more complex: Viner distinguished two sets of effects of a custom union - 'trade creation' between the trading partners, and 'trade diversion', where former trade partners are displaced by the beneficiaries of lower tariffs.) Furthermore, the theoretical arsenal mustered in favour

of NAFTA also considered the well-established 'factor price equalisation' theorem, which states that in the case of mobile factors (as in free trade conditions) their prices tend to be equalised over time due to equalising productivity. This is the argument against the 'pauperist' claims of politicians like Ross Perot and some members of labour organisations and Congress in the US.

In any event, there was not much serious theoretical dispute about the convenience of NAFTA for the three partners. Moreover, the GATT gave NAFTA its blessing, since it was agreed that the trade pact was consistent with the sacrosanct 'Rule number XXIV' that prohibits any raising of trade barriers (from the original level) to third countries.

The discussions were - and still are - mostly centred on transition costs, on potential trade diversion and possible discrimination against other trading nations.

NAFTA produced a deluge of papers and econometric 'Computable General Equilibrium' (CGE) models which assessed the *a priori* impact of the agreement. The results were quite similar and obvious: NAFTA would increase trade and have a positive net impact on employment and economic growth in the three countries. NAFTA would have a much greater effects on the smaller and poorer economy of Mexico, and relatively less on Canada and on the US. However, NAFTA's sectoral impact would vary in important ways, and the three countries would have to adjust and face some job losses in certain sectors. It was the sectoral surveys that provided ammunition to NAFTA's foes in the three capitals. Not only was employment at risk in some sectors, but the inter-sectoral losers were invariably considered as threats to national sovereignty. It was an parade of confusing positions, focusing on the trees and avoiding any view of the forest. Not surprisingly, NAFTA debates produced a wide variety of odd bed-fellows: the fiercely anti-*Yanqui* Mexican left, in alliance with Ross Perot against the treaty, and Canadian environmentalists in a cosy relationship with ultra-conservative Mexican business leaders. But after the dust had settled and NAFTA was ratified, two things remain clear: the conceptual background is actually a sturdy one (leaving aside the demagoguery and ultra-ideological arguments from both left and right), and the legitimate concerns about NAFTA were mostly in the realm of equity, transitional costs and the environment, but not that of labour - at least not in the aggregate.

This explains why the three highly sophisticated teams of technocrats who negotiated the treaty did not have any serious basic disagreement. The negotiations were tough, lengthy and contentious, mostly because each country wanted to maximise advantages and minimise risks or scrutiny. There were plenty of procedural discussions. But in the end, the government teams produced a coherent if lengthy document. Soon they realised that the real problem would come with the ratification process, mostly in the US, especially because by that time the 1992 election campaign was in full swing and the

American economy was not performing very well. This perhaps explained the odd candidacy of a NAFTA superfoe, Ross Perot.

Espousing free and increased trade as the basic achievement, each government considered that it had cut a good deal in signing NAFTA. Mexico was pleased because NAFTA assured free access to the largest market in the world (free from the vagaries and capriciousness of superpower behaviour). Moreover, the 'asymmetrical' level of development between the three was explicitly acknowledged, since Mexico was allowed a much longer period for opening the internal market (only around 40% of the tariff was immediately liberalised, with other chunks in five and ten years, while in agriculture it was as long as 15 years). In contrast, the US and Canada had to liberalise immediately over 70% of their respective tariffs.

Mexico's sensitive nationalised oil sector was spared the consequences of free trade and direct foreign investment (much to the dismay of the Americans and Canadians). However, Mexico considered that, by including investment and intellectual property protection clauses, it had a handsome built-in incentive for attracting foreign investment.

The Americans had ensured that the treaty would provide a powerful incentive for Mexico's reforms; they would rejuvenate competitiveness in some sectors through much cheaper labour, and would enlarge and deepen the rather shallow 1988 free trade accord (NAFTA now included services and investment).

The Canadians were happy because they would enlarge free trade with Mexico, which might be the poorer country, but has a population more than twice the size of Canada's and is blessed with a large store of mineral and metallic reserves. Besides, Canada did not yield to American pressure for further liberalisation of their grain sectors, and kept their 'cultural' reserves in entertainment and telecommunications.

To address the serious (and not so serious) concerns expressed about the environment and labour standards, and to appease the protectionist wing of the US Congress (let us not forget that this protectionist tendency dates back to the 1920s with devastating recessionary results), the three governments agreed to sign two 'parallel' agreements on labour and environmental issues. This caused great chagrin in Mexico, because it was obvious that these were intended as 'remedial' measures to compensate for Mexico's shortcomings. But beyond being a little embarrassing, the environmental provisions of the *ad hoc* parallel agreement were mostly appropriate and in the end very useful. The provisions were: to raise environmental standards, to improve accountability and enforceability, to clean the border and to monitor pollution in other industries. Mexico experienced a leap-frog advance in environmental standards and acquired a great deal of expertise in discerning when environmental issues were being used as a pretext or

trade barrier, and when the issues were valid. This was to serve Mexico well in its growing interaction with the rest of the world.

Labour matters are different. It is very important to defeat the 'pauperistic' argument that trading with a poorer country is a recipe for lowering wages in the US. The American NAFTA negotiator, Carla Hills, argued that if wages were the only determinant for trade advantage, many developing countries would already be economic superpowers. Workers in richer countries are paid more, usually because they are more productive. As the theory suggests, Mexican salaries will tend to increase, and eventually be comparable with those of their richer northern neighbours, basically through productivity increases. Another equally dangerous argument against the labour implications of NAFTA had to be qualified - the infamous 'sucking sound of jobs being siphoned off into Mexico' comment of Ross Perot. Yes, there is likely to be some job displacement *within* NAFTA in pursuit of increasing productivity. But the overall picture indicates net job creation and not the other way around. But some concerns about minimum job standards, retraining workers displaced by NAFTA, and so on remain relevant.

Finally, NAFTA came into effect on 1 January 1994. This was an '*annus horribilis*' for Mexico, but for reasons unrelated (at least, not directly) to NAFTA. There was the Indian-peasant rebellion in the impoverished southern state of Chiapas and the assassination of the PRI party candidate for President, Luis Donaldo Colosio. Both caused a very sharp capital flight (US\$10 billion). By the end of the year, the new administration of President Ernesto Zedillo took office and in a matter of days it had to face the maturity of very substantial short-term dollar denominated bonds (the infamous *Tesobonos*). A financial panic ensued after a badly handled currency devaluation, and what was meant to be a healthy correction became a massive recession as many investors withdrew their Mexican portfolios. The 'sucking sound' was not the sound of jobs being transferred from the US to Mexico ... but of dollars hastily leaving the country.

The new government was forced to adopt a spartan fiscal plan to adjust the economy on a massive scale. The American government had to act as lender of last resort (Congress again was reluctant) and finally the bleeding ended.

The economy recovered from this shock rapidly, mostly due to a very substantial NAFTA-driven export boom. After almost three years, the recovery is in full swing (after a minus seven percent plunge in 1995, growth was 5.7% in 1996 and prospects for 1997 are around 5.2%), although it will be some time before wages and employment can recover to pre-1995 levels.

These factors make it more difficult to assess the *real* impact of NAFTA, that is, what can really be attributable to the agreement. Whatever the case, the bold and imaginative financial

support that the Clinton administration gave to Mexico seems in large part to have been related to the convenience of keeping the Mexican economic reforms and NAFTA afloat.

An Assessment of NAFTA: Structure and Performance

Structure

Fortunately, NAFTA has not created major institutions and bureaucracy. It has very simple secretariats within the trade ministries in the three capitals. Its only institution is the NADBank, still a very modest financial facility, located in San Antonio, Texas. The NADBank is devoted mostly to environmental cleaning projects and is expected also to fund some re-training projects for workers displaced by NAFTA's trade dynamics. But it is safe to say that NAFTA is basically a set of well-defined, binding rules. It is important, then, to analyse briefly some of NAFTA's basic building blocks and provisions.

As is well known, NAFTA's basic aim at this point is to reduce trade barriers in order to stimulate trade and investment between Canada, the US and Mexico, and it is not expected - at least not in the foreseeable future - to attempt deeper integration, as in the EU. Thus, NAFTA is not expected to evolve into a customs union (in other words, with common external tariffs) or a monetary union. It has made provision for reduced tariffs at different speeds and in different sectors. This is because it explicitly recognises the different levels of economic development between the US, Canada and Mexico.

Besides, NAFTA had to take into account differences in legal systems and the constitutional ban in the case of Mexico on the inclusion of oil and immediately related activities. The agreement will be phased in over a 15-year period in order to give time to some 'sensitive' sectors as well as in agriculture to adjust. As is well known, NAFTA broke new ground. For the first time, it created free trade in services (including of course, telecommunications and insurance services). It also incorporated standards on pollution and - this was very important to Mexico - eliminated quotas on textiles and apparel.

Tariffs

NAFTA makes provision for the gradual elimination of all tariffs in all major economic sectors. The initial average US tariff on Mexican goods was 3.9%; the initial average Mexican tariff was ten percent. A similar provision existed in relation to Canada. More than 60% of US and Canadian tariffs were eliminated on 1 January 1994, when NAFTA came into effect. Mexican tariffs will be reduced more slowly, reflecting the 'asymmetrical' situation with regard to the level of development and the regulatory

environment. But it is expected that by 2009 all tariffs in the three countries will be zero. Of course, some safeguard clauses are contemplated. Within this basic frame, specific rules apply to agriculture, automobiles, textiles and energy (no free trade as regards Mexico's oil). One interesting feature is that, no matter what a safeguard might imply, it has to be consistent with the principle that no country can impose more stringent regulations on its neighbours' products than it does on its own.

Rules of Origin

Rules of origin were - and still are - one of the most controversial features of the treaty. NAFTA has established strict and complicated formulas to establish 'North American' rules of origin, which means that duties need to be paid on goods that derive a substantial portion of their value from labour, components or materials that originate outside North America. This goes far beyond the original US-Canada free trade agreement. It is said that the rationale was inspired by the big car manufacturers, who wanted to make it impossible for Mexico to be used by foreign automakers (especially the Japanese) to penetrate the US market. Whatever the case, the rules of origin provision has resulted in a very important stimulus to invest in Mexico, since that is a way to 'North-Americanise' certain industrial products. Strict rules apply to automobiles: 62.5% of the automobiles or their components have to be made in North American countries. Consequently, since NAFTA's inception Mexico has experienced a big boom in auto exports. New investment in the sector has also been very encouraging: BMW, Mercedes Benz and Honda have entered the manufacturing sector in Mexico.

Agriculture

Progress in this sensitive area has been remarkable. Mexico was able to negotiate a more gradual reduction than its trade partners in most agricultural tariffs (especially for maize and beans, the national staples), to give more time to the farming sector to adjust. In principle, it was agreed that all quotas were to be eliminated in favour of transitory tariffs ('tariffication'). Although Mexico was granted longer periods for products such as sugar, peanuts, and orange juice, it is the US which will require a longer period still. A very contentious issue was that of the 'non-tariff barriers', which are pervasive in US agriculture. A great deal has been accomplished in this regard through NAFTA (for example Mexico won access for its avocados after 92 years of an American ban), but there is still a long way to go. In spite of having won NAFTA's and the WTO's arbitration, the US Congress has upheld its ban of Mexican tuna on 'environmental' grounds. It is worth mentioning that, mostly for US-Canada grain disputes, NAFTA in agriculture is not a trilateral agreement but a set of three bilateral deals.

Services

The inclusion of services in a free trade agreement was in itself a bold step ahead. Now, with some exceptions, services are tradable. The partners agreed to grant each other 'national treatment', that is, any North American service provider must be treated equally and have reciprocal recognition of licenses and certifications. In the area of transportation, NAFTA provides for a gradual phase-out of constraints on cross-border movements by car, truck, train or ship. Mexico opens up most of its government purchases to fair bidding, but each of the three governments reserves certain areas for its own companies. It is ironic that the most restrictive element remaining does not involve Mexico: it is Canada's 'cultural exemption', which limits the share of US entertainment industry in Canadian television and film making.

In the very important area of financial services and insurance, Mexico will gradually eliminate most restrictions on market reserve and percentage of foreign ownership by the year 2000. Already there is American and Canadian investment in banks, securities firms and insurance companies. Mexico's largest bank, BANAMEX, has acquired banks in California and Texas. In telecommunications, Telmex, the huge, recently privatised telephone company of Mexico, has attracted US and French minority investment and, in its turn, is competing in the US market in the lucrative niche of long distance communication.

Energy

US and Canadian negotiators tried hard to get Mexico to open up its most sensitive area, oil and gas production. But Mexico stood firm on the constitutional principle which restricts ownership of that sector to the Mexican nation, through the parastatal PEMEX. But Mexico opened its electricity, petrochemical, gas and energy services sub-sectors, as well as its energy equipment markets.

Investment

For Mexico, one of the most appealing features of a trade deal with its northern neighbours was that of inviting investment, especially investment in capital goods technology and equipment, as well as in the service sector.

The three countries agreed to grant each other reciprocal 'North American' (equal to national) treatment for foreign investment. Although Canada and Mexico retained some limited capacity to screen foreign investment, this is only if the proposed initiative exceeds

US\$25 million. This threshold is due to rise gradually to US\$150 million by the year 2004.

Intellectual Property Rights

The three partner countries created a harmonised and durable regime to protect intellectual property rights for copyrights and patents. It also defined a common approach to prevent anti-competitive and monopolistic business practices. Since 1992 Mexico has established a fairly sophisticated Competitiveness Commission with large anti-monopoly powers.

Dispute Settlement Procedures

One of the main considerations that encouraged Mexico to pursue free trade with the US was that Mexico wished to avoid being locked out of the American market by the arbitrary application of unfair trade laws and other unilateral measures. Of particular concern were anti-dumping penalties and countervailing duties. NAFTA permits each country to retain its own laws on these matters, but also allows each to seek reviews of the other's ruling on trade through binational panels that can make binding judgments. A country has the option of trying to reverse these decisions by requesting review by a three-person challenge and arbitration committee.

In addition, NAFTA has established a North American Trade Commission, composed of cabinet-level officers, to assess complaints from each country in regard to trade violations of NAFTA. A small secretariat based in Ottawa, Washington and Mexico City respectively, each provide the staff work. If normal consultation fails to resolve a dispute within 45 days, then a country can convene a meeting of the Trade Commission. If that fails, the country can ask for the convening of an Arbitral Panel of Experts, either under WTO or NAFTA, which will issue a report with recommendations within three months. The country raising the complaint can then suspend the application of equivalent benefits (for example, not raising tariffs) until the issue is resolved. If the other country considers the retaliation excessive, it can seek another panel's recommendation.

Performance

Trade Performance

In spite of the deep recession of 1995, the Mexican export sector has responded in spectacular fashion to the launch of NAFTA. As a matter of fact, it was the ongoing

export boom which led the rapid Mexican recovery. Mexico is now the largest Latin American exporter, and ranks 11th in the world.

During the last three years, the growth of exports has averaged 23% a year, easily surpassing that of dynamic Asian tigers such as South Korea, Hong Kong, Taiwan and Singapore. The influence of NAFTA on performance is quite obvious.

Since 1993, Mexico's export sector has played a growing role in the country's economy as the modernisation efforts of the last ten years begin to show results. Total exports will top the US\$100 billion mark in 1997 (and total trade will be around US\$194 billion, more than 55% of GNP).

Since the inception of NAFTA, US-Mexico bilateral trade has grown 65% to more than US\$140 billion. Mexico is the most dynamic US trading partner. Exports to the US average US\$83 billion, while imports to the US from the rest of the world increased by just 33%. These figures make Mexico the third largest trade partner of the US, just behind Canada and Japan, well ahead of Germany or the United Kingdom. Indeed Mexico's penetration into the American market can be better appreciated through looking at the share of total US imports, which jumped from 6.8% in 1993 to 9.3% in 1996. Mexico's exports to the US were, for instance, larger than those of South Korea, Hong Kong and Taiwan combined.

During NAFTA's three initial years, Mexico was the main supplier of 673 items of the harmonised American tariff, but it now accounts for 1,124 items. In the last few years, Mexico has emerged as the source of choice for many goods, including 270 of 1,116 textile and apparel products, 101 of 1,346 chemical products and 49 of 347 electronic products. For instance, in the steel sector, Mexico jumped from eighth to fourth place, displacing Taiwan, Brazil and South Korea. It is now the second largest supplier of textiles and third largest supplier of automobiles, ahead of Germany. Mexico has also become a very large importer of American goods. In 1996 imports from the US were US\$67 billion, again, only exceeded by America's exports to Canada and Japan. This was more than the total amount the US sold to the United Kingdom and France combined, and more than double what it sold to Germany in 1996.

The number of exporting firms in Mexico is increasing very rapidly. Since 1993 the number of registered exporting firms has increased from 21,447 to 31,860, an increase of 48.3%. It is also geographically well diversified.

The composition of US exports to Mexico is remarkably similar to the composition of Mexican exports to the US, suggesting a strong sectoral integration. A comparative analysis of exports by sector not only shows that the two countries share a considerable

volume of two-way trade in these categories, but that the trade balance in these sectors remains quite even under NAFTA. Neither Mexico nor the United States has a significant trade advantage over the other in a given sector. Rather, the two countries tend to produce together within the same sectors, giving NAFTA nations a competitive advantage over other countries. As the US-Mexico trading relationship continues to grow under NAFTA, both economies are benefiting.

Mexico also imported more goods from the United States in 1996 than did the rest of Latin America, and accounted for nine percent of all US exports worldwide. These trade flows are a clear indication of Mexico's importance for US exporters.

Strong growth in US exports to Mexico under NAFTA has been geographically broad-based, but the South is leading. Forty-four of the 50 US states experienced growth in export sales to Mexico in 1996. Significant growth in exports extended beyond US border states such as Texas and California to include states as far away as the industrial Northeast, the Midwest, the South and the agricultural heartland.

Trade continues to strengthen in several key sectors. Since the implementation of NAFTA, Mexico has become the largest market world wide for 1,154 US products of 8,602 export products classified under the Harmonised Tariff Schedule. For example, Mexico now accounts for ten percent of worldwide US exports of agricultural crops, 23% of US apparel and other textile products, 21% of rubber and plastic products, 17% of fabricated metal products and 13% of electronic and electric equipment.

Although much more modest, Mexico's trade with Canada has also grown rapidly and become significant for the two countries since NAFTA started. By 1996 it had reached US\$4 billion, almost 40% above the 1993 figure. Mexico is the largest Latin American trade partner of Canada, and Canada is now Mexico's second biggest trade partner in the hemisphere. The main Mexican exports to Canada are autos and auto parts, computers, engines and TV sets.

Investment Performance

Regarding the attraction of foreign direct investment (FDI) into Mexico, performance has been quite remarkable (in spite of the 1994-95 financial crisis). From 1994 to 1996, Mexico has received an estimated US\$29 billion in long-term investment in plants and equipment (this is in addition to portfolio short-term capital). These record investment flows rank second only to China among the emerging economies in the world. As expected, most of this FDI comes from the US (56%) and Canada (six percent). But

other important traditional investors remain, such as Germany, Japan, the United Kingdom and the Netherlands. An important trend is an increase in investments from other countries of the emerging 'New' South, such as India and South Korea, as well as Brazil, Chile and Malaysia.

FDI is concentrated in the following strategic sectors: manufacturing (57%), banking and financial Services (13%), commerce (12%), and transport and telecommunications (eight percent). This foreign investment complements growing domestic investment in Mexico in an important manner, not only because of its significant amount but because it often embodies modernisation and state-of-the-art technology. Since it incorporated full respect for intellectual property and opened key economic sectors (minus direct oil exploitation) to foreign investors, NAFTA made an important contribution to investment growth. As a matter of fact, NAFTA-type disciplines are now being used as a model for the multilateral investment agreement (MIA) being negotiated by the Organisation of Economic Co-operation and Development (OECD).

As investment opportunities continue to rise and infrastructure is improved, other important manufacturing sectors will also benefit by receiving increasing levels of private investment. The magnitude of investment is fundamental to growing and modernising Mexico's industrial base and makes GDP growth sustainable.

NAFTA: A Success

Some basic questions can be asked in order to assess some of the impacts of NAFTA. Has NAFTA been a success so far? It is really killing American jobs? Where is NAFTA going?

First of all, taking the figures mentioned into consideration, it is quite obvious that NAFTA is succeeding. It has created plenty of trade and, from Mexico's point of view, it has induced a record amount of fresh foreign investment in spite of the economic crisis of 1995. Indeed, trade among the three NAFTA countries has been expanding to record levels, and the number of business partnerships is on the rise. The Mexico-US border in particular is experiencing an Asian-style economic boom.

Some critics of NAFTA argue that it caused the peso crisis (1994-95) due to inflated expectations and the abrupt opening of the economy. To the contrary, NAFTA is surely contributing to Mexico's rapid recovery. The Mexican financial crisis was the result of a combination of rising US interest rates, financial panic, political shocks and some erroneous policies. But exports were very robust throughout, and they were the engine of Mexico's recovery. Vigorous long-term investment inflows are also a contributing

and brightening factor for future growth prospects.

Nevertheless, many Americans, both within Congress and without, are again sharply criticising Mexico for US job losses. (Canadians are not making an issue of this.) But so far, the impact of NAFTA on *gross* job displacement has been negligible. It is worth noting that since NAFTA's inception, a booming US economy has created 2.25 million jobs. But the anti-NAFTA sentiment goes beyond facts. It reflects deep seated frustration in the US with rising income disparities and the declining real earnings of the less skilled workers. This has to be dealt with by means of retraining programmes and other measures not based in NAFTA.

Structural Changes Induced by NAFTA

NAFTA is inducing big structural changes, mostly but not only in Mexico. These are: the emergence of the border or *La Frontera* economy, which has grown well beyond the old *maquiladora* scheme; and increasing interdependence in certain regions (such as Texas), markets (like the labour market) and industries (like automobiles, glass, cement-construction, apparel and textiles, among others), which are energised through an enlarged demand and increased competitiveness. Of these, the most important is the emergence of a renewed border economy, or as it is called on both sides, *La Frontera*.

Only a decade ago the US-Mexico border, with few exceptions, was mostly a barren land dominated by the sharp socio-economic divide of two different countries and enormous economic differences. By then the most important economic programme prioritised the '*maquiladora*' plants, which consisted almost entirely of labour-intensive assembly plants benefiting from Mexico's much cheaper labour. There were around 200 plants, mostly on the Chihuahua-Texas border, plus a few in Tijuana and the state of Tamaulipas. All of the *maquiladoras* were plants of US origin, mostly in the textile or household appliances sectors, with a 'twin plant' established on the American side of the border.

But now *La Frontera* is changing very dramatically and very rapidly. A new economy is emerging. It has become a land of very distinctive features, promises, problems and even a unique culture. *La Frontera* stretches from Tijuana-San Diego on the Pacific west coast to Matamoros-Brownsville on the Gulf of Mexico. It is 3,380 kilometres long and its main cities are located within 210 miles from the border line in each direction. *La Frontera* has 11 million inhabitants (five million in Mexico, six million in the US), who make 250 million border crossings every year. This strip is North America's fastest growing region, with an expansion of 7.5% during 1996. It now has an output of over US\$150 billion, an economy larger than that of South Africa or Poland.

The most dynamic engine of growth of this area remains the *maquiladoras*. But they constitute a whole new generation, since most of the new *maquiladoras* are taking advantage of the many NAFTA incentives (rules of origin, size of the market, and so on) rather than the sole element of cheaper labour on the Mexican side.

The number of *maquiladoras* has changed dramatically: now there are more than 1,550 plants and hardly a week passes without a new plant opening. Most of these are concentrated in the urban sprawls of Tijuana, Juarez and Matamoros. Besides the American investors there are many new entrants, especially from Japan, Korea, Canada, Germany and several other countries that are using *La Frontera* as a point of entry to the NAFTA market. Although it is true that cheaper labour still constitutes one of the main incentives, it is not the paramount consideration: as has been said, the NAFTA incentive is the most potent reason. Besides, a disciplined working force, attractive energy prices and an improved infrastructure are located there. Backward linkages (or integration) used to be minor in the past: no more than three or five percent of local Mexican components besides labour. This also is rapidly changing, and in many *maquiladoras* the local component (still in compliance with the North American Rules of Origin) is as high as 20% or 25%. For this reason *La Frontera* can be considered a new phenomenon along the Mexico-US border, providing a competitive edge to many American companies. Mexico's imports from *maquiladoras* located at *La Frontera* were around US\$30 billion (there are some *maquiladoras* in other states too).

The Tijuana-San Diego area is perhaps the most dynamic and complex. A very large Asian presence in that Pacific Ocean City is transforming it into a node between NAFTA and the Asia Pacific Economic Co-operation (APEC) area. Only a generation ago, Tijuana was an uninteresting border town of ill repute; now it is a vibrant city of 1.5 million people, growing in the nineties at more than five percent a year. Asian companies, from Korean *Chaebols* to Japanese *Giagants*, are pouring hundreds of millions of dollars into electronic plants in Tijuana and in Mexicali. Spurring the influx are NAFTA's local content rules. To meet those requirements, TV manufacturers are putting up state-of-the-art plants. Precisely because of NAFTA rules, this has a multiplier effect on the local economy: each plant needs local services, supplies and parts. Now Tijuana is the world's number one producer of TV sets, making over 14 million each year. Among them are Matsushita, Sony, Sanyo, Gold Star, Samsung, Daewoo and Hitachi.

Another important example is the Ciudad Juarez-El Paso area at the Chihuahua-Texas border. The urban sprawl there has over two million people. Juarez has more *maquiladoras* than any other city. That is the auto-centred region, since it serves the big auto plants further south in Chihuahua (Mexico is the 11th largest producer of cars in the world with over 1.2 million produced in 1996). General Motors decided to open a 'Delphi Automotive Design Research Centre' in Juarez to serve its operations in Mexico

and the southern US. The centre employs a staff of 750 (mostly Mexican) engineering and computer personnel to design a wide variety of auto components. It runs 24 hours a day, with engineers always on duty to serve executives around the world. Now Delphi is building a US\$22 million research and development extension for the region. Thus an important 'cluster' of auto-centred and other manufacturing activities is emerging in the state of Chihuahua. This has been the focus of extensive research and analysis (a South African delegation visited Chihuahua very recently to analyse it). Other areas are also growing very fast, such as the much poorer and environmentally problematic area of Reynosa-MacAllen on the Gulf of Mexico Tamaulipas-Texas border.

Of course, *La Frontera's* vigour is also accompanied by negative traits such as illegal immigration, drug trafficking and environmental degradation, but this economic powerhouse is changing the very dynamics of Mexico-US interaction. It is important to note that the *maquiladora* programme will be gradually phased out and absorbed into NAFTA, because the original tax 'duty drawbacks' will be eliminated by 2001 and the plants will then be allowed to enter the Mexican market without any restriction. For this reason, it is very encouraging to see that *La Frontera* is rapidly becoming a manufacturing centre rather than the collection of assembly plants and sweat shops that it was just a decade ago.

Conclusion: NAFTA and the Future of the Mexican Economy

With NAFTA, the process of Mexico's integration into a wider North American economy has accelerated. NAFTA is the largest economy in the world, mostly because the enormous size and wealth of the US. But Canada too has a large and very advanced economy of its own. The case of Mexico is different. Although its economy ranks 13th in the world (11th if using the 'Purchasing Parities' method of measurement) it is much smaller and poorer than those to the north. But Mexico contributes a very large market of almost 100 million people, a large, disciplined and well trained labour force and plenty of natural resources. It is precisely this combination that makes NAFTA dynamic and interesting.

Mexico (and NAFTA itself) suffers from a paradox: no matter how large and successful NAFTA may become, it will not advance from 'shallow' (that is, a mere free trade area) into fuller, 'deep' integration (a full customs, fiscal and monetary union, as well as policy harmonisation and common institutions). This deepening is evident in the European Union and could occur within Mercosur, perhaps even in SADC - but not in NAFTA. For very different reasons, the three NAFTA partners will not agree to merge into a single economy, fully surrendering monetary, macro-economic and other economic policies to 'NAFTA-wide' institutions. For Mexico and Canada it would be perceived

as a very dangerous loss of sovereignty and autonomy, and for the US - the world's only superpower - it would be difficult (and unrealistic) to accept the intrusion of the other two partners in its monetary, trade and macro-economic policies. Superpowers simply do not surrender themselves to that kind of reciprocity and do not allow themselves to be held accountable to some sort of 'abstract' tri-national institution.

What is important and convenient for Mexico is to maximise the free trade issues within NAFTA, but to keep on diversifying and negotiating its way into the global economy in an orderly manner. This is precisely what is behind the ongoing policies of 'Multiple Belongings'. That is why Mexico has negotiated FTAs with Chile, Bolivia, Costa Rica, and formed the G-3 with Colombia and Venezuela. That is why Mexico is member of the OECD and a very active participant in the Asia-Pacific's exclusive club of countries, the APEC. And lastly this is the reason that - along with South Africa - it is negotiating an ambitious full free trade accord with the European Union.

More precisely, there are three main directions in which the Mexican economy can advance in its internationalisation:

- Mexico can improve and build upon NAFTA's foundations. NAFTA may not go as far as to produce 'deep' integration, but there are still many things that can be done with the agreement. Besides improvements in several specific chapters, Mexico should expand the 'side' agreements. Conceived mostly as toothless mechanisms for consultation, they could become major tools for upgrading NAFTA and improving North American conditions on two fundamental issues for the 21st century: the environment and labour.

The environmental agreement should evolve from a remedial philosophy to a much more pro-active one. It should transcend increasingly the Mexico-US border as its main area of pre-occupation, and truly cover the three countries. There is a very active civil society - NGO's, foundations and research and academic centres - concerned with the environment that could be encouraged to participate in improving the environment using an integrated, North American vision. Particularly, the NADBANK should upgrade its activities and operations. For this, it needs further capital, better project design capabilities and an expanded area of activity. Labour issues - as well as related problems of undocumented migration, and so forth - must also be tackled with the broad view of an increasingly interdependent labour market in the whole of North America.

- Second, Mexico shares with a small but significant number of large, emerging economies certain structural traits and common challenges. There is a 'New South' of middle-sized regional powers clearly discernible in the contemporary

world economy. Mexicans call it the New South, while others call it the 'Big Ten' or the 'emerging middle size economies'. Countries such as Mexico, Brazil, Chile, Argentina, Colombia, Turkey, South Africa, Egypt, Poland, Thailand and Indonesia, to mention just some of them, will play an increasingly important role in the shaping of world affairs. Mexico has a cordial, vibrant relationship with all of them, and should engage them even further because these are in the same league as far as economic size and status are concerned. Trade, cross-investments, cultural exchanges and political consultation are examples of things Mexico should engage in with the New South.

- Third and most important, Mexico should maintain a very active and broad co-operation policy with its Latin American brother countries, as is only natural. Latin America is the only region where deeper integration is possible. So, after walking the long way to North America, Mexico must also walk back into a more integrated and united Latin America. There are very encouraging trends in Latin America these days: democratic reforms, deregulation and free trade are booming in the region. These must be built upon. From Mexico's point of view, its FTAs with other countries are an encouraging beginning. The remarkable success of Mercosur is the best news in many years for *all* of Latin America, not only for the Southern Cone. The initial talks between Mexico and Mercosur constitute a good beginning - if a modest one. Let us hope that the next 'Summit of the Americas' to be held in 1998 in Chile will move ahead in the aim to establish a free trade area for the whole Western Hemisphere.

NAFTA PROFILE			
Economic Indicators - First Quarter, 1997			
	Mexico	Canada	United States
Area (000 sq.km.)	1,973.0	9,976.0	9,373.0
Population (per million), 1996	93.0	30.0	267
GDP nominal (billion) IQ	339.0	827.8	7 867.7
GDP real (% annual variation) IQ	5.1	2.8	5.8
GDP <i>per capita</i> (diis) IQ	3,600	21,798	29,467
CPI (% annual variation)	21.2	1.7	2.4
Labour force (million workers)	39.4	15.0	136.2
Unemployment (% labour force)	3.9	9.6	4.8
Budget deficit (% GDP)	0.09	2.4	1.4
Public Debt (% GDP)	33.3	74.4	88.4
Interest rates (%)	18.3	3.2	5.25
Stock Exchange Index (points)	4 397.82	5 874.0	7 688.98
	Mexico Jan-April	Canada Jan-April	United States Jan-April
Trade Balance (US\$ million)	66.8	96.7	505.2
Total Trade	34.2	50.0	220.6
Exports	32.6	46.7	285.0
Balance	1.6	3.3	-64.9
Current account (US\$ million) IQ	-406	200	40,966
Reserves (US\$ billion)	22.3	20.9	56.2
Exchange rate (local currency)	7.92	1.349	...
Interest rates: Mexico: CETES 28 days, average; Canada: Bank rate; US: Discount rate			
US figures refer only for merchandise trade. Fiscal year = April 1996 - March 1997; 1/March 2/April 3/May 4/end of June 5/1996			
Sources: DGAPNA, based on information from Banco de Mexico, SHCP, INEGI, US Department of Commerce, US Department of Labour, Federal Reserve Bulletin, Survey of Current Business, Statistics Canada/Canadian Outlook.			

Mercosur: Lessons for Southern Africa

José Botafogo Gonçalves

Comprising Brazil, Argentina, Paraguay and Uruguay, Mercosur (the Southern Common Market) was launched by the Treaty of Asunción in 1991, and since January 1995 has constituted a customs union. Its ultimate goal is the formation of a common market, but with no pre-established timetable.

Mercosur represents the most recent and successful experience of integration in Latin America. In the sixties, some attempts at regional integration in the continent were made, but they fell short of their original aims. The Latin American Free Trade Area (LAFTA) created in 1960 proved to be rather a rhetorical exercise. Its aim - the building up, in a single move, of a free trade area among all the Latin American countries - was very ambitious, and its mechanisms, which entailed the strict application of the Most Favoured Nation clause within the region, were too rigid. The advent of the Latin American Integration Association (LAIA) in 1980, in the place of LAFTA, favoured the proliferation of bilateral and plurilateral trade agreements across the continent, including those countries that are now members of Mercosur insofar as it allowed the exchange of trade preferences among a limited group of countries without the need to extend them to the other members.

A number of basic lessons drawn from Mercosur's experience as a regional integration scheme can be singled out as having possible relevance to Southern Africa.

Two factors that were present at the origin of Mercosur may be viewed as of vital importance for the success of integration efforts in general: democracy and trade liberalisation. The almost simultaneous return of democracy to a number of countries in the region was fundamental to Mercosur's emergence and has contributed to its sustained development. Integration was viewed as a means of legitimising the newly born democratic regimes since, during the military rule, relationships within the sub-region had deteriorated, in part as a consequence of the nationalistic ideals advocated internally. In this sense, integration served the purpose of drawing a clear distinction between military and democratic regimes. More importantly, in order to evolve, integration requires growing confidence among members, and an exercise of mutual concessions that are best nurtured within a democratic context.

It should also be noted that integration has, in turn, played an important role in strengthening democracy in the region. The institutional crisis faced in Paraguay in 1996, for example, was countered mainly due to its Mercosur membership. Furthermore, demonstrating respect for democratic principles has recently become a necessary condition for being a Mercosur member.

The convergence of liberal economic policies in the region is the second basic factor that explains the advent of Mercosur. Without the previous liberalisation of the national trade regimes of the four countries, the commitments taken on as a consequence of Mercosur - as much under the intra-regional liberalisation programme as in the formation of the Common External Tariff - would not have advanced beyond rhetoric. This is particularly true of Brazil, which had a high level of tariff protection up until the late 1980s: an average tariff of 35%. Underlying this convergence of policies was a shared position on the challenges imposed by the new reality - growing globalization and proliferation of regional agreements - and of the necessary responses to them: a joint effort to enhance international competitiveness and to open up opportunities for increased trade and investment.

Next, even though it nurtures an ambitious goal - the formation of a common market - Mercosur has adopted a flexible and 'step-by-step' approach, whereby any advance in the integration process is made only after the consolidation of previous successes. For example, although the Treaty of Asunción established that the Common Market should be implemented by the end of 1994, member states decided to revise this timetable in the light of complexities that arose during the course of negotiations. Another example refers to the horizontal expansion of the integration process: since 1994 Mercosur has been engaged in bilateral negotiations with the rest of LAIA, with a view to the gradual integration the whole of South America as envisioned in the Treaty of Asunción.

Third, Mercosur teaches that, although a necessary reference, the European paradigm should not necessarily be copied: one should avoid what may be called the 'supranational temptation'. Despite the fact that the European supranational structures tend to be viewed as the ideal model for other less developed regional schemes, the lightness of Mercosur's institutional structure (inter-governmental, no regional parliament, no court with authority to overrule courts of other member states nor a bureaucracy similar to that of the European Commission) has proven to be very satisfactory.

The absence of supranational bodies results in fewer costs, a smaller bureaucracy and, as a result, greater flexibility and speed in accommodating problems and differences that arise among member states. Suffice it to recall that Mercosur's Dispute Settlement Mechanism has been used only twice since its creation in 1991, and the controversies in question were resolved in the phases of direct negotiation with no recourse to the *ad hoc*

arbitral court. In other words, Mercosur's institutional structures have favoured informal and flexible solutions to the problems faced by the integration process, avoiding strains in the relationship among its members. Mercosur has not discarded a transition to supranationality, but it understood that this should happen when the current structure proves no longer able to attend to the actual needs of integration.

As far as the mechanics of trade liberalisation are concerned, two basic lessons may be drawn from Mercosur's experience:

- The automatic and 'across-the-board' approach to the liberalisation programme was fundamental to its success. The abandonment of the sectoral approach and the option for a linear and automatic scheme for tariff reductions covering the whole universe of products, through biennial reductions of tariffs on intra-regional trade, was a decisive factor in overcoming resistance from the more protectionist industrial sectors and in avoiding re-opening negotiations every six months.
- Though the Common External Tariff (CET) is not yet fully in force, it has already been defined for the whole universe of products and the existing exception lists are time-limited - calendars are defined for the eliminations of the exceptions to the CET. The deadlines expire between the years 2001 and 2006. With this approach, the Customs Union becomes less vulnerable to protectionist pressures and to political changes that may occur within member states.

Another aspect worth noting is related to the explosion of intra-regional trade derived from the liberalisation programme. The four countries' intra-regional trade grew by 310% between 1990 and 1996, to over US\$16 billion. This achievement has been perceived as a significant measure of Mercosur's success, thus providing an important basis for further advancement in the integration process, including progress in areas that are not exclusively economic.

Mercosur shows that regional integration may serve to encourage a more open trading system. Despite the impressive intra-regional figures, trade with non-member countries has also risen considerably: 150% since 1991. Moreover, treaties creating free trade areas with Chile and Bolivia have been signed and negotiations with the Andean Pact and Mexico are under way. Mercosur is also engaged in negotiations with the European Union for the liberalisation of trade, aside from being an active force in the Free Trade Area of the Americas (FTAA) negotiating process, not to mention other consultations being held with the Australia-New Zealand Closer Economic Relations Trade Agreement (CER) and Japan. This wide external agenda, together with the above mentioned trade figures, provides clear evidence that Mercosur pursues open regionalism, in the sense that it encourages the globalization of world trade.

Sixth, it is well known that one of the most important benefits of integration among developing countries is the consequent increase in their bargaining power, notably in trade negotiations, where power is measured in terms of market size. Mercosur's experience demonstrates that in order to be productive, this joint action requires a considerable effort of co-ordination in order to harmonise positions and avoid exposing internal differences. Without this co-ordination, acting as a unit becomes a handicap. In the FTAA negotiations, Mercosur members have been particularly successful in working together.

The continued political priority given to Mercosur is another essential element for its sustainable development. Presidential involvement in the process was decisive in launching Mercosur and has continued to play an important part in accommodating technical controversies that emerge during its implementation. This political support for integration prevents topical problems from becoming a hindrance to the whole process. Granted, sometimes it transforms minor technical problems into a major political controversy between member states but, on balance, the effect of political support has been positive.

All of the activities carried out in Mercosur's technical bodies are monitored by the Common Market Group and the Council of Mercosur, which are comprised of high ranking officials from the four countries. This centralised and high-level supervision is intended to allow full and equitable political control over the development of the integration process as a whole.

Mercosur's experience demonstrates the importance of regional schemes acting as 'global traders' rather than 'regional traders', so as to reduce their vulnerability and develop a wider scope for action on the international scene. Mercosur countries are not dependent on any single market for their imports and exports. Their trade pattern is well distributed among Latin America, the United States, Europe and Asia; hence, the importance of having a diversified external agenda.

It is vital that the integration process provides dynamic, balanced gains to its members. One should stress, in this context, the benefits of decisions taken by consensus, especially when there are asymmetries in terms of size among member states. Decisions taken by consensus are more solid in the sense that they mirror the four member states' interests better. The integration process should also take into consideration the differences between member states. Paraguay, for example, has a larger exception list and a longer time period allotted for integration in the free trade area.

Finally, regional arrangements should ensure the participation of civil society in the process of integration, not only as a democratic imperative, but also as a means of providing support. Mercosur includes in its institutional structure an Economic and Social Forum and a Joint Parliamentary Commission, both with advisory powers.

Glossary

ACP	African, Caribbean and Pacific
AEC	African Economic Community
ALADI	Latin American Association for Integration
ALALC	Latin American Association for Free Trade
ANC	African National Congress
APEC	Asia-Pacific Economic Co-operation
ASEAN	Association of Southeast Asian Nations
AT&T	American Telephone and Telegraph
BOT	Build, Operate, Transfer
CAP	Common Agricultural Policy
CARICOM	Caribbean Community
CER	Closer Economic Relations Trade Agreement (Australia-New Zealand)
CET	Common External Tariff
CFA	Communauté Financière Africaine (Common Franc Zone)
CGE	Computable General Equilibrium
COMESA	Common Market of Eastern and Southern Africa
CORFO	Coproración de Fomento de la Producción
EC	European Community
ECLAC	(United Nations) Economic Commission for Latin American and the Caribbean
ECOMOG	West African Economic Monitoring Group
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EU	European Union
FDI	Foreign Direct Investment
FTAA	Free Trade Area of the Americas
GATT	General Agreement on Tariffs and Trade
GDI	Gross Domestic Investment
GDP	Gross Domestic Product
GEAR	Growth, Employment and Redistribution strategy
GNP	Gross National Product

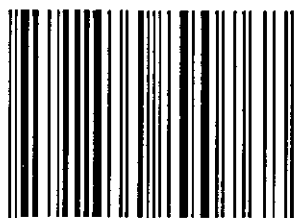
GSP	General System of Preferences
IMF	International Monetary Fund
IRELA	Institute of European-Latin American Relations
ISI	Import Substitution Industrialisation
LAFTA	Latin America Free Trade Agreement
LAIA	Latin American Integration Association
Mercosur	Mercado Comúne de Sur (Common Market of the South)
MFN	Most Favoured Nation
MIA	Multilateral Investment Agreement
NADBank	North American Development Bank
NAFTA	North American Free Trade Agreement
OAU	Organisation of African Unity
OECD	Organisation of Economic Co-operation and Development
PRI	Revolutionary Institutional Party (Mexico)
RDP	Reconstruction and Development Programme
ROI	Return on Investment
RPO	Red Meat Producers' Organisation
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community
SADCC	Southern Africa Development Co-ordination Conference
SAIIA	South African Institute of International Affairs
SSA	Sub-Saharan Africa
TDA	Trade and Development Agreement
UDEAC	Union Douanière et Economique de l'Afrique Centrale
UDI	Universal Declaration of Independence (Rhodesia)
UMEDA	West African Economic and Monetary Union
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organisation

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