THE CLOCK IS TICKING: REGIONAL INDUSTRIALISATION AND INTEGRATION

By ***Rob Davies***

The author is South Africa's minister of trade and industry. This is an edited version of his keynote address to the 2015 Trade and Industrial Policy Strategies (TIPS) forum[1]

How do we, as a continent and as a country, promote regional industrialisation through developing regional value chains? What are the focuses? And where are the institutional processes that will give effect to this vision?

Dr Rob Davies, Minister of Trade and Industry

INDUSTRIALISATION IMPERATIVE

Asked how they see the future of the continent, any number of African leaders will say that, having been identified as "the next growth frontier", Africa has to industrialise and move up the value chain. There are very good reasons for this. Among others, it is that the drivers of growth in the previous period are no longer present. The oil-producing countries are now the last to join the rest of us in seeing the end of bonanza rents from the mineral commodities "supercycle". This is not just a cyclical matter; it is also structural. The biggest demander of many of those mineral commodities – the People's Republic of China – is changing its growth strategy. China is emphasising consumption in its own economy and moving into a more diversified services economy. This is a much less resource-intensive growth path, and, by the looks of it, no other consumer is going to jump in and fill that [demand] gap.

In South Africa, if we look back to 1994, we had 5 percent growth in only 16 of 84 quarters. What drove growth during those periods? Consumption and mineral commodities. With the balance of trade as it is, we can no longer expect to live on a consumption-driven growth path, and nor, as I've said, can we rely on the commodities supercycle. We obviously need to promote higher levels of *inclusive* economic growth. I want to emphasise inclusivity, but we need high levels of growth. We have to move up the value chain.

This corresponds with all sorts of other research. A KPMG study called "Africa Risen", presented last year, said that Africa receives US$6 billion from coffee that it produces and exports. But that same coffee is converted outside of the continent – roasted, blended, packaged – into products that fetch $100 billion. In other words, the production and export of raw coffee beans captures only $6 billion of the $100 billion value chain. Another example was that that Italy earns more from the production and export of gold jewellery than South Africa does from the production and export of gold. The worst place to be integrated into global value chains is as a producer and exporter of primary products and as an importer of finished goods. »

Volkswagen South Africa plant, Uitenhage, Eastern Cape. *Photo: Volkswagen South Africa MediaClubSouthAfrica.com*

Even if we were to say that many jobs could be created in service sectors, evidence shows that those sectors will be more secure and of a higher quality if they are part of an economy whose productive base is diversified and moving up the value chain, rather than if they simply footloose – as, for example, Cyprus's banks were.

After much debate, there is now a consensus that the next phase of African growth has to be driven by industrial development, diversification, moving up the value chain and inserting the continent into a different place in the global division of labour.

Look at the situation in South Africa and the industrial development drivers identified in our Industrial Policy Action Plan (IPAP). First of all, we have a consistent trade surplus in Africa and our exports to African countries have a higher proportion of value-added products than our exports elsewhere.

In ongoing processes in the region, such as infrastructure-driven industrialisation, we're looking to use our own domestic infrastructure programme and some of its localisation measures to drive reindustrialisation, particularly focussing on capital goods and transport equipment. But those firms must also become part of a continental process, where infrastructure development programmes will also provide opportunities.

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Mineral beneficiation as a driver of industrialisation is a hard nut to crack, but clearly we will be able to effect the necessary policy changes more easily if we act together as a region and a continent than if we just act as individual countries.

How can we develop regional value chains that support industrialisation, not just in South Africa, but also in the region and continent? A new African growth spurt will benefit industrial development here in South Africa as well. This is the perspective on regional industrialisation that we support, and we see increasing support in large numbers of other African countries.

BROADEN FREE TRADE AREAS

A few years ago, the debate was about deepening integration within existing regional communities and setting timeframes for the Southern African Development Community (SADC) to move beyond the current free trade area (FTA) and become a customs union and then a monetary union. The focus of attention was to move further up "Jacob Viner's ladder" of regional integration.[2]

We were, as South Africa, extremely wary of those debates and started to ask very fundamental questions. What does moving from an FTA to a customs union bring in terms of promoting intra-regional trade? The answer from the researchers was: nothing.

People were telling us that we could lock in low tariffs and we would then benefit because we would somehow-or-other be integrated into global value chains. That approach to integration was extremely simplistic and didn't take account of a number of very important dynamics in the global economy. South Africa has, for example, successfully managed to integrate one of our sectors into the global value chain –the automotive sector. That required a significant, costly effort by government. It didn't come simply on the basis of trade liberalisation.

We've seen other examples. An international company that produced fire alarms in Cape Town was bought by another international company that came in and said, "Now you're part of our global value chain and we're taking all the manufacturing business elsewhere. You're going to be a depot for our products." Fortunately in that case, the managers worked with our team and we managed to establish a local South African company that is producing better products than they used to produce before. But it shows that integration into global value chains simply on the basis of trade policy does not necessarily mean that you get industrial development. In fact, you can get precisely the opposite: deindustrialisation. We can't see the benefit of this.

In the old Regional Indicative Strategic Development Plan (RISDP), we were supposed to have had a customs union in SADC by 2010 and a monetary union by 2016. Now, think a bit about Greece, which is in a monetary union with a currency that is set by a stronger economy. Apart from all the debt issues, Greece is facing massive deindustrialisation. Is that a model that we want to bring in? And isn't the whole approach shaped by a view that Europe or elsewhere has something like this and that we would be more integrated if we prioritised highly ambitious institutional arrangements over developments on the ground? I think that's the real issue.

If you go back to the work of Jacob Viner, he argued that regional integration made sense where you had high levels of complementarity, where one country produced what the other country needed and vice versa. That was the case in Europe. In Africa, many of the barriers to intra-regional trade are not because of high customs duties, but because of the nature of our productive sectors. We are producers and exporters of copper and iron ore, and we don't have much to trade with each other. That's our place in the global division of labour.

The issues have much more to do with promoting real-economy diversification and addressing other serious barriers to intra-regional trade, such as inadequate infrastructure that connects the mine to the port but doesn't connect us one to another. Even things like soft infrastructure – border arrangements and other regulations – are often more important than tariffs.

We have come to the conclusion – and this is the consensus driving the current programmes – that what we need is not to deepen regional integration within existing regional communities, but to *broaden* regional integration at FTA level *across* our existing regional communities, but within a framework which is developmental. In other words, we need a development integration approach.

There are a number of very practical reasons for this. And again, they've got to do with the state of the world economy. There was once an idea that we could all flood the European Union (EU) and the US with manufactured goods and that would drive industrial development. Even if that possibility existed in some earlier phase, which is debatable, it certainly doesn't exist now. The United States and the EU countries are themselves trying to reindustrialise. They are much less receptive to large influxes of goods from other parts of the world.

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Look at China and India. How are they seeking to drive the next phase of their industrialisation and economic diversification? They are emphasising their domestic market, and those emerging economies all have a large domestic market. So here comes the challenge for Africa: colonialism divided us into 54 different countries. None of us – certainly not South Africa, not even Nigeria – has a domestic market sizable enough to support industrial development and diversification. But if we look beyond our countries, beyond our regions? SADC, COMESA [the Common Market for Eastern and Southern Africa] and the East African Community [EAC] together have about 500–600 million people and a combined GDP of over $1 trillion. If we look at the African continent as a whole, we're talking $2 trillion and a population of about 1.5 billion people. We start to hit the numbers that can provide the basis to support regional development and economic diversification. I think that this definition of the project is the right way to go: broadening integration with a developmental paradigm.

STATE OF PLAY

This doesn't mean that there is no trade integration component. We have to have an FTA in place – not least because all of us are also negotiating with the EU. Without an FTA, we'll be trading with each other on worse terms than the EU, which can't be the basis of developing regional value chains.

For pragmatic reasons, we're not going to reopen the trade protocols that exist within each regional economic community. Instead, we're going to focus on negotiations with those countries or groups of countries in the tripartite area [COMESA-EAC-SADC] where each of us does not have any kind of trade preference.

A legal agreement for the establishment of the Tripartite FTA (TFTA) was adopted at summit in Egypt in June 2015. The summit also set a timeframe of one year to conclude the outstanding tariff schedule negotiations that have been started in one form or another. In our case – negotiating as the Southern African Customs Union (SACU) – we have already had a few rounds of negotiations with the EAC. We are pretty close to finalising the offer that we will submit to Egypt. That does leave Ethiopia, Djibouti, Sudan, and quite a number of others, but I think those two main ones are on track to be concluded by the end of the year.

The infrastructure project that goes along with the TFTA is the North–South Corridor, but it is running behind. One of the reasons we have been so keen on the new BRICS Development Bank is that we see an opportunity to tap into funds that can support infrastructure development across the continent and provide greater connectivity between our countries. Donald Kaberuka, the former president » of the African Development Bank, has said that the infrastructure deficit was costing Africa the equivalent of 2 percent growth.

A special conference was held about a month ago that was entirely devoted to developing the SADC industrial development strategy. That strategy document covers much of the same ground as our own national industrial policy framework and is worth looking at. It indicates the potential actions that can support industrial development, with a big focus on – and a big expectation of – regional value chains. The other critical issue is financing. Private credit extension is not going to support productive investment, by and large. The question of the role of development financing institutions (DFIs) in regional industrial development is a massive challenge.

At the level of the continent, it's the same. The AU has reached the obvious conclusion from the tripartite process: what about the rest of the continent? What about West Africa? What about the rest of North Africa? We need to move towards a continental FTA. Negotiations were opened at the AU Summit in Johannesburg, but the timeframe – let me put it as diplomatically as I can – is extremely ambitious. The negotiations are supposed to be concluded by 2017. That includes a trade-in-services component, which the TFTA put into phase two.

MAKING THE LINKS

Let me conclude with a few remarks about the challenges. First, regional value chains. In very broad conceptual terms, we've identified that there are things called regional value chains, which can include manufacturing, which involves inputs from different parts of the region or the continent, and that the identification and development of these is a critical component of African industrialisation. Getting down and dirty and really understanding and analysing these regional value chains is a challenge. What should we be doing to support an inclusive set of industrial activities? Because the temptation for some countries is to see the domestic market, and not the regional value chain, as the driver of industrial development. That can lead to a view that "there's no need for us to respect the SADC protocol", and that, in practice, would undermine the emergence and development of regional value chains.

Second, South Africa has supermarkets and exporters in all countries, with a high proportion of South African products on sale, and I think this model is going to have to change. We're going to have to move into a different spot in regional value chains. There are a few practical examples that are showing us the way. We were, for example, involved in very earnest engagements with Nigeria about their automotive programme and provided technical input into its design. At the same time, we are looking for South African companies to be suppliers into the Nigerian market of components that will be used in knock-down kit assembly and also some of the finished built-up units that would enter under the programme. As Nigeria begins to manufacture vehicles, maybe some of those will also find their way into South Africa. That's the kind of model that we're looking at.

Another practical example is a consortium, including Score Metals, that has established a plant to manufacture grinding material for the West African mining industry in Accra, Ghana. Before that, this material was imported from South Africa. Now there's a manufacturer there – but the components have come from South Africa. These are signs of things to come. We're going to occupy a somewhat different place in these value chains. What is that location for South Africa? For other countries? How do we promote an inclusive industrialisation based on regional value chains?

The other challenge, as I said, is the question of investment and finance. Does it all come from DFIs? We can promote some foreign investment in industrial activities. The portfolio investment into manufacturing – despite what's happening in mining – is actually holding up reasonably well. Quite a number of companies are betting that the regional market will integrate, that South Africa is critical in the industrial development of the continent, and that this is the place to invest in productive manufacturing activity. We've seen this in a number of different sectors. But how do we address the question of industrial financing? That is a very critical question.

This stage requires a very significant research input. SADC is at the level of identifying potential actions that can support industrial development across the region. The secretariat was given the mandate to turn this into a plan that must be tabled for adoption next year. The clock is ticking. In particular, the identification of regional value chains and how we promote some kind of inclusive involvement is critically important.

The last point is the World Trade Organisation (WTO). How do we defend the policy space to develop and support regional value chains against what I think will be a series of demands to lower industrial tariffs. The ostensible benefit is access to markets that are very distant from us – the risk is that the regional value chains will be undermined by the import of finished products coming from outside the region. NA

NOTES

1. This year's TIPS Annual Forum was co-sponsored by the University of the Witwatersrand, the United Nations University World Institute for Development Economics Research (UNU-WIDER) and the USAID Southern Africa Trade Hub, in association with the departments of trade and industry, performance monitoring and evaluation, and the National Treasury. It took place in Johannesburg on 14–15 July 2015.

2. Canadian economist Jacob Viner (1892–1970) laid out a framework theory of economic integration which moved from preferential trading agreements through customs union and common market to complete economic integration. ("Economic integration", Wikipedia)