

# Regional Economic Integration

**Presentation to the Portfolio Committee**

**26 September 2014**



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Trade and Industry  
REPUBLIC OF SOUTH AFRICA

# Objectives of regional integration

- Create **trading opportunities** by reaching a larger regional market and achieving greater **economies of scale**
- Address challenges of small and fragmented markets.
- Create an environment conducive to attract FDI.
- Promotes inter-connectivity between Member States.
- Address barriers associated with border controls and reduces transaction costs of trade.
- Promote flow of goods and services.
- Economic integration **enhances regional welfare** by removal of barriers and by co-operating on tariff and trade policy
- **Enhancing collective bargaining power** of Member States



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# Benefits of REI Arrangement

- Economic theory on integration – Jacob Viner (1950) and the linear integration model - Trade creation vs trade diversion.
- **Trade creation** - after the formation of an integration arrangement, the cost of the goods is decreased, leading to an increase of efficiency of economic integration.
- **Trade diversion** - when the trade flow is diverted from actually cost-efficient partner state to less efficient one within the integration arrangement – member's goods maybe cheaper within a union, but higher compared to the rest of the world.



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# Forms of integration

- **Preferential trading arrangement** — 2 or more countries form trading club by reducing tariffs on imports but member states maintain original tariff against 3<sup>rd</sup> parties.
- **Free trade area** — 2 or more countries form FTA / association by abolishing import duties & quotas on mutual trade of goods but retaining original tariffs against 3<sup>rd</sup> parties.
- **Customs union** — 2 or more countries form CU by abolishing duties on mutual trade in all goods & adopt CET on all imports from rest of the world.
- **Common market** — 2 or more countries form CM if they form CU and by allowing free movement of production factors (capital, labour, entrepreneurship)



# Forms of integration ctd

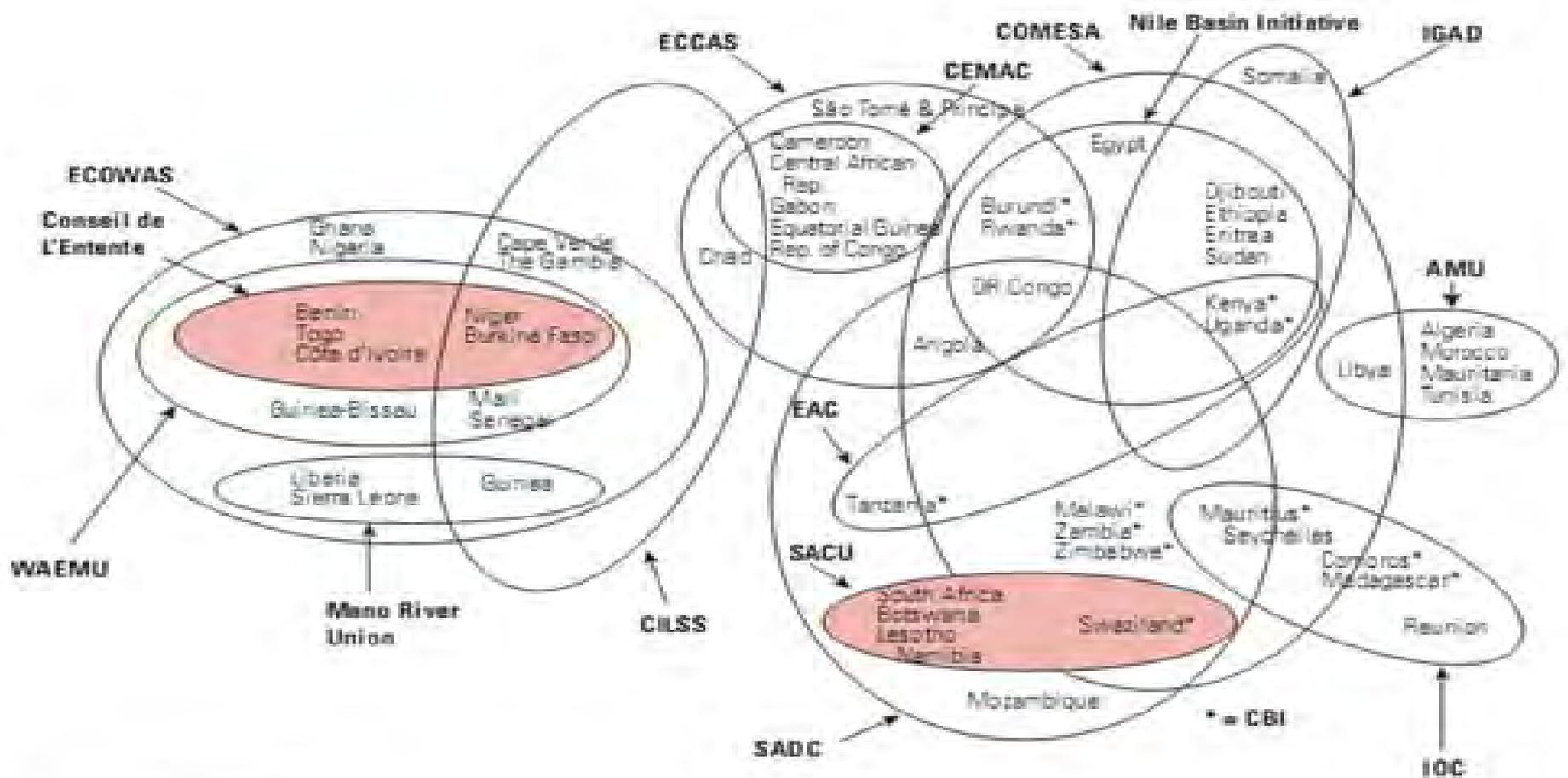
- **Economic & monetary union** — 2 or more countries form economic union by establishing common market. Advanced economic integration agenda incl. by harmonised taxes, monetary & socio-economic policies.
- **Complete economic integration** — Originally independent countries give up completely individual sovereignty & merge into one nation with unified fiscal, monetary and trade policies. This is akin to a federal country



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# Africa's spaghetti bowl



Source: World Bank staff.



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# Importance of REI to Africa

- Africa continues to engage at the periphery of the global economy, as is evident from the continent's declining share in global production and trade- accounting for approx. 3%.
- Most of Africa's countries have low per capita income levels and small populations which result in small markets.
- In 2008, 12 SSA states had populations of less than 2 million while 19 had a gross domestic product (GDP) of less than US\$5 billion, six of which had a GDP of less than US\$1 billion.
- Not only are most SSA economies small and poor, but 15 are also landlocked, an important contributory factor to high trade transaction costs, and more generally to the high costs of doing business in Africa.



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# Importance of REI to Africa ctd

- Small domestic markets and continental fragmentation translates into lack of scale economies in the production and distribution of goods and services.
- Transport costs in Africa among the world's highest - shipping a car from Japan to Abidjan costs US\$1 500 (including insurance); shipping that same car from Addis Ababa to Abidjan would cost US\$5 000 – importance of infrastructure.
- Need to find a REI arrangements that takes into account overlapping membership.
- Need to find an arrangement that addresses Africa's real constraints – productive capacity and supply-side constraints, lack of inter-connectivity and small and fragmented markets.



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# Africa's growth prospects

- Africa is second fastest growing region in world, after Asia.
- Enormous reserves of raw materials.
- 60% of unused arable agricultural land globally.
- Young and growing population.
- Growing middle class with considerable purchasing power.
- Rapid urbanisation.
- Improvements in economic governance.
- BUT Africa's full economic potential will remain unfulfilled unless we address challenges of poor infrastructure; small and fragmented markets; inadequate diversification.
- Hence importance of a developmental regional integration for Africa.



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# Development integration

- Addresses shortcomings and relevance of mechanical sequencing of Viner stages in developing regions.
- Argues major barriers to intra-regional trade often inadequate infrastructure and underdeveloped production structures rather than tariffs or regulatory barriers.
- Concludes integration processes must be complemented/preceded by advances in cooperation and coordination programmes to address real economy constraints. Latter must create objective conditions to make trade integration moves viable and sustainable;
- Depends on high level of political cooperation at an early stage of process.



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# SA's approach to REI

- Africa's growth prospects much improved.
- African continent is critical to SA's development objectives
  - 3 out of top 15 SA trading partners are African countries (Botswana, Namibia, Mozambique).
  - African continent is our biggest market for manufactured products
- But current growth path based on consumption and mineral exports is not sustainable.
- Africa requires structural transformation for value addition, diversification and inclusive growth.
- Development integration in Africa is SA priority.
- Market integration, cross-border infrastructure development, industrial development and economic diversification needed – move up GVCs.
- Pursue this in SACU, SADC, T-FTA and C-FTA.

# SA's approach to REI

- In view of overlapping membership and the need to address continental constraints priorities are as follows:
- Broadening rather than deepening integration at this stage.
  - Transforming SACU into a development integration arrangement
  - Consolidation of the SADC FTA
  - Establishment of the TFTA
  - Engage in process towards the establishment of the CFTA using the TFTA as a basis



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# SA's approach to REI ctd

- Address key constraints facing the continent
  - Transformation of current growth path based on consumption and mineral exports which is not sustainable.
  - Focus on structural transformation for value addition, diversification and inclusive growth.
  - Development integration in Africa based on market integration, cross-border infrastructure development, industrial development and economic diversification needed
    - move up GVCs.
- Pursue this in SACU, SADC, T-FTA and C-FTA.



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# Trade Agreements in Africa

- Southern African Customs Union (SACU) Agreement: Focus on revenue sharing, industrial and infrastructure development, and common positions in trade negotiations.
- Southern African Development Community (SADC) FTA, together with SADC Protocol on Trade in Services.
- Tripartite FTA (T-FTA) – negotiations underway.
- Memoranda of Understanding for technical cooperation.



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# SACU

- SACU is the world's oldest customs union- established in 1910 defined mainly by revenue sharing and
- In 1994, SA initiated re-negotiation that were concluded in 2002 and new SACU Agreement entered into force in 2004.
- The new Agreement democratizes relations between SA and Botswana, Lesotho, Namibia and Swaziland (BLNS).
- It retains the common external tariff (CET) for goods imported into the common SACU market.
- Retains a revenue sharing formula (RSF) favouring the BLNS - seen as 'compensation' to BLNS for lack of policy discretion.
- While SA contributes around 98% to the pool, BLNS receive around 55% of the proceeds.
- For 2013-14, for example, total disbursement will be approx R70bn, of which BLNS will receive R48bn.



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# SACU ctd

- Agreement also has enabling provisions for development of common policies and institutions.
- Key areas for common policy include industrial policy, along with cooperation on competition and agriculture policy.
- Enabling provisions provide for the establishment of National Bodies and a SACU Tariff Board which will make recommendations to Council on tariffs, trade remedies (anti-dumping, countervailing and safeguard duties) and rebates.
- Until these institutions are established, functions are delegated to the International Trade Administration Commission (ITAC) in SA.
- For SA the key was to transform SACU into a development integration arrangement - stabilise the RSF and to allocate a portion of funds for cross-border regional infrastructure and industrial development projects.

# SACU ctd

- Six-point, integrated plan was agreed in 2010:
  - Review the RSA;
  - Prioritise work on regional cross-border industrial development;
  - Work to promote trade facilitation border measures;
  - Develop SACU institutions;
  - Strengthen unified engagement in trade negotiations; and
  - Trade in services was added as sixth priority in 2013
- Progress is uneven:
  - Little meaningful progress on the review of the RSF.
  - Lack of progress on the development of SACU policies due to divergences in policy perspectives
  - Progress on trade facilitation and trade negotiations



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# SADC

- 12 SADC MS have established a FTA – priority is the consolidation of the FTA rather than establishment of CU .
- Intra-SADC trade has increased since the beginning of implementation of the SADC Protocol on Trade- intra-SADC exports increased from US\$5.8 billion in 2000 to US\$11.7 billion in 2010.
- Intra-SADC trade as a percentage of total trade has remained stagnant at roughly 15% of total trade over the entire period of implementation.
- The sectoral composition remains focused in traditional exports and has not resulted in diversification of export and production patterns either within SADC or with the rest of the world.
- While SADC intra-SADC trade has increased, the evidence does not support the conclusion that the SADC FTA has spurred export diversification and industrialization.

# SADC ctd

- Some non-adherence with TP commitments by Zimbabwe, Malawi and Tanzania- possibly Zambia - continuous engagement with these MS bilaterally and through SADC fora.
- To address these shortcomings SADC is focusing on –
  - Industrialisation- value addition and diversification
  - Infrastructure development as the SADC Infrastructure Masterplan and leveraging the infrastructure work programme to catalyse industrial development.
  - Consolidation of the FTA aims at ensuring full implementation of commitments, addressing NTBs, accession by non-members, review of RoO, trade in services.
- SA fully supports MS industrialisation efforts but must be implemented within the rules outlined in the TP and should not give undue advantage to third countries.



# Tripartite SADC-EAC-COMESA FTA

- Launched June 2011 to pursue T-FTA, cross-border infrastructure and regional industrial development.
- Infrastructure focused on North-South Corridor with significant progress on upgrading road links. Projects have been identified for rail, border posts and port development.
- Work on industrial development at initial stages.
- T-FTA will combine markets of 26 countries with a population of nearly 600 million and a combined GDP of US\$1 trillion.
- Provide market scale that could launch a sizeable part of the continent onto a new developmental trajectory.
- The T-FTA will form the basis for an Africa-wide FTA, which will create a market of US\$2.6 trillion.



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