# Bank of Namibia

## Annual Symposium 2005

## The Benefits of Regional Integration for Smaller Economies

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# PREFACE AND OVERVIEW

## PREFACE

The Bank of Namibia held its 7th annual symposium titled 'the benefits of regional integration for smaller economies" on the 1st September 2005 at the Windhoek Country Club Resort and Casino. One of the super trends in international relations is the growing regionalisation – the increasing number of regional integration arrangements and configurations. Indeed, regionalisation and globalisation have become two of the major trends in modern international relations. No country, whether developed or developing can escape them, otherwise, it will lag behind and fall into disadvantage in the international division of labour. The benefits often cited as stemming from regional integration are increasing market of the country's products, increasing investment and productivity, improving competition, accelerating trade and reduction in transaction costs. However, integration might yield undesirable results such as revenue losses, industrial polarization, trade diversion and deterioration of the country's terms of trade, to mention a few, if not properly designed and monitored. Based on the above, experts were invited to the symposium as an attempt to provide an understanding on the expected benefits from regional integration to the Namibian economy, and suggest what could be done to maximize such benefits.

## OVERVIEW

In his opening remarks Honourable Immanuel Ngatjizeko, the Minister of Trade and Industry, alluded to the fact that many of the African countries are landlocked, and the relatively poor state of their infrastructures and services, contribute to the delay in the much needed economic and industrial development of the African continent. Regional integration is therefore, an essential vehicle for the harmonisation of macroeconomic and structural policies, for promoting large-scale investments, and for promoting economic efficiency by encouraging the free movement of capital and labour.

Mr Kalenga presented the first paper on the overview of Namibia's participation in regional economic integration. This paper highlighted Namibia's participation in regional integration arrangements such as the Southern African Customs Union (SACU), Common Monetary Area (CMA) and Southern African Development Community (SADC). Among other things, the paper recommended that Namibia should prioritize its participation in SACU. The paper further suggested that, the move of transforming the CMA arrangement into a fully-fledged monetary union may further enhance its importance as an instrument of fostering a common economic space. This is expected not only to strengthen the involvement of Lesotho, Namibia and Swaziland in the monetary policymaking process, but will also prepare them to effectively participate in broader monetary integration at the level of SADC and the African Union. It also argued that Namibia stands to benefit from the SADC integration in terms of infrastructure development, reduction of transaction costs as well as the facilitation of exports. However, the paper identified the key challenges which come along with Namibia's membership in SACU such as the establishment of domestic policy and institutional capacity and the need to maintain the country's macro-economic policy credibility.

Dr Di Mauro, presented the second paper titled, evaluating the impact of "asymmetric" regional integration which was based on a case study of the impressive regional integration experience of the Czech Republic, Hungary and Poland upon their succession to the European Union in 2004. The paper indicated that positive results were realized in terms of increased trade, capital mobility and foreign direct investments as well as improvement in the general standards of living and welfare of the populations of these countries. The paper also alluded to the fact that these countries had to undertake structural reforms that were aimed at ensuring rapid growth of the private sector. The paper, however, observed that regional integration may have fiscal repercussions and other adjustment costs. In this regard, the paper recommended a gradual process of eliminating tariff barriers. The paper also, echoed the suggestion of the International Monetary Fund (IMF) for Namibia to craft a privatization strategy and set up policies that will attract foreign direct investment.

Dr Kaire Mbuende, the former Executive Secretary General of SADC discussed the main issues rose from the paper by Dr Di Mauro. In his critique he cited issues such as predictability of policies, strong institutions as pre requisites in instilling confidence among domestic and foreign investors. Furthermore, he emphasized the fact that liberalization may result in temporal current account deficits that most SADC countries will not be able to finance from their own resources. On the cost related to restructuring he wanted to know as to how this was financed in the case of the European Union, among other things.

The last paper, titled the challenges and opportunities of regional integration for developing economies was presented by Prof Samuel Asante. The paper began with an analysis of the opportunities as well as challenges which regionalism poses for developing economies. Among other things, the paper pointed out the main benefits derived from regional integration such as trade, larger markets, competition and investment. However, the paper also brought out other challenges that might accompany regional integration.

These issues include the inappropriateness of market integration arrangements in developing countries, industrial polarization or skewed distribution of benefits often created by market integration, loss of revenue and the challenge of managing regional integration, which requires political, will. The paper concluded by giving a number of key recommendations for consideration by Namibian authorities, as well as urging the business community in Namibia to become competitive and diversify its exports.

The discussant of the paper by Prof Asante was Ms Annascy Mwanyangapo, from the Ministry of Trade and Industry. In her discussion she highlighted the issues that indeed integration enhance trade and increase welfare gains in a developing economy. Further, she noted that in developing countries, institutional infrastructures, lack of authority and powers of secretariats, as well as low caliber of professional and technical staff seems to be a key challenge as highlighted in the paper. She also touched on the issues of multiple memberships to regional integration as well as the differences in the levels of development of integrating countries as possible constraints to integration efforts of developing countries, among other things.

# Opening Remarks By Honourable Immanuel Ngatjizeko, Minister of Trade and Industry

**Director of Ceremony**

**Mr Tom Alweendo, Governor of the Bank of Namibia**

**Invited Guests**

**Members of the media**

**Ladies and Gentlemen**

I am immensely honoured for having been invited to make a welcoming statement, in doing so; I will share with you my thoughts, on the concept of regional integration with specific emphasis to the potential benefits accruing to smaller economies.

Many countries of our sub-region and of the wider continent continue to face serious growth-retarding problems, associated with a number of key elements of the structure of African countries. These include the small size of the typical African economy, the fact that many of the African countries are landlocked, and the relatively poor state of their infrastructure and services. These and other factors continue to delay the needed economic and industrial development of the African continent. The only possible way out of this predicament is by forging ahead with a concerted effort, to economically integrate the different sub-regions of the continent and ultimately the entire continent.

**Director of Ceremony**

Regional integration can be equated to establishing a relationship through a contract to assist each other to attain specific goals and objectives. Such a relationship has, as its principal aim, the strengthening of each other's capacities in diverse areas of economic interaction.

The formation of the European Union (EU) provides an adequate empirical and a theoretical body of evidence that if properly structured, integration at regional level will boost the economies and raise the standards of living of inhabitants of the countries concerned.

Some European countries would not have achieved their current levels of economic performance if they acted outside the European Union. Today these countries benefit from the exchange of skills, technological transfer as well as better markets for their products. The provision for equal treatment of nationals of the EU makes it possible for nationals from less successful member countries to take advantage of good education and other services available at lower cost in rich countries of the union. This arrangement is critical for the development of all the members of the union especially the smaller economies.

**Director of Ceremony**

It is cliché, yet a stark reality, that our economies have become mere suppliers of un-processed raw materials to support the industries of the rich nations, and that we consume largely what we do not produce, and of course produce largely what we do not consume.

The debate about globalisation seems to have been settled only on the aspect that we cannot wish it away. However, we have not adequately pursued the debate of how best to take advantage of this phenomenon, which we cannot ignore. It is in this context that I believe regional integration will provide a platform for the much-needed strategic interventions from national governments.

Regional integration can help our economies to develop the necessary sophistication in terms of efficiency of the public and private sectors, improved labour productivity, and enlarged markets, to deal with the challenges of globalisation.

**Director of Ceremony**

During our liberation struggle the slogan, “united we stand, divided we fall” was very effective in mobilising the requisite unity of purpose in defeating the colonial regime of apartheid South Africa. I submit that regional integration must be accorded the same understanding.

Countries of the continent and those of our sub-region must unite in order to form the necessary synergies that will ensure economic success; failure in this aspect, will continue to subject our economies to remain at the receiving end of an increasingly globalising world.

In the southern African Region, the Southern African Development Community (SADC) is at the forefront of effecting regional economic integration. The momentum in this regard is not lost as witnessed by the recently held SADC Summit in Gaborone, Botswana. At this Summit, Madagascar was admitted as the fourteenth member of the community, this development demonstrate, that the project of integrating Southern Africa, is as relevant today, as it was when the Project started 25 years ago. SADC was born out of the realisation that Southern African countries could not individually hope to become strong players in the international economy. The region must benefit from the relatively different competencies and comparative advantages of the individual SADC member countries.

**Director of Ceremony,**

**Ladies and Gentlemen**

Throughout Africa, many policy-makers believe that in order for Africa to industrialise competitively, its sub-regional and eventually continental markets must be integrated to achieve economies of scale and other market efficiencies. Such integration needs to occur within a dedicated framework that encourages infant industries to develop.

The economies of scale argument for regional integration and cooperation applies also with respect to the joint provision of a range of infrastructural services where considerable lower per unit costs might be achieved than when each country attempts to provide the same set of services individually.

In this regard, I submit that regional integration must be both strategic and targeted towards un-locking regional potential. We must endeavour to achieve specific targets in order to give true meaning to this project. At its centre, regional integration must attempt to eradicate poverty and enhance the standard of living of all our people.

**Director of Ceremony**

The benefits of regional integration to smaller economies are enormous. Regional economic integration will evidently help the smaller economies to draw strength from the stronger ones in achieving macro economic stability.

Regional integration is an essential vehicle for the harmonisation of macroeconomic and structural policies, for promoting large-scale investments, and for promoting economic efficiency by encouraging the free movement of capital and labour. The anticipated increase in trade at the sub-regional level coupled with harmonised policy processes will provide an impetus for economic growth of smaller economies, which would otherwise remain isolated and stagnant.

One of the major problems faced by our economies is the issue of small and fragmented markets. Namibia cannot adequately convince foreign investors that we have a market large and sophisticated enough for them to effect investment, however if the SADC market was a key determinant, foreign direct investment could be attracted with the view that the SADC region forms part of the target market. In this regard we must endeavour to attract investment that is targeted towards the region and not only targeted to our relatively small domestic market.

**Director of Ceremony**

Let me also acknowledge, that our determination to integrate has not been free of pitfalls. Generally our economies on the continent have not performed to expectations, despite the efforts at integration. Evidently the decline of Africa's share of world trade is a clear testimony. Also, intra-regional and intra-African trade has not improved significantly.

The provision of jobs to our populations as well as the provision of much needed social services remain a big challenge to our governments in Africa. In order to address the slow economic performance of our region a paradigm shift is needed, from a pre-occupation on a narrow trade-promotion approach and thus jobless growth, to a more comprehensive, outward-oriented, multi-dimensional, and certainly pragmatic, employment and wealth generating economic approach.

**Director of Ceremony**

**Ladies and gentlemen**

The successes of regional integration in other spheres are notable, especially in the area of regional peace and stability. The region is enjoying better peace times, than it was a few years ago; our regional integration project must therefore be commented and promoted at all cost.

In conclusion, I am confident that the academics and experts present here today will guide us on how best, to move forward. The African continent and our sub-region must not be allowed to remain on the periphery of international trade.

With these few observations, I welcome all participants to this year's symposium and wish you fruitful deliberations.

I thank you

# Overview of Namibia's Participation In Regional Economic Integration

**By**

**Paul Kalenga**
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**Stellenbosch, South Africa**

*This paper provides a brief overview of the evolution of regional integration arrangements in Southern Africa, with a specific focus on Namibia's participation. These are the Common Monetary Area (CMA), the Southern African Customs Union (SACU) and the Southern African Development Community (SADC). The paper attempts to discuss the extent to which Namibia has benefited from these integration efforts. There are significant key challenges which should attract the attention of policymakers, if these schemes are to live up to their intended usefulness. In particular, the paper discusses how Namibia can maximize the gains from participating in these arrangements. In the final analysis, it is argued that deeper integration of monetary and trade ties with South Africa (in the context of the CMA and SACU arrangements) are likely to be more beneficial for Namibia. These arrangements also present themselves as springboards to wider regional integration in Southern Africa.*

## 1. INTRODUCTION

The decisions to remain party to the Southern African Customs Union (SACU) and the Common Monetary Area (CMA) were the most important economic policy decisions that the Namibian Government made at independence in 1990. By doing so, Namibia effectively ceded its substantial domestic policy space over some basic areas affecting the domestic economy. The adoption of these policy stances appeared to have been rooted in the desire to maintain close integration with the South African economy. This was seen as a critical factor during the initial phase of political independence.

The subsequent sustainability of Namibia's membership in these arrangements until now suggests their continued relevance.

The other important policy developments were the decisions to join the Southern African Development Community (SADC) - formerly the Southern African Development Coordination Conference (SADCC) and the Common Market for

Eastern and Southern Africa (COMESA) – which was earlier known as the Preferential Trade Area (PTA) for Eastern and Southern Africa. Experience so far suggests that these latter policy decisions were not made significantly on economic considerations but more on political grounds. This is typical of Africa's experiments with regional integration which has resulted in many African countries belonging to a 'spaghetti bowl' of multiple and often conflicting regional integration schemes. Namibia's withdrawal from COMESA in 2004, following Lesotho and Mozambique in 1997 and Tanzania in 2000 suggests that economic considerations are starting to inform Africa's regional integration process. This argument remains, however, inconclusive.

This paper provides a brief overview of the evolution of these regional integration arrangements with a specific focus on Namibia's participation. The paper attempts to discuss the extent to which Namibia has benefited from these integration efforts based on anecdotal evidence and available studies. The paper concludes by raising key challenges facing these integration schemes if they are to live up to their intended usefulness, and in particular, how Namibia can maximize the gains from participating in these arrangements. It is argued that Namibia is likely to gain more from deeper integration of the SACU and CMA arrangements, and using them as springboards to wider regional integration in Southern Africa.

## 2. THE COMMON MONETARY AREA

### 2.1 EVOLUTION OF THE CMA

The existing close monetary cooperation between South Africa, Lesotho, Namibia and Swaziland dates back to the period when these territories, including Bechuanaland, were under British colonial rule, and the pound was used as a common currency[1]. With the formation of the Union of South Africa in 1910 and the subsequent establishment of the South African Reserve Bank (SARB) in 1921, the South African pound became the legal tender. This was replaced by the rand in 1961. After the independence of Botswana, Lesotho and Swaziland during the 1960s, they signed a formal agreement with South Africa in December 1974 known as the Rand Monetary Area (RMA) Agreement, maintaining the South African rand as legal tender. Botswana opted out of the RMA in 1976 and decided to set its own monetary policy. Nevertheless, the South African rand has continued to be a key element of Botswana's currency basket.

[1] Namibia was a German colony until World War I but was given to South Africa under the League of Nations Mandate (1920).

South Africa, Lesotho and Swaziland signed the trilateral agreement – the common monetary area (CMA) agreement – with additional provisions concerning capital account liberalization, intra-zone fund transfers and seignorage compensations in 1986. Namibia joined the CMA after independence in 1990, resulting in the four countries signing a multilateral monetary agreement (MMA). This MMA recognizes that each of the contracting parties is responsible for its own monetary policy and the control of its financial institutions. Lesotho, Namibia and Swaziland (LNS) introduced their own national currencies – the loti (1980), the Namibia dollar (1993) and lilangeni (1974) – although they continued to be fixed at parity with the rand. The rand is still legal tender in Lesotho and Namibia for which they receive compensation from South Africa for the loss of seignorage[2]. The rand has officially ceased to be legal tender in Swaziland since 1992 but it is still widely used in practice. None of the other currencies, except the rand, are legal tender in South Africa.

## 2.2 KEY SALIENT FEATURES OF THE CMA

The CMA resembles both a monetary union (not a fully-fledged one)[3] and currency board - because the issuance of the pegged domestic currencies should be backed by foreign assets and the monetization of the fiscal deficits (the money-printing demon) is not permitted. The LNS are obliged to supply or redeem their monetary liabilities at a fixed exchange rate, which implies that they must hold foreign reserves at least equal to their total monetary liabilities. Under these conditions, even short-term interest rates become largely independent of the will of the domestic monetary authorities in the LNS countries. Market arbitrage forces them to keep interest rates as closely to those in South Africa.

Capital flows freely within the CMA. However, such flows should not be disruptive to money and capital markets or inconsistent with the management of domestic financial institutions. Access by governments and private firms in the other contracting parties to South Africa's money and capital markets is guaranteed. A contracting party shall not apply any restrictions on the transfer of funds (current and capital transactions) to or from the area of the contracting party unless in cases of investment or liquidity requirements prescribed to domestic financial institutions. The SARB can also act as a lender of the last resort to the monetary authorities of the LNS countries[4].

2 Article 6 of the CMA Agreement establishes the formula for compensatory payments.
3 See Corden (1972) for a discussion on monetary unions.
4 See Articles 3 and 4 of the CMA Agreement.

The arrangement provides for an explicit consultative process of contracting parties, particularly related to ensuring compliance with the agreement through the Common Monetary Area Commission[5]. Prior to the meetings of the Monetary Policy Committee (MPC) of the SARB, senior officials from all the research departments of the four central banks held consultative meetings primarily to discuss economic developments in their respective countries.

A recent development is the CMA Governor's Forum which meets on a quarterly basis[6].

Some analysts have argued that a move towards a fully-fledged monetary union promises more benefits to participating economies than mere monetary coordination. While the costs for any form of monetary integration are the same (i.e. the loss of nominal exchange rate), the benefits are, however, substantially greater with higher forms of monetary integration[7]. Clearly, the CMA remains a form of monetary coordination among members to support a fixed exchange rate pegging regime with South Africa. It does not have a shared monetary policy decision making process. A critical issue for debate is whether there is any economic justification for the transformation of the CMA into a fully-fledged monetary union. This debate becomes even more important in the light of SADC and the African Union (AU) ambitious monetary integration agendas.

## 2.3 CHARACTERISTICS OF THE CMA ECONOMIES

CMA countries are highly open economies. Tradable goods represents as much as 70 per cent of consumer price index weights. A key feature of the CMA economies relates to the relative large size and dominance of the South African economy. South Africa accounts for about 96 percent of the total gross domestic product (GDP) of the CMA economies and over 90 percent of the CMA total population. Over 80 per cent of the LNS imports are also sourced from South Africa. While the LNS exports are largely destined to industrial markets, South Africa remains an important market for the LNS manufactured exports.

Table 1 provides merchandise trade with South Africa for selected African countries. It can be seen that the LNS countries' trade with South Africa is very significant

5 This consists of senior treasury officials and has acted rather as forum to deal with exchange control matters rather than the conduct of monetary policy.

6 IPPR Interview No.7, October 2003 with Tito Mboweni, Governor of the SARB

7 See Grandes (2003) and Cobham and Robson (1994)

compared to the rest of Africa. This provides an obvious rationale for the economic usefulness of the peg. This minimizes transaction costs and exchange rate risks. The benefits of reduced transaction costs are likely to increase with improved trade volumes especially for the LNS diversified exports to South Africa.

However, it is not evident that the CMA has boosted intra-CMA trade flows. Such flows can largely be explained by the trade diversionary effects of the SACU trade policy regime which has been historically inward-looking. A point to make here is that the gains from this form of monetary coordination should perhaps be sought in other areas other than trade. In particular, even if the BLNS run bilateral trade deficits with South Africa, they might have benefited from trade with South Africa through additional spillover effects of investment and technology transfers along the lines discussed in the literature on trade and growth[8] as well as through such channels as economic sentiment and financial linkages.

**Table 1. Merchandise trade with South Africa as percetage of total merchandise trade (Average 1998 – 2002)**

| | |
|---|---|
| Angola | 3.5 |
| Ghana | 2.2 |
| Kenya | 5 |
| **Lesotho** | **70** |
| Malawi | 34 |
| Mauritius | 10.2 |
| Mozambique | 40.8 |
| **Namibia** | **56.2** |
| Nigeria | 1.2 |
| **Swaziland** | **80.6** |
| Zambia | 41.3 |
| Zimbabwe | 26.3 |

Source: IMF Direction of Statistics

[8] See Grossman and Helpman (1991), Rivera-Batiz and Romer (1991), and Romer (1990)

**Table 2. Selected Countries: Investment from South Africa, Stocks 1998 – 2002 (in percentage of GDP)**

| | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|
| Angola | 0.1 | 0.1 | 0.1 | 0.3 | 0.1 |
| Botswana | 7 | 3.3 | 3.1 | 3.3 | 2.4 |
| Congo, (DRC) | 0.8 | 0.4 | 0.3 | 4.1 | 0.2 |
| Ghana | 0.1 | 0 | 0.1 | 0.8 | 0.4 |
| Kenya | 0.1 | 0.1 | 0.1 | 0.3 | 0.2 |
| Lesotho | 10.6 | 21.3 | 29.4 | 29.5 | 11.7 |
| Madagascar | 0.6 | 0.1 | 0 | 0 | 0 |
| Malawi | 3 | 2.3 | 2.5 | 1.3 | 3.7 |
| Mozambique | 1.8 | 12.1 | 16.4 | 16.7 | 22 |
| Namibia | 10.1 | 8.7 | 9.2 | 7.5 | 10.1 |
| Swaziland | 23 | 21.5 | 20.1 | 6.5 | 5.3 |
| Tanzania | 0.5 | 0.2 | 0.3 | 0.7 | 0.7 |
| Uganda | 0 | 0.3 | 0.3 | 0.8 | 1.8 |
| Zambia | 2.4 | 1.7 | 1.8 | 4.5 | 4.3 |
| Zimbabwe | 3.3 | 3.8 | 2.1 | 1.6 | 0.6 |

Source: Adapted from Arora and Vamvakidis (2005)

The results of a recent study showed that South African economic growth (1970 – 2003) had a significant positive impact on growth in other African countries, with a 1-percentage-point increase in South African growth being associated with a 0.5 - 0.75 percentage point increase in the rest of Africa's growth. The share was substantially larger in the CMA countries ranging up to 20 percent of GDP. Mauritius and Mozambique also showed a significant relationship to the growth in the South African economy[9]. As Table 2 indicates, the size of South African investment stock in the LNS is quite substantial compared to the rest of sub-Saharan Africa, even as compared to neighbouring Botswana.

Another important feature of the CMA economies is their state of macroeconomic convergence, particularly on critical macroeconomic indicators that are necessary in promoting economic stability and growth such as inflation, budget deficit as percentage of GDP and external debt as percentage of GDP. Two factors are worthy

9 See Arora and Vamvakidis (2005)

to mention. Inherent in the CMA arrangement is the inability of the LNS to monetize their budget deficits and that their monetary liabilities should be backed by foreign assets. These prudent measures are important in promoting fiscal and monetary discipline. In addition, the free flow of capital between the developed capital markets in South Africa and the lesser developed financial systems in the LNS forces them to minimize interest rate differentials with those prevailing in South Africa. This is necessary to prevent the outflow of capital to South Africa. Since 2000, South Africa has adopted an inflation-targeting approach to the conduct of monetary policy. An inflation target of 3-6 per cent has been set by the South African government. The inflation rate (CPIX) has continued to stay within this target range since 2003. The average inflation rate in Namibia has also declined to 3.9 percent in 2003 and is estimated to be around 4.5 percent in 2005[10].

## 2.4 NAMIBIA AND CMA PARTICIPATION

A number of studies have attempted to assess the costs and benefits of Namibia's participation in the CMA[11]. An empirical question has been whether the loss of control over the nominal exchange rate as an instrument of economic policy matters for Namibia, in terms of the costs involved. There is an overwhelming consensus that the benefits of CMA membership outweigh the costs[12]. Such benefits can be summarized as follows:

- **Reduction of transactions costs:** About 80 percent of Namibia's imports are sourced from South Africa. The absence of the need to exchange the Namibia dollar into the South African rand so as to obtain these goods and services represent a significant saving in transaction costs. This enhances the usefulness of the Namibia dollar in its functions - as a means of payment and unit of account. Reduced costs to the Namibian economy can also be attributed to the fact that Namibia does not need the required institutions and technical expertise for sound monetary policy and exchange rate management.

- **Exchange rate fluctuations:** Exchange rate fluctuations generate uncertainty with adverse effects on trade and investment. The elimination of such fluctuations promotes economic stability. Given the volume of Namibia's trade with South Africa

10 Bank of Namibia (2005)

11 See Tjirongo (1995); Jenkins and Thomas (1997); Honohan and O'Connell (1997); Vollan (2000); Grandes (2003), amongst others.

12 See Alweendo (1999) and Kalenga (2001)

and the extent of investment flows from South Africa, having a fixed exchange rate with South Africa has promoted needed economic stability.

• **Financial development and deepening:** The degree of Namibia's involvement with international capital markets is low. The economy and financial system relied heavily on South Africa's currency and such reliance is still very extensive today.

• **Policy credibility:** At independence, there was a dire need to make Namibia's economic policies credible in the eyes of both local and international economic agents. Policy credibility is earned over a long time through consistent government behavior. CMA membership and its associated macro-economic implications has been an important factor in sustaining investor confidence in Namibia. This has been echoed by the International Monetary Fund (IMF) and commentators on determinants of foreign direct investment (FDI) flows to Namibia[13].

• **Price stability:** There is lack of agreement in the economic policy profession as to what is the optimal exchange rate arrangement. Even the IMF opted for not pronouncing itself on this issue. Its advice on exchange rate policies has always been tailored to a member country's preferred exchange rate regime[14]. But there exists now a broad acceptance that the key objective of monetary policy should be to deliver low inflation. The CMA arrangement is certainly a contributing factor in Namibia's ability to maintain price stability.

But these benefits must be viewed against Namibia's other experiences in the CMA system. Namibia experienced capital outflows to South Africa due to the level of sophistication of financial markets in South Africa and limited investment opportunities in Namibia. Such outflows have been found to amount to about 10 percent of GDP annually between 1995 and 2000, according to official sources. It has also been argued that these outflows could undermine the development and deepening of the domestic financial system.

The depreciation of the exchange rate around 1998 to 2002, also invoked a debate about the country's CMA membership, especially due to the high interest rates that resulted from South Africa's efforts to contain inflation. This meant that the cost of borrowing increased and the economy was credit-constrained[15]. Due to the

13 See UNCTAD (2002)

14 See IMF (2000), Appendix IV

15 Grandes and Pinaud (2004) argue that lowering interest rates and, thus, the cost of borrowing in the CMA is a priority to promote investment and economic growth.

characteristics of the country's export basket, exchange rate depreciation did not generate sufficient response necessary to make exports more competitive as in the case of certain South African exports. Today, there are also concerns about the appreciation of the exchange rate, making Namibian exports expensive. This has some adverse effects on certain sectors such as fishing, mining, agriculture and tourism. This is a matter of concern since the manufacturing sector has strong backward linkages with these sectors in the form of further processing. But despite these experiences, the gains of participating in CMA appear to be superior to associated costs.

### 2.5 DEEPENING CMA INTEGRATION

There is no doubt that membership in the CMA has promoted both macro-economic stability (in terms of low inflation, fiscal discipline and policy credibility) and micro-economic efficiency (arising from the reduction in transaction costs). CMA countries have achieved a satisfactory level of macro-economic convergence considering relatively similar macro-economic conditions (inflation, budget and current account deficits and levels of debt) and policies, a necessary pre-condition to deeper monetary integration.

This is in contrast to the wider SADC and sub-Saharan African economies which are still quite diverse in terms of macro-economic conditions and achievements. Therefore, a convincing argument can be advanced that the CMA is now ready for a fully-fledged monetary union, which will make monetary policy making a collective venture of participating economies. This will mean the establishment of a CMA central bank and a single currency. There are economic and political imperatives for such an argument to reach the public discourse, especially in terms of assessing its potential impact on the CMA economies. This requires a more pro-active approach by the LNS countries themselves. Such a transformation may not only be a stepping stone towards a continental wide monetary integration process but will also offer the LNS countries an opportunity to build the requisite technical expertise for participation in monetary policy management.

## 3. THE SOUTHERN AFRICAN CUSTOMS UNION

### 3.1 Evolution of SACU

The Southern African Customs Union (SACU) can be dated as far as 1889 when a Customs Union Convention between the Colony of the Cape of Good Hope and the

Orange Free State was established. This union was joined by Lesotho (then Basutoland) in 1891, Botswana (then Bechuanaland) in 1893 and Swaziland in 1904. With the formation of the Union of South Africa, bringing together the Cape Colony, Natal, Orange Free State and Transvaal in 1910, a new Customs Union arrangement was signed between this union and the three High Commission territories of the former British protectorates of Botswana, Lesotho, and Swaziland. This culminated into the 1910 Customs Union Arrangement[16].

Following independence of Botswana, Lesotho and Swaziland, this arrangement was re-negotiated and replaced by the 1969 SACU Agreement[17]. Namibia became the fifth de jure member of SACU on 10 July 1990; but was a de facto member when it was colonized by South Africa until 1990[18]. In the light of some pitfalls in the 1969 SACU Agreement, SACU members decided to re-negotiate it by 1994, culminating into the adoption of a new 2002 agreement. This was ratified by the legislatures of the five member States and came into force in 2004.

### 3.2 Salient Features of the 1969 SACU Agreement

Under the 1969 Agreement, members apply the common external tariff and other trade measures such as excise, anti-dumping, countervailing, and safeguard duties, unilaterally set by South Africa, to goods imported into the common customs area from countries outside the Union. While Article 5 of the 1969 Agreement requires South Africa to afford the other members adequate opportunity for consultations before imposing, amending or abrogating customs duties, except in specified cases, South Africa has unilaterally set the common external tariffs and other trade remedies, often in response to its own domestic trade and industrial policy interests.

The application of Article 5 was also constrained by the lack of appropriate institutional frameworks in the customs territory. Institutions that evolved such as Customs Union Commission and a number of technical committees were simply to ensure compliance with the agreement rather than influence trade and industrial policy developments[19].

16 The economic rationale for the formation of this customs union agreement was primarily to facilitate the collection and distribution of revenue from customs duties rather than the modern-day rationale of establishing them as regional integration arrangements.

17 Botswana and Lesotho became independent in 1966 and Swaziland in 1968.

18 Namibia became independent on 21 March 1990.

19 This emulated the CMA Commission discussed earlier.

The overall trade and industrial policy responsibility was vested in the South African Department of Trade and Industry (DTI) and its Board on Trade and Tariffs (BTT), which was responsible for determining the levels and changes of the common external tariffs and the application of trade remedies.

All customs and excise duties collected by the five members were pooled into a Consolidated Revenue Fund (CRF) administered by South Africa. The shares of Botswana, Lesotho, Namibia and Swaziland (the BLNS) countries were determined on the basis of a revenue-sharing formula (RSF) and the residual (after the BLNS countries have been paid) was allocated to South Africa. The RSF had an explicit provision for a compensatory payment to the BLNS for entering into a customs union arrangement with a larger and economically advanced trading partner.

The 1969 Agreement also permitted any SACU member to enter into preferential trade agreements with third parties provided that the terms of such agreements or amendments do not conflict in any way with the provisions of the SACU Agreement. This resulted in a number of bilateral preferential agreements such as Namibia-Zimbabwe trade agreement, South Africa preferential trade agreements with Malawi, Zimbabwe and Mozambique; Botswana-Zimbabwe preferential trade agreement, and recently the Trade Development and Cooperation Agreement (TDCA) between South Africa and the European (EU). It also led to Lesotho, Namibia and Swaziland joining the Common Market for Eastern and Southern Africa (COMESA). Swaziland is the only remaining SACU member in COMESA after Lesotho and Namibia withdrew in 1998 and 2004 respectively. Such multiplicity of agreements can be costly to member states since they require different sets of rules of origin and the associated costs related to customs procedures. Yet, as discussed later, the revision of the 1969 Agreement has not adequately resolved the issue of trade relations with third parties.

The 1969 Agreement provided for infant industry protection in the BLNS countries from intra- and extra-SACU competition. The use of such provisions by the BLNS has been rather limited.

Due to restrictive local content requirements the BLNS countries were not able to attract investment in industries that posed a competitive threat to South Africa’s highly protected industries such as the auto, textile and clothing industries. For example, the Hyundai assembly plant in Botswana was forced to close down. Recent Africa Growth Opportunity Act (AGOA)-induced investment in the garment sector in the BLNS (e.g. Ramatex textile factory in Namibia) are still restricted to take advantage of regional markets due to a restrictive rules of origin regime.

### 3.3 The 2002 SACU Agreement

At a SACU ministerial meeting in Pretoria on 11 November 1994, a formal decision was made to renegotiate the 1969 Agreement. Key negotiating issues were[20]:

- the technical revision of the revenue-sharing formula, including the level of compensation to BLNS states for the disadvantages of forming a customs union with South Africa (loss of fiscal discretion, price-raising and industrial polarization effects of the common external tariff)

- time lags in distribution of revenue by South Africa

- the review of the management and institutional aspects of the SACU trade policy regime; and

- the need for a dispute settlement mechanism.

The 2002 Agreement introduced a new institutional structure as part of the democratization of the customs union. These institutions include:

• a Council of Ministers, the supreme decision making body of the customs union

• a Customs Union Commission, comprising of the senior government officials of the Member States

• a Secretariat, a permanent body with headquarters in Windhoek that is responsible for the day-to-day administration of the customs union

• a Tariff Board, a body of experts that makes recommendations to the Council on the level and changes of customs and trade remedies

• the Technical Liaison Committees that advise the Commission in its work

• an Ad hoc Tribunal for the settlement of disputes, and

• the National Bodies that conduct national investigations and prepare submissions

20 See WTO (2003)

to the Tariff Board and provide comments on the submissions of other national bodies[21].

The above-stated institutions will now form the core of trade policy formulation and implementation in the customs territory.

The 2002 Agreement has also introduced a new system of managing and sharing the common revenue pool, which is being managed by South Africa for two years from the entry into force of the Agreement. Thereafter, a Member State or SACU institution is to be appointed by the Council to manage it. South Africa is no more receiving the residual but is now entitled to its share of customs and excise revenue just like other members. The total CRP has now three components, which are governed by a different set of distribution criteria. The customs component, consisting of all customs duties actually collected, will be distributed on the basis of each country's percentage share of total intra-SACU imports, excluding re-exports. The excise component, consisting of all excise duties actually collected on goods produced in the customs area (net of the development component), will be allocated on the basis of each country's share of total SACU GDP. The development component will be funded initially from 15 percent of the total excise component, and distributed on the basis of each country's GDP per capita: countries with lower income per capita will receive more[22].

The new agreement requires that trading arrangements would only be possible with SACU as a whole, and not with individual SACU members. Members are called to have a common negotiating mechanism, when negotiating trade agreements. Yet, article 31 of the new agreement allows member states to maintain preferential trade and other related arrangements already in force. It is also stipulated further that Members shall not negotiate and enter into new preferential trade agreements or amend existing one without the consent of the other members. This is quite problematic in view of the application of the common external tariff. It is therefore not clear, for example, how South Africa can continue to have a free trade agreement with the EU (the TCDA) and other members to conclude an economic partnership agreement (EPA) with the EU in a current SADC configuration, without undermining the integrity of the customs union.

21 At present, South Africa is the only Member State with a national body – the International Trade Administration Commission (ITAC), with enabling legislation to manage the common external tariff of SACU for the 12 months following the implementation of the new agreement.

22 See Gaomab II and Hartmann (2005) and IMF (2005) for further details about the 2002 SACU Revenue Sharing Formula.

While existing common external tariff structure and tariff policy continue, the new agreement calls for the adoption of common industrial policies[23] , but cooperation and collaboration in agriculture and competition, and unfair trade practices. On industrial policies, this requires each member to develop its national policies to inform the development of SACU-wide common policies. The agreement also calls for the harmonization of regulatory regimes on customs procedures, products standards and technical regulations.

### 3.4 Key challenges for SACU

The 2002 agreement affords all SACU members the opportunity for setting trade policy as opposed to the previous agreement whereby South Africa did so unilaterally. BLNS countries are now challenged to effectively participate in this process in order to ensure that SACU's trade policies are set in line with their industrial development priorities. This is not an easy task considering different levels of economic development, ranging from a relatively diversified giant South Africa and a least developed Lesotho. Policy integration in such an environment poses fundamental challenges, particularly in the promotion of industries and international trade. This is even more complicated when the majority of members' public budgets substantially depend on the revenue from customs and excise duties.

- **Industrial policy challenges**

The requirement of a common industrial policy poses significant challenges. Balanced development of the common customs area (CCA) is a fundamental recognition in the 2002 Agreement. From this perspective it is expected that such policies should favour industrial growth in the lesser-developed economies. This raises a number of important questions related to the appropriate industrial policy instruments or degree of intervention to be used and the extent to which the external tariff can be used as an instrument of balanced industrial development.

The menu of industrial policy instruments is quite long and varied and is not necessarily restricted to the import tariff. South Africa has, in the past, used a number of instruments ranging from the import tariff, rebates and other incentives. The current motor industry development plan (MIDP) in South Africa is a practical example.

23 The new agreement maintains the infant industry provision under which the BLNS can impose duties on imports from South Africa provided this is also done on extra-regional imports.

The use of anti-dumping, countervailing, and safeguard measures by South Africa continues to be tailor-made to South Africa's industrial strategies[24].

The challenge for the BLNS on industrial policy is to develop appropriate trade policy capacity in terms of enhancing a coherent trade strategy to promote the country's national interests so that they find space in the SACU policy cocktail; the establishment of the required institutions with appropriate technical expertise in trade policy analysis, tariff-setting, and in the investigation and application of trade remedies.

- **Challenges of the new revenue-sharing mechanism**

Apart from South Africa, the common revenue pool is an important source of the BLNS public revenue. Therefore, a mechanism to equitably share in the gradually declining customs revenue remains a critical challenge in various respects. First, the new SACU agreement explicitly recognizes 'the importance of tariffs as instruments for the implementation of industrial development policy' rather than for revenue generation[25].

Second, SACU's bilateral tariff liberalization with strategic trading partners (such the US, EU, MERCOSUR, China and India) and trade liberalization in the context of the World Trade Organization (WTO) will significantly reduce the common revenue pool. What does industrial policy mean in a liberalised trade environment?

Third, while the total amount distributed to members is limited to the estimated (declining) size of the common revenue pool, the allocation of members' shares is not on the basis of their imports from the rest of the world but significantly on the basis of their intra-SACU trade. Intra-SACU trade is certainly not affected by declining customs duties and granting of rebates.

It is argued that by allocating revenue shares according to intra-SACU trade rather than total SACU imports, this compensates members for the price-raising effects of the external tariff. Over 80 percent of the BLNS imports are sourced from South Africa, while South Africa's imports are mostly from the rest of the world. The problem arises from the fact that intra-SACU trade is supposed to move freely and instituting an administrative mechanism for collecting data on such flows, and

24 The WTO Trade Policy Review (2003) noted that South Africa, and by extension SACU, was among the leading initiators of anti-dumping actions among the WTO members.

25 See Preamble to the 2002 SACU Agreement.

making the distribution of the customs component of the revenue dependant upon this data, (however it is true that this data is very useful to inform industrial policy development) necessarily compromise the economic gains to be derived from the reduction of transaction costs on intra-SACU trade. It is also not clear as to how to deal with the question of re-exports from one SACU country to another.

Namibia is unlikely to continue drawing the usual share of revenue from the common revenue pool. Compared to 2004/05, preliminary estimates suggest that Namibia's SACU receipts will fall up to 2.5 percent of GDP in 2005/06, reaching 4 percent of GDP by 2009/10[26]. Namibia's 2005/06 budget has already indicated the profound nature of the fiscal implications of the new revenue-sharing formula.

- **Challenges of trade data reliability**

A discussion on the challenges arising from the sharing of the revenue common pool cannot be conclusive without emphasizing the need for improving the quality and timeliness of trade and economic data as well as revenue forecasting capacity in the member States. The basis for collecting data on intra-SACU trade is necessarily the sharing of the customs revenue. The incentives for members to inflate such data cannot be ruled out. This is a potential area for unnecessary conflict if not properly dealt with. Reducing substantial reliance on customs revenue should be a strategic priority. The situation is serious and pressing.

## 4. THE SOUTHERN AFRICAN DEVELOPMENT COMMUNITY

### 4.1 Evolution of SADC

SADC evolved out of the Southern African Development Coordination Conference (SADCC), which was established in April 1980 with nine members[27]. It was to be responsible for the mobilisation of funding and the coordination of the implementation of development projects of common interest among its member states[28]. The priority focus was on food security, agricultural research and the development of transport and communications infrastructure. Regional integration was not the initial focus of the SADCC agenda.

26 IMF (2005)

27 The founding members of the SADCC were Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe. Namibia joined after its independence in 1990. SADC continues to be donor-driven.

28 The founding members were Angola, Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Swaziland, Tanzania, Zambia and Zimbabwe. South Africa joined in 1994 and the Democratic Republic of Congo (DRC) and Seychelles acceded in November 1997, bringing SADC's total membership to 14 countries. Seychelles's withdrawal of membership became effective at the beginning of July 2004. Madagascar was awarded “candidate membership status” at the 2004 Summit in Mauritius. Its membership is expected to become effective in August 2005.

SADCC was transformed into the Southern African Development Community (SADC) on the 17th of April 1992 with the signing of the SADC Treaty in Windhoek, Namibia[29]. The transformation into SADC was significantly influenced by a number of regional and international developments. Namibia achieved independence in 1990 and the imminent demise of apartheid in South Africa removed the main political rationale behind SADCC. The 53 member States of the Organisation of African Unity (OAU) signed the Treaty Establishing the African Economic Community (AEC) in Abuja, Nigeria, in June 1991. The Treaty, commonly known as the Abuja Treaty seeks to create the AEC through six stages culminating in an African Common Market using the various Regional Economic Communities (RECs) as building blocks.

To participate in this process, SADC had to extend its agenda to include regional integration and trade liberalization. This also led to a SADC restructuring process resulting in the termination of member States-based coordination of sectoral activities and programmes and the adoption of a more centralised approach. The former 21 coordinating units were grouped into four clusters at the SADC Secretariat based in Gaborone, viz. trade, industry, finance and investment (TIFI); food, agriculture and natural resources (FANR); infrastructure and services; and social and human development and special programmes.

### 4.2 Intra-SADC trade liberalization

In 1996 eleven of the then twelve Member States of SADC signed the Protocol on Trade in Maseru, Lesotho, which entered into force on the 1st of January 2000 after being ratified by the required number of Member States. Angola and the DRC are not yet party to the trade protocol. The overall objective of the trade protocol is to have 85 percent of all intra-SADC trade at zero tariffs by 2008 and the remaining 15 percent to be liberalized by 2012, effectively establishing a free trade area (FTA).

The FTA is seen as the first step towards creating a customs union by 2010 and a common market by 2015[30]. Currently these targets seem to be rather optimistic considering the slow pace of implementing the trade protocol. The structure of tariff liberalisation offers and the timetables for implementing such offers suggest that many countries are cautious about intra-regional free trade either due to the fear that they will forgo substantial tariff revenues or that their import-sensitive' industries

29 SADC, RISDP (2003), para. 3.2.2.2. and Table 10.
30 SADC, RISDP (2003), para. 3.2.2.2. and Table 10.

will not withstand regional competition, especially from South Africa. A recent mid-term review of the SADC Protocol on Trade found that, with the exception of SACU and Mauritius, most member States are lagging behind their implementation schedules. While South Africa and its SACU partners agreed to move faster towards zero tariffs than other members, they insisted on the adoption of restrictive rules of origin[31] , especially on 'import-sensitive' industries in South Africa.

The removal of tariff barriers to intra-regional trade is not enough to promote intra-regional trade and enhance regional integration. Non-tariff barriers (NTBs) to trade are even more critical as they remain a serious hindrance to intra-SADC trade. Progress in addressing NTBs in SADC has rather been even slower. The SADC region remains characterized by a host of NTBs such as periodic import bans, non-transparent road charges, transit fees at border crossings, administrative delays at ports and border posts, cumbersome customs formalities, multiple inter-state checkpoints and roadblocks, etc. Although there is justification for some of these measures, it is important to note that NTBs reduce the economic benefits of market integration, especially if their non-transparent and arbitrary application increases transactions costs and creates uncertainty.

The move towards a customs union will particularly be difficult for a number of reasons. The establishment of a customs union will mean the setting of a common external tariff. The current most-favoured-nation (MFN) tariff rates vary considerably across SADC countries. This raises industrial policy challenges of moving towards a common external tariff. The motive behind customs tariffs in the least developed members appears to be revenue generation. Therefore, the loss of fiscal discretion arising from a common external tariff is likely to pose significant challenges. Membership to overlapping regional integration schemes such as the East African Community (EAC), COMESA and SADC remains a problematic challenge.

It is difficult to assess the impact of the SADC trade protocol on intra-regional trade flows for a number of reasons. Many countries have back-loaded their tariff reduction schedules, i.e., postponing most intra-SADC tariff liberalization towards the end of the tariff-phase down period. The rationale for such back-loading lies in

31 Rules of origin specify the necessary conditions that goods are produced in a SADC country so as to enjoy preferential treatment. While such origin rules are necessary to prevent trade deflection, they have largely become instruments of trade protection, with adverse consequences on the ability of the Trade Protocol to achieve its intended goals – of enhancing intra-regional trade, promoting the required investment, and the global competitiveness of regional producers (see Brenton, Flatters & Kalenga, 2004).

the apparent need to contain adjustment costs related to a reduction in customs revenue and pressure on import-competing industries. Most products that have the potential to respond positively to tariff changes – those that are currently being traded amongst members such as textiles and clothing, beverages, tobacco, leather, furniture and foodstuffs – are viewed as 'sensitive' and are only to be liberalized towards the end of the tariff phase-down period. Inadequate data on intra-SADC trade flows makes an empirical assessment of the SADC Trade Protocol rather difficult.

What can be said is that intra-SADC trade is still low. Table 3 indicates a low level of intra-SADC trade. The mid-term review of the SADC Trade Protocol at the end of 2004 concluded that at the broad level there was little evidence that the tariff phase down has had a significant impact on stimulating intra-regional trade[32]. There are limited prospects in the short- to medium term of increased intra-SADC exports despite preferential market access (except for South Africa). The reasons for this include similarity of economic structures and products among SADC countries and the weak industrial base and dependence on commodity exports. However, further liberalization in 'sensitive' products and relaxation of restrictive rules of origin holds some prospects for intra-SADC trade growth[33].

32 SADC Secretariat Report to the Trade Negotiation Forum/29/2005/3
33 See Brenton, Flatters and Kalenga (2004) for the discussion on SADC rules of origin.

**Table 3 Intra-Arrangement Trade in Africa (Percent of total trade)**

| | 1970 | 1980 | 1990 | 1998 | 2003 |
|---|---|---|---|---|---|
| **Exports:** | | | | | |
| CEMAC | 4.9 | 1.6 | 2.3 | 2.3 | 1.4 |
| COMESA | 9.7 | 9.1 | 8.1 | 8.9 | 8.6 |
| ECOWAS | 3.1 | 10.6 | 8.9 | 11.1 | 10.1 |
| WAEMU | 7.9 | 12.6 | 15.3 | 13 | 16.2 |
| **SADC** | **9.4** | **2.7** | **6.9** | **6** | **6** |
| Africa | 8.8 | 5.2 | 7.3 | 10.5 | 9.3 |
| **Imports:** | | | | | |
| CEMAC | 5 | 3.7 | 3.6 | 3.9 | 2.9 |
| COMESA | 6.7 | 2.8 | 3.4 | 3.9 | 5.8 |
| ECOWAS | 3.3 | 10.2 | 14.9 | 12.9 | 11.5 |
| WAEMU | 6.4 | 7.6 | 14.8 | 9.8 | 13.3 |
| **SADC** | **4.9** | **3.8** | **6** | **6.1** | **6.3** |
| Africa | 7.4 | 5.1 | 7.9 | 9.2 | 10.2 |

Adapted from IMF (2005b)

**Table 4. Some large investments in SADC by South African companies, 2000-2003**

| Host country | Target (acquired company) | Source | Industry |
|---|---|---|---|
| DRC | Grand Inga Hydroelectric | Eskom Holdings | Utilities |
| | Komato Copper Mine | Kumba Resources | Basic industries |
| | Vodacom Congo | Vodacom | Telecommunications |
| | Kolwezi Tailing Project | IDC | Basic industries |
| Mozambique | Pande-Temane gasfields | Sasol Oil | Basic industries |
| | Vodacom Mozambique | Vodacom | Telecommunications |
| | Mozal II | IDC | Basic industries |
| | Caminhos de Ferro de Mozambique | Ressano Garcia Rail | Rail service |
| | Banco Standard Totta de Mozambique | Stanbic Africa | Financial services |
| Namibia | Skorpion Zinc Project | AngloGold | Mining |
| | Commercial Bank Namibia | Nedbank | Financial of Services |
| Tanzania | Vodacom Tanzania | Vodacom | Telecommunications |
| | Ashanti Goldfields | AngloGold | Mining |
| | Geita Project | | |
| Zimbabwe | Zimbabwe | Impala Platinum | Mining |
| | Platinum Mines | | |
| | Hartley Platinum Mines | Impala Platinum | Mining |
| Angola | Business & Tourism Project | Sun International SA | Hotel/Tourism |
| Botswana | Investec Bank (Botswana) | Stanbic Africa | Financial Service |

Source: Businessmap Foundation

### 4.3 SADC and Macroeconomic Convergence

SADC has also an ambitious goal of deepening its integration towards a monetary union by 2018. A Memorandum of Understanding (MoU) on Macroeconomic Convergence has been adopted by SADC Ministers of Finance in 2001. This MoU provides a framework for the formation of a regional monetary union. Members have agreed to achieve and maintain macroeconomic stability. In order to monitor the implementation of this MoU, four indicators were identified as the rate of inflation; the ratio of budget deficit to GDP; the ratio of public and publicly guaranteed debt to GDP; and the balance and structure of the current account. It is believed that convergence targets for those indicators will provide the basis for smoothly integrating the economies of Southern Africa into a fully-fledged economic union. A macroeconomic surveillance mechanism will be established to monitor the movement towards convergence. Table 5 provides the numeric values of these target indicators. The SADC Committee of Central Bank Governors (CCBG), established in 1995 to promote closer co-operation between SADC central banks, in collaboration with the SADC Committee of Finance Ministers, is tasked with implementing this macroeconomic convergence programme.

**Table 5. Numeric Values of Target Indicators**

| | 2008 | 2012 | 2018 |
|---|---|---|---|
| Core Inflation | 9 | 5 | 3 |
| Budget Deficit as percent of GDP | 5 | 3 | 1 |
| External Debt as percent of GDP | 60 | 60 | 60 |
| Current Account as percent of GDP | 9 | 9 | 3 |

SADC still has a long way to go before it can achieve the goals set in the macro-economic convergence programme. Average inflation rate in SADC continues to be relatively higher compared to the rest of Africa.

Viewed on an average basis, annual inflation rate increased from 28.8 percent in 2002 to 43.6 percent in 2003. This is because there are still countries with three digit level inflation such as Angola and Zimbabwe. Angola has been experiencing a positive declining trend such that the annual inflation stood at 105.6 percent in 2003. In Zimbabwe, however, the annual inflation rate increased from 113.2 percent in 2002 to 365 percent in 2003. Excluding Angola and Zimbabwe, average annual inflation for the SADC region has declined from 20.1 percent in 2002 to 16.8 percent in 2003. Nine countries – Botswana, DRC, Lesotho, Malawi, Mauritius, Namibia, South Africa, Swaziland and Tanzania – have recorded inflation rates of less than 10 percent in 2003. Thus, for the majority of SADC countries, the target of 9 percent is not necessarily unrealistic. A caveat should be added. Measurements of the consumer price index (CPI) which is chosen as core inflation are not comparable across countries.

The fiscal deficit to GDP ratio in many SADC countries also suggests possibilities of attaining the 2008 target of 5 percent by 2008, since it averaged 4.0 and 3.7 percent in 2002 and 2003 respectively. Nevertheless, the majority of SADC countries are still largely dependent on customs revenue for their budgetary requirements. With increasing trade liberalization this source of revenue is under attack necessitating severe fiscal adjustments.

Southern Africa remains the least indebted region in sub-Saharan Africa, although Malawi, Mozambique and Zambia are classified as heavily indebted poor countries. The burden of public sector external debt continues to decline. It is likely to decline further as a result of positive international undertakings to cancel external debt for some countries. Mozambique and Tanzania were already entitled to full debt relief under the Enhanced HIPC Initiative. Countries like the DRC and Malawi have very high ratios in excess of 150 percent of GDP. The majority of countries have external debt levels below 30 percent of GDP.

The achievement of other macro-economic targets depends on other factors such as economic growth, import cover and official transfers. The challenge of raising growth in turn depends on the attraction of the necessary investment, especially foreign direct investment (FDI). Political stability and effective implementation of appropriate macro-economic stability policies are fundamental to the promotion of an enabling investment environment. As it stands, SADC's GDP growth performance remains insufficient to support its macroeconomic convergence programme.

### 4.4 Key challenges for SADC integration

There is a wide recognition of the limitations of intra-African trade liberalization. This argument undermines the popular belief that characterized the proliferation of integration schemes in Africa as 'apparent' training grounds to prepare regional industries for multilateral trade liberalization by first liberalizing intra-regional trade.

This has certainly fallen short of expectations. A SADC regional market is just too small and poor to support industries that can be internationally competitive. Therefore, intra-regional trade liberalization should be accompanied by further opening up to the rest of the world. Specifically, it will be in the best interest of participating economies if serious attention is paid to non-tariff barriers (NTBs), including the reform of rules of origin.

The success of the SADC integration process depends on the ability to attract the necessary investment required to address supply-side bottlenecks. This requires concerted efforts to improve SADC's credibility in terms of enhancing stability in its political and macroeconomic environment. SADC countries need to invest more attention on the improvement of basic infrastructure, especially those that lowers transactions costs of doing business. In the final analysis, it should be the policy and regulatory actions at national levels that should underpin regional integration. At present there seems to be a disjuncture between domestic policies and the ambitious aspirations of the regional integration agenda.

This agenda will have to be owned at national levels for it to succeed. The capacity to implement national policies that supports regional integration continues to be weak in many SADC member States. Without addressing these challenges, the prospects for success in effectively integrating SADC economies remain rather bleak.

## 5. Conclusions

Namibia should determine its priorities among competing demands of participating in various regional integration arrangements. An effective participation in the new SACU arrangement is definitely an immediate priority. This is largely so because it is the SACU arrangement that informs Namibia's policy and strategy of integrating into the global economy. The establishment of domestic policy and institutional capacity to engage the SACU regime, the building of requisite technical expertise for such engagement and an urgent focus on improving the collection and analysis of trade data are in my opinion immediate priorities for Namibia.

The SACU countries have recognized the benefits of more open economies. They have an aggressive agenda of concluding trading arrangements with major trading partners. This is in stark contrast to the other countries in the region. The 2002 SACU Agreement provides an impetus for deeper integration of the SACU economies. This depends on the extent to which members will deal with the complex issue of sharing the common revenue pool; the re-alignment of their national trade and industrial policies and strategies through the development of common policies; the appropriate evolution of common negotiating mechanism with third parties; and the formation of institutional capacity at national and regional level to effectively implement the new SACU agreement.

The second priority is to maintain the country's macro-economic policy credibility, which has largely been supported by participation in the CMA arrangement. This relates to the importance of price stability through fiscal and monetary discipline. As long as the CMA arrangement continues to support these goals, its relevance to the domestic economy is likely to be superior to a flexible exchange rate option. However, a move towards transforming the CMA arrangement into a fully-fledged monetary union may further enhance its usefulness as an instrument of fostering a common economic space. This is desirable as it will not only promote the involvement of the LNS in the monetary policymaking process thereby accommodating their national economic interests but also prepare them to participate effectively in the process of regional monetary integration envisaged under the SADC and African Union agenda. Flexible labour markets and labour mobility within the CMA is likely to enhance associated gains of deeper CMA integration. .  There is a need to assess the potential implications of such an option to Namibia (and other CMA members) and to encourage stakeholder debate on the issue.

Lastly, the SADC integration agenda remains vital to Namibia in so far as its original infrastructure development programmes are concerned. These will lead to a reduction of trade transaction costs in the region, and facilitate exports, primarily of fish and processed products to these countries. At a practical level, SADC Member States should demonstrate a political will and national commitment to regional integration at a level never seen before, if regional integration is to succeed. Regional integration in Southern Africa will only succeed if national policies are generally favourable to international trade.

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# EVALUATING THE IMPACT OF "ASYMMETRIC" REGIONAL INTEGRATION: THE RECENT EUROPEAN EXPERIENCE[34]

BY

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## ABSTRACT

*This article reviews the ongoing process of regional integration between the "old" and "new" members of the European Union. The liberalisation of trade and financial markets appear to have been important factors underpinning the ongoing catching up process. This is shown by (i) reviewing the impact of enlargement as suggested by various different modelling approaches and by (ii) examining a number of remarkable stylised facts. We come to the conclusion that, subject to some important qualifications, the success story of the new Member States sheds a positive light over the merits of regional integration even among countries of different size.*


## 1. INTRODUCTION

Over recent years regional integration appears to be one of the rising features of the world economy[35]. This phenomenon is generally portrayed by economists as positive, as it supposedly creates additional wealth, by enhancing competitiveness and raising standards of living. The aim of this article is to review some of the advantages of regional integration by examining in some detail the recent EU eastward enlargement. This experience provides a number of interesting insights, showing how integration may also succeed among countries which are very different in terms of standards of living and size. For convenience we will refer to this type of regional integration as "asymmetric".

A number of additional difficulties are associated with processes of regional

[34] This paper presents the authors' personal opinions and does not necessarily reflect the views of the European Central Bank.

[35] The rapid changes of the word economy are illustrated by the contemporaneous drive toward greater regionalism and globalisation. For a comprehensive analysis of the rapid changes in the external dimension of the euro area see Anderton, R., di Mauro, F. and Moneta F. (2004).

integration among countries with asymmetric characteristics. For example, in small and relatively poor countries concerns typically arise over a possible "loss of sovereignty" as soon as foreign companies and financial institutions start assuming a dominant role in the domestic market. In the larger "wealthier" countries the increased competitive pressures and exposure to foreign lower labour costs, often generate fears about the possibility of "job losses" and "production relocation". Despite these difficulties the experience of the new EU Member States vis-à-vis the rest of the European Union is judged by most commentators as overwhelmingly positive.

We begin by <u>reviewing the channels</u> through which regional integration may positively affect economic growth. We then <u>examine a number of alternative modelling approaches,</u> which have been conducted prior to the enlargement of the European Union in order to gauge its impact. These models suggested that regional integration process would be beneficial to all parties, although the benefits would be mostly felt by the smaller catching up countries. <u>We then analyse</u> how these optimistic expectations about the benefits of enlargement appear to have been largely fulfilled, although several challenges ahead remain. <u>We finally conclude</u> by remarking how the success story of the new Member States sheds a positive light about regional integration among "asymmetric" countries also for other areas of the world. However, one of the factors, which we think have played a fundamental role in supporting economic growth in the new Member States, has been the strong drive toward "institutional stability", as required by the enlargement process itself. The adoption of the "acquis communautaire" has also helped the new Member States attaining a stable macroeconomic and a predictable legal framework. At the same time the increased reliance to competitive market forces has strengthened economic efficiency providing the necessary environment for "catching up" to take place.

## 2. THE ASYMMETRY OF CENTRAL AND EASTERN EUROPEAN COUNTRIES

Our analysis begins by documenting the degree of asymmetry between the new EU Member States and the rest of the European Union both in terms of size and wealth. Table 1 shows a number of key indicators for the three largest countries, which joined the European Union in May 2004, i.e. the Czech Republic, Hungary and Poland.

**Table 1. Relative sizes**

| 2004 | Population mln | Population as % of EU-15 | GDP in bn EUR PPS | GDP as% of of EU-15 | GDP per capita in thous EUR PPS | GDP per capita as % of EU-15 |
|---|---|---|---|---|---|---|
| Chec Rep. | 10.2 | 2.7 | 155.9 | 1.7 | 15.3 | 64.4 |
| Hungary | 10.1 | 2.6 | 136.2 | 1.5 | 13.5 | 57.0 |
| Poland | 38.2 | 9.9 | 395.4 | 4.3 | 10.4 | 43.8 |
| **2000** | **Population mln** | **Population as % of RSA** | **GDP in bn USD PPS** | **GDP as% of RSA** | **GDP per capita in thous USD PPS** | **GDP per capita as % of RSA** |
| Namibia | 1.7 | 4.0 | 7.7 | 2.4 | 4.5 | 59.1 |

The degree of asymmetry was (and still is) rather large. For example, in 2004 both the Czech Republic and Hungary accounted for about 2.5 percent of the EU 15 population. Standards of living, although rising rapidly, remain considerably below the EU 15 average levels, standing at about 64 and 57 percent respectively of the EU 15 average.  The case of Poland is slightly different as the population was in 2004 considerably higher than in the other two countries (9.9 percent of EU 15). This notwithstanding, the size of the Polish economy is still relatively small (4.3 percent of the EU-15 GDP in 2004).

The degree of asymmetry with respect to the core in these countries is of course not unique to the case of the new Member States. For example, in the African context, a similar asymmetry can be found for Namibia vis-à-vis South Africa. Living standards stand in Namibia at about 60 percent of South African levels while the Namibian population represents just a small fraction (about 4 percent). Similar to the new EU Member States, the crucial question is whether further regional integration could “foster” or “hamper” the goal of equalizing standards of living.

## 3. THEORETICAL IMPACTS OF REGIONAL INTEGRATION

From a theoretical point of view one can identify two basic channels through which regional integration may improve economic growth, i.e. via (i) allocation and (ii) accumulation effects.

<u>The first channel</u> captures the way in which integration induces changes in economic efficiency by improving the allocation of resources and expenditure. The

allocation effects stem from increases international trade and occur through a combination of trade creation and trade diversion, of which the former is clearly beneficial, while the latter may be harmful. The traditional trade creation effect refers to trade generating new economic activity. When the prices of imported goods decrease following the elimination of import tariffs, the penetration of cheaper imports lowers the costs of goods available to domestic consumers, thus raising national welfare. Trade diversion refers instead to the re-direction of existing trade (supply-switching) as a result of changes in tariffs and other barriers due to regional custom unions.

<u>The second channel</u> through which increased integration affects economic growth is via so called accumulation (or dynamic) effects. These effects refer to mechanisms through which trade arrangements can alter the level rather than merely reallocating the existing stock of resources. Accumulation effects result from movements of factors of production (especially capital stocks), technology transfers, increased competition and possible economies of scale. The accumulation effects tend to have a much larger impact on GDP than the allocation effects.

Allocation effects effectively mean taking resources from one activity and reallocating them to another. Accumulation effects instead imply changes in the <u>stock of available resources,</u> and therefore lead to much more sizable changes in the amount of goods that can be produced by the same labour force.

The stock of capital is determined by demand and supply factors. Higher regional integration is likely to (i) increase the demand for capital, and (ii) reduce the country specific risk premium[36] required by investors, thereby decreasing the cost of capital. <u>The increase in the demand for capital</u> is associated to the improved market access after trade barriers are dismantled. If a country exports goods that are capital intensive, higher exports due to additional market access will increase the nation's demand for capital. <u>The reduction in risk premium</u> may be explained by many factors, including a change in the underlying uncertainty (i.e. increased macroeconomic and political stability) and an enhanced ability of investors to diversify risk (i.e. when domestic residents get improved access to wider capital markets).

[36] Compensation above the expected rate of return on an asset required by investors due to involved uncertainties.

By widening the market size, regional integration can also lead to improvements in efficiency, as average cost falls with scale of production in most industries. Since lower average costs imply more output with the same level of inputs, positive scale effects tend to improve national welfare. In addition to improved efficiency, through exploiting economies of scale, regional integration may result in a reduction of mark-ups stemming from increased competitive pressure. Lastly, regional integration can increase the range of varieties available to consumers. A wider choice increases consumers' utility, while on production side, a broader variety of input choices may raise industrial productivity. The average consumer therefore may stand to benefit from trade integration via (i) higher incomes (ii) lower mark-ups and (iii) greater goods variety.

## 4. SIMULATING THE IMPACT OF EASTWARD ENLARGEMENT

A number of empirical studies have been used to evaluate and quantify the economic consequences of regional integration prior to the eastward enlargement of the EU (see Table 2 for an overview of the results across different models). The empirical studies considering full integration of the accession countries into the Single Market of the EU have generally used either general equilibrium models (CGE models, e.g. Baldwin et al. (1997), or world macroeconomic models (such as Breus (2001)). There have been also some other studies which have applied a modified version of Solow-type growth models (see European Commission (2001)). The advantage of employing CGE models is that by construction they incorporate general equilibrium interaction between sectors, allowing one to evaluate the impact of allocation effects. However, the disadvantage is that they normally assume fixed labour input (full employment). Macro models, on the other hand describe the economy only at a broad level, but allow one to focus with greater flexibility alternative assumptions about labour market disequilibria and price rigidity. Additionally, while CGE models work with calibrated parameters for one specific benchmark year, macro models use estimated coefficients of behavioural equations.

Baldwin et al. (op cit.) apply the GATT/WTO CGE model, which was used to evaluate the results of the Uruguay Round on the world trade. With this framework they studied the impact of the EU enlargement on the Central and eastern European countries (CEEC) and on the EU. The model covers nine world regions, including among others CEEC7 (defined as the Czech Republic, Slovakia, Poland, Hungary, Slovenia, Bulgaria and Romania), and EU-15. Each region consists of 13 sectors. In some sectors, such as textiles, chemicals and machinery, the model allows for economies of scale and imperfect competition. Other sectors included in the model, such as agriculture, mining, services, assume perfect competition with constant returns to scale.

With product differentiation in all sectors, the model supports two-way trade in all traded sectors. Factor of production are capital and labour, with labour assumed to be fixed (full employment, no migration between regions) and regional capital stock to be endogenous.

With this set up Baldwin (1997) investigated two possible scenarios – a conservative scenario and a less conservative one. Under a conservative scenario the study considers both the role of allocation effects and accumulation effects. It reaches the conclusion that (i) all European regions would gain from enlargement, implying that integration is a non-zero game; ii) CEEC7 would gain much more than the EU in relative terms. In the CEEC7 real income is estimated to increase by 1.5 percent in the long-run, while EU-15 would gain 0.2 percent. Therefore according to this model, the small country always gains more from integration in a large customs union, while the incumbents gain less as the increase of their markets is only marginal. Under a less conservative scenario, joining the EU would have made the CEEC7 region a less risky location from the point of view of domestic and foreign investors. The authors conclude that integration would lead to a substantial reduction of risk premium (by 15 percent) for investment in the CEEC7. As a result, the capital stock is expected to increase on cumulative terms by 68 percent, instead of only marginally as in the conservative scenario. This alternative scenario has however been criticised in the literature as exceedingly optimistic.

Breus (2001) followed a different approach by relying on the Oxford Macroeconomic Model (OEF 2000). The model is a traditional Mundell-Fleming type macro model with standard demand and supply equations. Most of the equations consist of estimated parameters. While the functional form of equations if the same across countries, the estimated parameters differ. The model consists of four blocks: demand side, supply side, government policy and the rest of the world. Additionally there is a special section for the financial market and emerging market economies to allow risk premia reduction.

All country models are linked via trade, prices, exchange and interest rates. Similarly to Baldwin (op cit.), Breus (2001) found that, because of the asymmetry in size, the CEEC would gain on average more from the enlargement than the EU countries. After considering all possible integration effects resulting from the EU enlargement, the results suggest that Hungary and Poland would have increased their real GDP by around 8 to 9 percent over a ten year period, which implies higher annual growth rate of about 1 percent.

**Table 2. Consequences of regional integration prior to the eastward enlargement of the EU**

| | Methodology | Countries | Estimated effects |
|---|---|---|---|
| Baldwin, Francois, Portes (1999) | CGE Model<br>1) reduction in trade tariffs<br>2) risk premium reduction | CEEC 7: Bulgaria,Czech Rep., Hungary, Poland, Romania, Slovakia, Slovenia | Real GDP:1.5 |
| Breuss (2001) | Oxford Economic Forecast World<br><br>Macroeconomic<br>1) trade effects<br>2) Single Market Effect<br>3) factor movements<br>3) costs of enlargement | Poland, Hungary Czech Republic | Trade effects (cumulative effect over 10 yr):<br><br>Poland: 2.47<br>Hungary: 4.2<br>Czech Rep.: 2.84<br><br>Single Market effects:<br>Poland: 2.07<br>Hungary: 1.25<br>Czech Rep.: 0.54<br><br>Total effect:<br>Poland: 8.02<br>Hungary: 8.40<br>Czech Rep.: 5.65 |
| European Commis-sion (2001) | Growth model (a modified Solow model)<br>1) increase of capital stock<br>2) adoption of new technologies | CEEC 10: Bulgaria, Czech Rep., Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia<br>AC 8: Czech Rep., Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, Slovenia | Growth effect (contribution to GDP , annual avg.):<br><u>AC 8</u><br>Capital Stock:0.4–0.5<br>TFP: 0.6 – 1.3<br>Total GDP: 1.3 – 2.1<br><br><u>CEEC 10</u><br>Capital Stock:0.3-0.4<br>TFP : 0.5 - 1.1<br>Total GDP: 1.0 - 1.8 |

The Czech Republic gains were estimated to be somewhat smaller - an accumulated increase of real GDP by 5-6 percent over 10 years, or 0.5 to 0.75 percent higher yearly growth.

Finally a study of the European Commission (2001) investigated the macroeconomic effects of EU eastern enlargement on growth in the CEEC countries over a ten years period using methodology of growth accounting. The study focused on the supply side impact on growth. The analysis was based on a neo-classical growth model, initially proposed by Solow (1956). The basic idea is to decompose real GDP growth into its main determinants and try to measure: i) what part of the overall growth rate of GDP can be attributed to the accumulation of factors of production, i.e. employment growth and fixed capital formation; ii) a remaining residual (so called Solow residual) that can be attributed to independent technical progress – total factor productivity (TFP).

This framework enabled the researchers to capture the essential characteristics of the CEEC economies, especially their relatively low capital endowments and a low level of technology. The future speed of real GDP per capita convergence towards the EU average will depend on the rate of investment (including FDI) and the adjustment of TFP to levels of economically more advanced economies.

This study reaches the conclusion that the enlargement would stimulate growth via the following channels: first through higher physical investment ratios due to EU transfers and higher FDI flows; secondly through higher labour force growth due to increases in labour force participation rates; and finally via higher TFP growth due to shifts in sectoral composition of output and the implementation of structural reforms. The overall effect on real GDP growth is expected to be in the range between 1 and 2 percent per year. Overall, the various modelling used prior to enlargement depicted a very positive picture of the gains stemming from regional integration.

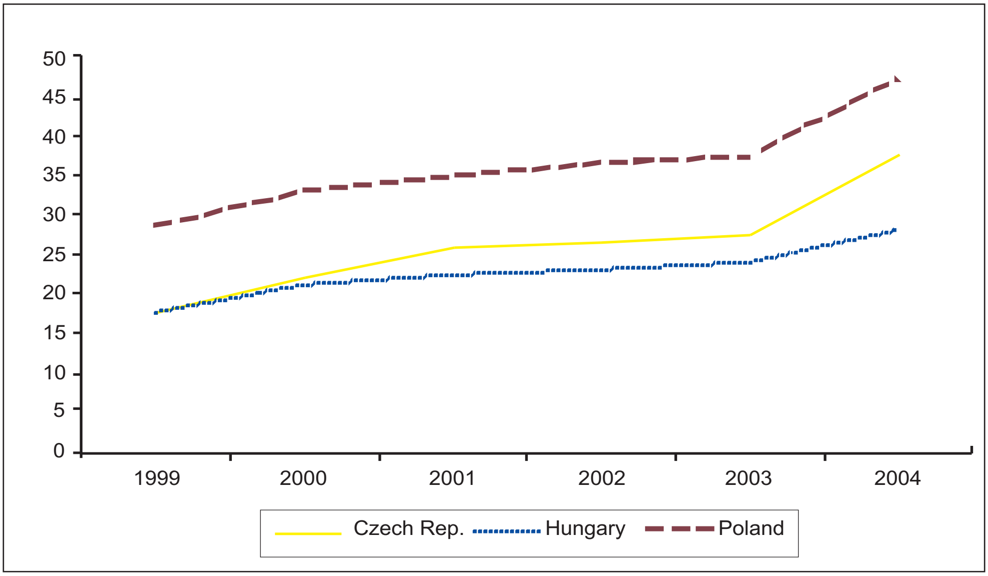
## 5. THE IMPACT OF EASTWARD ENLARGEMENT – STYLISED FACTS

To what extent did these optimistic expectations about enlargement translate into reality? To provide an answer to this question we present a number of stylised facts about the three largest Central and eastern European countries, i.e. the Czech Republic, Hungary and Poland (CEEC-3) over the period 1995-2004. As indicated in the previous section, regional integration is expected to have (i) positive repercussions on trade developments, (ii) higher FDI inflows and (iii) more generally lead to the convergence in real incomes and economic structures among the new and old members of the European Union.

## Trade

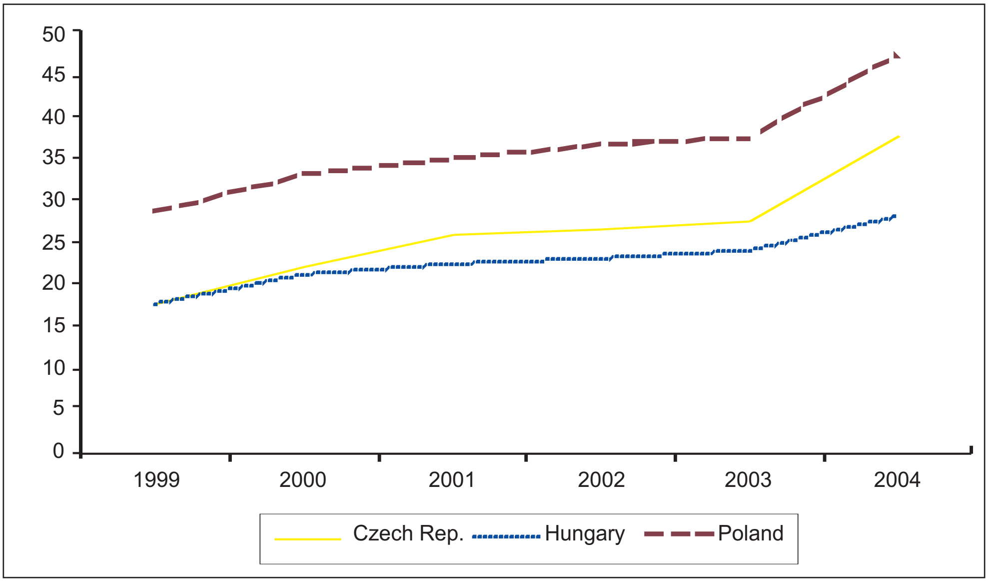
We begin by examining trade developments over the period under review. Trade between the CEEC-3 and the EU is governed by a comprehensive framework for bilateral relations - the Europe Agreements (EAs). The most important areas covered by the EAs include among others the establishment of a free trade area for industrial goods, and liberalisation of capital movements. The EAs led to a full elimination of tariffs on imports from the CEEC-3 to the EU already on 1 January 1997 and dismantling of tariffs on EU exports to the CEEC-3 was completed in 2002. After opening up to international trade and, in particular, as a result of the agreements with the EU, trade between the CEEC-3 and the EU developed rapidly. The value of Polish and Czech exports to the EU more than doubled in the period 1999-2004 while it increased by over 70 percent in case of Hungary. At the same time imports from the EU to Hungary and Poland rose by over 60 percent, doubling in Czech Republic (see Charts 1a and 1b).

**Chart 1a. Export to EU-15, in value terms, bn EUR**




Source: Eurostat

**Chart 1b. Import from EU-15, in value terms, bn EUR**

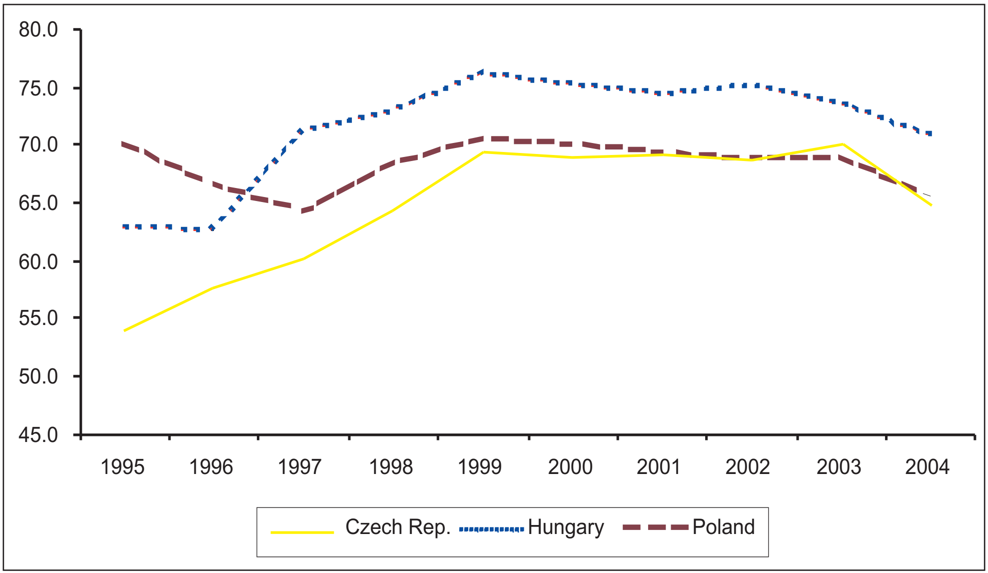



Source: Eurostat

Trade was also redirected towards the EU: in the CEEC-3 countries the share of exports directed to the EU increased from an average of 62.3 to 72 percent (see charts 2a and b2). In subsequent years, however, these shares stabilised owing to stronger intra-regional trade among Central and eastern European countries[37].

[37] It is still too early to establish whether accession to the EU in May 2004 may result in further re-direction of trade away from non-EU countries. Against this background, there are several other factors, such as changes in competitiveness and relative foreign demand, which have to be taken into account over a short-term horizon.

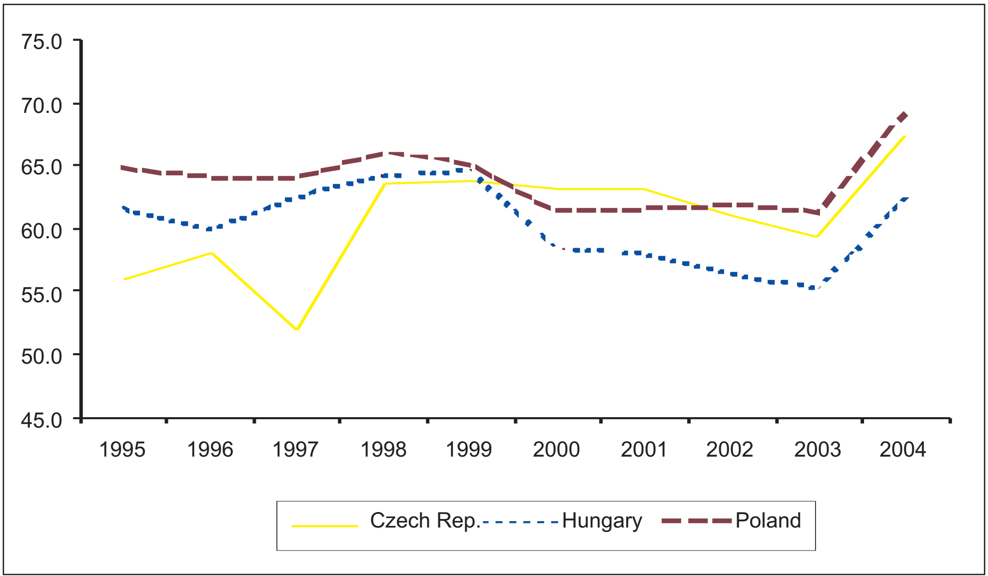
**Chart 2a. Exports to EU-15, percent of total exports**




Source: Eurostat

Import shares from the EU15 remained instead broadly stable between 1995 and 2003, as "cheaper" imports from non-EU countries rose at a similar pace. Coinciding with EU entry, however, one could observe a remarkable increase in the import shares of the CEEC-3 countries from the EU15.

**Chart 2b. Import from EU-15, percent of total imports**




Source: Eurostat

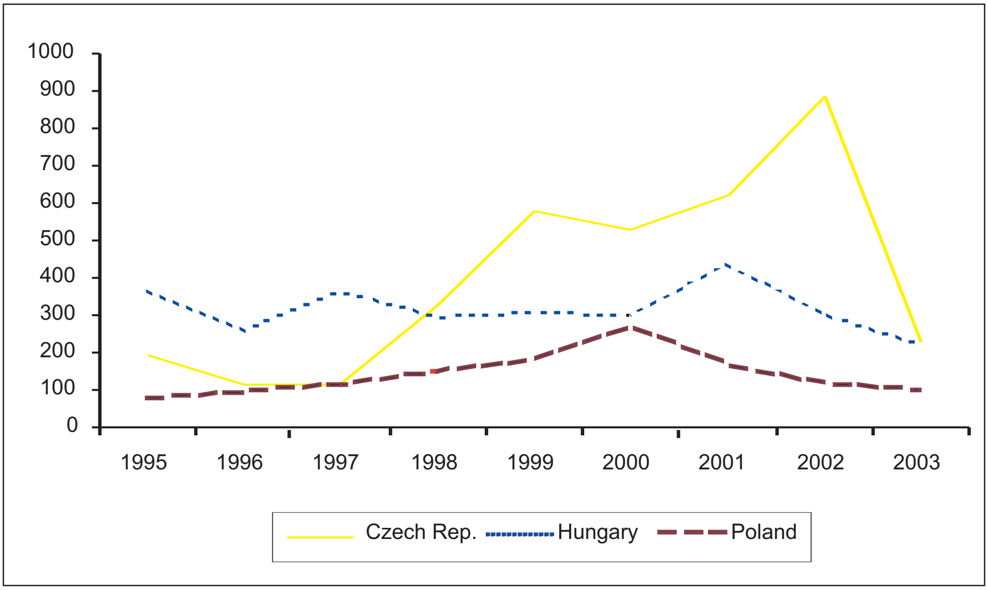
Overall the evidence appears to confirm that regional integration and the dismantling of duties and other regulations have led to a robust growth in trade.

**Capital mobility and foreign direct investments**

Besides international trade, capital movements are another major element to evaluate the effects of the European integration process. Capital movements represent an important source of growth in the CEEC-3 through the accumulation effects described in section 3. Up until recently most of the capital inflows the CEEC-3 were constituted almost exclusively by foreign direct investment (FDI flows) involving both the establishment of new plants ("greenfield investments") as well as the acquisition of existing firms.

There is an obvious link between the rising FDI inflows and the important reforms towards achieving a functioning market economy. Macroeconomic stability, non-discrimination towards foreign investors, provisions in areas such as profit repatriation and taxes, and more generally, investors' confidence in the regulatory and legal environment have all affected FDI flows. Among the new Member States the leading recipients of FDI in per-capita terms have been Hungary and the Czech Republic (chart 3). As FDI inflows are also partly linked to the privatisation process, most countries have experienced a high degree of volatility across different years.

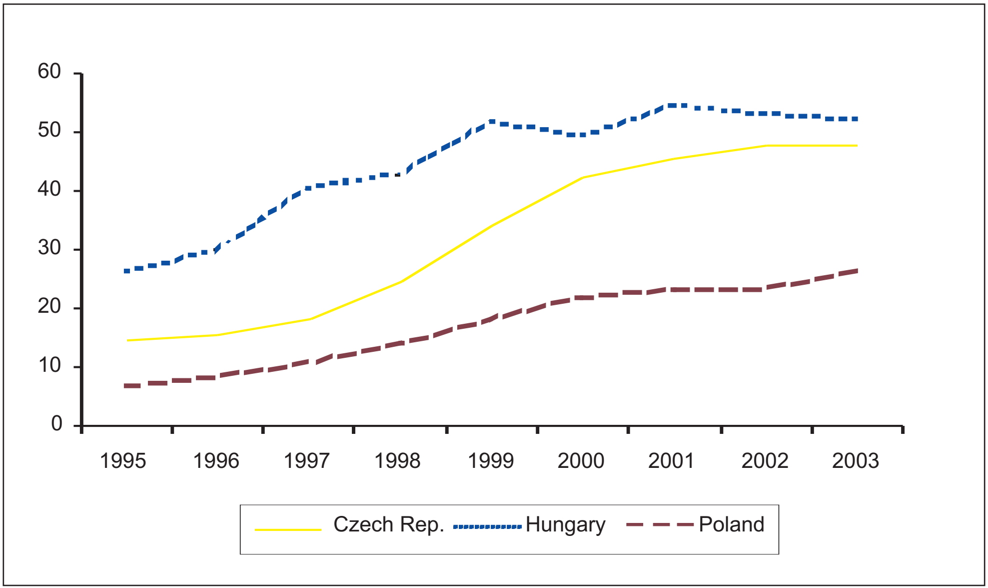
**Chart 3. FDI inflows per capita in EUR**




Source: WIIW

Nonetheless, on a cumulative basis these investment flows have been very large, effectively meaning that the CEEC-3 countries are all characterised by a very high stock of FDI as a share of GDP (chart 4).

**Chart 4. Inward FDI stock as percent of GDP**



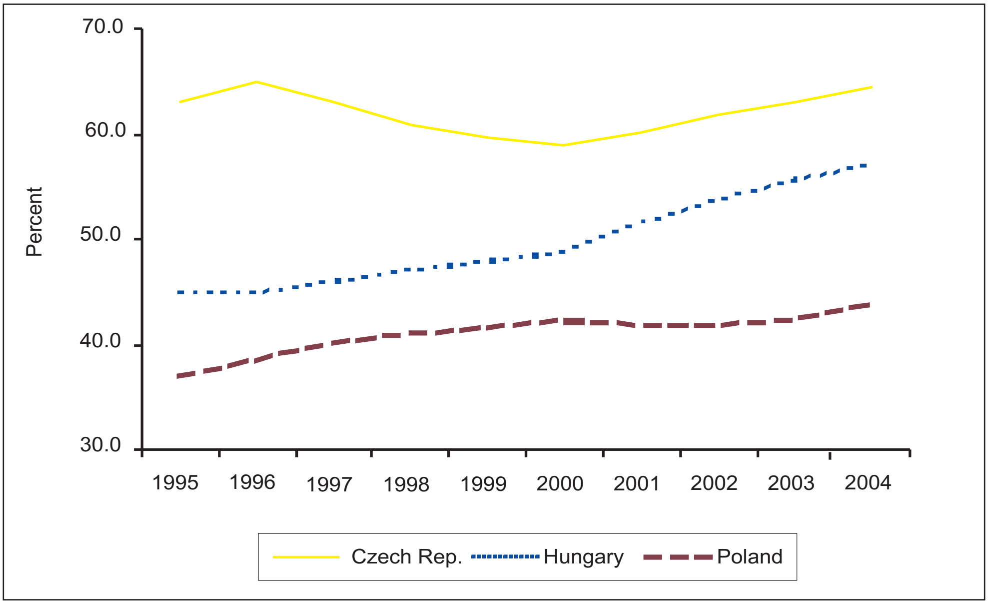

Source: WIIW

Two thirds of net capital flows into the CEEC-3 in the 1990's originated from the EU-15. Nearly half of the FDI flows have been directed to service sectors such as telecommunications and financial sector and only one fifth has occurred in relatively labour-intensive industries such as textiles, clothing and electrical machinery.

## Real convergence

In addition to increased trade and capital flows, economic integration with the EU has also had a great impact on GDP and welfare. Measuring GDP per capita in PPS terms, we find that over the past decade the CEEC-3 countries improved their living standards in comparison with the EU-15 rather sizeably (chart 5a).

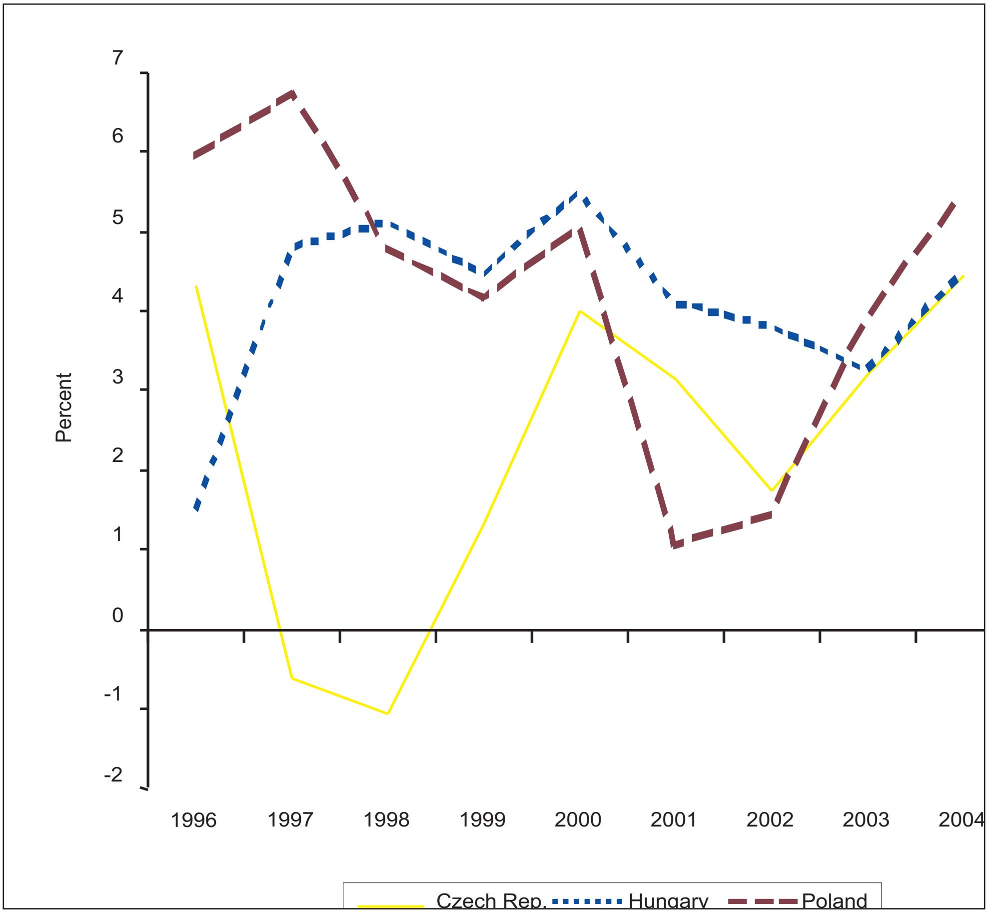
**Chart 5a. GDP per capita in PPS, percent of EU-15**




Source: Eurostat

In absolute terms on average real GDP per capita increased at rather buoyant rates (see chart 5b). The main exception took place in the Czech Republic in the aftermath of the 1997 banking crisis.

**Chart 5b. Real GDP per capita growth rates**




Source: Eurostat

The CEEC-3 countries have also undergone sizeable changes in their economic structure. As shown in chart 6, over the period 1995-2004 the share of agriculture and manufacturing in total value added has declined, while the share of the service sector rose rather significantly. Notwithstanding the progress which has already taken place, there appears to be still room for further structural change. For example, Table 3 shows how the share of services in the CEEC-3 countries is still considerably lower than in the EU-15.

Together with the shift in the sectoral composition of output, the CEEC-3 have also experienced a significant reallocation of their labour force. The respective shares of employment in agriculture and industry have declined sharply, while the share of employment in the service sector has increased. The ways in which these sectoral shifts were achieved was different depending on the country. Hungary has managed to create more that 300 thousand new jobs in the service sector in the period 1997-2003, while the losses in the other two sectors totalled less than 65 thousand (see Gruber (2004)). The Czech Republic also succeeded in creating new jobs in the growing service sector, but losses in industry and agriculture were higher, which led to an overall decline in employment. Developments in Poland were less benign, as job losses were recorded in all three sectors. The share of employment in services increased only because job reductions in the other two sectors were particularly sizeable. Despite a pronounced shift in the sectoral composition of employment that has occurred so far, the employment share of the service sector in CEEC-3 is still below the EU-15 average and further reallocation of labour is expected in the future.

**Chart 6. Change in economic structure, 1995 vs. 2004**

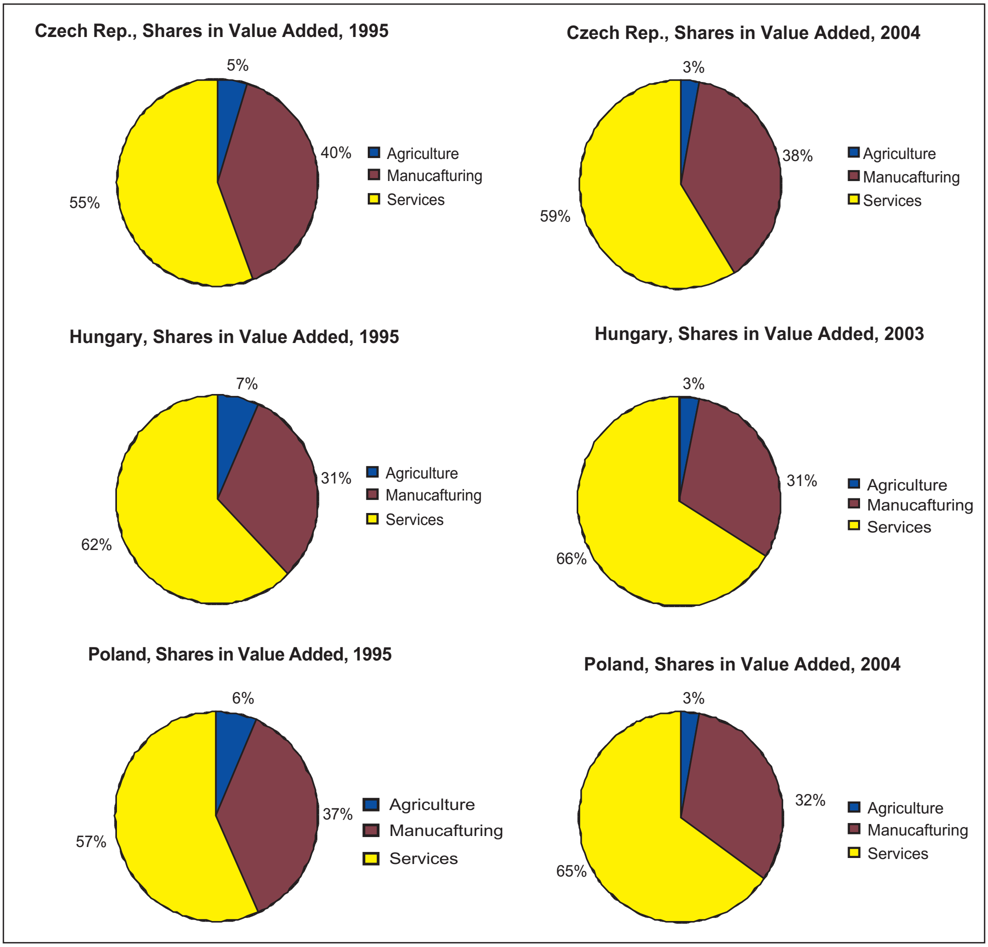


**Table 3. Shares in Value Added, 2004**

| | Czech Rep | Hungary | Poland | EU-15 |
|---|---|---|---|---|
| Agriculture | 3.0 | 3.3 | 2.9 | 2.0 |
| Manufacturing | 38.2 | 30.7 | 32.1 | 26.3 |
| Services | 58.8 | 66.0 | 65.0 | 71.7 |

Source: Eurostat

Note: Hungary refers to 2003

## 6. WHAT SIMILARITIES AND DIFFERENCES?

Although a fully-fledged comparative analysis is beyond the scope of this article, one could attempt to identify a number of analogies and differences between the experiences of the Central Eastern European countries and Namibia. A first analogy is of course the common challenge of maintaining a stable macroeconomic environment, notwithstanding the expenditure pressures associated to the catching up process. This is clearly a pre-requisite for maintaining an environment prone to investment and consumer confidence, hence preserving sustained economic growth in a medium term horizon. A second broad analogy is that processes of regional integration may have fiscal repercussions, as tariff barriers are progressively dismantled. The experience of the Central and Eastern European countries is, however, not easily comparable to any other. The use of custom tariffs was not widespread in socialist times (see OECD 2001), but became more important in the early phases of transition, following the introduction of standard trade practises. The magnitude of the tariff revenues, while non-negligible, never reached the scale of countries like Namibia. As shown in Table 4, tariff revenues in CEECs, while showing initially a tendency to increase, remained in most cases below the 10 percent threshold (in percentage of imports). This compares to the case of Namibia where 30 percent of total revenues comes from the Southern African Customs Union.

**Table 4. Tariff revenues in selected transition economies (percent of imports)**

| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 |
|---|---|---|---|---|---|---|
| **EU candidate countries** | | | | | | |
| Bulgaria | 2.4 | 4.1 | 7.1 | 6.9 | 6.1 | 4.6 |
| Czech Republic | .. | .. | 3.9 | 4.1 | 2.6 | 2.6 |
| Estonia[1] | .. | .. | 0.9 | 0.9 | 0.2 | 0.1 |
| Hungary | 9.1 | 11.8 | 12 | 12.6 | 12.9 | 9.6 |
| Latvia | .. | 2.8 | 2.9 | 3.2 | 1.8 | 1.5 |
| Lithuania | .. | .. | 1.1 | 3.2 | 1.4 | 1.2 |
| Poland | 12.7 | 14.7 | 15.3 | 18.5 | 15 | 10.7 |
| Romania | 6.7 | 5 | 6.6 | 6 | 6.2 | 5.1 |
| Slovakia[2] | .. | .. | 2.3 | 3.4 | 3.3 | 2.9 |

Source: Transition Report. EBRD

Notes: 1) excludes differential excise taxes on imports
2) refers to import tariffs, custom tariffs, customs duties and import surcharges

The CEEC's authorities soon recognised the importance that trade reforms should be associated to tax reforms so as to preserve a stable fiscal outlook. An important element facilitating the gradual process of elimination of tariff barriers was constituted by the setting up of the above mentioned Europe Agreements (EAs). The first EAs were signed already in 1991 with the former Czechoslovakia, Hungary and Poland. These agreements have functioned by relying on the so called "principle of asymmetry", which effectively meant that the EU would reduce trade barriers at a more rapid pace than its respective counterparts. This asymmetry facilitated the process of trade liberalisation, albeit the speed of the process varied depending on the sector. In this regard, the liberalisation of the agricultural products lagged behind compared to the liberalisation of industrial goods. The EAs also helped achieving other goals, such as the harmonization of legal and institutional standards in the field of trade policy. From the point of view of competitiveness, the gradual abolishment of tariffs did not entail significant difficulties to the CEEC countries, as their respective currencies were typically sizeably undervalued at the beginning of the transition process. Finally, the gradual abolition of tariffs was largely facilitated by the progressive revival of their economies. A strong determination to undergo structural reforms helped sparking off the catching up process, which in turn increasingly allowed the authorities to earmark further resources for public investment, further supporting the process.

The recent entry into the EU also had some fiscal repercussions. As a result of accession, which implies a common set of rules toward third parties, external tariffs in new Member States have on average fallen sizeably. Other budgetary repercussions resulted from the need to adhere to the higher EU standards in a number of different economic domains, while positive effects derived from the EU policies aimed at strengthening the economic and social cohesion across its various regions.

There appears to be some important differences between Central and Eastern European countries and Namibia as far as the experience with financial flows is concerned. The implementation of radical privatisation policies and a regulatory framework guaranteeing foreign investors have progressively opened up Central and eastern European markets to the rest of Europe. Foreign capital inflows have thus become an important factor supporting economic growth and had an impact on productivity (via the transfer of technology).

Further challenges may, however, lie ahead. The opening of financial markets also entails possible risks in terms of excessive consumer lending or financial market exuberance. This underscores the importance of continuing to strive toward macroeconomic and financial stability. Against this background a number of countries have in recent years exhibited relatively large current account deficits, which could, if prolonged over time, be seen as a sign of increased financial vulnerability. A number of countries have instead shown widening fiscal deficits, which may only be partly ascribed to the accession process.

In contrast to the new member states, Namibia has in recent years experienced net outflows of capital while exhibiting current account surpluses. Given the positive experience in Central and Eastern Europe, developing a privatization strategy and setting up policies to attract foreign direct investment, as suggested by the IMF, could be beneficial. Notwithstanding a number of pitfalls in some cases, privatization policies have reportedly played a positive role, ensuring the presence of strategic foreign investors in the CEEC countries. Privatization also helped the CEEC countries to de-monopolise their economies, support competition and increase access to foreign capital via the presence of foreign-owned banks.

To conclude, the benefits of regional integration for smaller economies are potentially very large. However, particularly in the early phases of adjustment, the authorities could face some adverse fiscal effects and other adjustment costs, such as employment losses, which could diminish the public support for these policies.

Structural reforms, aimed at ensure a rapid growth of the private sector, should go hand in hand with trade liberalisation, if the process is to be beneficial. The speed of liberalisation should also be consistent with the aim of preserving an overall stable macro environment, if these gains are not to be short-lived. Overall, the experience of the transition countries appears to suggest that it is possible to succeed on the difficult path of progressive trade liberalisation, economic reform and macroeconomic stability.

## 7. CONCLUSION AND FINAL REMARKS

In this article we have reviewed the recent experience with the integration of the new Member States to the European Union. Despite a number of challenges, the positive results - in terms of growth and other economic indicators - suggest that the European regional integration process has been important, not just because of its political repercussions, but also on its own economic merits. The ex-ante expectations of large gains, as suggested by various alternative theoretical approaches, appear to have been largely supported by what has effectively taken place. To this end, we believe that the strong drive toward institution building and the increased reliance on competitive market forces have been important factors underpinning the catching up process. Overall the recent European experience, although in many ways unique, sheds a positive light about the prospects of regional integration among countries of different size.

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## Comments By Dr. Kaire M. Mbuende On: Evaluating The Impact Of "Asymmetric" Regional Integration: The Recent European Experience By F. DI Mauro, M. CA' Zorzi And M. Przybyla

I would like to thank the Bank of Namibia for the opportunity to participate in its annual symposium with the theme, "The Benefits of Regional Integration for Smaller Economies". I am delighted that you decided to look beyond Africa to share ideas from different experiences.

I am glad that the symposium is not asking the question of whether to integrate or not to integrate. Integration is an idea whose time has come. The development in the world economy is characterized by increased in foreign trade and flow of financial capital across national boundaries. The economic success of individual countries will largely depend on their participation or degree of involvement with the world economy. Some economists have argued that the lack of progress in Africa can be explained in terms of its marginalization or limited involvement with the world economy in terms of the continent's share trade and investment flows. Regional integration was adopted as a strategy to integrate Africa into the global economy on competitive basis. The new integration schemes are designed to complement and not compete with the process of multilateral free trade. It is natural however for countries to promote trade with the regional partners. The political and economic stability of every country depends to a large extend on the success of its neighbors. The lack of progress will have spillover effects. This is true of the European Union vis-à-vis the countries of Central and Eastern Europe as it is of South Africa vis-à-vis SADC.

Regional integration is a product of specific historical circumstances. Regional integration agenda are forged with the view to addressing specific political and economic problems and needs. Economists have developed models of integration as attempts to capture specific historical experiences in conceptual terms.

The paper before us deals with an issue which has been of concern to Southern Africa and virtually all the regions of Africa. That is, asymmetry. Fears have been expressed whether the regional power house would not benefit at the exclusion of the smaller economies.

Paper starts from the assumption that regional integration creates additional wealth by enhancing competitiveness and thereby raising the standard of living in participating countries. The authors applied these general assumptions to the European Union eastward enlargement. They established that integration can succeed among diverse countries in terms of standard of living and size. More importantly, that such integration, which they call in want of a better word, "asymmetric", will yield positive results to the weaker countries. This experience, they argue should shed positive light on other regions of the world.

There are specific aspect of the integration process that has accounted for the success of Central and Eastern European countries. Institutional stability that reduced the risk premium is one such factor, trade and investments.

**Institutions**

Southern Africa, SADC, SACU and CMA should learn useful lessons from this aspect. Rule based, predictable and strong institutions are perquisite for success instills confidence among domestic and foreign investors. There are needs for rules about all aspects of policy that may affect trade. By the same token there is a need for institutions to make the rules, bodies to interpret them and agencies to enforce. Our region has a long way to go in this regard.

**Trade**

The gains from the terms of trade effects were also quite significant. The integration of the countries of Central and Eastern Europe to the EU generated trade creation instead of diversion among themselves as well as with the rest of the EU.

The removal of trade barriers allowed member states to specialize in what they are good at and what can give a high return on the long run. This process is not straight forward. There is cost associated with it as it involves restructuring of the economy. It would be of interest to know how the cost of adjustment was covered.

The creation of the Free Trade Area envisaged in the SADC protocol is trade-creating and will therefore have beneficial effects on income, employment and potential growth. Evans estimates that the implementation of the FTA will result in 1.0 percent in GDP growth. The process of liberalization may results in temporary current account deficit that most of the SADC countries will not be able to finance from their own resources. Intra-regional trade is relatively undeveloped as a share total export. There is a need to grow the regional market to act as spring board for products to be sold on the global market. The idea should not be to sell to your neighbor what no one else wants to buy.

It is expected that FTA will increase intra-regional commerce, accelerate economic growth, create jobs and raise the standard of living and quality of life of the citizens.

**Investments**

Another element according to the authors that contributed to the successful integration of Central and Eastern European countries is the east ward capital movement. Most of the capital flow was in the form of Foreign Direct Investments involving "Greenfield investments as well as the acquisition of existing firms through privatization and other takeovers. The bulk of the capital, two-thirds, originated from the EU. Half of the capital went to the service sector involving transfer of technology and only a fifth in labor intensive industries such as textiles, clothing and electrical machineries.

The success of this experience depended on Europe itself. It is the resourcefulness of the partners that made the integration of countries of Central and Eastern Europe successful. The success of SACU or SADC in terms of internal resource flow will depend on South Africa. South Africa though the biggest economy of the region has serious resource constrains to be the engine of development in the region. FDI have been flowing to South Africa more than to the smaller economies. The FDI that has come to the smaller economies is not much to exploit the regional market but to take advantage of multilateral instruments such as the Cotonou Agreement or AGOA.

Trade is an effect of investments. There are a number of supply side constrains that will continue to inhibit the development of trade and investments this include the cost of water and power as well as infrastructures. Member states have been addressing the supply side constrains through a program of functional cooperation which involved investments in the development of infrastructures such as roads, railways, rehabilitation of port and harbors, telecommunications and electricity.

The program of functional cooperation did address the needs of member states in terms of the sharing of the benefits of integration. Through cooperation in the area of electricity, a Southern African Power Pool was created to facilitate cross border trade in electricity. Low producers of power rely on the surpluses of other member states. Significant progress was also made in the area of transport and communication sector major roads linking the different countries with each other such as the Trans Kalahari road, Trans Caprivi road etc were built. To day, it is possible to move goods by road form the Atlantic Ocean coast to the Indian Ocean coast. The land locked countries have also been linked to the coastal countries by railways and roads or transport corridors. Increasingly, what was initially transport corridors have become development corridors. The infrastructures that were put in place in the corridors could be turned into industrialization platforms. In short, member states benefited from functional cooperation. There are always or other that will benefit more the others. On the whole the benefits were distributed by and large equitably. One should also add that this program was heavily depended on donors. The contribution of member states was limited to providing some local cost for donor funded projects and the management of the program of cooperation.

**Welfare gains**

Integration has resulted in welfare gains that resulted in per capita growth. The sizeable restructuring of the economy did not result in unemployment. More jobs were created than those that were lost.

**Conclusion**

The authors maintain that competitive market forces have been important factors in the catching up process. I must say that it would have been interesting to know what kind of financial aid was given to the countries of Central and Eastern Europe by the EU. What kind of support or incentives if any were given to European companies invest in the east? None market factors have been important in the integration of poorer regions of Europe and their relative weight should be pointed out.

# CHALLENGES AND OPORTUNITIES OF REGIONAL INTEGRATION FOR DEVELOPING ECONOMIES: NAMIBIA'S PERSPECTIVE

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## 1. INTRODUCTION

A key aspect of the development strategy, shared by many policy makers and economists today, is the recognition of the dynamic potential of regional integration whereby developing countries can break out of their narrow national markets and form regional groupings as an instrument of economic decolonization. They tend to attribute the causes of failure of different development policies in the developing world to the series of independent efforts carried out in isolated compartments. In their view, developing countries have inadequate resources or the technical capacity to compete with the relatively more developed ones in the same underdeveloped regions, much less with developed areas. Consequently, it is necessary to establish a gradual process of economic integration.

To this end, promotion of economic cooperation and integration among developing countries is now a well-accepted part of the international development policy. Almost all issues in the field of international economic relations are currently subordinated to the quest for regional economic associations and groupings among more or less contiguous areas. Over the past four decades more than a dozen customs and monetary unions, common markets, free trade areas, and other regional cooperative arrangements have been proposed or established in Latin America, Asia and Africa, following the success of the European Economic Community (EEC), now European Union (EU). Some of these cooperative schemes never got off the ground. Others were torn apart at a very early age by deep political conflicts. Despite the disappointment and the very slow progress that some of these schemes have made, the countries concerned continue to display a genuine desire to negotiate with each other for economic cooperation.

This process has received a great deal of impetus since the early 1990s, following the challenge posed by the combination of increasing regionalization and globalization, rapid changes in technology and continued liberalization of world trade, coupled with the new trading environment ushered in by the establishment of the World Trade Organization (WTO). These developments have created a radically new world environment which poses formidable challenges as well as opportunities for developing economies, particularly Africa. They could further accentuate the socio-economic crisis of the continent and its increasing marginalization in the world economy or trigger the turn-around process in Africa.

In the face of the opportunities and challenges posed by the new paradigm of the global economy, nations are moving to integrate their economies with those of their neighbours, to create larger and more competitive regional economic blocs, and to engage in international trade --- not as individual states but as regional powers. This shift is nowhere more urgent than in the developing countries. In Latin America, trade liberalization commitments were formalized bilaterally or between groups of countries; for example, between the Central American Common Market (CACM) countries and Mexico, while the Andean Group targeted 1995 for the establishment of a free trade area, and 1997 for the establishment of a common market. In Asia, several initiatives were advanced within the Association of East Asian Nations (ASEAN).

In Africa, more than ever before, regional economic cooperation and integration was widely recognized and accepted as a necessary condition for the long-term sustainable development of the African countries and as one of the most potent strategies for redressing the socio-economic situation of the continent. Its merits as a desirable strategy have been well documented in a large number of studies and reports on African development and reflected in virtually all recent action programmes for socio-economic recovery and long-term development in Africa from the celebrated Lagos Plan of Action (LPA) and the Final Act of Lagos (FAL, 1980) through the African Priority Programme for Economic Recovery (APPER,1985) to the all-important continental initiative, the New Partnership for Africa's Development (NEPAD, 2001).

The vision and commitment of African leaders to the ideals and principles of regional integration as a means of mitigating the development constraints faced by many small –nation economies led to the creation of such economic groupings as the Economic Community of West African States (ECOWAS, 1975), the Southern African Development Coordinating Conference (SADDC, 1980), transformed into the Southern African Development Community (SADC, 1992), and the Preferential Trade Area for Eastern and Southern Africa (PTA, 1981), now the Common Market for Eastern and Southern Africa (COMESA, 1993).

The overriding objective of the regional integration schemes in the developing countries is to overcome the economic disadvantages of small size of national markets, low per capita incomes, small populations and narrow resource bases, and of making possible a higher rate of economic growth. It has also been seen as a means of consolidating the political independence of developing countries and thereby strengthening their overall position vis-à-vis that of the developed countries. In brief, therefore, regional integration in general is not only desirable; it is necessary, particularly in the special case of Africa, if the continent is to eliminate poverty, to industrialize, develop intra-regional trade, strengthen capacities to benefit from globalization, raise productivity and efficient use of regional resources, reduce her vulnerability to fluctuating overseas markets, and finally forge the way to effective African unity, both political and economic, as reflected in the Constitutive Act establishing the African Union in 2002.

While an appreciable progress has been made by the economic integration schemes in Asia and, to some limited extent, Latin America, in the case of Africa, the success of economic groupings has been rather limited, with little or no impact on the economic growth of the cooperating countries. There is thus this striking contradiction between general emphasis on the need for economic integration and the scanty evidence of practical success. This has raised some searching questions. Why so little progress? What are the underlying factors which have rocked the very foundation of cooperation? What have been the stresses and strains of the economic community schemes in developing countries as they strive to translate articulated objectives into concrete results? It is within this context that this paper attempts to highlight the opportunities and key challenges confronting regional integration arrangements in developing countries. It identifies major issues requiring priority attention for revitalizing as well as adjusting the process of economic integration in the developing countries to the realities of the twenty – first century and to forge a new direction. Attention would therefore be focused on the appropriate strategies to be pursued by the developing economies in general, and Namibia in particular, to maximize benefits from integration arrangements while minimizing the costs.

## 2. OPPORTUNITIES FOR DEVELOPING COUNTRIES

The opportunities derived from regional integration arrangements, in terms of trade, larger markets, increased competition and investment, point to the inescapability of integration in developing countries. This section of the paper provides an overview of the more important gains and opportunities derived from regional integration.

It is generally argued that new trade opportunities are open to developing countries through formal regional integration arrangements that reduce barriers such as tariff to trade among member countries. Economic theory predicts that free trade will improve welfare by enabling citizens to procure goods and services from the cheapest source, leading to the reallocation of resources based on comparative advantage. It is thus tempting to conclude that regional integration arrangements will generate welfare gains. Such arrangements may also improve the terms of trade of member countries if changes in trade volumes lower world prices. The greater the regional arrangement's share in the world market, the larger the potential gain will be. But because the terms of trade gain comes at the cost of non-members, it has an unclear effect on global welfare.

Fernandez and Portes note that opportunities may be derived from regional integration arrangements that enable member countries to benefit through increased scale and competition, usually when countries, their endowments, or both are small and, market size limited. Small markets constrain the number and scale of firms or projects that can be sustained, hindering competition among firms and the development of scale economies.

Besides, regional integration arrangements provide an important opportunity for combination of markets and thus enabling firms to expand and markets to be more competitive. More competition and the increased possibility of bankruptcy may induce firms to eliminate internal inefficiencies and raise productivity. The consequent reduction in staffing and more intense competition can increase worker productivity, an attractive benefit to small and low income countries like those in Africa.

Schiff and Winters concludes in their recent illuminating study that investment, as a key component in economic development, has 'become one of the main objectives of countries pursuing regional economic integration'. The logic is that larger markets, more competition, and improved policy credibility will increase the incentives for investment and by that means raise incomes both directly, by increasing the capital intensity of production, and indirectly, by encouraging technical progress. This argument is relevant to investment from all sources but is most explicitly applied to foreign direct investment (FDI). Far more positive in intent is the argument that regional integration add credibility to government policies in general and thus help increase investment and attract FDI. The fact that regional integration arrangements can increase investment is evidenced in the case of the North American Free Trade Agreement (NAFTA), which substantially increased FDI in Mexico, and the Common Market of the South (MERCOSUR), which did the same in Argentina and Brazil.

Several studies have highlighted the extent to which regional integration arrangements enhance the international bargaining power of especially small countries in trade negotiations. This process may lead to better terms of trade (cheaper imports from the outside world and higher prices for exports to them). However, this opportunity becomes possible only if member countries negotiate as a group, an approach not always taken because of divergent national interests. A related goal of regional integration arrangements is to raise the profile of members.

One other opportunity, which regional integration provides, is related to its implications for security and conflict. When countries become dependent upon each other as a result of economic integration, the chances of armed conflicts between them are considerably reduced. A case in point is the Franco-German relations since the establishment of the European Union. The reduction of the risk of conflict may be seen in two ways. First, increasing interdependence among members makes conflict more costly. Second, as economic integration may pave the way for political integration, regular political contact among members can built trust and facilitate cooperation, including on security. Security arrangements and conflict resolution mechanisms are sometimes included in regional integration schemes, as evidenced in the following ECOWAS security mechanisms: the Non-Aggression pact (1978), Mutual Assistance on Defence (1981) and the Mechanism for Conflict Prevention, Management and Resolution (1999).

A little known but highly significant aspect of regional integration among developing economies is the opportunity which they provide for fighting poverty, as recently analyzed in a Briefing Paper of the Overseas Developing Institute (ODI). It is argued that regional groupings are well placed to address poverty by providing appropriate regional public goods and dealing with liberalization of sensitive service sectors. Regional integration arrangements can affect poverty in a variety of ways.

Two arguments are, however, relevant. One is the effect of growth on income distribution within countries. The traditional view is that faster growth might translate into more dispersed income distribution. Some counter - evidence advanced by Dollar and Kraay suggests that the growth rate of average income is matched exactly by the growth rate of the income of the poor, meaning that faster growth does not affect income distribution. Thus regional integration could promote growth and reduce poverty. The other is that regional integration can have an effect on income convergence across countries. Evidence for Europe suggests that poorer countries in a regional community catch up to richer countries (benign convergence). But the evidence is not universal. Downward convergence (malign convergence) or even divergence does occur, especially when regional economic communities (RECs) are formed among countries at similar level of development.

The briefing paper outlines a number of ways which regional integration arrangements can affect poverty at the country level. First, through the volume (for example, effects on allocative or dynamic efficiency) and poverty focus (for example, if regional exports are produced relatively more by the poor, or if regional imports benefit poor consumers relatively more) of trade; second, through the volume and poverty focus of investment; third, through the volume and poverty focus of migration; and fourth, through other routes (regional social and infrastructure programmes, or effective representation of poor people in regional trade negotiations).

Taken together, therefore, regional integration arrangements provide developing countries with a wide range of opportunities, particularly when viewed within the context of not only the United Nations General Assembly Millennium Development Goals (MDGs) of 2000 and the Africa Union's NEPAD initiative of 2001, but also within the framework of the recently released Report of the Commission for Africa, 2005. Successful economic groupings increase competition, reduce transactions costs, enable firms to exploit economies of scale more easily, encourage inward foreign investment, facilitate macroeconomic policy coordination and reduce negative spill over effects. However, the realization of these development opportunities would depend upon the extent to which the developing countries could effectively face the challenges posed by regional integration.

The key challenges, which have been impeding the process of regionalism among the developing countries during both the first-generation of regional integration arrangements (late 1950s to 1980s) and the second-generation or 'new regionalism' since the early 1990s, are wide ranging and may conveniently be grouped into two major categories. First, the challenges posed by the market integration approach adopted by the regional integration schemes in developing countries except SADCC; and second, the challenges of political commitment or, simply put, the complex problems of management of regional economic integration.

## 3. CHALLENGES POSED BY MARKET INTEGRATION

The inappropriateness of market integration approach to regional integration arrangements in developing economies has posed a number of interlocking challenges. The first is the challenge of removing tariffs and non-tariff barriers, as the focus of the majority of regional integration groupings in the developing world has been on liberalization of trade relations with a view to quickly establishing preferential and free trade areas, customs unions and common markets. There is no doubt that the removal of trade and non-tariff barriers is an important component of any efforts aimed at improving the prospects for economic integration. However, it may be argued that these non-tariff barriers contribute to only compounding a situation flawed from the start.

The small share of intra-group trade in total trade in almost all integration schemes in the developing countries, except the Southern African Customs Union (SACU), lies less in the persistent of trade and non-trade barriers, but fundamentally in the schemes' approach to regional integration arrangements, which is modeled on classical European Union (EU) prototype designed for developed countries. The model's underlying assumptions, as Ahmad Aly notes, 'are far from relevant in the context of the developing countries, especially sub-Saharan Africa (SSA). In Europe, the formation of EU and the European Free Trade Association (EFTA) were intended to increase trade among the European nations, but the situation in Europe is completely different from that of the developing world. The rate of industrialization and the rate of economic development are high in most of the countries in Europe, and the creation of the EU merely catered to trade in the existing products. The EU nations are able to offer products for mutual exchange.

Not surprisingly, the market integration approach adopted by developing economies' regional groupings has raised some crucial questions and provoked debates and exchanges on regionalism in the developing world. How appropriate is the market approach to regional integration arrangements in developing areas? How valid is the traditional treatment of trade as central and of other areas of cooperation as either trade – facilitating or secondary? Where are the commodities in which the countries of COMESA or ECOWAS, for example, are to conduct trade? In other words, since all the Eastern, Southern and West African countries have primary products to offer with no complementarity between them and since there are no manufacturing or processing industries to absorb the raw materials, is the mere formation of a common market necessarily enhance the flow of trade in Eastern, Southern and West Africa?

The major reason why intra –group trade in the developing economies might not rapidly increase is the lack of very much to trade. It is basically the low level of production that would be tradable in the markets of the developing countries that accounts for the small volume of intra-regional trade and the likelihood that the mere removal of trade barriers would not produce a rapid expansion of such trade. Consequently, the relative importance of intraregional trade remains low for most groupings in the developing world. In Latin America, although the share of CACM intraregional exports during its first decade of existence rose sharply between 1960 and 1970, it stagnated in the 1970s and declined in the 1980s. In 1990, the share of intraregional exports ranged from a high of 18.6 percent, in the case of the ASEAN, to regional groups in Africa with shares typically below 5 percent.

There is also the troublesome problem about industrial polarization or skewed distribution of benefits which the market integration approach generates. Although regional integration should result in substantial benefits --- economic, political and security-related ---, there is legitimate concern in many developing regions that the gains from market integration would accrue mainly to the larger or more industrially developed member countries, which are in the most advantageous position to capture immediately the additional income benefits from an open accessible regional market. If this is not contained and directed by regional policies, spatial polarization and biased industrialization patterns are bound to arise from unfettered market processes.

Asymmetries in the relative economic weight and capability of regional partners have contributed in the past to the disintegration of many regional arrangements in the developing world, as happened with the East African Community (EAC) in 1977. Such problems have been encountered in the Andean Pact countries in Latin America and have slowed down the process of closer integration in ASEAN. Other cases in point are the respective experiences of the West African Customs Union (UDAO) 1959, Customs and Economic Union of West Africa (UDEAO) 1966, and the withdrawal of Chad in 1968 from the membership of the Central African Economic and Customs Union (UDEAC).

Besides, loss of revenue derived from indirect taxes – mainly import and export duties -- as a consequence of the removal of barriers and tariff harmonization poses another challenge. This constitutes an immediate effect of establishing a preferential trade area, free trade area, or customs union, which can be quite severe considering the high share of customs duties in public revenues (50 to more than 70 percent for many African countries). Whereas the revenue losses are for certain and immediate, the benefits of market integration are a rather long-term prospect, particularly for countries that are not in a regionally competitive position.

The situation is made worse by the critical problem about compensatory arrangements, which are crucial concomitant of market integration, to compensate member countries for revenue losses. However, the compensatory schemes and solidarity funds have persistently been under-resourced and thus are often found not to be helpful in alleviating the fears of economically weaker countries and maintaining the momentum towards regional integration. Compensatory schemes need to be designed carefully to avoid disincentives to intraregional trade as evidenced in the ECOWAS scheme which rigidly penalized net exporters.

The failure of market integration to give priority to the basic industries and therefore reinforces the position of the foreign private sector in the developing countries and increases economic domination from abroad constitutes yet another key challenge. It creates problems for the participating countries with regard to the sharing of gains with transnational corporations (TNCs). There is always the tendency on the part of the TNCs to either become the main beneficiaries of the larger market, to the detriment of the indigenous agents of production and trade, or to fragment the market both at national and regional levels and entrench external dependence, thus defeating the objectives of regional integration arrangements and self-reliance. The analysis of Langdon and Mytelka of UDEAC, reinforced by the 1981 evaluation report by the Economic Commission for Africa (ECA) provides an excellent case study of the way in which TNCs derive benefits from regional economic schemes.

Thus, on the whole, market integration approach does not respond to the conditions, characteristics and prerequisites of developing economies. The structural problems like weak industrial and infrastructural base, high geographical and commodity concentration of trade, indispensability of customs revenues, permeating scarcity of foreign exchange that has thwarted the operations of regional clearing houses and solidarity funds, enormous discrepancies in terms of all relevant economic fundamentals and other factors -- all strongly militate against the workability of the classical concept of market integration in the context of developing countries.

In industrialized economic unions like the EU, where market integration approach is appropriate, the pursuit of the economic goals involved building a regional scheme upon existing economic structures and patterns to reap benefits in the form of incremental increases in welfare.

On the other hand, regional integration schemes among developing countries aim to use the processes of economic integration to create new economic structures and to fundamentally change the existing patterns of economic relationship. Put differently, developing countries are faced with the problem of developing on a collective basis a viable industrial structure that they could not develop individually because of their small size and poor economic and social infrastructure. Thus, in developing countries, economic cooperation in whatever form --- customs union or common market -- has little chance of contributing effectively to economic development and structural change without the concerted effort of the participating countries to coordinate their sectoral plans and programmes, most especially in agriculture, industry, transport and communications and energy production and utilization, as well as their overall development strategies and perspectives. The challenges of the market integration approach are compounded by a set of complex problems of commitment and management of regionalism.

## 4. CHALLENGES OF MANAGEMENT OF REGIONAL INTEGRATION

A key challenge facing the developing countries is the crucial issue of commitment or political will to keep to the agreed regional agenda. So far evidence tends to suggest what appears to be a lack of special interest in, support and total commitment on the part of the developing countries to the cherished goals of the existing regional integration arrangements. The lack of commitment to regionalism has manifested itself in member countries independently developing their own strategies, plans and priorities, with regional cooperation hardly reflected in them.

Closely related to this is the inadequate institutional structure of the integration arrangements to co-ordinate, implement, and monitor integration policies and programmes.

While emphasis on most comparative studies of regionalism is on the economic content of regional integration, a little more than a passing reference is made to institutional phenomenon. Yet the potential impact of institutional structures on the effectiveness and success of any integration scheme should not be overlooked. The institutional structures must not only be able to meet the short-term objectives that may have inspired the economic grouping in the first place, but also exert a leadership role in stimulating movement towards the fulfillment of the group’s long

– term goals. These structures are to be called upon to provide support, guidance, and leadership, and may constitute either a bottleneck or a driving force on the road to regionalism.

At the national level, although many of the integration arrangements among developing countries are ostensibly modeled on the EU, they are unable to endow their integration agreements with the institutional effectiveness needed to achieve their often ambitious objectives. This has been evidenced in, among other things, inconsistencies between national legislation and integration commitment and the absence of strong enforcement mechanisms. In general, decisions at the regional level have seldom been reflected in decisions at the national level in the form of legislation and regulations. Thus although regional integration schemes have been duly established in the developing areas, cooperation agreements have not been internalized in national administrations and development plans.

Deficiencies of the regional institutions constitute yet another challenge. The secretariats of almost all the regional integration schemes in the developing countries, particularly those in Africa, suffer from a lack of real decision –making process, and their resources are invariably totally inadequate for independent, practical cooperation and integration activities. They lack the authority, power, and resources to enforce decisions and see the implementation of programmes through to their logical conclusions. Their development is blocked by the marked dominance of nation-state interest, allowing genuinely supranational regional development policies only within a narrow framework. Many of them lack clarity of vision, strategies, and plans, resulting in diffuse activities. The presence, weight and influence of the member states are such that a good number of the secretariats are reduced to the role of technical and administrative units operating at low levels of responsibility.

One aspect of the challenge is the poor choice of personnel of the secretariats. Both in qualitative and quantitative terms, most economic groupings in the developing countries are inadequately staffed. It is a fact that the institutions of the EU were served by first class European personalities such as Gaston Thorn, Jacques Delors, Raymond Barre, and former Prime Minister of France. On the other hand, in the case of the integration schemes in developing areas like Africa, the quality of staff is low, largely because most of the executive and professional positions are to a large extent usually filled on political and geographical representation grounds rather than on experience, technical and administrative competence.

The institutional constraints have been aggravated by the often neglected challenge posed by the impact of the institutional, financial and economic links between the regional schemes in Africa, Caribbean and Pacific (ACP) and the EU on the process of regionalism within the framework of the EU-ACP Lome Convention (1975 – 2000) and the Cotonou Agreements of June 2000. Recent research has shown that the colonial heritage that left many ACP states dependent on their former colonial powers has tended to work against viable regionalism in these countries. Commercial and political links with Europe reflected in the Lome and Cotonou agreements continue to be more important than links within the ACP countries, and communications and transport networks oriented towards former colonial centres do not facilitate intra-regional trade in the ACP states.

More significantly, regional self-reliance, as the central objective of regionalism in the ACP countries aimed at reducing the age-old dependency syndrome and therefore challenging the external domination inherited from the colonial era, is fundamentally incompatible with Euro –ACP integration espoused in the Lome and Cotonou agreements. To a great extent, the Lome and Cotonou arrangements are geared towards reinforcement of the existing pattern of trade links between Europe and the ACP countries and thereby discouraging intra - ACP relationships. Trade with EU is sustained by the measures of the Lome Convention's special preferences, which are being replaced with effect from January 2008, under the Cotonou Agreements, by the Economic Partnership Agreements (EPAs) being currently negotiated between the EU and the ACP countries. While these prevail, the ACP regional schemes have been hesitant to implement protocols and programmes of their respective trade liberalization schemes aimed at promoting intraregional trade expansion through the elimination of the barriers to trade.

## 5. HIGHLIGHTS OF IMPACT OF THE INTEGRATION AGENDA

The combination of the complex challenges, constraints and shortcomings highlighted above have contributed to the poor performance of the regional integration arrangements in the developing areas. Although some important gains have been achieved, for example, in the area of infrastructural development and exploitation of common resources, as evidenced in the case of particularly SADC, the overall record falls short of the ambitious targets that had been set for all groupings. This is particularly the case if the achievements to date are to be judged by such measures as the degree of integration of markets, the harmonization of macro-economic policies, the co-ordination of sectoral policies, the streamlining of rules and regulations affecting the private sector and the creation of effective regional organizations.

To be precise, except in the special case of ASEAN, the regional integration arrangements in Africa, and to some extent Latin America, have not been able to play a vital role in the socio-economic transformation of the economies of the developing countries and help alleviate mass poverty through sustained recovery and growth. They have not been able to expand the opportunities for investment that will contribute to the mobilization of their underdeveloped resources. Neither have they had any impact on agricultural and industrial development and employment creation, nor made any appreciable inroads towards the all-engaging objective of creating a regional market, let alone an economic community, despite the human and financial resources deployed. In short, the regional economic schemes have not been able to show evidence of movement towards economic independence of their member countries through regional integration. In the case of ECOWAS, as Adedeji concludes in an illuminating analysis of the three decades of the Community, ‘no effective integration has taken place in ECOWAS – not in trade, not in production, and not in laying the foundation for the economic transformation of West Africa.

What, then, should be done in order to effectively meet the interlocking problems and constraints posed by the global resurgence of interest in regional economic integration today? How can a small country like Namibia maximize benefits from regional integration arrangements and adjust itself to the new realities of the brave new world of the twenty-first century?

## 6. FORGING A NEW DIRECTION: AN AGENDA FOR ACTION

It has become evident that the traditional or European model of economic integration with its emphasis on integration of markets rather than physical infrastructure and production is inappropriate in developing areas because of virtually non-existence industrial base. It is like ‘putting the cart before the horse’. The analyses so far point to the prematureness and inadequacy of the market integration approach in the particular context of developing economies.

The following section, therefore, focuses attention on an agenda for action on a number of the critical areas of regionalism in the developing economies.

### (i) Adopt a New Approach

The analyses point to the need to adopt new approaches for regional integration efforts, particularly in the context of the rapid globalization of world trade and production. For such efforts to succeed, they would need to go beyond the traditional and narrow trade-promotion approach and adopt, instead, a comprehensive growth – creation approach that involves three related dimensions: the integration of physical and institutional structures, of production structures, and of the markets.

Integration of physical infrastructures would foster efficient operations and sustainable development of national and regional economies, as well as fair and equitable distribution of products, services and other amenities among various peoples of a country or region. At the regional level, interconnection of infrastructures is a necessary condition for integration of national markets and industries to facilitate increased intra - group trade. Infrastructure is indeed crucial to advances in agriculture; a key enabler of trade and integration; and important for offsetting the impact of geographical dislocation and sovereign fragmentation. Transport and communications development is crucial to the integration of physical and institutional structures to address the problem of disjointed physical space with excessively extroverted transport and communications networks and limited horizontal links between countries of developing areas.

The second high priority is for the integration schemes to address the weak production structures with virtually no intersectoral links, that is, between the primary and secondary sectors in general and between agriculture and industry, between mining and manufacturing, in particular. Therefore, regional integration in the developing countries should now give top priority to production and devote substantial resources to production integration in order to reduce the excessive external dependence, critical lack of productive capacity and internal non-viability of member economies.

The third priority is to address the cumbersome tariff and non-tariff obstacles to intra – regional trade in order to bring about regional trade liberalization and market expansion. Trade liberalization is a major building block of economic integration and cooperation. Coincidentally, the scope for liberalization of trade has widened in the new atmosphere of movement towards general liberalization and opening of up of economies in developing countries.

Trade liberalization programmes should be enhanced by the convergence of economic and monetary policies. In this regard, the multilateral clearing and payments arrangements will have to be revitalized and their operations strengthened. The possibility of establishing limited convertibility schemes among willing member states should be explored with a view to alleviating problems arising from disparities in exchange rate regimes. Although monetary union is a desirable objective, it is likely to evolve only over time, given the complexity of the subject and the current situation in many developing countries, particularly in Africa, where there are many non-convertible currencies, differing floating exchange rates and with various foreign exchange restrictions.

### (ii) Adopt Pragmatic and Flexible Approach

In implementing all regional projects and programmes, it is advisable to adopt a highly pragmatic approach. This would allow progress to take place at variable rates in the different programmes and sectors. Indeed, every effort should be made to rapidly achieve those objectives and goals that are easily attainable – for example, cooperation and co-ordination of specific regional infrastructure projects – while efforts continue to be made to achieve the longer-term and more difficult goals of creating a customs union or a common market.

Flexibility is related to another principle, that of multi-speed development or variable geometry in the sequencing of member states' participation in regional development. This concept accommodates a situation where a sub-group of member states moves towards deeper integration than the others do. Rather than let progress be determine by the slowest member, those who are ready to proceed can do so. The EU, for example, considers it normal that some groups should proceed at different speeds in integration schemes involving a large number of participants. The approach is illustrated by the progressive growth of the EU itself from the original core of six countries to the current twenty – five.

### (iii) Put the Private Sector at the Centre of Integration Agenda

Of particular importance is the greater role which the private sector should play in all regional integration efforts. As the ECA stresses in its recent assessment of African regional integration, the private sector should be put 'at the centre of the integration agenda. It can be an important partner in integration by providing finance and human resources to support regional projects. With a view to promoting and increasing a more active participation of the business community in the integration process, particularly in trade and industrial cooperation, mechanism should be established in all the economic communities to encourage the participation of the private sector in the design and implementation of regional trade and production programmes.

### (iv) Build Institutional and Managerial Capacities

There can be no doubt that strong, autonomous institutions play a crucial role in regional integration arrangements. Strong and independent institutions are required to ensure that the grouping pursues clearly identified regional interest rather than the (sometimes) conflicting interests of different member states. Enhancing their effectiveness and technical competence is a prerequisite. An important step towards strengthening the regional institutions appears to lie in the genuine rationalization of the present institutional framework of the regional economic groupings with a view to harmonizing the activities of the different regional groupings and intergovernmental organizations (IGOs). This would not only prevent costly duplication, but also establish certainty and a better investment climate.

Strong institutions at the national level are indispensable for implementing the large and increasingly diverse number of conclusions and recommendations formulated in regional cooperation or integration schemes. The importance of regional integration requires that a key ministry – a ministry of regional cooperation and integration -- be established in each country to act as a focal point. It should be mandated to assume the coordination of all forms of regional integration and cooperation and should ensure that national development policies and decisions are cast in a regional perspective.

### (v) Provide Training in the Technology of Regional Integration

Besides strong institutions, human resource development and administrative, technical and research capacities are indeed fundamental in any strategy to promote regional integration. There is the need to develop analytical capacities – for example, in predicting the economic effects of trade liberalization and regional integration. The approach could cover the training of personnel responsible for policy design and for handling WTO and regional obligations. Indeed, training of government officials and technocrats charged with implementing regional policies, and finding ways to motivate them are key elements that may help to achieve the objective of regional integration arrangements.

An effort is needed to upgrade customs services to deal with issues such as verification of origin, and phytosanitary and sanitary regulations. There is also a need to simplify and harmonize rules of origin. The private sector should be involved in capacity building, for example, in areas such as standardization, quality control and international payments procedures. A critical mass of dedicated people within the administration is needed to ensure continuity. Exchange programmes and increased contacts at the personal level also play a major role in building support for regional integration initiatives and in creating a common language between the actors and stakeholders – both public and private – in the countries concerned.

### (vi) Harness Information for Regional Integration

Among the capacities required is information management. There is an acute lack of awareness of what other developing countries can offer to substitute the products presently being imported from developed countries. Institutionalized access to and quick transmission of information on rules and regulations implemented in partner countries and on bureaucratic procedures, publications of standardized statistical data and so on are needed to lay the groundwork for effective regional integration scheme. Timely and reliable information and data are required for economic policy making in the public sectors, for business decisions by private economic agents and for economic integration policy issues by community top executives.

### (vii) Involve a broad range of Economic Actors and Civil Society

As regionalism is not just a matter for national governments and international organizations, and as it cannot be imposed from above, but must be a need felt by, and supported by the general public, there is the need to focus attention on the involvement of a broad range of economic actors and civil society. For, beyond actions on policy, infrastructure and institutions lies a more fundamental need: to mobilize the media and educational and cultural institutions to promote the concept that cooperation within developing countries is likely to enhance the progress of all societies. Strong non-governmental participation is a key factor in achieving the goals of regionalism. Successful regional integration schemes in Europe and elsewhere have not been the work of governments alone. They have all benefited from active participation by a wide variety of groups such as trade unions, employers' organizations and private entrepreneurs. These groups ensured that issues of regionalism remained at the top of the political and economic agenda. The degree of participation by civil society can therefore be seen as a barometer to gauge the real effects of regional integration measures.

**(viii) Establish a Regional Parliament**

A regional parliament is crucial if not indispensable to regional integration, as it represents one of the best hopes of satisfying the yearnings of the people of a region. Members of the regional parliament, as legitimate representatives of the people of the region, serve as credible intermediaries between the people and the decision –making authorities of the integration scheme, while the parliament provides a forum which enables the people of the region to make their views known on issues relating to the process of regional integration and guarantees responsible and enlightened participation by the common people in the integration project.

A regional parliament does not only provide a permanent mechanism for popular monitoring of, and control over, the operations of the institutions of the integration scheme, it also serves as vehicle for strengthening the popular base of the process of regionalism, helping to create a popular dynamic group in support of cooperation and integration in the region, and mobilizing public opinion in the direction of the integration arrangements. Furthermore, a regional parliament ensures greater transparency and accountability, which is crucial in an era in which good governance, as underlined in the NEPAD initiative, is regarded as an essential condition of sustainable development. Above all, it provides for democratic element, which is essential for the health and survival of the regional integration scheme.

While the agenda for action identified so far are relevant to the Namibian situation, other specific aspects of the process of regional integration are worth emphasizing as agenda for action to enable Namibia to exploit the opportunities provided by its membership of the economic integration groupings in Southern Africa.

## 7. THE NAMIBIAN PERSPECTIVE

Given its small domestic market but favourable location and a superb transport and communications base, Namibia is a leading advocate of regional integration. In addition to its membership in the SADC, Namibia presently belongs to the SACU with South Africa, Botswana, Lesotho and Swaziland. What should Namibia do to exploit the opportunities created by the opening up of regional market?

A small state like Namibia with potential for rapid development needs the cooperation of her neighbouring states within the framework of SADC, in particular and SACU in general. As it would be difficult to establish viable enterprises to serve the Namibian market only, regional cooperation and integration is readily held out as a key element of domestic policy. Efficient regional integration arrangements would enable Namibia to surmount the obstacles posed by the country's relatively limited domestic market, permit it to realize greater economies of scale, and enhance its ability to trade on global basis.

Efficient gains could be captured by enlarging markets and overcoming functional losses in allocative, administrative, and transaction costs associated with small market size, market distortions and barriers to the movement of productive factors, as well as of goods and services resulting from protective national policies. Besides, regional integration would provide a framework within which Namibia and her partner states could cooperate to develop common infrastructure (in transport and communications, as well as banking and insurance) thereby equipping them to participate effectively in world trade.

Both existing and emerging industries can access the larger economic space created by regional economic integration. Increased competition and access to cheaper sources of inputs may support economic diversification drive and improve on industrial efficiencies. Trade liberalization may provide the impetus for more fundamental tax reforms and review of expenditures. To enable Namibia to benefit from the opportunities provided by its participation in the regional integration arrangements in Southern Africa, the following has been proposed as agenda for action:

### (a) Establish a Department of Regional Cooperation and Integration

To fully exploit the opportunities created by Namibia's participation in regional integration arrangements, establishment of a dynamic Department of Regional Cooperation and Integration within the existing Ministry of Trade and Industry to coordinate and harmonize the country's national positions on all integration issues has become increasingly necessary. Because of the small size of the Namibian civil service structure, a department, instead of a full separate ministry, would be a step in the right direction.

The present practice of making a unit within the Directorate of International Trade responsible for regional cooperation and integration affairs is no effective alternative to a separate Department  (or Directorate) of Regional Cooperation and Integration, as this would not be able to give high-profile recognition to the seriousness of the Government's commitment to regional cooperation.  One other short coming of this practice is that at the bureaucratic level, the mainstream responsibilities of the Directorate of International Trade may understandably tend to dominate its activities and probably leave regional development issues as the residual legatee of its time and effort. Moreover, the staffing, authority level, backgrounds and qualifications of personnel in the present Directorate may tend to be far below what is required to make them effective for regional cooperation and integration issues. The Department (or Directorate) of Regional Cooperation and Integration should have adequate authority, competence and capacity to ensure effective implementation of integration measures at the national level.

The functions of the Department may include, among other things, coordination of all government relationships with regional integration arrangements; monitoring and reviewing Namibia's involvement and participation in such integration schemes with a view to making periodic assessment of the costs and benefits from these groupings; coordination of close liaison with relevant government ministries, departments and agencies, private sector or business community on all issues of regional or bilateral cooperation; ensuring that regional policies are integrated into all aspects of national policy and that they are implemented according to plan; maintenance of close liaison with the top officials of regional or continental integration schemes both inside and outside Africa with a view to exchanging information of common concerns and learn from their experience as appropriate; and dissemination of regular information on Namibia's activities, including conferences, seminars  and workshops, in the area of economic  integration  and also publicizing through the media various forms of cooperation in both the developed and developing countries to the general public.

As regards staffing, it would be necessary to offer career incentives to public servants to attract them to serve in the Regional Cooperation and Integration

Department. The staff would have to be selected with the specific needs of regional integration and international economic cooperation in mind. They must be both narrowly technocratic and at the same time adopt broad perspectives and a multidisciplinary approach to development and its relationship to regional issues.

**(b) Create a National Commission for Cooperation and Integration**

There should also be established a National Commission for Cooperation and Integration (NCCI), as a consultative body, for permanent consultation on all issues of regional integration arrangements under the chairmanship of the Prime Minister or a senior minister. The NCCI should be composed of government representatives, representatives of private sector executives, civil society organizations and representatives of socio – economic associations – chambers of commerce and industry, labour organizations, and all other social and economic operators to provide a democratic framework of regionalism. This institutional machinery would enable the people to find appropriate and adequate channels of participation in Namibia's formulation and implementation of cooperation strategies and decisions at regional and international levels.

**(c) Establish an Interministerial Coordination Committee**

A high level Interministerial Coordination Committee (ICC) be established, (in addition to the one under the SADC regional structure), to formulate national policy and coordinate Government action in the area of regional integration. It should play a central role in pursuit of national policies and initiation of economic integration strategies. The membership of ICC should include ministers of foreign affairs, finance, planning, trade and industry, agriculture, transport and communications.

**(d) Promote Regional Programmes in National Plans**

To promote reflection of regional programmes in national plans, Namibia could formally set out, in its statements of national policy or development plan, explicit objectives relating to regional cooperation. Adopting a five-year indicative plan, for example, Namibia could outline its strategy for regional cooperation, laying down specific targets and highlighting the links between such cooperation and national objectives. In addition, there should be regular procedures, including the use of statistical and other indicators, for reviewing performance in meeting goals of cooperation with other countries. The point must be stressed that the effectiveness of any regional integration initiative depends on how it is perceived, accepted, and implemented at the national level.

Namibia should not only incorporate the decisions of the regional integration schemes into national policies and programmes; it must also collaborate in implementing regional production or infrastructural programmes, such as construction of roads and railways, telecommunications and other sectors, in its area, and translating regional common policies into national laws and regulations.

**(e) Strengthen the involvement of the Private Sector**

An important area of concern that requires immediate action is the inability of the private sector in Namibia to take advantage of the opportunities offered by the various preferential trade arrangements; neither is the business community actively involved in the negotiation of these agreements, let alone well informed on the product and country specific access conditions. The organized private sector, such as chamber of commerce, trade unions, professional and sector associations appear to have inadequate capacity to engage in an on-going dialogue with Government on the strategic choices to be made in regional economic integration.

Yet the private sector has a key role to play in the integration process, since it is essentially private entrepreneurs who produce and move goods and services for intra-regional and international trade. It must be noted, however, that the various central banks, stock exchanges, as well as the power utilities in the SADC region participate in the regional integration process.

To effectively meet the challenge of the private sector in the area of economic integration, a conducive climate needs to be created for the private sector to assume its role in economic integration in an environment of progressive removal of the tariff and non-tariff barriers, and provision of trade financing facilities. Without the appropriate regulatory, legal and legislative framework, the right fiscal and other incentives, the supportive macro-economic climate, it would not be possible to encourage the private sector to become a key stakeholder and an important partner in the integration process. The security of investment, the predictability of policies, and the building of the investors' confidence are extremely important. Government direct assistance to the private sector should, among other things, be focused on (i) technical support to improve the country's competitiveness; (ii) assistance for promotional activities and exposure; and (iii) the operationalization of development corridors as part of the Spatial Development Initiative (SDI).

### (f) Adopt Equity and Mutual Benefit

Namibia would have to press for equity and mutual benefit to meet the challenge of revenue loss from customs duties. Compensation measures adopted so far have not altered the position of Namibia and its partner states – Botswana, Lesotho and Swaziland – in SACU. The mechanisms have tended to be perceived as insufficient by the four SACU member states. The situation has been aggravated by the recently concluded EU-RSA Free Trade Agreement, as the Common Revenue Pool for customs and excise receipts would shrink, leaving lesser funds for distribution among the SACU members.

There is therefore the need for 'corrective measures to accompany compensatory measurers'. To this end, Namibia should press for such measures as the following to accompany compensation: a planned regional industrial development that distributes industries equitably on a regional basis; creation of a credit fund for infrastructure and industrial development; and creation of common fiscal incentives for foreign investment.

On the whole, the vehicle for economic integration are available for Namibia – SACU and SADC – and it is now up to the Namibian Government and the private sector to make strategic use of the facilities and resources. As a first step towards this objective, a Namibian Trade Policy needs to be formulated, based on proper research and analysis. Worth noting, also, is the limited resources directed at the private sector which may need to be supplemented by other initiatives.

## 8. CONCLUSION

At the dawn of the twenty-first century, the unrelenting and realistic pursuit of regionalism is imperative if the developing countries are to succeed in meeting their development goals to enable them to become an effective partner in the global economy. The paper has analyzed the opportunities open to them in regional integration arrangements and highlighted the interlocking challenges which regionalism poses for less developed economies. It has shown that the shortcomings and constraints in the approach and management of regional integration arrangements as a desirable strategy for development could be overcome, given the much needed sustained political will and strong commitment and the adoption of new approaches, as reflected in the agenda for action.

Special attention has been focused on Namibia, which has much to gain from its participation in regional integration arrangements in Southern Africa.

Among other things, teaming up in regional blocs can no doubt assist a small country like Namibia to more firmly place its issues on the international trade agenda. However, the business community in Namibia will need to become competitive and diversify its export basket through an expanded industrial base to reap the benefits from regional integration and globalization. Public-private partnership may be a powerful tool in the utilization of the opportunities offered by regional integration and the direction of trade facilitation and promotion efforts, as strongly highlighted in the recently released Report of the Commission for Africa. There is indeed the need for a sea change in the way the business community in Namibia engages in the regional integration process in Southern Africa. Taken together, what Namibia requires is to make clear, strategic choices in the regional economic integration process, which is one of the key priority areas of NEPAD, a ground-breaking initiative which holds the promise of accelerating economic integration efforts in Africa.

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# COMMENTS ON THE PAPER ON "CHALLENGES AND OPPORTUNITIES OF REGIONAL INTEGRATION FOR DEVELOPING ECONOMIES"

BY

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## GENERAL COMMENTS

Professor Asante's paper presents a very interesting piece of information about the academic research that has been done in the area of Regional Integration, and therefore a very good background material for our discussion today. The paper also acknowledges the importance of regional integration and cites a range of regional integration initiatives undertaken in various parts of the world, particularly in developing countries, it also provides a very detailed analysis of the challenges, benefits and opportunities emanating from regional integration. Thus providing us with a basis for appraising our own environment.

Overall, the presentation drives home the points that, it has been realized that for a developing country to achieve higher levels of economic growth and increased welfare gains, it cannot do that alone and within the confines of its domestic economy. This recognition, therefore explains the move towards regional integration whereby countries come to cooperate, liberalise their trade policy regimes and open up their markets for inter-regional trade, and also increase their capacity to eventually participate in multilateral trade as larger and competitive economic blocs.

In fact this is the spirit with which the World Trade Organisation (WTO) accepted and accommodated the notion of regional integration agreements concept (GATT Article XXIV) and to ensure that they are WTO compatible. The belief is that open regionalism would avoid trade warfare, facilitate inter- regional trade and thus ultimately lead to multilateralism, which is the ultimate objective of the WTO. So in the face of past and existing economic realities, regional integration seems to be a good model that could liberalize world trading system and bring sustainable economic development of countries.

The discussion paper goes to assess whether Africa have been successful in this process, and concludes that as far as the continent Africa is concerned, it have been limited, both in approach (strategy) and output (economic growth). A point must be made also that regional integration is wide, covering not only trade, but also multi-sectoral, with the objective of creating economic space for all operators.

**MARKET INTEGRATION APPROACH**

Professor Asante's paper argues that the market integration schemes adopted by Sub-Saharan African countries, with the exception of SADC and SACU, are copied from Europe and are not relevant to their own environment. Market integration is said to be inappropriate because it focuses on removal of tariff and non-tariff barriers to trade, yet, there is little to trade between the integrating countries. Furthermore, the production base of most African countries is very low. Therefore integration eroded their revenue bases (import and export duties); while the compensatory schemes put in place to reduce such revenue losses were not well resourced.

The paper also highlights the problem of industrial polarization, which implies that the gains from market integration will accrue to the most developed members of the economic bloc. One cannot agree more with the argument put forward. However, the exception given to the SADC and SACU arrangements has not been clearly pointed out in the paper.

One may agree that there is a diversity of products for the diversified markets both in the context of SADC and SACU but the rest of the factors as enumerated are also true to our environment. The issue of industrial polarization is evident in SACU where BLNS have lower levels of development in relation to South Africa. One would also argue that while SACU is one of the oldest customs union in the world. However, the objective of the pre-2002 SACU agreements was mainly the maintenance of common revenue pool.

In case of the 2002 SACU Agreement, there is a recognition that SACU cannot continue to focus on revenue management issues only as was the case in the past. Therefore, the current agreement obliges SACU to address sectoral policies through policy harmonization (e.g. in the area of industrial development, agriculture, competition and unfair trade practices). This approach is recognized in Professor Asante's paper that, in order for the integration arrangement to promote economic and structural changes of member countries there must be a mechanism to coordinate policies. However, the biggest challenge, as the paper recognizes, is the need to put in place adequate institutional structures that would coordinate and monitor the implementation of policies. This is a challenge that SACU is currently facing as it does not yet have such institutions.

Issues of lack of authority and power by institutions such as the "Secretariats" that manages the integration process, as well at the low calibers of professionals and technical staff have also been highlighted. These are part of the challenges that integrating member countries have to be constantly taking into consideration. In the context of SADC, this is a coherent approach that addresses enhancing and deepening of the regional integration process, such as:

- The multi-sectoral pronged approach
- Development of protocols to harmonize policies
- Adoption of the Regional Integration Strategic Development Plan (RISDP), which defines priority areas and programmers for the region and integrates Member State' national development priorities
- Institutionalization of SADC National Committees (SNCs), which enlists the participation of public and private sector and civil society as stakeholders in the regional integration agenda. All these say very little about management of the regional integration programme.

One major challenge being experienced in our region is multiple memberships to regional groupings. Countries are members to two or three regional integration groupings which poses serious resource constraint, incoherent strategies and uncoordinated attention to various interests. The uniqueness of our region, particularly where we have a big economy and many LDCs (more than half of SADC member countries are LDCs) is a challenge in trying to balance opportunities, benefits and costs.

Another factor is that regional integration groupings are made up of countries that are at different levels of economic development. Different levels of economic development is a challenge in itself, therefore the process of integration cannot be easy. This may be supported by the argument in the paper that asymmetries in the wealth and ability of regional partners have contributed to the collapse of some integration arrangements in the past. In the regional integration process, once started, there is no luxury of stopping for a while to assess as it is being suggested in the paper.

## FORGING A NEW DIRECTION

It has been suggested in the paper that new approaches for regional integration efforts must be adopted, particularly that we are faced with rapid globalization. It is agreeable, as the paper recommends, that the new approach should be:

- Pragmatic and flexible
- Stakeholder control
- Capacity building-oriented

On the recommendation for a regional parliament as an indispensable institution to regional integration, this may depend on the kind and focus of the programme being pursued. In the context of SADC, a regional parliament has been mooted, so we are on good track.

## NAMIBIAN PERSPECTIVE

The analysis of the implications of regional integration for Namibia has to take into account Namibia's membership to the regional integration processes of SACU and SADC. The paper recognises Namibia's small domestic market, superb transport, communications and financial infrastructures, strategic geographical location, potential for rapid development, limited institutional capacity, which present both opportunities and challenges not only to its economic growth and development but also its participation in the regional programmes.

The paper thus proposes some agenda actions to enable the country to maximize its benefits from opportunities emanating from the regional integration schemes. The paper recommends that Namibia should establish a regional cooperation and integration Department in the Ministry of Trade and Industry as this "will give high-profile recognition and seriousness of government commitment to regional cooperation".

One would agree that the Ministry of Trade and Industry has limited capacity. The point however is that given the model of SADC integration (clusters), the ministry does not have to do everything but play a coordinating role. There is a coherent approach that addresses efforts at national level both with respect to SADC and SACU, such as the SADC national committee and sub-committees and the SACU national bodies.

The paper recommends the creation of a national commission for cooperation and integration-"this will play the role of a consultative forum for all stakeholders". This is a good proposal and Namibia is on course since there is a cabinet decision for the establishment of a National Trade Forum. The paper recommends the creation of an inter-ministerial coordination committee-"to formulate national policy and coordinate government action". The paper further recommends the promotion of regional programmes in the National Plans.

The paper also recommends the strengthening of private sector involvement, and to adopt policies which will promote equity and mutual benefit in order to meet the challenge of revenue loss. This proposal links well with the debate currently in SACU on how to improve the development component for smaller members as well as ensuring equity.

In conclusion the paper brings out problems, challenges and weaknesses in policy coordination and management, and suggests policies from the perspective of Namibia. However, the paper should have also highlighted best lessons to draw from, either as a country or as a region.

# Conclusions and Issues Emanating From The Symposium

## Research Department

### CONCLUSIONS

All the papers presented were in agreement that, regional integration is important for Namibia's economic growth and development. The integration process is of benefit to the Namibian economy in terms of reduction of the transaction costs, elimination of exchange rate fluctuations which promotes economic stability, policy credibility and investor's confidence as well as the maintenance of price stability, access to a relatively large market, and the envisaged harmonization of economic policies such as competition and industrial policies. Furthermore, regional integration entail benefits for Namibia with regard to infrastructure development which would lead to a reduction of trade transaction costs in the region, and facilitate exports, primarily of fish and processed products to member countries of the SADC. The benefits of regional integration, especially in the context of the CMA appear to be superior to the associated costs.

Despite the potentially large benefits to be derived from the process of regional integration, it was noted that African Countries have put in a lot of efforts with little success relative to the European and East Asia countries. The main factors behind limited success of African regional integration arrangements are as follows: Inadequate infrastructure which limits trade within and between member countries, lack of political will, and deficiency of institutional and technical capacity, limited financial resources, and participation of countries in multiple regional integration arrangements. In addition, there are other challenges to regional integration in the Southern African region, such as the industrial policy, the new revenue sharing formula under the SACU 2002 agreement as well as trade data reliability.

### The following policy issues emanated from the symposium

#### Supply side constraints

It was noted that although, African Countries have put in a lot of efforts in regional integration, there has not been great success due to some challenges that Africa face, unlike in the case of European and East Asian cases, where integration has contributed to the increase in domestic growth. Inadequate infrastructure is one of the hindrances limiting trade within and between member countries in Africa. In addition, African countries are faced with financial resources constraints. Furthermore, the low level of production and the homogeneity of products that are produced in the member countries pose another challenge to African regional integration arrangements, which should be addressed by these respective countries.

**Challenges posed by adoption of the market integration approach**

One of the key challenges to successful regional integration in developing countries was identified as the adoption of the market integration approach. The adoption of the market integration approach poses the following problems for developing countries: loss of revenue derived from indirect taxes–mainly import and export duties, industrial polarization or skewed distribution of benefits whereby the benefits of market integration accrue mainly to the larger member countries within the regional integration arrangement. It is therefore of vital importance that developing countries, including the SADC countries address this key challenge for successful implementation of the regional integration process.

**Lack of political will/commitment**

Due to a lack of political commitment or complex problems of management of regional economic integration, regional integration in Africa has experienced limited success.

The key challenge here is the lack of commitment to the agreed regional integration agenda, coupled with inadequate institutional structure of the integration arrangements to co-ordinate, implement and monitor integration policies and programmes. A manifestation of the lack of political commitment to regional integration in developing countries is for example, the absence of the reflection of regional level decisions in national level legislation and regulations. In addition, the involvement of women groups and other stakeholders in the forums dealing with issues on regional economic integration are the other concerns which were raised.

**Maintenance of a stable macroeconomic environment**

Maintaining a stable macroeconomic environment despite expenditure pressures, as well as developing safety nets for short run costs are important factors in achieving successful regional integration. Fiscal repercussions coupled with the accompanying trade liberalizations poses further challenges. It is therefore crucial that the authorities take into considerations, the adverse fiscal effects as well as other adjustment costs in the early stages of the integration process. The speed of liberalization should be consistent with macro stability. Furthermore, it is necessary that structural reforms accompany the regional integration process, while the participation of the private sector should be encouraged.

### Institutional and human capacity

Empirical evidence from successful experiences of regional economic integration such as the European Union (EU) shows that, the availability of human, institutional and research capacity is essential to successful implementation of regional integration arrangements. It is thus important for Namibia and other SADC countries to build institutional, managerial, research and technical capacity within institutions involved in steering the process of regional economic integration. The process of capacity building (institutional, managerial, research, technical) should be carried out hand in hand with the harmonization of policies and the rationalization of membership in regional integration arrangements.

## THE WAY FORWARD

### Address the infrastructure problems

Inadequate infrastructure is one of the hindrances to trade within and between member countries, and thus to regional integration schemes in Africa. As a result, developing countries should concentrate on developing the necessary infrastructure, for regional of integration to success. Furthermore, there is low level of production and similar products are being produced within the different integrating African member countries which make it unnecessary to import goods from the other country. SADC should therefore, address the supply-side bottlenecks such as infrastructure development and production capacity to attract investment.

### Prioritise Namibia's participation in regional integration arrangements

It is argued that Namibia should determine its priorities among competing demands of participating in various regional integration arrangements. An effective participation in the new SACU arrangement is definitely an immediate priority, because this arrangement informs Namibia's policy and strategy of integrating into the global economy. The importance of domestic policy and institutional capacity to engage in the SACU arrangement can thus not be overemphasized. Furthermore, Namibia should focus on building technical capacity for it to effectively participate in the SACU regional integration issues. One of the key areas that need urgent attention in this regard is the improvement in the collection and analysis of trade data.

**Transformation of the CMA arrangement**

It has been argued that Namibia's membership of the CMA has promoted both macro-economic stability (low inflation, fiscal discipline and policy credibility) as well as micro-economic efficiency (reduction transaction costs). Furthermore, CMA countries have attained a satisfactory level of macro-economic convergence considering relatively similar macro-economic conditions (inflation, budget and current account deficits and debt levels) as well as policies, which are necessary pre-conditions for deeper monetary integration. As results, the CMA arrangement needs to be transformed into a fully-fledged monetary union so that it can enhance its usefulness as an instrument of fostering a common economic space. This will make monetary policy making a collective venture of member countries. This will mean the establishment of a common central bank and a single currency. Efforts in this regard are therefore laudable.

**Privatisation strategy**

It was argued that, although privatisation policies has a number of shortcomings, such policies have played a positive role, ensuring the presence of strategic foreign investors in the cases of Central and Eastern European countries, helping them to de-monopolise their economies, support competition and increase access to foreign capital via the presence of foreign-owned banks. Namibia should thus consider developing a thoroughly thought privatisation strategy as proposed by the IMF.

**Capacity building**

Regional integration agendas should be owned at national levels by member states, as a result there is a need to strengthen the technical and managerial capacity of the Directorate of International Trade within the Ministry of Trade and Industry in order to run the regional economic integration agenda more effectively. It is also very important that regional economic integration issues are accorded high importance within the Directorate of International Trade. Given the small economy size of the Namibian economy it is crucial that the country should enhance its potential for accessing bigger market to create jobs.

**Establish a national commission for cooperation**

One of the weaknesses of regional integration process is that decisions taken at the regional level are sometimes not reflected in legislation and regulations at the national level. As a result, it was argued that there may be a need to establish a national commission for cooperation and integration to be chaired by the Prime Minister which is to serve as a consultative body on regional integration issues as well as an Inter-ministerial coordination committee whose responsibility should be to formulate national policy and coordinate Government action in the area of regional integration.

Namibia should seriously consider establishing a national commission for cooperation and integration and this should work hand in hand with the envisaged National Trade Forum as per the Cabinet decision in this regard. Currently there are inter ministerial committees existing within the Government and within the framework of SADC to drive policy and manage implementation processes, consequently there may be no need to re-invent the wheel, those existing institutions can take care of this responsibility. It is of vital importance that the capacities of these inter- ministerial committees are strengthened for them to be able to perform their duties effectively.