Industrial policy in the Southern African Customs Union

Past experiences, future plans

INSTITUTE FOR GLOBAL DIALOGUE

Proceedings of a workshop on harmonising industrial policy in SACU

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P O Box 32571, Braamfontein 2017

Tel +27 11 315-1299
Fax +27 11 315-2149

Info@igd.org.za
www.igd.org.za

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Acronyms and abbreviations

ACP–EU	African, Caribbean, and Pacific countries and the EU
ADB	African Development Bank
AFTA	ASEAN Free Trade Area
AGOA	Africa Growth and Opportunity Act
ASBC	Association of the Swazi Business Community
ASEAN	Association of South East Asian Nations
ASGISA	Accelerated and Shared Growth Initiative for South Africa
ATEF	Africa-Taiwan Economic Forum
BBBEE	broad-based black economic empowerment
BCP	Basutoland Congress Party
BEDCO	Basotho Enterprises Development Corporation
BEDIA	Botswana Export Development and Investment Agency
BEE	black economic empowerment
BIDPA	Botswana Institute for Development Policy
BLNS	Botswana, Lesotho, Namibia, and Swaziland
BLS	Botswana, Lesotho and Swaziland
BOCCIM	Botswana Confederation of Commerce, Industry and Manpower
BOT	Build-operate-transfer
CCA	Common Customs Area
CER	Closer Economic Relations
CET	common external tariff
CMA	Common Monetary Area
CODESRIA	Council for the Development of Social Science Research in Africa
COMESA	Common Market for East and Southern Africa
CRP	Common Revenue Pool
CU	customs union
DATA	Debt AIDS Trade Africa
DCCS	Duty Credit Certificate Scheme
DFID	Department for International Development
EDF	Enterprises Development Fund
EFTA	European Free Trade Association
EPZs	export-processing zones
ETSIP	Education and Training Sector Improvement Programme
FAO	Food and Agriculture Organisation
FDI	foreign direct investment
FSAP	Financial Sector Assessment Programme
FTAs	free-trade areas
GDP	gross domestic product
GNI	gross national income
GSN	Globalisation Studies Network
GNP	gross national product
GSP	Generalised System of Preferences
HCI	heavy and chemical industry
HCTs	High Commission Territories
IDP	industrial development policy
IDZ	industrial development zone
IGD	Institute for Global Dialogue
IPAP	Industrial Policy Action Plan
IRCCs	Import Rebate Credit Certificates
IRIN	Integrated Regional Information Network
ISAP	Internal Structural Adjustment Programme
ITAC	International Trade Administration Commission
LBFC	Lesotho Building Finance Corporation
LNDC	Lesotho National Development Corporation
LNIG	Lesotho National Insurance Group
MEDS	microeconomic development strategy

MERCOSUR	Mercado Commun del Sur
MERG	Macroeconomic Research Group
MIDP	Motor Industry Development Programme
MIGA	Multilateral Investment Guarantee Agency
MITI	Ministry of International Trade and Industry
MTI	Ministry of Trade and Industry
MRAs	mutual recognition agreements
NBER	National Bureau of Economic Research
NDP	National Development Plan
NDS	National Development Strategy
NEPRU	Namibian Economic Policy Research Unit
NIPF	National Industrial Policy Framework
OECD	Organisation for Economic Co-operation and Development
OFS	Orange Free State
PBMR	pebble bed modular reactor
PSMP	Public Sector Management Programme
RIA	regional integration arrangement
SACU	Southern African Customs Union
SACUA	Southern African Customs Union Agreement
SADC	Southern African Development Community
SADCC	Southern African Development Co-ordinating Conference
SAP	Structural Adjustment Programme
SAPI	Swaziland Authority for the Promotion of Industry
SATPP	South African Trade and Poverty Programme
SBGT	Swazi Business Growth Trust
SCM	Subsidies and Countervailing Measures
SEDCO	Swaziland Enterprise Development Company
SFL	Swaziland Federation of Labour
SIDC	Swaziland Industrial Development Company
SIP	Strategic Investment Projects
SIPA	Swaziland Investment Promotion Authority
SMAWU	Swaziland Manufacturing Allied Workers Union
SMEs	small and medium enterprises
SMMEs	small, medium and micro enterprises
SNL	Swazi Nation Land
SPVs	special purpose vehicles
TRIMS	Trade-related Investment Measures
TRIPS	Trade-related Aspects of Intellectual Property
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	UN Development Programme
UNIDO	UN Industrial Development Organisation
USTR	US Trade Representative
WTO	World Trade Organisation

About the contributors

Jonathan Adongo previously worked for the Namibian Economic Policy Research Unit (NEPRU) in Windhoek, Namibia.

Oluyele Akinkugbe is a senior lecturer in economics at the University of Botswana.

David Kaplan is Allan Gray Professor of Business - Government Relations with the Department of Economics and the Graduate School of Business, University of Cape Town, South Africa.

Stephen Kapunda teaches economics at the University of Botswana.

Francis K Makoa is professor of political and administrative studies at the National University of Lesotho.

Colin McCarthy is professor emeritus of economics of the University of Stellenbosch, and an associate of the Trade Law Centre for Southern Africa (tralac).

Gabriel Tati is deputy head of the Department of Statistics of the University of the Western Cape in Cape Town, South Africa.

Brendan Vickers is a senior researcher for the IGD's multilateral trade programme.

Foreword

Brendan Vickers

Several member states of the Southern African Customs Union (SACU) – the oldest functioning customs union in the world, formed in 1910 – are in the process of crafting new industrial policies. These policies seek to promote economic diversification away from commodity dependence, and develop new competitive manufacturing platforms and services economies.

By its very nature, industrial policy is a contested terrain and debates vary widely over the appropriate balance of power between the state and the market in promoting economic development. Moreover, international trade rules enshrined in the World Trade Organisation (WTO) create a hostile environment for replicating the successful development trajectory of today's wealthy and industrialised nations (Gallagher 2005). Nonetheless, there has recently been renewed academic and policy interest in the role of activist 'developmental states' and proactive public support measures – or industrial policies – to direct and support economic development; stimulate diversification into dynamic new sectors and products; promote entrepreneurship and skills formation; and upgrade technological capabilities. On the one hand, this partly reflects the failure of the orthodox reform agenda and its far-reaching market-oriented reforms premised on liberalisation, deregulation and privatisation to catalyse global convergence and build sustainable economies, particularly since the 1980s. The inadequacy of the dominant development paradigm has therefore revived theoretical arguments that support the creative functions of markets and the creation of new areas of comparative advantage (see UNCTAD 2006). For all intents and purposes, industrial policy is back in vogue.

The late Sanjaya Lall convincingly argued the case for proactive interventions (including infant industry support) to build and deepen the requisite technological capabilities for industrial development in a globalised digital era characterised by first-mover advantage (Lall, 2004). Dani Rodrik has recast industrial policy as a process of strategic collaboration between the private sector and public authorities with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them. This is to be augmented by entrepreneurial experimentation and innovative investment to 'discover' the cost function of producing new goods or the feasibility of new modes of production (2004). Within SACU, for instance, South Africa recently embarked upon its own version of this 'self discovery' process.

More significantly, the Geneva-based United Nations Conference on Trade and Development (UNCTAD) has also led a frontal critique of economic orthodoxy. Today, UNCTAD is well positioned at the forefront of global debates on leveraging more 'policy space' for developing countries and mobilising domestic and regional resources to finance development (see UNCTAD 2006, 2007a–b). Other prestige United Nations (UN) panels have similarly highlighted the need for policy flexibility. For instance, the Zedillo Commission, set up by the former UN Secretary-General Kofi Annan to explore additional financing for development, supported limited, time-bound protection of certain industries by the late-industrialising countries: 'However misguided the old model of blanket protection intended to nurture import substitute industries, it would be a mistake to go to the other extreme and deny developing countries the opportunity of actively nurturing the development of an industrial sector' (Zedillo Commission, 2001: 9–10).

UNCTAD's outputs routinely emphasise economic development and invoke as exemplary the types of industrial and technological policies historically pursued by the East Asian tiger economies that 'governed' their markets, notably Japan, South Korea, Hong Kong and Taiwan. The Economic Commission for Africa concurs: 'A lesson that Africa can draw from the Asian experience is that trade strategy can seek to apply a well-sequenced and optimal combination of openness and control within the context of overall development strategies, while avoiding the kinds of protectionist policies of the 1960s and 1970s that seriously constrained competitiveness' (ECA 2004: 55).

UNCTAD essentially makes the case for strategic trade integration into the global economy. This entails a more targeted or selective approach to liberalisation, combined with proactive industrial policies and an outward orientation designed to achieve international competitiveness in increasingly more sophisticated (or dynamic) products. In doing so, it also seeks to balance the welfare advantages of low uniform tariffs and the industrial policy tool of flexible and differentiated tariffs. From this perspective, it is favourably inclined towards temporary tariff protection for dynamic products or processes, accompanied by disciplined public support for investment and technological upgrading.

Against this complex theoretical canvas and the multilateral pressures of the WTO's Doha Round of trade negotiations, the Institute for Global Dialogue (IGD) convened a workshop in October 2006 to critically reflect on recent industrial policy exercises and past policy experiences in SACU. The renegotiated 2002 SACU Agreement recognises the different levels of economic development of the membership. South Africa is as an advanced developing country; Botswana, Namibia and Swaziland are small and vulnerable economies; and Lesotho is a least-developed country. The 2002 SACU Agreement therefore enjoins the collective to ensure balanced industrial development. This includes a formal commitment 'to develop common policies and strategies with respect to industrial development' (article 38.2). As members of the Southern African Development Community (SADC), the SACU nations are also involved in negotiations around a Protocol on Industrial Policy Cooperation.

There are, however, a range of political, economic and institutional variables that complicate this industrial policy process and the scope and potential for forging common policy regimes. There are also questions relating to the effective use of tariff policy, the revenue sharing formula, the possible expansion of the customs union (to include Mozambique as a likely candidate), and regional competition and investment regimes. The purpose of the workshop was to investigate the potential for harmonising industrial policies within SACU to ensure 'developmental integration' and to develop a more comprehensive perspective on the various challenges and opportunities in this regard. We trust that the perspectives and insights contained in this publication will provide fresh intellectual infusion to this important regional policy debate.

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The challenge of reconciling revenue distribution and industrial development in SACU

Colin McCarthy

This paper provides a context within which to explore the harmonisation of SACU member states' industrial policies to ensure developmental integration. Specific issues to be addressed are the following:

- the institutional arrangements of the customs union (CU) and its revenue distribution formula;
- its development strategy, including the key elements of the SACU agenda; and
- considerations of SACU expansion and possible future scenarios.

The new SACU agreement, concluded in October 2002 and operational since July 2004, has given new impetus to the debate on the development of SACU, and its future as a regional integration arrangement (RIA) that aims to facilitate economic development. The new agreement represents a radical transformation in the management of SACU operations, and has distinct provisions for the economic development of SACU and its member states. These provisions have been formulated to take cognisance of the unequal nature in economic size and level of industrial development between South Africa, which generates more than 90 per cent of the SACU gross domestic product (GDP) and the much smaller Botswana, Lesotho, Namibia, and Swaziland (BLNS). Dealing with inequalities in a regional integration arrangement is always difficult; hence the importance attached to economic homogeneity and political commitment in achieving success in regional integration (Langhammer 1992). In the case of SACU, the difference in economic size is enormous by any standard. This and the peculiar political history of SACU add to the complexity of having to manage regional integration effectively.

In considering likely future developments and challenges, the premise of the paper is that an understanding of the past, that is, of the history of SACU, is necessary to contemplate its nature, and what the future under the 2002 agreement might hold. Hence, the paper will briefly touch on the origins and development of SACU. But to provide perspective on the SACU agreement as an instrument of development, it will be helpful first to contemplate the rationale for a CU as an integration arrangement. Against this background, it will be possible to review the conflicting goals of revenue earnings and economic development, and consider the possibility of SACU expansion.

Nature and rationale for a customs union

SACU is a customs union, which is a distinctive kind of RIA. The essential characteristics of a CU are the following:

- there are no tariffs on imports from other CU member states; and
- the member states share a common external tariff (CET).

In the linear model of regional integration, the first condition applies to free-trade areas (FTAs) as well, but these do not have a CET. Each member state has its own external tariff with respect to imports from non-members. This means that the *CET is the defining feature of a CU.*

The existence of the CET as the defining feature has implications for the management of a CU, for the reasons below.

Customs revenue must be collected and divided among the member states according to an agreed formula.

- An organisation must exist at the regional level to manage the CET, that is, decide on tariff amendments, including changes to the ordinary tariff, trade remedies, and duty rebates and drawbacks.
- The CET requires a CU to negotiate trade agreements as a single, legal entity.
- The import tariff is an important instrument of trade and industrial policy, and the existence of the CET means a loss of policy sovereignty in this regard, which requires a significant degree of industrial policy harmonisation and common trade policies.[1]

At the regional level, the CU must administer the collection and distribution of customs revenue, and provide support for the policy apparatus that decides on import tariffs.

Turning to the rationale for a CU, two questions need to be addressed. The first asks why any developing country would wish to join or remain part of a RIA, and, having answered this, the second asks why a CU would be the preferred model of regional integration.

The obvious and simple answer to the first question is that any prospective participant in a RIA seeks to accelerate its economic growth and development through participation. However, history and experience has shown that RIAs often have a political origin. The Southern African Development Co-ordinating Conference (SADCC), the predecessor of the Southern African Development Community (SADC), was largely initiated by a desire to be less dependent on apartheid South Africa. Even SACU had an underlying, albeit implicit, political motive in its early years.[2] There is even a view that the recent surge in regionalism has a non-economic and political explanation: 'Political ambition of creating territorial identity, political convergence, collective security and regional coherence now seem to be the primary, neo-mercantilist goals of the new regionalism' (Mistry 1995: 13). A final observation in this regard is that political and strategic co-operation in a region could even precede economic integration, as occurred in the case of the Association of South East Asian Nations (ASEAN). This regional bloc was established in 1967 for political and strategic reasons, and followed this only in 1977 with a preferential trading arrangement, and, in 1992, with the gradual establishment of the ASEAN Free Trade Area (AFTA) (Robson 1998: 294).

But even if political considerations drive RIAs, regional integration remains an economic construct from which member states will expect an economic return. Benefits will be considered in net terms, since participation in a RIA has the downside of costs for member states. If the net economic return is not perceived as positive, it is hardly likely that a country will conclude a RIA; or, if such a country is a member of an existing RIA, it will seek to change the rules and operations of the arrangement, or withdraw unilaterally. These observations are based on perceptions of absolute returns; the history of regional integration, however, reveals that often net returns are viewed in a relative context, that is, with member states comparing their benefits to those derived by other participants in the arrangement. The collapse of the first East African Community in 1977, for example, can partly be ascribed to the Tanzanian view that Kenya was deriving the lion's share of benefits from the RIA.

The question remains why regional integration, and specifically a CU, would provide economic benefits. In theory, the possible economic outcome is explained in terms of static and dynamic consequences of CU formation.

The *static effects* describe the once-off change in the economic welfare of society associated with the well-known Vinerian distinction between *trade creation* and *trade diversion* as possible outcomes of CU formation. Should CU formation cause the displacement of sales by a higher-cost domestic producer by the output of a cheaper producer in a partner country, production will be shifted to more efficient producers. This is called trade creation, and represents gains from regional integration.[3] But the opposite can also occur, with the CU causing lower-cost goods, imported from outside the CU, to be displaced by higher-cost goods, produced in a member state. This is called trade diversion. Comparing the two possible outcomes in aggregate will show whether there is a net welfare gain or loss to society.

It is widely agreed that the integration of developing countries is unlikely to produce net static benefits. For them the benefits are rather sought in the *dynamic effects* that result from the larger market for free trade created by the CU. An emphasis on dynamic benefits shifts the focus to the RIA as an instrument of economic growth and development.

Domestic producers that are complacent in their protected domestic economy must become more efficient to meet the *competition* of other producers within the union. Increased competition is also likely to encourage the development and use of new technology. The end result will be lower production costs, for the benefit of consumers. The lower production costs will be further enhanced by the second dynamic benefit, namely the opportunities for *economies of scale* provided by the larger market. These dynamic benefits are of particular importance for developing countries, for which the potential competitive gains may be larger than for developed economies. According to Schiff and Winters (2003: 52): 'The small size and relatively closed structure of many developing countries mean that there is scope for more fully exploiting economies of scale and for removing local monopoly power.'

The popular counter-argument is that small economies do not have to depend on CU formation for economies of scale. These can also be realised by production for the world market. This is true for high-income, industrialised small economies, but in the case of developing countries the contention is that it is relatively easier to expand production through exports if the market destinations are partners in the common customs area. For developing-country firms, the larger regional market presents an 'incubator' environment in which export skills can be developed. The corollary of this argument, when import-substituting industrialisation was in vogue during the 1960s and 1970s, was that the larger market, protected by the CET of the CU, provided more scope for import substitution than was available in the domestic market.

A third dynamic benefit is the possible encouragement of *investment* to take advantage of the enlarged market created by the CU. This need not be restricted to investment by firms located in the CU, but could be foreign direct investment, in which case the enlarged protected market encourages 'tariff jumping,' that is, subsidiaries of foreign firms locate in the common customs area to have access to the larger market.

In considering the rationale for a CU, with its CET, an issue that is highly relevant in the SACU context is the fact that CUs are not created to earn revenue for the participating member states. The economic reasons for the existence of a CU are sought in static welfare effects, and, as far as developing countries in particular are concerned, in the dynamic benefits of growth and development.

Pre-2002 history of SACU

SACU is an enigma. It is the world's oldest CU, on a continent known for its many failures of regional integration arrangements. What makes the survival of SACU even more surprising is that for nearly three decades it represented a CU between a political pariah, apartheid South Africa, and three, and later four, independent African states. Furthermore, the extreme heterogeneity of SACU, characterised by large differences in economic size and level of development between South Africa on the one hand, and the BLNS countries on the other, adds to the enigmatic nature of the CU.

An important characteristic that distinguishes SACU from most RIAs is that it did not come about through a pro-active and deliberate effort to integrate regional economies. It is the outcome of a historical process, and a colonial regime that created an institutional apparatus that sought to deal with the economic integration of separate political dependencies. This means that there is an important discrepancy between SACU and, say Mercado Commun del Sur (MERCOSUR), where four member states set out to create a CU. This distinction can, as will later be argued, explain the particular difficulties that SACU faces in adapting to the radically new management style required by the new SACU agreement.

SACU dates back to the formation of the Union of South Africa in 1910. Following the South African War (1899–1902), the Cape Colony, Natal, the Orange River Colony (the old Republic of the Orange Free State) and the Transvaal were, in 1910, joined together as the four provinces of the Union of South Africa. This union included only four out of a larger group of British-controlled territories in the area.

Before union, different customs arrangements existed among the various British territories, the first being the 1889 Customs Union Convention between the Colony of the Cape of Good Hope and the Orange Free State (OFS). This established a CU that provided for free trade within the CU area, and a CET of 12 per cent against imports from neighbouring territories and the rest of the world (Maasdorp 1990).[4]

Following this initial step, a number of other developments took place, including an expansion of membership and new CU agreements, all aiming to establish and manage a CET. An important development that preceded union, and the developments that this necessitated, was the adoption in 1906 of the South African Customs Union Convention.[5] This agreement created a customs territory consisting of the Cape Colony, Orange River Colony, Transvaal, Natal, Southern Rhodesia, North-western Rhodesia, Basutoland, the Bechuanaland Protectorate, and Swaziland. All these territories under the British flag, with the exception of the Cape and Natal, were landlocked, and thus depended on the harbours of the latter two for trade and imported supplies. Customs arrangements, therefore, were a prerequisite for commerce in the region.

Formation of the union required a major re-alignment of customs affairs. On 1 July 1910 two customs agreements came into operation. An agreement was concluded among the Union of South Africa, Southern Rhodesia, and North-western Rhodesia, providing for the remittance of duties collected on goods in transit to the importing territory, subject to a 5 per cent collection charge. This, in effect, represented an FTA with a 5 per cent revenue rate.

A second agreement established SACU – the subject of this paper – between the Union of South Africa and the High Commission Territories (HCTs) of Basutoland, Swaziland, and the Bechuanaland Protectorate. The CU provided for a duty-free flow of goods among member states. The common external tariff was a basic (uniform) *ad valorem* rate of 15 per cent. The revenue generated was administered by South Africa, and distributed among the members on the basis of fixed percentage shares that left South Africa with about 98,7 per cent of the revenue pool. The respective HCT shares remained unchanged until 1965, when it was adapted at the cost of Basutoland, substantially in favour of Swaziland, and marginally in favour of Bechuanaland.

The 1910 agreement remained in force until the independence of the HCTs brought about a need for a re-assessment of the SACU agreement, the outcome of which was the 1969 SACU agreement. This was concluded on 11 December 1969, and came into operation on 1 March 1970.[6] In the negotiations that led to the 1969 agreement, independent Botswana, Lesotho, and Swaziland (BLS) were particularly concerned that they were not getting a fair share of CU revenue (Landell-Mills 1971). They argued that the growth of their economies, and consequently their imports, was not reflected in the fixed percentage shares in revenue under the 1910 agreement, and furthermore did not compensate them for the effects of trade diversion that arose from the protective tariff designed to serve South African industrial development.

In its preamble, the 1969 agreement highlighted as an objective the maintenance of free trade behind a CET. However, it was envisaged that free trade within the common customs area would be managed in a way that would:

> … ensure the continued economic development of the customs area as a whole, and to ensure in particular that these arrangements encourage the development of the less advanced members of the CU and the diversification of their economies, and afford to all parties equitable benefits arising from trade among themselves and with other countries (Republic of South Africa 1969: 9).

Asymmetry in development was anticipated, with industrial development concentrating in the high-growth metropolitan areas of South Africa because of the forces associated with the economies of agglomeration. The important point to grasp is that the 1969 agreement explicitly provided for the development of the lesser-developed CU members, and thus displayed an effort at developmental regional integration.

The 1969 agreement and the management of the CU were characterised by operational problems inherent to the structure of the agreement.

Firstly, the South African tariff remained the CET, managed by South African authorities, primarily in the interest of the South African economy. The same applies to excise duties. Although the agreement specified consultations on changes to the CU, the consent of other parties was not required, and decisions and implementation were not withheld pending a response from the smaller partners in the union. Also, consultations were not required where interim measures were to be implemented to protect an industry, pending a full investigation by the South African authorities. South Africa could, in terms of the agreement, change tariff levels unilaterally.

This situation was at the heart of the argument that SACU was undemocratic. As Schiff and Winters (2003: 85) put it: 'In the most hegemonic of CUs, SACU, South Africa simply decided trade policy and compensated the smaller countries for the costs it imposed on them.' The compensation will be discussed below; at this point it needs to be noted that since a CU is defined by having a CET, it follows that it must also have 'a trade policy that is common in all respects' (Schiff and Winters 2003: 82). This allowed South Africa, although a member of a CU, the freedom to adopt SACU tariff policies that were in line with its own particular development objectives. However, a trade-off could exist between using the tariff as an instrument of trade and industrial policy, and the role that tariff has as a source of revenue, which in developing countries is more highly regarded than in developed economies.

This potential trade-off became a contentious issue in SACU, since it highlighted a second problem, namely the different perspectives on the role of the tariff. South Africa regards the tariff as an instrument of trade and industrial policy. Earlier, the tariff was used as an instrument to protect domestic industry for the sake of import-substituting industrialisation, but since 1994 the South African government has been committed to a lowering of the tariff, whether within the World Trade Organisation (WTO) system of multilateral trade liberalisation,[7] or in preferential trading arrangements. BLNS, however, sees the tariff primarily as a source of government revenue, a consideration that is regarded as relatively unimportant by South Africa. While the process of South African-driven trade liberalisation could have been expected to raise BLNS concerns about its impact on customs revenue, this was avoided by the nature of the 1969 agreement's revenue distribution formula, which, as will be noted below, guaranteed BLNS a minimum revenue return on imports, and dutiable consumption and production.

The third problem concerned the compensation and mechanisms that existed to address the drawback, for BLNS, of being part of a common customs area with a much larger and more developed economy, and for the policy sovereignty they sacrificed. For BLNS, the essential problem of trade diversion and economic polarisation had been that they perceived little proportionality between the distribution of costs and benefits between South Africa and BLNS. As the much larger and more industrialised economy, South Africa benefited from the growth that accrued to its producers, while BLNS only experienced the welfare losses experienced by their consumers. Of course, South African consumers also suffered welfare losses from having to pay higher prices for protected domestic goods, but as a society it at least had the benefit of the output and employment growth of the protected industries.

The disadvantages of trade diversion, economic polarisation and the loss of policy sovereignty were to be addressed in two ways. The first was to provide BLNS with a mechanism that would allow them to protect their industries against competition from established South African firms, by inserting in the 1969 agreement provisions that allowed BLNS to protect infant industries (article 6), or industries regarded as of special interest to their economies (article 7).

The second measure was contained in the design of the revenue-sharing formula, which calculated revenue shares for the BLNS countries, while South Africa kept the residual as its share. The formula provided for a nominal 42 per cent enhancement of the smaller countries' share of customs and excise revenue, but since 1975/6 the introduction of a stabilised revenue rate (the rate of revenue earned on imports and excisable consumption) around a target level of 20 per cent, within a band of 17 per cent at the lower end and 23 per cent as the maximum, the 1,42 multiplier was effectively done away with.[8]

This meant that BLNS have been guaranteed a minimum revenue rate of 17 per cent on import values, and excisable consumption and production. The adequacy of the compensation built into the revenue-distribution formula, and the effectiveness of the special provisions to encourage BLNS infant industries, were questioned by BLNS.

A counter perception, held especially by the South African Treasury, was that SACU had become an overly expensive fiscal exercise. This concern was exacerbated by the inclusion of excise duties in the revenue pool, and the stabilised revenue rate that produced an effective multiplier far in excess of the formula's 42 per cent. Including excise duties in the revenue pool of a CU is exceptional, and for South Africa the inclusion of this progressive source of taxation and its enhanced allocation to BLNS became a fiscal problem. It was not difficult to envisage a scenario which saw BLNS revenue allocations in excess of the revenue pool, with South Africa then having to supplement revenue from other sources. There was no provision in the 1969 agreement that the residual that remained for South Africa had to be a positive sum.

From 1910 until 1994, SACU had to deal pragmatically with small national entities – initially British dependencies, but later politically independent African states – that were locked into an integrated economy with the much larger South Africa. It could be argued that SACU's survival as a RIA under difficult circumstances can be ascribed to the fact that the implicit and explicit understanding under the 1969 agreement was that the BLNS would sacrifice important elements of their control over fiscal and trade policy to South Africa, who in practice managed these affairs as if BLNS were part of the South African economy. In exchange for this, and as compensation for the polarisation effect inherent in being part of a customs territory dominated by a much larger member, BLNS received the beneficial payments built into the revenue-distribution formula. The issue of whether the compensation was adequate or not does not detract from the fact that leaving the affairs of SACU to South Africa to manage served as a substitute for designated SACU bodies that would have been required to act, on behalf of the member states, in the common interest of the CU. A central theme of this paper is that this system of customs-union management had evolved historically, and was deeply imbedded in the colonial experience of the region, and in the economically subservient position of BLNS. It could also be speculated that after independence this system was a pragmatic and at-arms-length way for BLNS to contend with the politically embarrassing situation of being in a CU with apartheid South Africa.

Clearly, this arrangement could not endure in the long run, especially where the 'long run' brought about a democratic South Africa with whom BLNS could, without hesitation and qualification, associate politically. Hence, one of the first priorities of the SACU members following the political transition to democracy in South Africa was to renegotiate the SACU agreement. Before reviewing the outcome of these negotiations, it should be noted that the story told so far reveals four factors to have remained of fundamental importance for SACU (McCarthy 2003):

- Integration through a CU was necessary to accommodate the flow of goods among territories that were locked into an integrated economy with separate political jurisdictions. SACU forms part of the colonial legacy of Southern Africa. It started life, not as the pro-active formation of a CU by a group of independent neighbouring states, but as an ad hoc arrangement to deal with the practical problems of separate political entities more or less sharing an integrated economy.
- The South African tariff served as the tariff of the CU. The import tariff has long been an important instrument of industrial protection, but since the mid-1990s it has been lowered to encourage outward-looking development. For BLNS, however, the

tariff served as an instrument that generated revenue for a revenue pool on which they depend for sizable contributions to their treasuries.

- A CET generates revenue that, together with excise duties, has to be divided among member countries; consequently, the CU agreement had to provide a mechanism and formula for the distribution of revenue. The distribution mechanism was managed by South Africa, and in terms of the 1969 agreement it favoured BLNS. Payments were made to BLNS per formula within set minimum and maximum revenue rates, with South Africa's share determined as the residual. Over time, SACU-generated revenue has become an important, and in some cases the principal, source of recurrent revenue for the smaller member states.
- While the 1910 agreement was primarily a mechanistic means of dealing with the situation of three British dependencies' economic integration into South Africa, the 1969 agreement explicitly recognised and provided for the economically weaker position of the smaller CU members vis-à-vis South Africa. SACU came to be recognised as an instrument of development, at least in the wording of the agreement. For BLNS, the main consideration remained revenue.

The 2002 SACU agreement

The 2002 agreement in many respects can be regarded as a framework agreement. It sketches the outline of the rules that will apply in the management of the CU, but much of the detail on how this is to take place will have to be negotiated as protocols to be incorporated in annexes to the agreement.

The agreement represents a radical change in the management of SACU. What is important is the transformation of a uniquely managed CU into one that meets the requirements and characteristics noted above under the heading, 'Nature and rationale for a customs union'. The free flow of goods between member states that share a CET was an important goal of the 1910 and the 1969 agreements, and in the 2002 agreement the facilitation of the cross-border movement of goods is listed as the first objective in article 2.

Development and the intention to address inequality between member states also appears in the preamble to the 2002 agreement, where the contracting governments declare themselves '[m]indful of the different levels of economic development of the Member States', while acknowledging that global economic integration, with its emphasis on multilateral trade liberalisation, should place the economic development of members within the context of 'the need for their integration into the global economy' (SACU 2002). Global integration thus became a SACU goal, which was not the case in the 1969 agreement, thus reflecting the shift in South Africa's trade policy towards one of liberalisation and the enhancement of international competitiveness of industry.

In addition to this new angle of global integration, the preamble and the objectives of the agreement (article 2) add a further three important elements that distinguish the 2002 agreement from its predecessor:

- effective democratic institutions are to be established, including provision for dispute settlement;
- common policies and strategies, specifically the development of common industrial policies, are to be adopted; and
- the important role of the tariff as an instrument of industrial development policy is recognised.

It is also significant that the 2002 agreement, unlike the 1969 agreement, recognises the CU as a single negotiating entity in international negotiations and the conclusion of trade agreements (WTO 2003). The new agreement contains a separate section (part 8) that provides for common policies, of which the commitment to develop common industrial policies is of special significance.

The objective of democratising the management of SACU necessitated a radical change in CU institutions and practices. The supreme governing function is allocated to the Council of Ministers (article 8), which is to be supported by the Customs Union Commission (article 9), the Secretariat (article 10), the Tariff Board (article 11), and four technical liaison committees (article 12, on agriculture, customs, trade and industry, and transport). A Tribunal (article 13) is to provide a dispute-settlement mechanism. In addition to these CU bodies, each member state will also set up a National Body (article 14) or designated institution that will receive and investigate requests for tariff changes and other related SACU issues.

An extensive discussion of these institutions is not called for in this paper.[9] Suffice it to emphasise two important considerations:

- While the Commission and the Secretariat will primarily be responsible for administration and management of the CU, policy issues and decisions on changes in the CET will rest with the Tariff Board, which is to be an independent body, representative of all member states. The Tariff Board will consider requests and provisional recommendations from the national bodies on customs tariffs and duty rebates, refunds and drawbacks, as well as trade-related remedies, such as anti-dumping actions. The board will in turn submit its recommendations to the council for its decision on whether to accept or reject recommendations. It is apparent that the Tariff Board will play a crucial role in the trade and industrial policy of the CU.
- Decisions by the Tariff Board and the Council of Ministers are to be taken on the basis of consensus.[10] This means that each member state or representative will have a veto right. Should a dispute arise on the interpretation or application of the SACU agreement, the matter will be referred to the Tribunal. The latter will consist of three members, selected on an ad hoc basis from an approved list of potential candidates by the parties involved in the dispute, who by majority vote shall make final and binding decisions.

These two points demonstrate that the 2002 agreement has been designed on the premise of a fundamentally different approach to the management of SACU. Major decisions with respect to trade and industrial policy will not be taken by South Africa, effectively deciding on behalf of SACU, but will now be delegated to supra-national (interstate) SACU institutions. Overtures of Brussels make their appearance, and, once it is operational, the economic management of the CU will be a totally new ball game.

The policy environment that the new institutions will have to manage also differs dramatically from the 1969 regime. The 1969 agreement recognised and provided remedies and compensation for the differences between South Africa on the one hand and BLNS on the other. But the 2002 agreement is not only 'mindful of the different levels of economic development of the Member States', it goes further in recognising 'the importance of balanced industrial development of the Common Customs Area', and the objective 'to facilitate the development of common policies and strategies', while being 'aware that the implementation of the 1969 Agreement is hampered by a lack of common policies and common institutions'. Hence, a formal commitment of the 2002 agreement is 'to develop common policies and strategies with respect to industrial development' (articles 2 and 38).[11] In the context of these goals and ideas, the preamble to the agreement recognises 'the importance of tariffs as instruments for the implementation of industrial development policy'. True to the essential characteristics of a CU, the revenue function of the tariff is not mentioned, apart from the general objective 'to facilitate the equitable sharing of revenue arising from customs, excise and additional duties levied by Member States' (SACU 2002: 2[g]).

SACU as a source of revenue

The fact that fairness in the distribution of CU revenue, but not the significance of the tariff as a source of revenue, is reflected in the 2002 agreement should not detract from the importance that BLNS attach, in varying degrees, to the tariff as a source of government revenue. In 2006 the contribution of SACU revenue payments to government revenue came to 20,1 per cent for Botswana, 53 per cent for Lesotho, 41 per cent for Namibia, 56,9 per cent for Swaziland, and only 3,9 per cent for South Africa (Flatters and Stern 2006). Even for Botswana, with its more favourable macroeconomic conditions and other substantial sources of revenue, the contribution is substantial. For Namibia, the dependence on this source of revenue is substantial, and for Lesotho and Swaziland it is the principal source.

Table 1: Share of SACU revenue (%)

	Annual average for periods indicated	
	South Africa	BLNS
1987–1990	81,4	18,6
1991–1995	70,0	30,0
1996–2000	62,9	37,1
2001–2004	55,9	44,1

Source: Derived from the South African *National Treasury Budget Review* 2004 and 2005, Pretoria

Table 1 shows that the BLNS share in the revenue pool has grown progressively over time, and has been approaching 50 per cent, with estimates that under the distribution formula of the 1969 agreement their share would exceed 100 per cent by 2015 (Flatters and Stern 2005). If the latter materialised, South Africa would have been forced to pay additional funds into the pool from other revenue sources. Since the mid-1980s, table 2 shows, the real value of the revenue pool has declined because of the fall in the contribution of customs as a source of revenue. The fall in the real value of the customs component can be attributed to a number of factors: import surcharges that initially inflated the customs pool have since 1996/7 been phased out; the tariff has been lowered at the multilateral and regional level; and South Africa makes liberal use of tariff rebates to lower the input costs of South African industry.

Table 2: Annual average of revenue pool components (real values, constant 2000 prices derived from RSA GDP deflator)

	Excise % of nominal values	Pool value	Customs value	Excise value	BLNS share value	RSA share value
1987–1990	41,6	18 813,0	11 076,8	7 736,2	3 473,7	15 339,3
1991–1995	48,1	16 578,5	8 630,0	7 948,5	4 942,1	11 636,4
1996–2000	55,7	16 267,1	6 047,3	9 046,4	6 023,8	10 243,3
2001–2004	56,3	16 308,5	7 134,7	9 173,9	7 191,2	9 117,3

Sources: South African *National Treasury Budget Review* 2004 and 2005; South African Reserve Bank

The decline in the real value of the revenue pool would have been more serious had it not been for the inclusion of excise duties in the pool, and the increase in the contribution of this source by nearly 19 per cent from the average during 1987–1990 to the 2001–2004 average. This served as a counter to the 35 per cent decline in the real value of the customs component (table 2). During this period, the contribution of excise duties to the revenue pool increased from 41,6 per cent to 56,3 per cent. BLNS has not been affected by the decline in the real value of the pool, having more than doubled the real value of their average SACU revenue from R3 473,7 million during 1987–1990 to R7 191,2 million during 2000–2004 (table 2). For South Africa there has, of course, been a more than proportional decline in revenue of 41 per cent.

Under the 2002 agreement, revenue sharing will differ fundamentally from the 1969 agreement. Under the latter dispensation, the size of the revenue pool was of little concern to BLNS. Under the new agreement, the stabilisation factor and the guaranteed minimum revenue rate will fall away, and South Africa will receive its share of revenue not as a residual, but on the same basis as BLNS. Excise, contrary to initial expectations, was kept in the revenue pool, but the new distribution mechanism will deal separately with its allocation. Keeping excise in the revenue pool is contrary to normal practice in CUs, and during the early phases of the negotiations a change was anticipated. Apparently, the difficulty of administering separate excise regimes in a region with porous borders has led to the decision to keep excise in the revenue pool.

All customs, excise and additional trade duties collected in the common customs area are to be paid into a common revenue pool (article 32), managed by a member state or a SACU institution appointed by the Council of Ministers (article 33). The revenue, net of the budgeted cost to finance SACU bodies, is to be distributed as the sum of three separate components:

- Customs revenue in the pool is distributed on the basis of each member state's share in intra-SACU imports. The implication of this method of revenue distribution is that it requires the rigorous recording of trade between member states, which runs counter to the rationale of a free flow of goods at low transactions behind the CET of a CU.
- A development fund is provided, funded by 15 per cent of excise revenue. This will be distributed more or less equally – that is, at approximately 20 per cent of the excise component – among the five member states, with marginal variations above or below 20 per cent on the basis of a member's per capita GDP deviating from the mean per capita GDP of all member states. If below the mean, the member state will receive more than 20 per cent, and above the mean the share will be lower than 20 per cent.
- The remainder of the excise pool is divided among member states in proportion to the share of a member state in the SACU GDP.

The rationale for the distribution formula of customs and excise revenue is clear. The proportional sharing in the excise pool reflects the concern of South Africa, with its much larger GDP, to obtain the largest share of excise. This is a second-best solution after having accepted the practicality of keeping excise duties in the revenue pool. As far as customs revenue is concerned, the architects of the new agreement recognised the dependence of the smaller member states on SACU revenue, and consequently agreed on a revenue-sharing formula that would provide BLNS with revenue protection. Linking revenue distribution to intra-SACU imports, bearing in mind South Africa's large trade surplus with BLNS, is also said to compensate BLNS for the cost-raising and polarisation disadvantages of being in a CU with South Africa (Ngwenya 2002). Under the new agreement, with its democratic decision-taking procedures, the argument of compensation for the lack of policy sovereignty on the part of BLNS falls away. The development fund is a misnomer of the first order, since a separate fund to finance development projects is not provided for. It merely refers to a distribution of a part of excise revenue in a way that recognises differences in relative per capita levels, and ends up as contributions to recurrent revenue in the states' coffers.

To base the distribution of CU revenue on intra-CU trade, and not on shares in revenue-generating imports – imports into the common customs area, is unusual. This system of fiscal compensation could cause more problems than it solves, and might in the end even prove to be unsustainable. The fact that the BLNS share will be largely at the cost of South Africa is not the problem per se. This is, in fact, intentional compensation. What will prove to be serious are the problems that will arise in managing the distribution mechanism.

It is not the intention of this paper to discuss revenue distribution at length. What is relevant to the story told is the cost of the mechanism, and what the management of the distribution will do to relations between SACU members. Three points can be raised:

- The first point is the political sensitivity built into a distribution system that creates an incentive for each member state to inflate its intra-CU imports to increase its share of customs revenue. Since the revenue pool is a given amount that needs to be distributed among all members, a member state can only increase its share at the cost of other member states. To avoid this problem, the data supplied by member states on imports from the rest of SACU will have to be verified. This will require the rigorous recording of trade at border posts, using methodologies and forms that are harmonised and standardised. This will represent a departure from a principal objective of regional integration, and that is the lowering of the transactions costs of trade.
- A second problem is the need to differentiate imports from other SACU members from imports from the rest of the world, in a common customs area where the networks of trade and commerce are dominated by South African firms, who are registered as the importers of goods destined for BLNS. Existing data does not permit quantification in support of this point, but a priori reasons exist why major parts of BLNS imports from the rest of the world are re-exports by South African firms. For example, shoes imported from China but sold by Edgars stores in BLNS, are likely to be recorded as imports from South Africa, from where the shoes have been distributed. To the extent that re-exports are recorded as imports from South Africa, BLNS imports from South Africa will be artificially high.
- The third point of concern is the difference between BLNS and South Africa in their interpretation of the role of the import tariff. Should BLNS maintain a focus on the tariff and customs as a source of revenue, while South Africa sees the tariff as a negligible source of revenue but a meaningful instrument of industrial policy, a potential for conflict arises. The possibility also exists of a hiatus in the development of new SACU organisations and institutions, if BLNS are not sufficiently concerned to participate actively in the transformation of SACU to establish a new regime in its management according to common policy guidelines. An emphasis on revenue by BLNS is the outcome of the origin and development of SACU, characterised by the principal function of distributing customs and excise revenue, and of using the revenue-distribution mechanism as the mechanism to address inequality within SACU. To make the new agreement work will require a major change in a mindset that currently focuses on revenue distribution.

Industrial and trade policy

An outstanding feature of the 2002 agreement is the underlying theme that SACU must be developed as a single economic entity that recognises inequalities and sets out to tackle development through common trade and industrial policies and the overall co-ordination of economic policies. Part 8 of the agreement on common policies in many respects represents the heart and soul of the new agreement, and is complemented by the establishment of SACU bodies that will take consensual decisions that are crucial for the economic development of the region.

In the language of the new institutional economics, these bodies are organisations that must be established to achieve certain defined objectives (North 1990: 3). To establish a Tariff Board, a Secretariat, national bodies and a Tribunal formally is, comparatively speaking, the easy part of the exercise. The most difficult task will be to design and imbed a new culture of institutions or rules in the management of SACU relationships, without which the organisations are bound to fail in their defined missions.[12]

What are the institutions – the 'rules of the game' – required for the effective implementation of the 2002 agreement to give content to the spirit and the letter of the agreement?

A first rule would be to develop a consensus vision on the industrial development of SACU and its member states. Such a vision is a prerequisite in deriving the policy criteria that the Tariff Board, Council of Ministers, and ultimately also the Tribunal, can apply in their decisions.[13] Having this rule will in turn require a new institution or rule of regular consultation among SACU member states in designing and aligning objectives and strategies. Only if this occurs can the SACU organisations take appropriate decisions on tariff and related issues, and, as a single legal entity, as the agreement requires, participate in bilateral and multilateral trade negotiations. But the institution of sharing common policies and consultation to facilitate this can only be effective if organisations exist that can ensure that these policies are implemented.

On the organisational side of the new SACU management scheme, the council and the commission are ipso facto in place, and the Secretariat has been established, and is in the process of building its capacity. The Tariff Board, which will be a crucial body in the operation of SACU, still has to be established. The same applies for the National Bodies of BLNS. South African legislation has designated ITAC to be the South African National Body. In the absence of a Tariff Board, ITAC has been tasked by council to deal with SACU tariff issues, but to do so in consideration of the development needs of BLNS.

Setting up the bodies provided for in the agreement will be counterproductive if the member states continue to behave in the spirit of the 1969 agreement and the earlier regime. Current indications are that the BLNS are still primarily concerned with the revenue issue, while South Africa is involved in a serious effort of developing a new industrial policy. Currently, more than two years into the operational life of the new agreement, South Africa is reviewing its industrial development policy, and advanced drafts have been prepared on a regional industrial development strategy and a national industrial policy, apparently without extensive consultations with BLNS. It is reported that significant industrial policy changes have been implemented, or are planned, for Lesotho and Swaziland, again without apparent consultation. All of this hardly testifies to a commitment to the development of common industrial policies in SACU.

A lack of commitment to honour the new agreement as far as industrial development is concerned does not bode well for the effort that will be required to address particularly difficult problems. Article 38.1 requires member states to 'recognise the importance of balanced industrial development for the Common Customs Area as an important objective for economic development', and then, to effect this, the agreement proceeds in article 38.2 to record that 'Member States agree to develop common policies and strategies with respect to industrial development'. As noted earlier, the dominant economic position of South Africa has been the motive behind the objective of balanced industrial development.

A couple of reasons can be identified for the difficulties that will be encountered in designing and implementing common industrial policies. The first problem, as a starting point, will be to find common ground on the definition of industrial policy. A daunting obstacle facing the implementation of the new SACU agreement is that the architects of the agreement require member states to develop common industrial policies without a clear and precise definition of industrial policy in place, let alone the implications of a commitment to develop common policies.

Industrial policy is one of those popular concepts encountered in discussions on economic development, but on closer analysis proves difficult to define precisely. Differences in the definition of industrial policy are obviously reflected in the content found in designs of industrial policy. In this respect, two strands in variation can be identified (McCarthy and Hansohm 2005). The first concerns the spread across the economic sectors regarded as the target of industrial policy. Two broad views can be distinguished in this regard, the one being the conventional narrow interpretation that understands the manufacturing sector to be the target of the policy, while the second would have a wider perspective, to include not only manufacturing, but also growth in sectors such as services. The second strand is a variation within the approach that focuses on manufacturing growth, distinguishing variations in the 'hardness' or 'narrowness' of industrial policy. At the one extreme there will be those who define industrial policy broadly to include all policies that facilitate industrial performance, while at the other extreme there are those who equate industrial policy to that of sector-specific targeting (Chang 1997: 3).

Given these variations on the theme of industrial policy, it is understandable why it is often difficult to develop a common position on industrial policy in the national context. To do so within a RIA of disparate developing countries will be even more difficult.

The second problem, assuming a more or less common view among member states on the definition and content of industrial policy, will be to develop common policies for the disparate member states, and specifically to counter the agglomeration forces generated by the much larger, and industrially more advanced, South African economy, without having a negative impact on growth overall. The challenge is complex, since article 38, in addition to encouraging industrial performance in general, will require regional development at two levels, that is, the need to address polarised growth in South Africa by encouraging industrial location and growth in BLNS at one level, and, at the other, to address regional inequalities within South Africa. In the SACU debate on inequality, it is often not explicitly recognised that the number of absolutely poor people in South Africa exceeds the total population of BLNS.

A final observation on industrial policy is the question of whether the development of *common* policies, as required by the agreement, is a realistic goal given the widely disparate nature of the SACU economies. This issue requires substantial research and sober consideration of the definition of industrial policy, the meaning and implications of having common policies, and the appropriateness of having such policies. As noted earlier, the 2002 agreement is a framework agreement, and clearly it lacks substance on these questions. Suffice it to note that it would not be surprising to find that policy co-ordination and harmonisation will be sufficient to provide SACU institutions with the policy guidelines they need for decision-making.

Future expansion of SACU membership

When the subject of regional integration in the larger region is considered, SACU suggests itself as the established inner circle of variable geometry in the region. All SACU members also belong to SADC, the 14-member RIA that has adopted the ambitious roadmap of development towards a monetary union in 2016. Thus far, SADC member states have not all demonstrated a serious commitment to advancing regional integration, and against this background the expansion in the membership of an established CU within SADC could represent a nucleus that could allow SADC to provide the opportunity for member states to effect deeper integration within the larger group. It is even possible to envisage the possibility of another SADC country not only joining SACU, but also to integrating its money and capital market with that of South Africa by becoming a party to the Common Monetary Agreement. Adding monetary integration to trade integration adds a further dimension to regional integration variable speeds.

The 2002 SACU agreement, in article 6, provides for any state to join the CU by acceding to the agreement. Admission of a new member must be approved unanimously by the Council of Ministers after the applicant state has followed the admission procedures determined by council. Admission will be determined on the basis of criteria to be determined by council.

With the revenue-distribution mechanism that applied under the 1969 agreement, it can reasonably be assumed that South Africa would have opposed expanding membership, since new members would have added to the fiscal burden without being adequately balanced by the benefit of improved market access.[14] Under the new revenue distribution mechanism, the fiscal issue is a lesser issue for South Africa, but BLNS, with their emphasis on revenue, will be very careful in evaluating the contribution to the revenue pool of a new member vis-à-vis the allocation it will receive on the basis of its share in intra-regional imports. What this implies is that the revenue factor could be an important constraint on the expansion of SACU membership.

But it may not be wise to consider an expansion of SACU membership before the new CU management system has been fully deployed. The Secretariat is building capacity, and still has to gain experience in managing procedures which are not even in place yet. The Tariff Board still has to be established, and policy guidelines for tariff-amendment decisions based on a common vision of industrial development in SACU are, as far as can be determined, not even being considered yet. Furthermore, the bone of contention, revenue distribution, remains that, with informal reports emanating that the new revenue-distribution mechanism is not working smoothly and without contention. Considering all this, the accession of new member states would be a tall order for a CU that is still struggling to fit into the new coat provided by the 2002 agreement.

A final constraint on membership expansion could be the complex SACU tariff structure, noted for its large number of tariff bands and lines. Reconciling this structure with that of, for example, Mozambique, with its simple tariff structure, will be an onerous and complex exercise. Should the option be accepted of using an expanding SACU as a driving force of deeper integration in SADC, SACU will serve the cause of regional integration by taking renewed tariff simplification on to its agenda.

Conclusion

SACU has evolved from a neutral mechanism under the 1910 agreement that was designed to deal with the free flow of goods and the distribution of revenue in a colonial-style, integrated region, to the recognition in the 1969 agreement of economic development as an objective, and inequality in the level of development of member states. The economic development of the smaller member states and the compensatory distribution of customs and excise revenue became part of the SACU agreement. Throughout the history of SACU, the behaviour of the member states was driven by and divided on perceptions of priorities: South Africa managed the tariff as an instrument of industrial policy to serve the industrial development needs of its much larger economy, while the smaller member states focused on the revenue that SACU trade provided.

The 2002 agreement, which became operational in July 2004, is fundamentally different from the 1969 version. It provides for a radically different way of distributing revenue, and for consensual decisions by SACU bodies that will be required to derive their policy guidelines from common industrial policies, which member states have committed themselves to develop. It is also important that SACU is now cast as a single legal entity, which will allow it to negotiate international trade agreements as a group, with the persona of a single, unified market that seeks integration into the global economy. This will also require a common vision of the industrial development of SACU and its member states.

A break with the past is required to transform integration from 'integration through hysteresis', whereby organs and procedures inherited from the colonial era still survive, through an agreement that 'postulates the emergence of a new culture, based on consensus building, along with the establishment of new administrative organs' (Bach 2005). But the good intentions embodied in the new SACU agreement could remain just that – good intentions – if it is not understood that the establishment of bodies with ambitious agendas does not guarantee that SACU will henceforth be an effective regional integration arrangement that can replace the earlier regime. The establishment of SACU bodies to implement common policies will require institutional change, the cultivation of new rules and policies that will honour the commitments and objectives that feature in the agreement.

The distribution of revenue remains an important issue, and might prevent appropriate attention being focused on the CU as an instrument of development. Flatters and Stern (2005), in their policy brief for the South African Treasury, have proposed short-term and longer-term steps that could address the vexing problems of the distribution of customs revenue. But revenue is only part of the problem. A serious high-level dialogue on economic development policy for SACU, the development of common ground on policy objectives, and the identification of policy guidelines that SACU bodies can use to guide their deliberations, should be a first priority. The outcome of these deliberations should be annexes to the agreement on the common and co-ordinated policies envisaged in part 8 of the agreement.

SACU is the oldest CU in the world, and in the spirit of variable geometry could act as a nucleus of deeper integration within SADC, thus countering the lethargic movement of the latter on its over-ambitious roadmap by offering neighbouring non-SACU states the opportunity of membership. This is a viable option, which unfortunately could be obstructed by revenue-sharing expectation. But even regardless of this practical problem, it is debatable whether SACU should consider an expansion of membership while it is still trying to fit operationally into the 2002 agreement. SACU might be the world's oldest CU, but adjusting to the new agreement may be as problematic as the *de novo* formation of a CU.

Endnotes

1 Given the broad distinction and choice between inward-looking, protectionist policies on the one hand, and outward-looking, export-led policies on the other, it follows as a matter of course that it is impossible for some member states of a CU to opt for a protectionist policy position while others prefer the outward-looking approach. It is possible to accommodate differences in industrial policy, but, as will become clear, even in this regard the room for deviations is limited.

2 The expectation was that Bechuanaland, Basutoland, and Swaziland would eventually be incorporated in the Union of South Africa, and in this sense the SACU agreement could have been regarded as an interim measure to manage the economic integration of the separate political entities.

3 The net welfare gain to society will in theory be represented by an increase in consumer surplus, arising from a lower purchasing price, which is only in part offset by the loss of government revenue when the tariff is eliminated and the reduction in rent because of the fall in domestic production. This is summarised by the 'two triangles' of conventional partial equilibrium tariff analysis.

4 The article by Maasdorp can be consulted for a clear and succinct account of the different developments from the 1889 Customs Union Convention up to and including the Southern African Customs Union Agreement of 1969.

5 Prior to the establishment of the Union of South Africa, the term 'South Africa' as used in the sense of the Customs Convention was merely a geographic indication, and not the name of a country.

6 The revenue-sharing formula, discussed further on in this paper, was implemented retroactively from 1 April 1969.

7 Between 1988 and 2001, the weighted mean level of the SACU tariff for all products declined from 12 per cent to 5,6 per cent, and for manufactured goods from 9,5 per cent to 5,8 per cent (World Bank 2005).

8 The revenue-sharing formula could be stated as follows: R = $(m + q)/(M + Q)\ .\ H\ .$ 1,42, subject to the constraint $R = \geq 0{,}17\ (m + q)$ and $R = \leq (m + q)$, where R equals the revenue share of BLNS respectively; m the value of dutiable imports, and q the excisable consumption and production of a BLNS country; M the dutiable imports into and Q the excisable production in the common customs area; and H the revenue (customs and excise) in the CU pool. The stabilisation factor was constructed to produce a multiplier that would only come to 1,42 when the revenue rate prior to stabilisation equals 20 per cent precisely. When the revenue rate fell to below 20 per cent, as it mostly did since the introduction of the stabilisation factor, the enhancement would exceed 42 per cent.

9 For a brief description of the SACU institutions in the context of the historical development of SACU, see McCarthy (2003), and for a critical legal analysis of the institutions see Erasmus (2004).

10 In view of the large differences in economic size and level of economic development, this was an unexpected move. For example, Gibb (1997: 83) observed that 'it is hard to envisage a situation where Lesotho has the same voting rights as South Africa', and consequently he envisaged a 'form of proportional and/or qualified majority voting'.

11 With respect to agricultural policy (article 39) and competition policy (article 40), the key word is 'co-operation' in policy design and implementation. Article 41 requires the council, on the

advice of the commission, to develop policies and instruments to deal with unfair trade between members, which will be annexed to the agreement.

12 Institutional economics define institutions as 'the rules of the game in a society'. Institutions must be distinguished from the organisations that are developed to organise individuals to achieve defined objectives. North used the analogy of sport to illustrate the difference. There are rules (institutions) and players (organisations) in society. The rules define how the game is to be played, while the objective of the team – the organisation – is to play by the rules to win the game.

13 The need for appropriate policy guidelines, given the commitment to the development of common industrial policies, is reviewed and emphasised in McCarthy and Hansohm (2005).

14 Mozambique is often mentioned as a possible new member of SACU. Under the previous revenue-distribution mechanism the fiscal burden would have increased without substantial market-access benefits that do not already exist in terms of the bilateral agreement.

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Constraints and institutional challenges facing industrial policy in South Africa: a way forward

David Kaplan

In the current discussions and deliberations as to how South Africa could significantly raise its rate of growth, industrial policy has moved to centre stage. The Accelerated and Shared Growth Initiative for South Africa (ASGISA) outlines a number of key targeted sectors that will receive government support (Mlambo-Ngcuka 2006), and the National Industrial Policy Framework (NIPF) and the Industrial Policy Action Plan (IPAP) proposes a new approach, and a considerable expansion of industrial-policy supports. An external team of foreign experts engaged by the treasury to review South Africa's growth policies concurs with the central place accorded industrial policy.

However, industrial policy is currently confronted by a number of constraints. These are outlined in this paper. Furthermore, the institutional requirements for designing and implementing an effective industrial policy are very demanding. This paper reviews these requirements, and argues that many are currently not in place. The paper then goes on to propose, briefly, a way forward for industrial policy that takes account of, and works within, these constraints and limitations.

Industrial policy and manufacturing

South Africa's manufacturing and export performance

A number of recent assessments have found evidence of poor performance of South African manufacturing:

- *Output:* Manufacturing output per capita has been stagnant since 1985 (Haussman & Klinger 2006: 7). Over the past two decades, South Africa's share of global manufacturing value-add and regional (sub-Saharan Africa) manufacturing value has declined persistently (Kaplan 2004: 623–4).
- *Exports:* Over the decade 1992–2002, South Africa's manufactured export growth was somewhat slower than global growth, slower than growth in the Latin American countries, and significantly slower than that in developing countries (Alves & Kaplan

2004: 3–5). Post-1960, South Africa performed poorly when compared to all countries with a population of over 4 million and a GDP of at least 25 per cent of South Africa's – South Africa is an outlier in terms of export performance, ranking 50th out of 56 countries (Haussman & Klinger 2006: 3). In terms of exports per capita, South Africa also compares very poorly by comparison with other resource exporters – Argentina, Australia, Canada, and Malaysia. Even if the apartheid years are omitted, and only the period 1991–2004, when South Africa's performance improved significantly, is considered, 'South Africa still remains among the poor performers internationally in terms of export growth' (Haussman & Klinger 2006: 6).[1]

- *Composition of exports:* South Africa has very low participation in global trade in the most dynamic products, and its share is declining (Gibson & Van Seventer 2004; Zalk 2004). None of the manufacturing sectors are significant net exporters – only in minerals is there any significant net export. Categorised by technological level, South Africa has a very weak presence in high-technology products, with very little indication of any significant change (Alves & Kaplan 2004). In comparison with its income level, South African exports tend to be unsophisticated, that is, proportionately more of its exports are in the less sophisticated products that tend to be exported by countries with lower levels of income. There is evidence that the level of sophistication of a country's exports have an effect on its growth (Haussman, Hwang, & Rodrik 2006). Thus Haussman and Klinger (2006: 12) conclude that 'for much of South Africa's history, GDP has been pulled down by low level of sophistication of its export basket'.[2]

A focus on manufacturing?

There is a long tradition in development economics that sees manufacturing as the engine of economic growth and central to technological change.[3] Within this tradition, manufacturing is generally conceived of as possessing four sector-specific characteristics that are not held by other sectors. It is these specific characteristics that give manufacturing a particular, privileged role in the development process.

- Manufacturing development improves profitability throughout the economy. Strong backward and forward linkages allow for manufacturing growth to 'pull' growth elsewhere in the economy substantially and positively.[4]
- Manufacturing enjoys stronger dynamic economies of scale. Combined with learning by doing, this allows for higher productivity change in manufacturing than elsewhere.
- Manufacturing is the site of major technological innovation. This then diffuses to other sectors, raising their technological capacities and their returns.
- The above characteristics of manufacturing are combined with the historical observation that all the development 'successes' have been strongly associated with manufacturing growth. Hence, a growing manufacturing sector and growing manufacturing exports are seen as indispensable to economic development.[5]

Rodrik and Haussman see poor manufacturing growth and poor manufacturing export performance as having been central in retarding economic growth in South Africa. Rodrik (2006) compares the growth performance of Malaysia with South Africa, and attributes Malaysia's higher growth to its superior manufacturing performance. This conception is also evident in ASGISA, which identifies as a major imbalance a 'hollowing out' whereby non-commodity exporters are unable to compete effectively in global markets. Rodrik, Haussman, and ASGISA therefore share a common perspective that leads them to a policy focus on manufacturing sectors, and especially on manufacturing exports.

In this conception, increasing manufacturing growth and manufacturing exports will both increase employment, since manufacturing is more labour intensive (and especially more unskilled-labour intensive) than other sectors, and raise output growth, since this will have pecuniary and technological spillovers through the economy. Moreover, growing exports will clearly support the trade balance, which is currently in substantial deficit and which poses the major constraint to raising the rate of growth.

However appealing the association between growing manufacturing and manufacturing exports and the ASGISA objectives of raising employment and output appear to be, the empirical basis for such a standpoint in South Africa is not yet established. Output and employment have been increasing most rapidly in the service sector. While, in general, manufacturing tends to have a higher (unskilled) labour intensity than services, there are very significant variations within both the manufacturing and service sectors. Similarly, downstream and upstream linkages vary considerably within the manufacturing and service sectors, and while manufacturing as a whole tends to have a higher export ratio, there is again significant variation both between and within the manufacturing and service sectors.[6]

Indeed, some recent, albeit preliminary, work suggests that output, employment, and income multipliers may be higher for the services sector (Tregenna 2006: 46). Further empirical work will need to be undertaken to assess employment and output multipliers, and the contribution to net exports of the various manufacturing and service sub-sectors. If South Africa's industrial policy is to be in any way selective of particular economic activities, this should include sub-sectors that are located in both the manufacturing and the services sectors.

Key constraints on industrial policy

Two systemic constraints currently place severe restrictions on industrial policy. The first relates to the domestic macroeconomic framework, and the second to international agreements.

The macroeconomic framework

South Africa, in company with a number of other developing countries, particularly in Latin America, has adopted orthodox macroeconomic policies that are focused on ensuring low domestic inflation. These policies have had a considerable measure of success – from 2004 to 2007, domestic inflation averaged 4.1 per cent but has trended higher since 2006 when it breached the 6 per cent band. However, macroeconomic policies have not brought stability in key prices that matter for investors, and particularly for exporters – the interest rate and, especially, the exchange rate.

South Africa has experienced high real interest rates and significant interest rate movements. This has stifled investment – more particularly on the part of new entrants who tend to rely more heavily on borrowing.[7] South Africa has also had significant fluctuations in the exchange rate,[8] and (arguably) significant periods in which the exchange rate has been overvalued. The level and, especially, the volatility of the exchange rate have stifled investments. In a World Bank survey, 76 per cent of firms exporting to the United States regarded exchange-rate instability as a serious problem, as did 57 per cent of exporters to the other countries in the Organisation for Economic Co-operation and Development (OECD) (World Bank 2005: 97). The exchange rate has been particularly non-conducive to new entrants, who have to incur large sunk costs in order to enter export markets.[9]

Restrictions imposed on industrial policy by international agreements

New rules and regulations governing global trade and intellectual property, embodied both at the multilateral level and in many regional and bilateral arrangements, have significantly reduced the freedom of developing countries with respect to industrial policy (Gallagher 2005). There are three major areas where restrictions occur: Trade-related Investment Measures (TRIMS); the Agreement on Subsidies and Countervailing Measures (SCM) and the Agreement on Trade-related Aspects of Intellectual Property (TRIPS).[10]

Currently, South African industrial policy has only two explicitly targeted sectors – clothing and textiles, and autos and auto components. In both sectors, exporters receive support through earning rebates on imports that are proportional to their exports – the Import Rebate Credit Certificates (IRCCs) in respect of autos and auto components, and the Duty Credit Certificate Scheme (DCCS) in respect of clothing and textiles. These are almost certainly open to successful challenge in the WTO.

This concern has led to a reformulation of the Motor Industry Development Programme (MIDP). An explicit requirement is that the MIDP must be replaced by industry support that is WTO compatible. The SCM prohibits granting subsidies based on export performance. Policies that make state support dependent on export performance, such as were applied in Korea or Taiwan, are now prohibited. Subsidies that are conditional on the usage of locally produced goods are also prohibited. Existent policy for the auto and auto components sector in South Africa has centred on export support. While exports have risen, the main concern in regard to autos and components is the low levels of local content, particularly in relation to exports. It is not at all clear how a policy can be designed so as to continue to support exports and to enhance local content. More general subsidies, such as some form of production allowance, are possible. However, these are certain to be very expensive since they apply to all output. Moreover, the disciplining and monitoring standard that linked support to successful engagement in the export market has been removed, rendering such policies both less effective and much more difficult to monitor and control.

Institutional and governance requirements for effective industrial policy

The institutional arrangements to direct and manage industrial policy effectively are very demanding. Where the institutional basis is weak, the risks of government failure and the squandering of public resources are enhanced.

Coherence

Effective industrial policy requires coherence in at least two respects. Firstly, there needs to be coherence in terms of the goals and objectives of industrial policy. If industrial policy is defined in terms of desired policy goals and outcomes as aiming to favour or target certain economic sectors or activities,[11] it is important that the selection criteria by which the economic sectors or activities are identified be consistently applied. Inconsistent application of criteria and selection of activities will dissipate effort, cause confusion, and clearly be sub-optimal. Secondly, there needs to be coherence in terms of responsibility within government, such that industrial policy is effectively overseen and directed.

Currently in South Africa, a number of governmental policies do indeed very selectively favour certain sectors and activities. There is much that occurs that is effectively industrial policy, albeit disguised as other activity. This 'hidden industrial policy' includes the following:

- direct state support for armaments production – especially subsidies to Denel;
- support to mineral processing – especially subsidised infrastructure and energy to the Coega industrial development zone (IDZ);
- support to the development and production of nuclear energy plants – direct subsidies to the pebble bed modular reactor (PBMR); and
- intervention in upstream fuel and chemicals production – the proposed 'windfall' tax on SASOL, which the government subsequently decided against to preserve a favourable investment climate in the sector.

All of these policies are highly selective. Collectively, they entail very significant and very direct commitments of state resources. Most importantly, these economic activities embody very different economic characteristics – different from each other, and different from the objectives set out in ASGISA and the NIPF. To take just two examples:

- The PBMR is very research and technology intensive. This project alone absorbs a very large number of South Africa's scientists and engineers. Should government be supporting activities that are highly intensive of the factors that are in most scarce supply? None of the other sectors that are proposed for support in ASGISA or the NIPF are nearly as technology intensive as the PBMR.
- The mineral-processing activities, specifically aluminium, that government is attempting to attract to Coega to anchor the project and justify the significant expenditures on infrastructure are very highly capital intensive. Employment creation is minimal. There is a conflict here with one of the explicit objectives of ASGISA and the NIPF, namely that industrial policy has as a central objective an increase in employment.

This is not to argue that any of these selective interventions will not eventually succeed in their own terms. The PBMR or Coega, for example, may prove to be very effective. But their systemic impact on the effectiveness of industrial policy has not been considered. The skill and capital intensity of these projects are likely to render their systemic impact as negative.

In addition, it is noteworthy that many of these selective interventions are not driven by the department of trade and industry. Support for armaments, the PBMR, and Coega are instead driven by the department of public enterprises. The windfall tax on SASOL is driven by the national treasury. This is not to say that the department of trade and industry has no 'presence' in these areas. But policy is initiated and managed by other departments with little perceived reference to the NIPF. The conclusion is stark: institutionally, there is no clear centre in government that designs and implements industrial policy. No ministry presently has oversight and provides direction to the totality of industrial policy. Lack of coherence in desired policy goals and outcomes is complemented by a lack of organisational coherency within government.

Strategic collaboration

Information problems beset investors in developing countries. In particular, the cost functions of new activities cannot be determined *ex ante*, but only after the investment has actually been made. Information failures result in economies staying the same course rather than diversifying into new activities with associated spillover effects. Rather than conceiving of industrial policy as a set of outcomes, principally altering the sectoral composition of the economy, industrial policy can be seen as a process that entails discovering the underlying cost structure of an economy. This discovery process requires strategic collaboration between government and business. Government engages in discussion, particularly with businesses, and also other players, such as research institutions. The purpose of this discussion is for government to understand the opportunities and constraints that face investment, and for businesses to understand government's objectives in economic development and restructuring of production, and the constraints under which it operates. Structured information exchange between government and business therefore aims at identifying the barriers to diversification, and to the determination of policies that are likely best to overcome those barriers (Rodrik 2004: 3). Rather than the result of autonomous decision-making on the part of government, the determination of government policy flows from a process of strategic engagement with business.

Strategic collaboration between government and business can take many forms. But developing a well-functioning structured engagement is not a straightforward matter. There is no tradition of such engagement in South Africa. Apart from a very few examples, such as the Motor Industry Development Council at national level, and some important initiatives at the provincial levels (see below), there is currently limited institutional basis for this collaboration. A considerable degree of mutual 'suspicion' exists, as between business and government. This manifests in distance, and even distrust, which is inimical to an effective strategic collaboration. The prevailing model is accordingly essentially one of government making policy, albeit often supported by research. Consultation with business generally takes place once government has largely decided on its policy position.

What is being proposed here is a radically different model. If industrial policy is to be effective in South Africa, the role of business in the formulation and development of industrial policy must be considerably expanded, and this will need to be embodied in new, well-defined institutional arrangements. Moreover, where governmental capacities are weak, the optimal role of business in this strategic collaboration will in consequence be enhanced. In South Africa, governmental capacities in relation to industrial policy are indeed limited. These issues are elaborated on below.

Governmental capacities

The design and implementation of effective industrial policy is heavily dependent on a strong and competent state bureaucracy (UNCTAD 2006: 215). Ideally, this bureaucracy should be closely connected with the business community, and have a good understanding of their situation. This will allow for the interchange of information and facilitate the structured engagement outlined above. At the same time, the government bureaucracy should retain a degree of independence and autonomy, such that it does not serve narrow sectoral or other interests. This is best encapsulated in the term 'embedded autonomy' (Evans 1995).

Currently most of those responsible for industrial policies are new recruits to their positions. They have a limited understanding of their sectors. So-called sector specialists have no direct work experience in the sector to which they have been appointed. Indeed, very few personnel have experience of working anywhere in the private sector. In South Africa, there is no 'revolving door' as between business and government, such as that, for example, which has characterised the Japanese Ministry of International Trade and Industry (MITI).

It is accordingly crucial that government seeks to build and enhance its industrial policy capacities, particularly the capacities of sector specialists. This could be done by requiring governmental personnel to acquire experience working in the sector, and/or by recruiting into government those with such experience directly from the sector. But this will take some time to effect. In the interim, governmental capacities to develop and implement industrial policies will necessarily be distinctly limited.

In the context of its own very limited competencies, government will be particularly reliant on business in the formulation and design of effective industrial policies. Weak government capacities will require that business plays a larger role. Moreover, limited governmental capacities constrain the scope and the depth of industrial policy. Whereas in Japan, for example, high levels of competence and in-depth knowledge allowed for the government bureaucrats to engage directly in proposing significant large-scale interventions and supports for business, this approach would be far from optimal in South Africa.

Distributional conflicts

Industrial policy entails support to firms. The profitability of firms supported rises above the market level. Thus, at the heart of industrial policy is the creation of rents. Such rents allow these 'favoured' firms to grow at rates that exceed what would have been possible in the absence of industrial policy. The management of those rents is central to the effectiveness of industrial policy.

In South Africa, distributional concerns challenge this perspective. Thus, there is opposition to 'white' or 'well-established' businesses benefiting at the perceived expense of 'black' or 'emergent' business. Almost all policy programmes therefore provide enhanced support for black-owned and small firms. Industrial policy does not, therefore, only aim to enhance growth of particular sectors or activities; it also aims to enhance the growth of those firms in the sector, or of those that undertake the activity, that are black-owned or small. This can dilute the impact on growth. Export support is a case in point. Larger, well-established firms will tend to have a higher export potential than smaller firms and newer entrants – exporting frequently entails economies of scale and a minimal scale of entry. But it is smaller firms and black-owned firms that currently enjoy privileged access to export support measures.

Nor are distributional concerns confined to supporting black or emergent businesses. Industrial policies in South Africa are also configured with the intention of raising employment. This concern for employment is not confined to selecting sectors and activities that are held to be more labour intensive. It may effect the determination of the policy instruments themselves.

For example, the Strategic Investment Projects (SIP) scheme was developed to encourage large-scale 'propulsive investments'. Government's concern was that South Africa needed to be able to offer incentives to large investors, more particularly large foreign investors, who were being lured to other countries, at least in part by attractive investment incentives. The incentives were refashioned in such a way that support was conditional on, and proportional to, employment criteria. This linkage reduced the effectiveness of the incentive in terms of attracting investment and hence output.

This is not to question the validity of equity/distributional goals entailed in South Africa's industrial policy. But these goals do have consequences for output growth, rendering industrial policy, at least as presently applied, more problematic in South Africa than elsewhere, where distributional issues are of less concern, and where the focus can be exclusively (or almost exclusively) on enhancing output.

Skills and training

The central objective of industrial policy is to enhance the productivity and efficiency of firms. Where protection is resorted to, this should only be a temporary measure whereby 'space' is given to the protected firms to advance their productivity so that they can, within a defined period, compete without government support.

A number of factors will impact on firm-level productivity. Of particular importance in a knowledge-driven economy are human resources – the level of skills. The department of trade and industry's industrial strategy lays stress on the central role of knowledge and knowledge-driven activities in securing a competitive edge. All sectors of the economy, including manufacturing, are becoming increasingly skill intensive, but the supply of skills is severely constrained.

In the World Bank's recent survey of the country's investment climate, worker skills were named by enterprise managers as a serious obstacle to their enterprises' operations and growth more than any other area of the investment climate. Consistent with this, per-worker labour costs are very high in South Africa – over three and half times higher than in the most productive areas of China, over two and half times higher than in Brazil and Lithuania, and over 75 per cent higher than in Malaysia or Poland. Although wages are relatively high for all types of workers in South Africa, they are particularly high for highly skilled workers and managers. An additional year of education is associated with an 11–12 per cent increase in wages in South Africa – compared to about 5–7 per cent in developed economies. The high premium paid for education results in salaries for skilled workers and managers that are high by international standards. Despite this skills shortage, South African firms invest less in training, and were less likely to have training programmes, than in most comparator countries (World Bank 2005).

Where skills are in short supply, and where, in addition, training is very limited, industrial policies designed to raise productivity, however well designed and formulated, are likely to have only a very restricted impact.

Conclusion

Perhaps the two key institutional requirements for an effective industrial policy are the professionalism and capacities of the government, and the effectiveness of the strategic collaboration, as between government and business. Both are currently very limited in South

Africa. Moreover, the limited capacities of the government are currently exacerbated by a lack of focus on and cohesion around the objectives, content, and conduct of industrial policy. In addition, distributional conflicts make it difficult to develop institutions and practices to manage the rents that are a constituent feature of active industrial policies. Finally, the principal objective of industrial policy, namely to raise firm-level productivity, is severely constrained by the current scarcity of skills and the limited training being undertaken.

Two broad conclusions emerge from this analysis. The first is that government should not expect too much of industrial policy. Under current conditions, it is likely to have only a limited impact. The second conclusion is that the design of industrial policy needs to be fundamentally re-examined. The institutional constraints outlined above should be factored into a consideration of its scope and content.

A way forward

What are the implications of the above analysis for the further development of industrial policy?

Industrial-support policies should not be confined to manufacturing sectors. Further work is needed to determine the likely output and employment gains consequent upon any expansion of sectors and sub-sectors.

As regards the constraints, firstly, a macroeconomic policy that results in both high real interest rates and an exchange-rate regime that is (arguably) overvalued and (definitely) highly variable will severely curtail the impact of any industrial policy.[12] In South Africa, there is currently no coherence between macroeconomic policies and microeconomic policies designed to enhance investment and productivity improvement. This will need to be addressed.

Secondly, the constraints imposed by the WTO will require that South Africa's two current sector-specific policies – namely those for autos and auto components, and for textiles and clothing – will have to be fundamentally redesigned. The MIDP has been widely held as a highly successful policy, although this perspective has been strongly challenged (see Flatters 2005). Whatever perspective is adopted with regard to the MIDP, it is clear that the programme is no 'model' to be followed in other sectors. Export-import complementation schemes, such as are currently operative in these two sectors, are likely to be successfully challenged in the WTO. What has worked in the past (arguably) provides little guide for the future. Moreover, since it will be difficult to confine any support programmes solely to exports, any new programmes are likely to require considerable resources. Assessments of the economy-wide implications will need careful consideration – something that has been largely absent from the design of existent support programmes.

With regard to institutional and governance requirements, custodianship and system-wide responsibility for industrial policy should be clearly demarcated within government.

The overriding objective of industrial policy is to raise the productivity and efficiency of firms. This is consonant with the objectives of the department of trade and industry. Public enterprises and treasury have other objectives. Responsibility for industrial policy should therefore rest with trade and industry. While there may be real or perceived weaknesses within this department currently, the government should give attention to enhancing the department's capacities to manage and direct industrial policy. The proliferation of interventionist industrial policies, albeit under other guises, needs to be carefully reconsidered. The desirability of such policies cannot be assessed solely on their own terms. They should also be assessed in terms of how they contribute systemically to the structural transformations being sought for the South African economy as a whole.

To reiterate, industrial policies are growth policies. They are centrally directed at raising firm level productivity and efficiency. There is a danger that requiring industrial support measures to make an additional substantial contribution to other equity objectives – notably employment creation and the development of black- and female-owned firms – may serve to blunt the central purpose and efficacy of industrial policy. Industrial-policy supports do tend to favour existent firms, and hence raise returns for recipients. One consequence is that they can therefore entrench existent firms, which may impose barriers to entry for new firms. In designing industrial support measures, it is therefore important to attempt to ensure that these measures do not unduly serve to raise the barriers to entry for new firms. Similarly, government will want to safeguard against support measures enhancing capital intensity, and resulting in employment loss. Industrial policies should be seen as essentially growth policies which must accord with, and can make some contribution to, government's equity objectives. In the main, however, equity goals are best addressed through other measures that are specifically targeted to these goals.[13]

The efficacy of industrial policy is heavily dependent on policies implemented elsewhere in government. Of particular importance is the issue of skills. Skills have been identified as the key current constraint on firm investment and performance. The evidence suggests that the supply of skills is not being augmented, and that despite their difficulties in securing skills, firms are undertaking very little training.

Perhaps the most important institutional and governance requirement for an effective industrial policy relates to the respective roles of government and the business sector. Governmental capacities to formulate and to implement industrial policy are very limited at present. Where governmental capacities are very limited, the private sector, rather than government, should play the leading role in the identification of constraints and opportunities for sectors, and in the design of policies to address these.

This perspective has informed the approach taken in the development of the provincial microeconomic development strategy (MEDS) in the Western Cape. What is envisaged in the MEDS is that the proposals for enhancing productivity and efficiency will emanate very largely from business. While the proposals emanate from business, the decision on which proposals to support remains with government. Government should make its decisions on which proposals to support based upon its declared objectives for output, particularly, and for equity. Since government's capacities are limited, this may well require government having recourse to external advice (Western Cape Department of Economic Development and Tourism 2005).

Institutionally, strategic collaboration can take a number of forms. Sector associations are one institutional mechanism for the engagement of business. In the Western Cape, government has established a number of special purpose vehicles (SPVs) that are primarily composed of business representatives, with some representation from the provincial government and other stakeholders with an interest and knowledge of the sector.

What is being aimed at are associations that are broadly representative; that have legitimacy within the sector, and whose objectives are to develop the sector, but also to enhance opportunities for new entrants – small firms, and particularly firms under black and female ownership and management. Ideally, this should be reflected in the membership of the association, which should be diverse and include small firms. Government can have some confidence that policy proposals that emanate from such associations are likely to have broad legitimacy within the sector, and also to accord with governmental objectives of both growth and equity.

These associations would be the locus of exchange between the private sector and government. They would be the forum through which firms would first present their proposals for assistance. Government would gain information as to firms' future investments, and the factors that are promoting and restraining investment activity.[14]

The role of associations is not confined to discussing policy proposals. Associations may well engage directly in implementation. Thus, government may grant funding support for a proposal that emanates from an association, and task the association with ensuring that the programme is carried out, and that the funding is spent effectively. For example, a proposal for training by an association may receive government support, with the association managing and directing the programme. Thus sector associations can carry much of the burden of industrial policy – both in its design and in its implementation, thus economising on limited governmental capacities.

The institutional design proposed here is not free of risk. The capacities required of government are still far from trivial. The danger of governmental capture, always real, may be enhanced where a close relationship is cultivated with business associations and government capacities are weak. However this is institutionally structured in the present context in South Africa, the design and development of effective industrial policy will necessitate a major role for business.

Institutional arrangements will necessarily evolve and change over time. It is of critical importance that the institutional design of industrial policy embodies feedback mechanisms, and structured monitoring and evaluation, aspects that have been largely lacking in previous policies. This will enable governmental capacities to grow with experience – a version of learning by doing (Western Cape Department of Economic Development and

Tourism 2005: chapter 7). As its own capacities enhance and develop, government will be able to be more effective, and also more adventurous, in advancing its industrial policies.

Endnotes

1 Edwards and Lawrence (2006: 7–8), however, see substantial growth in South African non-commodity exports post-1990, at approximately the same level as global growth.

2 By contrast, using a different measure of the sophistication of exports, Lall et al (2005: 18) find that South Africa's exports are significantly higher than would be predicted by its income level, and that this has increased in the period 1990–2000.

3 Broadly associated with Kaldor, others in this tradition include Rosenstein-Rodan, Hirschman, Prebisch, Chenery, and Pasinetti.

4 As UNCTAD (2006: 153) notes, 'the presence of complementarities in investment, production and consumption is considered to be greater in manufacturing than in other sectors because manufacturing activities give rise to more and stronger forward and backward linkages'.

5 This is exemplified by UNCTAD (2006: 150): 'The development of a strong manufacturing sector has been at the core of all successful catch-up experiences over the past 250 years, which suggests that achieving a lasting productivity-based increase in manufacturing is indispensable for a sustained rise in income levels and ultimately the eradication of poverty.'

6 In their identification of sectors that may warrant particular support, the Haussman and Klinger schema relies on export data that is confined to industrial exports, and that excludes services. Thus, four of the 14 targeted sectors in the NIS 'do not enter our international trade data and therefore can't be evaluated' (Haussman & Klinger 2006: 31).

7 Established South African firms tend to rely heavily on retained earnings – not unexpectedly, when real interest rates are high (World Bank 2005). But new firms are much more reliant on borrowing from the banking system.

8 According to Gelb (2004), since mid-2001, the rand has possibly been the most volatile currency openly traded in global markets.

9 For a discussion of the impact of gyrations in the exchange rate in constraining Latin American exporters, see UNCTAD 2003: chapter 4.

10 For an inventory and discussion of these restrictions, see UNCTAD 2006: 166–79.

11 Chang (1996: 60) defines industrial policy as 'a policy aimed at *particular industries* (and firms as their components) to achieve outcomes that are *perceived* by the state to be *efficient* for *the economy as a whole*'. Similarly, Pack and Saggi (2006:196) define industrial policy as 'basically any type of selective intervention or government policy that attempts to alter the sectoral structure of production towards sectors that are expected to offer better prospects for economic growth than would occur in the absence of such intervention i.e. in the market equilibrium'.

12 This is similar to the situation that has prevailed through much of Latin America. For the impact of unfavourable macroeconomic policies on industrial policy in Latin America, see UNCTAD 2003: chapter 6.

13 Of course, it will also be important to ensure that policies for employment creation or black economic empowerment (BEE) will need to accord with industrial policies.

14 Rodrik (2004: 20) terms these co-ordination and deliberation councils. These councils can be created at the national and sub-national or sectoral levels.

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Botswana's industrial development policy and policy harmonisation within SACU: challenges and opportunities

Stephen Kapunda and Oluyele Akinkugbe

Botswana, like all the other member states of SACU, is facing the challenge of aligning the country's industrial policies with those of its SACU partners, as well as with other countries within SADC and in the world at large. This derives from the ongoing wave of globalisation, and the need to become regionally and internationally competitive, and to become a player in the global value chain. Botswana's current industrial development policy (IDP) was crafted in 1998, essentially to respond to the forces of a globalising world through an export-oriented strategy, and to promote economic diversification and employment creation (Kapunda 2005: 176; Harvey et al 2000: 24). Despite the impressive growth rates that the country recorded for about three decades after independence, available statistics indicate that Botswana's manufacturing value-added as a percentage of GDP has been rather low compared to those of other SACU member countries. This may be an indication of a relatively low degree of industrialisation, on the one hand, and the dominance of the mining (diamond) sector, on the other. This situation may have informed the conscious efforts of the government of Botswana to meet the challenge of diversifying the economy away from mining, and promoting the manufacturing sector, in order to achieve regional and global competitiveness.

The objective of this paper is to examine Botswana's IDP and the opportunities and challenges the country faces in the likely event of industrial policy harmonisation within SACU.

The rest of the paper is organised as follows: the first section presents an overview of Botswana's current industrial policy; the next examines the theoretical issues relevant to SACU industrial policy harmonisation; and the opportunities and challenges presented to Botswana in this regard are then highlighted in the following section. The paper closes with the presentation of conclusions and policy recommendations.

Overview of Botswana's current industrial policy

An IDP was first introduced in 1984. Its objectives were the diversification of the economy away from heavy dependence on mining, the promotion of the private sector, and the creation of employment opportunities for the growing population (Government Paper

No 1 of 1984). In the mid-1990s, a review was undertaken, necessitated by both the changing economic circumstances and the need to review the effectiveness of the original policy framework. Following this, a revised policy was published in 1998 (Government Paper No 1 of 1998). While the objectives remained the same, there was considerable change in the strategies identified for their achievement (Akinkugbe & Makepe 2006).

The 1984 IDP focused mainly on an import-substitution strategy of industrialisation. Whether such a strategy would be successful, given the constraints of the small domestic market, was always open to question. In any case, the change in the international and regional environment, especially the establishment of the WTO and Botswana's accession to the SADC protocol on trade and co-operation, necessitated a review. The strategy of the new IDP of 1998 was to address issues such as the limited scope for development based on the small domestic market. It was also to reorient the economy towards the existing SADC and SACU agreements on trade and industrial development, which provide increased competition for investment and trade opportunities within the region. Additionally, the impact of the decline in the degree of industrial protection against outside competition following the establishment of the WTO and opening of South Africa under the new political dispensation were to be taken on board. So, also, was the need to promote rapid growth in productivity and efficiency as critical elements of competitiveness in global trade in goods and services.

In order to meet the challenges of the changing regional and global environment, the objective of the new IDP is to develop an efficient and competitive export-oriented industrial and service sector. To this end, the government strategy is to provide an environment conducive to the development of the private sector through bilateral and multilateral negotiations, with the aim of maximising access to export markets. It is also aimed at encouraging investors and entrepreneurs to improve labour productivity; the promotion of competitive unit labour costs; and specific efforts aimed at reducing the cost of utilities in the country.

As part of the process of implementation, the government established a high-level national committee to implement the IDP. Specialised working groups in the key areas of land, infrastructure, and utilities; human-resource development and training; and technology development support the work of this committee. Also in line with the objectives of the new IDP, the government implemented additional measures of special sectoral support. These included the establishment of the Botswana Export Development and Investment Agency (BEDIA) and the programme to support small, medium and micro enterprises (SMMEs).

SACU industrial policy harmonisation

Theoretical considerations

Economic theory seems to suggest that co-operation on domestic policies can substantially increase the gains – static and dynamic – from forming a customs union (or trade bloc). It can lift barriers that insulate national markets, and deliver economic benefits many times more than those available from preferential trade agreements. Intergovernmental co-operation in designing and applying domestic policies such as taxes, health and safety regulations, environmental standards, and so on – what is generally called policy integration or harmonisation – can increase competition in domestic markets by reducing transaction costs and allowing new suppliers to enter markets. Co-operation on domestic policies can also help in overcoming market failures and ensuring that trade restrictions are not reimposed through the back door. All of these may then have informed the new SACU agreements that mandate its member states to develop common policies and strategies with respect to industrial development.

Moreover, more often than not, most of the existing regional integration arrangements (RIAs) aim only at reducing market segmentation by constraining the use of national policies rather than by actively harmonising them. The main exceptions are the EU and the Closer Economic Relations (CER) agreement between Australia and New Zealand. A number of other RIAs, such as SACU and SADC, are beginning to design the framework for industrial policy harmonisation, but without specific timetables for action and further negotiations, progress may not be achieved.

In this section of the paper, we explore the role that regulatory industrial policy harmonisation among SACU members could play, even in the event that each of the members is crafting individual, and sometimes different, industrial development policies. We draw mainly from the experiences of the EU, since that is by far the most advanced example at hand. Our main conclusion is that policy harmonisation offers scope for considerable gains, but only at the expense of very hard political and technical work, and at the risk of exacerbating rather than eliminating distortions. Furthermore, governments and enterprises in the respective SACU member countries (Botswana in particular) will need to be alert to the opportunities for reducing transaction costs and market segmentation held out by multilateral organisations and unilateral actions.

In what follows, we define industrial policy harmonisation and some of the modalities for pursuing it. We also distinguish between agreements that treat foreign goods or firms exactly the same as domestic ones (which is not policy harmonisation), from those that involve negotiating how both sets of goods or firms are treated (which is). Furthermore, we also distinguish among intergovernmental co-ordination of policies, harmonisation of standards, and recognition by governments of each other's standards, as approaches to industrial policy harmonisation. However, it needs to be mentioned that the first of these is more ad hoc and nonbinding, and therefore may not be a recommended approach.

Defining industrial policy harmonisation

National treatment

National treatment requires that foreign products or producers, once they have entered a territory, receive the same treatment as domestic counterparts with respect to taxes, health and safety standards, competition rules, and so on. This issue of national treatment has been one of the basic building blocks of RIAs and international trade treaties. It ensures that liberalisation commitments cannot be circumvented by the discriminatory application of domestic policies, such as an excise tax that is higher for foreign than for domestic goods. National treatment does not constrain a government's policy sovereignty per se; it merely precludes discrimination in favour of domestic suppliers, and allows foreign goods, services, and factors to compete with domestic goods on an equal basis. An important positive effect of national treatment is that it tends to encourage investment flows, assuring investors that governments will not discriminate against them after they have invested. The offer of national treatment to investors may, however, vary from the complete abolition of performance criteria and related policies, such as local-content and trade-balancing requirements. Finally, the WTO and the Doha development agendas also now call for members to liberalise market access, and entry by foreign firms across the board, completely.

Beyond national treatment, industrial policy harmonisation could take the form of co-ordination of domestic policies; harmonisation of national standards and regulations; and recognition of foreign regulatory regimes and conformity assessment procedures.

Co-ordination of domestic policies

This is usually limited to efforts by the respective governments or regulatory bodies to co-operate in developing or implementing a norm or rule, and it involves 'voluntary and largely unenforceable alignments of national policies and measures in particular fields or sectors' (Robson 1998). This co-ordination may be based on formal agreements on, for example, the use of the principle of positive comity in the application of competition law, or may even be ad hoc, as in co-operation on infrastructure projects. Other agreements may be on co-ordination and harmonisation of tax policies and anti-dumping policies.

Harmonisation of national standards and regulations

Harmonisation may involve the unilateral adoption by one country in SACU of another's set of rules, or the negotiation of a common set of disciplines. In many instances, these are driven by market-size disparities (such as those that exist between South Africa and Botswana). A typical example of this is Switzerland's adoption of the EU regime on technical regulations and industrial standards, so that Swiss goods can enter and circulate in the EU on the same basis as EU-produced goods (Messerlin 1998). Similarly, Korea imported many German and United States product standards in the 1950s as part of a strategy for upgrading the quality of industrial production.

Recognition of foreign regulatory regimes and conformity assessment procedures

For a country that sets certain norms for goods and services within its borders under domestic industrial policy, the natural first thought is to test imported goods on entry. This is, however, potentially very costly to devise and enforce, and so the necessity to co-operate with trading partners or fellow members of the RIA. In this regard, unilateral recognition of foreign regulatory regimes appears to be the simplest route: a country such as Botswana just adopts international norms or the standards of a trading partner (such as South Africa). Thus, as a simple example, the government of Botswana may decide that the professional qualifications of doctors or managers, trained and certified in South Africa or Namibia, are sufficient to allow them to practise in the country. The key to this unilateral recognition, moreover, lies in familiarity with, and trust in, partner standards and certification systems. In the case where familiarity or trust are weak, or where, for nationalistic reasons, partners are not willing simply to adopt each other's standards, mutual recognition agreements (MRAs) become a possibility. These entail each member recognising its partners' standards as acceptable within its own boundaries, but without applying them to its domestic producers and suppliers. MRAs can cover either the standards themselves, or the conformity-assessment systems used to establish compliance with standards.

In the SACU context, there is an opportunity to use 'mixing regulations' to promote regional industrial development. One way of doing this is to compel any importer in the region to purchase some percentage of its imports from producer(s) in the region. By this means, any good that is produced in the region would enjoy some degree of preference over similar goods from outside the region. The advantage of this approach is that, while there may be no ceiling on the quantity of imports into the region (which could contravene WTO regulations), it guarantees SACU producers a portion of the regional market. Any producer within SACU wishing to capture a larger share of the regional market will therefore have to ensure that its product is competitive with products from outside the region. A further advantage is that 'mixing regulations' are much easier to administer than either the imposition of a tariff or payments of subsidies. Experience has shown that tariffs are costly to administer and there are bound to be complaints that goods are being smuggled into the country (or region). The payments of subsidies to producers place a burden on the fiscal position of the country as well as posing a difficulty in ensuring that only the intended producers benefit from the subsidies. 'Mixing regulations' simply requires monitoring that the stipulated quantity of imports is purchased from producers within the region. This is fairly easily ensured by placing the onus on regional producers monitoring the situation, and raising complaints when importers do not comply with the stipulated regulation(s).

The case of Botswana

Botswana's participation in SACU

Botswana's membership in SACU dates back to 1910, when the newly-formed Union of South Africa signed a customs union agreement with the then Bechuanaland Protectorate (Sentsho & Tsheko 2005: 254). Since then, like the other SACU members, the country has been depending heavily on South Africa in terms of trade. In general, the economies of Botswana, Lesotho, Namibia, and Swaziland (BLNS), have been dwarfed by South Africa in terms of both economic and demographic size, as shown in table 3.

Table 3: SACU countries: basic data

Country	Population (million)	Real GDP (million US$) constant 1995 prices		Real GDP growth rate (%) average		GDP per capita US$	Trade balance as % GDP
	2003	2002	2003	1999–2002	2003	2003	2003
Botswana	1,8	6 607	6 851	5,5	3,7	3 965	10,1
Lesotho	1,8	1 151	1 199	2,1	4,2	625	–10,5
Namibia	2,0	4 372	4 533	3,0	3,7	2 324	–5,7
South Africa	45,0	183 088	187 116	2,9	2,2	3 572	–0,1
Swaziland	1,1	1 693	1 731	2,7	2,3	1 729	–41,1
SACU	51,7	196 911	201 430	1,9 *	2,0	2 500	–10,0

Sources: Compiled by the authors using the data from the African Development Bank (ADB) *African Development Report 2004*; and Sentsho and Tsheko (2005)

Notes: Preliminary data for 2003; *1990–2000

However, Botswana's GDP growth rate, GDP per capita, and trade balances have been impressive over the years, due to the successful exploitation and management of the country's diamond reserves. Botswana also recorded budget surpluses for most of the past 20 years (Sentsho & Tsheko 2005: 255). Despite its heavy dependence on revenue from minerals, especially diamonds (over 50 per cent), the country's dependence on SACU revenue has also not been negligible (about 13 per cent) (see table 4).

Table 4: SACU revenue payments (2001/02)

Item	Botswana	Lesotho	Namibia	Swaziland	South Africa (residual)
SACU payment (R million)	2 622	1 438	2 641	1 503	9 897
% of total revenue pool	14,5	7,9	14,6	8,3	54,7
% of total government revenue	12,8	51,0	30,4	54,1	3,9

Source: Customs Union Commission Reports

Nevertheless, and as previously mentioned, despite the high real GDP growth rate, Botswana's manufacturing value-added as a percentage of GDP appears to be the lowest in the SACU region, at 5 per cent (see table 5). Botswana thus has a relatively small industrial base. In response, the government has adopted various policies to arrest the situation by diversifying the economy.

Table 5: Industrial output as a percentage of GDP

Country	Industrial value-added		Manufacturing value-added	
	1990	2000	1990	2000
Botswana	56	44	5	5
Lesotho	33	44	14	16
South Africa	40	31	24	19
Swaziland	43	44	35	33

Source: World Bank *World Development Indicators 2002*

Note: Industry includes manufacturing and mining.

Overview of SACU harmonisation: Botswana perspective

The early SACU agreements underline the commitment by member states, including Botswana, not to set up tariffs against one another, but rather to operate as a single goods market with a common external tariff against the rest of the world (Sentsho & Tsheko 2005: 254). However, infant industries of the customs union countries may be protected from competition from one another, for up to a maximum of eight years (Siwawa-Ndai 2001: 339).

Until 1969, Botswana, like the other small-economy members, received fixed proportions of SACU's common revenue pool. In 1969, however, a revenue-sharing formula was adopted. The formula gave Botswana and the other smaller member states a share of the revenue from common external-tariff and excise duties, based on their share of imports and the assumption of goods subject to excise duties. The share was based on a multiplier of 1,42 to compensate for the price-raising effect of the common external tariff, and for the lack of any mechanism to induce investment in the peripheral countries. In the 1970s, a floor was placed on revenue, such that if the average tariffs on Botswana's imports fell below 17 per cent, a rate of 17 per cent would apply. Similarly, if the average rate rose above 23 per cent, that rate would apply (Sentsho & Tsheko 2005: 256).

However, one of the drawbacks was that the small countries received revenue based on their consumption of relevant commodities, regardless of the size of the total revenue pool. Furthermore, the adopted two-year lag payment from the revenue was unfair, because the enhancement factor was significantly depreciated by high inflation, loss of interest on revenue accrued but not yet paid, and depreciation of the exchange rate (ADB 1993; Guma 1990; Sentsho & Tsheko 2005). Similarly, the formula did not directly involve all members.

The new SACU agreement, adopted in 2002, aims to rectify this situation by promoting further regional and global trade, and by enhancing democracy and harmonisation, as implied by the following specific objectives for the customs union member states:

- promote the integration of the members into the global economy;
- facilitate the cross-border movement of goods between members;
- establish effective, transparent, and democratic institutions that will ensure equitable trade benefit to the members;
- facilitate the equitable sharing of revenue from customs excise and additional duties;
- promote fair competition and a significant increase in investment and economic development; and
- facilitate the development of common policies and strategies.

Like all other SACU members, Botswana's industrial policies had to be in line with these objectives. The new SACU agreement provides for the joint exercise of responsibility over tariff settings, the revenue pool, and SACU's overall direction. This takes place through the establishment of more democratic organs and institutions, such as Custom Union Commission and the SACU Tariff Board.

Furthermore, the new revenue-sharing formula is expected to apply to Botswana as it does to all other SACU members, and will be limited by the size of the customs and excise duty pools. The total customs revenue is expected to be distributed proportionately to each country's share of total intra-SACU trade (imports). Excise revenue is also expected to be distributed according to each country's share of total SACU GDP – a proxy for value of excisable goods consumed. The development component is expected to be a more or less fixed percentage of the excise pool to each SACU member. However, the shares accruing to each member state are expected to be marginally in favour of the lesser-developed countries in SACU (Sentsho & Tsheko 2005: 258).

Botswana is expected to take advantage of the opportunities implied by the revenue-sharing formula. Regarding industrial development, the new agreement is expected to enhance industrialisation and diversification. Specifically, the agreement is expected to:

- harmonise policies in industry, trade, and agriculture;
- harmonise product standards and technical regulation within the common customs area;
- minimise unfair trade practices; and
- permit national protection for infant industries in the BLNS for eight years.

However, as Sentsho and Tsheko (2005: 259) conclude, these industrial measures are not adequate. Further harmonisation of the industrial sector should be encouraged. This could be done by using investment and tax incentives, as well as other macroeconomic policies.

Opportunities and challenges for Botswana

Several aspects may thus be considered favourable for Botswana's industrial development objectives. Others pose a challenge. At the SACU level, the following opportunities and challenges may be highlighted.

The new SACU agreement holds a number of opportunities for Botswana. One example is the favourable revenue based on the new revenue-sharing formula, that is, revenue distribution according to a country's share of intra-SACU imports and SACU GDP. These shares are likely to be relatively significant for Botswana. The implied challenge, however, is Botswana's effort to use them judiciously and substantially in favour of industrial development, which is expected to promote significantly the economic diversification process.

Another example is the continuation of protection for infant industries for a specified period. This may be viewed as an opportunity to promote industrialisation in Botswana. However, it is also a challenge, in the sense that after the specified period of protection, the industrial sector should be able to produce high-quality products at low costs, in order to compete regionally and internationally.

It is very likely that before and after completing the specified period of protection for infant industries, Botswana will still struggle to compete with more industrialised South Africa, which has a long industrial experience in producing high-quality products at low costs, and more advanced technology with which to do it. This line of argument may also be generalised to other regional and global levels, when less industrialised countries are involved in trade with more industrialised countries.

The need for high industrial product quality and standards implied by the new SACU agreement and global markets should encourage Botswana and other producers to become more competitive. Botswana should make more effort in this regard. As the Botswana Institute for Development Policy (BIDPA) (2006: vii) maintains, the government should develop a 'standard strategy' that includes an assessment of the scope for greater harmonisation of standards within SACU – in particular, whether it would be feasible to introduce a single set of standards across the region, with inspections to be done by a single authority, with clear guidelines of why inspections are being undertaken. This is in line with the challenge of article 28 of the new SACU agreement, that is, that '*member states should strive to harmonise product standards and technical regulations within the Common Customs Area (CCA)*'.

Regarding economic integration, this analysis implies that Botswana is on the way to fuller integration into the global economy, given its participation (current and planned), not just in the WTO, but also in various – sometimes overlapping – regional integration arrangements, free-trade areas (FTAs), and other bilateral and multilateral cross-border initiatives. In the context of free trade under economic integration and globalisation, Botswana stands to benefit, provided the country's firms are strategically positioned to compete effectively in global markets. To this end, the country will benefit more if firms that operate within the country, both national and foreign-owned, are global players that have established themselves in the global value chain.

In the interim period, the challenges that Botswana and the economies of the region face are:

- to align their economic policies, including the role of the state in the economy, to emerging global trends;
- to intensify their work towards a gradual removal of tariffs and non-tariff barriers; and
- to intensify their work in the creation of firms that can penetrate and effectively compete in global markets.

Failure to make these necessary adjustments to the process of economic integration and globalisation, which appears to be beyond individual-country capabilities, is likely to prove very costly to the economy, no matter how sophisticated the domestic industrial policy turns out to be in terms of competitiveness in the new economic environment (not just within SACU), employment creation and retention, and industrialisation.

Thus far, Botswana has developed its export-oriented industrialisation strategy under the shelter of the high SACU external trade barriers that have for a long time protected South African industries. In fact, Botswana's exports to and imports from South Africa continue to dominate its trade structure. The process of economic integration in the region, and the globalisation it entails, will definitely remove trade barriers and expose the country's firms to fierce competition with more efficient firms from the EU, the United States, and other countries and regions of the world. This means that, while the private sector in Botswana has over the years enjoyed government economic incentives and a friendly macroeconomic environment, these benefits are similarly going to attract external rivals. Consequently, Botswana firms would need to position themselves strategically in the next four to ten years if they are to survive the imminent economic competition. Furthermore, the government will need to expedite the preparation and implementation of its competition policy if Botswana's industrial development and economic diversification objectives are to be realised.

Integration with South Africa's manufacturing industries should be considered for the following three reasons:

i. The proximity to South Africa constitutes both an opportunity and a threat to Botswana. Potential investors in productive enterprises in the Southern African region tend to favour South Africa, rather than Botswana, as their destination for a number of reasons. These include proximity to seaports, a large domestic market, low-cost utilities, the affordability and availability of investible funds, better infrastructure, and higher technological skills and facilities. On the other side of the coin are the higher tax rate, the high crime rate, and relative social instability, which constitute South Africa's weaknesses. A proactive reaction to these two dimensions of the proximity to South Africa can turn both into an advantage.

ii. Botswana can turn its relative disadvantages in size and lower level of technological development into an opportunity by integrating its industrial activities with those of South Africa. Integrated manufacturing agreements could be negotiated with selected major manufacturers under which Botswana would produce and supply component parts to South African producers, instead of establishing production units of competing brands. Such agreements seem viable in such industries, particularly in the case of motor vehicle manufacturing, electronic and household appliances, and agricultural equipment. The initiatives for such contractual arrangements have to be facilitated by a government-to-government approach and negotiation, involving the ministries of foreign affairs, trade and industry, finance, and economic development, and private-sector organisations, such as the Botswana Confederation of Commerce, Industry and Manpower (BOCCIM).

iii. However, one other dimension of proximity to South Africa relates to the difference in the macroeconomic environments of the two countries. Botswana offers a more stable social environment with a much lower crime rate and corporate taxation. It could therefore market itself as an alternative location to industries that are adversely affected by these aspects of South Africa's socio-economic environment. For such a strategy to be successful, Botswana would need to set up industrial facilities or estates at border towns with South Africa, and review its relevant policies and procedures to make them more attractive to target industries.

Botswana could also take advantage of its membership of both SACU and SADC to negotiate a 'fair distribution' of industrial establishment within the union and the community. The concept of 'fair distribution,' borrowed from the Cartagena Agreement (1969), is an attempt to deal with the issues arising from the economic relationship between unequal regional partners, so as 'to accelerate their growth and the rate of creation of employment and to facilitate their participation in the regional integration processes.' It substitutes a co-operative economic agreement for a competitive system, which ensures an equitable distribution of industrial enterprises among the various members of an economic union, rather than the 'winner takes all' system that is likely to characterise a competitive system.

Conclusion and policy recommendations

This paper has examined Botswana's industrial development policy and the various opportunities and challenges that harmonisation of policies within SACU portend for the country.

The paper presented an overview of the current IDP by examining its evolution over time as necessitated by regional and international issues of globalisation, competitiveness, and the need to form part of the global value chain. Industrial policy harmonisation was examined – theoretically, and in relation to what the likely opportunities and challenges Botswana may face in the very near future, given the likely event of the harmonisation of industrial policies within SACU, and even SADC.

In general, the policy recommendations may be summarised as follows:

- The government and the private sector should take advantage of the opportunities presented by the new SACU agreement and other regional and global agreements, and rise to the challenge of producing high-quality industrial goods for sale at competitive prices.
- The government should also develop a ‘standards strategy’ that aims at greater harmonisation of standards within the SACU framework.
- Botswana should judiciously use the revenue from the SACU pool in favour of industrial development, which is expected to promote significantly the economic diversification process.
- The government should expedite the preparation and implementation of the country’s competition policy to promote fair competition, protect consumers, enhance further industrial development, and accelerate economic diversification.
- In future, SACU members should keep on revising the common revenue-sharing formula with a view to promoting more industrial development.

Although most of these recommendations are directed at Botswana, some are likely to be relevant for other SACU members too.

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Industrial policy in the Kingdom of Lesotho

Francis Makoa

For a small enclave – poor, underdeveloped, and aid-reliant Lesotho – formulating a coherent and unambiguous industrial policy with clearly articulated implementing strategies and procedures has been a formidable, indeed daunting, challenge. Even more daunting is aligning such policy – should it be ultimately successfully formulated – with those of the partner countries of SACU, which are increasingly under pressure from a doubtlessly ambitious SADC. These features constitute the parameters of any industrial policy that the country may wish to pursue, demanding different sets of actions, strategies, responses and solutions to the kingdom's socio-economic predicament. For example, with its founding principles, SADC is supposed to be a replacement for, rather than an expanded or refurbished, SACU.

Therefore, the two organisations make different if contradictory policy demands on Lesotho, which is a member of both. The continued existence of SACU, and its efforts at sustaining and perpetuating itself as a separate and independent economic bloc from SADC, militate against or slow down the realisation of the latter's goal of regional integration. Yet until SADC ousts SACU, Lesotho will remain a member of and be bound by the latter's decisions, norms, and resolutions. It is, in fact, rational for Lesotho to stick with SACU: the customs union is Lesotho's largest single source of state revenue, about 50 per cent of the budget today.

Survival beyond SACU while remaining its loyal member

Lesotho has, along with the other SACU members, signed the 2002 Southern African Customs Union Agreement (SACU 2002) – coming in as an improvement on the previous one – of which article 38.2 envisages, as agreed by the SACU states, harmonised industrial polices, and implementing strategies within the union. Therefore, not only does Lesotho have to honour the agreement, but it also has to promote, pursue, and further SACU's interests, as defined by and institutionalised through the 2002 agreement. However, the economic and political development in Southern Africa fostered and polarised by colonialism and apartheid has meant that SACU was to become, and remain for decades after it was established in 1910, an ensemble of disparate outfits, brought together neither by a shared ideology or political vision, nor by parity in the levels of economic advance and mutual recognition as partners. It was, in fact, in part established originally to provide an honourable exit strategy for Britain, the colonial power, from the then three protectorates of Bechuanaland (Botswana), Basutoland (Lesotho,) and Swaziland, which appeared to have nothing directly exploitable economically, while proving increasingly costly to administer.

Britain had neglected the economic development of these possessions, which would have enabled them to generate funds needed to finance their own administrative activities. Pushing them into SACU membership was seen by Britain as the best option that would enable them to have some stable source of revenue, and hence pay for the cost of their colonisation. However, this arrangement would not make them genuine economic partners of South Africa. At the outset, therefore, Lesotho was – together with its sister protectorates – destined to follow the path of development described later in this paper, which should no doubt be factored into a plan that seeks to harmonise its industrial policy strategies and procedures with those of the other four SACU members.

With a population of just about 2 million people, and 60 per cent of all Basotho households living below the poverty line – thus lacking the necessary buying power since the dawn of the past decade (FAO 2006: 5), the Lesotho domestic market cannot absorb mass-produced industrial goods that are destined for local consumption. Thus, to this extent, its population's poverty feeds into, and undergirds and sustains, the lack of development in Lesotho. On the other hand, it dictates and shapes both the focus of the kingdom's industrial development policy and the necessary implementing strategies and procedures. Combined, Lesotho's peculiar features – namely its enclave status, domestic market size, poverty, and dependency – have been important factors in the choice and formulation of its industrial policy, limiting the policy-makers' degree of error in determining priorities.

These features have elicited pragmatic but often discrete responses from policy-makers, rather than coherent and stable instruments and guides to industrial development. Since 1966, when the country attained its independence, the main concern of the Lesotho authorities has been trying to encourage investment in sectors that produce for external markets, even though their continued operations in Lesotho, in terms of willingness to stay in the country and expand such operations, may have seemed doubtful. The Chinese textile-manufacturing firms encouraged by the government to invest in Lesotho as a desperate employment-creation measure are a case in point. The reasons for this type of policy are obvious, and the most important reason for the adoption of such an industrial development strategy has been because the country is devoid of options. In this kind of climate, there are no bad or good choices, and Lesotho seems to be fully aware and appreciative of this reality. Thus the kingdom has been, and seems set to continue being, dogged by the paradox of having to survive as a member of SACU with resources deriving from outside the union.

The above notwithstanding, the approach of foreign private enterprises to Lesotho's industrial development does yield some benefits for the impoverished and dependent enclave kingdom in the form of their 'positive' impact on the structure of the economy. Industry now accounts for 42 per cent of the country's GDP, while the manufacture of clothing by these enterprises offers employment to 47,000 Lesotho citizens (IRIN

2006:1). However, this increases the country's vulnerability to the vicissitudes of external markets, which are often volatile and unreliable. In fact, closely related to this problem as far as Lesotho is concerned, is the dependence on imported inputs of this textiles-based industry. None of the basic materials required for the production of the garments comes from Lesotho, the SACU region, or Africa. As a common market, SACU would cushion Lesotho against this problem. However, the union lacks such a tradition. Its members forge trading relations with the outside world and sever the existing ones whenever they see this as necessary.

SACU has functioned more as a market for goods produced by the dominant and economically more developed South Africa, whose concern has been self-protection from external competition rather than facilitating the transformation of the union into a common market. Lesotho recognised soon after attaining its independence that SACU ought to be more than just a common-tariffs and revenue-maximising regime. The kingdom's development planners have been, indeed, sceptical about the contribution of the revenues accruing from SACU to the country's development in the long term. The planners have argued that SACU revenues exacerbated Lesotho's vulnerability to political and institutional changes in the region. The Lesotho Third Five Year Development Plan for the period 1980–1985 observed of the customs revenues, for instance, 'the actual accruals are not subject to discretionary actions on Lesotho's part, having not resulted from any major broadening of the tax base' (Kingdom of Lesotho 1980: 61–82). In the past decade, the average share of customs receipts in the total state revenue was about 54 per cent, financing '78% of recurrent expenditure' (FAO 2006: 3).

Indeed, Lesotho joined SADC's forerunner, the defunct Southern African Development Co-ordinating Conference (SADCC), when this was formed in 1980, among other reasons, not only because it doubted SACU as an engine of industrial development, but also because SACU did not minimise its dependence on South Africa. However, the kingdom did not consider quitting the union, for this was not, and is still not, an option. Neither did it believe that SACU ought to be dismantled in favour of the emergent SADC. SACU is the largest revenue-spinner for Lesotho, as indicated above, while, if anything, with its emphasis on regional security and stability, SADC provides only protection for governments of the day in its member states.

Lesotho's industrial policy has evolved amid, and been shaped by, the parameters or specificities highlighted above. The paper thus assesses the challenges and prospects for harmonisation of its industrial policy with that of other SACU members against the backdrop of these parameters.

An undefined industrial policy, but clear objectives and strategies

Governments formulate, but never define or provide, a coherent and logical definition of industrial policy, but leave such functions to policy analysts. They decide on and set the desirable industrial-development goals and objectives or envisaged actions, spelling out the targets, thrusts, and implementing strategies, agencies, and/or institutions. SACU member states have done likewise in relation to their individual industrial-development needs. Lesotho, which constitutes this paper's case study, has also followed the same path, casting its industrial policy in a series of statements of intent, and the activities supposedly required for translating these into processes yielding tangible results. There is value in this approach. Tight minimalist conceptual schemas would not adequately reveal all the dimensions and ramifications of the policy in question. Yet a logically coherent caricature of industrial policy is necessary if only to order the inquiry and analysis, and to delimit their frontiers, while setting the parameters and scope of the analysis of the phenomenon of industrial policy itself.

In scholarly writings, it suffices to define industrial policy in minimalist terms, though, as long as the meaning and scope are clear. Yet there are as many definitions of industrial policy as there are their sources and/or formulators. A *Google Dictionary* definition is that industrial policy is 'any government regulation or law that encourages the ongoing operation of, or investment in, a particular industry'. The emphasis on regulation or law underscores the political and authoritative nature of industrial policy; that is, it is not a hollow declaration, but rather a pre-defined package for society that is to be put into practice through an enforceable process. Thus government decisions become policies because they are imposed and implemented through processes and agencies that are backed up by law or regulation, which in turn sets the framework for, and delimits their areas of operation. The concern, or rather focus, of an industrial policy is thus building industry, channelling investment capital into industries located in poverty-stricken areas, restructuring an existing industry, or helping to accelerate its growth – although what, for the purpose of policy formulation, constitutes industry, has largely been a matter for policy-makers and development-planners to determine. They have not had difficulty in stating what it is that is wanted or has to be achieved, and how it is to be achieved.

Government is pivotal also in the World Bank's definition of industrial policy: 'government efforts to alter industrial structure to promote productivity-based growth' (World Bank, cited in McCarthy & Hansohm 2005: 154). As in the case of the dictionary definition proffered above, the critical issue in the World Bank's definition of industrial policy is intervention by policy-makers, invariably the government. Such an intervention must alter or shift both the path of industrial development and its focus. Policy interventions assume different forms. Some are aggressive, that is, pursued vigorously, often through overt measures such as those backed up by new special legislation, state programmes and reforms. These set the goals and targets to be achieved through the use of clearly identifiable implementing institutions or agencies. The counterparts of this type of intervention usually occur within the existing frameworks, these being applied liberally to permit or encourage improvement and progress regarding the changes desired. Examples include the unrestricted right to establish business at a location of the investor's choice, free competition, the constitutional right to own property, and freedom to accumulate wealth in accordance with the prevailing norms.

The definitions provided above constitute schema through which this paper views the industrial policy in Lesotho. Spelled out in a set of largely incoherent statements detailing the country's needs and strivings, as will be seen later in the paper, the kingdom's industrial policy is traceable to the mid-1960s, that is, the period beginning barely one year after the country attained independence in 1966, and, indeed, it exhibits all the foregoing characteristics, and/or the dimensions provided in the foregoing discussion.

Lesotho's industrial policy

Lesotho's economic features and geopolitical situation may have been constraints on industrial policy-making, but not impediments to its evolution and that of the implementing strategies. If anything, on a more positive note, these features have spurred the kingdom to search for and adopt an industrial policy that specifically addresses the problems that they pose. However, there have been shifts in both the paradigm of Lesotho's industrial policy and the government's view of its role. The shifts have created two discernible periods, with distinct approaches to industrialisation and industrial-policy implementation, and the role played by the state in each of them. The first runs between 1966 and 1985. In this period, central planning was the norm, although commitment to a free-market economy with autonomous and competitive private enterprises remained unflinching. Not only did the state alone consciously make industrial policy and formulate economic development plans, but it also drove the development process, determined the objectives and strategies to be employed to achieve these, and set up its own implementing agencies and/or institutions. Industrial-development planning and policy-making were thus centralised, while the industrialisation drive was under the tutelage of, and guided and overseen by, public enterprises or industrial development corporations especially established to perform these functions, notwithstanding that private capital investment was also strongly encouraged.

The period saw the establishment of the present Lesotho National Development Corporation (LNDC) in 1967, with a broad industrial development mandate, and the Basotho Enterprises Development Corporation (BEDCO) in 1977, charged with the duty of assisting local, or Basotho, entrepreneurs. The overall industrialisation drive (of which success is not an issue here) included 'aggressive' mobilisation of international capital, and co-ordination of investment efforts; the building of industrial estates and infrastructure; the establishment of assisted investment schemes that lent money to potential and willing investors; marketing arrangements for locally produced goods; and direct participation in industrial production, alone, or in partnership with willing individuals. The drive witnessed a proliferation of manufacturing and processing industries, of which most were state enterprises or partnered by the state through the LNDC. These were backed up by government financial institutions, which provided the necessary loans. These were the Lesotho Bank, Agricultural Development Bank, Lesotho Building Finance Corporation (LBFC), and Lesotho National Insurance Group (LNIG). Originally placed under the Ministry of Development Planning, meanwhile, the LNDC worked in close co-oporation with, and reported to, the minister responsible for commerce and industry.

The industrial policy was vaguely cast, however, although palpably multi-focused and bringing under its purview virtually everything thought by the government to be essential to industrial development. According to the country's Five Year Development Plan for 1980–1985, for example, the policy sought to create jobs and achieve industrial efficiency, higher rates of growth, increased national income, production and availing of industrial products at low prices and costs, and stimulation of demand 'for industrial products both domestically and for export assistance for improving productivity in industry' (Kingdom of Lesotho 1980: 224). Industrial development was to be overseen and co-ordinated through industrial-licensing boards. The national development plan proffered varied industrialisation strategies. These are: improved management; skills training; creation of industrial estates; mobilisation of capital; localisation; export-oriented production and foreign trade promotion; improved marketing arrangements; pricing policies with controls; tourism; a labour-intensive-construction unit; mineral-resource exploration; and decentralisation (Kingdom of Lesotho, 1980: 226–7). The approach was therefore holistic, bringing under its scope, and seeking to address simultaneously, all the perceived socio-economic problems facing the country. As indicated above, this enhanced the role of the state and necessitated direct investment by the government in varied business enterprises.

The country's adoption, towards the end of the 1980s, of the International Monetary Fund's Structural Adjustment Programme (SAP), and the ascendancy of the free-market ideology, both averse to a developmentalist state and exerting pressure for privatisation, saw a gradual disengagement by the government from direct involvement in production and distribution of manufactured and processed products. This marked the beginning of the second and present phase of Lesotho's industrial policy, of which the pace of implementation accelerated with the coming to power of the Basutoland Congress Party (BCP) in 1993. A free-market regime replaced 'developmentalism' as both the framework and strategy for industrial development, while the role of the state diminished. State withdrawal from productive activity was also marked by a wholesale sale of state-owned business enterprises, and liberalisation of the entire economic sphere.

Lesotho's liberal industrial development policy has whittled down the LNDC's role and influence, so that today the organisation is an advisory body only, rather than an active participant in actual production processes. Its mandate is explained vaguely and hazily in its self-advertising pamphlets as 'to promote and facilitate development of manufacturing and processing industries, mining and commerce in a manner calculated to raise the level of income and employment in Lesotho' (http://www.lndc.org.ls/, 6 October 2006). Foreign direct investment (FDI) assumed importance as an alternative to state-supplied capital, and as the industrial policy's implementing mechanism, although it is beyond the control and influence of the industrial policy-makers and/or development planners. The collapse of communism had ushered in a 'new political economy' that demonised the state, and reinstated capitalism as a framework for, and engine of, growth and industrial development. As the minister responsible for commerce and industry said recently of the country's adoption of a free-market industrial policy, 'Lesotho's investment regime is fairly liberalised and embraces Foreign Direct Investment ... virtually in all sectors through incentives and stable political environment (Lebesa 2006).' LNDC adverts designed to lure foreign private capital also make mention of these incentives, thus: 'A number of fiscal incentives are available to manufacturing companies establishing in Lesotho, including

- unimpeded access to foreign exchange
- export finance facility
- long-term loans
- the existence of an import via credit facility provides an input tax credit upon importation and local purchasing of raw materials and capital goods (http://www.lndc.org.ls/incentives.htm).'

The Lesotho government's free-market and/or private-sector-driven industrial development is stressed by the LNDC in its investment guide thus: 'The Government of Lesotho is irrevocably committed to the development of private sector and is currently involved in a privatisation programme (http://www.lndc.org.ls/IG.htm).' This is, however, a euphemism for expatriate firms, for there are virtually no locally owned industrial concerns of a meaningful stature in terms of involvement in manufacturing and/or export trade.

Lesotho's commerce and industry ministry has retained some of its planning and co-ordination functions, however. But these exist mainly to ease investment; make the opportunities available to potential investors, and facilitate their taking advantage of them; to facilitate credit and exports/imports; to forge and sign trade agreements and protocols; and to licence businesses, rather than the functions acting as a 'commandant'. So, Lesotho's *laissez faire* industrial policy crucially rests on incentives, liaison, consultations, and negotiations between the state-owned LNDC and potential investors, as an addition to the package of implementing strategies mentioned above. The thrust has shifted towards the private sector, targeting it for development, but without sufficient political leverage by the state since it 'rolled back' after the overthrow in 1986 of the Jonathan government.

There is little doubt, if any, that the country has, by rolling back the state, in fact, lost or diminished its capacity to determine and direct the course of its industrialisation process – instead, increasing the bargaining power and influence of foreign private firms, which have now seemingly been anointed as the motor and purveyors of industrial development. Thus efforts by the Lesotho government to harmonise its industrial policies with those of SACU are likely to be a matter for hard bargaining with the existing industries, as noted in the following section. But it is clear that, for Lesotho, major challenges will come from its present *laissez faire* industrial development policy, which has edged the state out of the production process, limiting its role and authority, despite its being the embodiment of the people. Left to the highly mobile foreign private firms, as is the case now, the policy will clearly have no role in a scheme that may be introduced in order to eliminate, in accordance with SACU's 2002 objectives, the socio-economic development imbalances among SACU member countries.

As noted earlier, the 2002 SACU agreement, signed in December 2004, requires member countries, which include Lesotho, to have a common industrial development policy, although, as noted earlier, this has not been defined precisely. For McCarthy, 'an obvious objective of the common industrial policy will be to bring about a more even distribution of economic activity'. McCarthy notes that this is the practice among states that are regionally organised but unequal in terms of their levels of economic development. This recognises 'the importance of a balanced industrial development of the Common Customs Area as an important objective of economic development' (McCarthy 2004: 167–8). But the members' commitment to free-market economies suggests that such a distribution may be difficult to achieve, since governments can only encourage, and not move investors to, or assign them, specific geographic areas in which to do business. Moreover, competing for private capital investment, and under pressure to create jobs for their peoples, the SACU member states may be, or are likely to be, forced to adopt policies that negate or militate against the envisaged harmonisation of industrial policies.

A further complicating factor in the envisaged industrial policy harmonisation is, as McCarthy (ibid: 157) puts it, 'that SACU member states do not have a collective policy in general and … how much a policy should support development strategies at a balanced regional development'. The disparity in both wealth, and industrial and technological development, among the SACU countries is set to be another hurdle that might slow down or impede progress towards the development of common industrial policies and strategies, and the procedures for implementing them. South Africa accounts for over 90 per cent of SACU's total industrial production, thus implying that the industrial policy harmonisation that is envisaged by the agreement might be essentially no more than aligning the policies of other members with those of the Republic Yet, viewed from a different angle, this is sensible. It offers an opportunity for the less developed SACU member states to access or attract South African capital and technology, regardless of whether they are aware of it. But this assumes that South Africa would be willing to facilitate such access.

SACU revenue now has a development component, even though this is small. It also has an additional element that 'Lesotho, Namibia and Swaziland, the member states most dependent on SACU revenue', enjoy some 'protection against the decline in real value of the revenue pool' resulting from bilateral and multilateral trade, and increased tariffs and duties (McCarthy 2004: 169). However, SACU does not seem to have a means of ensuring that member countries use the revenue allocated strictly for development. The 2002 SACU agreement also provides 'for the protection of BNLS (Botswana, Lesotho Namibia and Swaziland) infant industries', defined or identified as those not older than eight years. The nationality of the industries does not appear to be the issue, and if this is the case, foreign firms will also enjoy protection. But this raises an important question, namely whether foreign industrial enterprises will be protected against their branches or sister firms operating elsewhere. Nor is it clear whether such infant industries will be protected from external competitors only. There is little or no doubt that in the case of Lesotho, with virtually no local industrialists, protection of infant industries means protecting foreign firms which may have invested their money in the country only while awaiting opportunities to emerge elsewhere. Indeed, the experience in Lesotho has been that some foreign firms have left the country after the expiry of their tax-holiday period of four years. In some cases, ownership of the firms' operation in Lesotho changes hands in the middle of the eight-year period that defines the infant status. It is clear that this would need to be addressed by the union.

Another important issue is how the foreign-owned firms that dominate what is today dubbed Lesotho's industry view the SACU scheme of industrial-policy harmonisation, in terms of how it fits in with their interests or jeopardises them. Thus, for Lesotho, success in harmonising or aligning industrial policy with that of SACU seems to rest, not on government action alone, but rather also on the implications for its predominantly foreign industrialists' interests. Worth noting, though, is that the predominantly textile-producing foreign manufacturing industries that have been assigned the task of industrialising Lesotho have had profound consequences for the structure of the country's industry. They have concentrated manufacturing and employment in textile manufacturers based on cheap labour, low skills, and rudimentary technology, and produced exclusively for export to the United States under its Africa Growth and Opportunity Act (AGOA), which opens up some aspects of that country's market for certain categories of goods produced in African countries. Thus, if it is to eliminate the earnings disparities and imbalances that permeate SACU, the envisaged industrial-policy harmonisation project must encapsulate alignment of labour and wages policies in the area. Also, increased trade in manufactured goods would, no doubt, be a crucial input into the harmonisation project, because this would create mutual dependence, and hence foster the co-operation that is the root of harmonised industrial policies.

That said, the 2002 SACU agreement is, according to one analyst, on its part unprepared for the tasks that it has set itself, one indication of this being that it has as yet no institutional base or really new strategies. Its current bodies are representatives of their own governments as per the provisions of the agreement. Moreover, the management of the union rests solely with the Republic of South Africa, despite the fact that this is implicitly a collective responsibility of its members (Erasmus 2005: 127–9). The 2002 SACU agreement has yet, as provided for in article 14.3, to assist member states with the establishment of common procedures, bodies, institutions, and technical capacity to ensure effective, efficient, and transparent functioning of national bodies (ibid: 129). But it should be noted that it is yet unclear what these bodies will be, and whether they are to be replicated in each of the member states, or organised in a single structure. In fact, this boils down to the issue of the lack of precise definitions, procedures, and standards alluded to by the agreement. Therefore, the need for harmonising the industrial policies, strategies, and the procedures for implementing them, and the opportunities offered by them, are not clearly discernible, and are perhaps inadequately articulated in the agreement. Indications are that there is no progress in this respect in Lesotho; nothing seems to be moving in the direction of tampering with its present industrial policy. There is no indication either of any processes that might be seen as constituting the drive towards the harmonisation that is desired, according to the 2002 SACU Agreement

Concluding remarks

The Southern African Customs Union Agreement of 2002 will not in itself lead to harmony in industrial policies of member states. A range of actions is needed to achieve this. This includes transforming SACU from being a solely tariffs- and duty-levying machine, albeit composed of economically unequal but competing states, into a common market and/or an economic bloc, while retaining its revenue and duty-levying functions. Its present character, and the fact that there is as yet a lack of movement towards setting up bodies that would initiate and guide the process of harmonising the SACU industrial policies, tempts one to conclude that such harmonisation and its presumed benefits are, for now, a distant dream.

Transformed into a common market or economic bloc, SACU would generate revenue for its constituent states, while providing a market for goods by firms located and producing within its individual member countries. With this type of SACU, member countries would pool rather than compete for resources, including international capital, of which the effect to date has been a polarisation of development, industrial, labour, and social policies, as capital owners negotiate differing agreements with host SACU countries. While Lesotho has been the most attractive location for the Chinese textile manufacturing firms, for example, it remains a low-wage economy, with these firms having little impact on the country's tax base and living standards. It would thus benefit greatly from the harmonised industrial policies in terms of its wages and incomes policy being more or less at par with the rest in the SACU area. This would also minimise competition for investment capital with the industrial power, the Republic of South Africa, thus releasing resources needed for the industrialisation of the kingdom.

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Development integration and industrial policy in SACU: the case of Namibia

Jonathan Adongo

Regional integration is achieved along various dimensions, such as the economic, political, social, and cultural. Economic integration involves liberalisation, or the reduction of economic discrimination among economic units. It can be achieved by the progressive elimination of trade and tariff discrimination between national borders (Adetula 2004); co-ordination of macroeconomic instruments, which is referred to as macroeconomic convergence; or efforts to achieve balanced development, which is referred to as long-run convergence.

The overall aim of regional integration as a policy instrument is to achieve development. The objective of this paper is to present the experience of the Southern African Customs Union (SACU) in attempting to achieve development integration, which is captured in the concept of long-run convergence through industrial policy harmonisation. The paper will then discuss industrial policy in Namibia as a member of SACU.

The rest of this paper will be organised as follows: the first section below will present the development integration experience in SACU. The central sections of the paper will describe industrial policy in Namibia, and discuss various positive aspects, challenges and opportunities that are relevant to the SACU industrial policy harmonisation initiative. The final section will present the conclusions.

Development integration in SACU

The 1969 SACU agreement was based on a dispensation that was managed unilaterally by South Africa, and in which the smaller economies of Botswana, Lesotho, Namibia, and Swaziland (BLNS) were compensated for both their lack of participation in decision making, and asymmetry effects. It was hoped that this arrangement would cater to the needs of the bloc. This section assesses whether development integration, represented by long-run convergence, was achieved in SACU over the period from 1991 to 2003. This represents a dynamic period in Southern Africa, which included the independence of Namibia, and, in 1994, the end of the apartheid regime in South Africa, which resulted in sanctions being lifted and allowed the country to pursue unhindered participation in economic activities in the region.

Long-run convergence is represented by conditional convergence (also known as catch-up, club or beta [ß] convergence). It is defined as a situation in which each country has its own long-run per capita gross domestic product (GDP) or steady-state growth path, and tends more rapidly towards it, the greater the gap between initial GDP per capita and its own steady state. If long-run convergence is to occur, low GDP per capita countries must grow faster than high GDP per capita countries, implying a negative correlation between the initial per capita GDP level, and a country's subsequent growth rate; that is, a downward sloping plot of average GDP growth rates on initial GDP per capita indicates long-run convergence.

Long-run convergence indicators

Although the most common indicator for long-run convergence is per capita GDP, it can also be proxied by certain structural variables that cause differences in steady states such as gross school enrolment, savings rates, birth rates, and the available technology (internet, mobile phones). These variables aim to capture initial human-capital endowments, and progress towards the steady-state value of the level of output per effective worker and the rate of technological progress.

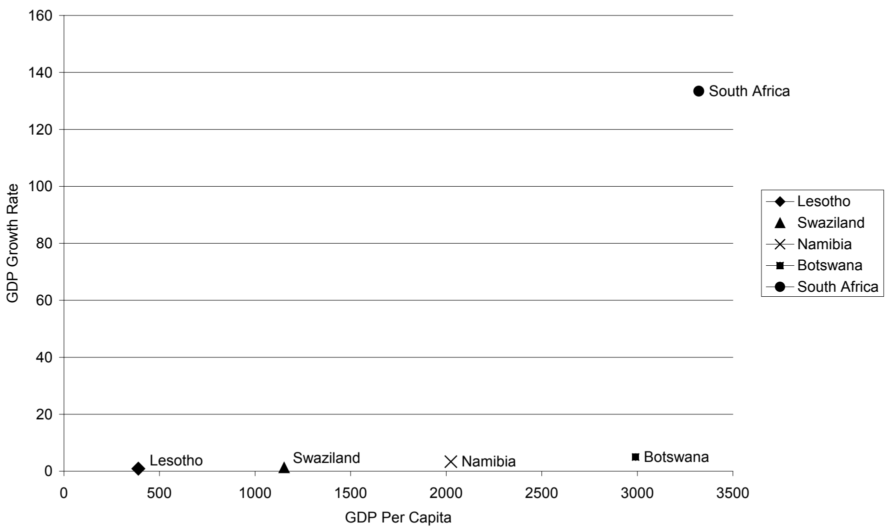
Source: Barro & Sala-i-Martin 1992

The method used to estimate long-run convergence is subject to various limitations. It collapses several dynamic processes into a single summary statistic. In addition, its assumption that each country has a steady-state growth path is not supported by the data. Also, if the relative purchasing-power parity does not hold across the specified countries, then the growth rates of real per capita income will be inaccurately measured. Keeping these limitations in mind, the long-run convergence for SACU is depicted in figure 1.

The picture is unclear because South Africa is an outlier. Therefore, we remove it from the plot to see clearly whether long-run convergence is occurring among the BLNS states. Based on the per capita incomes indicator, figure 2 indicates that SACU does not seem to be experiencing long-run convergence, and may actually be experiencing long-run divergence. Lesotho, which has the lowest initial GDP per capita, registered the lowest GDP growth rate from 1991 to 2003.

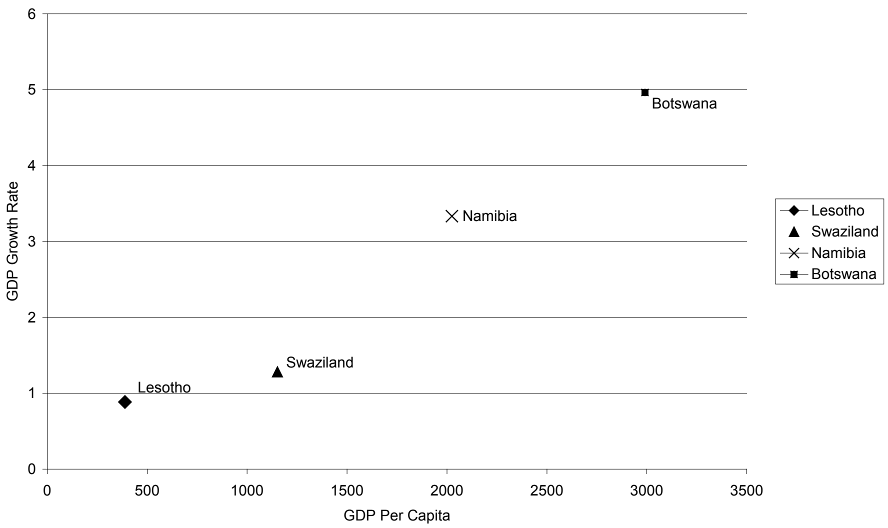
Therefore, it can be concluded that the 1969 SACU agreement, which relied on fiscal transfers, was not effective in achieving balanced development among its members. In recognition of this, the 2002 SACU agreement attempted to address the need to ensure benefits for bloc members.

Figure 1: Average GDP growth rate from 1991–2003 against 1991 GDP per capita for SACU



Source: IMF Database, http://www.imf.org/external/pubs/ft/weo/2004/02/data/dbginim.cfm

Figure 2: Average GDP growth rate from 1991–2003 against 1991 GDP per capita for SACU (excluding South Africa)



Source: IMF Database, http://www.imf.org/external/pubs/ft/weo/2004/02/data/dbginim.cfm

To achieve long-run convergence, article 38 of the 2002 SACU agreement states that common policies aimed at balanced development are to be adopted in at least four areas: industrial development, agriculture, competition, and unfair trade practices. In addition, it requires SACU members to agree on a joint industry policy (SACU 2002).

Industrial policy

Industrial policy refers to policies affecting the industrial sector. In the widest sense, every government has an industrial policy, since it intervenes to shape its economy's productive structure, by default or design (Shapiro & Taylor 1990). In a narrower sense, industrial policy is defined as directed public interventions at the sectoral or firm level, aimed at stimulating lines of economic endeavour by restructuring or promoting the activities of particular firms or sectors (Dietrich 1992).

Lall (1994) distinguishes three different approaches to industrial policy: the 'pure' neo-liberal or market-failure approach; the moderate neo-liberal, market-friendly, or Austrian approach; and the 'structuralist' or industrial-strategy approach. They are based on the same corpus of neo-classical economics; their difference lies in the assumptions that are made about how markets function in developing countries, governments' capability in coping with market failures (where these exist), and what we can learn from the East Asian model.

The part played by policies directly concerned with industry is hotly debated. The debate on industrial policy should be seen as a part of – and an exemplification of – the wider ideological controversy about the role of states and markets between neo-liberals and their critics. At the one extreme are those who see industrial policy as vital to industrial growth (for example, Lall 1994), and at the other are those who see industrial policy as at best irrelevant, or even counterproductive (for example, Siebert & Koop 1990).

Industrial policy in Namibia

Namibia is characterised by a small, open economy; dry, desert climate; a thinly dispersed population; and a highly unequal income distribution (all of which result in a small domestic market); as well as abundant natural resources; good infrastructure; and a relatively young state bureaucracy. A summary of its key features compared to some East Asian 'tigers' is provided in table 6 below.

In 1992, Namibia's Ministry of Trade and Industry (MTI) adopted a white paper on industrial development (MTI 1992). This outlined a pattern of industrialisation that can be compared to that pursued by Taiwan in the 1960s, where export-processing zones (EPZs) and support of small and medium enterprises (SMEs) were advocated in a small, open economy. Specifically, the government expects its industrial development to result in increased value added in manufacturing and service industries; forward and backward linkages in the industrial sectors; share of manufactured products in total exports; product and export-market diversification; and competitiveness through increased productivity and quality.

Table 6: Summary of the Namibian economy relative to selected East Asian countries

Indicator	Namibia	South Korea	Malaysia	Singapore	Hong Kong
2004 population (millions)	2	48	25	4	7
2004 GNP per capita (US$)	2 380	14 000	4 520	24 760	26 660
2003–2004 GDP growth (%)	6	4,6	7,1	8,4	8,1
Percentage share of income, highest 10% of population	64,5	22,5	38,4	32,8	34,9
2004 net savings (% of gross national income [GNI])	28,1	20,9	24,6	31,7	17,9
2000–2004 industry growth rate (%)	7,3	6,2	4,2	1,2	(3,6)
2000–2004 gross capital formation (average annual % growth)	12,3	3,4	1,4	(10,9)	0,1
2004 life expectancy at birth (years) – male/female	47/48	74/81	71/76	77/81	79/85
2002 manufacturing value added (millions)	314	129 449	29 095	22 942	7 033

Source: World Bank 2006

Note: Data on Taiwan is not reported separately from China

The expectation in Namibia was that the industrialisation framework was to be revised from time to time, in response to changing circumstances. In 1998 the MTI reviewed the white paper, and found some shortcomings that necessitated a review of the country's industrial policy (MTI 1999). An attempt to conduct this review was embarked on in 2003 by the Namibian Economic Policy Research Unit (NEPRU), which resulted in a document titled 'Second industrial policy and strategies', which is under consideration by the MTI. Therefore, Namibia still relies on the 1992 white paper to guide its industrialisation efforts.

The rest of this paper will highlight positive aspects that support industrial policy in Namibia, various challenges that may hinder its success on a within-country level, and opportunities that exist.

Positive aspects

For industrial policy to succeed, some essential prerequisites are needed. These include favourable initial conditions in a country before industrial take-off; favourable world-market conditions (such as access to markets and capital); and a generally conservative macroeconomic policy, emphasising fiscal stability.

This section will focus on the prerequisites that currently exist in Namibia, including macroeconomic stability, adequate financing, labour-market stability, and good infrastructure. Finally, it will explain how Namibia can benefit from the lessons learnt in industrialisation efforts of the 1960s and 1970s.

Macroeconomic stability

In addition to stability, democracy, rule of law, etc, a precondition for the success of microeconomic reform, which is pursued in industrialisation efforts, is having a stable macroeconomic environment, because it influences the productivity of investment projects (Rodrik 1993). As opposed to internal balance (full employment and price stability) and external balance (balance of payments equilibrium), it is adequate to have a relatively high quality of macroeconomic management.

Through its membership in the Common Monetary Area (CMA), which determines monetary and exchange rate policy for all SACU members except Botswana, and fiscal-policy targeting by its government, Namibia has managed to benefit from relative macroeconomic stability measured by its fiscal deficit, inflation, exchange rate, interest rate, and public debt levels. Table 7 below, which depicts various fiscal policy variables, shows that they seem to be tethered to the targets set by the government, even though there has not been strict adherence to the guidelines, which is expected in practice.

Table 7: Government's fiscal targets and actual outcomes

Indicator	Target	2001/2 Actual	2002/3 Actual	2003/4 Actual	2004/5 Actual	2005/6 Actual	2006/7 Estimate
Debt as % of GDP	25	26,2	25	31	34,2	32,4	35,6
Deficit as % GDP	3	4,2	2,6	7,5	3,6	1,1	–0,3
Expenditure, % of GDP	30	36	35,9	37,1	33,8	32,3	33,7

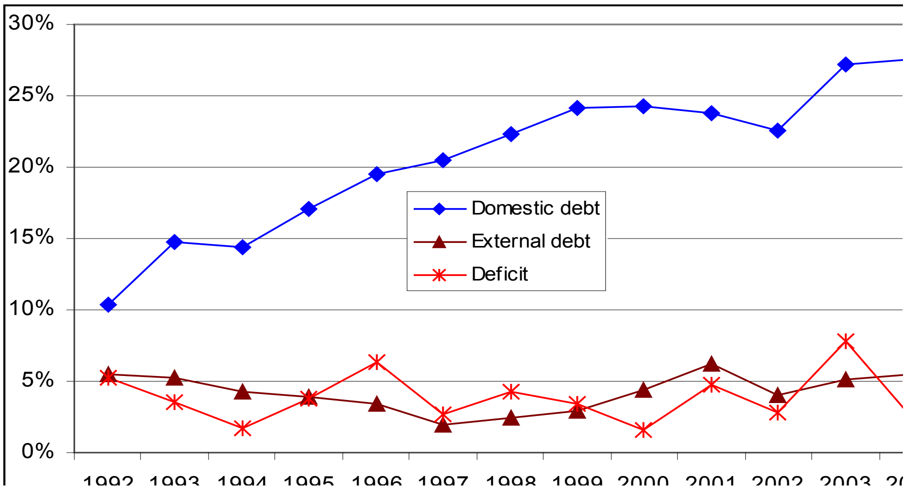
Source: Ministry of Finance (2001/2002–2005/2008)

Adequate domestic financing

Capital is an essential factor of production. Lack of, or inadequate, financing for large and small firms to accumulate capital and finance productivity can hinder industrial policy success.

Namibia is one of the few African countries that have surplus finance available for investment due to its high level of contractual savings. As a result, it has limited its level of external debt relative to domestic debt to a minimum. This is illustrated in figure 3, which displays the trends in domestic debt, external debt, and budget deficit in Namibia from 1992 to 2004, all expressed as percentages of GDP. Due to this low level of external debt, Namibia is avoiding the main source of risk that caused the 1980s debt crisis in developing countries that attempted to replicate the East Asian industrial strategies of the 1960s and 1970s.

Figure 3: External debt, domestic debt and budget deficit, % of GDP, 1992–2004



Source: Ministry of Finance

Despite adequate financing for investment, small firms face inherent barriers to financing that large firms can avoid, due to their access to foreign sources of financing. Furthermore, this is more pronounced in small firms located in rural, relative to those in urban, areas.

In recent times the suasion by policy-makers and donors on financial services for the unbanked in Namibia has resulted in the introduction of new financial products that should increase the access of small firms in both urban and rural areas to finance. In addition, the Development Bank of Namibia has provided funding for small firms, which is channelled through commercial banks such as Bank Windhoek.

Trade union stability

To the extent that trade unions are monopoly sellers of labour, they can limit innovation and distort the allocation of resources, resulting in inefficiency. This can hinder the success of industrial policy. Therefore, the relationship between trade unions and employer federations needs to be good, and based on trust and sound knowledge of the environment in which each partner is operating. This will help reduce labour disputes and conflicts.

Namibia's 1992 and 2004 labour acts were specifically designed to address the relationship between trade unions and employers. In addition to labour courts, institutions such as the Labour Advisory Council and the Office of the Labour Commissioner were established to consult with various stakeholders, provide advice on labour issues, and mediate in conflicts.

Good infrastructure

Good transport infrastructure, such as roads, railway lines, sea ports, and airports, needs to be in place to increase the chances of success for industrial policy, especially non-autarkic industrial policy. Since independence, the Namibian government has invested large amounts of money in a wide range of infrastructure. This includes road networks, for example, the Trans-Kalahari and Trans-Caprivi highways, and the Walvis Bay Corridor Group, which is an example of a successful public-private partnership that promotes the use of Walvis Bay, and the development of transport corridors through Namibia. Furthermore, the government has outsourced some service provision related to the transport infrastructure to increase efficiency and flexibility. This has resulted in Namibia ranking at quite a competitive level in infrastructure availability, compared to other countries in sub-Saharan Africa.

However, it is not only the availability of infrastructure that counts, but also its reliability and price competitiveness. Unfortunately, Namibia's rankings are not as impressive in this arena. Due to its reliance on electricity from South Africa, the increasing demand for power in South Africa has left Namibia vulnerable to the risk of power fluctuations. This could adversely affect cold-storage facilities, which are important for the preservation of perishable products such as grapes, dates, asparagus, meat, and fish. Also, Namibia is widely arid to semi-arid; therefore, water, which is important for industries such as textiles, is a scarce resource in the country. Finally, the telecommunication services are costly relative to Botswana and South Africa, as illustrated in table 8 below.

Table 8: Call cost ratios

	Telecom Namibia	Botswana Telecom	Telkom SA
Local	1,15	0,91	1,00
Zimbabwe	1,40	1,02	1,00
Angola	2,09	1,37	1,00
Germany	2,40	1,44	1,00
United Kingdom	2,53	1,69	1,00
United States	2,53	1,55	1,00

Source: Nepembe, Shilimela, & Deen-Swarray 2006

Note: based on 2005 tariff lists on websites of respective telecom companies

Lessons learnt from the East Asian experience

Industrial policy in developing countries is inspired by the transformation strategies of the East Asian 'tigers' in the 1960s, a period that is commonly referred to as the 'East Asian miracle'. This has led to industrialisation strategies whose common issues are summarised in table 9.

Table 9: Common issues in East Asian industrialisation

Common issue	Explanation
Education	Similar pattern of early and rapid increases in enrolment rates; emphasis on vocational, scientific, and engineering training; emphasis on capacity-building in areas useful to industry
Housing and health care	Considered important in maintaining a productive labour force; subsidies and expansion of basic health care and housing
Infrastructure	Heavy direct and early involvement of government in this area
Agriculture	Provision of inputs, procurement and pricing, land reform; significant levels of public investment; general subservience of agriculture to industry in early stages of industrialisation
Trade policy	Export protection as a product of heavy promotion
Credit and finance	Subsidised interest rates on the investment side; loan recipients allocated to priority sectors.

Source: Stein 1995

According to the World Bank (1993), the East Asian countries had many common elements in their industrial development. These included sound macroeconomic management; a good initial base of human capital; high rates of saving and investment, which financed investments in the hardware and software of learning; stable and predictable incentive frameworks for investment; administrative and institutional capital, both necessary to making markets work better and to mounting effective policies; close and continuous dialogue between the public and private sector; close monitoring of granted privileges; strong export orientation; the use of 'contests' to monitor performance and to ensure that favours were returned; being near Japan, which became the world's most dynamic region; the Chinese revolution, which created a large pool of entrepreneurs; and close interaction and learning from each other, which resulted in them gaining from spillovers of a favourable investment image.

As they embark on their individual and joint industrial policy design and implementation efforts, Namibia and SACU can draw on these experiences, as well as on the mistakes made by developing countries that attempted to replicate these transformation strategies, which led to the 1980s debt crisis.

Challenges

The success of industrial policy in Namibia is hindered by various constraints, which can be distinguished as SACU-wide or within-country issues. This section will focus on within-country issues specific to Namibia.

The resource curse

Traditionally, industrialisation is measured as trade in manufacturing or merchandise. The focus on manufacturing is important, because it can accommodate labour-intensive production methods and has unique growth inducing characteristics.[1]

Of 439 manufacturing enterprises interviewed in Namibia in 2000/01, 34 per cent were involved in the food, beverages, and tobacco sector, 18 per cent in basic metal and fabricated metal products, 12 per cent in wood products, and 10 per cent in non-metal mineral products and chemical products. A draft report of the 1999/2000 manufacturing census in Namibia revealed that the share of businesses involved in chemicals, rubber, and plastic production, as well as in wood production, increased from the 1995 level, while the share of food, beverage, and tobacco-processing companies declined. In addition, the manufacturing sector employed almost 24 000 people in 2000, compared to 14 000 in 1993, and 9 000 in 1989. Also, the majority of job creation occurred in the food, beverage, and tobacco subsector, with the employment of women increasing from 18 per cent to 30 per cent between 1993 and 2000.

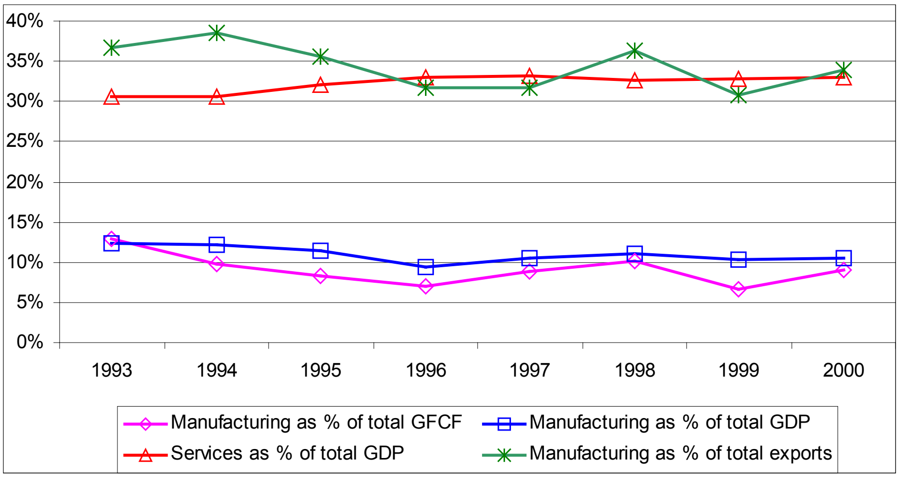
Despite the desirability of manufacturing, the natural-resource extraction industries, for example, the diamond, fishing and cattle-ranching sectors, control production in the Namibian economy. These do not use labour-intensive production methods. Therefore, Namibia is affected by the resource curse thesis, which affects countries rich in natural resources (Auty 1995). This thesis argues that when a country has a favourable natural-resource base, there is less pressure to achieve rapid industrial maturation, poor macro policies are tolerated longer, rent-seeking groups are tolerated for a longer period and become more entrenched, and there is a greater likelihood of decelerating and erratic economic growth.

In Namibia, the first point in the resource curse thesis is evidenced by a decrease in the manufacturing sector as a share of GDP, from 12,3 per cent to 10,5 per cent, and as a share of total exports from 37 per cent to 34 per cent, between 1993 and 2000. This is depicted in figure 4.

In addition, the share of investments directed towards the manufacturing sector declined from 13 per cent to 9 per cent between 1993 and 2000. Furthermore, capital investment to the sector as a ratio of compensation for employees has increased from 55 per cent in 1995 to 84 per cent in 2000, which implies that investors opt for a higher degree of mechanisation, much to the detriment of employment.

Therefore, Namibia can be said to be experiencing deindustrialisation, which occurs when there is a decline in the manufacturing industry. It is undesirable to the extent that it results in rising unemployment, if the rise in other sectors is insufficient to absorb the labour shed by manufacturing.

Figure 4: Role of the manufacturing sectors in Namibia's economy in %, 1993–2000



Source: Central Bureau of Statistics 2001, National Accounts 1993–2000

* GFCF* – gross fixed capital formation

The view of industrialisation as consisting of a structural shift in production and employment to manufacturing is criticised as early thinking, because it implies a negatively biased view of the potential of other sectors, which is not necessarily supported by evidence (Ewing 1968). Brown and Deanne (1993) show that manufacturing jobs do not necessarily have higher wages and productivity than other sectors, which also produce other externalities. Therefore, it is argued that focusing solely on manufacturing reflects a negative industrialisation approach because it moves resources away from particular activities, for example, those which it is believed are becoming obsolete. A more positive approach to industrial policy should concentrate on encouraging new industries, products, or processes alongside traditional growth sectors.

With the dominance of the natural-resource industry, most of the manufacturing enterprises in Namibia derive inputs from the agricultural and mining sectors. This exposes them to fluctuating climatic and environmental conditions. Also, exports continue to be dominated by unprocessed or semi-processed agricultural and mineral products.

One main issue in countries whose production structure relies on a few sectors is the extent to which market-allocation mechanisms could be relied upon to achieve investment and diversification of production (Dervis & Page 1984). In light of this, Namibia is actively promoting industrialisation strategies that are based on forward and backward linkages from the natural-resource-based industries. This includes activities such as the processing of minerals and the cutting and polishing of gems and semi-precious stones, which are commonly referred to as beneficiation and value-addition activities. An example of this is described below.

Industrial policy in the Namibia"s diamond sector

The original Diamond Act inhibited the processing of diamonds in the country. A new Diamond Act opened the door for the diamond-cutting and -polishing industry. The act provides incentives for selling diamopnds mined in Namibia directly to the processing industry in the country by exempting these diamonds from the 10 per cent diamond royalty. Since the implementation of the act, several companies have started businesses, providing jobs, and supplied the local jewellery market with cut diamonds. However, owing to NamDeb's policy of selling all its diamonds through the Diamond Trading Company in London, and since other producers can currently not provide a sufficient supply to the local cutting and polishing industry, diamonds are purchased from international markets.

Such a strategy is seen in countries that have heavy and chemical industry (HCI), which comprises base metals, non-metallic minerals, chemicals, engineering, and machinery. Neo-liberals argue that industrial policy that focuses on HCI is high risk, because it commits large amounts of capital to a relatively small number of projects, and forgoes the risk-reducing benefits that a more diversified portfolio of smaller industrial investments affords; there is a lengthy gestation requirement and long payback period for most HCI investments, because demand may change radically from that on which the initial investment decision was based; and HCI projects tend to be technologically complex, requiring the co-ordination of numerous linked investments in both infrastructure and projects.

Skills and education

Industrial policies in developing countries place emphasis on foreign direct investment (FDI) as a channel that can be relied on to attain their goals. This is because it can introduce modern technology into local production, and is expected to spread the knowledge of its use and maintenance. However, technology is non-tradable, and cannot simply be transferred to a developing country like a physical product. This is because knowledge in a communicable form is quite distinct from the capability to make effective use of it. Therefore, a country can only achieve technical diffusion from FDI if there is a minimum level of technological capability.

Technological capability is defined as the ability to make effective use of technological knowledge (Pack & Westphal 1986). It consists of firm-specific, institutional knowledge made up of individual skills and experience accumulated over time in technical, managerial, and organisational areas. It is not the same as 'innovation', which takes place at the frontier of technology, but covers a much broader range of effort that every enterprise must undertake to access, implement, absorb, and build upon the knowledge required in production. As the industrial sector grows more complex and sophisticated, there is a need for a higher level of technological capability, which requires a more qualified labour force.

Temple (1997) raises the argument that the initial conditions found in East Asian economies favoured their industrial development. Taiwan and Korea had 'a level of socio-economic development, education … and institutional quality far ahead of other countries with similar per capita income levels' (ibid).

Table 10 shows educational patterns among the East Asian 'tigers' compared to SACU member countries. It illustrates that SACU members lack skilled human resources relative to their East Asian counterparts.

Due to socio-political factors in Namibia's history that can be attributed to its colonial regime, the majority of Namibia's workforce consists mainly of unskilled labour. With a modicum of skills, infrastructure, and cheap labour, simple labour-intensive activities will start up. However, upgrading to more complex and demanding technologies may be limited, because the more dynamic and beneficial areas of manufacturing are knowledge-intensive rather than material-intensive. In addition, a threat to productivity and a skilled workforce in Namibia is the HIV/AIDS pandemic.

Skills development is important for technological absorption and diffusion. In the process of industrial development, institutions and firms become more conscious of the need for skills development and training. However, given the complexity of the information involved, the long-term nature of investment in skills, and the inherent externalities, purely market-driven sources may fail to keep up with skill needs. Therefore, interventions can be introduced to overcome learning costs to alleviate this situation. Technologies are constantly changing, and differ in their learning needs, therefore interventions cannot be functional, they have to be selective.

Table 10: Educational patterns in East Asia vs SACU

	Namibia	Botswana	Lesotho	Swaziland	South Africa	Hong Kong	Malaysia	South Korea	Singapore
2004 Primary completion rate (%)	81	92	71	61	–	111	95	105	–
2004 Labour force (millions)	0,6	0,6	0,6	0,3	19,1	3,6	10,7	24,1	2,2
2004 Public expenditure on education (% of GDP)	7,2	–	9	6,2	5,4	4,7	8,1	4,2	–
2004 Gross pre-primary enrolment ratio (% of relevant age group)	29	–	31	–	33	70	99	87	–
2004 Gross enrolment ratio primary (% of relevant age group)	101	104	131	101	105	108	93	105	–
2004 Gross secondary enrolment ratio (% of relevant age group)	58	74	36	42	90	85	70	91	–
2004 Gross tertiary enrolment ratio (% of relevant age group)	6	6	3	4	15	32	29	89	–

Source: World Bank 2006

Note: Data on Taiwan is not reported separately from China

Selective intervention involves skills development and capability formation. Skills development means formal education and training (including that provided in firms). Capability formation means the development of skills and knowledge derived from technological and managerial effort (both formal, in the form of research and development [R&D], and informal).

At low levels of industrial development, the focus is on raising the quantity and quality of primary schooling and basic technical education, and encouraging all firm training. At higher levels, there has to be greater emphasis on high-level, specialised training, with close interaction between education and production. This is a more difficult process, and many developed economies worry about the quality and content of their educational structures.

In addition, knowledge about local circumstances is tacit, and because foreign agents may have their own distinct strategies, appropriate local strategies may not be identified or implemented by foreign agents. This gives a sound economic justification for favouring the development of technological capabilities by agents under local control (Pack & Westphal 1986).

Namibia has articulated in various fora the important role education plays in its development goals. Recently the government launched an Education and Training Sector Improvement Programme (ETSIP). This is a broad framework that encompasses the vision and implementation of the strategy that the Namibian government will embark on to develop and train its skills base.

Due to its small population, the absolute number of the labour force is low compared to the number required for an effective industrial policy in Namibia. To reduce this source of risk, it has been argued that skills can be attracted from outside. This is similar to the East Asian experience where, among other countries, Singapore embarked on a deliberate effort to attract expertise from outside its borders, which resulted in its industry being boosted by a large number of R&D scientists and engineers that they did not previously have. However, the Chinese revolution that created a large pool of entrepreneurs in countries such as Taiwan cannot be replicated, and more innovative solutions need to be explored.

Since the structure of the Namibian economy is based on natural-resource industries that are capital intensive, efforts to increase labour intensity are required. These include the removal of obstacles to labour-market flexibility; maintaining an appropriate cost of capital to discourage excessive capital intensity, while permitting investments for job creation in the newly competitive spheres; recognising the economic and social costs of unemployment when designing exchange-rate and fiscal strategies; and the design of a commercial policy in line with comparative advantage, as dictated, in part, by the skills structure of the labour force (Lucas 1997).

Intervention in boosting the quality of Namibia's labour force will be complicated, because a firm's ability to capture benefits is highly uncertain due to various externalities. For instance, a worker trained by one firm may go to work for a competitor, so firms will tend to concentrate on training specific to the firm, when what is needed are skills that benefit the whole economy (Pack & Westphal 1986). In addition, efforts to reduce the difference between vocational and academic institutions are challenging, because there is a large opportunity cost in training people to a high level of skills, since these are usually the people who are already well educated, and whose time is expensive. This creates a lack of clarity on who should pay for the training.

Neo-classical economists argue that individuals should pay for the training if it benefits them, and employers if they derive benefit, with the role of the state being minimal. Interventionists argue that the market fails due to negative externalities, resulting in individuals not paying for training because they lack knowledge of the labour market, and the financial market does not function well in this area because lenders are unwilling to provide funds for credit because borrowers have little collateral to offer.

Property rights

The success of industrial policy also depends on confidence in property rights. Both domestic and foreign investors need land, unserviced or serviced, to set up production plants. To invest substantial amounts they need confidence that their ownership or leasing rights will be upheld by courts or other arbitrators. Small firms can often use land or the buildings and immovable assets on them as collateral.

Where land rights are not entrenched in the individual, this is a barrier to access to capital. The validity of contracts is based on existing contract law, the avenues that exist to redress grievances, and whether judgements are passed in a timely and fair manner. Finally, innovation requires that patent rights and intellectual property rights exist to encourage R&D activities.

Unequal access to land in Namibia creates the need for land reform. Using a willing buyer–willing seller strategy, this is being addressed through various land-reform initiatives. However, the main area where property rights are weak in Namibia is in the communal land system. Customary tenure gives no guarantee against land expropriation. The country must implement solutions to solve this situation.

FDI through multinational companies can circumvent these legal obstacles, mainly because these firms have internalised, intermediate markets for capital, skills, and technology. Based on this advantage, one can advocate that multinational companies may be an effective means of launching industrialisation because they are effective where technologies are changing rapidly, production is tightly linked across nations, and market access is difficult for new entrants. However, such a strategy should not be pursued while neglecting the need to address the pre-existing constraints in the legal environment, which affect smaller firms that are limited to the local market.

Autarkic vs non-autarkic industrial policy

Neo-classical trade theory predicts gains for all countries that engage in free trade under conditions of identical factor endowments, perfect competition, and constant returns to scale. Ben-David (1994) demonstrates the assumption that trade is the main mechanism through which convergence occurs, and presents convincing evidence that increasing mutual trade among affluent countries leads to long-run convergence. In light of these findings, contemporary industrial policy is increasingly outward-oriented, when compared to earlier approaches that concentrated on incentives for import substitution and other inward-oriented development strategies (Dervis & Page 1984).

An outward-oriented industrial policy is increasingly necessary because internationally, the trade protection walls have crumbled dramatically in the post-war rounds of trade liberalisation. Because the very low customs do not constitute any significant protection, their complete abolition is being discussed.

The advantages of an outward orientation are increasingly recognised. It often accompanies more equitable income distribution, higher growth, superior economic performance, faster industrialisation, and greater employment growth (World Bank 1993). This arises because the economic liberalisation that is a key component of this outward orientation reduces static inefficiencies arising from resource misallocation and waste; enhances learning, technological change, and economic growth; increases the ability of the economy to cope with adverse external shocks; and is less prone to wasteful rent-seeking activities (Rodrik 1993). Also, the promotion of trade creates a realistically competitive environment for entrepreneurs to gain experience in running their own business, and to become successful merchants. Furthermore, it allows the manufacturing sector to benefit from links to various markets to source cheap but quality inputs and explore new export markets.

Economists increasingly emphasise the existence of increasing returns to scale, external economies, and imperfect competition (Krugman 1986). With these pre-conditions, trade allows firms to benefit from a larger market where domestic markets are small. With the increasing returns to scale, average production cost falls when output expands. This allows firms to expand production at the cost of competitors by producing more than they would in a market that can only support a limited number of producers. However, in such an imperfect market, production does not respond continuously to price movements or to shifts in demand. Although contemporary industrial policy is averse to import-substitution methods, some faults are erroneously attributed to them, which arise not from the misallocation of resources between alternatives, or inefficiencies arising from such misallocation, but from inefficient use of resources (Streeten 1982).

Several qualifications of the superiority of outward orientation have to be made. The magnitude of the reductions in static inefficiencies is not clear; the analytical foundations of the links among liberalisation, learning, technological change, and economic growth are also not too clear; there is no clear understanding of how and why certain configurations of economic policy render the economy more resilient to external shocks than others; and, finally, while costs may be genuinely immense, it does not follow that a correction of price distortions and a move to outward orientation necessarily eliminates them (Rodrik 1993). On a theoretical level, it has been pointed out that no a priori case for either an open or a closed trade-policy regime can be made. It has also been shown that outward orientation does not necessarily mean less government intervention.

Export growth is important, but more as a factor that facilitates a growth process derived from the expansion and nature of the supply side of the economy. Gaulier (2003) argues that other aspects of openness that are strongly correlated with trade, for example, FDI, may be the underlying causes of the positive growth and trade relationship.

Industrial policy in Namibia is outward oriented, with established links to export markets such as South Africa, the EU, and North America. Although trade is important for increasing growth in exports, one needs a capacity to produce tradable goods. A key issue in Namibia is that most of its imports are finished goods from South Africa. This puts pressure on domestic producers of similar goods, who find it difficult to locate markets for their products. This creates an incentive to pursue import-substitution strategies to support efforts to identify products for the domestic market that could replace imports in some areas, such as perishable agricultural produce. The focus here is on the protection of infant industries, which is historically one of the most popular and effective means of selective intervention.

The evidence on the success of investment promotion based on the infant-industry argument, for example, on total productivity growth, is mixed (World Bank 1993). Also, infant industry protection can be a dangerous tool. Apart from the cost it imposes on consumers, it dilutes the incentive to invest in capability development, the very process it is meant to foster. Firms are very sensitive to competitive pressures in deciding to invest in capabilities, and the protection offered in typical import-substituting regimes tended to detract from costly and lengthy investments in competitive skills and knowledge. To reduce these risks, firms can be offered limited protection; performance requirements can be imposed; or early entry into export markets, while maintaining domestic protection, can be enforced. The last has the added advantage that it taps the information externalities of export activity, and was the option used by the larger East Asian countries. The SACU agreement includes an infant-industry clause that provides for protection. However, it requires a clear schedule of phasing out the protection, which eliminates the risk of a sustained subsidy on domestic producers.

Trade policy is a key instrument in industrialisation to support an export-oriented strategy. It can be used to support efforts to diversify not only the export patterns, but also the patterns of manufacturing activities. Although Namibia has no explicit trade policy, the outward-oriented principle is implemented in various other policies and programmes that focus on trade and investment promotion.

Namibia's trade-promotion targets were captured in its second National Development Plan (NDP), which ran from 2000 to 2005. Over this period, the country aimed to finalise the SACU negotiations by 2001; implement the Southern African Development Community (SADC) and Common Market for East and Southern Africa (COMESA) free-trade areas by 2001;

double Namibia's share of intra-regional trade; increase the number of beneficiaries of the export development strategy as from 2001; streamline the import and export management regime by 2001; set up a representational office to the WTO in Geneva by 2001; establish a quality control and standardisation body by 2001; computerise the companies, close corporations, patents, trademarks, and designs registration system by 2001; conform to all agreement on trade-related aspects of intellectual property rights (TRIPS) obligations by 2001; and enact the Industrial Property Act and Competition Law by 2001. Some of these goals were not achieved because they were beyond the country's own control, for example, the pace of liberalisation of SADC and COMESA.

Investment-promotion targets were also captured in NDP2. Over this period the country aimed to increase its present level of FDI to 50 per cent by 2006; increase the present level of domestic investment to 30 per cent by 2006; increase the present number of investors and investments into EPZs by 20 per cent by 2006; increase the number of companies benefiting from incentives for manufacturers and exporters of manufactured goods to 50 per cent by 2006; and establish at least three new commercial offices abroad by 2006.

Trade-promotion programmes and activities rely on exploring new export destinations for Namibian products. Investment promotion relies on incentives to attract FDI, including tax and non-tax incentives, such as the Special Incentives for Manufacturers and Exporters Scheme and the EPZ scheme, which was one tool used in the industrialisation strategy of East Asian countries. For these industrial parks to work, administering and monitoring them must be transparent and effective. A review of applications for incentives under the Manufacturers and Exporters Scheme revealed that of 360 applications in Namibia since 1993, 70 per cent were still pending, while only 19 per cent were approved, and 11 per cent rejected. An additional component of Namibia's industrial policy is a focus on small enterprises, with an industrial-development programme contained in its 1997 Policy and Programme on Small Business Development. Its objectives included increasing the rate of growth of existing small businesses, reducing the rate of business failure, increasing the rate of new business formation, and diversifying the activities of the sector's businesses.

Industrial-development targets were also included in NDP2. The country aimed to complete the establishment of industrial parks with factory shells and market stalls at various regional centres and all potential economic growth points by 2006. With reference to volume 3 of the NDP2, which details the public sector investment programme, at least one industrial park was to be constructed in each region; common facility centres were to be established, where there was an identified need, by 2006; the computerisation of the activities of the MTI was to be completed by 2003; an SME group purchasing scheme was to be set up by 2002; the ozone action programme was to be completed and the provisions of the Montreal Protocol were to be implemented by 2001; an industrial census was to be completed by 2001; support services to SME operators were to be intensified; the average income of the SME sector was to increase to 10 per cent by 2006; the SME sector's contribution to GDP was to increase from 5 to 10 per cent by 2006; and the capacity of the Namibia Development Corporation (now subsumed under the Development Bank of Namibia) was to be strengthened to contribute more effectively to the implementation of the industrial development programme.

Despite this focus on small businesses, in a dynamic environment, the public sector should not waste resources on solely focusing on incentives that are conducive to a few sectors, but focus also on those that add value to the overall business climate (Hallberg 2000). This should include a focus on reducing transaction costs and uncertainty, which are key constraints for investment decisions.

Multiple membership in various trade blocs

Non-autarkic industrialisation in Namibia is complicated by the country's membership in multiple trade blocs. Besides SACU, other trade and co-operation agreements include the SADC Trade Protocol and the partnership agreement signed among the African, Caribbean, and Pacific countries and the EU (ACP–EU) in Cotonou – often referred to as the Cotonou Convention.

These have different goals and schedules of liberalisation. The SADC Trade Protocol commits member countries to reduce trade barriers over a period of eight years, starting 1 September 2000. The ACP-EU Partnership Agreement provides for non-reciprocal trading arrangements up to the year 2008. Thereafter, different options exist for member countries to proceed with trade-liberalisation negotiations with the EU. This results in the application of different standards, quality control procedures, and certification schemes, which are often a stumbling block for increased trade.

Institutions

The neo-liberal view has neglected the institutional dimension of the industrialisation process. This has to do with both the capacity of the state bureaucracy and the interaction between the state and other actors. The arguments for state intervention rest on doubts concerning the market's ability to achieve optimal results, that is, market failures. This views development as a process of dynamic, non-marginal change, and the price cannot be relied on to guide 'big' industrial decisions (Shapiro & Taylor 1990).

Developing countries, suffering massive and widespread de-industrialisation, need supportive policies that go well beyond the neo-liberal consensus. Successful industrial strategies largely work through markets. An orientation towards market forces in industrial policy does not imply a weak state. On the contrary, a strong and able state is the condition for successful economic policy in the first place. Governments can alter incentives in a way that is favourable to industrialisation. This view is supported by the experience of the East Asian 'tigers', which industrialised in a highly interventionist manner. They depended on an efficient bureaucracy, and were able to discipline the private sector. Close interaction between government and the private sector was essential.

Governments are not necessarily any better than markets. More important than various strategies has been the ability to implement them effectively and efficiently. For specific government intervention to be effective, it must be time-limited and costed prior to its inception. Appropriate intervention needs a good information basis. On the practical side, industrial policies have often constituted a package of complicated and often contradictory laws and regulations, including licensing and other quantitative restrictions, high and extremely differentiated tariff rates, export taxes, and burdensome bureaucratic requirements and paperwork on the trade-policy side; and inefficient and loss-making public enterprises, entry and exit restrictions on private enterprise, price controls, discretionary tax and subsidy policies, and soft-budget constraints on the industrial-policy side (Rodrik 1993).

Among those favouring industrial policy (‘industrial strategists’), there is neither consensus about what constitutes ‘industrial strategy’, nor agreement about which elements of industrial strategy are crucial (Pack & Westphal 1986). Any attempt to replicate the experience of the East Asian ‘tigers’ must take into account that their industrial strategy went beyond ‘remedying market failures’ in the conventional sense. The ‘tigers’ were not trying to make markets work better to achieve some static equilibrium. They were choosing among countless potential equilibria, and bending their resources to obtain the ones they had (more or less clearly) selected. The tools were not that different from those used in less successful economies – the secret lay in the combination of coherent policies, and the efficacy of their implementation through good administrative capabilities (Lall & Teuball 1998).

When making decisions concerning which industries to promote and how to do so, the East Asian governments almost always consulted extensively with the private sector, which had the relevant knowledge and possible interest in the outcome. This approach placed emphasis on the private sector, and avoided excessive interventions. Together with these important consultations, the decision-making process was a highly flexible one.

In addition, the focus of development co-operation is changing from the side of donors, with more emphasis placed on trade or public-private partnership. Also, industrial policy is conducted within the administrative and political context of decentralisation. This requires development of internal controls to ensure effective monitoring and accountability between national and sub-national levels of government.

In Namibia, the government’s role is seen as that of a facilitator of industrial development that creates an enabling environment for the private sector. The MTI is the line ministry for industrialisation, and is responsible for the co-ordination of the policy implementation. Its Directorate of Industrial Development leads the implementation of the policy, in consultation and co-ordination with other directorates, such as the Directorates of International and Internal Trade, the Namibia Investment Centre, and the Offshore Development Corporation. In addition, close co-operation with other line ministries affected, such as the Ministry of Basic Education and Higher Education and Ministry of Labour and Social Welfare, is vital. Its industrial-strategy approach involves close consultation with the private sector through existing bodies, for example, industrial and business associations. To promote efficiency in the public sector, a charter to create and increase a professional work attitude among public servants is being promoted.

Monitoring of an industrial strategy is one of the key features that contributed to the East Asian miracle. In South Korea, continuous monitoring was used to assure that exports were both privately and socially profitable (Pack & Westphal 1986). It is advocated that monitoring efforts should be co-ordinated by the Directorate of Industrial Development, through regular representative surveys and opinion polls among business people. This effort can be supported by research institutions that can conduct the surveys, and analyse and present their findings.

The case for industrial policy depends on the ability of government to design and implement the necessary interventions. If the pattern of intervention has its origins in a policy-making capacity that is often weak and fragmented, extensive intervention has various negative side-effects. It adds to the cost of doing business, entry barriers are created, economic dualism is encouraged, and incentives for arbitrage are created (directly unproductive production, rent-seeking). Central planning also faces the problems of lacking incentives and motivation. Therefore, to define, design and implement an industrial strategy would need substantial administrative knowledge and capacity on the part of government. This results in the necessity to raise government capabilities. Namibia's young public sector does not allow for large selective interventions, such as those of South Korea. Therefore, specific government intervention in Namibia in terms of industrial policy must be treated with caution. Capacity-building in skills and institutions is necessary to develop sufficient expertise in the technical and policy areas. Capacity-building on how to engage with donors and the private sector to achieve this transition effectively and smoothly is also needed. In addition, a clear definition of the role of each institution can help avoid the risk of duplicating programmes.

Also, one of the major lessons learnt from developing countries that tried to replicate that East Asian miracle, and ended up in the 1980s debt crisis, was that financial-sector regulation needs to be effective. One of the major findings of the Financial Sector Assessment Programme (FSAP) mission conducted by the World Bank and International Monetary Fund in Namibia in 2006 is that the capacity of the country's regulators of financial institutions is weak. Therefore, before any industrial policy is actively implemented, this situation has to be remedied.

Information

Firms optimise choices on production technology based upon full information on factor and product prices. The effectiveness of consultative meetings between government and various stakeholders depends on the availability of up-to-date information and data that is accurately interpreted, which ensures productive discussions and decisions.

Availability of information is becoming an increasingly crucial factor in trade and investment decisions, and affects smaller firms more than large established businesses. The new theories of both growth and foreign trade that are relied on in designing industrial strategy are good at explaining economic phenomena, but their policy application depends on a considerable amount of information on which R&D expenditures will stimulate growth; how large the external effects that are to be compensated for are; what production functions look like; how demand behaviour is characterised; what the future innovations will be; the existence of foreign suppliers to source inputs at competitive prices, and of markets for export; and domestic producers and products that can benefit from opportunities created by backward and forward linkages. Information problems adversely affect the implementation of industrial policy. Furthermore, where there is a lack of information, risk avoidance results in an informal policy-making system that often stands behind the formal structure. This results in uncertainty and unpredictability regarding rules (World Bank 1993).

The information problems point to the relevance of the theory of institutional competition. According to this theory, there is no need for complicated and comprehensive data for an efficient economic policy. When frame conditions for a functioning competition are set, optimal economic policy will result (Krieger-Boden 1995). Institutional competition is also a driving force for identity of users and payers; the internalisation of benefits and costs can be obtained by benefit taxation, user charges, other reforms of private financing, and privatisation.

One weakness identified in a review of the industrial white paper of 1992 was that business people hardly knew anything about it (MTI 1999). Recommendations to address this situation encompassed the use of the internet and government offices throughout the country, and Namibian embassies abroad, to facilitate information dissemination to the private sector, and potential local and international investors. In addition, the Namibia Investment Centre was transformed into a one-stop centre to provide potential investors with all necessary information, and assist in all necessary paper work, in a convenient and time-efficient manner.

Lack of supporting policies

Industrial policy requires supporting policies to succeed. One example is in the area of technology, which is an enabling infrastructure. Markets tend to fail in this area because a firm may be unable to appropriate a return equal to the social value of its innovative effects, and so will under-invest. If firm A benefits from the innovative activities of firm B, then each firm will tend to hold back its technological efforts; there may be duplication, with several firms doing identical research; and it may be necessary for governments to intervene to gain a strategic advantage for firms in the country, or to offset strategic advantages being gained elsewhere, perhaps because of government help in competing countries (Stoneman 1990).

Due to the presence of externalities in this and other areas such as education, government intervention can include public provision, subsidies, co-operative R&D, or the use of supporting policies. These are needed in areas such as competition, science and technology, education and training, public procurement, trade, and standards.[2] These emphasise the development of market economies.

Namibia lacks a competition policy, and has no explicit trade policy and no fully functional standards agency, and is recognised to have a weak record in implementing its human-resource development programme. The policy deficiency in Namibia can be attributed to the resource-curse thesis that argues that if production depends on extractive natural resource industries, the absence of inadequate policies will be tolerated for longer periods, because growth can be achieved without them. The existing situation hinders the success of any efforts to implement an industrial strategy.

Shared growth

In most developing countries, industrial-policy interventions address a number of non-economic objectives. As a result, they tend to be haphazard and non-selective, and are subject to pressures from political and special interest groups.

Like South Africa, apartheid in Namibia deprived the majority of the population of active participation in economic activities. Consequently, Namibia is a highly unequal society, with a Gini coefficient of 0,6 (Namibia Household Income and Expenditure Survey 2003). Therefore, non-economic objectives are crucial to achieving shared growth, and maintaining the social fabric of the society.

In Namibia, industrial policy takes cognisance of the historical imbalances by promoting an industrialisation process with equity, which places special emphasis on women and other groups that were disenfranchised under colonialism and apartheid. However, these efforts have not resulted in the envisioned gains. An example of this occurred in the fisheries sector, where the government encouraged partnerships between established companies and newcomers from previously disadvantaged groups, which did not result in any material gains to the target group.

An Affirmative Action Act is not an adequate supporting policy to achieve shared growth in Namibia, because it focuses on increasing diversity in existing businesses. The challenge in Namibia is to design and implement clear strategies that will identify and achieve the broad objective of empowerment in its various facets. This is not an easy task, and it is important not to marginalise the previously advantaged while trying to address the valid concerns of the previously disadvantaged. An example of the difficultly of incorporating non-economic objectives into industrial policy is evident in South Africa, which has implemented various black economic empowerment (BEE) codes. However, due to the absence of any material gains being achieved by the target group, disillusionment has led to a new policy, termed broad-based black economic empowerment (BBBEE, also referred to as Triple-BEE).

Opportunities

Despite the challenges to Namibia for its own industrial policy, and SACU in terms of a joint industrial policy, various opportunities exist. These will be discussed in this section.

Co-operation

The East Asian economies pursue regional strategies. These comprise strategies for regional networking in East Asia as a whole, and those for subregional networking countries (Masuyama 1997). The fact that a joint industrial policy has not been designed for SACU presents a unique opportunity for the members to co-operate in developing strong domestic production structures, and articulating their independent trade policy issues at the common SACU level. This will be of use for the bloc as it negotiates with the European Free Trade Association (EFTA) countries, Mercado Commun del Sur (MERCOSUR), and the United States in bilateral trade agreements.

Sustainable development issues

The demand for environmentally friendly products is growing. Namibia's reliance on natural-resource-based industries, such as mining, agriculture, fisheries, and tourism, increases its support for the sustainable use of renewable resources, and the efficient management and utilisation of non-renewable resources. Namibia has committed itself to international environmental conventions such as the Montreal Protocol on Substances that Deplete the Ozone Layer and the United Nations Framework Convention on Climate Change. With a powerful environmental-protection lobby group in the country, sustainable development should be a key component of its industrial policy.

Sustainable development in industrial policy is captured in areas such as the implementation of high environmental standards and avoidance of inputs in the production process that are regarded as causing damage to the environment and/or to human beings; the efficient use of water, which is a scarce resource in Namibia's desert climate; the exploitation of mineral deposits in a way that minimises negative impacts on the environment and biodiversity; and ensuring that users of production sites rehabilitate the area when they complete their activities, to reduce hazard risks and to create an environment conducive for natural diversity.

With experiences such as the Ramatex Textile factory circumventing existing environmental-protection legislation, Namibia has unique experience that will add value to a joint industrial initiative on how to address the tradeoffs in attracting FDI to support industrialisation efforts.

Spatial policy

The comparative success of some countries or regions over others is often explained by differential natural-resource endowments under the principles of comparative advantage. This principle was advanced by David Ricardo, a 19th century economist, who argued that regions and countries should specialise in those areas of production in which they have a natural advantage over other areas to achieve economic growth and development.

The weakness in the Ricardian theory of comparative advantage is that manufacturing capacity and services, which are the drivers of modern economy, are not natural endowments. They must be built up, and the process of building them up can yield the cumulative benefits of technical change (Eatwell 1982). In addition, the principle of comparative advantage is in relation to land-based activities. Once we enter into processing activities this link is tenuous at best (Kaldor 1970)

In today's world, the differences in real income among countries and regions is explained by the unequal incidence of development in industrial activities, as opposed to differences in natural-resource endowments (ibid).

Myrdal's concept of circular and cumulative causation argues that external economies arise through regional agglomeration, and initial disparities in growth become exaggerated over time; that is, in a self-enforcing tendency, regional disparities are deepened. This is more so in sectors such as manufacturing, which offer opportunities for higher productivity gains well in excess of those for land-based activities. Therefore, if an area establishes an advantage in a manufacturing activity, then the gap between itself and rivals can widen, and gains become cumulative (Myrdal 1957; Kaldor 1970). Furthermore, initially more industrially developed areas will gain from the progressive opening of trade at the expense of the less developed regions, through backwash effects.

Differential rates of unemployment are used as an indicator of disparity. According to the principles of market economics, if left to operate freely, the market should eradicate unemployment differentials between areas. All those who seek work should be able to find employment, and there should be no involuntary unemployment. However, this work may be extremely poorly paid and unpleasant. Given factor mobility, those who are dissatisfied with the employment prospects in the region should seek work elsewhere. At the same time, if wages are low in a region, this should have the effect of attracting new investment and new employment to that region. Due to deficient market factors, such as labour immobility, this mechanism may not be relevant. This will result in some regions or countries growing at different rates, with some being left well behind the leaders.

This virtuous spiral of growth and vicious spiral of decline from the cumulative-gains effect justifies the need for policy intervention, because in the absence of intervention, successful regions may continue to develop while other areas sink into despair. To address this, in more recent times, industrial policy is being shelved in favour of spatial policies that focus on making countries attractive places to live and do business. Spatial policy is concerned with reducing economic inequalities that exist between geographical areas by job creation, additional tax income, and stimulating economic growth in less-developed regions. It consists of regional and urban policy.

Regional policy arose in the 1920s and 1930s to deal mainly with disparities in unemployment. Government intervention focused on increasing factor mobility, in both physical and human capital. It was argued that areas suffering from unemployment lack the investment necessary to provide employment. Another reason was based on market forces. It was argued that individual firms may, in acting rationally, locate in lower-cost, better-developed areas. However, unbalanced location of manufacturing activities can lead to socially and politically undesirable consequences, such as congestion and pollution, which may lead to higher social costs. Therefore a more even spread of economic activity was desirable from a welfare-gains perspective. Until the 1970s, regional policy was concerned with reducing economic variations between regions with respect to such variables as per capita income and output, but most particularly with respect to employment.

The establishment of industrial clusters was advocated as one policy tool of regional policy. Its advantages included external economies of proximity (for example, well-developed networks of suppliers and buyers), and potential gains of consciously pursued joint action (for example, sharing orders). Clustering has especially helped small enterprises to overcome well-known growth constraints and sell to distant markets (Schmitz 1998).

However, these industrial-cluster approaches are based on location theories that focus on transport costs. Transport costs are only a significant explanation in cases where bulky and/or heavy items are transformed into much smaller or lighter products, thus reducing the costs of transport to the market. In the case of steel and other mining industries, it makes economic logic to locate the plant close to deposits, but in the modern world such industrial location is significantly less important.

Due to the inherent targeting in regional policy, the shift has been more towards urban policy. Urban policy was originally concerned primarily with the necessity for planning in order to deal with the structural problems evident in urban decay and deprivation. It helps to reduce transaction costs. Countries with differences in transaction conditions end up with the different income levels and growth rates. This leads to their entering the take-off stage at different points in time. The countries with better transaction conditions will enter the take-off stage earlier. If country A enters the take-off stage earlier than country B, then the differential of per capita income and in marginal growth rates between the two countries may increase. This divergence occurs because countries with different initial states each converge to a steady state different from the steady state to which the other countries converge.

Urban policy is based on several strategies that focus on incentives to attract investment to ‘problem’ areas, by developing cities into more attractive places for people to live in. This could be through using financial incentives to attract new industries to areas suffering from the decline of their staple industries; restricting the ability of firms to locate or expand in booming areas; embarking on property initiatives, such as building industrial estates and housing for workers; or developing infrastructure, particularly road networks.

Other strategies focus on enterprise development through improving the performance of existing enterprises; encouraging the formation of new enterprises; developing sites for economic development by increasing the rate of site reclamation and the improvement of existing buildings for private-sector development; skills development through improving vocational and employment-related skills, and adult numeracy and literacy; increasing motivation to work by enhancing personal development and enterprise in job searching;

increasing inter-agency co-ordination by improving interdepartmental and intergovernmental co-ordination, and creating ways in which the public, private, and voluntary sectors can work jointly; increasing access to employment and services by removing barriers to recruitment and to accessing publicly provided services; focusing on housing development by improving the quality of the housing stock and the quality of management of public housing, and increasing the quantity of private housing; focusing on the built environment to improve infrastructural services, and the provision and running of transport networks; paying attention to the social fabric by strengthening communities, and increasing local self-help and community care; and enhancing safety and security by reducing the incidence of crime and vandalism, and of accidents (Robson et al 1994).

One successful example of effective urban policy is New York City, which in the mid-1980s was the murder capital of the United States, but is now one of the most vibrant cities in the world. South Africa has embarked on a similar project with its Gauteng province initiative. In Namibia, local economic-development initiatives are being designed by various municipal agencies, but inadequate focus is put on them as key industrial-development tools.

Despite the attractiveness of urban policy, the forces that cause a region to slacken in the first place are seldom addressed in the short term, leading to a feeling of a waste in public funds by public officials who are due for re-election. In addition, despite rapid transport and performing communication networks, local proximity remains important, with industrial districts exhibiting above-average performance (Meyer-Stamer 1997).

Since the 1970s, the distinction between the regional and urban policy has become increasingly blurred, with some common factors affecting both of them. Using employment as an indicator for evaluating regional and urban (spatial) policy is difficult. Employment may increase while unemployment may continue to rise, because if old industries are dying, the loss of employment may outweigh the gains to employment that arise from new industries attracted to the area.

Also, a successful spatial policy may slow down migration from an area, keeping the labour supply at a higher level than would have been the case in the absence of policy. Also, if spatial policy creates some hope for and prospect of employment, then more people are likely to register for employment, thus keeping unemployment levels at a higher rate than would have been the case had these people dropped out of the labour market. Spatial policy, although creating and safeguarding jobs, is a cost to the public sector; a cost-benefit analysis is usually required.

Conclusion

Despite SACU's long existence, development integration is yet to be achieved. Industrial policy is advocated as one tool that can correct this. Industrial policy in Namibia is based on the 1992 white paper on industrial development. Despite macroeconomic stability, adequate domestic financing, trade union stability, good infrastructure, and the lessons that can be drawn from the East Asian miracle and the experiences of developing countries that attempted to replicate the East Asian experience, various challenges exist for industrial development in Namibia.

These include the resource curse; inadequate skills and low levels of education; uncertain property rights; deficiencies in non-autarkic initiatives; multiple memberships in various trade blocs; weak institutions, including inadequate financial-sector regulation; lack of information; lack of supporting policies; and the difficulties of incorporating the objectives of shared-growth principles. Due to the limited resources that exist in Namibia, there must be accountability for any direct intervention on the market.

Success in industrial policy at the national level has positive implications for a joint SACU-wide industrial policy. For industrial policy to work in a regional context, attention needs to be given to supply-side policies aimed at improving the initial endowment levels of each country, which will result in increasing their steady-state levels. This requires laying down stable and long-term conditions for an efficiently functioning market economy: the maintenance of a competitive economic environment, as well as a high level of educational attainment and social cohesion (McCarthy & Hansohm 2005).

Success in industrial policy will ensure that the BLNS countries do not suffer from the effects of trade liberalisation on the Common Revenue Pool (CRP), and dominance by South Africa in setting a common industrial policy for the SACU region.

In general, while it is easy to make a case for industrial policy, this case only holds under strong specific conditions. While the case for industrial policies in the wide sense, including reference to a stable macro-economy, education and training, etc, is generally accepted, the case for specific interventions directed at specific industries is subject to more conditions.

An important general principle is that interventions should attack the problem of market failure closest to its source. According to the World Bank, 'the real question is not how fast an economy can industrialise, but how to structure the industrial sector so that it supports economic growth'. The development of industry should not be seen as an end in itself, but as a means to achieve other goals, such as economic growth, employment, or income distribution. Furthermore, it should not be seen in isolation from other sectors of the economy (World Bank 1993).

Also, there is an increased awareness that interventions are not a cost-free alternative to market failures. Although interventions are meant to remedy market failures, not to replace markets, the case for industrial policy depends on the nature and extent of the market failures, and the ability of government to design and implement the necessary interventions (the potential costs of government failures). The success of industrial policy depends on state competence, the effectiveness of interventions, and a degree of independence from international trade at both the within-country and SACU-wide levels.

Endnotes

1 The services sector can also accommodate labour-intensive production methods to a large extent.

2 It is increasingly argued that SMEs are no different in their policy needs to other enterprises, therefore the value-add of a separate policy in this area is debatable.

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The new SACU agreement: some industrial challenges and opportunities from the perspective of Swaziland's development strategy

Gabriel Tati

This study examines some of the major industrial policy challenges in Swaziland, as one of the smaller economies within SACU. Although the paper reflects heavily on the content of article 38 of the SACU agreement (SACU 2002), which refers to industrial development policy, it also takes stock of the dominant traits that have so far marked the development strategy of Swaziland's industrial policy. Such an introspective approach provides an appropriate analytical framework for assessing the ways in which Swaziland can seize industrial opportunities from a more equitable economic integration. The new SACU agreement represents a step of great significance for the member states in terms of the customs union's legal and institutional development. For each individual country, it also provides a more workable framework for economic integration with the region and with global trade flows. Within SACU, industry is closely related to trade relations, and, accordingly, the customs union plays a crucial role in the process of fostering more coherent national and regional policy partnerships or co-operation. It is argued that through the renegotiated arrangement, the conditions for greater integration into the global economy have been improved (SACU 2002). Among the expected outcomes, the members aim to achieve a common industrial policy that would contribute to shared growth, and diffused or balanced economic development. The feasibility of this common policy is discussed in this paper from the perspective of Swaziland.

In terms of revenue, in Swaziland's 2006 budget, SACU receipts comprised 63 per cent of revenue and grants. As the revenue pool is likely to diminish over the medium term (because of failing international tariff barriers) the government will need to diversify its revenue sources. This need is also underscored by the problems facing the sugar sector, notably the reforms of the EU's sugar regime. As a result of these reforms, it was expected that prices paid to Swazi sugar producers would fall by 36 per cent over four years from 2006/2007 (*Research Economics*, February 2006). This issue is critically examined in the last part of the paper.

The paper begins by examining the critical components of Swaziland's industrial development strategy. A retrospective stance is taken to review the various instruments used in the country's changing national industrial policy, and its relations with the overall development strategy. In this review, special attention is paid to the dynamics of intra-SACU trade. To complete this review, the paper then presents the outcomes of various industrial interventions. It goes on to discuss some of the industrial policy challenges that Swaziland faces in the process of implementing the new SACU agreement. One of these is undoubtedly associated with the establishment of an efficient textile and apparel industry, which operates under the African Growth and Opportunity Act (AGOA), which is a special trade arrangement with the United States. It represents what is termed in the agreement 'infant industry,' but this needs to be articulated properly with the textile industry of South Africa. Swaziland's textile and apparel industry is under threat due to numerous problems. The substance of these problems is outlined in the appendix to this paper.

Industrial policy instruments, measures, and institutional reforms

Industry in Swaziland was originally the responsibility of the Ministry of Industry and Commerce, before being handed to the Ministry of Enterprise and Employment, which is also responsible for handicrafts. The term 'national industrial policy' may sound inappropriate in the context of Swaziland, as the various industrial activities undertaken so far in the country do not seem to reflect a coherent policy framework. For example, although foreign investment has for many years been strongly encouraged, there was no investment code in place to guide investors. The emphasis on foreign investment is essentially a policy statement by the government and individual ministers, without the necessary institutions to support such a policy. Since manufacturing is predominantly a private-sector activity in Swaziland, the government's main role is a supportive and regulatory one. This sector is important to address the government's objectives of boosting employment and diversifying the country's export base. For this reason, the focus has always been on the more effective exploitation of the country's resources and increasing domestic value-add in manufacturing.

As part of the effort to promote industrial development, the government encourages the establishment of new industries by promoting both local and foreign investment. This has entailed looking into ways of promoting industrial development through the government's overall macroeconomic policy, and/or by introducing incentive schemes. The policy framework is also concerned with planning, servicing, and administering industrial estates. To facilitate this, the ministry has made a continuous effort to provide and maintain basic infrastructure, such as roads, storm-water drainage, and water and sewerage lines, and the allocation and sale of industrial plots to investors. Some regulation of industrial development has also been incorporated into the policy to ensure that it is appropriate, labour-intensive, and environmentally safe. The promotion of industrial development is basically driven through the implementation of policies aimed at creating an enabling environment for investment; the rehabilitation of existing industrial-investment institutions; and the promotion of Swazi-owned, informal, small and medium, resource-based, labour-intensive, and export-oriented industries. The manufacturing sector is relatively capital intensive.

So the government's industrial strategy centres on promoting industries that are labour-intensive, export-oriented and value-added. The diverse industries established in the country consist predominantly of private-sector enterprises. A sizeable number of these existing businesses are in the textile industry, locating Swaziland in the global economic environment. Economic growth in Swaziland centres largely on the manufacturing sector, which accounts for 36 per cent of gross domestic product (GDP). Because of the limited size of the domestic market, non-agricultural manufacturing activities are highly export oriented, as well as capital intensive. Light-manufacturing enterprises and agro-industries are the main focus of the government's export diversification programme. Their manufacturing performance is highly vulnerable to shocks affecting world markets, especially in Asia and South Africa. The sector is also subjected to fluctuations affecting domestic interest rates. For example, Swaziland's manufacturing sector and the pulp industry were particularly hard hit by an adverse economic environment created by high domestic interest rates during 1998. The establishment of new factories in the textile industry has contributed to a slight improvement in the growth of Swaziland's gross employment. However, the manufacturing sector has experienced poor performance with the closure of many industrial plants, such as a light vehicle assembly plant (AMC Swaziland) and a refrigerator company that was forced to stop production, due to low demand from the South African market and high interest rates. The pulp industry has also experienced reduced demand. The market problems are essentially related to periods of crisis in the Asian market. Low export earnings underscore some of the constraints the country faces in achieving market diversification of its products. At present, industrial processing involves sugar, citrus, pineapples and cotton. The sugar and the soft-drink processing industries have been able to increase production, but only marginally.

The ministry has also included in its policy the task of identifying new areas for industrial-estate development outside of the main cities and towns. In the policy process, it is intended to review the small-scale loan guarantee scheme, which was established in 1991 to address the problem of credit availability and lack of collateral in this sector. Concerns over the establishment of the quality assurance system, and the accompanying legislation, are also central to the policy. In line with this, the need has been expressed for the Company Act to be reviewed, with adequate consideration also to be given to competition policy. The review of trade control (the Development Act) is also an area of policy reformulation.

The other areas of concern in the formulation of a national industrial policy were identified as follows:

- encouraging increased participation by local entrepreneurs in the manufacturing sector;
- the establishment of core industries;
- the provision of proper training to Swazi nationals in managerial and industrial skills, such as engineering and technology;
- the provision of a separate package of incentives for encouraging local entrepreneurs involved in manufacturing; and

- the consolidation of the function performed by the investment promotion agency within the Ministry of Industry and Commerce, in order to improve investment-information services.

A similar agency was established in 1999, and since then its main tasks have included the development of small, medium and informal industries, and intensifying efforts to publicise Swaziland's favourable investment climate through publicity campaigns and seminars, as well as by participating in international trade fairs, exhibitions, and investment promotion. In terms of policy input, some efforts have been made towards the formulation of an investment code setting out all the rules and regulations pertaining to investment and industrial development. The policy also seeks ways and means to encourage appropriate technology transfer, especially in relation to the textile industry.

Because of Swaziland's membership in other regional groupings, the facilitation of cross-border trade and investment in both East and Southern Africa has been given some importance in industrial policy. At the regional level, efforts are being made within the policy framework to facilitate economic integration by encouraging cross-border trade, payments, and investment. A technical working group was formed, in line with the Preferential Trade Arrangements subregion (which afterwards became the Common Market of East and Southern Africa [COMESA]) and using the same terms of reference, to identify factors that hinder the progress of regional integration, in order to find common solutions.

As the Republic of South Africa gained a prominent role in political leadership in the region, it became urgent for the government of Swaziland to redesign its industrial strategy in order to incorporate the new regional context. In 1994 the government began considering the ways in which the industrial policy should be formulated. Since then, the discussion has been kept on the agenda. In this section, some of the outcomes of this ongoing process are outlined.

The preparation of the national industrial policy, with technical assistance from the UN Industrial Development Organisation (UNIDO), started with informational studies to highlight the problems affecting the sector. As part of this exercise, a study was conducted to document issues of importance in the formulation of an industrial policy, which is a vital building block for a long-term national development plan. The study recommended, among other things, that the policy should provide the basis for adopting a focus on outward-oriented industrialisation, with an export-led growth potential. In line with this recommendation, the government has been pursuing, over the past years, an industrial strategy focusing on the development of the manufacturing sector. The following elements were identified as being among those that should be considered in such a policy:

- a conducive macro-economic environment with the following attributes: fiscal discipline, prudent economic management, and a high level of savings and investment;
- an outward orientation in attracting foreign investment into growth areas of the economy;

- ensuring that the available manpower is trained and equipped with the relevant technical skills;
- continuously improving the range and quality of supporting services and infrastructure to the business community; and
- generally maintaining a conducive business environment that is competitive.

An important issue raised by the study is the constraints imposed on Swaziland by its membership of the Common Monetary Area (CMA) with Lesotho, Namibia, and South Africa. In effect, this issue relates to the establishment of export-processing zones to provide a stimulus for export industries, thus accelerating growth in this area. The study recommended that such zones should not be established, due to the fact that Swaziland has membership of SACU. It was recommended that Swaziland should rather create a competitive business climate and vigorously attract foreign investment, with the assumption that an independent body or entity would assist the ministry in managing industrial and trade relations. To complement these recommendations, another study, funded by the EU, was commissioned to investigate possible institutional structures or reforms to be adopted by the government, in order to accelerate inward and domestic investment growth.

All these studies have, in the course of governmental action, resulted in an agenda calling for the establishment of an investment-promotion centre, which could actively promote the country in external markets. In addition, there has been a call for an urgent review of bureaucratic obstacles to investors, and their removal; and the need to identify the initial promotion strategy, and to improve Swaziland's competitive advantage in the Southern African region, has been stressed. The agenda also called for the improvement of the legislative framework, and the promotion of local direct investment. To translate this agenda into policy action, it was envisaged that the capability and capacity of the ministry to contribute to the development of the industrial sector would be consolidated. This has required a review and a restructuring of the ministry's mandate.

In line with these recommendations, the ministry resolved to develop a policy and strategy for small-scale industry, aimed at promoting local investment and self-employment.

The Swaziland Enterprise Development Company (SEDCO) corporate plan

In 1988, SEDCO formulated a corporate plan which was not implemented. The plan covered both the institutional structure of SEDCO, and its overall strategy and objectives. It recommended several changes to the company's role, among which was the need to concentrate resources on improving the quality of workshops, the management of its industrial estates, and the training offered to estate tenants. To address the non-implementation of the 1988 plan, SEDCO formulated another corporate plan in 1992/1993, which, among other proposed actions, featured the provision of a package of services to the entrepreneurs on a declining subsidy for a period of five years, with the application of the subsidy levels over that period to be based on commercial rates, and the rehabilitation of industrial estates during the development-plan periods. Since that date, SEDCO has undertaken several actions to improve its services, notably the production of pamphlets summarising the corporate plan, and distributed to members of the public through the various media houses; the construction and rehabilitation of several industrial sites; and the revamping of the consultancy and training services, with particular regard to participation in trade fairs, and franchise promotion.

In 2000, SEDCO secured a two-year technical assistance programme from the British government through the Department for International Development (DFID), which significantly contributed to the implementation of its activities. Presently, SEDCO's strategic and operational activities are directed to small and medium enterprises. These activities range from training and counselling, to estates, marketing, and manpower development. The organisation is subjected to some constraints, such as its narrow income base, rent defaulters, and a lack of timely decision-making by government (a case in point is SEDCO's Strategic Plan 2000–2003, which at the time of writing was not yet approved by the government).

Industrial estates

The principal industrial estate in Swaziland is located at Matsapha. Co-financed by the government and donors, the estate has undergone considerable development since its establishment, in order to provide an appropriate amount of serviced land for the creation of new, and the expansion of existing, industries. As part of the industrial land reclamation of Matsapha, the Ministry of Public Works has been engaged in dredging the Mkinkomo reservoir, and refilling the adjacent area with the dredged material. The maintenance and the provision of both physical and social infrastructure within the industrial estates are also under the mandate of that ministry. With regard to the rehabilitation and extension of infrastructure, an important infrastructure project was completed in carrying out the development plan of 1996–1998. This project involved relocating sewage-treatment works, rehabilitating refuse dumps and roads, constructing new roads, and providing basic infrastructure in the new area. The industry section of the ministry technically assisted this project. The development of the estate is driven by a public commitment to make it an independent entity by establishing an efficient and effective rating system, and developing a long-term programme for its maintenance and management.

The decentralisation of industrial activity away from the main towns and cities has been central to public thinking on this development. The Ministry of Industry and Commerce maintains that an industrial master plan is needed to guide this decentralisation. This idea is still being contemplated. The objective of industrial decentralisation is to spread employment opportunities across the country, and to manage the rapidly growing industrial activity in the Matsapha industrial estate. In line with the objective of establishing new industrial estates to facilitate decentralisation and provide an even distribution of employment opportunities, two further estates, at Nhlangano and Ngwenya, received funding for their development, and were completed during the plan period 1996–1998. Their establishment has considerably enhanced industrial development and much-needed economic growth.

In conjunction with these decentralisation efforts, it has become increasingly important to address the need to adopt a holistic approach, by ensuring that the accompanying industry-support services and social infrastructure are made available in order to offer a complete package. This refers to services such as railway and road connections, utilities, schools, hospitals, relevant government administration, etc.

Promotion of investment, finance, and technical support

Investment promotion is a permanent feature in the industrial transformation of Swaziland. Public records suggest that this promotion has been undertaken well beyond the territorial boundaries within the Southern African region, in order to attract foreign investment. As South Africa has become a more viable location for foreign investments, the ministry has kept alive the necessity of a more aggressive investment promotion strategy. The Multilateral Investment Guarantee Agency (MIGA) has provided assistance in this endeavour. Towards the end of the 1990s, the creation of an investment promotion authority was endorsed, and this was reflected in the establishment of the Swaziland Investment Promotion Authority (SIPA). Its main functions include marketing Swaziland in the region and internationally, and serving as a one-stop information centre. SIPA became operational in 1999. Around that time, an investment incentive package was reviewed, in conjunction with the overall investment climate, in order to accelerate private industrial investment, and to be competitive within the Southern African region. All these initiatives complemented those undertaken in previous years, such as the launching of two credit schemes to assist local entrepreneurs with loans, a loan-guarantee scheme for small enterprises, and a development fund.

Small Enterprises Loan Guarantee Scheme

This is an initiative whereby small-business development can be promoted through the availability of credit. Under this scheme, loans have been extended by the commercial banks, while the Central Bank guarantees the loans from a government-established fund. This scheme has provided a way of acquiring start-up capital for small businesses (the main beneficiaries) that otherwise would face problems in raising sufficient collateral for normal commercial loans. During the period 1992–1998, the loans benefited 376 borrowers, of whom 131 were women, 134 men, and 111 companies. Claims were made in respect of only 2 per cent of the sum disbursed. At the end of this period, the scheme was reviewed to make it easier to operate, and to encourage potential borrowers. The review also provided the basis for developing a long-term plan for the scheme.

Small Business Development Fund

This scheme has been under the administration of the Swazi Business Growth Trust (SBGT). It started with a great deal of uncertainty surrounding its establishment, but thereafter became fully operational in 1997/1998. Up to that date, in spite of uncertainty, the trust granted 1 365 loans, of which 533 went to women who were running businesses. The SBGT extends loans to operating and new small-scale enterprises engaged in agri-business, manufacturing, construction, tourism, retail, and transport. To consolidate its activity, the SBGT has established a special small-business development department to strengthen its strategy for the development of business in Swaziland.

In the sections that follow, the overall performance of industry is assessed, in line with the country's continuous attempts to reposition itself in the post-apartheid regional reconfiguration.

Industrial performance, liberalisation, and economic growth

On the industrial policy front, Swaziland has made a considerable shift dictated by the reconfiguration of regional politics. From its independence in 1968 to now, Swaziland's development has been dominated by its relations with South Africa, the dominant regional power. South African capital and imports, SACU, the South African labour market, and the CMA (the successor to the Rand Monetary Area) have shaped the economy and restricted the scope for independent economic policy.

From the 1990s to the present, Swaziland's economic structure has undergone a fundamental transformation, moving away from the domination of the agri-business sector to the textile-led export industry. This industrial transformation has been accompanied by an increased incorporation of female labour into the garment-manufacturing and trade systems. Up to the 1990s, production for exports tended to concentrate on agri-business within the Southern African boundaries. Swaziland's international trade consisted, to a large degree, of the export of agricultural processed products, especially to South Africa and European markets. As with most of the countries surrounding South Africa, the structure of agriculture of Swaziland has been directly related to the historic hegemonic influence of that regional power (McFadden 1987).

As earlier noted, the economy of Swaziland has always been characterised by its extreme openness, with recorded imports and exports accounting for 88 per cent and 61 per cent, respectively, of the GDP in the 1990s. Although the country's economic growth has fluctuated since independence in 1968, the overall economic performance has periodically been impressive. Economic growth rates have recorded levels of 7 per cent. Periods of economic slowdown, however, have also punctuated the economic cycle of the nation. When viewed from the structural angle, the economy is highly vulnerable to external shocks. This is visible through a modern sector that remains under the domination of agriculture and forestry products. Within this sector, the largest industries are sugar refining and wood-pulp processing. Other large processing industries are cotton ginning, fruit canning, and meat packing. From the very nature of its economic structure, Swaziland is essentially an exporter of unprocessed or semi-processed products; hence, little value is added to such products.

The country has long experience of development planning, with the first plan dating back to the period 1946–1956. Throughout the planning exercises, a lack of trained manpower has constantly been recognised as one of the major developmental constraints in the country. This makes it difficult for most Swazi workers to enter highly paid employment. Most of them have been incorporated into the capitalist system of production as unskilled labour. Political manipulation through, among other things, alienating land relations, has been a driving force of this incorporation. For its part, the context of globalisation comes with increased forms of proletarisation as the country maintains its pursuit of greater openness to trade liberalisation. Swaziland has made some considerable steps into the global market through its openness to foreign investment from multinational agri-business corporations. Since the 1990s, however, the country has increased its position as a location for investments in the global commodity market for textile products. To move away from the export of mainly unprocessed primary products, the government has strived to create an enabling environment for the country to remain within, and benefit from, the trade- and investment-related preferences of the Generalised System of Preferences (GSP) and AGOA. Indeed, globalisation provides opportunities to Swaziland through wider markets for its textile industry and some other goods.

The policy framework supporting the insertion into the global market is institutionalised through the National Development Strategy (NDS). This long-term national vision, initiated in 1993 but officially launched in 1997, is intended to run up to the year 2020. The NDS is expected to develop strategies that encompass, among other things, sustainable development, with special reference to the cross-cutting issues of poverty reduction, equity, and self reliance. Since the early 2000s, the country has initiated some approaches towards tackling the issue of widespread poverty through its national strategy for poverty eradication. In this context of globalisation, the main challenges facing Swaziland in eradicating poverty and ensuring sustainable livelihoods are translating economic growth into sustainable employment opportunities, and preparing and implementing a manpower development plan that is consistent with labour market conditions (UNDP 1996).

All previous development plans have contained a permanent declaration from governments of Swaziland affirming the virtues of economic liberalisation, giving a prominent place to an export-oriented development strategy. The priority of achieving economic growth and accelerated job creation has been present in the political economic agenda claimed by successive prime ministers in their inaugural discourses. These discourses have always stressed a concern with the need to increase national income in order to achieve a sustainable improvement in welfare for the Swazi people. Casting doubt on the official discourses has been the erratic rate of income per capita growth, especially when compared with the rapid increase in the population.

Swaziland is a relatively small country, covering an area of only 17 364 sq km. With a per capita income of U$1 100 it is, however, classified as a middle-income developing country. For most of the 1980s and up to 1991, the country experienced robust economic performance, growing on average by 6,6 per cent a year. At the same time, fiscal surpluses led to accumulation of considerable reserves (domestic and external), and substantial investment in social and economic infrastructure. Thereafter the economy lost momentum as real GDP growth averaged 2,8 per cent for the five years up to 1995/1996. Among the main factors was the persistent drought of 1991 to 1995, which seriously affected the two main factors of the economy, agriculture and manufacturing. The manufacturing sector has also been affected by the political changes in the Republic of South Africa, mainly through declining foreign direct investment (FDI) as investors, who had earlier diverted resources from South Africa (to escape international sanctions imposed on the apartheid regime), started to reverse that trend. Overall economic performance has been even bleaker, with the emergence of fiscal deficits – averaging 4 per cent of GDP – leading to unsustainable drawdowns in reserves (UNDP 1996), which have become chronic over recent years.

Although the overall size of the national economy remains small, the penetration of capitalist investments in the domestic economy has been considerable since the early 1960s. The share of exports has always been very important, counterbalanced by an equally important volume of imports. The importance of imports and exports is a strong indication of a high dependence on the performance of the world economy – for example, world prices, exchange rates, and the growth rate of Swaziland's major markets. On the regional front, the country is also in competition with other countries in Southern Africa for investments. Thus, as a destination for foreign investment, Swaziland has constantly to compare itself with the other countries in a region where the economy of South Africa remains dominant, and more attractive to investors.

South Africa is Swaziland's most important trading partner. This economic link has historical roots, and finds continuity in the geographical position of Swaziland with respect to South Africa. Throughout the past years, a high proportion of FDI has originated from South Africa. Swaziland is landlocked, sharing borders with Mozambique and South Africa. Because of the strong linkage between the Swazi and South African economies, political and economic developments in the latter country have critical implications for the small, open, and export-oriented Swazi economy. The cross-border mobility of capital is reinforced by the fact that Swaziland is part of the CMA, with the national currency, the lilangeni, currently linked to the rand at par (one rand = one elangani). Swaziland is also a member of SACU. Because of the high degree of regional economic integration, changes in economic performance indicators for South Africa, as well as changes in its economic policy, are of major concern for the government of Swaziland. Following the end of apartheid in 1994, which gave way to the first democratically elected government, renegotiations of the SACU agreement started in late 1994. The main issues of discussion had to do with arrangements on revenue sharing, institutional issues regarding the administration of trade-related disputes and the revenue pool, economic development, and the possible inclusion of new members. At the regional level, representatives from Swaziland take part alongside those from Lesotho, Namibia, and South Africa in the SACU task team to renegotiate the terms pertaining to some of the arrangements. On the Swaziland side, these renegotiations shaped much-needed shifts in intra-regional trade and capital flows from South Africa, impelling Swazi authorities to look for alternative sources for investment. In 2002, a new SACU agreement was signed between the five members, and its implementation became effective in 2004.

The reliance of the national economic strategy on extreme openness did sometimes pay off for Swaziland. GDP at factor cost grew at an average rate of 2,8 per cent up to the early 1990s. Many analysts regarded this rate as being very satisfactory. Thereafter the GDP growth rate marked a decline, in the years that followed the end of apartheid in South Africa. Despite episodic recovery, the country's economy has always failed to achieve the levels of GDP recorded when the apartheid regime was in place in South Africa. In recent years, economic growth has declined substantially, with GDP growth often sinking to negative rates.

The fluctuation of GDP has mostly affected the agricultural sector, where exports play a predominant role. This sector is largely dependent on climatic conditions and world market prices. With the agricultural sector declining, economic growth has come to rely on the performance of the manufacturing sector, which accounts for the largest share of GDP. Paradoxically, as previously suggested, the apartheid era was relatively more conducive to GDP growth in Swaziland than the post-apartheid era has been. High levels of FDI resulted in an upturn in the manufacturing sector in the latter half of the 1980s. FDI has been the main engine of growth for the economy in the recent past. Official statistics indicate that manufacturing accounted for the largest share of GDP between 1989/1990 and 1993/1994. In 1993/1994, for instance, manufacturing accounted for 36,4 per cent of GDP. However, even though average annual growth was estimated at 4,4 per cent over that period, the sector's contribution to GDP stagnated. This was largely attributed to the slowdown in FDI, and, as a result, the growth dynamic of the Swazi economy was significantly reduced. The first signs of this downturn in economic performance, however, were perceptible by the early 1990s. Available records show a negative GDP growth rate in 1991/1992. During that period, the contribution of the manufacturing sector to GDP stagnated, coinciding with the recession in South Africa. To a large extent, the climate of recession was associated with the mounting fear and uncertainty in the business sector about what would come next, after the end of apartheid. The culminating effect of this was reflected in a low demand for exports from Swaziland.

Furthermore, as the national economy relies heavily on the activity of agri-business, climatic variation adds factors that frequently hamper increases in real GDP. Agricultural performance was affected by recurrent periods of drought; the most acute being recorded in 1993/1994. More specifically, the drought heavily affected agriculture on Swazi Nation Land (SNL), which is almost exclusively rain-fed, reducing the sub-sector's contribution to value added by about 70 per cent.

Until the mid-1990s, despite some diversification in industrial production as a result of FDI, the manufacturing sector's value added originated largely from only five export-oriented industries: wood-pulp production, drink processing, fruit canning, refrigerators, and sugar processing. Other important industries included sweets manufacturers and food processors. Swaziland's major export industry remains based on agricultural and forestry production. As noted previously, attracting new investments constantly requires Swaziland to compare itself as an investment location with, particularly, South Africa, and other countries in the region. South Africa, with a considerably higher level of resource endowment and development, stands out as having a much stronger attraction for FDI.

Consequently, investment coming into Swaziland from South Africa, to take advantage of the access to international markets, has considerably slowed down. Some of the advantages Swaziland had over South Africa as an investment location have been eroded, thus forcing the government to focus on alternative ways of creating an enabling environment that can attract foreign investment.

The changes in the political climate in South Africa and Mozambique have also led to a serious decline in the regional demand for Swazi migrant labour. Jobs had to be created in the domestic economy to address the gradual restrictions imposed by the South African mines on the recruitment of Swazi workers. The combined effects of both diminishing FDI and restrictions on Swazi miners have been visible through the slowdown in the capacity of the state to create jobs in sufficient numbers. The creation of wage employment, from which most rural households earn their livelihoods, has been significantly impaired from 1992. The government's annual fiscal deficits have increased, and the capacity of the public sector to absorb labour has also weakened. These developments necessitated the introduction of a number of institutional interventions and structural measures to try to redress the economic downturn. These measures include the Internal Structural Adjustment Programme (ISAP), the NDS, the Public Sector Management Programme (PSMP), and the Enterprises Development Fund (EDF), among others.

In the search for alternatives to restore growth, the government of Swaziland has striven to create a stable and conducive environment, with the necessary infrastructure, for the private sector to flourish. Efforts have also aimed at increasing levels of domestic and foreign investment. A survey of firms conducted in January 1995 provides some interesting insights in this regard (Ministry of Economic Planning 1996). The survey showed that among the advantages of locating business in Swaziland, as against South Africa, the most important are the relatively lower costs of labour, lower sales tax compared to VAT, and access to the EU/United States markets. Some manufacturing firms mentioned other advantages, including cheaper sugar, income tax incentives, and stability of labour. Manufacturing firms were more interested in foreign-market access and natural resources than were non-manufacturing concerns. The same survey also pinpointed Swaziland's disadvantages, as compared to South Africa. Most of these referred to the limited endowment of vital infrastructure for efficient business. The shortage of skills and labour relations were also high in the rankings.

Trading and growing as a peripheral economy to South Africa

The predominance of South Africa in the Swaziland trade regime is reflected in the sheer quantity of imports and exports from and to that country (see table 11). A rise in exports to South Africa is always a reason for political celebration, and a decrease in exports has always been a matter of political concern. It is no exaggeration to say that the economic wealth of Swaziland is inextricably linked to its exports to South Africa. The 2003 annual report of the Central Bank of Swaziland indicated that the country's exports to South Africa increased by 21 per cent to R1,3 million, as compared to 12 per cent growth recorded in

2001 (*Times of Swaziland*, 19 September 2003). The increase was attributed to growing South African demand for wood pulp, zippers (indirectly benefiting from AGOA), and refrigerators.

Table 11: Value (in South African rand) of exports to South Africa (1997–1999)

Origin/ destination	Imports			Exports		
	1997	1998	1999	1997	1998	1999
Total exports	5 353 972,4	6 385 776,8	7 104 243,1	3 502 506,4	5 292 362,6	5 647 461,9
South Africa	4 440 069,4	5 365 089,9	6 305 440,5	2 593 177,4	3 462 632,0	4 067 939,9
Other countries	913 903,0	1 020 686,9	798 802,6	909 329,0	1 829 730,6	1 579 521,9

Source: Swaziland Annual Statistical Bulletin, 1999

Against this background, however, a consistent determination to maintain an investment climate that is attractive to foreign businesses, and a policy of accepting the dominance of its powerful neighbour, has brought Swaziland a rate of post-independence capital formation not achieved in most African states. Swaziland's per capita income is actually ranked among the continent's highest, although it is, after Gambia in West Africa, the second smallest state in mainland Africa. Referring to the 1990s, estimates from the World Bank established that the capita income ranged between US$1 210 and US$1 440, enough, as noted previously, to rank Swaziland as a 'middle' income economy (Sparks 2000). It must be reiterated that most investments at the time were politically motivated. The Kingdom benefited from sanctions imposed on the apartheid regime, as foreign and South African companies relocated to Swaziland. The imposition of international sanctions in 1986 against South Africa benefited the country as quite a number of multinationals relocated to Swaziland. One of them was the giant United States firm Coca Cola, which relocated its regional concentrate plant to Swaziland in 1987, resulting in some 5 per cent real value added in manufacturing by 1988. The conditions for investment were made more attractive and more competitive, when compared with the situation in other countries in the region. From 1985, the government of Swaziland reinforced its programme of incentives for investment, and also embarked upon a promotion exercise to advertise the benefits of Swaziland to foreign industrialists. An instrument of the incentives package was a five-year tax-exempt period offered to investors in Swaziland. Abolished in 1996 because of its small effect on potential investors, this incentive has been selectively reintroduced for investors in the textile industry exporting to United States markets, under the trade arrangement governing AGOA.

Because of its excellent agricultural potential and its cheap labour, the country experienced huge inflows of capital directly through financial assistance from diverse bilateral and multilateral donors. Most of this went into commercial agriculture, manufacturing, and infrastructural development, notably into the surfacing of main roads leading from the principal centres of agriculture to South Africa (McFadden 1987). The extraction of surplus in agriculture has been rendered possible by the role the state played from the 1970s to date in providing political conditions conducive to its linkages with the industry. From a political economy standpoint, the role has essentially been assumed through the opening up of the economy to total domination by multinational and South Africa capital.

This effectively allowed the multinationals to dictate economic policy (ibid). In this process, the agricultural sector received a high priority in hosting investments from the international capitalist system, as its efficient integration into the international agri-business structure was vital for the continued profitable operation of the world capitalism.

Changing industrial strategy: the repositioning of Swaziland in the garment-manufacturing chain

The frequent slowdown in the patterns of economic growth rates has always been a major cause of Swaziland's low employment growth rate. The government tends to respond to the decline in employment by reorienting its industrial policy. One of the instruments it has used has been to take advantage of the benefits derivable from AGOA. In effect, government responses to persistent loss of jobs have been quite visible in the expansion in the garment and textile-derived industry (Tati 2005). Swaziland's exports have increased over recent years, as the country has become one of the major attractive locations for FDI in this industry, which has recorded significant investments from Asian business, sometimes having financial connections with senior nationals. Part of this industrial growth is the result of a strategic handling by the government of Swaziland of the problematic recognition of Taiwan as an independent state by the international community. Swaziland has attracted a considerable number of investors from that country by adopting a pro-Taiwan political stance, while at the same time managing its relations with mainland China. Competitive economic interests with South Africa dictate the adoption of this stance. One can refer to the freezing of diplomatic relations between Taiwan and South Africa, a situation generated by South Africa's decision to recognise the People's Republic of China. This political decision benefited Swaziland, as Taiwan, in response to the recognition, suspended new investment in South Africa. Much of the Taiwanese investment originally intended for South Africa found its way to Swaziland.

Giving a boost to this Taiwanese investment has been the opening up of the United States markets to textile-derived products and other products from African countries under AGOA. This special trade regime aims to promote greater trade and investments between the United States and sub-Saharan Africa, by ensuring free access to the United States market. Adding to this is the promotion of economic development and reforms in sub-Saharan Africa through diverse activities, which grant substantial advantages to entrepreneurs, farmers, households, and firms. According to many observers, AGOA has, to some extent, opened up the economic space of Swaziland to the United States market through the sale of textile products. Swaziland, being eligible for AGOA, has achieved its participation in the added-value commodity chain through FDI from, predominantly, Taiwanese finance. In terms of employment, the flows of investments in the textile industry have resulted in massive incorporation of the female labour force into the low-waged global manufacturing chains. Under the AGOA regime, Swaziland, as is the case of some other eligible sub-Saharan African countries, has so far striven to meet the conditions for duty-free and unlimited quotas for exports to the United States markets. AGOA offers a wide range of benefits to investors and established firms in eligible countries.

The number of garment firms presently operating in Swaziland is a strong illustration that the country is now part of the new globalising investment patterns of specialisation among countries, which entails the fragmentation and geographic relocation of manufacturing processes on a global scale. The opening up of the United States market to textile-derived and other products from African countries within the framework of AGOA has been a driving force for garment-business growth.

As of the beginning of 2003, there were 30 companies registered for AGOA benefits in Swaziland. Most are located in the Matsapha industrial estate in the Manzini district. Two noticeable features have accompanied this connection to the United States market. The first is that most of the firms, if not all, are owned by investors from Asian countries. The second is the sheer numbers of women working in the garment factories.

For Swaziland, AGOA is undoubtedly a gateway to the global economy. However, as table 12 suggests, it is not among the top beneficiaries from AGOA. In 2002, the main winner was Lesotho (Emergingtextiles.com 2003). With AGOA, Lesotho reoriented its economy to remedy the crisis generated by declining extractive industries and diminishing remittances from expatriates. Debt AIDS Trade Africa (DATA) (2003) reported that the benefits of AGOA were best evidenced in Lesotho, as the country had exported US$318 million in goods to the United States under AGOA in 2002, and more than $370 million in 2003. Investments have been achieved in the forms of a denim rolling mill, 17 garment factories, and the construction of a cotton mill. As far as employment is concerned, Lesotho has generated some 25 000 jobs as a result of its AGOA status.

Table 12: AGOA-eligible countries according to the volume of exports to the United States market (US$ million)

	1st Q 2001	1st Q 2002
Lesotho	43,504	70,172
Mauritius	11,416	12,435
South Africa	10,660	9,418
Madagascar	8,853	9,990
Kenya	3,481	5,757
Swaziland	2,544	3,851
Malawi	0,664	1,078
Botswana	0,434	0,638
AGOA countries	199,409	253,961

Source: United States Department of Commerce, quoted in Emergingtextiles.com (2003)

Industrial challenges in Swaziland in the context of the new SACU agreement

The ending of apartheid opens up new perspectives for the development of a more integrated economy among SACU members. Swaziland, through its economic and financial relationships, is faced with new challenges regarding its industrial policy. Since independence, the Swazi economy has been evolving under the SACU agreement signed in the late

1960s, together with Botswana, South Africa, and Lesotho (Department of Foreign Affairs 2001). Under this agreement, South Africa has always been in the leading position, both in setting up the duties, and as the custodian of the common revenue pool from customs and other duties on goods entering, or being produced in, the common area. Swaziland, like other members, is entitled to a portion of the revenue derived from the agreement, which provided for a more equitable distribution of the pool between the parties. To many national experts, the agreement has a certain oppressive dimension, because it limits the country's fiscal and monetary policy discretion. This has been of particular importance to Swaziland, since a major part of the state's revenue came from customs and other duties. More importantly, it can be argued that the SACU agreement has also effectively prevented Swaziland from developing its own manufacturing industries behind protective tariffs, and indeed provided South African industries with a captive market.

The political change in South Africa provides a new context for renegotiating the agreement, to achieve considerable modifications in it. It is important to note that there was, as of 1994, a real commitment from the African National Congress (ANC), through an established Macroeconomic Research Group (MERG), to implement an economic programme incorporating better arrangements of the agreement for the peripheral countries. The programme emphasised the need to reconstruct the economic relations with the Southern African region in the context of a democratic South Africa. In the formulation of the programme, recognition was made of the millions of lives lost as well as several billions in damage inflicted upon the economies of the neighbouring states in the 1980s. In its programme, the ANC reiterated its commitment to foster greater regional co-operation actively along new lines, with the aim of correcting the imbalances in SACU. The review of these relationships by this group of experts led to three options. The first was a continuation of current neo-mercantilist policies. The second suggested a more sensitive hegemonic bilateralism. The third option privileged a wholly new path of full and active partnership on regional programmes.

The evolving situation on the ground since the takeover by the ANC tends to suggest that the first and, to a large extent, second options have materialised. The third would be the more profitable for Swaziland, and by extension, for the other partners. So far, the SACU members have been engaged in (lengthy) discussion on ways of achieving this partnership. It is important to go beyond the discussion, and promote a real partnership in formulating a regional programme, subject to negotiation and renegotiation. Such a partnership must also take account of membership of organisations established by the rest of the region, while recognising the need for institutional reform. Partnership is an appropriate channel for SACU members to contribute to the development of an agreed upon, mutually beneficial programme, combining elements of co-operation, co-ordination, and integration. The partnership recommended in the third option has to incorporate some recognition that any South African economic programme would have to include significant counter-polarisation measures with a strong development focus. Looking at these implications, one easily realises the extent of difficulty in pursuing any such path of development. Swaziland's relations with South Africa reveal the chief problem related to the overwhelming relative strength of the rand, based on the South African economy, which has a gross national product (GNP) equal to more than twice those of all the other SADC countries combined.

The collection of customs revenue for the SACU pool is critical for Swaziland, as it constitutes over half of the total revenue available to the country. As a result of this arrangement, the position of this country, as is the case for the other countries, excluding South Africa, is of a very complex nature. As pointed out by Sandrey et al (2006), it is true that the SACU revenue distribution could be regarded as an income transfer from South Africa to SACU, as the BLNS countries receive tariff revenues that are around four or five times what they would be if the goods came directly into these countries. The authors also recognise, however, that under the SACU arrangement, South African industrial policies are in effect denying the BLNS access to lower-price imports, and forcing them to consume South African goods. Consequently, consumers in BLNS make transfers to South Africa's industrial sector (Sandrey 2006). Swaziland's industry has long been constrained by the structure of the external tariff, which has often reflected South Africa's policy priorities and industrial structure. The revised 2002 SACU agreement provides an opportunity to work with a joint SACU tariff board that could determine duty rates, including anti-dumping and countervailing duties. In response to this constraint, Swaziland's government has often announced that it wanted to diversify its revenue base through increased trade with partners outside SACU.

On the monetary policy front, Swaziland has long had a monetary agreement with the Republic of South Africa. The Rand Monetary Agreement of 1974 was changed in 1986 into the CMA. This arrangement adds strength to Swaziland's elangeni. It is, however, argued in some economic circles that while the South African rand provides backing for the Swaziland currency, it does so at the cost of following South Africa's monetary policies. The worst economic scenario envisaged by most regional analysts is the possible collapse of Swaziland's economy if it leaves the CMA. Theoretically speaking, the aim of the establishment of the common area is to sustain the economic development of such countries as Swaziland. In practice, however, far from being a strength, South Africa's increasing financial difficulties have been visited on the other, smaller economies.

The new SACU agreement symbolised a significant development, giving way to a more workable platform for regional integration into the global economy. Article 38 of the new agreement makes provision for industrial development policy as part of the common policies. The article states:

1. Member States recognise the importance of balanced industrial development of the Common Customs Area as an important objective for economic development.
2. ... Member States agree to develop common policies and strategies with respect to industrial development.

This provision stipulates the possibility for each member state to formulate its own industrial policy, while fully complying with the objective of achieving common policies and strategies. The article does not stipulate or clarify how such common policies should be set up. This role is directed to SACU members, who are to specify the nature of actions to undertake. As the article on industrial development specifically refers to the formulation of common policies and strategies, it gives space to Swaziland's government to engage in, and consolidate, its industrial process from a separate perspective.

On the other side, article 38 opens up some options for each country to propose a set of objectives or principles guiding its industrial policy, taking into account its national specificity. Any step in that direction could specify the strengths of the Swazi industrial sector, or specify the developments that could have negative impacts on its industrial development. In other terms, the country has a choice of informing other member states about areas that are vulnerable to poor performance because of the decisions made by other states. In this regard, the policy for investment presently pursued in the textile industry can be regarded as being in line with article 38. At the same time, the internal dynamics of the sector may represent a threat to the economy of South Africa, because of the distortions affecting the integration of the sector to the global economy. The sub-sector of the textile industry necessitates, therefore, a set of rules that can prevent the emergence of unfair trade in goods that would disadvantage the South African industry.

The economic performance of the past years might sound like a confirmation of the so-claimed benefits of economic liberalisation. As far as its past economic growth is concerned, Swaziland indeed appears to have been a country which, in the midst of economic decline in most parts of sub-Saharan Africa, saw a remarkable rise in GDP and a sustained increase in manufacturing value added. This occurred in the context of macroeconomic and industrial policy that explicitly favoured private, rather than state, ownership, and which concentrated government intervention on short-run subsidies and price adjustments. It must, however, be emphasised that the achievement of this success was, to a large extent, due to the presence of South African investments in the kingdom. But the fact is that there are also a variety of reasons to suggest that this manufacturing progress could have been better. Moreover, evidence in recent years suggests that much of the progress made has been the result of factors other than those the policy-makers believed were influencing industrialists. This, then, is the point at which to propose an outline of the industrial policy that should form the basis for Swaziland to take real advantage of the opportunities, and reap the trade-related benefits, derived from the framework of the new SACU agreement.

The spirit of the industrial policy initiated in 1994, and reported in the subsequent development-plan documents, should be pursued and revamped. In line with this initiative, the task will be to design a policy that promotes the government's major planning objectives, which have always been to further economic growth and, over recent years, some independence from the South African economy; to diversify the economy away from sugar; and to achieve these objectives in the context of a national development strategy. The explicit aims of the industrial policy are to create productive employment for Swazi citizens, to train those most needed for jobs with higher productivity, to increase the GDP accruing in Swaziland and to citizens, to diversify the economy, and to promote industrialisation across the country. The heavy emphasis on skilling citizens as a theme of industrial policy arises from the particular dependence of the economy on non-citizens. A large fraction of gross national income accrues to non-citizens in the form of employee compensation, with as much again accruing as operating surplus of expatriate-owned enterprises in the sugar-production sector.

Although Swaziland has persistently pursued a liberalised economy, the role of the state has been dominant in the most important sectors. Within the framework of the new SACU agreement, it is important to minimise the role of the state in industrialisation in the most productive functions. This is to say that, for the sake of arriving at some sort of industrial-policy harmonisation, that role should be consolidated with regard to regulating corporate behaviour that may result in unfair trade practices within SACU. In line with this, three basic principles are proposed. The first is that government must cultivate the belief that a free-enterprise, market-oriented system for the industrial sector is both efficient in producing goods (and services), and economical in the use of scarce administrative capacity. The second is that the sectoral emphasis should be on the utilisation of the country's forestry resources, and the establishment of linkages with the other major sectors of the economy, notably agriculture. And, thirdly, recognising the divide between the domestic and non-domestic economies, assistance to the large-scale sector should predominantly take the form of incentives, whereas the small-scale sector should be additionally assisted with the share derived from the common revenue pool. Three incentives can be offered: local-preference purchasing, protection (limited partly through government design, and partly through the terms of the new SACU agreement), and financial. These three facilities could be made available to enterprises on the basis of agreed-upon arrangements. In addition to these incentives, the government must commit itself to the provision of infrastructure (priced at opportunity cost), limited state ownership though parastatals (where no private investor is in prospect), and the promotion of foreign investment. There is also a pressing need to address the lack of equity capital and the absence of long-term financing, which constitute, it is believed, the two major obstacles to investment by Swazi citizens. These issues can be redressed through the appropriate use of the share derived from the common revenue pool and the development component within the SACU agreement.

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Appendix: an infant industry under threat

The trouble-torn nature of Swaziland's textile and apparel industry

The development of the textile and garment industry under AGOA in Swaziland has not gone without major problems affecting its trajectory. The industry is permanently exposed to diverse factors that put its efficiency at stake. The sections that follow provide a critical review of some of these factors, and the way in which they affect a credible and viable inclusion of Swaziland into the garment chain under AGOA.

Limited time frame and scope of AGOA, and prospects for job creation

The prospect that AGOA, as a special trade regime, has a very limited life span has always posed a threat and promised a bleak future to the many firms operating in the affected sector. This is a feature that has been criticised. However, AGOA has been extended until 2015. (This was ratified by all partners at the US–sub-Saharan Africa Trade and Economic Cooperation Forum held in Accra, Ghana, 18–19 July 2007.) The extension provides additional time to secure growth in the textile and garment industries where they currently exist, and to create markets and stimulate production in areas where capacity is currently lacking in Africa.

Swaziland is a beneficiary of AGOA under the provision of the granting of its GSP status. At the end of 2003, Swaziland was one of the 19 countries, out of a possible 39, that had qualified to benefit from AGOA. Its status was confirmed in 2004, after a review. As in all other countries that have qualified, AGOA has created many new job opportunities, and the challenge for Swaziland is not only to increase its exported goods, but also to diversify production. Challenges have been plentiful. In 2004, the country had to start dealing with the issue of transhipments, discussed below. Another was the coming to an end of the WTO Multifibre Agreement in December 2004, resulting in a removal of quotas on United States textile imports, thus enabling the Asian economies to enter that key market in competition with products from weaker countries, like Swaziland. A WTO study predicted that China and India would take a 71 per cent share of the global market. This concern seems to have materialised in light of what the textile industries of many African countries, especially South Africa, have experienced.

Given the opportunity cost associated with not being part of AGOA, the Swazi authorities have striven to ensure that they continue to benefit from it. Public records indicate that Swaziland has always defended its position at the hearings conducted by the office of the United States Trade Representative (USTR). The government has publicly claimed its commitment to enforcing union-recognition procedures and other workers' rights on the textile and garments sector, engendering a new spirit of greater co-operation between employers and employees. The observable reduction in 'illegal' strikes is evidence of this. In 2004, the Ministry of Enterprise and Employment published a Textile and Garment Wages Bill that addressed the unique aspects of the sector.

As of January 2003, the companies listed in the box below were registered for AGOA.

List of local companies registered for AGOA benefits (January 2003)			
1	Zheng Yong	16	First Garments
2	Matsapha Knitwear	17	Vietex Garments
3	Nantex Textiles	18	New Biella
4	FTM Garments	19	AI Garments
5	Proton Investment	20	Brand Knitting
6	Ho's Enterprise	21	New Epoch Knitting
7	Sigugi Arts and Crafts	22	The GMS Corporation
8	Tuntex Textile	23	Sun Tay Lon
9	Tuntex Garments	24	Shun-Li Manufacturers
10	Kangfa Knitwear	25	Unique Garments Investments
11	Leo Garments	26	Taitex
12	Orient Sun Clothing	27	Bao Sheng Textile
13	Euro Swazi Textiles	28	TexRay Swaziland
14	Ngwenya Class	29	Hong Ye (PTY) Limited
15	W7W Garments	30	Fashion International Swaziland

Source: SIPA

During the financial year 2003, SIPA reported that 95 per cent of foreign investments in new businesses took place in the textile and apparel sector. While government initiatives centred on AGOA have contributed to an export-oriented clothing industry that has created around 28 000 jobs, the rate at which new jobs were created began to decline just as the numbers of new entrants to the labour market was increasing. Increasing supply at a time of falling demand has swollen the numbers of unemployed. The first half of 2003 saw the creation of some 8 000 new jobs, mainly in the textiles and garment sector. Although divestments were minor up to 2003, two major companies, First Garments and GMS Textiles, closed down. There was, however, some expectation that more jobs would be created through AGOA as an expansion of factory shells was programmed.

The local textile industry was indeed due to expand, as 15 investors from Taipei were expected to set up business. In September 2004, it was reported that 20 000 jobs had been created through Taiwanese Trade Co-operation, which is an initiative between the governments of Taiwan and Swaziland. The bilateral co-operation, it was reported in the official statistics, resulted in more than 50 companies investing in Swaziland, and the creation of over 20 000 jobs. The companies were mainly in the textile sector, and included Tuntex and a bulk of others dominating the Matsapha industrial sites. The Taiwanese direct investments have played a huge role in the economic upsurge of the country, and brought in a huge percentage of the country's foreign income. They are spread throughout the country in places such as Nhlangano, Mankayane, Ntfongeni, and Siteki, among others. Taiwan's representatives in Swaziland have always claimed that Taiwan's mission in the country has empowered a large number of Swazis in terms of skills, and promoted bilateral trade between the two countries.

The exchange rate and the United States economy

The health of the United States economy and developments in the US$ exchange rate have tended to dictate the benefits qualifying African countries could enjoy under AGOA. The exports depend on United States demand, and a strengthening of the South African rand against the US$ increases the vulnerability of Swaziland's export industry to shocks as the goods become less competitive. Flint (2004) reported that the total imports by the United States from sub-Saharan African countries under AGOA experienced a sharp decline in the aftermath of the September 2001 terror attacks – in October 2001, AGOA operations were temporarily suspended. Although the declining trends also reflected in imports from other regions of the world, sub-Saharan Africa was the most affected. However, according to Flint, United States imports from sub-Saharan Africa increased in 2002, even though their levels remained below the imports from other regions of the world. In 2003, the trends revealed a significant advantage of sub-Saharan Africa over the rest of the world, thus compensating for the slow recovery in 2002. However, the gradual weakening of the dollar throughout 2003 and 2004 had a quite substantial negative effect on the United States imports from sub-Sahara, including AGOA imports.

The strength of the lilangeni/rand continues to be a source of major concern for the textile industry. With the financial positions of the exporting companies being eroded whenever the rand gains strength against the US dollar, they are compelled to reorganise their financial resources to counter the predicament they find themselves in. The situation also affects the labour force, as erosion of companies' financial base is likely to lead to job losses.

Adding to this currency-related uncertainty is the frequent unavailability of primary fabric material such as yarn, which, until recently, had to be either African in origin or imported from the United States, to qualify for export to that country under the AGOA regime. Chronic United States shortages mean that many textile-export countries constantly run out of material. The combination of this and the exchange-rate issue has always imposed a serious limitation on countries striving to increase their apparel and textile volumes.

Swazi business-community exposure to the United States market

The direct exposure of the Swazi business community to the United States market is quite limited, despite the opportunities offered under AGOA. The country does not, for instance, hold a trade fair in that country to exhibit products and create awareness. It is not an exaggeration to say that the country is almost unknown in United States markets – an observation supported by the comments of numerous American consultants, invited to Swaziland by the United States embassy, that Swaziland is unknown in their home country. These consultants advised that a local agency named Business Fraternity should be marketed to American investors to publicise the country and its products. Swaziland, like most AGOA beneficiaries, needs transatlantic business endeavours, which could not only be profitable to the business community, but also to the economy, by increasing foreign earnings. Despite the quite substantive number of American investors – 900 – in the southern region, the country was not publicised. This concern was central to the proposition made by the United States embassy to host an event that could give locals a chance of meeting these investors, and open business in the country. The organisation of a workshop called 'Making AGOA work for you,' hosted by the embassy, came as an attempt to address such concern. A number of local business representatives converged to learn more about AGOA. Issues discussed during the workshop included the way in which AGOA could be used, how to determine whether the products offered are eligible, United States regulations, shipping, determining the final costs, and information resources. The workshop focused on the textile and apparel sectors, among others, where large and small business have been encouraged to take advantage of the lucrative markets presented by AGOA. During that workshop, it emerged from the Association of the Swazi Business Community (ASBC) that an exhibition in the United States was on the cards.

Short lifespan of garment factories, and managerial accountability for poor performance

The precarious employment conditions in the textile and garment industry, an aspect examined below, are a matter not only of employee welfare, but also of job security. Closures without notice have been increasing among existing factories. In some cases, the first sign notifying employees that the factory has closed down is a main gate closed at the time it is usually open, when they report for work in the morning. A joke widely shared among female workers is that Chinese bosses of bankrupt factories always depart at night, to avoid being stopped by their employees for unpaid wages.

The reason for closure is generally associated with low levels of orders. Some companies announce their closure shortly after commencing operation. For example, in August 2003, a company officially opened by the King of Swaziland was on the verge of closure after a year of operation, as it was encountering problems in South Africa's textile markets. As a result, the company decided to put all of its 600 employees on a short-time basis, which effectively meant that they were at work only three or four days a week. The explanation given by the company's deputy manager was that, though the storerooms and warehouses were full, the goods could not be sold due to lay-offs and the closure of some companies in South Africa. Retrenchments and reduced working hours were part of the company's strategy to minimise production and avoid closure, but retrenchments were ruled out after negotiation with the labour department.

Public perception is that some managers deliberately cease operation without prior discussion with the ministry in charge of the sector. The case of First Garment (First GMT) is illustrative. This factory collapsed in October 2003, leaving more than 400 workers stranded without pay or jobs. Information gathered during the present author's field work indicated that, shortly before the liquidator moved in, a message was sent from Taiwan with strong indications that all material should be sneaked out immediately. The instructions urged that all of First GMT's made-up goods be moved out and hidden at other factories, with shipment to be executed under that factory's name. Machinery and clothing material also went missing from the factory, clearly in a bid to save them from the liquidator. The names of some of the Chinese nationals and the firms involved were identified by the law firm in charge of the liquidation, as they were all in Swaziland at the time the instruction came out. The situation gave rise to a government investigation, and it transpired that a shipping vessel had been arranged, and the shipment of some of the equipment was due to take place in Durban, South Africa, with Taipei as the final destination. The discovery of the removal of the machines prompted the law firm to seek and obtain an order of the High Court to conduct a hunting expedition, and some equipment was found hidden in store rooms of nearby firms in Manzini – only 30 machines in all. Some owners of the firms in question refused to co-operate with the investigation, despite the threat of arrest.

The trade union was instrumental in making the investigation possible, by providing information on the machines missing from the firm. The president of the Swaziland Manufacturing Allied Workers Union (SMAWU) criticised the lack of honesty on the part of the Chinese factory owners. As he put it during an interview, 'The First Garment factory boss has eloped without paying his employees.' He added:

> Some of the Chinese investors come to Swaziland with nothing in hand, but are assisted locally, which is why they complied with the message to hide the equipment. As I speak, a total of 400 former employees from the … firm [have not been] paid … One wonders how they would be paid if all the equipment is not recovered. Above all, I suggest that government must conduct a thorough investigation on such people, who call themselves investors.

The law should be applied, he said, to those firms found hiding the missing equipment.

Thereafter, the matter was taken to the Embassy of the Republic of China. Against all odds, the embassy denied the allegations, while stating some willingness to help former employees to get their payments.

Swaziland's Minister of Enterprise and Employment was not aware of the situation regarding the non-payment of wages. In his official statement, he said that the matter had not been reported to him by SMAWU. Strangely, he went on to comment that the firm was operating as a private institution. The issue of missing equipment was, in the end, taken to court as, according to the minister, this was a 'commercial crime common even at international level'. Seven Chinese firms were investigated for their alleged involvement in concealing more than 1 000 machines from a liquidator who was winding up assets for a factory that had collapsed.

The soft ministerial attitude instigated a call by the Swaziland Federation of Labour (SFL) for the Chinese embassy to intervene and deal harshly with their nationals who had committed the so-called ‘commercial crimes’. The federation’s secretary-general was critical of the statement made by the minister, and was acerbic in his comment that such intolerable practices, while undermining the welfare of their members, ‘could ruin the cordial’ relations prevailing between Swaziland and Taiwan. The SFL publicly disapproved of such unethical practice, threatening to report corporate behaviour of this sort to the international markets. The compliance of some of the Chinese companies in hiding equipment said a lot about the character of some of the investors operating in Swaziland. In the words of the SFL’s president:

> If a firm comes to the point of liquidation, the matter should be put on the table for discussion so that local employees do not find themselves at the losing end. There is need for an urgent meeting between the Chinese embassy, the Minister for Enterprise and Employment, and other concerned parties.

This case raised the puzzling issue of how the company manager was able to leave the country without paying the employees, in the face of the expectation that the government of Swaziland would protect its citizens.

Factory infrastructure delivery

As part of the incentives offered to investors under AGOA, the government of Swaziland has to provide a factory shell to locate the equipment. The shell, which also serves as premises for the company, is rented by the investor, and remains the property of the state. From the government perspective, however, things are not as simple as they appear. The construction of factory shells is a costly investment. In 2003, for instance, when the E92 million allocated for the factory shells programme was exhausted, payments for the purpose had to be made from the E42 million set aside for the trade fair’s relocation, and meant a delay for that project. The cost of factory shells had increased by a staggering E35 million, due to the increased scope of work. The need for more factory space continued to put pressure on the need for more funds to be made available. The strategy of offering factory shells as part of the incentives package to attract FDI under AGOA was obviously showing its limits. This may have been the factor that motivated the government to recommend that SIPA review its negotiating approach with investors, to bring it in line with a new financing mechanism for the factory shells. An international consortium was approached in 2003 to audit the factory shells project.

Parliament proposed to involve the private sector in the financing of factory shells on a build-operate-transfer (BOT) basis, and urged the ministry to call upon the private sector for involvement in the provision of factory shells for foreign direct investors. These efforts paid off as two major firms, Palace Engineering LTA and KPMG Consortium, were reportedly recommended, through a tender process, to undertake financing and construction of three and two factory shells, respectively. The Economic Planning and Development Ministry said the decision to engage the private sector came as a result of the inability of government funds to cope with the demand for factory space by investors. banking on the private-sector initiative for the realisation of this construction.

Compromising diplomatic relations with Taiwan

While several African countries experience the dilemma of choosing between Taiwan and mainland China, there is no doubt that Swaziland has made its choice, positioning itself on the side of the former. It is officially claimed that without the fruits of its bilateral co-operation with Taiwan, Swaziland could not have made the leap to its present economic position. Taiwan has been involved in most of the development projects implemented in Swaziland. As a developing country, Swaziland has had no material assistance to offer Taiwan, but the country needs Swaziland's political support due to its own complex situation. Since declaring independence in 1945, the Asian state's sovereign status has remained without official recognition by many countries worldwide. Swaziland's diplomatic relations with Taiwan are a reflection of the strategy deployed to attract FDI in an effort to stimulate economic growth. The framework under which this strategy is carried out is known as the Africa–Taiwan Economic Forum (ATEF). In 2003, seven African countries joined Swaziland to set up the forum. One of its missions is to promote Africa's institutions, interests, and values within the context of NEPAD. The priorities of ATEF, whose offices are at the Taiwan World Trade Centre in Taipei (the capital city of that country), are centred on promoting and advancing trade and investment relations between Africa and Taiwan, among other aims. The anticipated outcome is a contribution to an African government's efforts to create jobs and build the skills required for competing in a globalising world. Swaziland was particularly praised by the Taiwanese embassy for making it easy for Taiwanese investors to travel to the country by removing visa requirements. Most of these investors were interested in opening textile firms.

The inability to move away from lower-end customer markets and promote original brands

As the removal of quota systems drew nearer, local exporters began considering targeting higher-level customers, supplying world-renowned labels, in order to remain competitive. Two names were particularly targeted: Tommy Hilfiger and Levi's. Some manufacturers publicly expressed concern that clothes produced in Swaziland are mainly consumed by the lower-end markets. These include minor South African retail outlets with branches in the country. A textile company manager commented in 2004 that the situation was related to the fact that 'the textile industry in Swaziland is only three years old, and so is the skill base'. Even so, the industry is regarded as being in a position to move from producing for the low-end market, towards the upper end. The products were relatively competitive, but, as a textile company manager commented, 'Most products from Swaziland are similar to what is produced by overseas producers, hence the fear that China could dominate the export market.' The production of high-quality garments would enable the local industry to manufacture export products for top-name companies, especially in the area of sports wear. This would require considerable effort.. In the context of quota removals, local textile companies will have to acquire skills in managing higher-level operations. Part of this effort should come from wage-related incentives. Industrial relations are to be improved for the betterment of workers. A manager in the industry stated that employee wages will have to be doubled, by virtue of the fact that the companies will be producing a better quality of goods for high-level consumers. He regarded the new situation as making Swaziland more attractive for investors, which would in turn strengthen the industry. In the Southern African context, he concluded, 'Potential buyers who come to the region should not only come to see a single supplier, but there should be a wide range of such companies in the region. The industry has to remain strong, we must retain the investors.'

One area regarded as a means of boosting garment sales is label design, and, unlike Asian firms, those in sub-Saharan African countries operating under AGOA lack skill in this field. Information gathered from field work revealed that the government of Swaziland was taking some steps in view of remedying the situation. Associated with the issue of label design is that of brand or, as Geriffi (1995) puts it, 'original brand-name manufacturing'. This is another issue that is not considered on the AGOA agenda. In the new global economy, brands represent an important source of profits. In South East Asia, garment companies have switched from merely producing products, to marketing aspirations, images, and lifestyles by lining up with well-known brands (*The Economist*, May 2001). Many apparel manufacturers have embarked on ambitious programmes of forward integration into retailing, using their own brand names and retail chains for their products (Geriffi 1995). The brand option, while still remote for relatively less-advanced African countries, establishes a benchmark against which the most ambitious export firms will be measured.

Transhipment

Transhipment is a growing malpractice affecting the textile industry. This is an arrangement whereby a company manufactures a product elsewhere, brings it into the country only to attach the 'made in Swaziland' label, and then sends it overseas as Swazi-made goods. With a reported increase in cases of transhipment, involving the majority of companies in the sector, the fragile garment industry of Swaziland was faced with a real threat to its eligibility for AGOA. The Ministry for Enterprise and Employment issued a warning, threatening closure to the companies found to be transhipping their products. The minister publicly denounced this practice, as transhipment by a single company could disqualify the entire country from receiving the benefits of AGOA. A policy of spot checks on companies was commissioned by the ministry, and companies were called upon to police each other on this matter.

The rules of origin under AGOA are not clarified (DATA 2003), and it is this lack of clarity that has led to a proliferation of transhipment practices, and frequently resulted in the United States customs denying duty-free status to garments under AGOA because some components of them are of neither African nor American origin. Information collected from garment factory workers confirmed that some of the products on which they worked required only that labels be sewn on, and that they are then packed into boxes for shipment.

The origins of these products were not known, but the main destination was the United States market. Taiwan is not eligible for duty-free exports to the United States, but uncertainty still prevails over what constitutes an AGOA-eligible garment. As long as this has been the case, eligible African countries have not been given the greatest latitude under the act.

The rehabilitation of existing industrial-investment institutions, and the promotion of Swazi-owned, informal, small and medium, resource-based, labour-intensive and export-oriented industries, are aimed at creating an enabling environment for investment. The major instruments of the nascent industrial policy have been built around the activities of SEDCO, the Swaziland Industrial Development Company (SIDC), the Swaziland Authority for the Promotion of Industry (SAPI), and Tibiyo Takagwane. SEDCO is a wholly government-owned company, with the responsibility of promoting small business by providing managerial and marketing assistance to local entrepreneurs. SEDCO also runs a number of small industrial estates throughout the country, which provide entrepreneurs with locations to start up their businesses. In 1993, before the revamped industrial policy, 24 units with a total area of 780 square metres were constructed in Sidwashi. This brought the number of completed units to 144 since 1992.

SIDC is a private company set up in 1987 as a joint venture between the government of Swaziland and major international finance institutions. The company has promoted and financed private-sector investment projects in manufacturing, mining, agri-business, tourism, commerce, and services. Other opportunities offered by SIDC include equity participation and loan financing, and, like SEDCO, it leases factory space to entrepreneurs. In a related function, SIDC provides development finance, giving priority to investments that encourage employment creation, domestic-resource utilisation, export industries, linkages within existing industries, and knowledge transfer. The company has reported that it has so far contributed to the creation of 5 000 jobs, in projects with a total investment of about E400 million, of which SIDC provided in excess of E100 million in the form of equity, loan finance, and buildings. The 1995 records showed that SIDC's sources of equity were the Swaziland government, the German Investment Development Company, Barclays Bank, and Standard Chartered Bank. This company has, to a large extent, been the first contact for investors in Swaziland, and it has also committed itself actively to promoting development projects to attract local and foreign entrepreneurs. It provided some assistance to the government in formulating policies on ways to improve the attractiveness of Swaziland for investors, such as revised instrument incentives, and the establishment of an investment-promotion project (which resulted in the creation of SAPI). Its operation has had international ramifications through its position as the antenna for the Centre for the Development of Industry in Brussels, which provided valuable joint-venture and marketing assistance. SIDC has contributed to most of the key projects and programmes in the industrial sector of Swaziland.

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