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PROGRAMME

Report on

ECONOMIC POLICY FORUM
DRIVERS OF REGIONAL INTEGRATION ROUNDTABLE

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Cape Town

The following report does not represent consensus views of the Economic Policy Forum or the participants of the "Drivers of Regional Integration" roundtable. Statements reflect dominant debates and points of interests in discussions, rather than the views of individual participants.

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Overview

Following discussions earlier this year in Rio de Janeiro, EPF members met for their second roundtable on "Drivers of Regional Integration" in Cape Town, South Africa. The 2-day workshop was organized and hosted by EPF founding member, the South African Institute of International Affairs (SAIIA), supported by the EPF secretariat in Berlin at Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH. The meeting was held in parallel and in parts jointly with a workshop of representatives from different Regional Economic Communities (RECs), and followed by exchange visits to the Cape Town Port Authority TRANSNET and the South African Revenue Service (SARS).

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The BRICS and other large emerging countries have a mixed relationship with regional integration. Embedded as they are in fast-growing regions, greater integration offers the opportunity for each country to grow with their neighbours, and to safeguard their important economic role in their regions. However, as the regional hegemons, smaller countries may be wary of agreeing to deep integration that opens their markets to competition from their larger neighbours. Similar concerns arise amongst BRICS and other large emerging economies, where a network of bilateral agreements exist, but are largely offer limited market access. This roundtable on “Drivers of Regional Integration” aimed to find avenues for integration that look beyond simple market liberalisation, and offer returns for both the BRICS+ and their neighbours.

Session I: The Development of Regional Value Chain

Key takeaways

1. **The Splintering of the Riccaridan Black Box:** Old conceptions of trade in primary and final goods are outdated, trade is increasingly concentrated in intermediate goods.
2. **Breakdown of old models of integration:** Traditional linear models of regional integration (from PTAs to FTAs to custom unions) do not fit the reality of global value chains.
3. **Competitive Advantage in Tasks:** Specialization in goods is no longer the basis for gains from trade. Specialisation in tasks is quickly taking its place, allowing single customs units to engage in activities in multiple different sectors.

Traditional models of regional integration are underpinned by two elements: a Riccardian understanding of trade, and a linear European model of integration institutions. Both are increasingly losing relevance.

The Riccardian understanding of trade is premised on trade in primary goods and final goods, with the space between these composed of a “black box” of (largely domestic) production processes. These black box production processes are increasingly splintering. The conversion of goods from primary to final stages is no longer undertaken by a single firm, but multiple firms across multiple countries. Trade in intermediate goods requires a shift in thinking, away from a speciliasation in specific primary or final goods, and towards efficiency in small niche links in the value chain. The traditional vision of comparative advantages in final goods is giving way to comparative advantages in tasks. These tasks can cross industries, allowing for a new diversity of sectors in single customs areas. This new specialization also allows for the rapid movement of production centers, as tasks can be easily transferred from one country to another, as efficiency shifts. Old conceptions of stable productive centers, turning out good you can buy in shops, is increasingly eclipsed by the new logic of Global Value Chains.

And yet despite this, old models of regional integration still remain influential. Integration is imagined to proceed on a relatively linear pathway: moving from preferential trading agreement, to free trade agreement, to customs area; and then finally embracing the free movement of capital and people. Since gains from trade are drawn from specialization in tasks, linear liberalizations of trade in goods may not be as important as the alignment of norms and standards. New complications to regional integration may also arise, such as attempts to reduce intellectual property rights below you in the value chain, in an attempt to capture more value. The uneven distribution of value in GVCs means the question of where a country sits in the value chain may prove as important as gaining access to the chains in the first place.

The global trading system – including the WTO and emerging megareginoals - must be responsive to the new reality of global trade. This includes facilitating global value chains, but also managing their negative spillovers. Environmental concerns must be more firmly brought into the dialogue on trade. The rise of global value chains offers both opportunities and risks in this regard: opportunities to improve the efficiency of productive processes and thus smooth energy consumptions, and risks in the growing environmental cost of transportation.

Session II: Trade Facilitation and Infrastructure Development

Key takeaways

1. **Noodle bowl approach to trade facilitation:** With trade facilitation being tackled at the WTO, megaregional, regional, bilateral and unilateral level, can a simple outcome be possible?
2. **Infrastructure beyond transport:** The focus on road, rail and air links is not enough; greater emphasis is needed on supporting infrastructure like communication and energy.
3. **Industrialization for trade facilitation:** Efforts to smooth trade will be given extra impetus if countries have the capacity to move up value chains.

Interest in trade facilitation and infrastructure development has grown rapidly, giving rise to numerous divergent approaches. The World Trade Organization signed its headline Trade Facilitation agreement in Bali, focusing on smoothing border efficiency, while regional blocs have launched their own programmes. New megaregional groupings, such as the Transatlantic Trade and Investment Partnership and Transpacific Partnership, have gone further than most, attempting extensive regulatory alignment to smooth trade flows. The lack of coordination between these efforts risks adding complexity in a process that is meant to reduce it.

This disjointed approach to trade facilitation is further complicated by implementation challenges. Basic technical differences, such as different rail-line widths used in different countries, will require long-term work to overcome. The complex political economy of these efforts requires winning the buy-in of the interests that are sustained by the problems trade facilitation is trying to overcome. For example, the development of mass transit systems helps consumers but is a direct challenge to taxi companies, governments will need to balance the interests of opposition parties to assure the political environment to make these projects work.

To overcome these challenges, trade facilitation efforts should be led by a strong regional institution, which engages extensively with the private sector, and operates with maximum transparency. Focus must not only be placed on challenging physical infrastructure projects, but must also incorporate supporting infrastructure, such as communication and energy equipment.

Efforts towards trade facilitation and infrastructure development should support the emerging prioritization of industrialization. The Southern African Development Community, for example, has shifted its priority from regional integration to industrialization. Infrastructure development is particularly important in achieving this aim, and has been promoted recently as a means to improve export efficiency and move African countries up the value chain. In the African context, the headline effort in this regard is the African Development Bank’s Programme for Infrastructure Development in Africa.

Session III: Emerging Power Trade Cooperation

Key takeaways

1. **The Signing of the TTIP or TPP will have negative welfare effects for BRICS:** Almost all countries that are not part of the deal suffer negative welfare effects, while most signatory countries benefit.
2. **The signing of the Tripartite Free Trade Agreement will have mostly positive welfare effects for signatories**: However some countries, such as Zambia and Zimbabwe, may lose out.

3. **The development of Regional Value Chains may help counteract the impact of megaregionals:** ASEAN and the broader "Factory Asia" offers lessons for building competitive regions.

Emerging countries face the prospect of trade being increasingly balkanized into megaregional groupings – such as the Transpacific Partnership and Transatlantic Trade and Investment Partnership – from which they are excluded, and regional groups – such as Africa's Tripartite Free Trade Agreement – which they attempt to use to counterbalance the megaregionals. The empirical implications of these agreements were examined in this session, and are summarized in Annex 4.

While there was some debate amongst participants over the quantitative model used, the study indicated that the formation of megareginal blocs will give rise to predictable patterns of trade diversion and trade creation, with those inside the blocs gaining and those outside losing. For South Africa, the formation of a Tripartite Free Trade Area was helpful in offsetting the impact of TTIP and TPP, however the study argued that bilateral deals with major partners – particularly the US and China – would create greater benefits for the country.

The BRICS and other large emerging countries do have some scope to respond the megaregionals, by creating similar blocs in their own regions. These efforts are well established, perhaps most notably in the Association of East Asian Nations. ASEAN's work towards a common economic community has joined with the broader development of regional value chains, to drive interregional trade and – perhaps most importantly – improve productive efficiency through broader specialization in tasks. The rise of "Factory Asia" is a powerful reminder of how regional integration can improve competitiveness and promote growth that is robust in the face of a rapidly evolving global trading system.

Session IV: Regional Investment Strategies

Key takeaways

1. **Investment strategies are viewed as a driver of diversification:** Countries increasingly value FDI in sectors that promote value-addition.
2. **Global Value Chains mean investment and trade policies cannot be viewed in isolation:** Trade strategy is needed to unlock the potential of investment strategy.
3. **Nations must embrace efficient regional divisions of labour:** Firms should take advantage of the productive advantages offered by neighbouring states.

Large emerging countries like the BRICS host huge stocks of foreign direct investment, but much of this investment is in traditional sectors, like extractives. Increasingly, governments are attempting to build incentives that do not simply aim to attract investment, but to attract investment in certain sectors and certain regions. Russia is a useful example of this trend. While generally perceived as being dominated by natural resource extraction, the top two sectors receiving inward FDI are finance and insurance, and retail and wholesale. Investment tends to be geographically concentrates (with more than half going to Moscow) and features low levels of manufacturing investment. In response, the government has developed a series of Special Economic Zones, and has attempted to develop closer ties with its booming Asian neighbors. The efforts are together meant to diversify the geography and sectorial distribution of inward FDI.

The rise of global value chains, however, means that these investment strategies are hard to disentangle from trade strategies. The kind of mobile, competitive investment that these strategies aim to attract is sensitive to national competitiveness, and competitiveness is closely tied to trade policy. Products produced in value chains that cross borders at multiple stages of production accrue the cost of trade barriers for each border crossing. Trade barriers thus restrict the capacity of firms to locate their operations at the most efficient location for each stage in the production process. Restrictive trade policy may thus undermine competitiveness, and divert investment.

Examples from the European Union highlight the role that regional integration can play in driving investment. In the case of Europe, automobile manufacturers responded differently to the deepening integration of the region. Italian car manufacturers in particularly resisted moves to shift production to parts of the Union with lower costs, and focused instead on localizing production. Germany, on the other hand, shifted production of key labor-intensive components to former Eastern bloc countries like Hungary, while maintaining other production process at home. The different strategies resulted in divergent fortunes, with Italian car production in 2013 only a third what it was in 1990, while German production has expanded both domestically and abroad. So long as regional value chains support domestic competitiveness, they can be useful in expanding domestic production and employment, and protecting against the movement of jobs abroad.

Session V: Corporate Drivers of Regional Integration

Key takeaways

1. **Which private sector?:** The private sector is particularly heterogeneous, with the experience of small firms no comparable to those of large multinationals.
2. **Private sector actors can act as guides in integration processes:** On the ground experiences are key to identifying bottlenecks and areas for cooperation.
3. **Investment is the new frontier in regional integration:** Regional value chain-led trade growth requires investment, and regional blocs should create policies to promote this investment.

Regional integration is often a top-down process, driven by governments and regional organizations with little direct experience in navigating regional barriers. However, increasingly, at a less noticeable level, the private sector has been driving the practical integration of regions. In the Southern African context, this stretches from the entry of major South African brand into neighboring markets, to informal traders venturing across loosely regulated borders. While not on the grand level of regional summits and agreements, this still facilitates real connections across borders and forms the bread-and-butter of trade relations.

Large private companies and government SOEs play a particularly valuable role. This is perhaps clearest in China and East Asia, where regional value chains between firms have given rise to record regional trade flows and closely intertwined the future of the region. This can often spark mixed responses, as has been witnessed by the fortunes of South African firms' operations in neighboring countries. South Africa is often considered an economic hegemon, and is accused of bullying neighboring country firms, even though evidence suggests their operations are socially aware by global standards.

Much of this interaction takes place beyond trade, in regional value chains that develop through investment. This relationship means regional trade can develop through regional investment policies. The signing of a China-ASEAN investment treaty, which simplifies investment approval processes and offers national treatment clauses, could spark a deepening of the already entrenched Asian productive hub. Similar efforts are worth considering as large emerging countries continue their shift from investment destinations to emerging foreign investors. Creative solutions can bring the private sector into these investment efforts, through programme's such as Turkey's development of regional investment corridors.

Session VI: BRICS+ Currency Cooperation

Key takeaways

1. **International reserve currencies play a crucial role in determining trade volumes:** The domination of the dollar is evident across international currencies.
2. **China may exert undue influence in the New Development Bank:** Thanks to huge monetary reserves, with US debt to China over $1 trillion, and its political clout.
3. **BRICS partners mostly do not believe China will dominate:** The Yuan still has a way to go if it is to become a global reserve currency.

In order to become a global currency (currency of reference and major reserve currency), particular conditions must be present. It must be a trustworthy currency with low-inflation. China doesn't yet seem able to operate regularly at low inflation. The currency must be based on a sound financial system, with an appropriate banking system. Chinese banks are very big but they are state-owned. China does not yet have a globalised world-class financial market – Shanghai may be world class, but is still a local market.

There is a possibility that a BRICS currency, or a solid alternative currency may eventually displace the dollar as global currency. The effort of de-dollarisation has been led by Russia and China (since June 2014) through regular and sizable ruble-yuan swaps. The Russia-China US$ 400 billion energy deal for 38 billion cubic meters of gas flowing through the pipeline from Russia to China is a symbolic step in decoupling significant trade volumes from the dollar, as it foresees payments in local currencies, rubles and yuan. This offers an alternative to the traditional US dollar-based trading currency.