SOUTH AFRICAN INSTITUTE OF INTERNATIONAL AFFAIRS

Development through Trade Programme

Trade Reform in Southern Africa: Vision 2014?

Working paper

IMPLICATIONS FOR THE BLNS COUNTRIES OF SOUTH AFRICAN TRADE POLICY REFORMS

Implications for the BLNS Countries of South African Trade Policy Reforms

by Ron Sandrey

Trade Law Centre for Southern Africa

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Implications for the BLNS Countries (Botswana, Lesotho, Namibia and Swaziland) of South African Trade Policy reforms.

Ron Sandrey

Summary and key points

The current SACU trade regime combined with the regional dominance of South Africa restricts the BLNS countries to limited trade policy space. In particular, their 'offensive' interests for exports are focussed upon (a) the EU where the offers under the EPAs are currently for complete quota and duty free access upon signing for all products except rice and sugar and (b) the US where the AGOA provides good but not permanent duty-free preferences for most but not all exports. Their 'defensive' options for imports are extremely limited as they are locked into (a) duty-free imports from South Africa for the large bulk of their imports and (b) the TDCA for EU and the SADC preferences for another considerable portion.

The welfare implications from FTAs are very minor excepting for the very large gains accruing to the rest of SACU from a massive increase in (Swaziland) sugar to the EU following quota and duty-free access to that market. These gains are assessed at 3.12 percent of the aggregated GDP of the Lesotho, Namibian and Swaziland aggregation, and the resource 'pulls' into the sugar sector are enough to induce output reductions in all other sectors. At the detailed level we emphasis that that this result is a function of several assumptions and possible limitations of the model, and while there is a major potential for sugar exports from Swaziland to the EU under these access conditions the scale of and the subsequential implications from this result must be treated with caution. There are few other direct trade results to either Botswana or the rest of SACU other than the dampening of all rest of SACU sectors other than sugar.

The welfare implications from a possible Doha outcome are similarly muted, with a welfare loss to Botswana of $12 million and a positive increase of $20 million for the rest of SACU. Gains to the rest of SACU mirror the sugar results above bur with much lesser increases in exports to the EU, while both Botswana and the rest of SACU suffer from reduced textile and apparel exports.

The major outcome though is the decimation of the government revenue base for Lesotho and Swaziland in particular. They currently get over half of this revenue from the SACU customs pool, and providing duty-free access to most of South Africa's import sources reduces the estimated tariffs by just over 80 percent. This in turn reduces Lesotho's total government revenues by 42.5 percent and Swaziland's by 45.6 percent. While the actual numbers may or may not be accurate, the percentage share losses are certainly more than indicative and indicate a massive potential problem for the BLNS should trade liberalisation continue apace.

Overall, the situation is that the BLNS are very closely tied to South Africa for their 'defensive' or import policies in that there is a common tariff and they are part of that tariff, and reductions in this tariff schedule impact dramatically upon their government revenues. Conversely, they operate almost independently from South Africa in that their 'offensive' or access conditions for their exports to their major foreign markets have, to date anyway, had little or nothing to do with South Africa's access conditions to these markets. And in the area of 'flanking' trade policies such as industrial and competition policies they again live in the shadow of South African policies.

1 Introduction

While South Africa's regional influence spreads beyond the immediate neighbourhood of SACU into the full Southern Africa Development Community (SADC) region and beyond, this paper will limit its discussion to the non-South African members of SACU only. This is partly to keep the paper manageable but more importantly because these SACU members are much more closely inter-linked with South Africa's trade and economic policies. In addition, all SADC members have practically duty-free entry into South Africa through the asymmetrical nature of the much-hyped but questionably implementable SADC free trade programme[1], thus further direct trade policy gains they may achieve from South African liberalisation are somewhat limited.

In general, the BLNS live in the shadow of South Africa, and this is especially apparent when trade policies are considered. Their scope for independent or even BLNS-initiated actions is extremely limited. For direct trade access issues, their defensive interests are really subsumed into the common SACU tariff schedule that contains the TDCA and SADC preferences. For offensive positions their interests are focussed upon access into the EU and maintaining and possibly improving their access into the US; both of these are largely but not entirely independent of South African influence. With respect to the WTO and any possible Doha Round agreement, while the BLNS are members in their own right and have individual bound tariff rates, as members of SACU this is rather irrelevant as they are effectively locked into a common tariff policy by definition of a Customs Union. With respect to 'flanking' trade policies such as industrial, competition and trade remedy policies, the asymmetrical influence of South Africa again becomes apparent. This then leaves the nature of the BLNS/South African relationship as a subservient one. While the general comment that a strong and prosperous South Africa has large spin-offs for the economies of the BLNS is valid, that is more in the nature of the relationships between trade and economic policies in generating growth than the nature of the South African trade policies *per se* directly upon the BLNS and this discussion will be eschewed here. It does however have relevance to the sharing of the SACU customs pool revenue, as a large percentage of the revenue shares currently going to the BLNS are effectively regional aid grants and the diminution of this pool through tariff reductions has a significant effect upon these grants.

The objective of this paper is to discuss the implications of trade reforms in South Africa for these so-called BLNS countries. The focus will be strictly forward-looking, as the focus of this project is premised upon the assumption that South Africa has undergone considerable trade liberalisation and the issue at hand is to review the case for continuing that momentum.

That South Africa is a relatively open economy is confirmed by an analysis of the tariffs facing exporters at the South African/SACU border, and this generalisation is made emphatic by factoring in the tariff preferences offered with firstly SACU itself through the customs union and secondly through the TDCA and SADC preferences. For agriculture the MacMaps (Bouet *et al*, 2005) data shows that excepting for maize, meats and dairy produce agricultural imports are lightly protected, and this generalisation is confirmed by the OECD (2006). Furthermore, Sandrey et al (2007) analysis these agricultural tariffs and conclude that South Africa has limited policy space to increase them due to either WTO commitments or direct tariff preferences such as the TDCA and SADC

[1] SADC is scheduled to implement a Free Trade Agreement by 2008 and a Customs Union in 2010. This seems implausible given that the composition of SADC contains three failed or near-failed states, that there has been practically no movement from the non-SACU members to advise on how they intend to reciprocate SACU's access conditions for them to SADU, and considering that even 2010 is, as the soccer World Cup officials appreciate, not far away. The year 2008 is even closer.

ones. For natural resource products the protection is even lower and indeed close to zero. For manufacturing products the residual protection is concentrated in the so-called TCF sectors of textiles, clothing and footwear and the controversially protected motor vehicle sector. By definition of a common tariff these same comments are germane to the BLNS as well.

Thus, further direct SACU tariff liberalisation will be concentrated upon somewhat incremental changes in agriculture or more comprehensive liberalisation of the TCF and motor vehicle sectors in manufacturing. This would need to be done within a multilateral framework (the Doha round of the WTO), regional agreements (although SADC has duty-free access now), bilateral agreements in the form of meaningful bilateral agreements with major trading partners or unilateral liberalisation. Sandrey and Jensen (2007, forthcoming) undertake analytical research on the implications for South Africa and SACU on the Doha agreement and a suite of comprehensive FTAs, and the implications of these for the BLNS are discussed later in summary form.

The structure of the paper is as follows. Section 1 includes this introduction and looks at the institutional background to the BLNS relationship with South Africa before briefly examining how this relationship severely restricts trade policy space for the BLNS. Section 2 provides a short overview of the BLNS trade profiles, and this highlights (a) how dependent they are on South Africa for imports and (b) how dependent they are upon the markets of South Africa, the EU and the US for their exports. Section 3 gives a profile of BLNS access conditions into the EU and the US. Section 4 introduces the results for the BLNS of the simulations that have been conducted and discusses these results. The final Section 4 expands on the implications of the tariff revenue losses to the BLNS from trade reforms.

1.1 Institutional background

These four BLNS countries are independent sovereign states that, along with the dominant partner of South Africa[2], comprise the Southern African Customs Union (SACU), the worlds oldest and one of the most efficiently functioning Customs Unions. Their trade policies are therefore inter-twined with South Africa's, and especially so as over 90 percent of the imports coming into SACU are destined for South Africa and the tariff revenue into both South Africa and the BLNS countries are pooled and distributed in a formula that results in an income grant transfer from South Africa to the BLNS of around three rand to every one 'actually earned by the BLNS'[3]. Thus, when tariff revenues into mainly South Africa are reduced, this has a dramatic leveraging effect on BLNS revenues. This is likely to be perhaps the most pressing issue of South Africa trade policy reform, and will be discussed in detail later.

In and earlier but not that long ago era in keeping with the 'business as usual' situation the BLNS had no (or very limited) input into the negotiation of the TDCA, as it was negotiated by South Africa directly with the EU prior to the new SACU agreement. This situation is in part rectified in the new 2002 agreement, which, in Article 31, part 3, specifically states that "No Member State shall negotiate and enter into new preferential trade agreements with third parties or amend existing agreements without the consent of other Member States". How this applies to a potential WTO agreement is uncertain, as although SACU has a common tariff the members do not have common

[2] According to the World Bank 2006 GDP data South Africa contributes 92.5 percent of SACU's GDP. This is followed by Botswana (3.7%), Namibia (2.3%), Swaziland (0.9%) and Lesotho (0.5%).

[3] Money goes into the revenue pool from tariff revenues collected on all imports into SACU from outside. This money is then allocated on the basis of the proportions of intra-SACU imports between members. As the majority of the latter are mostly domestically produced South African goods being imported into the BLNS these two concepts are not closely related. See for example the WTO 2003 Trade Policy Review of SACU, Box II.1.

WTO tariff schedules and indeed in theory as states at different stages of WTO-defined development they would not be required to make the same concessions.

In theory, Article 31, part 4, outlines how goods imported into the region under a preferential agreement (read into South Africa under TDCA preferences) but are then subsequently exported to another member the normal SACU tariff rate will be charged at the second (BLNS) border and the difference paid into the revenue pool. However, this is not a practical option as the operational procedures at the SACU borders seem inadequately set up to administer complexities of this nature.

Another major concern is relevant to the above view and must be introduced at this stage, and that relates to the quality of the trade data in the region. This data is generally accepted as being poor, and this is exemplified when the revenue pool sharing exercise is carried out. In general, South Africa does not publish its trading data with the BLNS and despite the fiscal implications from both the SACU tariff pool which is allocated on the basis of inter-SACU imports and the transfer of VAT revenues the border data is inadequate.

1.2 BLNS: way ahead?

The trading relationship between the Southern African region and the EU is at a crossroads, where there are two major directions possible for the region plus numerous side roads that may or may not lead anywhere. Those two major roads are for (a) a consolidation within the SACU behind South Africa and the TDCA and (b) for South Africa and the non-South Africa members of SACU (the BLNS countries) to continue on somewhat parallel pathways both within the TDCA but the BLNS negotiating as a team that includes Mozambique, Angola and Tanzania (MAT) along with South Africa as an observer partner for the best possible deal with the EU under the wider Economic Partnership Agreements (EPAs).

There is a strong case that SACU, as the worlds oldest and one of the most efficiently functioning Customs Unions, should forget the EPA option with the EU and rather pursue an enhanced Customs Union-to-Customs Union bilateral deal. The stark realities are (1) on imports, all of SACU are intertwined anyway and bound by the common tariff; and (b) the enhanced export preferential opportunities that the BLNS enjoy to the EU are probably able to be cemented by negotiations within a SACU agreement.

2 Current trading patterns

Table 1 shows the most recently available BLNS overview of their aggregate trading data from the TIPS website. Data for Botswana is for 2005, Swaziland for 2003 but that for Lesotho and Namibia is for 2003. Exports from Botswana of \$4.45 billion are more than the other three countries combined (\$3.53b), and again Botswana dominates the imports (\$3.3b) with the other three in very similar range between \$1.11 billion for Lesotho to \$1.50 billion into Swaziland. In addition, the table highlights;

1. the dominance of South Africa as an import source (at least 80%);
2. the variance of South Africa as an export destination (from 9% to 72%);
3. the importance of the EU as an export destination for Botswana;
4. the importance of the US as an export destination for Lesotho; and
5. the importance of RSA as an export destination for Swaziland.

Table 1: overview of the BLNS trading patterns, US$ million and RSA % share.

Botswana 2005	**World**	**RSA**	**rest SADC**	**EU**	**East Asia**	**USA**	**RSA%**
Exports	4,450	401	212	3,418	0	98	9%
Imports	3,272	2,770	96	214	55	40	85%
Trade Balance	1,178	-2,369	116	3,204	-55	59	
Lesotho 2003							
Exports	474	92	0	1	1	367	19%
Imports	1,107	909	1	4	170	2	82%
Trade balance	-633	-817	-1	87	-169	366	
Namibia 2003							
Exports	1,279	404	336	383	18	35	32%
Imports	1,403	1,128	28	107	34	14	80%
Trade Balance	-123	-724	308	276	-16	21	
Swaziland 2004							
Exports	1,781	1,283	131	28	38	133	72%
Imports	1,502	1,433	6	8	9	2	95%
Trade Balance	279	-150	125	20	30	131	

Source: TIPS database

Expanding upon Table 1 and examining the more specific trade profiles for the BLNS countries shows in particular;

1. the dominance of diamonds (75% of all exports) to the EU in Botswana's exports;
2. the dominance of clothing to the US in Lesotho's exports;
3. the dominance of drink flavouring to RSA and the rest of the world in Swaziland's exports; and
4. the general spread of imports from mostly South Africa across different goods.

3 Direct trade related issues for the BLNS

It is instructive to take the trade data from Table 1 and the discussion from this and look at what interests the BLNS may have for exports (the offensive interests) and imports (the defensive interests) against this background. We suggest that as export access to South Africa is guaranteed, the offensive interests are concentrated upon cementing access into the EU after the expiry of the Cotonou Agreement (ostensibly at the end of 2007) and maintaining and perhaps improving upon the access concessions granted to Africa under the US's African Growth and Opportunity Act (AGOA). On the defensive side the BLNS are valiantly endeavouring to maintain tariff protection on a limited number of goods from both 'outside' (mainly through South Africa) and from South African-produced goods directly. This latter task is made harder by the current absence of competition policies in the BLNS and the reliance upon South Africa to maintain some protection through the Republics' trade remedies regime, and the absence of industrial policies in the BLNS makes it hard to give a strategic focus to overall trade policy.

3.1 The defensive interests

Currently (and historically) around 40 percent of South Africa's imports are sourced from the EU, and given the virtually free transfer of these imports through SACU this means that BLNS countries are tied to the TDCA. Although, as discussed above, they have the authority to charge duties that relate to the difference between the MFN rates and TDCA preferences, it is entirely impractical to do so. An examination of the TDCA preferences shows these preferences to be significant and still declining. By the end of the TDCA implementation period during the 2010 - 2012 period imports from the EU into SACU will be almost duty-free excepting for meat and dairy products[4] in agriculture and clothing but more significantly motor vehicles and their parts. This has implications for the BLNS in that it is almost impossible for them to formulate sensible industrial policies given the limited and diminishing degrees of freedom in tariff policies and the dominance of South African industrial policies within the region. The BLNS really have no tariff policy *per se* and their wider trade policy options are limited. The TDCA also has implications for the BLNS revenues, and highlights the need (from a BLNS perspective) to isolate the 'aid transfer' component from South Africa of the revenues shares and place a hold to stop these retreating in the face of declining tariffs. This will be discussed in more detail later.

In addition, there is the intra-SACU component of imports; currently all imports from non-SACU SADC sources are duty free, except for used clothing and vehicles and their parts. Table 1 highlights the crucial importance of these concessions for the BLNS, as adding the EU and remainder of SADC imports to the percentage share from South African on the right hand side means that at least 90 percent of the imports (and possibly more when the duty rate from other sources is examined) are effectively free anyway. Thus, there are really are no defensive interests for the BLNS, although the issue of WTO concessions should an outcome to the DDA be negotiated does need to be kept in mind, as the concept of a Customs Union having different WTO bound tariffs is an intriguing one.

3.2 The offensive interests

3.2.1 **The BLNS and the EU**

The big issue here is for these countries to preserve their market access conditions into Europe under the Economic Partnership Agreements (EPA) for the African, Caribbean and Pacific Island countries (ACP). The EU has proposed to remove all remaining quota and tariff limitations on access to the EU market for all ACP regions as part of the EPA negotiations. The offer covers all products, including agricultural goods like beef, dairy, cereals and all fruit and vegetables. It will apply immediately following the signing of an agreement - with a phase-in period for rice and sugar. The only exception will be South Africa where a number of globally competitive products will continue to pay import duties. Thus, except for Swaziland's sugar, all BLNS exports to the EU will be quota and duty free. Sugar is delayed until 2015, and there are some rather significant qualifiers attached to the offer that will create uncertainty as to the final outcome and real benefit of the EPA for sugar. Meanwhile, faced with the EU sugar reforms exporters from the region (including Swaziland) with current preferential access into the EU will see major declines in their rents (Sandrey and Vink, 2007).

The following discussion leads on from Table 1 and examines the export profile in more detail for BLNS country.

Lesotho

As a least developed country Lesotho has duty and quota free access into the EU under the Everything but Arms (EBA) regime, but only a minor 1.2 percent of total exports went to the EU during 2003. Of these, some 88.4 percent were diamonds (where some 97% of the diamond exports

[4] The remaining protection on meat products into South Africa and therefore SACU is an intriguing situation given the insistence from Namibia and Botswana that they are internationally competitive in beef production. If the latter is true, then why is protection necessary?

went to the EU) and effectively all the remainder was clothing where the EU imported a minor 0.2 percent of the clothing exports from Lesotho[5].

Swaziland

As a developing country Swaziland does not have access under EBA, but does have preferential access under both/either of the GSP or the Cotonou Agreement. Again, as with Lesotho, only 1.6 percent of exports from Swaziland were destined for the EU during 2004. These were concentrated in agricultural products (74%), with the next grouping being textiles and clothing. The largest global export from Swaziland is HS 3302, odoriferous substances for industrial use (but classified by the WTO as an agricultural product), and other agricultural exports include processed fruit and nuts, cane sugars and some fresh vegetables, and some fresh/chilled beef exports. Sugar remains the main issue for Swaziland, as the access arrangements under the EPA are not yet finally settled.

Botswana

This is truly a case of diamonds being a country's best friend, as 74.9 percent of all recorded exports from Botswana are diamonds and 99 percent of these are destined for the EU. These exports in turn represent 96.9 percent of Botswana's exports to the EU, with textiles and clothing (1.5%) and beef (1.1%) almost completing the entire portfolio. As mentioned above (and this is also relevant to Namibia) diamonds are duty free from all sources. The beef exports of $38.9 million or 52 percent of the total beef exports from Botswana enter the EU under a preferential arrangement, and it is this arrangement, along with the textiles and clothing trade access, that currently represents Botswana's interests into the EU.

Namibia

As with Botswana, diamonds are again important, but this time making up a lesser 13 percent of Namibia's global exports with 79 percent of these destined for the EU. In turn, these were 34 percent of Namibia's exports to the EU during 2003. Similarly as for Botswana, beef exports to the EU are of strategic and symbolic interest to Namibia, but the data shows exports of only $1,072,993 in the entire HS 02 Meat Chapter as being exported to the EU during 2003. As a percentage of Namibian global exports totalling $1.3 billion these are insignificant[6]. Fish products with 24 percent of the total exports, are however, crucial for Namibia, and in turn some 68 percent of these are destined for the EU. The next most important HS 4 lines destined for the EU are uranium or thorium ores and concentrates, zinc products, leather, fluorine and hides and skins, where, excepting for the five percent duty on zinc products, access into the EU is duty free to all sources. These exports cover 95 percent of the total to the EU.

Conclusion

In conclusion, the 'big picture' for the BLNS exports to the EU suggests that there are few direct access issues that remain unresolved between two parties if one accepts the EU EPA offer in good

[5] We would note that currently clothing exports to the US under AGOA are effectively the only 'outside' export from Lesotho to the world, and further note that it is likely that restrictive rules of origin are the factor constraining clothing exports from Lesotho to the EU.

[6] These export figures do not reconcile with the much higher EU import data that shows beef imports into the EU of between thirty to thirty five million Euros over the last three years of 2003, 2004 and 2005 (and a higher Euro 49 million for each of the two years previous to that.

faith. There is however the matter of negotiation to try to secure better sugar access conditions, and the remaining rules of origin and SPS issues that are beyond the of the scope of this paper. This scenario, coupled with the reality that the BLNS countries are locked into the TDCA with European imports, reinforces that the common sense approach is to negotiate the EPA/TDCA review on a Customs Union to Customs Union basis.

Products requiring special attention to preserve their access arrangements into the EU from the BLNS focus on beef from Namibia and Botswana in particular and Swaziland sugar (where no concessions have been granted to South Africa under the TDCA for either beef or sugar), and possibly fish and fish products from Namibia (where again few if any concessions have been granted under the TDCA). Beef exports to the EU of HS 020130 and HS 020230 (fresh and frozen beef respectively) face rates of at least 91 percent under the TDCA and even higher in some lines, and tariffs of this level would stop exports to the EU valued at Euros 45.1 million, 30.3 million and 0.13 million from Namibia, Botswana and Swaziland respectively. Currently the beef is exported to the EU with a preference that reduces the tariff by some 92 percent for Botswana, Namibia and Swaziland, along with a quota that does not seem to be binding. Fish is duty-free from Namibia, and Swaziland has a sugar preference deal.

3.2.2 The BLNS and the US

The **African Growth and Opportunity Act (AGOA)** is a United States Trade Act that significantly enhances U.S. market access for (currently) **38** Sub-Saharan African (SSA) countries. The Act originally covered the 8-year period from October 2000 to September 2008, but amendments signed into law by U.S. President George Bush in July 2004 further extend **AGOA** to 2015. At the same time, a special dispensation relating to apparel was extended by three years to 2007. On 20 December 2006, key changes to AGOA were signed into law, extending the garment provisions to 2012.

AGOA builds on existing U.S. trade programs by expanding the (duty-free) benefits previously available only under the Generalised System of Preferences (GSP) program. Duty-free access to the U.S. market under the combined AGOA/GSP program stands at approximately 7,000 product tariff lines. Notably, these include items such as apparel and footwear, wine, certain motor vehicle components, a variety of agricultural products, chemicals, steel and others. Exclusions of interest to the BLNS again include beef and sugar.

Table 2 shows the most recent 2006 bilateral trade data with the US, with a concentration upon the import data into the US from the BLNS countries. The highlights are:
1. The biggest import source for the US is Lesotho, and these are all clothing under AGOA;
2. The next biggest is Botswana, and here most of the exports ($221.5m) are diamonds that enter the US duty-free from all sources, and clothing as shown;
3. Then comes Swaziland, again with mostly clothing under AGOA; and
4. Finally Namibia with some clothing under AGOA, diamonds ($15.2m) that are duty-free from all sources, and radioactive elements (44.2m) that are also duty-free.

Table 2: US – BLNS trade 2006, $1,000

	Botswana	Lesotho	Namibia	Swaziland
All sectors:				
US Exports	26,700	4,029	113,220	11,301
Total US Imports	252,107	408,407	115,650	155,807
Of which AGOA covered	28,251	384,591	33,228	149,815

Source: USITC website

In examining how much further trade liberalisation with the US may provide benefits to the region Sandrey and Jensen (2007, forthcoming) undertook a computer simulation of the possible impacts for a comprehensive FTA between the US and SACU. They found that the welfare gains for Botswana were insignificant, but there were however much more significant gains for the rest of SACU (an aggregation of Lesotho, Namibia and Swaziland) where welfare is projected to increase by $30 million. Featured for the rest of SACU is a big increase in sugar exports to the US and, to a lesser extent, an increase of imports from the US of motor vehicles and their associated parts. This increase in sugar constitutes most of the increased exports, and furthermore these increases will be having a ripple effect through the economy that marginally increases other costs and creates some reallocation of resources domestically. We caution that this is not a clear-cut picture, as the GTAP model used is aggregating three diverse and largely isolated economies into one, with the changes in reality only taking place in Swaziland's sugar sector.

Common supporting policies

Recognising that trade policies are much more than merely tariff policies and direct border measures, the new 2002 SACU agreement recognises the need to develop common SACU policies on industrial development (Article 38), agriculture (Article 39), competition policies (Article 40) and unfair trading practices between the member states (Article 41). While the member states are required to develop a common industrial policy, they are required to merely cooperate in the other areas of policy.

Industrial policies

Recognition of the linkages between trade policies and industrial policies is acknowledged in the South African Industrial Policy paper[7], where Section 9.1 discusses the importance of integrating trade policy into this industrial policy. This is extended to the need to now acknowledge not only the SACU dimension but also the wider SADC regional integration implications of South African industrial policies.

Currently the SACU member states are involved in developing their individual industrial policies, with South Africa way ahead of the others. Given South Africa's dominance in manufacturing capacities in the region this latter is to be expected, as it is difficult to see how the BLNS countries may adopt industrial policies in the absence of a shielding South African policy framework given their own limited industrial capacities, and especially so when they have little or no control over tariff policies. Nonetheless, the BLNS countries are developing their own industrial policy strategies and all have submitted drafts to the SACU secretariat.

There would seem to be two crucial sectors of interest to the BLNS in the South African draft policies; apparel and motor vehicles and their associated parts. While the protection given to the latter sector in South Africa probably raises domestic prices, and by implication prices in the BLNS, it also provides an opportunity for the BLNS to operate in niche vehicle parts manufacture. Similarly for the former, where Lesotho in particular has a substantial clothing sector that operates mainly because it has preferential access to the US market. The unilateral imposition in late 2006 of quotas on the importation of selected lines of clothing from China from January 2007 provides an

[7] 'A National Industrial Policy Framework', available on the DTI website at http://www.thedti.gov.za/nipf/niPF-3aug.pdf

opportunity for Lesotho and possibly other BLNS countries to export more clothing to South Africa. However, there is evidence as early as the March and June quarters of 2007 that other sources of clothing were substituting for Chinese imports, but there was no evidence that Lesotho or other BLNS countries were among these substitute sources (although data limitations here are critical).

Other areas highlighted as possible action points for the industrial plans include a review of the tariff schedule to reduce tariffs on upstream inputs into manufacturing and on goods that are neither manufactured nor likely to be manufactured in South Africa[8]. Empirically analysing the impacts of the former on manufacturing costs is a complex calculation and one that has generally been undertaken in developed countries before and not after a unilateral tariff reduction regime has been put in place.

Another important linkage between tariff and industrial policies is the issue of 'policy space', defined here as the abilities to raise tariffs within the confines of the WTO obligations. Here the critical issue is the applied rates that operate at the border (with the so-called MFN rates that apply to all except those with preferences used here rather than a combination of the MFN rates and preferential rates) and the WTO so-called 'bound rates' which governments pledge not to go above. An examination of the data shows that nearly one half of the non-agricultural imports for the first half of 2007 have no or very limited policy space, and that overall the average gap between applied and bound rates is 10 percentage points. This and the other detailed data really says little except that raising import duties provides South Africa with some but not much 'wriggle room' to protect its industry in the future by using tariff protection. We would also note that under WTO rules subsidies to non-agricultural goods are not allowed, and that many observers consider that the South African motor vehicle regime is vulnerable to a WTO challenge.

The so-called Singapore issues

More widely, a feature of the World Trade Organization (WTO) during its first ten years has been the impact of the so-called Singapore issues of investment, competition, government procurement and trade facilitation (Sandrey, 2006). The name association arises because WTO Members decided at the 1996 Singapore Ministerial Conference to set up three new working groups on trade and investment, on trade and competition policy, and transparency in government procurement. They also instructed the WTO Council for Trade in Goods to look at possible ways of simplifying trade procedures, or, as it became known, 'trade facilitation'. These four issues were also included on the Doha Development Agenda (DDA), but following the infamous 'train wreck' of Cancun, a wreck induced in part by the acrimonious debate on the same Singapore issues, WTO Members agreed to proceed with negotiations in only one Singapore Issue, trade facilitation and the other three were dropped from the DDA. The Singapore issues were clearly 'a bridge too far' for the WTO, and in particular they fuelled the developed-developing country schism. Investment, competition policy and government procurement were seen as areas where the developed countries were imposing their standards upon developing countries in a one-way manner (one-way in that, conversely, the developing countries cannot be expected to have any influence at all on developed country markets). One could argue that within SACU a similar developed (South Africa)-developing (BLNS) schism exists.

On the contingency trade remedies front, the BLNS countries apply anti-dumping, countervailing and safeguard measures that have been imposed by South Africa. These measures are imposed to

[8] We note that limited mention of SACU is made in these and most other areas where 'Stakeholder Departments' are listed in the plans.

protect South African manufacturers, and by definition increase consumer prices in the region and therefore are likely to entail a net cost to the BLNS. This aspect of trade policies is important, as South Africa has a voracious appetite for contingency measures. There seems to have been limited serious attention paid to the BLNS in South African investigations, although recommendations from the International Trade Administration Commission (ITAC), South Africa's national body which is currently serving the customs union, until the establishment of the SACU Tariff Board and national bodies for the BLNS) have to be approved by the to-be-established Tariff Board. This would further delay investigations to the frustrations of industry and BLNS countries may use the Tariff Board and approval of remedies in exchange for other issues. Recent encouraging developments have been that during ITAC's acrylic blanketing investigation against Turkey cognisance was taken of the injury experienced by the industry in Botswana and in the investigation on bed linen from Pakistan cognisance was taken of the injury to the producers in Swaziland.[9]

The issue of competition policies or, more specifically, the lack thereof, is one that is concerning the BLNS. While South Africa has a competition policy framework regime that on the face of it is right up with international standards, there may be some questions legitimately asked about the abilities to enforce these policies. However, such policies are of indirect interest to the BLNS, while the unfair competitive policies of South African companies operating in the BLNS are of direct interest. These complaints allege that South African firms are engaged in, for example, predatory pricing and exclusionary behavior (exclusive dealing contracts). Such activities are outside of the mandate of South African officials, and in the absence of specific BLNS competition laws there is limited control on such activities. BLNS countries have been developing competition policies for several years now, but the processes are extremely slow. Namibia is most advanced having promulgated a Competition Act in 2003; however budget and capacity constraints have meant that the Namibian Competition Commission is not yet operational. Meanwhile there are several complaints against South African companies that have been submitted to the Department of Internal Trade at the Namibian Ministry of Trade and Industry.

At the SACU level progress is also very slow. Article 40 of the SACU Agreement requires that the member states cooperate in the enforcement of competition policy, but with only South Africa having a functioning Competition Authority this seems far off still. Given the importance of competition policy within the context of a customs union, and the asymmetry of industrial development between South Africa and the BLNS this is an important trade-related policy lacuna in SACU.

Of direct relevance to this paper is that competition policy is dealt with in Art. 35 – 42 of the TDCA. The basic objective is to monitor and prevent anti-competitive practices affecting trade between the EC and South Africa, but only in the two areas identified in Articles 35(a) and 35(b). These articles stipulate that restrictions of competition and abuse of dominance in trade between the two territories are incompatible with the TDCA. However, Article 36, which deals with the implementation of competition policy, can have a potential impact on countries acceding to the TDCA, as it mandates new members to adopt laws and regulations for the implementation of Article 35 within a period of three years. This may have implications for the extension of the TDCA to incorporate all SACU members formally as distinct from the de facto relationship they now have with respect to tariffs at the SACU border. This would place considerable pressure on the BLNS, as they currently have no competition policy in place.

[9] Gustav Brink, personal communication.

Similarly, investment negotiations were at least a component of the TDCA. In Article 5(3), for example, the TDCA guarantees that the coverage will include provisions on investment, and Article 33(1) compels parties to ensure the free movement of capital, relating only to direct investment, before Article 33(2) then qualifies this obligation in much looser terms. Thus, the provisions show an intention of the parties but contain no substantive conditions or deadline for liberalisation. At best the agreement is to encourage cooperation between the parties, and perhaps that is about as far as such an agreement between dissimilar economies should go.

An examination of the TDCA shows that pursuant to Article 45 the parties agreed that government procurement be 'governed by a system that is fair, equitable and transparent, which implies that government still has the autonomy to procure in line with the government's policies. It was further agreed in Article 45(2) that progress would be periodically reviewed, which may be a clear indication that the EC will be pushing hard to include government procurement in the TDCA review. Should the SACU/US Free Trade Agreement (FTA) proceed, an examination of the Australian/US FTA gives some idea of the US 'negotiating' template on government procurement with a country that is arguably closer to South Africa than some of the other recent partners of the US FTA. Chapter 15 of the Australian/US FTA agreement requires changes to government procurement process, documentation and reporting at both federal and state levels. In general terms, the goal has been to make government procurement more transparent, and governments are now required to treat Australian and US vendors equally. Agencies are now required to publish annual notices of their procurement plans, and tender response times must give vendors adequate time to prepare bids; and reporting on tenders and contracts has been made more complex. As with the TDCA comments above, in any SACU/US FTA agreement, many aspects contained in the Australian/US FTA will be vigorously resisted given the asymmetrical development levels of the US on one hand and SACU members on the other.

On the final Singapore issue, there is no question that general trading costs, including the trade facilitation costs as defined here, are very high in Africa. This has repeatedly been pointed out in reports on this region such as the WTO (2003) and the Integrated Framework reports. Furthermore, as an important and related component of trade facilitation problems in the region, the lack of reliable trade data within Southern African Customs Union (SACU) becomes a serious problem when the regional tariff pool allocation is being made on the basis of intra-SACU imports. However, this problem is being addressed through the integration of procedures between South Africa and the respective SACU partners. Indeed, the subsidy/development grant component of this tariff pool distribution could be partially thought of as a trade facilitation grant from South Africa. Furthermore, any trade facilitation reforms made in South Africa are certain to have almost immediate direct benefits to the BLNS given South Africa's role as a conduit for the BLNS trade.

Unresolved is the role of trade facilitation in the forthcoming Economic Partnership Agreements (EPA) negotiations with the EU. More widely, Commissioner Mandelson of the EU considers that development funds in general are an integral part of the negotiations: 'While development funding is not a specific part of the EPA negotiations, the EU has been clear that EPA-related assistance will be a central priority for the European Development Fund'[10].

Services

[10] Speech, 3 August 2006, Nairobi Kenya, as reported in the Nation. [Online]. Available: http://allafrica.com/stories/200608030320.html.

Of particular concern to the BLNS should be the invidious dominance of South Africa in their service sectors. Economists generally recognise that the gains from services liberalisation in a moderately protected economy are potentially higher than the gains from the goods sector, but for a variety of reasons research on this lags research on goods liberalisation. The problem in the region is that the dominance of South Africa in the region's services is possibly more apparent than the manufacturing dominance, as standing in and looking down the main street of any of the four BLNS capitals will attest. At issue is that these same South African service providers are not generally internationally competitive based upon global pricing and provision standards, and therefore due to the first-mover advantage and scale economies blocking out other global competition the BLNS are locked into a services structure that is uncompetitive. It is difficult to see how reforms in South Africa *per se* will do much to alleviate this.

4 The FTA simulation and their impacts upon the BLNS

In a series of papers tralac have undertaken analysis on some of the FTA options facing South Africa/SACU (Sandrey et al, 2007). These analyses have involved using the GTAP computer model, and the model and the version used for these FTA papers and the associated assumptions and limitations are documented in this work. The series of FTA options have all included the BLNS countries that along with South Africa make up SACU, with South Africa and Botswana modelled as countries in their own right but the other three countries of Lesotho, Namibia and Swaziland are aggregated together. While the latter is not ideal, there is no other option with GTAP.

The FTA analysis been undertaken on the following on a one-off bilateral basis:

- extending the Trade Development and Cooperation Agreement (TDCA) between South Africa and the EU to a full FTA beyond the TDCA;
- an FTA with the US;
- an FTA between India, Brazil and South Africa/(SACU) – the so-called IBSA configuration;
- an FTA with Japan;
- an FTA with China; and finally
- (a) these has been extended to examining the implications of involving a large scale comprehensive bilateral FTA that includes South Africa/SACU on the one side and all of the above on the other side (the 'comprehensive FTA') as series of agreements that occur simultaneously between South Africa/SACU and the individual bilateral partners only. This is known as a "hub and spokes' configuration, with South Africa/SACU as the 'Hub' and the individual partners as the 'Spokes' radiating out from the Hub; and
- (b) there has also been an examination of the possible outcome from the WTO Doha Development Agenda.

As always, there are a series of assumptions made in undertaking the modelling work and there are always limitations in the GTAP or any other model. The limitations that specifically apply to the BLNS include the modelling of tariff barriers only (i.e., no Non Tariff Barriers), no liberalisation of services, no modelling of the tariff revenue transfers between the SACU member countries, the aggregation of Lesotho, Namibia and Swaziland into one region in the GTAP model, some uncertainty surrounding the GTAP modelling of current BLNS trade preferences into the EU in particular, and questions over the overall quality of trade data for the BLNS countries.

Prior to simulating the suite of FTAs the final outcome of the TDCA agreement was incorporated into the new baseline. This enabled an estimation of the implications of the TDCA for the BLNS to be made even though strictly speaking the BLNS are not direct partners in the TDCA. The welfare gains to the BLNS from the TDCA were $23 million for Botswana but losses of $12 million for the rest of SACU. Trade responses for the BLNS were muted for both groups, with some minor increases with the EU effectively negated by declines with South Africa. .

Next was the so-called comprehensive FTA (when all the FTAs are modelled together), and this assumes a complete 100 percent reduction in merchandise tariffs between South Africa/SACU as the 'Hub' and the individual 'Spoke' partners (but no changes between the 'spokes'). Here Botswana makes modest gains of $29 million in welfare terms, while the rest of SACU makes major gains of $631 million (some 3.12 percent of GDP). The gains to both Botswana and 'rest of SACU' are mostly from unfettered access to the EU, although we again caution that these results may seriously underestimate the welfare losses from tariff revenue changes and further note that for the BLNS access gains into the EU the EPA negotiations may well provide most these independently of any FTA[11].

For Botswana, the large trade picture shows relatively minor changes to trade flows. For the rest of SACU the overwhelming story is the massive increase in sugar exports (Swaziland) of $960 million or 160 percent to the EU in response to the abolition of the 81 percent duty rate. This resulted in a global export increase in sugar of $916 million as some was diverted from other markets, and a consequential increase in production of over 100 percent in response to the 50 percent price increase. All other exports declined excepting for minor increases in fisheries products as resources are diverted towards sugar. This left an increase in exports of $476 million overall[12]. Again, in response to the FTA imports in all sectors increased by $477 million, thus effectively export declines in all other sectors and the increasing imports almost exactly cancelled out the increases in sugar exports.

4.4 The Doha outcome

The overall results from a simulation of a possible Doha Round outcome show a gain to the rest of SACU of $20 million but a loss to Botswana of $12 million. Botswana's losses were across both agriculture and non-agriculture (NAMA), while the rest of SACU gained a lot from better agricultural market access but lost most of this from NAMA changes. In **agriculture** the big Doha story for the rest of SACU is that sugar exports to the EU increase by $169 million, and this dominates the overall increase in exports of $145 million as many other sectors decline in response to the re-direction of resources to sugar. For Botswana there is an increase in exports of $5.8 million, with beef to the rest of the world as defined in the model ($5.3m) dominating these changes. In **non-agriculture (NAMA)** changes to the trade patterns within the BLNS countries are generally restricted to the changes in both textiles and apparel in rest of SACU.

5 The tariff revenue implications

The BLNS countries obtain much of their total government revues from the SACU revenue pool, and liberalisation of the tariff schedule will have effects upon these revenues. Just how dramatic this effect is can be shown when the BLNS sources of government revenues are examined.

[11] Where as part of the EPA negotiations the EU have offered duty free and quota free access to all ACP countries for all products except for rice and sugar.

[12] In reality, this is an aggregation problem of the model, as happenings in Swaziland's sugar are unlikely to have much influence upon either the Lesotho or Namibian economies. For example, the results suggest that (presumably) Namibian beef exports to both the EU, South Africa and globally decline by just over 50 percent even though the producer price increases by 18.8 percent. This seems implausible, and reinforces that an incomplete trade picture may be emerging.

Bertelsman-Scott and Grant (2007) show how for Lesotho and Swaziland in particular the 2006 revenue share from the SACU tariff pool was an estimated 53.0 and 56.9 percent of total government revenues and 28.2 and 24.1 percent of GDP for the two countries respectively. Sandrey et al 2006 expand upon this and firstly calculate the revenue loses to the SACU tariff pool from the Trade and Development Cooperation Agreement (TDCA) with South Africa and secondly, using a computer model of Lesotho, demonstrate the impacts upon the economy of these reductions. To date these reductions have been masked, as the tariff revenues has been driven by increases in South African imports that mean the revenues are increasing despite the TDCA preferences (and of course any trade diversion resulting from this TDCA). This has led to some confusion about the actual revenues versus what the revenues would have been in the absence of the TDCA. The crucial points are that the tariff revenue is likely to fluctuate or even decline for a number of reasons that includes both trade policies and South Africa's economic performance and import propensity.

This then creates a rather perverse result in that the BLNS countries have an incentive to maintain the protective nature of what is effectively South African tariff policy despite consumer costs to the BLNS from more expensive imports. However, to the extent that South African imports are directed at a more luxury market and these luxury goods face higher tariffs while the BLNS imports more basic consumer goods with lower tariffs this income-related effect may be mitigated. More in-depth research outside of the mandate of this paper is required to assess that[13]. However, the basic premise remains that given what is in effect a *de facto* regional development transfer grant from South Africa to the BLNS that operates in a much disguised manner that is dependent almost entirely upon both the level and tariff regime of South African imports, this leaves the BLNS countries vulnerable to fluctuations in imports and tariff levels. Over the last few years since the 2002 implementation of the new SACU Agreement this has not seemed important as South Africa has enjoyed an import boom driven by combinations of economic growth and a strengthening currency.

The GTAP database and the output generated by the model in assessing the impacts of possible FTAs for South Africa/SACU as discussed allow for a calculation of what these tariff revenue losses may be. Note that these calculations are based upon South African results, but since South Africa totally dominates the direct SACU results this is an acceptable methodology. The following steps were taken to derive the tariff revenues:

- from the baseline data the imports into South Africa by source at 2015 were isolated;
- the base-line tariff revenues collected at 2015 were assessed by calculating the imports against the tariffs as shown by source (and after being adjusted for the TDCA and minor other cases)
- these imports were then augmented by the changes in their values as a result of the comprehensive FTA as discussed above and the new tariff revenue was then calculated. This is of course set against tariff rates for the FTA partner sources that, along with BLNS and other African imports[14] are now zero. This leaves only imports from rest of the world, and the tariffs here were calculated by GTAP sector by taking the weighted average tariffs on imports from India, China, the US, Japan and Brazil as the sources that had no preferences prior to the FTA.

[13] This is done in a journalistic manner by Nic Dawes in an article in the Mail and Guardian 16 July 2007, where the influence of the South African motor vehicle regime and associated tariffs on spending in the BLNS is highlighted. Available at http://www.mg.co.za/articlePage.aspx?articleid=314063&area=/insight/insi

[14] An examination of Nigerian imports shows these to be almost exclusively coal, oil and gas, imports that are duty-free anyway, while imports from the rest of Africa were similarly assumed to be duty-free given the presumably large concentration of other SADC imports here.

The results of this exercise show that:

- the initial pre-FTA tariff revenues were assessed at 2015 as $1.38 billion at an average duty of 4.2 percent[15];
- the post-FTA tariff revenues were assessed at 2015 as $0.27 billion at an average duty of 0.9 percent;
- this is a reduction of $1.1 billion or just over 80 percent;
- this, in turn, translates into a total government revenue reductions for Lesotho and Botswana of 42.5 and 45.6 percent respectively.

This outcome is dramatic and of course untenable for the two countries concerned.

This analysis also highlights the potential problems of trade diversion with FTAs, although of course the more partners that you place in your 'FTA basket' the less of a problem trade diversion will become. Total imports from the rest of the world as defined stay virtually the same pre and post the comprehensive FTA; from $8,062.9 million pre-FTA to $8,060.7 post FTA as many agricultural and resource sectors actually increase imports in low-tariff sectors. What does change however is that the average tariff rate on these imports declines from 5.2 percent pre-FTA to 4.2 percent post-FTA as imports from actual duty-paying sources reduce in favour of the new (trade diverting) duty free sources. This happens in textiles (21.5% MFN tariff) and motor vehicles (18.8% MFN tariff) in particular. Thus, trade diversion is accentuating the tariff loss to the revenue pool.

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[15] This average tariff rate may seem low, but it is post-TDCA and given the dominance in motor vehicle tariffs in the collection of South African tariff collections the impacts of the reducing motor vehicle tariffs and the rebates systems need to be taken into account.

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