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SACU and the Political Economy of Regionalism: Towards Deeper and Broader Integration?

As one of the world's most durable economic initiatives, regional the Southern African Customs Union (SACU) must be central to any discussion of deeper and broader market integration in Southern Africa. Established under a 1910 agreement between South Africa and neighbouring British protectorates, it has weathered nearly a century of turbulent and often polarised regional politics - including the rise of the apartheid regime and the political independence of Botswana, Lesotho, Swaziland and, later, Namibia. Yet changes during the 1990s - especially, South Africa's transition to democracy, and the strong multilateral push towards trade liberalisation – prompted perhaps the most fundamental rethinking of SACU's policies and institutions. This culminated in the 2002 ratification of a new agreement. The agreement affirmed a commitment to 'open regionalism' - in the sense of reducing SACU's external trade barriers in line with World Trade Organisation (WTO) rules - while simultaneously calling for new institutions bringing more consensual decision-making among SACU member governments.

Yet in addressing past shortcomings, the 2002 agreement has created major challenges for the future. SACU's durability has reflected a pattern of intergovernmental co-operation grounded in precisely the combination of South African decision-making dominance and a protectionist external tariff that the new agreement seeks to eliminate. For its smaller members, SACU has offered a tradeoff between the costs of granting

By Rod Alence

South African goods preferential access to their markets and the benefits of receiving increasingly generous shares of the common revenue pool. The 2002 agreement removes central elements of this model: If the envisioned reductions in the external tariff are enacted, the revenue pool that has become SACU's main attraction to its smaller members is very likely to shrink; yet within the new consensus-based institutions, each of these governments now effectively possesses veto rights over policies and agreements that would reduce the external tariff. SACU may eventually realise the vision projected in its 2002 agreement, but doing so will require it to go beyond the particular model of intergovernmental co-operation that has sustained it through its long history.

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The aim of this trade policy briefing is to clarify key issues surrounding SACU's potential role as a vehicle for deeper and broader economic integration in Southern Africa. With respect to deepening integration, it focuses on the challenge of achieving sustained intergovernmental co-operation within the parameters of the 2002 agreement, whose implementation is in its infancy. Can SACU extend its impressive record of co-operation among member governments while embracing the principles of open regionalism and consensus-based decision-making? With respect to broadening integration, it focuses on the possibility of expanding SACU's membership - Mozambique, Malawi and Zambia having reportedly expressed some interest in joining, and SACU also being regarded as a possible mechanism for Zimbabwe's

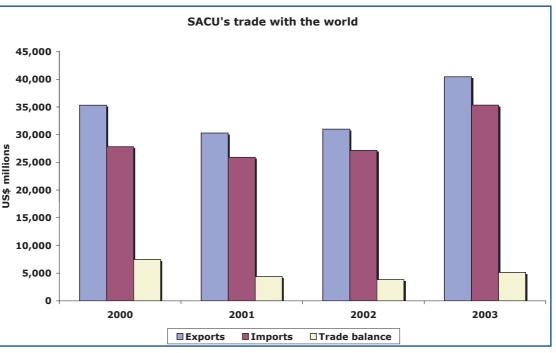
eventual reintegration into the regional economy. Expanded membership would complicate the challenges facing SACU. However, if SACU has a clear-cut 'comparative advantage' over other alternative groupings such as the Southern African Development Community (SADC) and the Common Market of Eastern and Southern Africa (COMESA), it lies primarily in its ability sustain meaningful to intergovernmental COoperation under difficult circumstances.

The analysis draws upon game-theoretic perspectives on the strategic foundations of

sustained international co-operation. A key insight from game theory is that the availability of mutual gains from regional integration is insufficient to induce strategically rational governments to cooperate. Effective regional institutions can be crucial to translating common economic interests into meaningful co-operation among governments. The next section of this policy briefing presents a non-technical introduction to game theory, also discussing its relevance to the political economy of regional integration. The following section uses these ideas to clarify the foundations of SACU's past durability, highlighting how the combination of South Africa's decision-making dominance and a protectionist external tariff created possibilities for sustained intergovernmental co-operation. The final section of the briefing turns to the challenges of achieving deeper and broader integration under the 2002 agreement - considering intra-SACU relations in areas such as regional industrial and infrastructure development, and in external trade negotiations.

Game theory and the political economy of regional integration

Over the years, African governments have agreed to pursue many ambitious regional economic initiatives, but rarely have these agreements been followed



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by meaningful implementation. Why have governments expended so much energy identifying potential benefits from economic integration, yet had so little success co-operating to reap those benefits? A game-theoretic perspective helps clarify why governments often struggle to achieve mutually desirable outcomes. It provides tools for analysing strategic interaction among rational actors - that is, situations where actors' choices are guided by their own preferences, but where achieving one's own preferred outcomes depends upon the ability to anticipate the choices of others. Game theory has been widely applied in the fields of economics and international relations. In fact, the 2005 Nobel prize in economics jointly recognised the contributions of Kenneth

Within the new consensus-based institutions, each of these governments possesses veto rights over policies that would reduce external tariffs. Aumann, a microeconomist, and Robert Schelling, an international relations specialist, in using game theory to analyse conflict and co-operation.

Challenges related to regional integration bear important resemblances to a simple game known as the 'prisoners' dilemma'. The story behind the dilemma crops up regularly in television crime dramas, though its relevance to the political economy of regionalism might not be immediately obvious. It begins as two suspected accomplices are arrested and charged with armed robbery. Yet without a confession, the prosecutor has only enough evidence for convictions on illegal gun possession, which carry light sentences. She, therefore, sends the suspects to separate interrogation rooms and independently offers each the same deal: 'If both of you confess to armed robbery, I will recommend lenient sentences. However, if only one of you confesses, I will make sure that whoever refuses to confess serves the full sentence, while the other will be let off without any jail time."

A game-theoretic approach helps clarify the strategic dilemma. Each prisoner has two options, 'confess' or 'don't confess'. Each prisoner's sentence depends not only on his own choice, but also on his accomplice's. Table 1 summarises the situation. Prisoner 1's options are listed down the left side of the table, and Prisoner 2's across the

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top. The four boxes inside the table represent the four possible outcomes, determined by the prisoners' choices, with Prisoner 1's sentence in boldface type and Prisoner 2's in italics. For example, if both prisoners choose 'don't confess', the upper-left outcome will be realised – both receiving light sentences for illegal gun possession. If only

one prisoner confesses, the lower-left or upper-right outcome will result – the confessor receiving no jail time and his unfortunate accomplice serving a heavy sentence for armed robbery. Finally, if both confess, both receive moderate sentences (armed robbery with leniency), the outcome in the lower-right box.

As strategically rational actors, each prisoner chooses the option that yields his most preferred outcome that is attainable, expecting that his accomplice will be trying to do the same. Assume for now that both prisoners care only about receiving the smallest possible sentences and ignore other implications of their choices - such as feelings of solidarity or guilt, or prospects of subsequent rewards or retribution. Looking at the dilemma from Prisoner 1's perspective, he knows that his sentence depends not only on what he does, but also on what Prisoner 2 does. What if, for whatever reason, he expects Prisoner 2 to refuse

Table 1: The prisoner's dilemma		
	PRISONER 2	
	don't confess	confess
don't confess	light sentence	heavy sentence
PRISONER 1	light sentence	no jail time
	no jail time	moderate sentence
confess	heavy sentence	moderate sentence

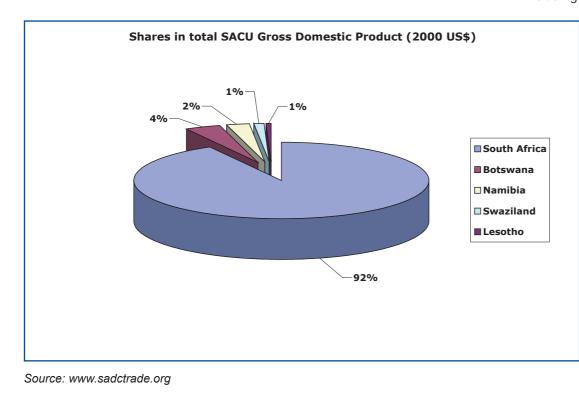
to confess? This would mean Prisoner 1's choice would effectively be between the outcomes on the left side of the table: By refusing to confess, he would force the upper-left outcome, receiving a light sentence; by confessing, he would force the lower-left outcome, receiving no jail time. If Prisoner 1 expects Prisoner 2 not to confess, strategic rationality therefore dictates that he confesses. Meanwhile, if, for whatever reason, Prisoner 1 expects Prisoner 2 to confess, the two available outcomes are those on the right side of the table: By refusing to confess, Prisoner 1 would force the upper-right outcome and receive a heavy sentence; by confessing, he would force the lowerright outcome and receive a moderate sentence. Therefore, if Prisoner 1 expects Prisoner 2 to confess, strategic rationality again dictates that he confesses. So, in the end, Prisoner 1's choice does not depend on what he expects Prisoner 2 to do - whether or not his accomplice confesses, confessing gives him the

shortest attainable sentence. Because Prisoner 2 faces an identical situation, strategic rationality requires that he also confess.

The prisoners' dilemma shows how strategically rational behaviour by individual actors can produce mutually undesirable outcomes. In seeking

to minimise their sentences, both prisoners choose to confess. The only outcome consistent with strategically rational behaviour is thus the one in the lower-right corner of the table - both confess, and both receive moderate sentences. Yet an outcome exists that both accomplices would prefer - the outcome in the upper-left corner, in which both refuse to confess, and both receive light sentences. The prisoners' strategic rationality is directly at odds with co-operating to achieve a mutually desirable outcome. The prisoners cannot co-operate to 'stonewall' the prosecutor because they are strategically rational - not because they would not both prefer lighter sentences, and not because they cannot think clearly about their own interests.

This story is much too simple to capture the complexity of real-world interactions, but the underlying strategic dilemma appears in many settings – including efforts by governments to co-



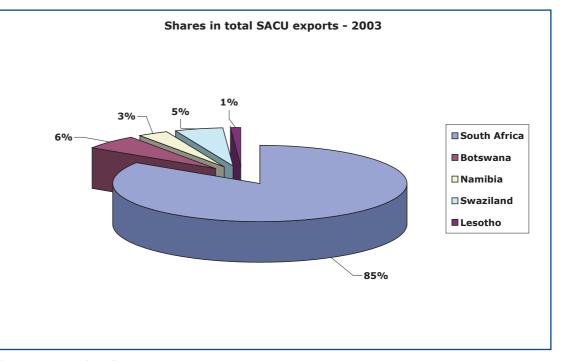
operate to reduce barriers to international trade. The basic disjuncture between individual rationality and collective welfare in the prisoners' dilemma holds for co-operative initiatives in which 'free riding' on the contributions of others is possible. For example, governments in a region might agree that all could benefit if all removed barriers to intraregional trade, even though each government prefers to retain the discretion to protectionist impose measures. The leader of any single government could follow a line of reasoning similar to the prisoners': 'If everyone else is going to remove

their trade barriers, I would prefer to take advantage of the open regional market without giving up my own policy discretion; if no one else is going to remove their trade barriers, I do not want to give up my policy discretion for nothing." Whatever it expects others to do, each government might conclude that it is not in its strategic interest to give up its policy discretion, and efforts at mutually desirable regional integration would collapse.

Governments considering a regional economic initiative are unlikely to see themselves facing a 'once-off' stra-tegic dilemma as in the story

of the prisoners, and expectations of repeated interaction improve prospects for co-operation considerably. In fact, even the prisoners would have been in a better position to 'stonewall' the prosecutor if they expected to face each other again after the trial. Repeated interaction is crucial in game theory because it allows for 'contingent strategies', which impose punishment or offer rewards in future rounds of the game contingent upon past behaviour. A government that blatantly reneges on regional commitments, for example, may face the threat of sanctions or even expulsion, and this threat makes co-operation more likely. However, administering a contingent strategy often requires the creation of formal institutions especially where detecting and punishing violations is difficult or costly, and where there are many members. Without such institutions, the problem of 'free riding' may reemerge in a different guise, with each member hoping that others will take the trouble to monitor and enforce. Game-theoretic reasoning suggests that regional institutions are likely to be more viable if one member stands to benefit so substantially from co-operation that it is willing to play a leadership role, bearing most of the costs and responsibilities of establishing and operating them.

Insights from game theory thus



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counter the simplistic notion that the mere existence of potential benefits from regional economic integration will necessarily inspire governments to cooperate. The story of prisoners' dilemma suggests that the general failure of regional integration schemes in Africa does not necessarily indicate the lack of potential economic benefits, nor the inability of governments to pursue their interests strategically. From a gametheoretic perspective, the failure of most regional economic initiatives is probably less surprising than SACU's ability to secure the co-operation of its members for nearly a century. The next section

'If everyone else is going to remove their trade barriers, I would prefer to take advantage of the open regional market without giving up my own policy discretion.' analyses the strategic and institutional factors behind SACU's durability.

The classic model of SACU cooperation

The co-operation sustained through much of SACU's history has been grounded less in the benefits of intraregional specialisation and exchange emphasised by liberal economic theory than in pragmatic arrangements combining South African policymaking dominance with financial compensation to the other members. This pattern became most evident after Botswana, Lesotho and Swaziland became independent in the 1960s, forcing a major renegotiation that led to the 1969 SACU agreement. For South Africa, whose economy is much more industrialised and much larger than those of the other members, SACU's attractions were historically based on the political advantages of maintaining close trade and fiscal relations with its neighbours. For the other members, the principal attractions have been their allocations from the common revenue pool, which South Africa has periodically increased as necessary to preempt serious consideration of withdrawal by the other governments. As a result, the smaller members became more fiscally dependent on SACU. Not surprisingly, debates about SACU have

SACU was established through a 1910 agreement between the newly formed Union of South Africa and the British High Commission responsible for the territories later become Botswana, to Lesotho and Swaziland. It was initially conceived as a temporary measure to hold only until the High Commission territories' expected political incorporation into South Africa. However, South opposition to Africa's emerging racial policies led Britain to retain the territories as colonial

protectorates until their independence in the 1960s. Nearly from its inception, SACU was enmeshed in political tensions between South Africa and Britain. South Africa regularly exercised its dominance of customs policy and administration within SACU in ways detrimental to the neighbouring countries' interests, in part to show the disadvantages of non-incorporation. From the other side, heavy-handed treatment could be taken as evidence of the dangers of incorporation.

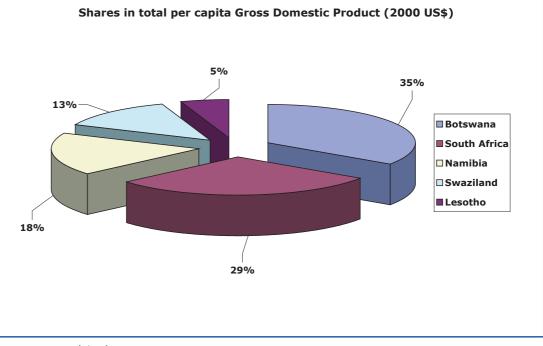
With stalemate over the territories' political status, the 1910 agreement went on to govern customs arrangements virtually unchanged for 50 years. A key provision of the agreement was a static revenue formula, based on average customs receipts for the three fiscal years 1907-10, which locked in a 98.7% South African share and divided the remainder among the High Commission territories in fixed proportions. Though perhaps reasonable as a temporary measure, the formula was insensitive to longer-term economic and policy changes among the member countries. In the mid-1960s, with Botswana, Lesotho and Swaziland on the verge of political independence, Britain modified their respective proportions of the non-South African share to reflect current consumption of dutiable imports. Yet no adjustments Game-theoretic reasoning suggests that regional institutions are likely to be more viable if one member stands to benefit so substantially from co-operation that it is willing to play a leadership role.

were ever made to compensate for the 'trade-diverting' effects of South Africa's protectionist industrialisation policies, adopted beginning in the 1920s, which forced other SACU members to purchase more expensive South African goods that earned no customs revenue. The 1910 agreement required that all SACU countries maintain tariff and tariff-related policies substantially in line with South Africa's, effectively allowing South Africa to impose its policies on SACU as a whole.

The negotiations culminating in the 1969SACU agreement took place in a very

different political environment, allowing the newly independent governments to secure more favourable provisions. South Africa's deepening international isolation gave it a strong political stake in maintaining close economic links with its neighbours. Tying Botswana, Lesotho and Swaziland into a revamped customs union would curtail the threat of the South African government's opponents using these countries as platforms for guerrilla activities. On the broader global stage, a SACU agreement would help South Africa make a more plausible case that it was willing and able to work co-operatively with independent African states. The political setting gave South Africa strong incentives to reach an agreement; meanwhile, the threat of non-agreement gave Botswana, Lesotho and Swaziland considerable negotiating leverage.

While the 1969 agreement reflected substantial concessions by South Africa, it also reinforced the asymmetries underlying intergovernmental cooperation in SACU – combining South African policy dominance with fiscal compensation to the other members. On trade policy, South Africa was pressed to allow scope for infant-industry protection in BLS while backing down on demands to protect its own 'mature industries'. However, it retained authority to set the common external tariff and excise duties



Source: www.sadctrade.org

in consultation with the other SACU members. On revenue allocation, South Africa was forced to accept the principle that customs unions between countries at different levels of development benefit the more developed disproportionately, justifying compensation to the less developed exceeding shares based simply on the value of dutiable imports. The formula adopted in the 1969 agreement raised the BLS shares to two and three times what they would have been under the 1910 agreement. A 1976 amendment to 'stabilise' payments expanded them further. Whatever the economic merits of offering additional compensation, the timing and size of changes to the revenue formula closely reflected the political imperative of securing continued BLS participation.

SACU's durability was rooted in South Africa's self-interested willingness to play a leading role in administering the customs union, including its system for distributing common-pool revenues. South Africa gained economically from SACU, but political considerations were always central to its position. From the 1960s, with its deepening international isolation and BLS independence, South Africa found it needed to concede ever-larger shares of SACU's revenue to the other members to sustain their co-operation. As a result, BLS became increasingly dependent (with the partial exception of Botswana) on these transfers. In the 1990s, the contextual foundations for this distinctive model of intergovernmental co-operation began to crumble, and the renegotiated 2002 agreement represents an attempt to adapt SACU to changing realities.

The 2002 SACU Agreement: Towards deeper and broader integration?

During the 1990s, South Africa's political transition and the completion of the Uruguay Round of multilateral trade negotiations profoundly altered the environment in which SACU operated. South Africa's democratic transition inclined it towards more consensual relations with its neighbours, but also freed it from the overriding apartheidera imperative of cooperating with the other SACU members at nearly any

SACU's durability was rooted in SA's self-interested willingness to play a leading role in administering the customs union.

cost. Meanwhile, the WTO's increasing pressure towards 'open regionalism' in the developing world posed a challenge to South Africa's past practice of using SACU's external tariff to protect its domestic industries. The prospect of steady reductions in trade barriers entailed the likelihood of steady reductions of the common revenue pool that had become the linchpin of cooperation within SACU – and on which the smaller members (by now including an independent Namibia) had become fiscally dependent.

The 2002 agreement, reached after several years of negotiations, seeks to adapt SACU to these major changes in regional politics and the world economy. Regarding decision-making, the agreement calls for a sharp break with the South African unilateralism of the past, establishing several regional institutions and requiring consensus among member governments on all substantive matters (including the admission of new members). A fulltime secretariat is being established with headquarters in Namibia. Changes to the external tariff are to be considered by a SACU-wide board - rather than, in the past, by South Africa's national Board on Tariffs and Trade. Moreover, any changes must be ratified consensually by a Council of Ministers

SA's democratic transition inclined it towards more consensual relations with its neighbours. with cabinet-level representation of all member governments. Regarding policy, the 2002 agreement's preamble affirms the aim of promoting the further integration of SACU countries into the global economy. Financial and revenueallocation arrangements implicitly recognise that 'opening' SACU is likely to reduce receipts from the common external tariff. They are structured so that an overall decline in SACU revenues cannot expose South Africa (or any other member) to financial liabilities exceeding their obligated contributions to the tariff and excise pools. Meanwhile, the revenue-allocation system includes a development component to compensate poorer member countries - and this is calculated as a share of the excise pool, which is less sensitive to the effects of external trade liberalisation.

In addressing shortcomings of its predecessors, the 2002 SACU agreement creates new challenges. Achieving sustained intergovernmental co-operation within a regional initiative requires much more than the existence of mutual economic gains, as the analogy to the prisoner's dilemma has highlighted. SACU's most impressive accomplishment has been its durability despite deep conflicts among its members rooted in tense regional politics and stark economic disparities. The particular pattern of cooperation involved an overwhelmingly dominant member, with a very strong political interest in SACU's survival, using an ample revenue pool to induce continued participation by smaller members. The vision of consensual decision-making and open regionalism in the 2002 agreement calls for a guite different pattern of co-operation. A central challenge is to forge a consensus behind SACU's further integration into the world economy, recognising that reductions in external tariffs are likely to shrink the revenue pool that is a central attraction to most of SACU's smaller members. This challenge is likely to become steeper if SACU's membership is expanded. Failing to meet it would mean sacrificing at least one of the 2002 agreement's two key principles - consensual decisionmaking or open regionalism.

Though the obstacles are steep, they are far from insurmountable. On the policy front, for example, it is important to recognise that reducing the common

external tariff carries important economic

benefits for less-developed SACU members. In the past, their governments have rightly complained of being forced to bear the burden of South Africa's protectionist industrial policies. A lower external tariff means easier access to more competitive imports from outside SACU - open regionalism reducing, intended. the trade-diverting as consequences of the customs union. Though trade liberalisation is likely to reduce fiscal transfers to governments, it holds the prospect of economic benefits to consumers throughout SACU. On the decision-making front, it is important to recognise that the 2002 agreement's emphasis on consensusbased procedures is not entirely new to SACU. In fact, under the previous SACU agreement (and WTO rules) the 1999 Trade, Development and Co-operation Agreement (TDCA) between South Africa and the European Union required the 'concurrence' of all SACU member governments. The TDCA was a major step in integrating SACU more closely with the global economy, and its ratification formally required consensus among its members. The TDCA negotiations were complex and difficult but led to an agreement. They foreshadow the kinds of problems and possibilities likely to emerge as SACU considers agreements with other potential partners, from the United States to China.

In seeking to realise the 2002 agreement's vision, SACU might adapt elements of its established model of intergovernmental co-operation. For example, further moves towards external trade liberalisation could be combined with new forms of financial compensation. The development fund component of the new revenue allocation formula could serve as an inducement to SACU's less developed members, and has the advantage basing shares on transparent economic criteria (per capita income). A complication is that, if SACU is expanded, new members would at least initially be net beneficiaries of the fund, cutting into current beneficiaries' shares. The BLNS governments might, therefore, oppose expansion unless South Africa agrees to expand the fund through higher excise contributions. Another possible source of compensation for a liberalising SACU might be external partners, who might Financial and revenue-allocation arrangements implicitly recognise that 'opening' SACU is likely to reduce receipts from the common external tariff.

see increased development assistance as the price paid for SACU consensus in trade negotiations. During the TDCA negotiations, much was made of European special interests' ability to wrest concessions from South Africa. Yet it also appears that the BLNS governments, who could conceivably have blocked the agreement by withholding their 'concurrence', won new commitments of European aid. Meanwhile, in another scenario, it is possible that South Africa will soften the liberalising thrust of its trade policies in favour of a more interventionist 'developmental state' approach. In this case, it might seek to use common industrial policies or regional infrastructure projects to compensate SACU's less developed members, rather than relying primarily on direct financial transfers.

Can SACU serve as a vehicle for deeper and broader economic integration in Southern Africa? Considerable uncertainty exists about current trends in the governance of global and regional trade. Rather than advancing strong claims about SACU's future, the aim of this briefing has been to highlight the importance of thinking clearly about the

Another possible source of compensation for liberalising SACU might be external partners. challengesofachievingintergovernmental co-operation. Through its long history, SACU's 'comparative advantage' has been its ability to sustain such cooperation under difficult conditions. Co-operation is not an end itself, and should be oriented towards the region's economic advancement. Yet, as the logic of the prisoners' dilemma illustrates, the mere existence of mutual economic gains from co-operation is an insufficient foundation for intergovernmental cooperation. To succeed, SACU must forge institutions and policies to align the strategic self-interests of member governments with the achievement of collective developmental goals.

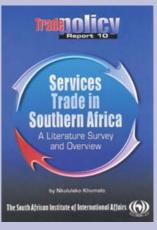
Sources and suggested readings

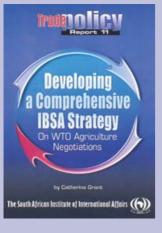
For overviews of the 2002 SACU agreement, see Robert Kirk and Matthew Stern, 'The New Southern African Customs Union Agreement', Africa Region Working Paper 57, Washington: International Monetary Fund, 2003, downloadable from the IMF website, www.imf.org; and Colin McCarthy, 'The Southern African Customs Union in Transition', African Affairs 102, 2003, pp.605-630. On the agreement's institutional dimension, see Gerhard Erasmus, 'New SACU Institutions: Prospects for Regional Integration', Tralac Trade Brief, Stellenbosch: Trade Law Centre for Southern Africa, 2004, downloadable from the Tralac website, www.tralac.org. On other recent challenges, see 'Trade Liberalisation and Financial Compensation: The BLNS states in the Wake of the EU-South Africa TDCA, MA thesis, Wits University, 2004. On SACU's history, see in particular Stephen Joel Ettinger's excellent study, 'The Economics of the Customs Union between Botswana, Lesotho, Swaziland and South Africa', PhD thesis, University of Michigan, 1974; and Ngila Mwase and Gavin Maasdorp, 'The Southern African Customs Union (SACU),' in Regional Integration and Trade Liberalisation in Sub-Saharan Africa, Vol. 3, Regional Case Studies, eds. Ademola Oyejide, Ibrahim Elbadawi, and Stephen Yeo, Houndmills: Macmillan, 1999, pp.197-249. Finally, for a very readable introduction to game theory and the prisoners' dilemma, see Avinash K. Dixit and Barry J Nalebuff, Thinking Strategically: the Competitive Edge in Business, Politics, and Everyday Life, New York: WW Norton, 1991.

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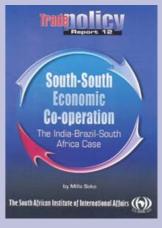


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