SOUTH AFRICA FOUNDATION

OCCASIONAL PAPER
No 3/99

NOVEMBER 1999

THE SADC
Free Trade Agreement

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The Foundation seeks to formulate and express a co-ordinated view on macro-economic and other national issues and to promote the interests and further growth of South Africa's private sector both domestically and internationally. The Foundation strives to promote enterprise and an environment conducive to the conduct of business. It is also believed that the development of human capital and the raising of income levels are essential in building a successful nation.

The *South Africa Foundation* fosters relationships between South Africa and the rest of the world, in the belief that these relationships will improve opportunities for South Africa as well as for the entire southern African region.

The contribution made by Whitehouse and Associates is gratefully acknowledged. This paper does not necessarily reflect the views held by individual members of the South Africa Foundation.

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THE SADC FREE TRADE AGREEMENT

1. INTRODUCTION

Trade policy in South Africa has undergone fundamental change since the lifting of sanctions during the early nineties and the subsequent transition to a political democracy. South Africa has had to catch up with the rest of the world in liberalising its trade with other countries, and has done so judiciously over a comparatively short period of time.

The first step was a relatively simple one - entering into several existing trade agreements to gain better access to the markets of traditional trading partners. The result was the signing of the US-SA Generalised System of Preferences (GSP) and the SA-EU GSP agreements, allowing South African goods limited preferential access to US and European markets (SAF, 1999).

The second step in transforming South Africa's trade regime was to begin negotiating the more permanent Free Trade Agreement with the European Union. The fact that the EU is South Africa's largest trading partner made this a logical step, especially in light of the world-wide trend towards the creation of trading blocs and the signing of accompanying free trade agreements. It thus made sense for South Africa to free up its trade with a region which accounts for 35 % of its total trade (SAF, 1999: 2).

Over the past four years, much debate has focused on the likely impact that such an agreement would have on South African industries and the potential benefits and costs that would accrue from the agreement (SAF, 1999). The process culminated in the signing of the agreement on 11 October 1999. Until recently the debate surrounding the European FTA overshadowed the proposed Southern African Development Community (SADC)[1] Free Trade Agreement. With final closure of the EU FTA, however, attention has now shifted to the latter agreement.

It is envisaged that the first phase of the SADC FTA will be implemented on 1st January 2000, along with the EU FTA, or as soon as possible thereafter, and it seems therefore worth looking into the effect that the former agreement will have on the Southern African region. Before analysing potential developments in the region, however, the agreement and the rationale behind it need to be explored. In addition, there are overarching considerations such as compliance with World Trade Organisation (WTO) regulations that need to be examined in order to understand the context of the agreement.

It is important also to note at the outset that the initial South African offer focuses on only six of the other thirteen countries making up the SADC region. Four of the thirteen countries - Botswana, Lesotho, Namibia and Swaziland - are, together with South Africa, members of the Southern African Customs Union (SACU) and thus have free trade between them already. Three other members - Angola, the DR Congo and Seychelles - will only become party to the agreement at a later stage.

[1]SADC consists of Angola, Botswana, DR Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

The agreement, then, effectively focuses on liberalising trade between SACU and six other countries. These are Mauritius, Malawi, Mozambique, Tanzania, Zambia and Zimbabwe. Furthermore, South Africa currently has bilateral trade agreements with Zimbabwe, Zambia, Malawi and Mozambique allowing goods from these countries preferential access to the South African market, subject to certain quotas and restrictions.

2. THE TRADE IMBALANCE

The South African government has on numerous occasions emphasised the need to bolster trade relations between South Africa and the rest of Africa, where it has an obvious locational advantage *vis-a-vis* the rest of the world. SADC countries, because of their proximity to South Africa, will naturally receive more immediate attention than other countries, with the proposed SADC FTA being an important first step. Furthermore, according to Trade & Industry Minister Alec Erwin, the SADC FTA should be viewed as an agreement that complements the existing EU FTA.[2] South Africa's foreign policy - of which trade policy forms an integral part - is shaped partly by the geographic and demographic realities of the Southern Africa region. One of the cornerstones of South Africa's foreign policy is 'regionalism', or the formation of mutually beneficial trading blocks - hence the current focus on the SADC FTA.

South Africa is a dominant player within the SADC region. Imports from SADC in 1990 amounted to roughly R600 million, and whilst this had increased to over R 2 billion in 1998, it still accounts for only 2% of South Africa's total imports. By contrast, South Africa exported R 15,6 billion worth of goods to SADC in 1998, or 15% of its total exports. Most of these exports fall into four categories of manufactured goods, i.e. chemicals, metal products, machinery and transport equipment (SAF, 1998). SADC has clearly become an important market for South African manufactured exports, making it possible for South Africa to diversify its exports and become less dependent on traditional mineral exports. But this advantage is being threatened by growing trade imbalances within the SADC region.

The trade imbalance between SACU and the rest of SADC has already reached unacceptable levels, with the ratio of exports to imports currently standing at 8:1. SADC states are concerned that the EU FTA may worsen the situation, with the EU getting preferential access to the South African market that is not available to other SADC members, thereby discriminating against imports from SADC states. South Africa's large trade surplus *vis-à-vis* the rest of SADC has become something of a political hot potato within the region, and is also economically unsustainable: net importers in SADC may run out of foreign currency and stop buying manufactured goods from South Africa.

The proposed SADC trade protocol is one way of redressing the trade imbalance. Aimed at creating a common market in Southern Africa by eliminating trade barriers over an eight-year period, it should go a long way to providing greater access for products from SADC countries to the South African market. If the protocol should also free up factor movements across the region, the trade

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[2]Address given at the Johannesburg Chamber of Commerce and Industry business breakfast, 22/4/99

imbalance could be offset by increased South African investment in other SADC countries. Not only will such investments help to improve the balance of payments positions of these countries, but they may also promote higher levels of trade within the region as a whole.

3. WTO COMPLIANCE

New regional trade agreements must comply with the rules and regulations governing world trade and finance. All new agreements need to complement those already in existence in order to create as seamless a trading environment as possible. Global trade is expanding at roughly twice the pace of global GDP, and the World Trade Organisation (WTO) aims to facilitate this process even further through measures that will reduce or abolish protectionism in the international arena.

The WTO stipulates that all FTA's should adhere to certain principles, chief amongst them being that they should cover 'substantially all trade'. Thus in order for an FTA to meet WTO requirements, all sectors of trade between the signatories must be addressed. Provisions are made for sensitive industries, but the FTA must liberalise at least 90% of total trade between the contracting countries. Failure to comply with WTO regulations can cause many problems, including countervailing sanctions from aggrieved parties, such as in the case of the banana dispute between the US and the EU.[3]

The second stipulation refers to the extent to which duties are reduced. South Africa is a contracting party to the WTO, and has undertaken to reduce duties in line with WTO stipulations. Thus again, import duties have to be substantially liberalised in order to facilitate free trade between countries and regions. South Africa's economy in the past was built on an inward-looking protectionist strategy, but the removal of sanctions has led the government to change its strategy towards creating industries able to compete in the international arena. One mechanism is to reduce duties on imports to stimulate manufacturing through cheaper inputs. South Africa's tariff structure is now in compliance with WTO regulations, and in most instances goes beyond the GATT binding duties.

A related issue - often overlooked - is the fact that South Africa, unlike most other countries, assesses duties on the FOB value of goods - not the CIF value. Duties are levied on the price of goods at the point of departure, rather than the point of arrival, thus implying that transport and insurance costs are not included in the dutiable value. This effectively reduces the level of duty paid.

Two other issues have had an impact on the SADC negotiations. The first is the EU FTA and the second the upcoming Seattle Round of WTO negotiations in late November. South Africa did in fact consider the proposed SADC agreement when negotiating the EU FTA so as to try and minimise the impact it would have on sensitive industries in the SADC region. These include issues affecting beef and pork production and the fisheries industry, amongst others (SAF, 1999).

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[3]The US argues that preferential access given to the ACP countries by the EU discriminates unfairly against producers in Central America. The WTO has agreed with the US position, and the US has placed limited punitive duties on certain EU goods as a result.

The EU negotiations gave South African officials the opportunity to refine their understanding of the issues at hand and bring a more sophisticated approach to the SADC talks. It also gave South Africa invaluable insights into the positions likely to be adopted by developed nations at the next round of WTO negotiations in Seattle. South Africa will thus be able to play a crucial role in formulating a developing nations mandate in general, and an African mandate in particular.

South Africa is at the forefront of the developing world's push to gain greater access to markets in developed countries for so-called 'grandfather industries'. These are industries where developed nations are no longer able to compete with developing countries, such as agriculture, textiles and iron and steel. Central to the argument is the need to remove all types of barriers, including non-tariff ones, limiting the movement of these goods between and within developed and developing nations. South Africa's own efforts in this regard, as well as those of her SADC trading partners, will no doubt send a strong signal to the WTO that compliance must be complementary - especially in light of the stated objective of stimulating economic growth and consolidating gains made in the developing world.

4. SADC FTA : CURRENT STATUS

South Africa has put forward a comprehensive line-by-line offer to all the other SADC countries, to which most have already responded. The South African offer entails a reduction of those tariffs that range between 0% and 17% to 0% on implementation of the FTA next year. Tariffs that range between 18% and 24% will be reduced to 0% over a three year period, whilst those that range between 25% and 50% will be phased down over a five year period. Tariffs above 50% - as in the case of textiles, sugar, steel, auto components and red meat - will be dealt with under separate protocols.

South Africa has indicated that in order to speed up the process, tariffs will be unilaterally reduced. The first phase of the reduction in tariffs will be implemented on the 1st of January 2000, or as soon as possible thereafter, regardless of the status of the FTA at that stage. Trade that falls outside of those sectors identified as sensitive industries will therefore be fully liberalised over a five-year period.

In view of its sensitivity about regional trade imbalances, the South African government has given its Customs Union partners eight years instead of five to reduce their tariffs and bring them into line with South Africa's. Other SADC countries also have a total of eight years to liberalise their imports from South Africa, giving these countries an effective eight-year period to restructure industries that currently benefit from tariff protection.

The Free Trade Agreement is not simply a tariff reduction agreement between trading partners. It is an attempt to create an integrated market that allows for the most complementary trading environment within the region. The agreement thus stresses the need to eliminate non-tariff barriers to trade such as documentation differences, standards requirements, subsidies and export duties. In addition the stated intention of using the agreement to build industrial capacity within the region has necessitated the introduction of strict rules of origin regulations to ensure that goods are not simply imported into the region, repackaged and sold to other SADC countries. Such practices benefit no one - except perhaps a few individual traders - and are unlikely to build capacity and create new job opportunities in the region. Indeed, it could have the opposite effect of undercutting fledgling industries in SADC

5. RULES OF ORIGIN COMPLIANCE

The FTA proposes to standardise customs procedures within the region and change the regulatory framework of those procedures to ensure that rules of origin are adhered to. The rules of origin procedures that are being proposed would basically follow those used to govern exports from ACP[4] countries to the EU. The EU rules of origin are based on the principle of "substantial transformation". What this means is that substantial value has to be added to a product imported from outside the free trade region before it can be freely traded between member countries of that region.

This is one of the more contentious issues in the SADC FTA. South Africa has nineteen customs points linking it with the other Customs Union countries, and cannot stop the flow of illegal goods into the country. It will thus be very difficult to police all possible entry points throughout the region. There is a very real (and in some instances justified) concern among South African businesses that our SADC partners will simply import huge quantities of cheap goods from other developing regions and sell them through to South Africa as SADC products. Of particular concern is textiles and clothing from countries in the East.

The small number of control points throughout SADC (South Africa included), coupled with a lack of administrative capacity, would suggest that it will be difficult to prevent illegal imports under the rules of origin. This said, an analysis of our trade patterns with SADC points to the fact that sudden increases in imports of particular products from specific countries will be easy to identify, and thus make the task of ensuring compliance a little easier.

The porous nature of borders in the region is counteracted somewhat by the inadequacy of the transport system in SADC. Fears that the DR Congo or Angola could be used as transit routes for goods coming from Central and West Africa (or anywhere else) are unfounded. Conflicts aside, the transport systems from these countries into Southern Africa are almost non-existent and it is likely to be costlier trying to smuggle goods through these countries into Southern Africa than it is to go through the regular procedures. Indeed, Angola and the DR Congo act more as a hindrance to greater legitimate trade in Africa than as a route for smuggling.

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[4]ACP - African, Caribbean and Pacific countries, which are signatories to the Lomé Convention.

6. STANDARDS AND OTHER NON-TARIFF BARRIERS

South Africa has long been accused by her trading partners in SADC of using standards as a non-tariff barrier to trade. Two sectors that have come under the spotlight are textiles and food - especially canned food. It is a fact that outside of its major urban centres, South Africa is as underdeveloped as many of her neighbours. SADC countries would like to be able to tap into these markets, offering goods of variable quality at lower prices, as a means of stimulating agricultural and manufacturing production in their own countries.

The South African government is adamant that it does not use standards as a non-tariff barrier, though it will not allow lower quality goods into the country. According to Mfundo Nkhulu of the Department of Trade and Industry, harmonisation of standards in SADC should be a priority, but standards should be harmonised upwards, so that SADC products become competitive outside of the region as well - "South Africa is looking for world class benchmarks in order to become a global player".[5]

Despite the assurances of the South African government to the contrary, however, SADC countries remain convinced that South Africa has not and will not level the playing fields in this regard. Allied to this is the frequent assertion that South Africa has a complex documentary framework that discourages exports to South Africa. However, the harmonisation of documentary requirements under the proposed FTA will - much like in COMESA - address these concerns.

There are of course many non-tariff barriers to trade other than standards and documentary requirements. Primary amongst these are a lack of productive capacity within SADC, high transport costs, an inadequate infrastructure, administrative constraints, and a lack of knowledge in South Africa as to what the rest of the region has to offer. None of these barriers can be overcome by the stroke of a pen, and it is therefore important that the SADC FTA should at least put in place the building blocks necessary to address these issues over time.

7. IMPACT OF THE FREE TRADE AGREEMENT

What impact is the SADC FTA likely to have on the region and on individual countries within the region? There is really very little to go on. But bearing in mind that the other SADC countries - bar Botswana, Lesotho, Mozambique and Tanzania[6] - are part of COMESA, and hence already have a relatively favourable trade regime in place, a look at South Africa's trade with the rest of SADC may give some indication of possible developments.

7.1 South African Imports from SADC

It is a fact that SADC countries do not export a wide variety of products to South Africa, and given the nature of their economies there is invariably a high degree of overlap in the products that they can offer. SADC accounts

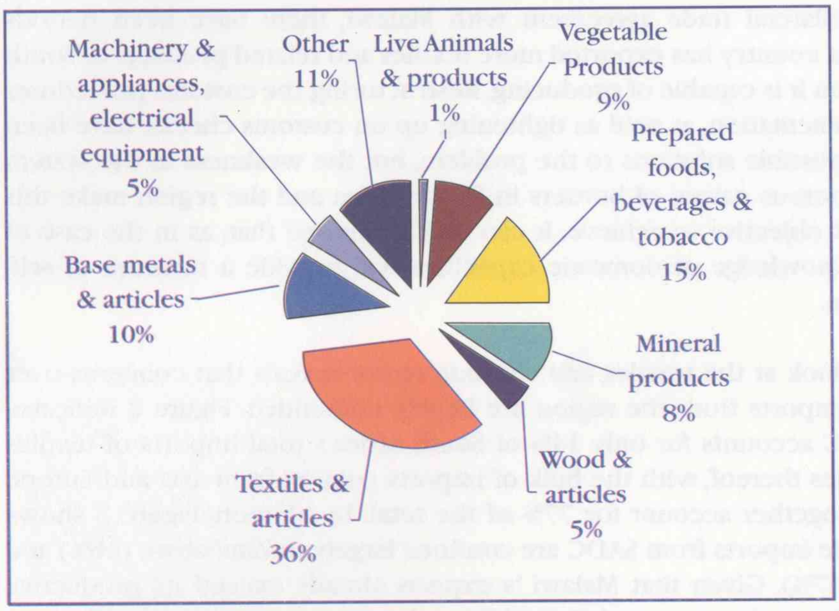
[5]Mfundo Nkhulu, Keynote address at the International Trade Centre UNCTAD/WTO meeting on sub-regional trade development in Johannesburg, May 1999.

[6]Botswana has never been a member of COMESA, whilst Lesotho and Mozambique withdrew from COMESA with effect from 1998. Tanzania's withdrawal from COMESA becomes effective in the second half of 2000.

for 57% of South Africa's imports from Africa making it South Africa's main continental source of goods. However, imports from SADC accounted for only 2% of South Africa's total imports in 1998 - roughly R2 billion.

The composition of South Africa's import basket from SADC is illustrated in Figure 1 below. It shows that foodstuffs, beverages and related consumer products make up about 25 % of all South Africa's imports from the region. Textiles alone contribute 36 % to the total, while base metals, minerals, wood products and appliances together contribute about 40 % - all presumably used as inputs in local manufacturing processes. It thus seems that most SADC exports to South Africa are of a primary or intermediary nature - not final consumer goods.

Figure 1 Product profile of South African imports from SADC



It is useful also to consider the sub-national trade potential. A recent study by the International Trade Centre (ITC - UNCTAD / WTO, 1999) compared actual SADC exports to South Africa with potential exports, where the latter was defined in terms of the estimated supply capacity in SADC countries and import patterns among SACU countries. After allowing for the impact of tariff preferences under the SADC FTA on imports from SADC countries into South Africa, the study concluded that the leading 100 products offered a combined trade potential of US$ 790 million or R 4 740 million. The latter figure is about 2,5 times the current level of South Africa's imports from SADC and, if realized, would lower the current export : import ratio of 8 to1 to a more respectable 3 to 1.

Figure 1 and the UNCTAD / WTO findings indicate that SADC primary producers could potentially derive great benefits from the proposed FTA. In areas such as agro-processing, for example, several SADC countries stand to benefit from the preferential access they will enjoy in the South African market. This is particularly true of Zimbabwe, which has traditionally had a strong agro-processing industrial sector. Indeed, this sector accounts for roughly 40% of all industrial output in Zimbabwe, and whilst it is difficult to quantify the increase in trade opportunities that the lowering of tariffs and other barriers will create, it should provide a boost to manufacturers in this sector

The one area where there is an apparent clash is that of textiles and clothing. The issue has become clouded however as textiles is one of the sectors expressly excluded from the general FTA agreement. South African producers argue that the local industry is not in a position to compete with low cost imports from the region. Furthermore, there is the fear that SADC countries will simply become conduits for cheap textile imports from other regions. As incentives for local production are eroded by cheap imports, it is argued, the industry and the region as a whole will suffer job losses.

This is a valid concern as the DTI has already conceded that under the current bilateral trade agreement with Malawi, there have been periods when that country has exported more textiles and related products to South Africa than it is capable of producing. Restructuring the customs procedures and documentation, as well as tightening up on customs checks, have been cited as possible solutions to the problem, but the weakness in the system and the porous nature of borders in South Africa and the region make this a difficult objective to achieve. It can only be hoped that, as in the case of Malawi, knowledge of domestic capacities will provide a measure of self-regulation.

A closer look at the textiles and clothing sector reveals that concerns over massive imports from the region are largely unfounded. Figure 2 indicates that SADC accounts for only 14% of South Africa's total imports of textiles and articles thereof, with the bulk of imports coming from Asia and Europe - which together account for 77% of the total. In addition, Figure 3 shows that textile imports from SADC are confined largely to Zimbabwe (36%) and Malawi (47%). Given that Malawi 's exports already exceed its productive capacity, it can be expected that additional exports will come mostly from Zimbabwe. But the South African government has in any case recently increased the quota available to Zimbabwe under the bilateral trade agreement, thus negating some of the effects of tariff liberalisation. Textile imports from other SADC countries are generally very small, though some of them, especially Tanzania and Mauritius, may well benefit from a liberalisation of the textile sector.

Figure 2. South Africa's Total Imports of Textiles and Textile Articles by Geographic Region, 1998

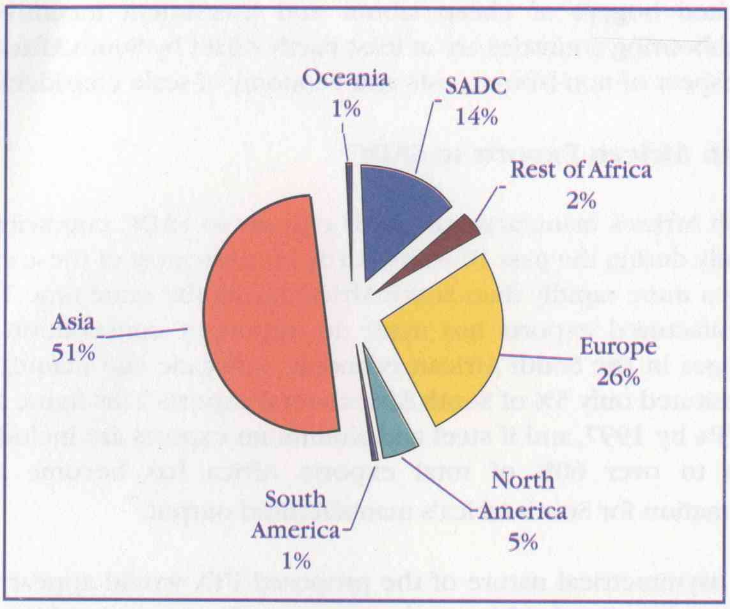
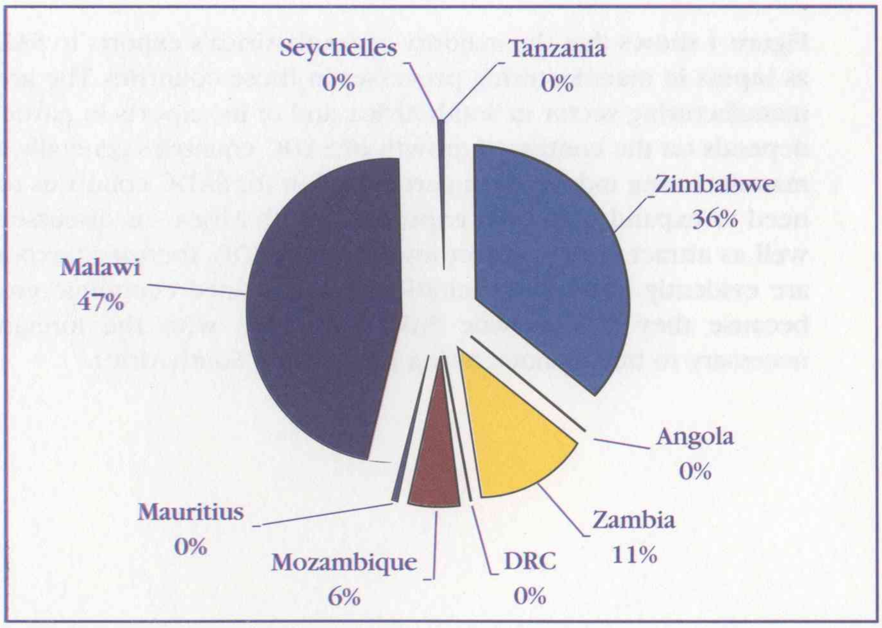


Figure 3. South Africa's Total Imports of Textiles and Textile Articles from SADC, 1998



The liberalisation of South Africa's tariff regime does of course provide incentives for manufacturers in the region to increase production and penetrate South African markets, but it is unlikely that the SADC FTA alone will provide enough incentives to swamp South African industry. The oft-cited bogeys of cheap labour and investment incentives in several neighbouring countries are at least partly offset by South Africa's advantages in respect of non-labour costs and economy-of-scale considerations.

7.2 South African Exports to SADC

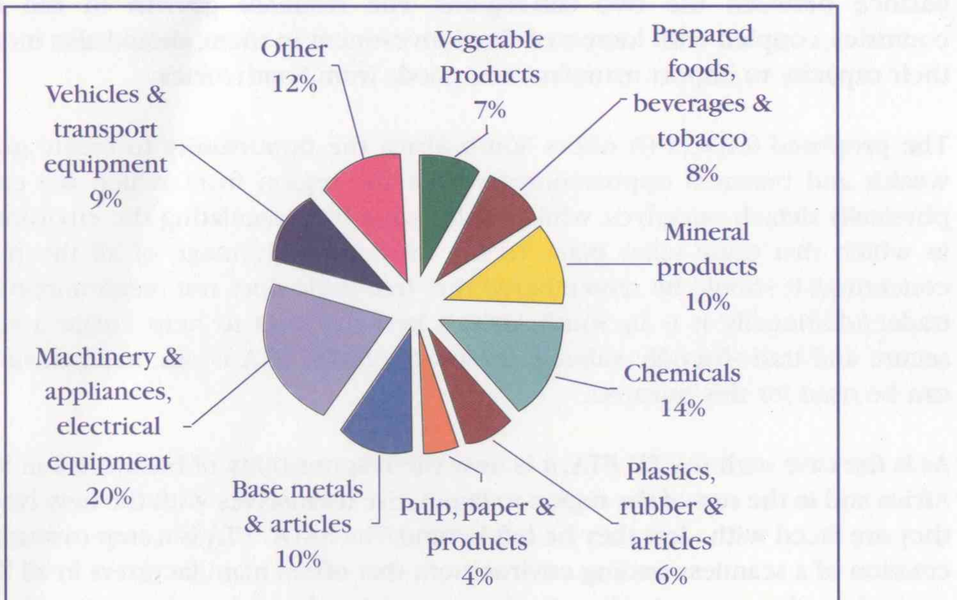
South Africa's manufactured goods exports to SADC countries have grown rapidly during the past 10 years, partly because most of these countries have grown more rapidly than South Africa during the same time. The growth of manufactured exports has made an important contribution to structural changes in the South African economy. A decade ago manufactured goods constituted only 5% of South Africa's total exports. This figure had increased to 25% by 1997, and if steel and aluminium exports are included, the figure rises to over 60% of total exports. Africa has become an important destination for South Africa's manufactured output.[7]

The asymmetrical nature of the proposed FTA would appear to encourage imports into South Africa at the expense of encouraging further exports to the rest of SADC. This is certainly true of the initial three-year phase of tariff reduction, with the South African government actively encouraging SADC countries to expand exports to South Africa and grow their local industries. While some of these industries do compete with South African industries, and may thus threaten their future survival, an analysis of South Africa's exports to SADC countries paints a rather more encouraging picture.

Figure 4 shows that the majority of South Africa's exports to SADC are used as inputs in manufacturing processes in those countries. The growth of the manufacturing sector in South Africa, and of its exports in particular, clearly depends on the continued growth of SADC countries generally, and of their manufacturing industries in particular. But for SADC countries to grow they need to expand their own exports to South Africa - as discussed above - as well as attract foreign direct investments (FDI). Increased exports and FDI are evidently important conditions for sustained economic growth, partly because they will provide SADC countries with the foreign exchange necessary to buy manufacturing inputs from South Africa.

[7]Alec Erwin, JCCI breakfast

Figure 4. Product profile of exports to SADC



In addition to encouraging SADC exports to South Africa, the proposed FTA should actively promote FDI in the SADC region as a whole, e.g. by freeing up the movement of capital and other resources between South Africa and its neighbours. Such measures should enable South Africa to continue exporting manufactured goods to other SADC countries.

8. CONCLUSION

The last five years have seen a marked transformation in the international trading environment. The global system is moving inexorably towards free trade on a regional, inter-regional and international level. South Africa is part of this process and has set out to make the best use of the unique opportunities presented to it by the country's re-integration into the international system.

As part of this re-integration, South Africa has had to assess her domestic economy and the regional and international dynamics that shape it in order to formulate new policies aimed at utilising new trading opportunities. The government has therefore pursued several new regional and international policy initiatives to facilitate this process, the most important of which is the signing of new free trade agreements with our principle regional and international partners.

The SADC Free Trade Agreement is a case in point. South Africa has offered to cut taxes currently ranging between 0 % and 17 % to 0 % immediately, and to phase out tariffs ranging between 18 % and 24 % over three years and those ranging between 25 % and 50 % over a five year period; with tariffs in excess of 50 % to be dealt with under separate protocols. South Africa intends implementing the first phase unilaterally on the 1st of January 2000, or as soon as possible thereafter, and to give its SACU partners and the rest of SADC eight years instead of five to reduce their tariffs and bring them into line with South Africa's. Outstanding issues include finalising the rules of compliance and identifying and removing existing non-tariff barriers such as standards and documentary requirements.

The agreement is likely to encourage South Africans to import greater quantities from several SADC countries, thus improving what is now a very lop-sided trade balance between the two sub-regions. The resultant growth in the latter countries, coupled with increased fixed investment in them, should also increase their capacity to import manufactured goods from South Africa.

The proposed SADC FTA offers South Africa the opportunity to create greater wealth and business opportunities within the region from which we cannot physically detach ourselves, whilst at the same time regulating the environment in which that trade takes place to the maximum advantage of all the parties concerned. It should be remembered that free trade does not mean unregulated trade. Additionally, it is in South Africa's best interests to help create a stable, secure and trade-friendly sub-region, and the SADC FTA is one mechanism that can be used for this purpose.

As is the case with the EU FTA, it is now the responsibility of businesses in South Africa and in the rest of the region to familiarise themselves with the new realities they are faced with - lest they be left behind. The SADC FTA is a step towards the creation of a seamless trading environment that offers manufacturers in all SADC countries the opportunity to lower costs through access to cheaper manufacturing inputs and larger target markets. The preferential access that South Africa is now set to enjoy with two of her major trading partners - the EU and SADC - is bound to make local industries globally more competitive. Businesses in South Africa should thus welcome the opportunity to compete in these markets without the hindrances created by artificial barriers to trade.

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Prepared for the SA Foundation, October 1999

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