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U R G E N T

TO : H.E. Ambassador Carl Niehaus
The Hague
THE NETHERLANDS

FAX NO. : 003120 6269975

FROM : Elias Links
Ambassador

DATE : 11 March 1999

NUMBER
OF PAGES : 1 + 16

SUBJECT : SA/EU NEGOTIATIONS: INFORMATION REQUESTED

Transmitted herewith is a report on the latest state of the negotiations between South Africa and the European Union on a Trade, Development and Cooperation Agreement as requested urgently by Minister Nzo.

Could you please hand this document to Minister Nzo at a convenient time.

To: Minister A Nzo
From: Ambassador E Links

1. Please refer to the telephonic request to provide a backgrounder on the current status of the negotiations between the EU and the South African Government.
2. Under separate cover, I am forwarding by facsimile to the Operations Room in The Hague, a copy of the briefing document by the Department of Trade and Industry which was distributed subsequent to a briefing for the Parliamentary Portfolio Committee on Trade and Industry in Cape Town on 24 February 1999.
3. Essential elements of the current status of the negotiations are that:
 - 3.1 The negotiations have now been dragging on for more than three years.
 - 3.2 At a meeting in Davos, Switzerland on 29 January 1999 Commissioner Joao de Deus Pinheiro and the South African Minister of Trade and Industry, Minister Alec Erwin, reached a compromise on outstanding issues which should have brought the negotiations to finality.
 - 3.3 The compromise was subsequently presented to and endorsed by the South African Cabinet. The General Affairs Council (GAC) of the European Union was due to consider the compromise reached at the Davos meeting on 22 February 1999.
 - 3.4 Following a meeting between Messrs Pinheiro and Erwin in Cape Town on 2 December 1998, South African and European Commission negotiators explored compromise solutions around a set of outstanding issues which included the usage of the terms port and sherry and the tariff treatment of sensitive products such as textiles and automotive components. The Vienna Summit of EU Heads of Government which was held in December 1998 had also instructed the European Commission to explore solutions with South Africa, with the aim of concluding the Agreement by March 1999. The Minister and the Commissioner discussed four agenda items at Davos. These were port and sherry, oranges, front loading of certain EU industrial products and faster liberalisation for SA automotive exports.
 - 3.5 On the issue of oranges, the EU proposed excluding spring oranges from tariff liberalisation. South Africa conceded to this request as part of finalising the negotiations. The EU also requested the front loading (faster liberalisation) of some 192 industrial items which were of specific importance to the EU's export interests. South Africa agreed to this request, for the majority of these items. This liberalisation will take place from the fourth year after the entry into force of the agreement. On South Africa's request for front

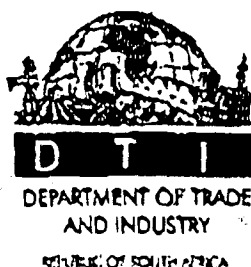
loading of automotive components, Commissioner Pinheiro agreed that SA components could enjoy entry into the EU market at a fifty percent reduction in GSP rates.

- 3.6 It was also intended that the Commission would now assess the effect of this agreement on SACU economies with a view to making additional funding available to finance any adjustment which might be needed by these countries as a result of the agreement.
- 3.7 The elements of the compromise package reached at Davos on port and sherry are the following:
 - 3.7.1 South Africa notes the objective of the EU to establish the exclusive protection by the WTO of the EU names "port" and "sherry" on all markets.
 - 3.7.2 South Africa will phase out the use of the "port" and "sherry" names on all export markets within 5 years, except in the case of non-SADC countries, where an 8 years phase out period would apply.
 - 3.7.3 For the purpose of the Wines and Spirits Agreement, the South African Domestic market is defined to cover SACU (Botswana, Lesotho, Namibia and Swaziland).
 - 3.7.4 South African products may be marketed as port and sherry on the South African domestic market during the 12 years transition period covered by this agreement. Beyond that period the denominations of these products on the South African domestic market will have to be jointly agreed between South Africa and the EU.
 - 3.7.5 From entry into force of the agreement, the EU will provide a duty free quota for wines covering the current level of trade of 32 million litres of South African exports to the EU, with allowance for the future growth of this quota.
 - 3.7.6 As an additional effort to the main objectives agreed for the Development programme for South Africa to be funded by the EU, the EU will provide assistance of 15 million Euro for the restructuring of the SA wines and spirits sector and for the strengthening of marketing and distribution of SA wines and spirits products.
4. The General Affairs Council meeting of 22 February 1999, however, decided to postpone a decision on the South African dossier because of reservations on the part of some Member States. These states also argued that there were still two General Affairs Council meetings scheduled to be held before the EU Special Summit of Heads of State and Government in Germany on 24 and 25 March 1999 during which the agreement

- could be endorsed. They argued further that the Agreement should be conditional along the same lines as the Fisheries Agreement. They believe that the Wine and Spirits Agreement lacks a starting time to give certainty to the various time frames for the port and sherry phase outs. Such dates can trigger the incentives built into the Wine and Spirits agreement, i.e., 15 million Euro and the duty free market access for wines.
5. Mr Philip Lowe, the Director-General of the Commission's Directorate-General VIII (Development) and Chief Negotiator on the EU side was instructed to travel to South Africa to continue the discussions with Minister Erwin and to convey the sentiments of the GAC. This meeting took place in Pretoria on 1 March 1999 and was attended by officials in Pretoria who will be able to complete the details of the discussions which took place during Mr Lowe's visit.
 6. Following the meeting between Mr Philip Lowe and Minister Alec Erwin, a letter was sent by Mr Lowe to Mr Bahle Sibisi of the Department of Trade and Industry which contained, inter alia, a revised compromise package on port and sherry. The Commission expected a reply from South Africa by Monday, 8 March 1999, but this has not been forthcoming as yet.
 7. An element of the draft agreement which has resurfaced subsequent to the meeting in Davos is the question of "illegal immigration". In this connection Member States led by Germany would want South Africa to declare its readiness to readmit illegal immigrants into South Africa via bilateral agreements with the Member States. The issue could also be discussed within the context of the Lome negotiations. South Africa, however, strongly rejects this as an issue to be addressed in this agreement as well as any reference to the post Lome negotiations, even though it is aware of the fact that the topic will be on the agenda.
 8. Two of the Governments which feel most strongly about a firm declaration on Immigration are those of Germany and the Netherlands. These two Governments are also in a strong position to put pressure on those States holding up the Davos and subsequent compromises/proposals agreed in Pretoria on 1 March 1999, i.e., on Port and Sherry, the Wines and Spirits Agreement and other agricultural issues.
 9. In a discussion with the German Ambassador to the EU yesterday, Ambassador Dietrich Von Kyaw proposed that a final strategy be decided upon for the handling of the 'end game' as he called it. He is of the opinion that the timing of the presentation of South Africa's final offer is of importance and that the climate has to be tested beforehand.
 10. Comment

It is our view that the Netherlands Foreign Minister can best assist South Africa in his discussions with the German Foreign Minister in seeking a compromise on the Immigration issue in the Agreement as a means of taking the matter forward and putting pressure on those EU members who are holding up the Agreement on the agricultural and related matters.

To : Mrs Pretorius
From : Mr Ndlangana



SA/EU Negotiations

Trade, Development and Co- operation Agreement

**A briefing document by the Department of Trade and Industry
on the conclusion of the agreement**

24 February 1999

Briefing Document on the conclusion of the RSA - EU negotiations for a Trade, Development and Co-operation Agreement

1. BACKGROUND

29 January 1999 marked the end of more than three years of negotiations with the European Union towards a Trade, Development and Co-operation Agreement. Commissioner Pinheiro and Minister Erwin finalised the agreement which has since been presented and endorsed by the South African Cabinet and the European Commission.

The European Council of Ministers is expected to approve the agreement on 22 February 1999. This would open the way for the official signature and presentation to the South African Parliament for its ratification of the agreement.

1.1 The origins of the Agreement

The call for negotiations with SA was expressed as part of the EU's desire to support SA's new democracy and address the legacy of the past. The EU argued that a free trade area was the best and only way it could provide SA with better market access. The EU's mandate tempered SA's high expectations. South Africa, however, chose to engage and develop a strategic partnership with the EU which is SA's major trade and investment partner.

As part of economic transformation, the government has adopted policies which seek to reposition and re-integrate the South African economy within a rapidly changing global economy. This necessitates the establishment of globally competitive economic enterprises. The move toward global competitiveness has to be accompanied by regional economic cooperation that advances a broad and integrated process of industrialisation and modernisation in the economies of Southern Africa.

A growing South African economy that facilitates intra-regional economic trade and investment flows is a major opportunity for development in Africa and more particularly Southern Africa in the medium term. Not only will it source a wider range of products from its neighbours but it will also be able to invest in activities that will increase the region's exports. This can only happen if South Africa is able to expand its production base by strengthening and enhancing its competitive advantage in the beneficiation of its natural resources. This in turn requires that there is an increase in value added production and a larger manufacturing sector.

The bold move toward a free trade agreement with the EU is intended to contribute towards restructuring of the economy. It is also aimed at consolidating the strategic links with the economies of the member states of the EU, securing preferential market access for South African products and providing certainty and added leverage for foreign investment into the South African economy.

2. OVERALL RESULTS

The Trade, Development and Co-operation Agreement with the EU covers a wide range of issues in a comprehensive field of co-operation. It includes, inter alia;

- ▶ Political dialogue
- ▶ Provisions for a Free Trade Area
- ▶ Trade related issues
- ▶ Economic co-operation
- ▶ Financial assistance and development co-operation
- ▶ Social and cultural co-operation

As part of establishing a comprehensive relationship with the EU, two other agreements have been concluded:

- ▶ Science and Technology Agreement (signed in December 1996)
- ▶ Partial Membership of the Lomé Convention (agreed in April 1997)

At the request of the EU, SA accepted to negotiate a Wines and Spirits Agreement and a Fisheries Agreement. SA insisted, however, that such agreements should be mutually beneficial and that there should be no conditional linkage with the main agreement. The main agreement contains a so-called hook-clause providing for future negotiations for a co-operation agreement on fisheries and there is also a side letter covering the political agreement on port and sherry.

3. KEY FEATURES OF THE AGREEMENT

3.1 Essential Element and Non-execution provisions

Respect for democratic principles, fundamental human rights and the rule of law is established as key elements of the agreement. Good governance is established as another important principle. Any violation of these principles by one party would lead to the other party taking appropriate measures, including withdrawing some concessions. SA insisted on the formulation of these provisions such that there is objectivity in the test for breach of the essential element of the agreement without the risk of unilateral action nor the balance of economic or political interests becoming the determining factor. The agreed text has a better definition of good governance and circumstances under which the non-execution

provision can be invoked.

3.2 Free Trade Area (FTA) Provisions

3.2.1 General Features

When SA presented its trade offer to the EU in June 1997, it called for free trade with asymmetrical coverage of all trade and sectors and special protocols to cover sensitive products. It also called for development and financial measures to support further regional integration and to facilitate the adjustment process in Southern Africa. The outcome of the negotiations meets the WTO requirements of Art. XXIV GATT 1994. The coverage of the FTA will be around 90% of current trade between the Parties with the following elements:

- ▶ Community: full liberalisation of 95% of imports from SA at the end of the transitional period of 10 years.
- ▶ South Africa: full liberalisation of 86% of imports from EU at the end of the transitional period of 12 years.
- ▶ Includes both traded and non-traded products.
- ▶ Provides for the protection of SA's sensitive sectors (automobiles and components, textiles and clothing, red meat, sugar, winter grains, and dairy).
- ▶ Includes the agricultural sector, alongside all other sectors with partial liberalisation and provision for regular reviews on products on the reserve lists.
- ▶ Commits the EU to provision of support for SACU for adjustment efforts resulting from the establishment of the FTA.
- ▶ Contains several elements that assure a positive regional impact on the other countries of SADC.

3.2.2 Industrial Sector

Approximately 86% of SA's total exports to the EU consists of industrial products. While the EU's average tariff levels for industrial products is low, the removal of tariffs will nevertheless give SA's exporters a relative advantage against some of their competitors in the EU market. The EU will eliminate its industrial tariffs either immediately or within three years after the entry into force of the agreement. This includes most of the sensitive products of textiles and clothing (only about 20% of SA's textile exports to the EU will be phased out over a longer period, i.e. 6 years from the entry into force of the agreement). At entry into force of the agreement tariffs on auto-components will be reduced to

50% of the MFN rates¹ applied by the EU. Other products like ferro-chromium with tariff elimination starting in the 4th year will continue to have a global duty free quota. Only six lines of aluminium will remain on the reserve list. The products on the reserve list will nevertheless be subject to reviews.

As indicated the transitional period for the phasing out of tariffs by SA is twelve years to allow for adjustment by firms. Sensitive products like automobiles and parts will remain on the reserve list without any tariff elimination or reduction schedules at this point. This will be reviewed in the light of the outcome of the mid-term review of the Motor Industry Development Programme. With regard to other sensitive products, South Africa persuaded the EU to moderate its initial expectations. This will enable SA to have a slower phase-down. In the case of clothing and textile there is a commitment to reduce the tariffs applicable to imports from the EU. Depending on the segment of the market, by the end of the 8th year the tariffs will vary between 5% and 20%. Between the 8th year and the end of the transition period, EU products will enjoy a preference over the MFN rate of around 40%. The agreement therefore takes into account the changes in these industries at a pace far beyond what was conceivable a few years ago.

3.2.2 Agricultural sector

The agricultural sector is traditionally the most protected sector in the EU and has generally been excluded by the EU in other free trade agreements. In its mandate the EU *a priori* excluded about 46% of agriculture from the FTA with SA.

♦ Agricultural safeguard clause

While the EU's Common Agricultural Policy (CAP) is still a matter of concern, the agreement provides (with regard to agricultural policies) for consultation and compensatory adjustments for any changes which may affect the balance of concessions. The Agricultural policies provision is supplemented by an Agricultural safeguard clause which gives SA the right to challenge the EU should there be proof that increased imports of agricultural products are causing harm or threatening to cause harm to the domestic industry. The onus is on South Africa, especially the industry, to put in place an effective monitoring system that will serve as an early warning signal in this regard.

♦ EU export subsidies

Although SA did not succeed in eliminating EU export subsidies completely, there are some important breakthroughs. Firstly, the EU has committed itself not to pay export refunds on cheese exported to South Africa under the tariff quota of 5000

¹The MFN rate is the rate applicable to all other contracting parties of the World Trade Organisation (WTO).

ton. Secondly, the EU is willing to eliminate export refunds on products South Africa might want to offer for front-loading during the implementation period. Refunds will be eliminated in full once tariff liberalization starts. This is an important aspect of the agreement, as most of the EU agricultural products will not be competitive on the domestic market without refunds. South Africa will take up this challenge. Should the EU be unwilling or unable to eliminate export refunds, South Africa can simply retract its offer of front-loading.

♦ Tariff quotas

The introduction of tariff quotas is important in that it makes inroads into the EU reserve list. Especially the tariff quotas for canned fruit (60 000 ton), fruit juices (5 000 ton) and cut-flowers, in particular proteas (900 ton) are of interest to the industry in SA. The quotas for wines and sparkling wines, as well as for cheese are also significant.

♦ Reserve list

The EU list of exclusions has been reduced, i.e. from 46% to 38% (based on 1997 trade statistics). If one takes into account tariff quotas, it has been reduced even further to 26%. This is an important development. In addition, it is now called a reserve list subject to regular reviews with a view to further opening of the market. South Africa will therefore be continuously pressing for a review of this list in the light of changing circumstances on EU and/or world markets.

3.3

Trade-related issues

While the SA law on the regulation of economic activities is consistent with international practices, SA took a view that provisions on trade-related issues in the bilateral agreement with the EU should not go beyond the current multilateral conventions and disciplines agreed in bodies like the WTO, WIPO etc. This is particularly important given SA's commitment on playing an active role in advancing the interests of the developing countries in the multilateral fora. A number of the trade-related issues put on the table by the EU are still subject to intense debates and examination in the multilateral fora. On issues like government procurement and intellectual property rights the agreement provides for mechanisms for further dialogue with the EU. Generally speaking, commitments that were made were regarded as necessary for the proper functioning of the free trade area. These include:

♦ Customs Unions and FTAs

The agreement provides for consultations to take into account the mutual interests in the event that the maintenance or establishment of CUs or FTAs affect each other's interests. For SA, this provision was regarded as essential for the protection of domestic interests against the change in the balance of rights which may arise from the future enlargement of the EU.

◆ Anti-dumping and Countervailing Measures

The agreement provides for parties to consider alternatives (constructive remedies) before imposing definitive anti-dumping duties and counter-vailing duties. This creates an opportunity for the relevant firms to put options for undertaking on price, volume and/or combination of that rather than to face prohibitive duties.

◆ Safeguards

There is a comprehensive provision covering regular, regional and transitional safeguard measures. The regular safeguard provides for measures to be taken in the case of import surges which threaten or cause injury to domestic producers. This is supplemented by the non-reciprocal provision in terms of which SA will be able to take exceptional measures to protect infant industries or sectors facing serious difficulties caused by increased imports during the transitional period. There is also provision for measures to be taken to safeguard any of the other SACU² members against increased imports which threaten or cause serious deterioration in that member's economic situation. The comprehensive safeguard provision is important to ensure that SA and other SACU members can temporarily protect themselves or slow down the pace of liberalisation if the impact proves to be more than what SA or the respective SACU member can handle.

◆ Used goods

The exceptions clause provides for the protection of domestic producers against the importation of used goods.

◆ Competition Policy

SA sought to ensure that the provisions do not go beyond those of the new competition policy and law. It provides for consultative mechanisms to attempt to accommodate the interests of each Party with the application of domestic law. It does not regulate the provision of state aid, nor deals with services and government procurement as was proposed by the EU.

◆ Public Aid

The agreed text recognises that it is in both parties' interest to ensure that public

distorts fair competition.

◆ Dispute Settlement

To ensure that there are no unnecessary delays in the resolution of disputes, the agreement sets out clear disciplines for the trade chapter. Other disputes on the general provisions of the agreement or for those arising in areas such as Development Cooperation and Economic Cooperation will be governed by a less tight procedure.

4. ECONOMIC COOPERATION

The agreement provides for co-operation in a variety of fields including industrial restructuring and modernisation, investment promotion and protection, trade development, development of SMMEs, information and communication technology, energy, mining and minerals, transport, tourism, services and consumer protection.

5. PROTOCOL ON RULES OF ORIGIN

Rules of origin form the backbone of a preferential trade agreement like the one SA is about to sign with the EU. These rules prohibit the deflection of trade and thereby protect the integrity of the agreement. The protocol will therefore determine the administrative framework of the agreement between SA and the EU. It prescribes what would count as local content and has the same function as a passport for a human being. The rules determine the ability of economic operators in the contracting parties to reap the rewards of duty-free access to one another's markets. Important features of the protocol include:

◆ Cumulation

Cumulation of the rules of origin is an instrument³ enabling the parties to a free trade area to use material originating in certain other countries, i.e. without violating the rules of origin. The protocol provides for diagonal (or partial) cumulation between SA and the EU as well as with materials originating in non-SACU ACP countries. As far as SACU is concerned it allows for full cumulation with materials originating in BLNS.

As far as cumulation within the context of the Lomé Convention is concerned - i.e.

³ There are basically two types of cumulation, i.e. a) partial or diagonal cumulation; and b) full cumulation. In terms of the former imported material has to meet the rules of origin applicable to that specific intermediate product. In the case of the latter the countries which are allowed to cumulate are treated as a single customs territory which means that whatever value is added in whatever part of the territory will count towards meeting the rules.

trade in the direction SA to all ACP countries to the EU - the EU has undertaken to remove the current ad hoc provision with regard to SA and to replace it with **diagonal cumulation** with SA. This means that ACP countries including BLNS will be able to cumulate with materials which have acquired originating status in SA.

◆ **List rules**

These are specific rules for specific products, based on the tariff nomenclature. This list which is contained in Annex II of the protocol describes the working or processing to be carried out on non-originating materials in order that the final product can obtain originating status. SA's view was that some of these rules did not reflect the level of productive capacity in South Africa. These are 04.03 (cream yoghurt); 09.02 9 (tea); 20.08 (peanut butter); 20.09 (fruit juices); 22.02 (beverages); and 25.25 (mica). This matter is still under consideration by the EU.

◆ **General value tolerance rule**

Art. 5 allows a certain percentage of the value of the final product to be imported from other countries, notwithstanding the conditions set out in the list rule. The protocol makes provision for a general tolerance of 15%, with the exception of textiles (which will be covered by explanatory notes 5.1 and 6.1), fish, tobacco and alcohol.

◆ **Prohibition of drawback of, or exemption from, customs duties**

The Commission's proposal contained in Art. 14 of their draft protocol specified that non-originating materials used in the manufacture of products destined for the EU or SA market shall not be subject to drawback of or exemption from customs duties. However, it did not preclude the application of the export refund system for agricultural products applicable in the EU.

This proposal was not acceptable to SA and the prohibition on draw-back has therefore been deleted from the protocol.

◆ **Definition of fishing vessels**

As far as the definition of fishing vessels is concerned, a paragraph has been added at the end of article 4.2 to reflect SA's position on the requirement for officers and masters, subject to the entry into force of tariff concessions on fishery products (which in reality will only be granted if SA is willing to grant the EU access to its fishing waters).

6. Sectoral Agreements

6.1 Fisheries Co-operation

The EU put SA under lot of pressure for a Fisheries Agreement with provision for access to SA's fishing resources. It thus made a linkage between the Fisheries agreement and the market access concessions as well as the overall agreement.

From the outset SA explained its new fisheries policy and its efforts towards the restructuring of the industry and conservation of fisheries. It emphasised that access to fishing resources would not be possible. An agreement regarding the future fisheries co-operation was reached in December 1998. This includes:

- ▶ Both sides declared that they will make their best endeavours to negotiate and conclude a co-operation agreement no later than the end of the year 2000.
- ▶ The EU wants to hold back the implementation of tariff concessions to SA on fisheries products. The most sensitive of these concessions are only envisaged in the light of the content and continuity of the future fisheries agreement.
- ▶ SA will abolish its tariffs on fisheries products in parallel to the elimination of duties of the corresponding tariff positions by the Community.

6.2 Wines & Spirits

The political compromise on port and sherry which was reached in Davos on 29 January by Minister Erwin and Professor Pinheiro contains the following main elements:

- ▶ Phase out clause for SA use of names port and sherry in exports to third countries.
- ▶ Definition of SA domestic market to include all of SACU.
- ▶ SA to continue the use of names port and sherry on its domestic market throughout the transitional period of 12 years.
- ▶ Review of the use of names within the transition to decide on the names to use beyond the 12 years.
- ▶ SA wine sector to enjoy a duty free quota and financial assistance for restructuring of the industry.

7. CONCLUSION

The recently concluded agreement with the EU will, among other things, establish for the next 12 to 15 years the trade relationship with its major trading partner and important trading block. The agreement establishes as good concessions as each party can get at this point. There is room for improvement within the reviews as set

in the agreement. The draft agreement reached between Minister Erwin and Commissioner Pinheiro is now the only basis for both Parties to move forward after more than 3 years of protracted negotiations. The draft agreement is expected to be formally signed and then submitted for ratification by Parliament. The venue for the signature of the agreement is more than likely to be in SA which would mark the historical agreement between SA and Europe.

24 February 1999

C:\WORK\OFFICIAL BRIEFING.3

ANNEX 1

Agreed elements of a compromise package on port and sherry

1. South Africa notes the objective of the EU to establish the exclusive protection by the WTO of the EU names "port" and "sherry" on all markets.
2. South Africa will phase out the use of the "port" and "sherry" names on all export markets within 5 years, except in the case of non-SACU SADC countries, where an 8 years phase out period would apply.
3. For the purpose of the Wines and Spirits Agreement, the South African domestic market is defined to cover SACU (Botswana, Lesotho, Namibia and Swaziland).
4. South African products may be marketed as port and sherry on the South African domestic market during the 12 years transition period covered by this agreement. Beyond that period the denominations of these products on the South African domestic market will have to be jointly agreed between South Africa and the EU.
5. From entry into force of the agreement, the EU will provide a duty free quota for wines covering the current level of trade of 32 million litres of South African exports to the EU, with allowance for the future growth of this quota.
6. As an additional effort to the main objectives agreed for the Development programme for South Africa to be funded by the EU, the EU will provide assistance of 15 million euro for the restructuring of the SA wines and spirits sector and for the strengthening of marketing and distribution of SA wines and spirits products.

Davos, 29 January 1999