

Should Mozambique Join SACU? A Review of Key Policy Issues

Final Report

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Acronyms

AGOA	African Growth and Opportunity Act
BLNS	Botswana, Lesotho, Namibia, Swaziland
BLS	Botswana, Lesotho, Swaziland
BTT	Board of Tariffs and Trade
CET	Common External Tariff
COMESA	Common Market for Eastern and Southern Africa
EPA	Economic Partnership Agreement
EPZ	Export Processing Zone
EU	European Union
FTA	Free Trade Agreement
GDP	Gross Domestic Product
HS	Harmonized System of Tariff Classification
IMF	International Monetary Fund
MERCOSUR	Southern (American) Common Market
MIDP	Motor Industry Development Program
MFN	Most Favored Nation
PARPA	Action Plan for the Reduction of Absolute Poverty
PTA	Preferential Trading Arrangement
RSA	Republic of South Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SARS	South African Revenue Service
SPS	(Zoo-) Sanitary and Phyto-sanitary Standards
TBT	Technical Barrier to Trade
TDCA	Trade and Development Cooperation Agreement
TIPS	Trade and Industrial Policy Strategies
UNDP	United Nations Development Program
USAID	United States Agency for International Development
VAT	Value Added Tax
WTO	World Trade Organization

Executive Summary

The report assesses the main economic implications for Mozambique from joining the Southern African Customs Union (SACU). The report seeks to highlight and quantify the costs and benefits to Mozambique from removing duties on trade with the five members of SACU – Botswana, Lesotho, Namibia, South Africa and Swaziland- amending its own trade policy to conform with the SACU Common External Tariff (CET) and participating in the common revenue pool.

The main potential benefits to Mozambique of joining SACU include duty and quota free access to the SACU market without having to meet the restrictive SADC rules of origin, duty free access to all countries with which SACU has a free trade agreement, and the potential for reducing transaction costs on cross border trade. It may not be necessary for Mozambique to join SADC in order to realize these potential benefits. The ongoing Mid Term Review of the SADC Trade Protocol may result in the rules of origin being liberalized. Mozambique is already eligible for duty free access to the EU and the US markets through the Cotonou Agreement and AGOA, moving towards reciprocal duty free access with major trading nations will reduce the costs of obtaining imported inputs and contribute towards Mozambique's increased integration into the global economy. The existence of borders between the existing SACU Members for intra-SACU trade –goods are exported and then imported and have to go through two sets of customs transactions- indicates that although the joining SACU creates the potential to reduce transaction costs, it is not a condition. To realize this benefit Mozambique would need to insist on single border posts as a condition of entry.

Joining SACU presents Mozambique with the opportunity to engage more closely with its major regional trading partners. SACU accounts for 26 and 19 per cent of Mozambique's imports and exports respectively. In principle, the Southern African Development Community (SADC) Trade Protocol will provide for duty free access to the SACU market and Mozambique will also remove tariffs on SADC imports by 2012-2015. However, for goods to qualify for SADC preferential tariffs they will need to satisfy the rules of origin. Under the present rules it is unlikely that many labor-intensive manufactures-particularly clothing-will qualify. By joining SACU Mozambique would be able to export duty free to SACU countries without having to meet a rule of origin. As a member of a customs union Mozambique would have to amend its tariff to conform to the SACU common external tariff.

Joining SACU would certainly accelerate Mozambique's integration with South Africa – the major economy in the region – and has the potential to increase trade and investment opportunities. The relatively small size of the SACU market in global terms would limit the potential for growth based solely on supplying regional markets. **For Mozambique to achieve higher growth rates it will be necessary for producers to be able to achieve export competitiveness in the world market.**

The commitment of SACU to conclude FTAs with key markets in the global economy, such as the US, promises to open up the SACU market and significantly reduces the risk of trade diversion. Reducing SACU external barriers to trade in conjunction with lowering and removing internal barriers to trade within the customs union would substantially increase the benefits to Mozambique from joining SACU.

In order for Mozambique to maximize the benefits from joining SACU it is necessary to address the domestic regulatory environment. A series of recent reports have identified the importance of removing some of the obstacles to trade and investment in Mozambique. The difficult 'enabling environment' results in exporters and potential exporters facing considerable anti-export bias. Reform of the domestic regulatory environment is a necessary component of the trade policy process and is essential if Mozambique is to realize higher rates of investment in non-traditional sectors. **Joining**

SACU has the potential to allow Mozambique to reform its enabling environment as part of its SACU implementation strategy.

The SACU structures provide a framework for Mozambique to build on its own reform program over the past decade. The 'flexible' framework presented in the new SACU Agreement creates an opportunity for the existing Members and any new Member(s) to actively influence the outcome. The objectives of the 2002 SACU Agreement include:

- *To facilitate the cross-border movement of goods between the territories of the Member States;*
- *To substantially increase investment opportunities in the Common Customs Area;*
- *To promote the integration of Member States into the global economy through enhanced trade and investment.*

The Government of Mozambique could ensure that a SACU implementation schedule would meet these objectives through establishing specific criteria that would address many of the weaknesses within the domestic regulatory framework while also addressing the overall level of external protection. Tackling these regulatory issues would bring substantial benefits. Of course, it is possible for Mozambique to tackle these issues regardless of SACU membership. However, it is recognized that entrenched vested interests can constrain the emergence of the necessary domestic political consensus to implement regulatory reform. To the extent that joining SACU may enable the Government to build a consensus for change this would be a considerable benefit. However, if joining SACU is considered to bring benefits independently of revising the enabling environment the benefits from simply adjusting tariffs to the level of the SACU CET would be much lower and may even be negative.

The study finds that SACU offers a number of significant opportunities to Mozambique. These include:

- **Accelerating the implementation of her SADC commitments to her largest trading partner**
- **Eliminating the problem of restrictive rules of origin on this trade.**

In return for obtaining duty free access free of rules of origin and quotas Mozambique would lose the freedom to adjust its Most Favored Nation (MFN) tariffs to reduce the risks of trade diversion that might result joining the SACU. This would be mitigated through participating in any SACU-US FTA, especially if liberalization of imports of manufactures and processed agricultural goods were implemented sufficiently quickly.

The study identifies the impact on the Mozambique economy of joining SACU by:

- Identifying the key tariff differences between the SACU CET and the Mozambique MFN tariff;
- Assessing the revenue implications of adopting the SACU CET and the new SACU Revenue Sharing Formula.

In addition reference was made to the new SACU institutional structures and commitment to establish a harmonized industrial policy and for cooperation on agricultural policy. The SACU CET is much more complex than the Mozambique tariff containing 38 ad valorem rates compared to five respectively. The removal of duties on SACU imports carries the risk of trade diversion with Mozambique realizing no tariff revenue on the imported product. In practice the removal of SACU tariffs against both the EU and the US will reduce the potential for trade diversion. Further the avoidance of rules of origin on exports to South Africa will represent a significant benefit to Mozambique.

1. Introduction

Following recent high-level discussions with the Republic of South Africa, Mozambique is considering joining the Southern Africa Customs Union (SACU). This report has been prepared for the Government of Mozambique to assist in addressing the key policy issues necessary for developing a strategy and reaching decisions on this issue.

Joining SACU could have major implications for Mozambique in terms of both its trade policy regime and the structure and levels of its government revenues. It would also have implications for the way certain key policy decisions are made and implemented in future.

Membership would require adopting the SACU Most Favored Nation (MFN) external tariff system applied on non-preferential trade with non-SACU countries. Mozambique would no longer impose import tariffs on its trade with SACU members and would itself receive duty-free access to the markets of the current member states. In the future Mozambique would no longer exercise independent control over tariff policy; it would be determined instead at the SACU level. As a member of SACU, of course, Mozambique would have a voice in determining SACU's trade and investment policy strategies. Membership presumably would also commit Mozambique to participate in present or future trade agreements between SACU and the World Trade Organization (WTO), MERCOSUR, the US or any other country or group of countries. It might have serious implications for Mozambique's options for participating in Economic Partnership Agreements (EPAs) with the European Union (EU).

The economic effects of this shift in trade policy can be understood and interpreted only against the background of Mozambique's more general trade policy environment and its likely evolution with and without membership in SACU. Mozambique's current MFN tariff structure is significantly different than SACU's. What are the implications of accepting such a different external trading environment? This depends on the nature and magnitude of the differences now and in future.

Under the terms of the SADC Trade Protocol Mozambique and SACU are already committed to removing most tariffs in trade between themselves by 2012. What would be the implications of removing these tariffs more quickly by joining SACU? It is important to note, of course, that qualification for SADC tariff preferences depends on meeting what are generally regarded as quite restrictive rules of origin. Such conditions would not apply to intra-SACU free trade.

Joining SACU also has potential implications for government revenues. In addition to adopting the SACU customs duty and excise tax structure, membership would require Mozambique to join the revenue sharing arrangement for dividing SACU customs revenues and excise taxes among its members according to a recently revised and agreed formula. Such changes will affect not only the revenues received by Mozambique but also those of the existing SACU members. Again, the economic impact of such changes must be evaluated in terms of the existing and future paths of the SACU revenue arrangements.

Joining SACU would involve Mozambique in a whole set of new intergovernmental processes and procedures, including both those involved in negotiating and acceding to SACU and, after joining, those related to participating in the ongoing operation of the customs union. What are these procedures and processes, and what would they mean in concrete terms for Mozambique?

It is not the purpose of this study to provide a simple yes/no recommendation on SACU membership, but rather to provide relevant information about SACU and a greater understanding of the implications of the options available. This requires discussion and review not only of SACU but also of pertinent features of Mozambique's trade, investment and regulatory policy environment. This has the potential to make Mozambique's SACU review process of much greater value than a consideration of the 'simple' question of SACU membership alone.

2. Mozambique: Challenges and Policy Issues¹

Mozambique's recent history has been colored by struggles against the effects of civil and natural calamities. Despite its many natural advantages – human and geographic – this has left Mozambique a poor country. However, civil stability and the government's commitment to prudent macroeconomic management and market-oriented reforms have brought substantial improvements in the overall economic environment and in economic performance over the last decade.

Table 1 gives an indication of both the challenges and the success of recent policies. In recent years, Mozambique has been one of the fastest growing economies in the world. However, it remains one of the world's poorest countries with a per capita Gross Domestic Product (GDP) of only \$212 and more than a third of the population living in extreme poverty – i.e. at incomes of less than \$1 per day. To address these issues, the government has targeted double-digit growth through 2010 to be achieved through a vigorous program of economic reform and development. (See the government's *Action Plan for the Reduction of Absolute Poverty (PARPA)* April 2001.)

Table 1: Mozambique Economic Indicators

	1998	2001	2002
GDP (Current USD, billion)	3.8	3.6	3.9
GDP Growth (annual, %)	12.6	13.8	9.9
Population (millions)	17.0	18.1	18.4
Per Capita GDP (USD)	224	199	212
Exports of Goods and Services (% of GDP)	13.4	28.3	27.3
Imports of Goods and Services (% of GDP)	26.9	44.2	51.3
Trade in Goods (% of GDP)	26.3	49.0	N/A
2003 Human Development Index Rank: 170th of 175 countries			
% of Population Living on Less than \$1/day, 1990-2001: 37.9			
% of Population Living on Less than \$2/day, 1990-2001: 78.4			

Source: World Bank (2003), United Nations Development Program (UNDP) (2003)

The trade policy regime will play a key role in determining whether or not these ambitious growth targets can be achieved. The small size of the domestic market means that it is only through a strong outward orientation and export expansion that such rates can be attained.

Market access for Mozambique's exports is obviously important. However, this is only part, and probably one of the least important ones, of the story. International competitiveness requires a regulatory regime that facilitates trade, reduces costs of doing business and ensures efficient and low cost access to imports of capital and intermediate goods.

While foreign market access depends on the behavior of one's trading partners and might be subject to negotiation, access to Mozambique's own markets is entirely within domestic control and could be improved quickly through unilateral MFN tariff reductions.

Over the past decade the Government of Mozambique has substantially liberalized its external trading regime through lowering tariffs on an MFN basis, joining the WTO from the outset in 1995 and by actively participating in and implementing the SADC Trade Protocol. As a result of these efforts, trade is rapidly becoming more substantial portion of the economy with the share of both imports and exports in Mozambique nearly doubling since 1998 (see Table 1).

¹ This section draws in part on Flatters 2002b.

Despite considerable progress, however, there still is substantial room for improvement in Mozambique's MFN tariff policy.

- Even after the tariff reductions of 2003 and those scheduled for 2006 there is and will remain substantial cascading of tariff rates, resulting in very high rates of effective protection for goods produced for the local market. Furthermore, the classification of items such as cloth as final consumption goods imposes a large burden on exporters of garments, which is a sector of great export potential in Mozambique.
- The use of temporary tariff surcharges invites rent-seeking and results in arbitrary increases in protection for successful pleaders, and substantial increases in costs for the users of their products.

Adoption of a much more uniform tariff structure would reduce the large and arbitrary differences in effective protection provided to different sectors. Lower tariff rates would reduce corruption and smuggling. They would reduce the anti-export bias of the current tariff structure. The effects on revenues could be positive or negative, but would not be important in a budget that depends on trade taxes for only about 15 percent of total revenue.

Binding current (and future reductions in) tariff rates under the WTO would remove the temptation to impose arbitrary surcharges. It also would provide some limited bargaining power under the peculiar rules of the WTO negotiation process.

Strict disciplines should be imposed on any contingent protection measures introduced for "antidumping" and "safeguard" purposes defined by the WTO. As international experience has shown, there is very real danger that, even with WTO disciplines, such measures will be captured and used for arbitrary protection.

Within SADC, Mozambique's tariff reduction schedule is very heavily back-loaded, especially on trade with South Africa, Mozambique's largest SADC trade partner. In addition, it is widely recognized that current rules of origin will remain a serious barrier to intra-SADC trade even after preferential tariff rates have been liberalized. Most importantly, the entire SADC market, including South Africa, is still very small (smaller than Turkey) relative to the scale necessary to develop internationally competitive production levels in many activities. Integration with SADC is not a substitute for more general international integration.

Import duties are only one of the costs of engaging in international trade. There is a wide range of 'behind the border' regulatory issues that are substantial barriers to Mozambique's attractiveness to investors and its international competitiveness. These are widely recognized in the domestic business community and have been well documented in policy documents (e.g. FIAS 2001 and Nathan 2002).

Customs, inefficiencies in ports and import procedures, licensing and other regulatory requirements placed on imports and exports impose costs that are more difficult to measure but no less important. Reform of customs and port procedures can reduce the costs of trade substantially. Customs reform measures in Indonesia in 1984 reduced importing costs by over 20 percent in less than a couple of months.

Recent customs reforms in Mozambique have focused much more on revenue than on trade facilitation. As a result, customs procedures remain onerous and costly. Port clearance costs are high and unpredictable. Most egregious in this regard are the substantial delays and costs of importing goods overland as a result of the Frigo warehousing facility. Import and export licensing and registration procedures impose further bureaucratic costs with little if any apparent benefit.

The biggest burden of barriers to international trade is borne by exports and other sectors that cannot or do not benefit from significant tariff protection on their outputs. The freeing of exports from these costs cannot always await slow paces of reform in import tariffs, customs and trade facilitation. The most effective interim solution is often the creation of export processing zone (EPZ) facilities which permit easy access to international inputs and to markets for exports. This was the key to Mauritius' success in overcoming what appeared to be insurmountable barriers to development 30 years ago.

Mozambique has created EPZ facilities for exporters, but they do not work well. If Mozambique wants to capitalize on the export possibilities made possible by domestic reform and by international opportunities, effective cleaning up of EPZ facilities is essential. This is particularly important in the context of the new opportunities offered under the African Growth and Opportunity Act (AGOA) and other preferential arrangements. For exporters that do not qualify for EPZ privileges, it is equally important that duty drawback programs with respect to imported inputs work smoothly and efficiently. This appears not to be the case at present.

Proposals to monitor EPZ firms and to make their fiscal and other privileges conditional on their linkages with the domestic economy (Nathan 2002) are based on the same failed development model underlying the EU and SADC preferential rules of origin. They would further reduce the effectiveness of EPZs in Mozambique.

A value added tax (VAT) is at least in principal superior to most other forms of commodity taxes in its effects on trade. The fact that it is levied at the same rate on imports and domestic goods and that exports are zero-rated makes it neutral with respect to trade. It provides no differential advantage in favor of domestic production over imports and it does not tax exports. Unfortunately this is not the way the VAT works in Mozambique. First, there is much greater evasion and underpayment of VAT on domestic goods than imports. This has the effect of turning the VAT into a net tax on imports, adding to the cost-raising burden of import duties. Second, VAT rebates on imported inputs for export production are often very difficult to obtain. Refunds are generally paid at best after long delays and often never at all. This turns the VAT into a tax on exports.

Reform of EPZ facilities and VAT administration and the removal of all other unnecessary barriers that burden exporters with the costs of the domestic regulatory environment must be one of the highest priorities in trade policy reform in Mozambique. Without such changes, Mozambique will have great difficulty realizing its potential to attract internationally competitive investments and achieving its growth and poverty reduction goals.

The FIAS report (FIAS 2001) clearly documents many of the basic problems in what best might be termed Mozambique's "disabling investment environment". While Mozambique has attracted several large capital-intensive investments based on natural resource availability, it has had far less success in attracting investments that capitalize on abundant labor resources which would contribute in a more direct way to growth of employment and poverty reduction. Problems in labor laws, land procedures, tax systems, the financial sector, company laws and regulations, telecommunications, transport, law enforcement, corruption, etc. all beg for reform. Removal of these administrative, legal and systemic barriers has been a slow process. Yet these reforms are a critical complement to effective trade policies.

The key issue for Mozambique now is how to increase the pace of trade and complementary regulatory reforms to speed up its integration in the global economy and to ensure continued growth and poverty reduction. Would SACU membership assist in achieving these aims more quickly or more effectively than the current trade policy or any other potential trade policy options open to Mozambique?

There are some significant potential benefits of SACU membership.

First, SACU is the most important source of imports for Mozambique and the leading regional market for Mozambique's exports. SACU membership and the elimination of tariffs between the two markets would bring significant reductions in overall protection at a single stroke. This would have even greater effect if well-known and self-imposed administrative barriers on this important border could also be eliminated or at least substantially reduced.

Second, SACU membership would allow Mozambique to participate in the SACU-US free trade area (FTA) currently under negotiation. This holds the prospect of preferential access for Mozambique's products to the world's largest single market.

Along with these potential benefits are other effects whose net impacts are not so clear without further investigation.

First, adopting SACU's tariff and excise structure could have significant implications for the structure and magnitude of Mozambique's government revenues. These effects could be beneficial or harmful, and this cannot necessarily be measured simply by whether the initial impact on overall revenues is positive or negative.

Second, in adopting SACU's common external tariff (CET) Mozambique would lose direct control of this key instrument of external trade policy. To determine whether this is good or bad requires consideration of both tariff regimes and of their likely future paths. However, it is at least possible that the benefits of gaining free trade access to one or more important markets might have to be weighed against the costs of adopting an inferior external tariff regime and losing the power to reduce and further rationalize MFN tariffs.

Third, entering into a preferential trading arrangement with SACU and possibly by extension with the US or other countries exposes Mozambique to the danger of costly trade diversion. Granting tariff preferences to South Africa might make goods which are more costly to buy from there than elsewhere appear to be less expensive. Buyers would be induced to switch purchases to South Africa at a net economic cost to Mozambique of the difference between the (true) costs of the goods in South Africa and from other sources. The likelihood and cost of such trade diversion depends on the height of the SACU MFN tariffs on the goods in question. The greater the SACU tariff, and hence the greater the tariff preference given to South Africa by virtue of joining SACU, the greater the danger of trade diversion and the greater its likely cost.

If SACU were not a customs union, the dangers of such trade diversion could be reduced by simply lowering Mozambique's MFN tariffs, hence reducing the preference margin that is the cause of the trade diversion. In fact the dangers of trade diversion could be eliminated entirely by granting all preferences on an MFN basis. Since SACU is a customs union, however, Mozambique would not have the freedom to reduce MFN tariffs in this manner. The best she could hope for would be to persuade SACU to reduce its MFN tariffs and especially to reduce tariff peaks on goods where trade diversion might be expected to be significant.

3. What is SACU?²

The Southern Africa Customs Union comprises five member states – Botswana, Lesotho, Namibia, Swaziland (BLNS) and South Africa. It is one of the world's oldest customs unions, having originated as an agreement among South Africa, Basutoland, Swaziland and Bechuanaland in 1910.³ The original agreement remained in force until the British Protectorates achieved independence in the mid 1960s. The newly independent states entered into negotiations with the apartheid government in South Africa and a new agreement was signed in 1969. When Namibia became independent in 1990 it became a member in its own right.

With free internal trade conducted behind high common external tariffs, the 1969 agreement effectively ensured that throughout the sanctions period three frontline states (Botswana, Lesotho and Swaziland) continued to depend on South Africa for their imports and to a lesser extent their exports. The agreement also included a revenue sharing formula for the division of customs and excise revenue collected in the union and the BLNS received a significant proportion of their government revenue through this formula. Four of the members (Lesotho, Namibia, South Africa and Swaziland) also maintained a monetary union.⁴

The agreement reflected both the dominance of South Africa and the revenue concerns of Botswana, Lesotho and Swaziland (BLS) following their independence from the United Kingdom. South Africa, which accounts for more than 90 per cent of total SACU GDP, assumed absolute discretion over external trade policy. This was acceptable for as long as the smaller member countries considered the customs union a vehicle for the collection and distribution of customs and excise revenues, and to a lesser extent for facilitating imports. While the possible costs of the customs union were recognized, calls for reform were muted by the increasing magnitude of the revenue transfers.

The democratic transition and the end of the international isolation of South Africa provided the opportunity to rethink the economic basis of SACU. Discussions began prior to the change of regime in South Africa and continued for almost a decade until a new agreement finally was signed in October 2002. During this period of discussion and negotiation, the SACU trade policy regime underwent a major shift as policy makers adjusted to the removal of externally imposed barriers to South Africa's global participation and engaged in major regulatory and trade policy reforms to adapt to and take advantage of this new reality.

The new agreement embodied significant changes to both processes of SACU governance and substantive economic arrangements. With respect to governance, the main change was to 'democratize' decision making among all members, reducing the previous dominance of South Africa in economic policy making. As well, for the first time in SACU's history explicit provision was made for the entry of new members to the customs union.

The most important and most difficult substantive economic change was in the revenue sharing formula. Changes in fiscal realities, especially reduced dependence on import duties for revenue purposes, had exposed serious weaknesses in the 1969 formula. Continuation of the arrangement would have imposed fiscal obligations on South Africa (and conferred corresponding benefits on the other members) that would soon outstrip underlying revenue sources. While South Africa's primary concern was to place a cap on this open-ended commitment, other members wanted to ensure no reduction in their entitlements under the revenue sharing arrangement. Concern with the particular size of the fiscal burdens and entitlements caused considerable friction in the negotiations and

² Much of the factual information in this section on the history and structure of the SACU Agreement draws on Kirk and Stern 2003.

³ Great Britain and South Africa were the only parties to the 1910 negotiations and agreement.

⁴ Botswana withdrew from the Rand Monetary Area (now the Common Monetary Area) in 1974.

impeded a more fundamental examination of the underlying basis for and alternative mechanisms to achieve the goals of revenue sharing. The result has been agreement on a new formula that might have difficulty standing the test of time, changes in internal SACU arrangements (e.g. addition of new members) or closer examination of underlying economic rationale.

3.1 SACU Governance

A major weakness of the 1969 SACU Agreement was the absence of joint decision-making. The Agreement provided for South Africa alone to determine the external tariff policy of the customs union: all changes to customs tariffs, rebates, anti-dumping and countervailing duties were effected by the South African Minister of Trade upon the recommendation of the South African Board of Tariffs and Trade (BTT). Excise policy was determined the South African Minister of Finance.⁵ SACU itself was administered on a part-time basis by annual meetings of the Customs Union Commission and there were no effective procedures to ensure compliance or to resolve disputes.

The asymmetry in decision-making resulted in the perception (and reality) that SACU's common external tariff and related trade policies were set to protect or promote South African interests, generally interpreted as those of selected South African producers, without consideration of the interests of the BLNS. Consumer interests in general and in the BLNS in particular had little influence on trade policy decisions. Attempts to develop new industries in the BLNS that competed with established South African interests were constrained by a host of non-tariff barriers⁶ and the BLNS were unable to address issues of predatory pricing and unfair competition by conglomerates located in South Africa. Moreover, preferential trade agreements entered into by South Africa with third parties compromised the integrity of the customs union.⁷

The new agreement provides for the establishment of an independent, full-time but administrative secretariat to manage the affairs of SACU, to be located in Namibia. The South African BTT will be replaced by a 'SACU Tariff Board' which will consist of a panel of professionals, one nominated by each Member State, to consider all changes to the common external tariff. All recommendations emanating from the Tariff Board must be ratified by the SACU Council of Ministers which will consist of one Minister from each member state. The Council will be supported and advised by a Customs Union Commission, made-up of senior SACU civil servants, and an independent but *ad-hoc* Tribunal to arbitrate on any disputes. Decisions of the Council and all other SACU institutions will be made on the basis of consensus.

Critically, all technical work is subjugated to 'national bodies' to be established by each member state. Thus the South African BTT will remain (albeit under a new name) and will have a national rather than a SACU mandate. The BLNS will also develop national level bodies or departments (or may just appoint officials) to conduct tariff and trade remedy investigations and make recommendations to the SACU Tariff Board. It is expected that this might prove a major challenge for the BLNS, none of which has significant experience or expertise in this area. It will also be interesting to see the reaction of South Africa in the event of serious participation of BLNS members. Some members of the South African business community have been quoted as expressing serious misgivings about the participatory procedures under the new SACU agreement.

The new SACU arrangements clearly provide greater scope for the BLNS (and by extension any new members) to participate in SACU trade policy decision-making. However, the new secretariat is not yet operational and there is not any experience on which to assess the practical implications of these

⁵ The Agreement did require consultation on excise changes but these seldom took place and the BLNS usually learned of changes to SACU excise rates during the delivery of the South African National Budget.

⁶ For example, in the late 1970s and early 1980s a firm assembling television sets in Lesotho and a fertilizer plant in Swaziland found it impossible to meet South African standards and eventually closed down.

⁷ Most notable are South Africa's bilateral agreements with Zimbabwe, Malawi and of course Mozambique.

changes. We shall see in the following section as well that some critical issues about management of the revenue sharing mechanism remain unresolved.

3.2 SACU Revenue Sharing

The revenue sharing formula is a mechanism for sharing customs tariffs and excise taxes, the only two revenue sources with common structures across all members. Despite the growth of importance in the VAT as a revenue source and the significant economic benefits that would arise from its harmonization across member states, it is not yet included in SACU joint decision-making or revenue sharing arrangements.

The revenue sharing formula that was agreed in 1969 specified the determination of the shares of total customs duty and excise collections in the customs unions that would accrue to BLNS (prior to 1990 BLS only). South Africa would then receive the residual amount. A 'stabilization factor' that was added to the formula in 1976 required that the BLNS each receive at least 17 per cent and at most 23 per cent of the value of their total c.i.f. imports (from all sources) plus excisable production inclusive of excise duties. Decreasing import duty rates resulted in the floor of 17 percent becoming the effective determinant of the BLNS revenue shares since 1980.

By the late 1990s, the BLNS members were receiving over 50 percent of the total revenue pool and by 2011, according to plausible estimates, their share of the pool would exceed 100 percent. Despite accounting for over 90 percent of SACU GDP and over 80 percent of SACU's total imports, South Africa was receiving less than 50 percent of customs and excise collections by the late 1990s, and with no change in the revenue sharing formula this would fall to zero in about a decade. This was not sustainable and it was a matter of some urgency in the renegotiation of the SACU Agreement.

As in the past, revenue sharing applies only to customs duties and excises. The formula, however, comprises three elements: a customs, an excise and a development component. The customs component allocates customs duties according to members' share in intra-SACU trade. The excise and development components apply to the pool of excise revenues. Most of this (the excise component) is allocated according to the size of members' national incomes. The remainder (the development component) is intended to achieve some redistribution of the remainder of excise pool from South Africa to the smaller and poorer BLNS members. At the moment, the customs and excise pools are of roughly equal values. The relative importance of the customs pool will almost certainly diminish as a result of continuing tariff reform and the implementation of new preferential trading arrangements.

3.2.1 The Customs Pool

The customs component allocates SACU import tariff revenues according to countries' shares of total intra-SACU imports. This is very different than simply distributing to each member the customs revenues collected on their own imports. The BLNS all have intra-SACU import shares that exceed by a considerable margin their shares of total imports from all sources. The result is that these countries get four to six times more customs revenue than they would collect on their own imports, while South Africa retains only one-quarter of the customs revenues collected on its own imports.

The rationale for this method of distributing the customs pool is not clear. It certainly is not an attempt to share the revenues according to import duties members would have collected in the absence of a common collection mechanism. It involves substantial redistribution of customs revenues from South Africa to the BLNS. While there might be many reasons for South Africa to wish to make transfers to the BLNS, it is not obvious why this should be done on the basis of shares of intra-SACU trade.

Table 2: Members' Shares of Imports and of SACU Custom Revenues

	(1) Total Imports	Share of (2) Customs Revenues	Ratio (2)/(1)
Botswana	5.7	26.6	4.69
Lesotho	2.3	13.4	5.83
Namibia	5.0	24.9	4.96
South Africa	83.6	20.5	0.25
Swaziland	3.4	14.6	4.29
Total	100.0	100.0	1.00

Sources: Column 1 from Kirk and Stern (2003) Table 3; column 2 derived from World Bank *World Development Indicators 2003*

An interpretation of the formula that is sometimes offered is that it is compensation to the BLNS members for the 'price-raising' effects of South Africa's import tariffs. There are some difficulties with this explanation.

- First, it assumes that the BLNS would not impose any customs tariffs were they not members of SACU. This is highly unlikely. Customs duties remain a significant source of revenue for almost all countries in the world, especially poorer ones. This being the case, the BLNS would almost certainly suffer the 'cost-raising' effects of import duties regardless of whether they were part of SACU. The only cost of SACU would be due to differences between the SACU tariff structure and the structures they would choose if they were not part of SACU. It is generally argued that as a result of South Africa's industrial policy goals SACU tariffs on many manufactured goods are higher than would be chosen by the BLNS. On the other hand, the SACU tariffs on some goods might be lower than those that would be chosen by BLNS on their own. Would negative compensation be called for in these cases? In any case, it is only the difference between the SACU tariff and the tariff that would be chosen by any country if they were not in SACU that calls for compensation. It is not the entire amount of the SACU tariff.
- Second, even if it were agreed that the BLNS suffer from and should be compensated for the price-raising effects of South-African-determined import duties, a correct measure of the damage is the tariff-induced increase in the price of such goods from all sources, domestic, SACU and the rest of the world. A SACU tariff on any good raises its price regardless of whether it is imported from South Africa, from anywhere else in the world, or whether it is produced domestically under the umbrella of this import protection. Assuming that the goods in question are not produced in the BLNS, the correct measure of damage caused by the SACU tariff would be the tariff-induced increase in the price of imports from all sources, not just SACU. Table 2 shows that allocating the customs pool on the basis of intra-SACU imports provides far more compensation to the BLNS than would be necessary, even if the entire amount of all SACU import tariffs could be thought of as 'cost-raising' to the BLNS – i.e. even if the BLNS would have imposed no import duties in the absence of their membership in SACU.

It is much more likely that this part of the formula reflects political considerations rather than economic logic. These considerations undoubtedly relate to the long term relationship between South Africa and the BLNS. What would happen under SACU expansion? Existing members might be reluctant to make similar redistributions to new members. Additionally, new members would likely have the same attitude if application of the formula resulted in significant transfers of tariff revenues from their citizens to South Africa or the BLNS. This raises potentially serious questions about the stability of the formula under expansion of SACU membership. Regardless of the difficulties that were encountered in reaching agreement on the new formula, changes in SACU membership might require reopening these discussions. If redistribution from richer to poorer members is to continue as

part of the SACU arrangement, it might be necessary to base it on a different indicator than intra-SACU imports. If the main aim of the redistribution is to deal with historical understandings between South Africa and the BLNS, it might become necessary or at least preferable to handle it outside of the SACU revenue sharing formula.

There are as well two more practical problems with this part of the formula.

The first is that intra-SACU import data are generally of much lower quality than that for total imports. In fact, the absence of import duties on intra-SACU trade means that there is very little customs justification to collect accurate data on these trade flows.

Second, any tightening of customs controls simply in order to improve the quality of these data would serve as an impediment to the intra-SACU trade, and help to defeat a principal goal of the customs union – to promote free trade among SACU members. There should be no revenue need in a customs union to collect data on trade among its members.

A clear indication of the weakness of the intra-SACU trade data is the fact that the most recently data that are publicly available are for 1998/99. This is a potential source of friction in the administration of the formula in future. It has been agreed as an interim measure that management of the pool and of the revenue payments will continue to be handled by South Africa for the first two years. Negotiations are continuing to find a more permanent and transparent mechanism. Unfortunately, the current formula does not admit any easy solutions. A more sustainable solution would be to convert the customs mechanism to a simple revenue sharing formula and to seek another mechanism for achieving redistributive goals.

3.2.2 The Excise and Development Pool

As already mentioned, the excise pool is divided into two components. A small portion of the excise pool (initially 15 percent) is set aside as a development component, and this is distributed in almost equal 20 percent shares, adjusted slightly in favor of the lesser developed countries, according to the deviation of each country's per capita GDP from the SACU average. Since the shares are not adjusted for population size, the smaller BLNS economies get much higher shares on a per capita basis. The amount of redistribution involved in this development component, therefore, is inversely related to a member's population size, which means that it operates generally in favor of the BLNS at the expense of South Africa. Since the BLNS population sizes are all relatively similar, there is little discrimination among them on this basis.

However, a new member whose per capita income was equal to or lower than the BLNS, but whose overall population was much larger might find itself relatively unfairly treated by this redistribution mechanism. Once again, expansion of SACU to include new members with different characteristics than existing members might put some strain on the existing revenue sharing mechanism.

The largest part (85 percent at the moment) of the excise pool is distributed in proportion to members' shares of total SACU GDP.⁸ This might be reasonably thought of as a simple proxy for each member's contribution to the excise revenue pool. However, to the extent that poorer countries might have lower (or higher) propensities to spend on excisable goods this mechanism also includes some redistribution in favor of (or against) poorer members.

Table 3 shows estimates of the distribution of the customs and excise pools among existing SACU members under the new revenue sharing formula. The first four rows show the amounts received

⁸ Sustainability of this distribution arrangement depends on a commonly agreed excise tax structure in all member countries. Until now, the base and rates of this excise tax structure have been decided and announced in the budgets of the South African Minister of Finance.

under each of the formula's components and their total. The final two rows show the shares of the revenues enjoyed by each member and, for comparative purposes, their shares of total SACU GDP.

Table 3: Receipts using the New SACU Revenue Sharing Formula (2001/02)

	Botswana	Lesotho	Namibia	Swaziland	South Africa	Total
Customs	2,297	1,156	2,149	1,262	1,769	8,632
Excise	288	50	170	71	7,471	8,050
Development	266	306	287	294	267	1,421
Total	2,851	1,512	2,606	1,628	9,506	18,102
Share of Total (%)	15.7	8.4	14.4	9.0	52.5	100.0
Share of SACU GDP (%)	4.2	0.6	2.5	1.0	91.6	100.0

Note: These are calculated based on the principles of the new Revenue Sharing Formula. Actual payments to the Member States continue to be made under the 1969 Agreement. The new formula is expected to be effective in the Financial Year 2005-2006.

Sources: Revenue estimates are from Kirk and Stern (2003) Table 8. GDP data are from World Bank *World Development Indicators 2003*. Revenue amounts are all in millions of South African Rand. GDP data are for 2001.

3.2.3 Summary of Redistribution under the Revenue Formula

The revenue formula provides for a considerable amount of fiscal redistribution from South Africa to the BLNS. The development component gives explicit redistribution based primarily and inversely on population size. A small part of the development component is based on differences in per capita incomes. However, the development component is only a small part of the overall revenue sharing arrangement and contributes only a small part of the scheme's redistribution.

The principal source of redistribution is the customs component and this is based on members' shares in intra-SACU trade, which has at best a highly questionable rationale in terms of any redistributive objective. How this arrangement will stand up over time and/or in the face of SACU expansion is difficult to predict.

3.2.4 Administration of the Revenue Formula

Although the basic outline and most of the details of the administrative mechanisms for revenue sharing have been determined, some features remain to be decided. It has been agreed that the shares of each component will be calculated from the most recent and audited trade, GDP and per capita GDP data, and unlike under the 1969 arrangements, they will not be adjusted for estimation errors in future years. These shares will be applied to agreed customs and excise forecasts, with adjustments necessary in the ensuing two years to reflect revised estimates and then actual collections. As mentioned earlier, South Africa will continue to manage the pool and payments for the first two years of the new agreement. There is no precedent yet for resolving major discrepancies in or disagreements over trade or other economic data used in the formula. This could be an issue for Mozambique, whose trade data on imports from and exports to South Africa differ considerably from South African data. Negotiations are continuing over the establishment of a permanent and hopefully more transparent mechanism for managing such issues among current members.

3.3 Trade and Fiscal Policies: Common Elements and Scope for Independence

The SACU Agreement requires that members abide by a common external tariff, impose zero tariffs on intra-SACU trade, and maintain a common excise tax structure. It also has a general provision calling for the development of "common policies and strategies with respect to industrial

development.” In addition it includes specific exceptions to these requirements, especially for the poorer members – i.e. for the BLNS.

The most important of these exceptions, in practice and in terms of the interest of BLNS negotiators, is the provision for ‘infant industry’ protection, which is available to the BLNS but not to South Africa. Under this article, the BLNS can impose duties on imports from South Africa, provided the same additional duties are also imposed on imports from the rest of the world. An infant industry is defined as an activity that has not been located in the BLNS for more than 8 years, and this protection is also limited to 8 years.⁹ The Council of Ministers may impose additional conditions, which are not specified. This article replicates a similar provision in the 1969 Agreement and which was used on various occasions by almost all the BLNS. Available evidence suggests that this provision has been captured by selected vested interests in these countries and that, while its use might have provided substantial profits to some investors, it has contributed little or nothing to the achievement of broader development goals. See Box 1 for a brief discussion of infant industry protection for pasta in Namibia.

In addition to the scope for additional protection through infant industry tariffs on particular products, the agreement also permits members to grant duty rebates on imported inputs. All of the BLNS, for instance, grants duty rebates to millers of imported wheat. This has been a source of concern to South African millers who fear being put at a cost disadvantage in their domestic market.¹⁰ The solution has been an understanding whereby the BLNS bans the export of wheat flour to South Africa. The alleged ‘leakage’ of wheat milled from rebated flour into South Africa’s market has been a constant irritant in relations between South Africa and the BLNS.

Not only can duty rebates be used to give a competitive advantage to domestic producers, but this can be done at almost no fiscal cost to the government granting the rebate. Any rebate comes in the first instance out of the aggregate duty pool. The only fiscal cost to the government granting the rebate is its share in the reduction of the size of the pool. Most of the fiscal cost of rebates is passed on to other SACU members. Duty rebates granted to domestic producers are paid for primarily by taxpayers in other SACU member countries. This is true of special rebates such as those on wheat, exemptions and drawbacks granted to exporters, and special import duty reduction programs such as those offered under South Africa’s Motor Industry Development Program (MIDP).

Independent use of a wide range of other industrial policy instruments seems to be permitted as well. An important element of South Africa’s MIDP, for instance, involves very strict controls on the import of used cars. The BLNS, on the other hand, are much more lenient in this regard, recognizing that used vehicles can be a useful source of low cost transportation for lower income consumers and small entrepreneurs. This gives rise to some tension as South Africa worries about leakage of these imported used cars into their domestic market, which would reduce the pricing power of and effectiveness of import protection given to domestic vehicle producers. Until now, therefore, it would appear that the commitment to common industrial policies is honored almost entirely in the breach.

The new agreement also contains a clause (Article 41) requiring a common approach to unfair trade practices, which also has had no effect to date. Antidumping and safeguard measures appear to be entered into on a largely *ad hoc* basis by individual members. Until recently, Botswana and Namibia both had local purchase requirements as conditions for importing wheat flour. Namibia’s was replaced with a complete import ban, while Botswana’s was replaced by an ‘antidumping’ import duty surcharge. Late last year Botswana also imposed a ban on the import of bread, even from South Africa and other SACU members.

⁹ This requirement allows for the a country to grant protection to a new entrant even though there may be firms already in the sector, as long as existing firms are less than eight years old.

¹⁰ South African millers, however, do get rebates on wheat milled for export.

Box 1 SACU Infant Industry Protection: Pasta in Namibia

The SACU agreement includes a provision for the protection of new domestic ‘infant’ industries. Namibia chose to take advantage of this provision in the pasta sector.

The SACU MFN tariff on pasta is 25 percent. At the request of the local flour milling group that wished to build a new pasta factory, the government agreed to impose an additional import duty of 40 percent. This would remain in place for four years and then be phased out gradually over another four years. Since the milling branch of the company gets wheat on a duty-free basis, its flour is also effectively duty-free, except for any excess of its milling costs over those of international mills.

The factory was completed in 2002 and is operating at almost 100 percent of capacity – three shifts, seven days a week. It is obviously a commercial success. This should not be surprising in light of the very high levels of protection given. The effective rate of protection *vis à vis* South African producers is about 89 percent while *vis à vis* international competitors it is about 425 percent (based on cost data from the firm).

Other than rents created for the South African owned firm, what benefits does the infant industry protection give to Namibia?

Small increases in demand for local wheat do not affect the price received by farmers. They receive no more than the pre-tariff world market import parity price regardless of local demand.

What does the new pasta factory provide for consumers? Increased import duties ensure that consumers have much less choice in buying pasta. The factory employs a special high temperature process that allows the use flour milled from inferior local wheat rather than durum wheat. This gives a product that is acceptable to some consumers, but disagreeable to many others. A tour of local supermarket shelves reveals only the local brand. ‘Specialty’ pasta (‘normal’ pasta in most other markets) has to be bought at very high duty-inclusive prices in specialty shops. High prices and low sales volumes have made this an unprofitable product for most supermarkets to stock.

What about employment? The pasta factory operating at full capacity with three shifts employs 20 workers (10 less than the minimum promised when applying for infant industry protection). But this low number does not even represent the net job creation from the factory. Prior to the establishment of this factory, another local pasta producer served the local market with pasta made from flour purchased from the milling company that now operates the new pasta plant. Shortly after the new pasta plant commenced production, the old producer’s line of credit was revoked and its factory was forced to close. Data have not been obtained on the number of job losses this caused. But it can be stated with certainty that the net number of jobs created by this infant industry protection is less than 20.

Source: Erasmus and Flatters 2003

At this stage, the two articles requiring common policies, namely industrial policy and unfair trade practices, remain hortatory with no attached annexes. In each case, it is understood that the existing policies will remain in place pending development of and agreement on new common policies and strategies. The development of common policies will remain the responsibility of members rather than the new Secretariat. The divergent interests and levels of capacity between member states will have implications for future SACU policy strategy and the Secretariat may end up being drawn into policy analysis and development work.

Unlike industrial policies, the article on agriculture refers only to co-operation and does not mention common policy. It appears that the considerable differences in agricultural policy between the members will be permitted to continue under the new Agreement. It was necessary to retain an article addressing agricultural marketing arrangements as several of the BLNS economies continue to retain single marketing channels. Under the 1969 Agreement this article had been used to justify closing markets within SACU to protect domestic agricultural producers. The new Article 29 explicitly allows for each Member State to impose marketing regulations for agricultural products “...providing such marketing regulations shall not restrict the free trade of agricultural products between Member

States, except as defined below.” The loophole includes both emergent agriculture and related agro-industries and “any other purposes as agreed upon between Member States,” and consequently provides for the continuance of restrictions on agricultural trade within SACU.

The earlier agreement explicitly recognized the importance of zoo-sanitary and phyto-sanitary (SPS) requirements and allowed for consultations (Article 18). However, there was no reference to technical barriers to trade (TBT). The new Agreement contains two articles. Article 28 on TBT explicitly references the WTO Agreement on Technical Barriers to Trade and seeks that “Member States shall strive to harmonize product standards and technical regulations within the Common Customs Area.” Article 30 on SPS simply urges consultation and notes that members reserve the right to apply SPS measures in accordance with their national SPS laws and international standards.

There is no provision for a common competition policy; members are required only to “co-operate with each other.” South Africa is the only member with a formalized competition policy framework. In recent years, there have been some discussions about substantive cooperation between South Africa and certain SACU members.

The biggest gap in the area of fiscal cooperation is with respect to value added taxes. All members except Swaziland now levy a VAT. However, differences in rates, coverage and exemptions result in substantial difficulties and costs in intra-regional trade. Effective cooperation in VAT policies and administration could have very large fiscal and trade facilitation benefits.

4. Overview of Mozambique's Trade Patterns

The implications of any changes in trade policies, especially when they involve changes in preferential trading arrangements, will depend in large part on current and likely future patterns of trade. This section gives an overview of geographic patterns and commodity composition of Mozambique's imports and exports.

As indicated earlier, recent and ongoing reforms have substantially increased the importance of trade in Mozambique. Table 4 provides an overview of recent trends in overall exports and imports. In the last three years, exports have almost doubled, increasing by 87 percent, while imports have grown by much less, only 12 percent. The strong export performance over this period is due almost entirely due to exports of MOZAL aluminum. Over the past three years aluminum exports increased more than fivefold while all other exports increased by just 5 percent.

Table 4: Overview of Mozambique Trade Flows

	2000	2001	2002	B Change 2000-2002
Exports	363.9	703.1	682.0	87.4
Imports	1,140.9	1,031.2	1,277.9	12.0

Source: Government of Mozambique, Trade Statistics. All Values are in USD Millions.

Tables 5 and 6 provide an overview of Mozambique's exports by commodity and destination.

The mega-projects, MOZAL aluminum and electricity from the Cahora Bassa Dam dominate exports and account for nearly 62 percent of the total. Other important export products include fish and crustaceans (prawns), cotton, oilseeds and oilcakes (products of cottonseed, coconut and copra), sugar, and some categories of apparel. Mozambique exports a very narrow range of products. Even at the most disaggregated level (using the 8-digit Harmonized System (HS) customs classification) only 574 products were exported, with 15 products accounted for almost 90 percent of the total.

The pattern of exports to SACU is broadly similar to that of overall exports albeit somewhat less concentrated. The top three categories electricity, aluminum and prawns account for nearly 49 percent of the total. SACU is a particularly important market for oilcakes and oilseeds (HS chapter 23) and for apparel and textile exports in HS chapters 60, 61, and 62 absorbing nearly all of Mozambique's exports in these categories. Additionally, SACU is the destination for nearly all of Mozambique's exports of rubber (HS chapter 40) and articles of iron and steel (HS chapter 73).

The EU accounts for a large portion of the aluminum exports and has overtaken SACU as the leading market for Mozambique products. Belgium alone absorbed 41 percent of exports in 2002. Regionally, South Africa is the most important market for exports in the region accounting for nearly 19 percent of total exports. The BLNS accounted for only a trivial percentage and the rest of SADC only 7.1 percent.¹¹

As noted above, exports have been increasing at a much higher rate than imports. Electricity and gasoline imports (HS chapter 27) account for the largest portion of imports followed by vehicles and parts, cereals, machinery, and foodstuffs. As with exports, imports from SACU follow broadly the pattern of overall imports. South Africa is the largest single source for Mozambique imports (25 percent) with the BLNS countries and the remainder of SADC accounting for roughly 3 percent.

¹¹ Of the exports going to non-SACU SADC countries in 2002, 70 percent or 5 percent of total exports were electricity exports to Zimbabwe.

Electricity and gasoline imports (HS chapter 27) account for the largest portion of imports by sector, followed by vehicles and parts, machinery, and foodstuffs.¹²

Table 5a: Mozambique 2002 Exports by Commodity

HS Code	Description	Total Exports		Exports to SACU		
		Value	%	Value	%	% Total
76	Aluminum and Articles Thereof	361.6	53.0	21.1	16.4	5.8
	Electricity	57.3	8.4	23.9	18.5	41.6
	<i>Subtotal</i>	418.9	61.4	45.0	34.9	10.7
03	Fish and Crustaceans	99.5	14.6	18.2	14.1	18.3
52	Cotton	16.1	2.4	1.3	1.0	8.2
23	Oilcakes and Seeds (Cotton, Copra, Coconut)	16.1	2.4	16.1	12.5	99.8
08	Edible Fruit and Nuts...	13.8	2.0	5.8	4.5	42.2
44	Wood and Articles of Wood	12.3	1.8	2.5	1.9	20.4
27	Mineral Fuels, Mineral Oils... Excluding Electricity	9.4	1.4	1.3	1.0	13.8
24	Tobacco	9.1	1.3	0.0	0.0	0.0
17	Sugar	8.0	1.2	0.0	0.0	0.0
61	Apparel: Knitted and Crocheted	7.7	1.1	6.9	5.4	89.7
62	Apparel: Not Knitted or Crocheted	6.7	1.0	6.7	5.2	99.8
15	Animal or Vegetable Fats and Oils	6.2	0.9	4.5	3.5	71.4
87	Vehicles, Parts and Accessories	5.7	0.8	1.5	1.1	25.5
40	Rubber	4.6	0.7	4.1	3.2	90.9
73	Articles of Iron or Steel	3.8	0.6	3.6	2.8	95.9
84	Machinery, Mechanical Appliances, Parts Thereof	3.4	0.5	2.1	1.6	60.5
60	Knitted or Crocheted Fabrics	3.3	0.5	3.3	2.6	100.0
25	Salt, Sulphur,...Lime and Cement	1.6	0.2	1.2	0.9	72.3
71	Precious Metals	1.1	0.2	0.9	0.7	78.7
85	Electrical Machinery, Equipment and Parts	0.9	0.1	0.7	0.6	79.7
	All Other	33.8	5.0	3.1	2.4	9.2
	Subtotal	263.2	38.6	83.8	65.1	31.8
	Total	682.0		128.7		18.9

Source: Government of Mozambique, Trade Statistics. All values are in USD Millions. Percentages are relative to total exports or SACU exports. Percent total shows SACU's share of total exports in the category. HS Codes are 2 digit chapter headings from Harmonized System of Classification with modified descriptions provided.

¹² South Africa is both the largest importer and exporter of electricity for Mozambique. Under the arrangement, South Africa buys from the Cahora Bassa hydroelectric plant at a price of 2 cents/KWh and then exports electricity to Mozambique at 4 cents/KWh. WTO (November 2000)

Table 5b: Mozambique Exports by Destination

	2002 Exports	
	Value	%
SACU	128.7	18.9
South Africa	128.1	18.8
BLNS	0.7	0.1
Non-SACU SADC	48.4	7.1
Zimbabwe	37.1	5.4
Malawi	10.3	1.5
EU	347.6	51.0
Belgium	282.5	41.4
Portugal	28.1	4.1
Spain	26.9	3.9
US	6.7	1.0
Rest of World	150.6	22.1
Switzerland	58.3	8.5
Japan	29.2	4.3
Total Exports	682.0	

Source: Government of Mozambique, Trade Statistics. All values are in USD Millions. Percentages are relative to total exports. HS Codes are 2 digit categories from Harmonized System of Classification with modified descriptions provided.

Table 6a: Mozambique 2002 Imports by Commodity

HS Code Description	Total Imports		Imports from SACU		
	Value	%	Value	%	% Total
27 Mineral Fuels, Mineral Oils... (Electricity)	149.7	11.7	75.0	22.2	50.1
87 Vehicles and Parts	98.2	7.7	50.4	14.9	51.3
10 Cereals	74.3	5.8	3.4	1.0	4.6
85 Electrical Machinery and Equipment	72.2	5.6	18.3	5.4	25.3
84 Machinery and Mechanical Appliances	63.8	5.0	30.3	9.0	47.4
39 Plastics and Articles Thereof	52.8	4.1	7.3	2.2	13.8
88 Aircraft, Spacecraft and Parts Thereof	36.4	2.8	0.0	0.0	0.0
73 Articles of Iron or Steel	35.5	2.8	14.2	4.2	39.9
30 Pharmaceutical Products	24.8	1.9	1.5	0.4	6.0
3 Fish and Crustaceans	16.2	1.3	16.1	4.8	99.7
72 Iron and Steel – Primary Products	15.2	1.2	14.1	4.2	92.3
90 Optical, Photographic, Medical and Related Equipment	13.6	1.1	3.1	0.9	22.8
38 Miscellaneous Chemical Products	13.0	1.0	6.2	1.8	47.2
48 Paper and Paperboard	12.7	1.0	10.2	3.0	80.3
94 Furniture, Bedding, Mattresses, ...	11.7	0.9	7.0	2.1	60.3
25 Salt, Sulfur,...Lime and Cement	10.9	0.9	7.3	2.2	67.5
15 Animal or Vegetable Fats and Oils	10.6	0.8	2.2	0.6	20.4
40 Rubber and Articles Thereof	10.1	0.8	5.0	1.5	49.2
49 Printed Books, Newspapers,...	8.7	0.7	1.9	0.6	22.2
63 Miscellaneous Textile Articles	7.6	0.6	1.4	0.4	18.2
34 Soap and Related Products	7.1	0.6	6.4	1.9	89.9
44 Wood and Articles of Wood	5.0	0.4	3.9	1.2	77.6
17 Sugars and Sugar Confectionary	4.1	0.3	3.6	1.1	87.9

All Other	523.8	41.0	48.7	14.4	9.3
Total	1,277.9		337.4		26.4

Source: Government of Mozambique, Trade Statistics. All values are in USD Millions. Percentages are relative to total imports. HS Codes are 2 digit categories from Harmonized System of Classification with modified descriptions provided.

Table 6b: Mozambique Imports by Origin

	2002 Imports	
	Value	%
SACU	337.4	26.4
South Africa	320.4	25.1
BLNS	17.0	1.3
Non-SACU SADC	18.5	1.5
EU	158.5	12.4
Portugal	77.1	6.0
France	22.4	1.8
US	55.7	4.4
Rest of World	707.7	55.4
India	53.7	4.2
Japan	42.6	3.3
Saudi Arabia	25.0	2.0
Total Imports	1,277.9	

Source: Government of Mozambique, Trade Statistics. All values are in USD Millions. Percentages are relative to total imports.

5. Mozambique-SACU Tariffs and Trade

Trade between Mozambique and SACU is currently governed by the terms of the SADC Trade Protocol. In addition, Mozambique is granted preferential access into South Africa's markets through a long-standing bilateral trade agreement with South Africa.¹³ The SADC Trade Protocol entered into force in January 2000 with an overall objective of attaining a free trade area by 2012. To this extent, in the long run, the elimination of tariff barriers between the Mozambique-SACU markets will be achieved regardless of Mozambique's membership in SACU. However, preliminary evidence suggests that SACU membership has some attractive features vis-à-vis Mozambique-SACU trade both in the short and long run.

First, although the SADC Free Trade Area will allow duty free access to SADC markets for virtually all 'qualifying' products – to qualify products will have to comply with the restrictive SADC rules of origin – which will remain in effect after 2012. SACU membership for Mozambique would eliminate this substantial barrier to regional integration between the two countries.¹⁴ Second, in implementing the trade protocol, Mozambique's tariff phase down offers are significantly 'back-loaded' – that is, most of the tariff reductions will take place in the later stages. In Mozambique's offer to South Africa, after four years of tariff phase downs, Mozambique will have only achieved 9 percent of its total liberalization vis-à-vis South Africa, after eight years, 62.7 percent of liberalization.¹⁵ However, the greatest benefits to Mozambique come from lowering its trade barriers quickly (depending, of course, on the timing of an agreement to join SACU) – SACU membership would achieve this at a single stroke. Finally, a number of goods are entirely excluded from consideration under the protocol. While Mozambique's excluded goods include mostly firearms and related items, SACU's restricted list includes several categories of goods of potential importance for Mozambique.

5.1 Mozambique's Exports to SACU

Immediate tariff-free access to the large South African market is certainly one of the most appealing features of potential SACU membership for Mozambique's exporters. As indicated in Table 5b, SACU markets are the destination for nearly 19 percent of Mozambique's exports – virtually all going to South Africa. Overall, the value of exports to SACU has more than doubled since 2000 with most of this increase coming from exports of aluminum and electricity. While the EU is the largest destination market for exports, SACU and South Africa in particular are the leading regional markets for goods with the rest of SADC accounting for only 7 percent of exports.

The commodity composition of Mozambique's exports to SACU is highlighted by major category in Table 7. The pattern is broadly similar to that of overall exports with electricity, aluminum and prawns accounting for nearly 56 percent of the total. SACU is a particularly important market for oilcakes and oilseeds (HS 23) and for apparel exports in HS chapters 61 and 62, accounting for nearly all of Mozambique's exports in these categories.

Under the SADC trade protocol, Mozambique's access to SACU markets will be duty free by 2008 and for existing exports is largely so now. The final column of Table 7 lists the trade weighted average tariff faced by Mozambique's exports in the SACU market. Using trade data from 2002 (the most recent available) and applying SACU's tariff phase down offer to SADC, ***89 percent of Mozambique's exports will enter duty-free as of January 2004 and overall face a trade weighted average tariff of only 1.6 percent.***

¹³ To date, we have been unable to obtain detailed information on the terms of this bilateral agreement. However, discussions with the Ministry of Trade suggest that the tariff phase downs under the SADC Trade Protocol have largely overtaken it.

¹⁴ Flatters (2002a) presents a detailed discussion of the damage done to SADC integration as a result of the Rules of Origin.

¹⁵ SADC Trade Policy Project (2001b).

Table 7: Mozambique Exports to SACU 2002 and Average Trade Weighted Tariff

HS Code	Description	Value	%	Average Tariff
27	Mineral Fuels, Mineral Oils, (Electricity)	25.18	21.88	0.00
76	Aluminum and Articles Thereof	21.07	18.31	0.00
03	Fish and Crustaceans	18.21	15.82	0.00
23	Oilcakes and Seeds	16.07	13.96	0.00
61	Apparel, Knitted and Crocheted	6.89	5.99	15.00
62	Apparel: Not Knitted or Crocheted	6.69	5.81	14.98
08	Edible Fruit and Nuts...	5.85	5.08	0.00
15	Animal or Vegetable Fats and Oils	4.45	3.87	0.00
40	Aircraft, Spacecraft, and Parts Thereof	4.15	3.60	0.00
73	Articles of Iron and Steel	3.61	3.13	0.00
87	Vehicles and Parts	1.45	1.26	2.27
52	Cotton	1.33	1.15	0.01
63	Other Textile Articles	0.14	0.12	5.13
57	Carpets and other Textile Floor Coverings	0.01	0.01	5.00
	All Other	13.61	50.00	0.00

Source: Government of Mozambique, Trade Statistics; SADC Secretariat SACU Offer Under the SADC Trade Protocol. Values in USD Millions, shares are the percentages of total exports to SACU 2002. Tariffs are calculated using SACU phase downs to be implemented January 2004.

Of the remaining products, textiles and apparel in HS chapters 61, 62, 63, and 57 are subject to the highest tariffs and have to comply with the rules of origin under the SADC trade protocol. The rules of origin will remain in effect even after 2012. In general these rules of origin require inputs to be sourced within SADC, although in the case of textiles and clothing Mozambique qualifies as a Least Developed Country for an alternate rule of origin that allows clothing to use third party cloth subject to a fixed quota in the SACU market. This alternate rule of origin will be reviewed in 2004. Even in the sectors where Mozambique is already trading under the bilateral agreement with South Africa, the rules of origin require inputs to be sourced from within SADC.

Exports in HS 87, vehicles and related parts, face a trade-weighted tariff of roughly 2.3 percent in SACU markets – this is largely associated with the protection of the South African motor industry. In addition, sugar is a potentially important export to SACU. Sugar is subject to a special SADC Protocol to determine the amount of duty free access to SACU. An amount of sugar based on the percentage growth of the SACU market is allocated amongst SADC sugar producers in accordance to their exposure to the world market. SACU is also eligible to share in this allocation, and thus the amount of sugar left for the non-SACU countries is very small. Given the high level of protection within SACU there are significant rents at stake in this sector.

Further investigation is required on these issues particularly with regard to the magnitude of benefits to Mozambique from eliminating the effects of the SADC rules of origin and possibly also the constraints of the sugar protocol.

5.2 Mozambique's Imports from SACU

While tariff-free access to SACU markets is appealing for Mozambique, the greatest potential concern is allowing SACU, particularly South Africa, tariff-free access to Mozambique's markets. In many of the interviews conducted for the study, the oft-repeated fear was that with SACU membership Mozambique would be flooded by imports from South Africa and be able to export nothing. Disregarding the mercantilist flaw of this argument, it bears repeating again that opening the border to

SACU imports is potentially the biggest advantage to membership – in addition to the enormous gains to consumer welfare, in terms of development strategy, increased exports require increased imports.

As seen earlier (Table 6b) nearly 27 percent of Mozambique’s imports currently originate in SACU, with South Africa being the single largest source. However, both the value of imports and the share from SACU has declined since 2000 as more products are sourced from within the EU whose share has increased nearly six fold in the last three years. Table 8 below provides further detail on Mozambique’s imports from SACU. As noted above, the leading import from South Africa is electricity followed by vehicles and parts, machinery and equipment, fish, and iron and steel products.

Table 8: Mozambique Imports from SACU 2002 and Average Trade Weighted Tariff

HS Code	Description	Value	%	Average Tariff
27	Mineral Fuels, Mineral Oils, (Electricity)	75.18	22	2.97
87	Vehicles and Parts	50.63	15	8.66
84	Electrical Machinery and Equipment	30.22	9	5.90
85	Machinery and Mechanical Appliances	18.25	5	9.41
03	Fish and Crustaceans	16.24	5	0.09
73	Articles of Iron and Steel	14.16	4	8.00
72	Iron and Steel	14.04	4	5.52
48	Paper and Paperboard	10.17	3	8.86
25	Salt, Sulfur, ...Lime and Cement	7.33	2	7.36
39	Plastics	7.28	2	11.03
94	Furniture and Bedding	7.02	2	24.44
34	Soap and Related Products	6.38	2	11.50
38	Miscellaneous Chemical products	6.14	2	1.67
	All Other	74.59	22	1.47

Source: Government of Mozambique, Trade Statistics; SADC Secretariat Mozambique South Africa and Differentiated Offers Under SADC Trade Protocol. Values in USD Millions, % provides % of Total Imports from SACU 2002, HS Codes are 2 digit categories from Harmonized System of Classification with modified descriptions provided. Mozambique’s January 2004 tariff phase down offer to South Africa and BLNS was used to calculate average trade weighted tariffs.

In contrast to the access enjoyed by Mozambique’s exports in SACU markets, tariffs faced by SACU exporters are comparatively high. Table 9 provides a breakdown of average trade-weighted tariffs faced by SACU importers calculated using Mozambique’s tariff phase down offers to South Africa and BLNS to be implemented in January 2004. ***Overall, SACU imports face a trade-weighted tariff of 7.4 percent. Most of this is due to the average 7.7 percent trade-weighted tariffs faced by South Africa goods. By contrast, imports from the BLNS countries face a trade weighted average tariff of only 1.6 percent.*** The high rates on South African exports are due to the slow tariff phase down being offered by Mozambique under the SADC trade protocol, which is even more heavily back-loaded for South Africa. The lower average for the BLNS reflects the different commodity composition of their trade.

Compared to the impacts for Mozambique’s access to SACU markets, the increase in access for SACU exporters would be comparatively larger. However, this is somewhat misleading in that Mozambique accounts for only a small percentage of total SACU trade while SACU is a dominant market for Mozambique. Thus, large tariff changes on a small percentage of SACU exports will be unlikely to have as large an impact as small tariff changes in the market for a large share of Mozambique exports.

Table 9: Mozambique Tariffs on Imports from SACU, January 2004

Rate 2004	SACU Imports	South Africa Imports	BLNS Imports
0.0	27	23	89
2.5	1	1	0
5.0	29	31	1
7.5	28	29	6
25.0	15	16	4
Trade Weighted Tariff	7.4	7.7	1.6

Source: Government of Mozambique Trade Statistics, SADC Secretariat Mozambique South Africa and Differentiated Offers Under SADC Trade Protocol.

6. Comparison of MFN Tariff Regimes

The key component of trade policy in Mozambique's development strategy is a strong outward orientation. Any trade regime chosen should seek not only deeper regional integration but more importantly seek deeper integration with the global economy. Joining SACU would have important implications for Mozambique in this regard as membership would require the adoption of the common external tariff imposed by SACU. After reviewing the overall tariff structures of Mozambique and SACU, in the following sections we review the potential benefits and drawbacks of this facet of SACU membership for Mozambique.

6.1 Mozambique's MFN Tariff Structure

Mozambique has reformed its MFN import duty structure considerably since the mid-1990s by rationalizing and reducing overall rates. The current tariff structure comprises five bands as shown in Table 10. As indicated, 50 percent of current imports enter duty free with an overall trade-weighted tariff of 5.2 percent on imports. One area of concern is that this is a cascading tariff structure with a significant gap between the rates on general consumer goods and on capital and intermediate goods. The rate on consumer goods is scheduled to fall to 20 percent in 2006. Although the rates are relatively low, the significant gap between those on consumer goods and inputs can result in quite high rates of effective protection for some consumer goods, while the effective protection to inputs is quite low.¹⁶

Table 10: Mozambique MFN Tariff Rates

Type of Good	Import Duty Rate (%)	% Imports 2002
Basic Goods	0	50
Raw Materials	2.5	4
Fuel or Equipment	5	13
Intermediate Materials	7.5	22
Consumer Goods	25	11
Average Trade Weighted Tariff	5.2	

Source: Government of Mozambique Trade Statistics; SADC Secretariat Mozambique South Africa and Differentiated Offers under SADC Trade Protocol. Average Trade Weighted Tariff calculated using MFN Tariff Rates and Mozambique's January 2004 South Africa and Differentiated Offers under the SADC Trade Protocol.

6.2 SACU's MFN Tariffs

By contrast, SACU's MFN tariff schedule demonstrates a stunning variety of rates and type of tariffs, as outlined in Table 11. The schedule includes 38 *ad valorem* bands as well as specific and combined tariffs for a total of 216 different rates.¹⁷ Despite its complexity and associated administrative burdens, 64 percent of imports from non-SADC countries enter SACU duty free. However, the rates on the remaining goods are quite high with *ad valorem* rates ranging up to 55 percent as a result, the average trade weighted-tariff facing imports from non-SADC countries is nearly eight percent.

¹⁶ There are, however, some issues in classification of goods that can serve as either inputs or final goods. The classification of such products as consumer goods reduces the effective protection of products that use them as inputs.

¹⁷ TIPS (2002) provide a comprehensive analysis of the SACU tariff structure and its implications for South Africa.

Table 11: SACU MFN Tariff Schedule, 2002

Tariff Range	# Rates	# Lines	% Imports
0.0%	1	3438	64.1
0%<Tariff<=5%	3	329	3.7
5%<Tariff<=10%	8	615	4.8
10%<Tariff<=15%	6	571	3.1
15%<Tariff<=20%	6	578	4.9
20%<Tariff<=30%	6	341	10.7
30%<Tariff	8	39	3.8
Total Ad Valorem	38	5911	95.2
Combination Rates	136	1816	2.6
Specific Rates	42	187	2.2
Total	216	7914	
Maximum Ad Valorem	55%		
Trade Weighted Average Tariff	7.7%		

Source: South Africa Department of Trade and Industry.

6.3 SACU's Tariff Structure: Implications for Mozambique

In assessing the implications of the SACU tariff structure for Mozambique, we have initially assumed that Mozambique adopts the SACU structure without alteration. Applying SACU's MFN tariff and SADC phase down offer for 2004 to Mozambique's 2002 import data reveals that *with SACU membership, the trade weighted average tariff on all imports would drop from 5.2 percent to 2.4 percent - a 53 percent decline with more than 40 percent of imports experiencing lower rates.* While 70 percent of this drop is accounted for by the freeing of trade between Mozambique and SACU, the remaining 30 percent represents more general liberalization on imports from the rest of the world.¹⁸

Table 12 provides estimates of the changes in trade-weighted tariffs on imports from the rest of the world for selected aggregated categories.¹⁹ Categories were selected that had either a large change in tariffs and/or represented a significant proportion of Mozambique's imports. The table presents the trade-weighted average in each sector faced by non-SACU, non-SADC countries under Mozambique's current schedule, under SACU and the magnitude of the change.

Vehicles and parts (HS 87) would experience an increase of 9.3 percent and forms a significant portion of imports. The high SACU tariffs in this chapter are largely a result of South Africa's protection of the motor vehicle industry. In sectors where SACU's MFN tariff is significantly higher than Mozambique's, SACU membership would give rise to the possibility of serious trade diversion. However, in sectors such as plastics, and miscellaneous textile articles, the high trade weighted tariff under the current structure suggests that most of the products are classified as consumer goods and face Mozambique's highest tariff rate. Adoption of the SACU tariff schedule would lead to a decline – but in the particular case of plastics, the change is marginal and identical reduction will be accomplished as Mozambique drops its top rate to 20 percent by 2006. However, for chapter 63, which includes a variety of miscellaneous textile articles, the reduction is more than would be achieved by the gradual phase down in Mozambique's rates.

¹⁸ Changes in trade-weighted tariffs faced by imports from non-SACU SADC countries are trivial as they represent a small share of overall imports.

¹⁹ While the use of aggregated categories provides an overall picture, the level of aggregation can disguise significant variation within categories.

Table 12: Changes in Trade Weighted Tariffs: Imports from Rest of World

Code Description	Share Imports	Current Tariff	SACU Tariff	Change
87 Vehicles and Parts	5.0	8.4	17.7	9.3
69 Ceramic Products	0.4	8.2	17.7	9.5
30 Pharmaceutical Products	2.5	0.0	1.1	1.1
85 Electrical Machinery and Equipment	5.9	8.3	8.7	0.4
28 Inorganic Chemicals	0.2	0.7	14.4	13.8
56 Wadding, Felt and Non-Wovens	0.1	2.0	17.0	15.0
52 Cotton	0.2	25.0	3.3	-21.7
90 Optical and Photographic Equipment	1.1	5.9	1.1	-4.8
63 Miscellaneous Textile articles	0.7	24.6	4.8	-19.7
84 Machinery and Mechanical Appliances	3.5	7.7	2.2	-5.5
39 Plastics and Articles thereof	5.0	23.2	18.9	-4.3
88 Aircraft, Spacecraft and Parts Thereof	4.0	7.5	0.0	-7.5
10 Cereals	7.8	5.5	0.0	-5.5

Source: Government of Mozambique, Trade Statistics. Share of Imports denotes Share of imports from non-SADC Countries. Tariffs are trade weighted based on Mozambique 2002 imports. 2003 tariff rates are used for Mozambique, 2000 for SACU.

All of these results describe only the impacts of joining SACU and other policy scenarios on *nominal* rates of protection – tariff rates on the outputs of different economic activities. To determine the effects of changes in tariff structures on production and investment it also necessary to consider the effects of tariff changes on *effective* rates of protection, the net impact on producers of different products of changes in tariffs on both their outputs and their inputs. This should be part of the preparation of a detailed implementation strategy.

7. Preferential Trading Arrangements

Both Mozambique and the SACU member states are current participants in and/or actively negotiating preferential trading arrangements (PTAs) – both bilateral and regional. This gives rise to a number of issues with respect to potential SACU membership for Mozambique.

- How would Mozambique's current PTAs and future negotiations be affected by SACU membership? In most cases, such arrangements would be overtaken by the necessity of adopting the SACU tariff structure.
- Would Mozambique be able to benefit from current and planned SACU PTAs – such as the US-SACU agreement?

7.1 Regional Bilateral Agreements

Mozambique is currently engaged in discussions with several other SADC Member States with a view to formalizing free trade arrangements that will involve immediate removal of almost all import duties and adoption of simple rules of origin, much closer to those in COMESA. The particular countries with which discussions are now under way are Malawi, Zambia and Zimbabwe, all members of SADC. From the perspective of tariff preferences, *per se*, therefore, the only effect of any of these bilateral agreements would be to accelerate the phase-in of SADC tariff reductions. Since the countries in question are all included in Mozambique's differential offer to non-SACU Members (and vice versa), the acceleration is likely to be minimal. The main advantage of successful conclusion of any of these negotiations would be instead the acceptance of more liberal rules of origin than currently in place under the SADC Trade Protocol.

These three countries together represent only a small portion of Mozambique's trade. They account for 7 percent of Mozambique's exports; but 71 percent of these are exports of electricity to Zimbabwe which already is duty-free. On the import side, the three markets account for only 1.3 percent of Mozambique's imports with tobacco being the most important product. As an alternative strategy to SACU membership, clearly these arrangements do not promise to provide substantial liberalization in the overall tariff structure.

If Mozambique became a member of SACU these and other bilateral preference arrangements would be in clear violation of the common external tariff policy. As such they would not be allowed to continue, except with some special dispensation. Mozambique's bilateral trading partners of course could also apply for SACU membership and this might be a viable longer term arrangement. However, this is unlikely to provide an immediate solution to the common tariff problem. A condition for SACU membership might be for Mozambique to terminate bilateral preferential trading arrangements.

7.2 Other SACU Trade Agreements

7.2.1 With the EU

South Africa recently entered into a preferential trade agreement with the EU (the EU-South Africa Trade and Development Cooperation Agreement, or TDCA). The agreement is characterized by a long and asymmetric tariff phase-down schedule with South Africa phasing down more slowly than the EU. The agreement is characterized by relatively restrictive rules of origin and exclusion of a significant number of sectors considered sensitive by South Africa. What will be the implications for other SACU members?

On the import side, it might be expected that the existence of the customs union would make the BLNS countries *de facto* beneficiaries of tariff preferences granted to the EU by South Africa. However, South Africa is apparently still taking the formal position that it will continue to collect tariffs on EU imports that are destined for BLNS markets. However, it would be difficult for such a practice to survive in light of the obvious opportunities for arbitrage it would create within the customs union.

On the export side, there would be no apparent benefit for BLNS countries to participate, since their access to EU markets under the Cotonou agreement is better than South Africa has negotiated in its agreement with the EU.

The non-reciprocal Cotonou agreements, however, are now scheduled to be replaced by reciprocal Economic Partnership Agreements (EPAs) between the EU and self-selected groups of trading partners. A widely held view is that South Africa, having already made a preferential trade agreement with the EU, will not be part of any EPA. This view rests in part on the implicit assumption that the *de facto* arrangement involving the BLNS in the TDCA can be easily formalized. Otherwise the BLNS would be in the awkward and inconsistent position of being members of both SACU and separate EPAs. Somewhat surprisingly, however, little progress has been made in this regard.

Expansion of SACU to include Mozambique and maybe other members would complicate this TDCA/EPA configuration considerably. The real question that would have to be resolved is whether the TDCA could be expanded to include all SACU members or whether the TDCA might be better renegotiated as a new EPA including all SACU members. The latter option would give the opportunity for South Africa and its SACU partners to negotiate a better arrangement than the current one, which is viewed by many critics as excessively protectionist on both sides. Mozambique would certainly want to be wary of falling into the TDCA by default rather than taking the opportunity to be part of a more liberal trading arrangement with the EU.

7.2.2 With the US

Of equal or possibly much greater significance are the negotiations that are now under way for a preferential trading agreement between SACU and the US (SACU-US FTA). While the negotiations are still in their early stages it is apparent from the examples of similar recent agreements with Chile, Singapore and other countries that a successful conclusion would lead to an agreement with broader coverage and much less restrictive rules of origin than in EU, Cotonou and other preferential schemes. There are indications that the US would welcome expansion of such an agreement to include new members of SACU.

8. Fiscal Implications of Joining SACU

Participation in the SACU revenue-sharing mechanism will have fiscal implications for the government of Mozambique. The immediate impacts will arise from the removal of import duties on imports from SACU, adopting the SACU import tariff and excise tax regimes, and participating in the corresponding revenue sharing mechanism.

The loss of the tariff revenue on SACU imports is primarily a short run issue. Unless restrictive rules of origin prevent preferential trade from occurring under the SADC Trade Protocol, almost all Mozambique-SACU trade will be tariff-free in ten years or less, regardless of whether Mozambique joins SACU. Further unilateral tariff reductions under Mozambique's long term program of trade liberalization, and participation in other preferential trade liberalization exercises, such as an EPA with the EU, will also diminish the overall importance of tariff revenues as a source of government revenue. This means that any estimate based on existing MFN tariff structures will give an overestimate of long term revenue losses.

Whether total revenues will rise or fall depends on the nature of differences between Mozambique and SACU excise and import tariff structures, and on the operation of the revenue-sharing formula. This section provides some preliminary estimates of the net fiscal effects of joining SACU, based on available data in Mozambique and on current structures of MFN tariffs. It abstracts from the inevitable reduction in importance of tariff revenues arising from future MFN trade liberalization and negotiation of new preferential trading arrangements, most importantly EPAs and a SACU-US FTA.

8.1 Current Revenue Structure

Table 13 provides an overview of Mozambique's current government revenue structure.

Table 13: Mozambique Tax Revenues

	2001	2002	2003	2001	2002	2003
	Billions of Meticaís			% of Gov. Revenue		
Taxes on Goods & Services	5,822	7,390	8,847	61.7	64.0	61.5
VAT	3,572	4,587	5,549	36.3	38.7	37.7
Domestic	1,539	1,967	2,460	0.0	0.0	16.2
Imports	2,034	2,621	3,089	0.0	0.0	21.5
Consumption Tax	773	952	1,215	9.2	8.3	8.2
Domestic	523	635	825	5.1	5.4	5.5
Beer and Soft Drinks	378	470	548	4.0	4.3	4.0
Tobacco	143	162	275	1.0	1.1	1.5
Other Products	1	3	2	0.0	0.0	0.0
Imports	250	317	390	4.1	2.9	2.6
Customs Duties	1,477	1,851	2,083	16.3	17.0	15.6
Other Taxes	1,137	1,214	1,783	16.9	13.8	12.0
Total Tax Revenue	6,959	8,604	10,631	78.7	77.8	73.5

Source: Government of Mozambique. 2003 figures are budget projections.

The VAT, introduced in 1999 and levied at a rate of 17 percent, is now Mozambique's single most important revenue source, accounting for 38 percent of government revenue in 2003. As observed earlier, the VAT is a very important step forward in the restructuring of Mozambique's government revenues. However, its effectiveness is seriously impaired by administrative and implementation

weaknesses, the most important of which are low and arbitrary collection rates, especially on domestic goods, and failure to provide timely refunds of input credits due to exporters.

Import tariffs account for a small (less than 16 percent) and declining share of government revenues. As already observed, with SADC, EPAs and continued unilateral tariff reform the downward trend will continue. The ongoing process of tax reform, including the recent replacement of the turnover tax with a VAT, show the government's commitment to raise necessary fiscal revenues more efficiently, and in particular to reduce reliance on highly distorting trade taxes. The growth of bilateral and other preferential trading arrangements will increase the distorting effects of remaining tariffs, and the more so the higher the levels of MFN rates. The ongoing implementation of fiscal measures to reduce dependence on import duties will enable Mozambique to reduce MFN rates in parallel with the granting of bilateral and regional tariff preferences.

A selective excise tax (*Imposto Sobre Consumos Especificos*) is the next most important source of tax revenue, accounting for 8 to 9 percent of total revenue. The excise tax is levied on domestic goods and imports at equal rates. It covers 144 8-digit HS tariff lines, at rates of 65, 40, 30 and 15 percent. The highest rates are on alcohol and tobacco products, art and antiques, gems and jewelry. The lower rates are levied on motor vehicles, perfumes, toiletries, and toys, games and sports equipment. By far the most important items in terms of revenue collections are beverages and tobacco products.

8.2 SACU Revenue Sharing

The SACU revenue-sharing arrangement would affect Mozambique's second and third most important sources of tax revenue – customs duties and excises. In 2003, these two taxes accounted for about one quarter of Mozambique's government revenue.

8.2.1 Customs Revenues

Customs duties would be affected in three ways.

- Tariffs on imports from SACU would be eliminated.
- Mozambique's tariff structure would be replaced by SACU's.
- Instead of retaining customs revenues collected at its own borders Mozambique would get a share of the SACU customs duty revenue pool.

The first two of these effects determine whether and by how much the burden of import duties in Mozambique will rise will or fall as a result of joining SACU. Based on 2002 data, it is estimated that total import duty collections in Mozambique would fall by 43 percent. Almost 80 percent of this reduction arises from the freeing of trade with SACU (almost entirely from South Africa). The remainder is due to the fact that SACU tariffs on goods imported into Mozambique from the rest of the world are somewhat lower than those currently in effect in Mozambique. Of the reductions from the rest of the world, a very small share is on imports from non-SACU SADC.

A large part of the reduction in tariff collections, therefore, would be simply a small acceleration in impact of implementing Mozambique's SADC commitments.

Whether the elimination of duties on imports from SACU will have an appreciable effect on prices for users of importable goods in Mozambique is unclear. Unless there is considerable competition among South African suppliers and South African supplies are able to meet all of Mozambique's needs, there would be little price reduction other than that due to differences between Mozambique and SACU tariffs. Most of the benefits of price reductions from SACU trade liberalization are likely to arise from the lowering of (average) MFN import duties as a result of adopting the SACU tariff structure.

The discussion so far has centered on the effects of SACU on Mozambique's tariff collections – i.e. on the revenues collected on imports of goods into Mozambique. Under the SACU revenue sharing arrangement, tariffs levied on Mozambique's imports would be contributed to the SACU customs pool. The net impact of SACU on Mozambique's actual customs duty revenues will depend on the revenue-sharing formula. Recall that the formula distributes customs duties according to member countries' shares of total intra-SACU imports. Because the BLNS shares of intra-SACU imports are much larger than their shares of total imports, this has the effect of redistributing a substantial amount of customs duty collections from South Africa to the BLNS. The same would also be true of Mozambique.

Based on Mozambique's trade data for 2002, application of the formula in that year would provide customs revenues to Mozambique of 1,200 billion Meticaís, which is 17 percent higher than her estimated contributions to the SACU customs pool, and 34 percent less than current (2002) customs revenues when Mozambique was outside of SACU.

These estimates are sensitive to the data used on Mozambique's intra-SACU trade, and especially its imports from SACU. The estimates presented here are based on Mozambique's trade data for 2002. There are several observations that should be made in this regard.

- There are serious questions about the quality and accuracy of Mozambique's trade and customs data. Among the most important issues in the context of SACU membership is the discrepancy between the data on Mozambique-SACU trade as recorded by the government of Mozambique and by the South African Revenue Service (SARS). In 2002, for instance, Mozambique's recorded imports from South Africa are 46 percent lower than South Africa's recorded exports to Mozambique. Acceptance of the South African data would mean a significant increase in Mozambique's revenue from the customs pool. Similarly, Mozambique's reported exports to South Africa in 2002 were 243 percent higher than South Africa's reported imports from Mozambique. Acceptance of the South African data here would increase Mozambique's share of the customs pool. There clearly are some serious data issues that would have to be resolved before Mozambique would be able to predict with accuracy and agree to any customs revenue implications of joining SACU.
- SACU bases its customs valuations on *job* rather than *cif* values, a rather unusual practice by international standards. Mozambique uses the more traditional (and economically correct) *cif* system. The Mozambique data used in these estimates reflect *cif* values. See section 9.2.4 below for further discussion of the economics of this issue.
- Shares in the customs revenues pool depend not on countries' shares of dutiable imports, but rather on their shares of (non-dutiable) intra-SACU imports. Increased market integration with South Africa or other SACU members' economies could result in significant increases in Mozambique's customs revenues, even though the increased trade is duty-free and there might even be reduced imports of dutiable goods from the rest of the world. Changes in the prices of major resource products (electricity, aluminum, etc.) could have a major impact on measured flows of intra-SACU trade and hence on shares of the customs pool. An increase in the price of electricity exported from and re-imported by Mozambique might cause a large increase in Mozambique's customs revenues without any changes in dutiable imports from the rest of the world.²⁰

In summary, joining the SACU customs pool with the current SACU tariff structure is likely to have the following results.

²⁰ As this example illustrates, a member could increase its share of the revenue pool simply by moving duty-free goods back and forth across its border with another member.

- Government customs revenues would fall by about 34 percent according to preliminary estimates.
- Import duties collected on imports into Mozambique would fall by even more, by about 43 percent according to initial estimates. Most of this is due to the elimination of duties on imports from South Africa and probably would not be fully reflected in reduced prices for users of importable goods in Mozambique.
- The difference between import duties collected and revenues received would represent a net transfer of customs revenues from the rest of SACU to Mozambique. The net transfer is estimated to be about 17 percent of duties collected on imports into Mozambique.
- All of these estimates are based on weak trade and customs data collected in Mozambique and would be subject to verification and reconciliation with other information, especially from SARS. The estimates are also contingent, of course, on continuation of the existing revenue formula and SACU tariff structure.

8.2.2 Excise Duties

After a small portion of the excise pool (initially 15 percent) is set aside as a development component, the remainder of SACU excise collections are distributed in proportion to members' shares of total SACU GDP.²¹ This development component is distributed in almost equal 20 percent shares, adjusted slightly in favor of the lesser developed countries, according to the deviation of each country's per capita GDP from the SACU average. Since the development shares are not adjusted for population size, the smaller BLNS economies get much higher shares on a per capita basis.

Except for the development component, there is little direct redistribution of excise taxes under the revenue-sharing formula. Since the bulk of the excise pool is distributed among SACU members according to their GDPs, the only direct redistribution of this part arises from differences in per capita consumption of excisable goods between higher and lower income members.

The development component is designed to achieve two types of fiscal redistribution.

- The use of equal proportional shares has the effect of redistributing from members with large populations to those with small populations.
- The additional adjustment factor that is applied to these shares is designed to redistribute from members with high per capita incomes to those with low per capita incomes.

The second of these criteria would clearly benefit Mozambique. However, since Mozambique's population is much greater than in the BLNS, the effect of the first criterion is uncertain *a priori*. Overall, however, the development component represents less than 8 percent of the total revenue pool, and so any redistribution through this part of the revenue-sharing formula, whether favorable or unfavorable to Mozambique, will be very small.

Differences in the bases (per unit in SACU versus *ad valorem* in Mozambique) and structures of excises between Mozambique and SACU make it difficult to estimate the effects of adopting the SACU excise structure as would be required in joining SACU. However, rough estimates can be made on the basis of the observation that SACU excises currently yield revenues of about 1.5 percent of GDP, while the current Mozambique excise taxes yield only about 1.1 percent of GDP.

²¹ Sustainability of this distribution arrangement depends on a commonly agreed excise tax structure in all member countries. Until now, the base and rates of this excise tax structure have been decided and announced in the budgets of the South African Minister of Finance.

On this basis, it can be estimated that adoption of the SACU excise tax structure would increase Mozambique's excise tax collections by about 43 percent, yielding revenues of about 1,365 billion Meticaais. These excise collections would be Mozambique's (or Mozambique consumers') contribution to the SACU excise pool. Applying the current formula, Mozambique would receive in return a total of 1,488 billion Meticaais, divided almost half and half between 'excise' and 'development' components.

In summary adoption of the SACU excise tax structure and the SACU revenue sharing formula would have the following results.

- Mozambique consumers would pay 43 percent higher excise taxes than at present.
- The Mozambique government would receive an increase in excise revenues of about 56 percent.
- Mozambique would receive a net transfer from SACU of about 9 percent of its new level of excise collections.

8.2.3 Net Revenue Impacts

The estimated net revenue impacts of Mozambique's SACU membership, under current revenue-sharing arrangements are shown in Table 14. Joining SACU would result in a major reduction in customs duty payments by Mozambique importers and a large increase in excise tax payments, with a net effect of a 16 percent reduction in payments of these two taxes. As a result of the of the revenue sharing arrangement in SACU, total government revenues in respect of customs duties and excise taxes would decrease by only 3 percent. Since these taxes account for only 26 percent of total fiscal revenue, the percentage reduction in total government revenue would be less than 1 percent. The redistributive elements in the revenue formula would result in a net transfer to Mozambique of almost 300 billion Meticaais, or 12 percent of Mozambique's collections of import duties and excise taxes.

Table 14: Implications of SACU Revenue Sharing for Mozambique

	2002 (billions of Meticaais)		
	Customs	Excise	Total C&E
Memo: 2002 Actual	1,815	952	2,767
Collections and Revenues if in SACU:			
Collections (Contributions to SACU Pool)	1,028	1,365	2,393
Government Revenues (from SACU Pool)	1,200	1,488	2,688
Change in Collections	-787	413	-374
Change in Collections (%)	(-43)	(43)	(-16)
Change in Government Revenues	-615	536	-79
Change in Government Revenues (%)	(-34)	(56)	(-3)
Excess of Revenue Over Contributions	172	123	295
Excess of Revenue Over Contributions (%)	(17)	(9)	(12)

The reduction in import duty revenues would come primarily from the elimination of duties on imports from South Africa. Since most of these duties would be eliminated in the near future as part of Mozambique's SADC commitments, this is really just a small acceleration in a process that is already underway.

From the perspective of Mozambican users of taxed goods, joining SACU can be thought of as speeding up the tariff reductions on imports from South Africa, obtaining some small reductions, on average, in tariffs on goods from the rest of the world, and accepting the longer term burden of higher excises. Users of imported goods are unlikely to benefit from the full amount of the tariff reductions on imports from South Africa, since SACU's MFN tariffs will continue to provide protection to South African and Mozambican sellers.

8.2.4 Impact on Other SACU Members

Mozambique will need to be sensitive not only to the implications of revenue sharing for itself, but also for other members. Table 15 shows estimates of total revenues accruing to each of the other SACU members with and without Mozambique as a member. The total revenue loss to other members is only 0.8 percent of previous revenues, representing the net transfers to Mozambique shown in the previous section. However, the losses are not shared symmetrically. While South Africa benefits from an increase in its revenues, the BLNS members all suffer small losses, ranging from 3.6 to 4.8 percent of their previous SACU revenues.

While the losses to the BLNS are relatively small, this could become a sensitive issue. One possible solution would be to increase the proportion of excise collections that go into the development pool, which would have the effect of redistributing revenues from South Africa to the BLNS members (and Mozambique). However, this illustrates a more general problem regarding the role of revenue redistribution in SADC. Redistribution was part of the original understanding between South Africa and the BLNS. The new revenue-sharing formula lacks any rationale other than as a vehicle to achieve traditional levels of redistribution. The arbitrariness of the formula is almost certain to present new problems whenever new members are admitted to SACU. At some point it might be necessary to rethink both the special relationship between South Africa and the BLNS and the role of redistribution in SACU. With the addition of new Members to SACU South Africa may need to consider how to address the special relationship with the BLNS outside of the mechanism of the SACU. This could result in major changes in the SACU revenue sharing arrangements.

**Table 15: SACU Customs and Excise Revenues for Other Members
With and Without Mozambique (2002, millions of Rand)**

	Without Moz.	With Moz.	Change	% Change
Botswana	2,925	2,821	-104	-3.6
Lesotho	1,514	1,441	-73	-4.8
Namibia	2,633	2,530	-103	-3.9
Swaziland	1,640	1,564	-76	-4.6
South Africa	9393	9,604	211	2.2
Total	18,104	17,959	-145	-0.8

9. Should Mozambique Join SACU? Issues to Consider

There are two fundamental questions that need to be asked about SACU membership.

- Will joining SACU improve Mozambique's trade, investment and fiscal environment?
- Will it facilitate her commitments under the PARPA to increase economic growth and reduce poverty?

Or can it be used to accomplish these purposes?

9.1 Key Issues

Speeding up Mozambique's integration with South Africa has the potential to increase trade and investment opportunities in Mozambique. However, the South African market is small by global standards and there are dangers that, protected by SACU MFN duty structures, Mozambique would suffer from costly trade diversion on imports of protected goods from South Africa. Furthermore, any benefits from decreased trade barriers with South Africa would be diminished without the removal of well known problems with customs clearance on the Mozambique side of the South African border. Of course, liberalization of trade with SACU could provide the incentive necessary to improve trade facilitation in Mozambique and, if so, this would be a major benefit of joining SACU.

Of much greater importance might be the opportunities through SACU to increase Mozambique's integration with much larger markets in the global economy. Being a partner in a SACU-US FTA has the potential to open up much more significant trade and investment opportunities for Mozambique. Freeing of trade with a major market such as the US would also remove many of the dangers of trade diversion in a closed and exclusive trading arrangement with SACU. Once again, realization of these benefits would be contingent in large part on Mozambique's ability to improve its own regulatory and investment environment through policies that addressed well-known domestic trade and investment barriers.

Joining SACU would also have serious implications for Mozambique's future trading relations with the EU under the proposed new Economic Partnership Agreements. Expansion of SACU would increase the pressure on both the EU and South Africa to renegotiate and improve South Africa's current trade agreement with the EU (the TDCA) under the EPA umbrella. Without such a renegotiation, joining SACU might impose significant costs on Mozambique's future trade and investment relations with the EU.

The regulatory improvements necessary to maximize the benefits of joining SACU would be of enormous economic value in their own right, regardless of whether Mozambique actually joined. If the prospect of entering SACU could be used to increase the urgency of undertaking such reforms, however, this would be another great benefit of SACU. Whether SACU would help in this regard is a question that is best answered by policy makers in Mozambique.

9.2 Other Issues

9.2.1 Revenue Sharing

The SACU revenue-sharing formula has several peculiarities relative to most other customs unions in the world.

Of greatest importance is the method of sharing customs revenues on the basis of members' shares of (duty-free) trade among themselves, rather than on the duties actually collected by each country on

their imports. At the moment this formula would appear to work in Mozambique's favor, in the sense that she would receive more customs duty revenues than she would collect. However, there is no guarantee that this would continue in future – it would depend on the evolution of intra-SACU trading patterns. Furthermore, collecting the data required to implement this part of the formula requires the maintenance of significant customs controls on intra-SACU trade, thus defeating one of the principal purposes of the customs union, to free up trade among its members.

The bulk of the excise pool is allocated on a simpler and more rational basis, meant by and large to reflect the revenues actually collected in each member. However, the development component of this pool is also designed to achieve redistribution from richer to poorer members. This also works in Mozambique's favor at the moment. But the size of the development pool (15 percent of excise collections at the moment) has not been set permanently, and the circumstances under which it would be adjusted are not clear. It was suggested earlier in this report that South Africa might want to increase the development share to compensate the BLNS for adverse effects of Mozambique's entry. However, this would also increase the amount of redistribution to Mozambique.

The rationale for this redistribution is based on historical relations between South Africa and the BLNS countries and it is not clear whether South Africa would wish to continue it in its present form, especially under future expansion of SACU. Mozambique would need to consider the possibility that, as a side-effect of discussions about its membership in SACU or as part of some future SACU expansion, South Africa might propose removing the main redistributive parts of the revenue formula out of SACU and making them part of a separate arrangement with the BLNS.

The revenue-sharing formula was one of the most difficult and contentious issues in the recently-completed renegotiation of the 1969 SACU agreement. It has not yet even come into force.²² Nevertheless, for greater certainty about the revenue implications of joining SACU and to try to increase the economic rationality of the arrangement, Mozambique might wish to consider raising the issue of the revenue-sharing formula.

One possible proposal would be to eliminate the development pool and to base the distribution of customs duties on dutiable imports from non-SACU sources. South Africa and the BLNS could then work out any desired redistribution among themselves outside of the SACU revenue-sharing arrangement. Even if Mozambique did not wish to suggest this, she should be prepared for a discussion if the issue is raised by other SACU members.

Another possibility would be for Mozambique retain her own excise tax arrangements and not participate in the excise pool at all. However, this would result in a serious impediment to cross border trade in SACU, and would become especially burdensome if and when SACU were to reach agreement on harmonization of VATs. (See section 9.2.3 below.)

9.2.2 Trade and Tax Data

Estimating the fiscal implications of joining SACU and its effects on domestic consumers requires more detailed data on tax and tariff regimes and on trade flows than are generally available. The most recent data that are available on intra-SACU trade flows are for 1998-99. There are in addition some well-known discrepancies in bilateral trade statistics collected by the governments of Mozambique and South Africa.

This is a serious problem. Mozambique and SACU cannot engage in rational or responsible discussions about SACU membership without access to better data and without some means to

²² The new agreement was signed in October 2002 but could only be implemented after completion of the annexes. This was only completed in February 2004 when the South African Parliament ratified the agreement and the annexes. The new formula will come into effect in 2005/2006.

resolve outstanding data discrepancies. An early requirement of any such discussions, therefore, should be the establishment of a high level working group to ensure transparency and disclosure of relevant data among all parties, and to work at resolving data discrepancies. This would provide the basis for re-estimating the fiscal implications of different scenarios for Mozambique's membership in SACU.

9.2.3 VAT Harmonization

One of the great weaknesses of SACU is the lack of harmonization of VAT systems. This results in unnecessarily high transactions costs for intra-SACU trade, defeating the main purpose of the customs union, to facilitate trade among its members. The VAT is relatively new to SACU, and the revenue-sharing formula involves taxes that traditionally have been of greater importance. This might be a partial explanation for why this issue has not been addressed so far in SACU. However, customs duties and excises are both falling in importance and are being displaced by the VAT as a primary revenue source. The entry of a new member might be the appropriate occasion for opening discussions on the harmonization of members' VAT systems. If this could also be used as an opportunity to examine and improve Mozambique's own VAT administration, this would be an additional benefit for Mozambique.

9.2.4 Customs Valuation

Mozambique currently uses the internationally accepted system of customs valuation based on *cif* prices – i.e. values of goods delivered to the port of arrival in Mozambique. SACU uses *fob* prices as the basis for its customs valuation – i.e. it does not include any of the costs of freight or insurance in customs values. The SACU system reduces overall customs values and revenues for any given set of tariffs. In addition, however, it provides an incentive for importers to change sourcing patterns from less to more costly suppliers. If Mozambique were forced to adopt this valuation system as a condition for joining SACU, it would require a major overhaul of customs valuation procedures and would impose an additional economic cost due to the distortions the system would impose on import sourcing decisions.

9.2.5 Coordination and Independence of Trade Policy

By joining SACU Mozambique would no longer have independent control of its external tariff policy. On the other hand, it would gain some influence over the trade policy regimes of South Africa and other SACU members.

The new SACU administrative secretariat is still being established in Namibia, as is the 'SACU Tariff Board' which will consider all changes to the common external tariff, and the Customs Union Commission, made-up of senior SACU civil servants assigned to advise the SACU Council of Ministers.

In the absence of any experience yet it is too early to tell whether the new 'democratic' processes will result in any real devolution of power over trade policies from the key players in South Africa's Department of Trade and Industry and the former Board of Tariffs and Trade. As was observed earlier some members of the South African business community have expressed serious misgivings about the participatory procedures involving all members under the new SACU agreement.

Mozambique will still have certain powers over trade policy, such as the ability to give 'temporary' protection to infant industries and to grant duty rebates (whose fiscal burdens will be shared by all SACU members). Presumably she would remain free to import used cars, as are the BLNS, despite the virtual ban on such imports in South Africa. But whether and how much influence she will have over the core instruments of trade policy is still an open question

9.2.6 SADC and Bilateral Trade Agreements

Mozambique is a member of the SADC Trade Protocol and at the same time is negotiating bilateral FTAs with a number of SADC members. What would joining SACU mean for these arrangements?

There are no serious technical difficulties with the SADC Trade Protocol. However, there would be implications for certain key issues in SADC. As already mentioned, joining SACU would eliminate the issue of restrictive rules of origin in trade with SACU members.

For textiles and garments, the special arrangement negotiated for market access by the MMTZ countries would no longer be necessary for or applicable to Mozambique. Mozambique's garment makers would have quota-and rule of origin-free access to SACU. However, they would be faced with the cost-raising penalties of SACU import duties on textiles. In this regard they would be on a level playing field with respect to South African producers. In order to export garments outside of SACU, however, Mozambique would have to ensure a smooth and effective exemption or drawback program to eliminate the cost-raising effects of tariffs on textiles.

If Mozambique joined SACU, bilateral FTAs with any country outside of SACU would presumably be in violation of SACU's common external tariff. There should be little question, however, that membership in SACU would be far more helpful to Mozambique than any of these bilateral agreements, many of which would be formed for the benefit of a small number of selected stakeholders in Mozambique and or its bilateral partners.

A more general question is what SACU expansion would mean for the SADC Trade Protocol. Further expansion of SACU would reduce the importance of the Trade Protocol. The only way to increase the economic significance of the SADC Free Trade Area in these circumstances might be to transform it into a free trading arrangement with few restrictions on qualifying products. If SACU expansion were to lead to a common external tariff in SADC and an elimination of rules of origin, this would certainly be an important side-benefit of SACU.

9.3 A Preliminary Checklist for Joining SACU

The new SACU Agreement provides for the Admission of New Members in Article 6 subject to unanimous approval from the existing members. The procedure and criteria for admission are subject are not specified. Paragraph 3 simply states 'The Council shall determine the procedures and criteria for the admission of new members'. In light of the absence of precedent within SACU how can Mozambique prepare itself to apply to join SACU? Under the old 1969 Agreement Namibia acceded upon Independence from South Africa in 1990 by accepting identical treatment as Botswana, Lesotho and Swaziland. Prior to independence Namibia as South West Africa had been applying the SACU Common External Tariff and SACU Excise duties, consequently acceding to SACU as a full member did not require any domestic policy changes. This is not the case for Mozambique.

Mozambique has an independent external tariff and excise duties that are not equivalent to those prevailing in SACU. Should Mozambique decide to apply to join SACU it would have the option of offering to simply accept the prevailing SACU policies and thus avoid any negotiation. This approach would require consumers and producers in Mozambique to adjust to the new tariff and excise duty dispensations. Such an approach is not recommended, precedents from other regions provide support for a negotiated accession that seeks to address specific concerns by providing for a transition period and also exacts support from the existing members for the adjustment since all members are expected to gain from the enlargement. The multiple expansions of the European Union provide some illustrative examples of this approach.

The absence of a suitable regional precedent in conjunction with the new SACU Agreement and the rapidly changing international trading environment provides the context that Mozambique must consider when framing its approach to the existing five members of SACU. Mozambique has transformed its tariff structure over the past decade as tariffs have declined and the number of tariff bands reduced. The maximum tariff of 25 per cent applies to consumer goods, with basic goods and raw materials being zero and 2.5 per cent. The cascading structure results in continued anti-export bias. The SACU Common External Tariff has also been reduced substantially and further reductions are expected over the next decade as tariff decline on the selected pockets of import substituting industries.

Mozambique should prepare an offer to SACU that request that in all cases where the SACU CET exceeds the Mozambique external tariff then SACU reduces it tariffs. For those tariff lines where the SACU tariff is lower than the Mozambique tariff, Mozambique should be prepared to lower their tariffs. Further reductions in Mozambique tariffs will require the government to consult with stakeholders (including consumers) to identify any likely adjustment issues.

The Ministry of Finance will need to prepare schedules to estimate the likely revenue implications of moving to the SACU Revenue sharing formula and to prepare to amend the tariff and excise duty rates.

The move to the SACU revenue sharing formula will require improved trade data to ensure that Mozambique's payments are accurately reflected.

The new SACU structures require each member to 'establish specialized, independent and dedicated National Bodies or designate institutions which shall be entrusted with receiving requests for tariff changes and other related SACU issues. The National Bodies will carry out preliminary investigations and recommend any tariff changes necessary to the Tariff Board' (Article 14(1)). Mozambique maintains an independent tariff policy and has developed some capacity for assessing the implications of proposed tariff changes.

The checklist might include:

- Preparation of a proposed SACU Common External Tariff aimed at ensuring a reduction in anti-export bias and supporting Mozambique's increased participation in the global economy;
- Proposed phasing for moving from the Mozambique National Tariff to the SACU CET;
- Revenue sharing proposals aimed at ensuring revenue stability while reducing dependence on trade taxation;
- Proposals for significantly reducing the transaction costs of cross border trade. This will require increased cooperation with the South African Revenue Services;
- Preparation of policy papers addressing: industrial and agricultural issues, safeguard measures, competition policy, and dispute settlement;
- Administrative issues including recommendations for implementing and participating in new SACU structures; and
- Consultation within Mozambique to ensure the effective involvement of the private sector.

The majority of these administrative and policy issues need to be addressed by the Government of Mozambique independently of deciding whether to participate in SACU as they are national policy issues. Indeed it is important that Mozambique clearly identifies its national interests prior to engaging in any external trade negotiation. The ongoing Integrated Framework initiative will assist the process of augmenting trade policy capacity and provide support for ensuring national trade strategy is anchored to the core government objectives of increasing growth and reducing poverty.

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Appendix A: List of Contacts and Interviews

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