



## The SADC FTA Where Are We? What Next?

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## Purpose

- To explore progress of and future challenges to SADC integration
- To ask in particular:

*How can the SADC Trade Protocol and other regional integration initiatives help Member States meet their development needs?*

## Some Key Messages

- Trade is important; but trade policy is far more than trade negotiations
- For SADC the main benefits from trade will be from successful *global* integration
- Trade in SADC is costly; potential gains from remedying this are substantial
- Questions on timing of a SADC CU
- Focus on competitiveness; not just trade

## Background

- Enormous diversity in economic conditions of SADC Member States
- SADC is *economically small*; smaller than Turkey, Poland or Sweden
  - *much larger ASEAN has based growth on **global** competitiveness*
- SADC is *geographically large*; faces 'hard' and 'soft' logistical infrastructure challenges

## Recent SADC Experience (1)

- Trade Policies
  - Considerable MFN trade reform, but...
  - Many preferential initiatives (EU-SA TDCA, EPAs, AGOA, SACU, SADC...)

## Recent SADC Experience (2)

- Actual Trade
  - Some growth in intra-SADC trade since the 1980s, but much less recently
  - Trade asymmetric, with SA dominating; very little under SADC preferences; mostly final goods for regional markets; little indication of developing and participating in global production networks
  - SADC TP seems to have generated little new intra-SADC trade. Why? Slow implementation? Complex rules and tariffs (especially RoO)? Or deeper issues?

## Economics of Integration

## A 'Natural' Progression?

- Common view of 'natural' progression of regional integration (FTA to CU, etc) can be misleading
- Regional integration is multidimensional, and any strategy must be pragmatic and take account of unique economic circumstances, needs and constraints of all partners

## Transit Trade

- Transit and entrepôt trade are critical for many countries (e.g. roles of Singapore and Hong Kong in Asia)
  - *Especially true for many small and/or landlocked SADC Members – for both imports and exports*

## Tariff Reform

## Tariff Preferences

- Preferential reduction of import tariffs is a major focus of regional integration, in SADC and elsewhere
- Purpose: to reap the economic gains from trade creation among partners
  - *but be aware of possible unintended consequences...*

## (1) Trade Diversion - Imports

- Tariff preferences can divert imports from low cost to higher cost partner sources
- The dangers and costs are higher the greater are tariff rates on third country imports
- *Solution:* coordinate regional tariff reform with broader MFN-based reforms aimed at improving global competitiveness

## (2) Trade Diversion - Exports

- Preferences in partner markets might lead a country into sectors with no hope or incentive to become globally competitive
  - *can be beneficial in short run; but what happens when preferences erode?*
- *Solution:* use trade and other policies to encourage competition and increase competitiveness

## (3) Rules of Origin

- Necessary (to prevent trade deflection) but costly; 'origin' not simple with global production chains
- Most critical when external tariffs differ
- To minimize compliance costs and interference with trade:
  - *coordinate reform of preferential and MFN tariffs*
  - *keep rules simple; remember goal is only to ensure some meaningful manufacturing activity*

## (4) Misuse of Rules of Origin

- Rules of origin are often (mis)used:
  - *to subvert freeing of trade, for protection or to guard against lax customs enforcement in partner countries*
  - *to force local content to achieve industrial policy goals (often at high cost and usually with perverse results; reflects a misunderstanding of the nature of global value chains)*
- *Solution:* understand costs and use the most appropriate tools

## (5) Other Concerns

- Policy diversion and policy subversion
  - *attention diverted from more critical issues and constraints*
  - *policy-makers captured by the negotiating myth of gains and losses from forcing and making 'concessions'*
- Government revenue

## **Customs Unions**

### **Customs Union: Benefits**

- Reduced need for (and costs of) customs controls on intra-union trade
- No need for preferential rules of origin (with a common external tariff, no incentive for trade deflection)

### **Some CU Requirements**

- Agreement on common external tariff structure and strategy (incl. external trade negotiations)
- Agreement on sharing of customs tariff costs and revenues
- Trust in partners' customs administrations
- Agreed limits on other import restrictions (e.g. antidumping, infant industry protection)

### **Pragmatic Reform**

## 'Deep' Integration

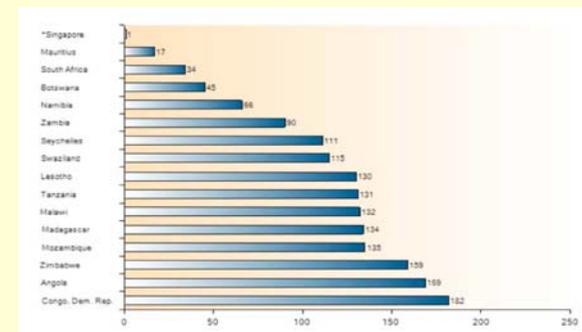
- Much can be done individually, cooperatively or collectively to strengthen integration with regional and global economies
  - *Not necessarily based on trade negotiations*
- *Goal:* raise productivity by reducing costs of trade, investment and doing business, promoting competition (e.g. logistics, standards, service regulation, fiscal reform and cooperation, competition law)

## Indonesia: An Example

- Early 1980s: looming macroeconomic crisis in a poor, highly resource-dependent country
- Identified tariffs, NTBs, customs and ports as major sources of high cost; attacked them in many ways over a sustained time period
- Abolished all special tax incentives
- Result: doubled share of ASEAN investment; high growth of incomes and employment; massive poverty reduction

## 'Competitiveness': Where Does SADC Stand?

## SADC Rankings 2010



## SADC Trade Rankings 2010

	Overall Rank	International Trading
Angola	169	171
Botswana	45	150
Congo, D.R.	182	165
Lesotho	130	143
Madagascar	134	111
Malawi	132	172
Mauritius	17	19
Mozambique	135	136
Namibia	66	151
Seychelles	111	93
South Africa	34	148
Swaziland	115	158
Tanzania	131	108
Zambia	90	157
Zimbabwe	159	167

## Summary of Rankings

- Wide diversity among SADC countries, but on average competitiveness rankings are low
  - *much room to improve*
  - *potential for collaboration with and learning from partners*
- Among the most problematic areas is cost of international trading – SADC and even SACU have ‘thick’ and costly borders

## Costs of Inefficient Trade

- Hard and soft barriers to logistical efficiency in SADC have very high costs
  - *it is estimated that a 20% reduction in time delays could increase African exports by 10% - worth far more than any conceivable import liberalization in Europe or N America*
  - *huge gains from improved and harmonized customs procedures, efficient transport corridors, better transport regulations, etc. (a focus of recent and future Hub work)*
  - *great scope for individual and cooperative action*

## Transit Trade

- Transit trade important regardless of other preferential agreements
- Differences in trade policies, lack of tax coordination, mistrust of partners’ customs enforcement, etc. have resulted, intentionally or not, in costly and disruptive transit arrangements in SACU and SADC
  - *harmful impacts on global competitiveness*

## **SADC Rules of Origin**

- Compliance costs high; potential barrier to new competition; costs paid by consumers
- To develop and be part of global value chains we need liberal rather than restrictive rules ('origin' an almost meaningless term)
  - *garments and textiles: EU, AGOA, denim clause*
  - *the problem of differing tariffs on inputs*
- Initial SADC rules simple, but hijacked by special interests and bad economics

## **Preferences & Competitiveness**

- Tariff preferences can create significant incentives, with no need to be or become competitive
  - *this is especially so in SADC where some external tariffs are high and partner country input tariffs low*
  - *creates the possibility of a rude awakening and/or support by small partners for continued protection by partners, hindering the transition to global competitiveness*

## **Infant Industries**

- SACU and SADC have infant industry exception clauses
- Economic case is weak
- Regional experience indicates infant industry protection is disruptive, costly to consumers and does not promote development of competitive industries

## **Questions and Lessons**

## Importance of SADC

- SADC can be of great value if used as a platform for improving global competitiveness by reducing costs of and barriers to trade (imports as important as exports), and cooperating on regulatory reform to improve productivity
- It can be unhelpful and even dangerous if it deflects attention from key issues and focuses attention on protected local and regional markets

## A SADC Customs Union?

- A CU would help to reduce border controls, incl. preferential rules of origin
- But...
  - *many important things can (should?) be done before a CU (transit, customs procedures...)*
  - *partners not ready to give up 'policy space' (infant industries, NTBs, etc.)*
  - *huge differences in tariff policy*
  - *diversity permits and encourages learning from partners*

## Is SACU a Model?

- World's oldest CU and includes 5 SADC members
- But...
  - *it is a CU more in name than in fact (border controls, infant industries, NTBs, etc.)*
  - *no joint decision-making on tariff policy*
  - *the revenue sharing formula is neither desirable nor replicable*
- SACU has lessons for SADC; but it is not a model

## Monitoring Performance

- Visionaries and trade negotiators – how to bridge the gap?
  - *Focus on competitiveness and not just trade*
  - *Monitor success in dealing with constraints to growth; not just compliance with agreements and growth of intra-regional trade*