The SADC Trade Protocol:
Impacts, Issues and the Way Ahead

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Executive Summary

The ultimate impacts of the SADC Trade Protocol will depend on how it is implemented and on how it is further developed and deepened by the Member States.

Limitations of the Protocol and Weaknesses in Implementation

The existing agreement is limited in a number of important respects. The pace of implementation of tariff reductions is slow. Only a very small share of the agreed reductions takes place in the first four years, and the degree of attainment of tariff-free trade is surprisingly small even after eight years. This is not serious if Member States remain committed to the Protocol, if timetables are not delayed and if final tariff targets are not weakened as implementation deadlines draw closer.

There are other more serious concerns about the degree of intra-SADC trade liberalization that will be achieved. While there are provisions for the elimination of non-tariff trade barriers, virtually nothing has been done yet to achieve this goal. A number of goods and sectors are excluded from the agreement. There is explicit provision in the Protocol for continuation of infant industry protection. Anti-dumping and safeguard measures are permitted with no limitations beyond those contained in the WTO rules. Rules of origin in many sectors are highly restrictive and explicitly designed to protect rather than liberalize regional industries. This will raise production costs and reduce international competitiveness of affected industries, many of which are central to regional development. There is little evidence of progress on further deepening of trade liberalization and facilitation

The negotiating process itself has encouraged protectionist attitudes among participants. The language and behavior of many participants in the negotiating process seems to be based on the view that the benefits of trade liberalization by any Member State are enjoyed principally by other members, and that the “costs” of granting market access are borne primarily by the liberalizing country. As result, negotiators feel it is their job to resist making concessions that reduce barriers to imports in their own markets.

This interpretation of the effects of trade liberalization is contrary to economic theory and to evidence that has accumulated around the globe over the past two hundred years.

There has been excessive concern about revenue effects of tariff reductions. Revenue losses are not an economic cost. They will be more than offset by gains to consumers and industrial users of imported goods. Furthermore, estimated revenue losses are small and will not be felt for many years. Any such losses will easily be made up through normal economic growth. Most Member States are already engaged in tax reforms that will reduce dependence on inherently distortionary import duties, in favor of more general and less costly income, sales and value-added taxes.

The Way Ahead

The Protocol can make a major contribution to sustainable and equitable development of Member States. For this potential to be realized, there must be recommitment of SADC members to implementing, deepening and extending measures agreed under the current Protocol. This must be accompanied by equally strong initiatives in more general MFN-based trade liberalization and domestic market reforms. Such policies are the responsibility of the individual Member States. This is appropriate, since the principal beneficiaries of SADC and of the complementary reforms will be the citizens of these Member States.

The entire SADC market is very small – smaller than Turkey. An inward-looking strategy based solely on preferential access to this market is doomed to failure. To achieve sustainable and equitable development of the Member States, the SADC Trade Protocol must be part of a broader strategy of integration with the global economy to improve regional competitiveness. This outward looking approach to regional integration is generally described as “open regionalism.”

Failure to embrace open regionalism will pose several dangers. At best, it will make SADC irrelevant in the development plans and prospects of the Member States. At worst, if the Member States embark on an inward-looking strategy for regional integration, they may be drawn into an economic dead-end that will seriously impede the development prospects of their citizens.

Many of the elements of an outward-oriented strategy are already foreseen in the Trade Protocol. Harmonization of Customs and cooperation in improving other parts of the machinery and regulatory framework of the trade infrastructure in the region, for instance, can play a major role in achieving the goals of international integration of the SADC countries. Removal of other non tariff trade barriers will have similar effects.

The Africa Growth and Opportunity Act (AGOA) comes at a fortuitous time for SADC. By providing broad, secure and preferential access to the US market for eight years, it sends a signal about the benefits of global integration and provides strong incentives and opportunities to improve the region’s competitiveness in the world market. There are already encouraging signs of the response of foreign and domestic investors in accelerating industrial restructuring processes in the textiles and garments sectors in a number of SADC countries. Policies to deepen SADC integration will give all Member States a major advantage in capitalizing on the opportunities provided by AGOA.

Action Plan

In the immediate short run, it is important at least for the Member States to sign on officially to implementation of the Protocol by submitting their Instruments of Implementation. It is also necessary to undertake a thorough review of all country offers to ensure that they meet with the terms and conditions agreed in the TNF process. A surprising amount of misunderstanding of and non-compliance with these conditions is apparent in the documentation available at this time.

It is important as well to develop an agenda and begin to move on all the non-tariff trade issues covered in the Protocol. Identification and cataloging of existing NTBs and QRs is a necessary first step. This includes not only a listing of such measures, but also development of processes for changing them and of safeguards against their use as instruments of hidden protection. In this exercise, NTBs must be interpreted broadly to include all policy measures affecting economic incentives, especially those that unnecessarily raise costs and otherwise cause harm to the investment environment.

A further step must be to find ways of prioritizing reforms by determining the beneficial and harmful effects of existing measures. This requires quantifying their effects on economic incentives facing investors, producers and other economic actors.

The scheduled review of the Trade Protocol in 2004 will be an important landmark for judging progress to date and for considering changes in the strategy and implementation schedule. This might be an appropriate time to review not only tariff reduction schedules and progress in achieving other trade facilitation goals, but also to reexamine the rules of origin negotiated in the initial TNF process. The magnitude, incidence and economic benefits and costs of the often sizable economic incentives provided by these rules have scarcely been considered in the negotiation to date.

Other issues requiring consideration as part of the 2004 review include progress in tax reform to lessen the budgetary impacts of revenue losses that will arise from tariff reductions, and development of dispute settlement procedures.

A more ambitious review process at this time might also include revising or even removing some of the measures in the Protocol for dealing with anti-dumping and safeguard actions, and for providing special protection for infant industries. Consistency with the WTO is inadequate to ensure that existing provisions in these areas do not become new instruments of protection that result in costly divergences from the SADC goals of free trade and of sustainable, equitable development.

It is equally important that the Member States look “beyond SADC”. The most important issue in this regard is a continuation and deepening of the commitment of Member States to the MFN-based trade liberalization process and to the continuation of market-based economic reforms. Rapid implementation of MFN-based reforms is necessary to maximize the advantages of regional integration, and to avoid costly trade diversion and other dangers of inward-looking regionalization.

The SADC Trade Protocol:
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1. Introduction

The SADC Trade Protocol came into effect on September 1, 2000. The negotiation process and the implementation of the Protocol have been met by a wide variety of responses, ranging from hopes and fears to ignorance and apathy.

The purpose of this paper is to provide a preliminary assessment of likely impacts of the Protocol and to review some of the more important issues in its implementation and further development. This requires an examination not only of the Protocol itself, but also of its relationship to the broader policy environments in the Member States and in the wider global community.

While the terms of the Trade Protocol and many issues related to its implementation have already been decided, there is still considerable uncertainty about strategies for its deepening and further development. With this in mind, a general review of the Protocol is scheduled to take place in 2004. The preliminary assessment presented in this report is intended as a tool to assist in future discussions and in developing strategies for maximizing the potential benefits of regional integration in SADC.

This assessment concludes that the Protocol can make a major contribution to sustainable and equitable development of its Member States. For this potential to be realized, implementation of the Protocol must be accompanied by equally strong initiatives in more general MFN-based trade liberalization and domestic market reforms. Such policies are the responsibility of the individual Member States. This is appropriate, since the principal beneficiaries of SADC and of the complementary reforms will be the citizens of these Member States.

The vision of integration for the region must be directed outward at the global economy, not just inward at the markets of the Member States. Regional integration in SADC should be seen as a means for improving the competitiveness of the region in the global economy. This is what is generally described as “open regionalism”, and it is the appropriate model for SADC. The individual Member States and even SADC as a whole are far too small to achieve prosperity through go-it-alone development policies.

Failure to embrace open regionalism will pose several dangers. At best, it will make SADC irrelevant in the development plans and prospects of the Member States. At worst, if the Member States embark on an inward-looking strategy for regional integration, they may be drawn into an economic dead-end that will seriously impede their development prospects.

The SADC forums and processes can play an important role in encouraging and facilitating a process of fruitful regional and global integration.

2. An Overview of the Trade Protocol

The basic Trade Protocol document is relatively short. It provides the framework for an agreement among the Member States to achieve a substantial liberalization of trade among themselves by 2000, with (almost) complete elimination of tariffs on intra-SADC trade by 2012. The main instrument of trade liberalization is to be the elimination of customs tariffs and non-tariff barriers (NTBs) on the vast majority of intra-SADC trade. In addition, however, there are measures related to a number of other forms of trade facilitation, including customs cooperation, promotion and facilitation of cross-border investment, liberalization of trade in services, and facilitation of transit trade. To date, it is liberalization of trade in goods, and especially the phasing down of import duties on intra-SADC trade, that has been the primary focus of attention in the Trade Negotiation Forum (TNF) process.

2.1 Limitations and Exceptions

As in almost all similar arrangements in the world, the terms outlined in the Trade Protocol do not represent an agreement to establish completely free trade among the Member States. What it does is to substantially liberalize trade within the region and at the same time to define the extent of and the limits on free trade. The limitations on and exceptions to free trade under the Protocol will play a key role in shaping its economic impacts. We focus here on a few of the key limitations on the extent of trade liberalization contained in the Protocol.

Rules of Origin

The Protocol sets out criteria that must be met for goods to be certified as originating in member countries and hence to qualify for preferential tariff treatment under the Protocol. There is no intention to harmonize members' external tariff rates. If these differences are substantial, there will be an incentive for importers to engage in "tariff jumping" – i.e. to import goods into low tariff countries and re-export them to other (higher tariff) SADC members under the preferential terms allowed by the Protocol. It is to avoid such tariff jumping that preferential trade agreements (PTAs) find it necessary to develop rules of origin (ROO).

The rules of origin in the Trade Protocol signed in Maseru in August 1996 are relatively simple, requiring simply that one of the following three criteria be satisfied:

- the goods have been *wholly produced* in the exporting member state, or
- the goods have undergone substantial transformation in their production and
  - imported materials account for no more than 60 percent of those used in their production, or
  - the value added resulting from their production accounts for at least 35 percent of factory cost, or
- there is a change of tariff heading resulting from the production or processing of imported (non-originating) materials.

In discussions leading to ratification of the Trade Protocol, the ROO became a source of considerable contention and revealed significant differences of opinion about the SADC trade liberalization strategy.

The result of the negotiations was a substantial tightening of the ROO, with product-specific ROO drawn up for a large number of significant manufactures including electronics and electrical goods, textiles and garments, and motor vehicles. This was done in order both to achieve greater "clarity" of the regulations and to achieve industrial development goals.

It is the use of ROO as an instrument of industrial development, however, that is of greatest importance from a trade policy perspective, and which throws considerable light on differences in interpretation of "free trade" in SADC. This is discussed in sections 2.4 and 4.4 below.

Non Tariff Barriers to Trade

Articles 6 and 7 of the Trade Protocol provide for the elimination of non-tariff trade barriers (NTBs) and for the phasing out of quantitative restrictions (QRs) on imports (and exports) originating in (destined for) other SADC Member States. The NTB clause (Article 6) calls for the elimination of all existing NTBs and for refraining from the imposition of any new NTBs on intra-SADC trade.

The elimination of quantitative import restrictions (see Article 7) is slightly more qualified. No new restrictions must be imposed, and existing restrictions are to be phased out according to timetables and arrangements agreed in the TNF process. However, provision is also made in Article 7 for members to apply quotas on SADC originating imports, as long as the tariffs under such quota systems are more favorable than the preferential rates agreed under the Protocol.

Article 8 provides for the elimination of QRs on exports, on similar terms to the elimination of import QRs.

Article 9 allows for the continued imposition of quantitative import and export restrictions (QRs), for a number of reasons including the protection of public morals and maintenance of public order, protection of human, animal or plant life or health (i.e. for sanitary and phytosanitary reasons), and for protection of national treasures and cultural property.

Sanitary and phytosanitary issues are given further treatment in Article 16, which provides that SPS measures should be based on international standards, should be harmonized, and should be guided by the WTO Agreement on the Application of Sanitary and Phytosanitary Measures.

In spite of the qualifications provided in Articles 7 and 9, the Protocol provides for an ambitious and important program of elimination of NTBs and QRs. This program is to be undertaken in large part through the TNF process. Relative to the amount of attention that has been paid to tariff reduction schedules and to rules of origin, however, very little effort has been put into documenting, let alone designing a program for elimination of NTBs and QRs. This will be an important part of the agenda for future implementation of the Trade Protocol.

Excluded Goods

Some of the Articles already alluded to, as well as a more general provision related to national security, allow for the exclusion of certain goods and sectors from the general trade liberalization provisions of the Protocol. Under these provisions, each country has excluded certain goods from its tariff reduction offers. In addition, the TNF process has resulted in special provisions for a number of sectors. The special measures are exceptions to the general provisions for tariff reductions and elimination of NTBs and QRs under the Protocol.

In many cases, however, it appears that goods have been excluded for reasons other than those permitted by the Protocol. In particular many exclusions seem to be based on the need to satisfy vested domestic interests that are unwilling to have their sectors opened to international competition, or else because of alleged revenue needs of member country governments fearing loss of tariff revenues due to trade liberalization.

The two most important sectors, other than textiles and garments, that have been singled out for special treatment under the Protocol are sugar and motor vehicles. The agreement on sugar is a special one in which major producing countries have negotiated quota-limited access to the South African market at highly preferential prices (relative to world market prices in the free market). Although no agreement has been reached yet, it appears that motor vehicles will be subject to special provisions guided by South Africa's complex incentive scheme to protect domestic producers, encourage high levels of domestic content, and provide special incentives for exports of certain motor vehicle products.

Wheat flour is another sector in which agreement has not yet been reached. However, it appears likely that this sector will be subject to arrangements to provide special and very high rates of effective protection to millers in most member countries. This will be achieved through a combination of high import barriers and strict rules of origin on wheat flour.

The cases of sugar and wheat flour are simple reflections of resistance to freeing of markets and as such are clear violations of the spirit, if not the letter of the Protocol. The special treatment of textiles and garments and of motor vehicles is more complex. While appearing to violate much of the spirit of trade liberalization, this treatment is arguably consistent with another stated goal of the Protocol, as stated in paragraph 2 of Article 4:

> "The process should be accompanied by an industrialization strategy to improve the competitiveness of the Member States."

While some members regard trade liberalization and facilitation as being at the heart of an industrial and more general development strategy to secure sustainable and equitable development of all member states, others regard continued use of special protection and incentive measures as necessary to secure their countries' development objectives. The first view sees no conflict between trade liberalization and the goals of industrial policy. This makes the above-quoted clause unnecessary or at least quite innocuous. The second view gives rise to fundamental conflicts between the goals of trade liberalization and of industrialization and hence places great reliance on the industrialization strategy clause, as a counterweight to the other provisions for trade liberalization.

This issue will be discussed further below in the context of the Protocol's rules of origin.

While not technically excluded from the measures to secure trade liberalization, trade in services has not yet received much attention in the TNF process. This is an area that will deserve much greater attention in future discussions of implementation of the Protocol, not in the least because of the strong complementarities between trade and efficient service provision in areas such as financial services, telecommunications, transport and other trade services.

Anti-Dumping, Safeguards and Infant Industries

In accordance with other international trade agreements, and especially the provisions of the World Trade Organization (WTO), the Protocol provides for suspension of trade liberalizing measures in order to protect domestic producers from harmful effects of dumping by other SADC exporters (Article 18) and to provide safeguards against damaging surges of imports into the domestic market (Article 20).

While such measures are provided for under the WTO, there is increasing recognition that they can be and often are used as a form of disguised protection, and that standard techniques for determining the need for anti-dumping and safeguard measures are heavily biased in favor of narrow producer interests and against the broader national interests of users and consumers of importable goods. There is also a growing recognition that true dumping, in the economic sense, is just one type of anti-competitive behavior that should be dealt with as part of broader domestic policies to ensure competition and smooth and efficient working of domestic markets.

In the SADC context, there is no doubt that the claim of "dumping" is often used by producers seeking continued protection of non-competitive domestic industries. Some SADC members have been among the heaviest users of WTO anti-dumping provisions in recent years, and this has been a great hindrance to the achievement of many of the promised economic benefits of international economic integration. Furthermore, a number of the smaller SADC countries are concerned about anti-competitive behavior of industries in larger member countries that is reinforced by investment and import policies of their national governments, as well as by restrictive rules of origin.

There is also concern that already weak WTO criteria for anti-dumping and safeguard measures will be weakened much further when implemented in the SADC context.

Another potentially dangerous exception provided by the Protocol is found in Article 21, which allows for the possibility of temporary measures to promote infant industries by suspending trade liberalization obligations under the Protocol. Such measures must be approved by the Committee of Ministers responsible for trade matters (CMT) and are supposed to be "subject to WTO provisions".

Given all the other measures provided by the Protocol, especially with respect to transitional provisions (see below), dumping, safeguards and rules of origin, the infant industry provision is a potentially dangerous, if not merely redundant, deviation from the free trade objectives of the agreement. This has not received much detailed attention in the TNF process, and it is still too early to determine how important it will be in practice.

2.2 Transitional Arrangements

Trade liberalization under the Protocol is not to be achieved immediately; it is to be phased in gradually. Furthermore, during the period of transition to free trade, different rules apply to different members, generally according to their levels of economic development. The coexistence of both more and less developed members within SACU presents some special problems because of its common external tariff.

The offers group traded goods into three main categories – the A, B and C lists. The A list comprises goods which already face low or zero tariffs, which will be reduced to zero almost immediately. The B list is goods whose tariff rates will be phased down to zero within 8 years of implementation of the Protocol. The C list is goods of a "sensitive" nature, which countries will be permitted to protect for an additional 4 years. There is, in addition, a small list of goods that are excluded from trade liberalization under the Protocol. Excluded and sensitive products together are not permitted to account for more than 15 percent of a country's SADC imports in the case of non-SACU countries and for no more than 3 percent for SACU.

In recognition of the special situation of South Africa, with both its larger size and higher level of development in SADC, it has been agreed that the non-SACU members of SADC may make differential offers to South Africa and to other members. The underlying principle of differentiation is that the speed of trade liberalization will be permitted to be slower with respect to imports from South Africa. The rationale is to provide the less developed members a longer period to adjust to competition from South African producers than from others. The common SACU external tariff arising from this customs union makes the differentiated offer option unavailable to the BLNS members of SACU.

Fear of transshipment of South African goods through the BLNS countries apparently made the non-SACU countries reluctant to grant accelerated tariff reductions on imports of goods from BLNS countries that might be produced in South Africa as well. As a result, a number of the BLNS countries feel they have gained very little from the provision for differentiated tariff offers to South Africa and to the remaining SADC members.

There are similar differences in transitional arrangements between more and less developed members with respect to phasing in of rules of origin. Under this provision, all of the non-SACU members other than Mauritius and Zimbabwe, the so-called MMTZ countries, are granted a period of five years during which their textile exports need only satisfy a single rather than double transformation rule to qualify for preferential treatment on exports to South Africa. However, the amount of trade that will benefit from this special provision will be restricted by South African import quotas. Any trade in excess of these quotas will be granted preferential treatment only if the goods meet the much stricter double transformation rule. Otherwise, they will face South Africa's MFN tariff rates.

2.3 Characterization of Offers

Despite the official implementation date of September 1, as of late February 2001, only five members, Mauritius and four members of SACU (Botswana, Lesotho, South Africa and Swaziland) have submitted their Instruments of Implementation of the Trade Protocol. Three other members of SADC (Angola, DRC and Seychelles) have not joined the Protocol and one of the other members (Zambia) has not yet ratified it. A number of countries have not yet submitted final tariff offers. Many of those that have been submitted, in preliminary or final form, are inconsistent with the terms agreed under the Protocol, in both form and substance.

Despite these differences and the lack of complete clarity regarding the terms of all the offers, it is possible to characterize some of the key features of the tariff liberalization commitments that will underlie implementation of the Protocol.

Back-Loading

A general perception has emerged that almost all the offers are significantly back-loaded; that is, a large part of most countries' trade liberalization is postponed until the late stages of implementation of the Protocol. Most of the products being liberalized in the early years are those that already have very low MFN rates and/or have very little intra-SADC trade.

A simple measure of the pace of tariff liberalization is the proportion of the planned reduction in a country's trade-weighted average tariff rate achieved at various points in the liberalization process. Tariffs on intra-SADC trade of non-sensitive products (i.e. those on each member country's A and B lists), are to fall to zero within eight years. This is clearly one important landmark in the liberalization process. To give a sense of the pace of liberalization, Table 1 shows the extent to which each country's trade weighted tariff rate on intra-SADC imports will have progressed towards zero by the end of four years, and Table 2 shows progress at the end of eight years.[1] For the non-SACU countries, the calculation is shown for the offers both to South Africa (RSA) and to the rest of SADC.

Table 1 shows that, in the case of SACU, 47 percent – almost one-half – of its liberalization of SADC imports is offered in the first four years. Zimbabwe and Zambia, with 39 and 37 percent of their tariff reductions provided in the first four years, are next to South Africa in terms of speed of trade liberalization with non-RSA SADC. On the other hand, the Malawi, Mauritius and Mozambique commitments to non-RSA SADC are more significantly back-loaded, offering only 12, 7 and 9 percent of their tariff liberalization in the first four years.

Table 2 shows the achievements at the end of eight years. By the measure used here, SACU is once again the speediest at achieving SADC free trade, reaching 99.5 percent of complete free trade by this time. Tanzania's commitment is second speediest, with a plan to achieve 88 percent of the free trade target on non-RSA SADC imports. Mauritius, Mozambique and Tanzania are next speediest, achieving 73, 76 and 77 percent of free trade on non-RSA SADC imports by the end of eight years. What is notable, however, is that these three countries still plan to have about 25 percent of the free trade goal on non-RSA SADC imports unachieved even at the end of eight years. Malawi and Zimbabwe are slower still, with 40 and 38 percent respectively of their free trade targets on non-RSA SADC imports still unachieved eight years after implementation of the Protocol.

The data in Tables 1 and 2 give clear support to the perception of significant back-loading of tariff reduction schedules offered by most member countries.

Another indicator of back-loading is the extent of use of the C and E lists – goods whose tariff reductions are to be phased in over 12 rather than 8 years, and those excluded from the goal of achieving zero tariffs under the Protocol, respectively. The agreement is that such goods will not constitute more than 15 percent of total SADC imports in any country. This

[1] If a country's trade weighted tariff rate is 20% at the beginning of the liberalization process, and it falls to 10% after four years, we say that the country has achieved 50% of its planned tariff reductions by the end of four years ((20-10)/20 = 50%).

ceiling would suggest that these products are not a major hindrance to successful implementation of Protocol.

However, it should be noted that many of the goods on the C and E lists face high tariff and in some cases non-tariff import barriers, and it is for this reason that trade levels are low. A low level of imports under current tariff levels is not necessarily an indication that such goods are not *potentially* important in SADC trade. Furthermore, as Table 2 indicates, a combination of high tariff rates and significant trade flows on at least some sensitive or excluded products has ensured significant deviations from the goal of free trade even after the initial eight years of implementation of the Protocol.

Table 1
Proportion of Liberalization Achieved in First Four Years (%)

	Offer to RSA	Offer to Rest of SADC
SACU	NA	46.8
Malawi	1.0	12.0
Mauritius	26.4	7.4
Mozambique	9.2	8.7
Tanzania	8.3	31.4
Zambia	18.5	38.7
Zimbabwe	18.6	37.4

Source: Derived from SADC Trade Protocol Project 2001

Table 2
Proportion of Liberalization Achieved in First Eight Years (%)

	Offer to RSA	Offer to Rest of SADC
SACU	NA	99.5
Malawi	70.4	60.0
Mauritius	70.4	72.5
Mozambique	62.7	76.3
Tanzania	87.3	87.9
Zambia	62.7	76.9
Zimbabwe	68.3	57.7

Source: Derived from SADC Trade Protocol Project 2001

Differentiation of Offers Between RSA and the Rest of SADC

In order to give lesser developed members of SADC more time to adjust to trade liberalization under the Protocol it was agreed that South Africa (and therefore SACU) would open its markets more quickly than other members, and that non-SACU members would open their markets to imports from South Africa less quickly than from other members.

Table 1 shows that there has been mixed experience in attaining these principles of tariff differentiation. First, as has been observed already, both Zambia and Zimbabwe have agreed to open their markets to non-RSA members almost as quickly as has South Africa. At the end of four years, Zambia and Zimbabwe will have completed 37 and 39 percent respectively of their liberalization of non-RSA SADC imports, compared with South Africa's achievement of 47 percent of this target.

Second, the Mauritius and Mozambique offers provide for more rapid liberalization of trade with South Africa than with the rest of SADC. Mauritius is the most notable in this regard, offering to achieve 26 percent of its liberalization of imports from South Africa in the first four years of the Protocol, and only 7 percent of its liberalization of these imports from the rest of SADC (see Table 1). At the end of eight years, Malawi and Zimbabwe will have achieved greater liberalization of their imports from South Africa than from the rest of SADC (see Table 2). In both these cases, they will have provided approximately 10 percentage points greater liberalization of RSA imports than non-RSA imports from SADC.

2.4 Immediate Issues of Strategy and Implementation

There are several key strategic and implementation issues that have captured most of the attention of observers of the negotiating process.

Preparedness of Stakeholders

There is wide variation among SADC members in the preparedness of public and private sectors for implementation of the Protocol. In some cases, the private sectors and relevant parts of the government bureaucracies have been active participants in the TNF process, or at least have been kept well informed of the results of negotiations. These countries are relatively well positioned to respond to the changes in regulations and tariff regimes that will accompany implementation of the Protocol. In other countries, implementation will be poor, private sectors and bureaucracies will be ill prepared to respond to the changed environment, and this is likely to be a source of resistance to deals made under the Protocol.

Slow Pace of Phase-In of the Protocol

There is no doubt that tariff reduction schedules are significantly back-loaded. Not a single member plans to achieve 50 percent of its planned tariff reductions in the first four years of implementation of the Protocol. After eight years, a number of countries will have achieved only 75 percent or less of the target of intra-SADC tariff-free trade (as measured by reductions in trade weighted average tariff rates applicable to intra-SADC trade).

Nevertheless, concerns about the implications of this back-loading for the long term success of the Protocol are easily exaggerated. Experience in other successful regional PTAs suggests that a) no matter how long the transition period, the end date comes more quickly than people anticipate; b) providing a clearly defined phase-in period is a good way to minimize unnecessary disruption of markets and to give investors and producers a period over which to plan the transition to the new incentive environment; c) constituencies for speedier liberalization can make their voices heard, and negotiate for speeding up the process.

However, there always remains the danger that a long transition period can be used to rally the forces opposed to liberalization, and to delay implementation of the original transition schedule.

If the phase-in schedule is adhered to, then a long transition is of little concern, and can be an asset in terms of its allowance for a reasonable period of adjustment. Of greater importance than the length of the transition period, is a firm commitment by all members to abide strictly to the agreed implementation schedule. The recent experience of the ASEAN Free Trade Area (AFTA) indicates the possible value of some mechanism that either limits access to preferential tariff rates of members depending on whether they meet their agreed commitments, or imposes some other sanctions on members that do not fully meet their commitments.

Restrictive Rules of Origin

As indicated earlier, the rules of origin became a source of considerable contention and revealed significant differences of opinion about the SADC's strategy for free trade. The result of the negotiations was a substantial tightening of the original rules of origin, with specific rules drawn up for a large number of significant manufacturing products including electronics and electrical goods, textiles and garments, and motor vehicles. This was done in order both to achieve greater "clarity" of the regulations and to achieve industrial development goals.

It is the use of rules of origin as instruments of industrial development, however, that is of greatest importance from a trade policy perspective, and that throws considerable light on differences in interpretation of free trade in SADC.

Many industries of interest to developing countries are now characterized by globalization of production for the world market. For industries such as garments and textiles, footwear, and electronics, production is dispersed across the globe according to differential costs at each stage of the process. This applies to raw materials, capital goods, intermediate inputs and assembly and sub-assembly processes.

The stages of the production process represented in any location depend on the availability and costs of the necessary locally sourced inputs, especially labor and local services. To participate at all, of course, requires smoothly functioning and relatively low cost trading infrastructure, including ports, customs services and domestic transport utilities. High costs and/or low reliability of these basic trading services result in loss of production opportunities, and lower returns to the participating domestic factors of production.

For many developing countries, the usual entry point is in the assembly of final products or particular sub-components, based on availability of low cost, relatively unskilled labor. The most frequently observed examples are in the garments and textiles, electronics and footwear industries.

If production is aimed primarily at the protected domestic market, the process usually starts and ends with simple domestic assembly of final consumer products. However, if international markets are the targets of the investors, the picture is usually quite different.

First, the scale of operation for export-oriented production is generally much larger than would be the case of production aimed only at a protected domestic market. Most domestic markets and many regional markets are not large enough to support internationally competitive production plants. This is certainly true of SADC (see further discussion in section 5.1 below).

Second, the assembled products in export-oriented production are just as likely to be components or intermediate products for use in production processes elsewhere, rather than final consumer goods. It is generally the goods at the most labor-intensive part of the production chain that are the first to be produced or assembled in developing country locations. In the case of garments and textiles, this often applies to final consumer products, where stitching and assembly are highly labor-intensive. However, in the case of electronics, the components and sub-components sectors can often be the most labor-intensive.

Third, in the case of successful and sustainable export-oriented production, the investment process is dynamic and continues to grow. Over time, expertise and skills in labor-intensive assembly improve. This is generally accompanied by a variety of scale and other factors that make it profitable to broaden the range of related products produced locally. Backward and forward linkages expand with the development of local supporting industries. As the process continues, the location might even lose its comparative advantage in the labor-intensive activities that characterized the initial investments.

The development and evolution of such industrial "clusters" is an ongoing process in successful export-oriented investments. The process has been observed in electronics, footwear, and garments and textiles in many parts of the world. In east and southeast Asia, this has become known as the "flying geese" pattern of industrial development. A similar process is now underway in the garments and textiles industry in parts of southern Africa. Mauritius some time ago became an attractive center for investment in export-oriented garment production, especially in the form of labor-intensive knitwear and in cutting and sewing garments from imported cloth. From the beginning, investments in these activities were export-oriented and aimed at world markets.

Success of these export-oriented investments, together with accompanying experience and skills development, have led to rising wages and shifting patterns of Mauritian comparative advantage. Mauritius is now facing declining comparative advantage in labor-intensive garment production. At the same time, expertise and competitiveness are growing in textiles and in supervision and coordination of garment production in more labor abundant regional locations. Mauritian investors are now involved in garment production in Madagascar and a number of SADC countries, including Botswana, Lesotho, Malawi and South Africa. They are also involved in logistics and in the development, coordination and sourcing of textiles from Mauritius, South Africa and international markets. Mauritian workers are shifting towards more skill-intensive, higher wage activities, in other sectors as well as the skill-intensive parts of the garments and textiles sector.[2]

The changing patterns of production, trade and investment in this sector are similar to and just as dynamic as those seen in east and southeast Asia over the past two or three decades.

The export-oriented flying geese model of east and southeast Asia (and Mauritius) is quite different from the inward-oriented model being pursued through vigorous application of strict

[2] This process presents some important domestic policy challenges in Mauritius. A number of sectors of the economy remain heavily protected from external competition. Some parts are heavily dependent on imported labor. The economy continues to be shaped by special arrangements for the sugar sector, without which it would be far less competitive internationally. The longer run challenges for Mauritius in making the transitions discussed here relate to both a continuation of deregulation and reduced dependence on protection, and programs to enhance human skills and the strength and flexibility of its market economy.

rules of origin under the SADC Trade Protocol. The SADC approach is superficially similar to the flying geese model inasmuch as strict rules of origin are meant to encourage the evolution and development of supporting industries in a number of manufacturing sectors, including garments and textiles, motor vehicles, and electronics.

The key difference, however, is in the extent of outward orientation. The rules of origin are a requirement that must be met for preferential access of finished goods to the protected SADC market. As has already been noted, the SADC market is too small to support globally competitive scales of production in most, if not all, upstream or downstream industrial sectors. (See also the discussion of market size in section 5.1 below.)

The danger for the lesser developed members of SADC is that by orienting themselves to the ROO-bound, inward-looking SADC development model, they will be doomed to perpetual lack of international competitiveness and to correspondingly low incomes and development prospects.

If, on the other hand, they wish to follow the east and southeast Asian model, SADC must use inputs from lowest cost international sources. Under the SADC rules of origin this will deprive them of access to the SADC market. Given the small size of the SADC market, this will be of little consequence. But it will mean that SADC markets will play no role in such countries' long-term development scheme. In other words, the SADC rules of origin carry the danger of making SADC irrelevant to successful development of the region's less developed economies.

Many of the dangers of the rule-of-origin-based, forced industrialization model can be avoided if the SADC Member States are sufficiently outward-oriented in their trade relations with the rest of the world. If the Member States were to pursue vigorous programs of MFN-based trade liberalization in parallel with and at a similar speed to their preferential tariff reductions and other trade facilitation measures under the Protocol, international competition would reduce the dangers of the development of small-scale, uncompetitive supporting industries. Access to inputs and raw materials on internationally competitive terms would permit SADC investors to gain access to world markets, and not become reliant on small regional markets. A virtuous cycle could be created in which the region becomes a dynamic and competitive part of the global economy.

The choice between inward and outward-looking regional integration will be critical to the success of the Trade Protocol in promoting sustainable and equitable development of the Member States. This is a decision to be made by SADC members themselves. However, the special preferential market access opportunities to the US market under the Africa Growth and Opportunities Act (AGOA) might be just the fortuitous external spur necessary to encourage SADC to take the outward-looking regional integration option. This will be discussed further below.

2.5 Broader Issues

In addition to these strategic and specific implementation issues, there are several broader concerns related to the ultimate achievements of the trade liberalization program under the Protocol.

Protectionist Bias in the Negotiating Process

A major concern of a very general nature is that the entire negotiation process has been depicted and conducted in a language and in a manner that is inherently protectionist. Tariff reductions and NTB and QR removals are referred to as "concessions" and as "obligations" of Member States. Less developed members are granted the "privilege" of being permitted to implement trade liberalization measures at a slower pace than more developed members.

The language and the behavior of many of the negotiators seems to be based on the understanding that the benefits of trade liberalization by any member country are enjoyed principally by other members, and the "costs" of granting market access are borne primarily by the liberalizing country. As a result, negotiators feel it is their job to resist making concessions that reduce barriers to imports in their own markets.

This interpretation of the effects of trade liberalization is contrary to economic theory and empirical evidence that has accumulated around the globe over the past two hundred years.

While there might be some political necessity for viewing trade liberalization in this distorted manner, there is a real danger that negotiators and the stakeholders in the participating countries come to believe this protectionist rhetoric and conduct themselves accordingly. Some negotiators, for instance, appear to be proud to have secured agreement on preferential SADC tariff rates that exceed their WTO MFN commitments.

This issue is discussed further below in relation to lessons from international experience.

Commitment of Members to Implementation

A closely related issue is the commitment of the Member States to implementation of the Trade Protocol. The TNF process has dragged on for a long period of time. The target implementation date had to be postponed several times. As mentioned earlier, by late February only five countries have submitted their Instruments of Implementation. Most of the offers submitted to the TNF are very heavily back-loaded. A number of them do not yet meet the deadlines agreed among the Member States. The strictness of the rules of origin in many sectors suggests a real reluctance to permit trade liberalization to bring significant foreign competition to bear on domestic markets.

What does this mean? Does it reflect legitimate differences of opinion about the appropriate pace of liberalization? Does it represent the result of compromises among competing domestic interests in the various Member States? Or is it the inevitable outcome of indifference, opposition and/or lack of commitment of Member States to the trade liberalization goals of the Protocol?

As will be discussed further below, the impact of the SADC Trade Protocol will depend very much on whether regional integration develops a momentum that increases support for trade liberalization and makes it an accelerating and self-perpetuating process. This will depend in large part on whether stakeholders in Member States' private sectors develop a vocal interest in pushing the process forward, and whether officials in the public sector can find ways to accommodate and support such initiatives.

Many of the basic parameters of SADC trade liberalization in the short-term are already set, and the immediate future of the process will depend on diligence and effectiveness of relevant officials in implementing what already has been agreed. However, the Member States have also scheduled a general review of the status of SADC regional integration to take place at the mid-point of the tariff reduction process in 2004. This could be a critical occasion. This might be used by recalcitrant members to plead for further delays and exceptions to existing commitments, or it may be used as an opportunity to increase their commitment to the twin processes of global and regional integration. Which of these possibilities unfolds will have an important bearing on the ultimate impacts and effectiveness of the Trade Protocol.

"Deepening" of Regional Integration

The Trade Protocol lays the framework for a wide variety of measures to promote intra-regional trade and economic integration. Most of the effort so far has centered on tariff reductions. While this is an essential and central element of the trade liberalization process, it is only one part of it. The success of the Protocol, both in promoting regional integration and in increasing the global competitiveness and development prospects of the Member States, depends as well on achieving the much deeper economic integration that will come only through implementation of all the other programs outlined in the Protocol.

Deepening economic integration requires the development of programs for identifying and phasing out NTBs and QRs, for improving and harmonizing customs and other border procedures, for improving physical infrastructure and the regulatory environment related to services, and for a thorough review and rationalization of industrial policy measures in the Member States.

All of these measures are necessary to remove distortions in economic incentives and to eliminate policy-induced sources of high costs of economic activity in the region. Success in achieving deeper economic integration will make the entire region a more attractive and productive location for domestic, regional and international investment. This in turn will increase regional competitiveness and plant the seeds for badly needed new development opportunities.

Policy development in this area suffers from lack of documentation of the nature and magnitude of the incentive effects created by the current policy environment. Prioritization of measures to deepen regional integration would benefit from more work in identifying sources of adverse incentives quantifying their associated cost burdens.

3. The Broader Trade Policy Environment in SADC

SADC's member countries traditionally have participated much less in trade and investment with the world economy than has been the case in many other regions of the world. The same has been true, generally to an even greater extent, with respect to trade and investment among themselves. The trade that does occur has been heavily influenced by domestic tax and regulatory restrictions aimed at meeting a mix of revenue needs and industrial development and social goals.

The region's relative isolation arises from a variety of historical and policy factors. The forced isolation of South Africa in the era of sanctions, and the social upheavals that accompanied the demise of apartheid have had a profound effect on the country's development and on domestic policy approaches. Patterns and habits arising from the colonial era have also influenced historical trade and investment flows throughout the region. At the same time, policy choices made since independence have sometimes tended to aggravate isolationist tendencies.

Insufficient integration and excessively distorted links with the global economy are among the more important explanations offered for the relative underdevelopment of most southern African countries, and especially of their poor performance relative to the "Asian Miracle" economies of east and southeast Asia in recent decades (Sachs and Warner 1995).

Nevertheless, recent years have seen considerable progress in the integration of SADC member countries with both global and regional markets. International integration in southern Africa has proceeded along a number of different fronts – both MFN- and preferentially-based.

3.1 MFN Trade Policies

The MFN initiatives are based on the simple notion that unilateral trade liberalization is the most effective means for a small economy to integrate with world markets and to create domestic incentives necessary to promote market-based economic development.

All SADC members have been participants in the WTO process. In this context, they have been adjusting their trade policy regimes to comply with WTO requirements and to take advantage of the opportunities available in the world trading system. Unfortunately, the WTO regime grants "special and differential status" for the poorest developing countries, a large proportion of which are found in sub-Saharan Africa. A major feature of this special status is a sanctioning of a "go slow" approach to reducing their own trade barriers, thus removing any pressure to make use of one of the greatest development tools available – unilateral trade liberalization. (See Flatters 2001 for further discussion.)

Many SADC members have also been involved in IMF/World Bank structural adjustment programs and are now entering into agreements concerning the design and development of poverty reduction strategies. Structural adjustment programs have come to be viewed in many quarters as instruments of forced trade liberalization and have had mixed success in inducing ownership of resulting domestic market reform programs. Poverty reduction strategies are still in their early stages and it is unclear yet to what extent they will emphasize trade liberalization as a development and poverty reduction strategy.

The starting point for negotiating preferential trade arrangements in SADC is the MFN tariff structures in the Member States in 1998; all SADC tariff reductions use this as a base. This raises a number of interesting issues that will have an important bearing on the impacts of the Trade Protocol.

First, large initial differences in the MFN trade policy regimes of the Member States have led to corresponding differences in the tariff reduction schedules offered in the TNF process.

This is primarily a transitional issue, since the end point of the SADC tariff reduction program for all members is zero-rates on all qualifying intra-SADC trade.

Second, differences among members' initial MFN tariff structures and, more importantly, in the pace of their MFN tariff liberalization programs, are likely to produce significant inter-country differences in the gaps between preferential SADC tariff rates and corresponding MFN tariffs. These differences will occur both during the transition and after final implementation of the preferential tariff schedules. Laggards in MFN trade liberalization will have greater gaps between SADC and MFN rates than speedy trade liberalizers. The laggards are much more likely to suffer the harmful effects of trade diversion, and hence will gain less from SADC membership (see further discussion of trade diversion below).

3.2 Regional and Bilateral Arrangements Among SADC Members

Running in parallel with these MFN-based initiatives is a bewildering variety of bilateral and plurilateral preferential trading arrangements in which SADC members do or are planning to participate. The SADC Trade Protocol, is just one of a large number of regional and bilateral trading arrangements in which the members are involved.

The South African Customs Union (SACU) is a five country grouping completely contained within SADC. The Common Market for Eastern and Southern Africa (COMESA) includes a number of countries that are not part of SADC, and also excludes several SADC members, most notably South Africa and, following their withdrawal from COMESA, Mozambique and, most recently, Tanzania. Of less importance to SADC are the Cross-Border Initiative and the Indian Ocean Commission.

While all of these regional arrangements are designed, in principle, to maximize the opportunities for free trade and market access in the region, their proliferation and the accompanying plethora of rules, restrictions and special requirements creates uncertainty and administrative complexity for policy makers and market participants. This uncertainty and the inevitably high transactions costs reduce transparency, increase market risks and deter rather than promote trade and investment in member countries. This is aggravated by instabilities in membership of the various groups and unevenness and unpredictability in the enforcement of agreements made by member country governments.

In addition to these regional arrangements, a number of SADC members have entered into or engaged in discussions and negotiations for the establishment of bilateral trading agreements among themselves. Zimbabwe is involved in four such arrangements with Botswana, Malawi, Namibia and South Africa. Discussions are underway for an arrangement with Tanzania. In addition to the arrangement with Zimbabwe, South Africa has entered into bilateral agreements with Malawi and Mozambique. This list is not exhaustive.

The bilateral trade pacts involve various combinations of tariff reductions and quota arrangements. Terms are often sector-specific. Considerable differences have arisen in at least some of these agreements about interpretation and enforcement of their terms and conditions. Such differences, on occasion, have caused major disruptions in local industries serving markets covered by bilateral agreements.

Misunderstandings about the terms of bilateral agreements have added to the complexities of SADC trade negotiations and have created the possibility of future trade conflicts among Member States. This is especially true in the case of highly restricted and protected sectors like textiles and garments, where misunderstandings about whether access opportunities offered under the Trade Protocol are additional to or substitutes for previously negotiated access under bilateral agreements.

This kind of ambiguity is of concern not only to trade negotiators, but much more importantly to potential investors who need some certainty about rules and conditions related to market opportunities. While bilateral and regional trade agreements are intended to open markets, they have the unfortunate side effect of creating an investment environment in which decisions are based primarily on preferences granted under special trade deals. When the interpretation and enforcement of these deals are seen to be ambiguous, as is almost inevitable at the moment, the resulting uncertainty becomes, instead, a barrier to investment.

3.3 North-South Trading Arrangements

The SADC Member States have traditionally benefited from a variety of trade preferences and special trading relationships with more developed countries. Among these, the Lome Convention, providing special preferences on a variety of goods exported to the European market, has been a major factor for several decades. The main advantage of this arrangement has been preferential access of a number of agricultural products and on some manufactured goods, especially in the garments and textiles sectors. This convention is now being revamped and will be replaced with what are likely to be no more generous with respect to its market access provisions and will begin to require reciprocal preferences for EU imports into African markets.

A more recent arrangement for access to EU markets that is of special interest to SADC, is the EU-South Africa Free Trade Agreement (FTA). At the outset of the negotiations, this FTA was regarded with high hopes in South Africa and with some trepidation in the rest of southern Africa and especially SACU. Indeed, there was even considerable concern about how such an arrangement could be made in light of the common external tariff in SACU. More fundamentally, however, other southern African countries viewed this special arrangement for South African access to EU markets as a real threat to their ability to compete, especially in the post-Lome era.

After two years of difficult and sometimes acrimonious negotiations, views on both sides have moderated. Under the terms of the final agreement, market access will be seriously limited by many different conditions, and it will be phased in over a lengthy transition period.

The most exciting north-south trading arrangement for southern African countries is the recently enacted Africa Growth and Opportunity Act (AGOA). AGOA provides major improvements in access to the US market, largely on a preferential basis, for eligible countries from sub-Saharan African countries. The following are its principal features.

- It extends GSP duty free privileges on imports from eligible countries into the US market in two important ways. It guarantees GSP privileges for 8 years, rather than requiring approval on a year-to-year basis. And it expands the list of GSP-eligible products significantly, to include previously ineligible products such as textiles, apparel, watches, footwear, handbags, luggage, flat goods, work gloves and leather wearing apparel, as well as certain electronic, steel and glass products and other products that are deemed import sensitive.

- Non apparel/textile products must satisfy several eligibility requirements, the most important of which are that they be produced in eligible countries and that they satisfy a value-added condition stipulating that 35 percent of their value be sourced in eligible countries (or the US).
- For textile and apparel products, all existing quotas on US imports from eligible sub-Saharan African countries are lifted. Duty/quota free access to the US market is provided to several categories of textile and apparel products:
  - sub-Saharan apparel made from yarn and fabrics not available in the US, and
  - apparel made in Africa from US yarn and fabric, knit sweaters from cashmere and some merino wools, and apparel made of silk, velvet, linen and other fabrics not produced in commercial quantities in the US
  - apparel made in Africa from African/regional fabric and yarn (subject to caps).
- Exports of textile and apparel products from the poorest sub-Saharan African countries are granted temporary duty/quota free access to the US under a much less restrictive rule of origin; they are permitted to use third country (non-sub-Saharan Africa, non-US) fabrics in their apparel exports to the US for the first four years of the agreement.

Eligibility for these benefits is determined on the basis of a number of criteria designed to determine whether a country is using "best practice policies that will ultimately attract trade and investment and foster widely-shared prosperity" (US Trade Representative 2000). Eligibility will be reviewed annually, on the basis of the same criteria. Technical assistance can be provided to help in the design and implementation of the market-based policies and systems required to meet the criteria and to benefit from the opportunities made available under AGOA.

As of December 2000, all SADC Member States except Angola, DRC, Swaziland and Zimbabwe had been declared eligible beneficiaries of AGOA.

Preferential access to the US market provides an enormous opportunity to SADC Member States. By the simple measure of relative GDPs, the US market is 50 times larger than all of SADC (see section 5.1 below). According to the Office of the US Trade Representative, the average US external duty on apparel for which preferences are offered by AGOA is 17.5 percent (US Trade Representative 2000). To be granted exemption from these duties in the huge US market confers a large competitive advantage to SADC and other African producers.

Just as with SADC, however, rules of origin must be satisfied to gain preferential market access. For many products, the AGOA rules of origin are quite similar to those used in SADC. In fact the double transformation rule applied to many apparel projects under AGOA is surprisingly similar to those in SADC, as are the local content or value added rules that apply to many other products.

The difficulties with these rules of origin in the context of an inward-looking SADC have already been pointed out – the size of the SADC market alone is too small to achieve the economies of scale necessary to be internationally competitive in many raw materials and intermediate inputs sectors. However, for production aimed at a market as large as the US, the picture is very different. In this case, economies of scale can be achieved.

AGOA could be a great help in ensuring that SADC becomes truly outward looking and that its producers become internationally competitive. The challenge for SADC is to create an investment environment that will be attract domestic and international investors wanting to use the region as an export platform for the US and other global markets. This could provide a useful focus to SADC, in which it would be seen more as a mechanism for improving the competitiveness of its Member States rather than as a means of providing mutual preferential access to its members' markets. AGOA has already provided a large additional incentive for the industrial restructuring that was referred to earlier in the context of garment and textile production in Madagascar, Mauritius, South Africa and a number of other SADC Member States.[3]

4. Impacts of Regional Trade Liberalization – Lessons from International Experience

The Trade Protocol is one element of a strategy to pursue sustainable economic development of member countries through greater regional cooperation. Advocates of regional trade liberalization foresee opportunities arising through

- the efficiency-enhancing effects of access to broader markets for their countries' products,
- access to lower cost imports of consumer goods, intermediate products and capital goods from lower cost foreign suppliers,
- resource reallocations in line with each country's comparative advantage, and
- productivity improvements arising from increased competition.

As a result, regional trade liberalization is expected to lead to higher economic growth, increased long run employment growth, and substantial reductions in poverty.

Skeptics point to the danger of substantial public sector revenue losses and dislocations arising from fierce competition facing domestic producers as a result of trade liberalization.

International experience has taught a number of simple lessons regarding the economic impacts of preferential trade liberalization schemes. Some lessons relate to the aggregate economic impacts of preferential trade liberalization, and others to the distribution of benefits and costs among member countries. There has also been considerable discussion, especially in recent years, of broader political and social impacts of regional trade liberalization. Among the more controversial and yet unresolved issues in this regard is whether regional and other preferential forms of trade liberalization promote or hinder MFN-based trade liberalization.

4.1 Unilateral, MFN-Based Liberalization Versus PTAs

The first lesson about trade liberalization is that its principal beneficiaries are the citizens and residents of the country reducing barriers to its trade with the rest of the world. For a small

[3] Madagascar is not a member of SADC. But the example raises an interesting question regarding the possibilities of broadening SADC membership in order to maximize the potential scope of and benefits from regional economic integration under its umbrella. If SADC is not able to be open in this sense, it runs the risk of becoming irrelevant in the broader and more important context of global integration of its Member States.

country, i.e. one too small to have a significant impact on world markets through its participation in these markets, the benefits of its own trade liberalization measures accrue entirely to itself.

This simple fact stands in sharp contrast to a common myth of trade negotiation – i.e. that tariff reductions are concessions to one's trading partners. Perpetuation of this myth is arguably one of the largest costs of the multilateral trade liberalization exercises of the past several decades. By depicting and treating tariff reductions as "concessions," they have become a massive source of disinformation to policy makers and observers.

Trade liberalization by any small country (and all SADC members certainly fall in this category for all or at least the vast majority of their trade) has a negligible effect on world prices and hence on the trading possibilities of its trading partners. However, by bringing domestic prices closer in line with world costs and prices, it ensures a more productive and efficient use of its domestic resources, and lays the strongest possible foundation for long-term development. In addition, trade liberalization increases the degree of actual or potential competition in domestic markets, and hence provides strong incentives to improve domestic productivity and competitiveness. This is a major long-term dynamic benefit of trade liberalization.

Is there any economic benefit to be gained by liberalizing trade with respect to only a subset of its trading partners, as is done in a PTA? In strict economic terms, the answer is clearly no. There is no benefit from doing so, and there is a potential cost if it has the effect of inducing the country to import from a higher cost international supplier as a result of preferential tariff rates given to the higher cost source (see section 4.3 below). MFN-based (i.e. non-discriminatory) trade liberalization is always economically superior to preferential liberalization.

This is not to say that preferential trade liberalization is necessarily bad. There are two broad arguments for preferential trade liberalization.

The first is based on "second best" considerations. If for political or other domestic reasons, non-discriminatory liberalization is not possible, preferential liberalization *might* be a second best alternative. Whether preferential liberalization is economically preferable to the *status quo* depends on the circumstances in each case and, in particular, whether the trade creating effects of the measures undertaken outweigh their trade-diverting effects. The greater is the extent of trade diversion induced by a PTA, the greater is the chance that it will be inferior to no liberalization at all. A separate discussion of trade creation and trade diversion in PTAs is deferred to section 4.3.

The second argument for preferential trade liberalization is that it can be used as a device either to secure preferential or otherwise improved access to external markets, or to bind domestic policy makers to enter into and maintain market opening measures with respect to their own market. In other words, collaborative trade liberalization among a set of countries can be used to ensure commitment to tariff reductions and other market opening measures, over the objections of domestic vested interests opposed to liberalization. This is discussed in the following section.

4.2 Collaborative Liberalization as a Form of Commitment

Viewed from a national perspective, an open trade policy regime is a key element of a strategy for long-term development and for raising the incomes of a country's citizens. However, from the perspective of particular vested interests, protection of a domestic market from foreign competition can be an immediate and significant source of profits and of incomes. Furthermore, the special interest gains from (increases in) protection are generally highly concentrated, while its costs are often much more widely dispersed. Hence, the political pressures for (increases in) protection are often much stronger than those for liberalization.

Trade liberalization agreements with a set of other countries can serve a very useful purpose in this context. They can be described as a means of securing preferential access to the partners' markets – each member agrees to provide such access to its markets in exchange for reciprocal measures on the part of its partners. Trade liberalization can then be "sold" to domestic protectionist interests as a means of securing expanded market access for its own producers and sellers. Once entered into, such agreements then serve as a credible commitment to trade liberalization. The agreements can be a powerful tool, both to secure trade liberalization in the first place, and to resist domestic pressures for subsequent increases in protection.

Collaborative trade agreements differ in the degree of compulsion or conditionality attached to market access. Most agreements involve some kind of reciprocity requirement. AFTA, for instance, imposes a condition of sectoral reciprocity for a member to gain preferential market access under the agreement. That is, a country cannot gain preferential access to any sector in a partner country until it had already met its agreed liberalization targets for that sector. As issues have arisen in recent years concerning delays in the originally agreed implementation schedule, AFTA has also introduced punitive sanctions. Under these new provisions, a country which delays implementation of market opening commitments can be subject to countervailing penalties by any partners judged to be harmed by such actions.

APEC, on the other hand, is quite unusual in this respect. Tariff reductions and other trade liberalization measures "offered" under APEC are made available to all countries on an MFN basis. That is, market opening is provided on a non-preferential basis, to all countries in the world qualifying for MFN treatment, regardless of their membership in APEC. Under this non-preferential, voluntary trade liberalization scheme the only form of commitment is of a "moral" or self-interested nature on the part of any liberalizing member. In reality, APEC is primarily a "talk shop" in which members can discuss issues related to trade liberalization and provide mutual encouragement and demonstration effects in their individual efforts to achieve the benefits of opening their markets to international trade. Despite the absence of any kinds of sanctions or reciprocation requirement, APEC has been a remarkably effective commitment mechanism for governments wishing to pursue trade liberalization policies.

The APEC experience provides evidence regarding another important question about trade agreements and commitment – to what extent do regional and other forms of PTAs encourage or discourage the movement towards MFN-based, global free trade? APEC is clearly designed to encourage multilateralism and openness. Do other more exclusive PTAs such as NAFTA, Mercosur, and the growing array of bilateral and plurilateral "free trade" deals do the same, or do they encourage balkanization of the global economy into isolated groups? While most PTAs claim to be based on a commitment to "open regionalism", the evidence on their net effects is not yet clear. Nevertheless, the fact that this question is raised so frequently suggests at least a real danger that the proliferation of PTAs might be a stumbling block rather than a building block for global free trade.

4.3 Trade Creation and Trade Diversion

As indicated earlier, preferential trade liberalization has some effects that are efficiency and growth enhancing and others that are efficiency and growth reducing. The former, known as *trade creation* effects, improve efficiency and increase growth by bringing domestic prices more in line with world prices and increasing competition in the domestic market. This is the principal effect of non-discriminatory trade liberalization.

In the case of discriminatory trade liberalization, however, there is an additional effect. As a result of preferential treatment of partner imports, there is an incentive to source imports from higher cost partners rather than from their lowest cost international source. This *trade diversion* reduces tariff revenues with only a partial (or maybe no) offsetting cost reduction to consumers or industrial users of imported goods. The difference between the loss of tariff revenues and (smaller) reduction in import costs is a net loss to the economy.

Because of the potential for trade diversion, PTAs are economically inferior to non-discriminatory trade liberalization, and might actually be worse than no liberalization. A key consideration in engaging in a PTA, therefore, is to minimize the dangers of trade diversion. The potential for and costs of trade diversion are greater the higher are the costs of imports from one's trading partners, and the greater are the differences between preferential and non-preferential tariff rates.

Differences between a country's preferential and non-preferential tariff rates are much more controllable than are differences between costs of its PTA partners and non-partners. This has important policy implications. To maximize the benefits and minimize the dangers of preferential trade liberalization, a country should ensure that its MFN tariff rates remain as close as possible to preferential rates it offers to its PTA partners. If MFN rates are liberalized in parallel with PTA rates, trade diversion will not occur. Furthermore, under this strategy, a country's economic self-interest ensures that regional/preferential tariff reform is a major building block for multilateral trade liberalization.

4.4 Intra-Industry Trade and Deeper Integration

Trade liberalization – reduced tariffs, removal of non-tariff import barriers, and measures to improve trade facilitation – improves economic welfare by lowering the cost of imported goods. This is of direct benefit to consumers. However, the largest users of imported goods in most economies are producers, who import intermediate goods, raw materials and capital goods as inputs in domestic production. Trade liberalization, therefore, has a major impact on domestic producers by increasing competition and lowering costs in markets for their raw material and intermediate inputs. This is one of the important avenues through which trade liberalization improves international competitiveness of domestic producers in countries engaging in trade liberalization.

Intra-industry trade in intermediate inputs as well as final products has been a major source of the success of effective regional PTAs in both lesser and more developed regions of the globe. The EU and NAFTA have both had enormous success in facilitating integration of markets at all stages of manufacturing production. The ASEAN Free Trade Area (AFTA) has been predicated largely on the goal of supporting the free trade of raw materials and components among member countries and with the outside world. The result has been specialization in production of components for sectors such as electronics and motor vehicles to increase not just the regional but more importantly the international competitiveness of these sectors. This is being achieved, not through inward looking industrial and trade policies and restrictive rules of origin, but rather through facilitating free and efficient trade in all industrial goods, and especially in raw materials and components.

Successful intra-industry trade of this sort requires far more than relaxation of tariff barriers. It requires much deeper economic integration, starting with non-distortionary domestic regulatory regimes and strong, stable and transparent investment environments. For developing countries, this usually demands action on a broad range of areas aimed at improving market institutions and regulatory performance. Deeper integration requires the provision of trade infrastructure and services at international standards. This means regulatory reform and promotion of domestic and international competition; it requires world-class performance by public and private sector actors, from transportation companies to port and customs services.

Deeper integration and a broadened scope for intra-industry trade go hand-in-hand with open regionalism in making for successful, outward-looking regional integration.

4.5 Distribution of Benefits Among Members

Among the generally agreed findings about trade liberalization are:

- it is mutually beneficial to all trading partners (i.e. trade liberalization is a positive sum game) and
- small countries have more to gain from trade liberalization than do larger countries.

Furthermore, open trade regimes generally promote more rapid and equitable development of poor countries than do inward looking protectionist policies. However, as has been apparent in some of the preceding discussion, regional trade liberalization is sometimes more complex than unilateral or MFN-based multilateral liberalization.

There is considerable experience to suggest that regional/preferential trade liberalization has many of the same effects as non-preferential free trade, and in particular that it promotes the development interests of poorer countries. Spain, Ireland and Portugal have been major beneficiaries of European integration; the same is true of Mexico in NAFTA.

However, there are exceptions to these findings (see ch. 3.3 of World Bank 2000a and Venables 1999). Within regional groupings with richer countries, poorer members have benefited much less if they have lagged in implementing broader market-based domestic reforms. The absence of such reforms has reduced Greece's benefits from participating in the EU, and has caused it to lag behind the pace of European development. The lesson here is that trade liberalization, regional or MFN-based, is most effective when conducted in a market-friendly economic environment.

Within south-south regional agreements, there is a danger that the relatively poorer and less-developed members of the group might suffer at the expense of richer members. It is argued, for instance, that Tanzania and Uganda stagnated while Kenya derived most of the industrial development benefits from the East African Economic Community.

This asymmetry in the distribution of benefits from regional integration arises primarily from a combination of differences in structures of comparative advantage and policy-induced trade diversion. The argument is as follows. As less developed countries, the members of a regional PTA among poorer countries all tend to have a comparative disadvantage, relative to the rest of the world, in many manufacturing sectors. These are the same sectors that are often heavily protected in the member countries. Within the grouping, however, the relatively more developed members tend to have less of a comparative disadvantage in these sectors than the poorest members.

In these circumstances, the formation of a regional PTA can give rise to considerable trade diversion, in which the preferential tariffs induce members to replace imports of manufactures from outside the region with imports from other Member States. With their relative comparative advantage in these sectors within the group, the richer members become the main source of these diverted imports. While this drives the richer members into trading and production patterns that are out of line with their global comparative advantage, there can still be a net benefit for them, arising from their increased access to intra-group markets. On the other hand, the poorer members can be made worse off as a result of this trade diversion of manufactured imports from low cost international sources to higher cost suppliers within the PTA.

Two conditions are necessary for this undesirable outcome of a regional PTA. First, relative to the whole group, the richer members must have a comparative advantage in all or at least most of the heavily protected manufacturing industries represented in the membership of the group. There is no natural reason for this to be the case. Second, there must be substantial differences between preferential tariff rates on these goods within the PTA and the external tariffs on imports of the same goods from the rest of the world. In an outward-looking PTA, in which regional integration is part of a general strategy for global integration, high external tariffs will be eliminated, and the general level of external protection will diminish in parallel with the process of regional integration. This is sufficient to prevent the type of harmful trade diversion described here.

For a small or poor country worried about the prospects of being harmed by participation in programs of regional integration, there is a simple lesson from all the cases considered here – make sure that regional integration does not get in the way of more important programs for global integration, MFN-based trade liberalization, and domestic market reforms.

5. Likely Impacts of the SADC Trade Protocol

There have been a number of empirical studies of SADC and other regional and global integration schemes.[4] These are generally done in the context of relatively highly aggregated macroeconomic models that abstract from many of the details of the arrangements under

[4] For a brief but useful review of a number of these studies, see Annex 2 (by Ron Hood) in Tsikata, Radack and Hood 1999.

consideration. While these are useful in providing overviews of different broad policy alternatives and some of their general macroeconomic implications, they are less helpful in providing guidance to policy implementation at a more detailed level. In estimating the economic impact of the SADC Trade Protocol, for instance, they generally ignore the transitional provisions and phase-in periods, and take no account of the incentive effects of such fundamental features of the agreements as the rules of origin.

This report is aimed, instead, at highlighting strategic policy issues and choices in implementing and deepening economic integration under the Trade Protocol. It does not attempt to provide macroeconomic estimates of the sort found in these other studies.

This section is organized around two types of issues: those arising from existing and likely changes in patterns of trade and production arising from the Protocol, and those related to specific concerns about public sector revenues.

5.1 SADC Regional Markets and Trade Patterns

The discussion of trade patterns and regional markets is divided into three parts, providing a review of current trade patterns, an examination of issues related to market size, and a discussion of the scope for trade complementarities.

Current Trade Patterns

The most striking feature of SADC's intra-group trade is its relatively small amount. The other is the degree of asymmetry in the patterns among different Member States.

Table 3 shows estimates of the composition, by source, of each SADC member's imports in 1998. Overall, for all SADC members, SADC accounts for only 20.2 percent of their imports; the remaining 79.8 percent of SADC imports come from non-SADC sources.

This pattern, however, varies considerably across countries. The BLNS countries (Botswana, Lesotho, Namibia and Swaziland), all members of SACU, rely on SADC for more than 76 to 90 percent of their imports. However, almost all of their SADC imports are from SACU, and most of that from South Africa.

Malawi and Zambia are the only non-SACU members that source more than half their imports from SADC, and once again most of their SADC imports are from South Africa. Mozambique and Zimbabwe are intermediate cases, sourcing 41 and 39 percent respectively of their imports from SADC. The majority of their SADC imports are also from South Africa.

At the other extreme, Angola, Mauritius, South Africa and Tanzania all source only small parts their imports from SADC, with the SADC shares ranging from 0.3 to 14 percent. South Africa sources less than 7 percent of its imports from SADC, and about three quarters of this is from other members of SACU. South Africa derives less than 2 percent of its imports from non-SACU members of SADC.

With only 20.2 percent of SADC imports sourced from other SADC countries, there clearly is not, at least at the moment, very much integration of merchandise imports. In fact, except for

SADC imports that are sourced from SACU countries, primarily by other SACU members, the amount of integration is almost trivial. Only 2.2 percent of SACU imports are sourced from non-SACU members. For those countries that do source a significant share of imports from SADC, the vast majority is from SACU, and most of this is from South Africa.

A similar pattern emerges when looking at export patterns of SADC members (Table 4). Overall, only 21.2 percent of SADC member exports are destined for other SADC members' markets. Over 70 percent of these exports are destined for SACU markets, with most of these exports originating in SACU as well, and most of it destined for South Africa. Within SACU, the two members most heavily dependent on exports to SADC are Lesotho and Swaziland, with 54 and 74 percent of their exports respectively going to other SADC countries. Almost all of Lesotho's SADC exports go to SACU, and the vast majority of Swaziland's do the same. Mozambique is the most heavily dependent of the non-SACU countries on exports to SADC; 46 percent of its exports are destined for SADC markets, over 60 percent of which go to South Africa.

Malawi, Zambia and Zimbabwe depend on SADC for 21, 20 and 24 percent of their exports respectively. South Africa sells 24 percent of its exports to SADC, almost 70 percent of which go to other members of SACU.

Angola, Mauritius, Namibia and Tanzania are the least dependent of SADC's members on exports to SADC. The SADC shares of their exports are 0.1, 1, 17 and 4 percent respectively.

The patterns of SADC imports and exports indicate some basic asymmetries in trade patterns. South Africa and several other non-SACU countries (most notably Mauritius and Tanzania) rely very little on imports from SADC. A number of the smaller economies, especially Malawi, Zambia and the non-RSA members of SACU, rely much more heavily on SADC for their imports. By far the largest share of SADC members' imports from other SADC countries comes from South Africa.

Although South Africa is the principal source of most SADC imports from SADC, the SADC market is of only moderate importance for South Africa, accounting for 24 percent of her exports. This, of course, is much larger than South Africa's dependence on imports from SADC (less than 7 percent). It is worth noting as well that, although the SADC market is not particularly important for South Africa in absolute terms, it is large relative to the overall size of the SADC market in the global context.

Other than a couple of SACU countries, Mozambique is the most dependent of all SADC members on exports to SADC, most of which go to South Africa, with a smaller but important share going as well to Zimbabwe. Malawi, Zambia and Zimbabwe have moderately large shares of their exports going to SADC (21, 20 and 24 percent respectively), although not as large a share as South Africa's.

Table 3: SADC Trade Flows, 1998
Percentage of SADC Imports by Source
(importers shown in first column; sources in top rows)

	SADC			ROW	Total
	SACU	**Non-SACU**	**Total SADC**		
Angola	0.0	0.3	0.3	99.7	100
Botswana*	74.8	3.4	78.2	21.8	100
Lesotho*	89.6	0.2	89.8	10.2	100
Malawi	40.4	13.6	54.0	46.0	100
Mauritius	13.5	0.4	13.9	86.1	100
Mozambique	36.4	4.6	41.0	59.0	100
Namibia*	74.5	1.4	76.0	24.0	100
S. Africa*	4.9	1.7	6.7	93.3	100
Swaziland*	83.9	0.9	84.8	15.2	100
Tanzania	8.9	2.3	11.2	88.8	100
Zambia	39.1	17.7	56.8	43.2	100
Zimbabwe	36.2	2.6	38.8	61.2	100
Total	18.1	2.2	20.2	79.8	100

Note: * indicates membership in SACU
Source: Derived from SADC Trade Protocol Project 2001

Table 4: SADC Trade Flows, 1998
Percentage of SADC Exports by Destination
(exporters shown in first column; destinations in top rows)

	SADC			ROW	Total
	SACU	**Non-SACU**	**Total SADC**		
Angola	0.0	0.0	0.1	99.9	100
Botswana*	27.0	2.3	29.3	70.7	100
Lesotho*	53.1	0.7	53.7	46.3	100
Malawi	15.5	5.0	20.6	79.4	100
Mauritius	0.7	0.6	1.4	98.6	100
Mozambique	28.1	17.5	45.6	54.4	100
Namibia*	16.0	0.6	16.6	83.4	100
S. Africa*	16.0	7.5	23.5	76.5	100
Swaziland*	61.0	13.4	74.4	25.6	100
Tanzania	1.4	3.0	4.4	95.6	100
Zambia	15.1	5.2	20.3	79.7	100
Zimbabwe	13.8	10.0	23.8	76.2	100
Total	15.3	6.2	21.6	78.4	100

Note: * indicates membership in SACU
Source: Derived from SADC Trade Protocol Project 2001

Market Size

Other than South Africa, the SADC Member States are very small countries. With small populations and relatively low per capita incomes, self-sufficiency, or autarky, is not a viable economic strategy for individual SADC countries; engagement in international trade is necessary to achieve economies of scale and advantages of specialization. For both the larger and smaller Member States, regional integration is seen as a means to expand the scope of their markets and achieve some of these gains from international trade.

Is the SADC market sufficiently large to make a difference? The data in Table 5 do not look very promising in this regard. The total SADC market, as measured by aggregate GDP, was only US$174 billion in 1999. Three quarters of this is accounted for by South Africa alone. To put the size of the market in international perspective, the memo items at the bottom of the table show that the entire SADC market is smaller than Turkey.

How does the SADC market compare with other regional PTAs? Again, the comparative data bottom of the table show that SADC's aggregate GDP is less than one-third the size of the ASEAN Free Trade Area (AFTA). Furthermore, despite its larger size, AFTA's success in promoting industrial development lies not in the economies of scale afforded by the regional market, but rather by opportunities it provides for regional industrial clusters to become more competitive in exporting to *global* markets.

The importance of the global market is seen in comparing the economic size of SADC with the USA. SADC's total market size is less than one fiftieth that of the US.

While there may be many other economic advantages of SADC, economies of scale offered by access to a greater regional market does not appear to be one of them. Other research draws a similar conclusion in comparing the advantages to SADC members from access to each other's markets with those from access to the EU.[5]

[5] Lewis *et al* 1999 conclude that "The South African economy is not large enough to serve as a growth pole for the region. Access to EU markets provides substantially bigger gains for the rest of southern Africa than does access to South Africa." (p. 24)

Table 5: Size of SADC Economies

	1999 GDP ($US millions)	Population (1999, millions)
Angola	3,058	12
Botswana	5,996	2
Lesotho	874	2
Malawi	1,820	11
Mauritius	4,203	1
Mozambique	4,169	17
Namibia	3,075	2
South Africa	131,127	42
Swaziland	1,379	1
Tanzania	8,777	33
Zambia	3,325	10
Zimbabwe	5,716	12
Total SADC	173,519	145
Memo:		
US	8,708,870	273
AFTA	532,567	512
Turkey	188,374	64

Source: Derived from World Bank 2000b, Appendix Tables 1, 1a and 12

Possible Trade Complementarities

With the exception of a number of countries in SADC and a few bilateral relationships between non-SACU countries and South Africa, current levels of intra-SADC trade are very low. By global standards, the size of the entire SADC market is low. What does this mean for the likely benefits from regional integration under SADC?

Recent research conducted at the World Bank has looked at both levels and the composition of trade among various combinations of African countries to determine the likely benefits of different regional integration schemes (Yeats 1998). The research concluded that the scale of the markets, together with similarities in economic structures and trade patterns among Member States made the potential gains from regional integration very small. The one possible exception to this conclusion, and a region that was not as thoroughly considered in the study, was southern Africa. Southern Africa differed from other areas examined in both the larger size of the potential regional market and in the existence of a greater degree of diversity, and hence potential complementarities, in production and trade patterns.

While Southern Africa might exhibit greater potential than other parts of Africa for benefiting from regional integration, international experience and the information presented here suggests that any complementarities are much more likely to bear fruit in the context of a region aimed at becoming integrated with and competitive in the global economy. The basic question will be whether SADC becomes inward-looking, with its primary focus on access to the domestic markets of the Member States, or whether it can become an example of open regionalism, in which regional integration is just one part of a strategy to become more fully integrated with the world economy, and to tailor domestic policies to maximize the benefits from doing so.

5.2 Public Sector Revenue Issues

Many of the parties in the TNF process had major concerns about the possible effects of SADC trade liberalization on government revenues. This is of greatest concern to members that depend on import duties as a major source of government revenue and that collect a significant portion of these revenues on intra-SADC trade.

Estimated Revenue Losses

Table 6 shows that, except for Mauritius (and SACU for which we do not have data at the moment), all the Member States rely on import duties for between 13 and 17 percent of total government revenues. However, because of differences in import propensities from other SADC countries, and also on tariff rates on such trade, the members' dependence on import duties on intra-SADC trade varies much more. In addition, due to various preferential tariff schemes under SACU, COMESA and bilateral arrangements, a great deal of intra-SADC trade is already duty-free or is burdened by very low rates.

SACU and Tanzania derive only 0.4 and 1.1 percent of government revenues respectively from duties on SADC trade. Malawi, Zambia and Zimbabwe have the highest dependence on intra-SADC tariff revenues at the moment, with dependency rates of 8, 9.2 and 7 percent respectively. Mauritius, despite its high overall dependence on tariff revenues, has a dependency rate on revenues from its SADC trade of only 5.8 percent. This is due to a combination of relatively low amounts of trade with SADC and the existence of COMESA preferences on a significant proportion of that trade.

Table 6: Dependence of Member States on Import Duty Revenues

	% of Gov't. Rev. from All Import Duties	% of Gov't. Rev. from Tariffs on Imports from SADC
Malawi	15.9	8.0
Mauritius	31.9	5.8
Mozambique	15.9	5.4
SACU		0.4
Tanzania	13.2	1.1
Zambia	14.0	9.2
Zimbabwe	16.7	7.0

Source: Derived from SADC Trade Protocol Project 2001

Based on existing trade structures and fiscal structures, therefore, it appears that the revenue implications of SADC free trade for some Member States are likely to be very small indeed. For other members, based on the same assumptions, revenue implications may not be entirely trivial. Before discussing how large is "large" in this context, however, it is important to recall that tariff reductions under the Protocol will be phased in quite gradually. In particular, it is almost entirely imports with zero or very low duty rates that will be liberalized in the first few years of implementation of the Protocol.

Table 7 shows the percentage reduction in import duty collections due to the Protocol after four years and after eight years, based on the country offers in effect in late 2000. It shows the percentage difference between import duties that would have been collected in the absence of the Protocol and those that will be collected in the presence of the Protocol. The estimates are based on existing trade patterns and MFN tariff structures.

Table 7 provides another indication of the extent of back-loading of tariff reductions under the Protocol. For all Member States except Zambia and Zimbabwe, the revenue losses in the first four years are extremely small. And even for Zambia and Zimbabwe, the import duty losses by the end of the fourth year represent only 3 and 2 percent respectively of total government revenues.[6]

Table 7: Timing of Import Duty Losses Due to the Protocol

	% Reduction in Import Duties after Four Years	% Reduction in Import Duties after Eight Years
Malawi	1.5	42.6
Mauritius	4.7	21.4
Mozambique	6.4	33.6
SACU	2.6	3.6
Tanzania	1.5	10.6
Zambia	22.6	47.7
Zimbabwe	13.8	37.8

Note: Revenue reductions are measured as the difference between import duties collected with the Protocol and without it.
Source: Derived from SADC Trade Protocol Project 2001

The Economics of Revenue Losses

There is often considerable confusion in discussions about the economic implications of revenue losses from trade liberalization.

The revenue losses estimated in the previous tables are based on existing trade patterns. While such decreases are a loss to the members' government treasuries, they are not an economic cost to the countries' citizens. They represent simply a transfer from the treasury to the users of imported goods. There is no net change in total economic welfare as a result of this transfer. To the extent that the tariff reductions encourage trade creation, there is a net economic gain.

There may be additional revenue losses due to trade diversion. Tariff reductions on intra-SADC trade may encourage importers to switch from low-cost global suppliers to higher cost SADC sellers. As pointed out in section 4.3, this might be a more serious danger in some of the smaller, less developed Member States. But it would occur only if they failed to continue with ongoing MFN-based tariff reduction programs.

[6] Recall from Table 6 that import duties account for only 14.0 and 16.7 percent of government revenues in Zambia and Zimbabwe respectively.

To the extent that revenue losses are due to trade diversion, there is a net economic cost. However, the economic cost is not the total amount of the revenue loss. Rather, it is only the difference between this revenue loss and the higher cost of SADC-sourced imports compared with what they would have cost if bought from the lowest cost source. The revenue loss is an upward-biased estimate of the loss from trade diversion. The size of this bias is larger the smaller is the difference between MFN tariff rates and preferential SADC rates on the diverted goods.

If revenue losses do not represent significant economic costs, why are they the source of so much attention in trade negotiations? One reason, of course, is that Ministry of Finance and Customs officials, who have a vested interest in revenue issues, often play a large role in the negotiations. Their vested interest is more acute in countries with weak revenue systems, and especially in those that operate on the basis of collection targets. Like any other vested interest, their concerns should be balanced against the broader national interest when developing and implementing strategies for trade policy reform.

There is also, however, a potentially legitimate concern about revenue losses in countries with weak revenue systems. In such systems, tax collection has high direct costs, and also creates serious distortions in economic incentives. As a result, the economic cost of public sector revenues can be very high. In the face of these constraints, poorer countries tend to rely relatively heavily on taxes on international trade. To forgo revenues from this source might make it necessary to rely on other sources with higher economic costs of tax collection. These additional economic costs are another cost of revenue losses from tariff reductions. Once again, the cost is not measured by the size of the revenue losses, but rather by the difference in the economic costs of collecting revenues from alternative sources.

Taxes on trade are a *relatively* low cost revenue source in poor countries. However, in absolute terms trade taxes are still very costly. This is why countries switch to other taxes, levied primarily on income and consumption, as quickly as possible in the process of economic development. Most SADC Member States are already well along in programs for the modernization of their tax systems. A key element in these programs is the introduction of value-added taxes, which are much more productive at revenue-raising and distort economic incentives far less than trade taxes. Value-added taxes have an additional advantage for countries like the SADC Member States is that a large share of collections takes place at international borders, but without the adverse production incentives created by import duties.

In this context, the revenue losses that will occur as a result of SADC (and even more so as a result of MFN-based tariff reduction programs) should be seen as part of the general process of tax reform being undertaken in the Member States. Any acceleration of the tax reform process arising from SADC should be seen as an additional benefit rather than a cost. In any case the gradual phase-in of the SADC-related revenue losses provides more than adequate time to make necessary policy adjustments.

6. The Future of SADC: A Vision and Critical Issues

The ultimate impacts of the SADC Trade Protocol will depend on how it is implemented and on how it is further developed and deepened by the Member States.

6.1 Vision: Open Regionalism and Global Competitiveness

The Protocol can make a major contribution to sustainable and equitable development of its Member States. For this potential to be realized, implementation and further development of the Protocol must be accompanied by equally strong initiatives in more general MFN-based trade liberalization and domestic market reforms. Such policies are the responsibility of the individual Member States. This is appropriate, since the principal beneficiaries of SADC and of the complementary reforms will be the citizens of these Member States.

Failure to embrace open regionalism will give pose several dangers. At best, it will make SADC irrelevant in the development plans and prospects of the Member States. At worst, if the Member States embark on an inward-looking strategy for regional integration, they may be drawn into an economic dead-end that will seriously impede the development prospects of their citizens.

The SADC forums and processes can play an important role in encouraging and facilitating a process of regional and global integration. Harmonization of Customs and cooperation in improving other parts of the machinery and regulatory framework of the trade infrastructure in the region, for instance, can play a major role in achieving the goals of international integration of the SADC Member States.

The vision of integration for the region must be directed outward at the global economy, not just inward at the markets of the Member States. Regional integration in SADC should be seen as a means for improving the competitiveness of the region in the global economy. This is what is generally described as "open regionalism", and it is the appropriate model for SADC. The individual Member States and even SADC as a whole are far too small to achieve prosperity through "go-it-alone" development policies.

To achieve these goals, SADC must move beyond simple tariff reductions and continue a process of achieving much deeper integration in the region and in the world economy. Many of the necessary elements of such a strategy are already foreseen in the Trade Protocol and other SADC initiatives. A clear understanding of the need and a firm commitment to the process of deeper integration in the region must be embraced by the Member States.

The Africa Growth and Opportunity Act (AGOA) comes at a fortuitous time for SADC. By providing broad, secure and preferential access to the US market for eight years, it sends a signal about the benefits of global integration and provides strong incentives to improve the region's competitiveness in the world market. There are already encouraging signs of the response of foreign and domestic investors in accelerating industrial restructuring processes in the textiles and garments sectors that are already underway in a number of SADC countries. Policies to deepen SADC integration will give all Member States a major advantage in capitalizing on the opportunities provided by AGOA.

6.2 SADC Implementation Issues

In the immediate short run, it is important at least for the Member States to officially sign on to implementation of the Protocol by submitting their Instruments of Implementation. It is also necessary to undertake a thorough review of all country offers to ensure that they meet with the terms and conditions agreed in the TNF process. A surprising amount of misunderstanding of and non-compliance with these conditions is apparent in the documentation available at this time.

It is important as well to develop an agenda and begin to move on all the non-tariff trade issues covered in the Protocol. Identification and cataloging of existing NTBs and QRs is a necessary first step. This includes not only a listing of such measures, but also descriptions of processes for changing them and of safeguards against their use as instruments of hidden protection. In conducting this exercise, NTBs must be interpreted to include as broad a range as possible of policy measures affecting economic incentives, especially those that unnecessarily raise costs and otherwise cause harm to the investment environment.

A further step must be to find ways of prioritizing reforms by determining the beneficial and harmful effects of existing measures. This requires development of agreed methods for quantifying and judging their effects on economic incentives facing investors, producers and other economic actors.

The scheduled review of the Trade Protocol in 2004 will be an important landmark for judging progress to date and for considering changes in the strategy and implementation schedule. This might be an appropriate time to review not only tariff reduction schedules and progress in achieving other trade facilitation goals, but also to reexamine the rules of origin negotiated in the initial TNF process. The magnitude, incidence and economic benefits and costs of the often sizable economic incentives provided by these rules have scarcely been considered in the negotiation process to date.

Other issues requiring consideration as part of the 2004 review might include progress in tax reform to lessen the possible costs of revenue losses that will arise from tariff reductions, and development of dispute settlement procedures.

A more ambitious review process at this time might also wish to consider in more detail the implications of revising or even removing some of the measures in the Protocol for dealing with anti-dumping and safeguard actions, and for providing special protection for infant industries. While these measures are all couched in terms suggesting consistency with the WTO, it has become increasingly obvious to many observers that they are significant and possibly quite costly divergences from the goals of free trade and of sustainable development.

6.3 Beyond SADC

The most important "beyond SADC" issue is a continuation and deepening of the commitment of Member States to the MFN-based trade liberalization process and to the continuation of market-based economic reforms.

A strong commitment to MFN-based reforms is necessary to maximize the advantages of regional integration, and to avoid some of the potential dangers of inward-looking regionalization.

These are issues of sovereign interest to individual Member States, and the citizens of these countries themselves will bear most of the benefits and costs associated with success, or lack thereof, in this process. Nevertheless, there are several ways in which SADC could be of assistance. One possibility would be to follow the APEC example of using the regional forum to encourage and assist Member States in their domestic policy reform processes. An initial step might simply be to continue to benchmark progress in the various dimensions of MFN-based trade liberalization by providing standard formats and regular reporting schedules, so that members can see where they stand relative to their regional neighbors.[7]

[7] Tariff reduction offers of the Member States are all supposed to include information on MFN tariff rates for all goods listed in their offers. This was intended primarily to ensure that members offer preferential rates no higher than MFN rates in 1998. However, this reporting requirement could be extended, for information purposes only, by asking for annual updates on MFN rate structures and future reduction plans.

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