SOUTHERN AFRICA TRADE HUB

Technical Report:

Rules of Origin and the SADC Textiles and Garments Industries

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ACRONYMS

AGOA	African Growth and Opportunities Act
APDP	Automotive Production and Development Programme
BLNS	Botswana, Lesotho, Namibia, Swaziland
COMESA	Common Market for Eastern and Southern Africa
DCCS	Duty Credit Certificate Scheme
DTI	Department of Trade and Industry
EPA	Economic Partnership Agreements
EU	European Union
FTA	Free Trade Area
MFN	Most Favored Nation
MIDP	Motor Industry Development Plan
MMTZ	Malawi, Mozambique, Tanzania, Zambia
PTA	Preferential Trade Agreement
RIM	Research in Motion
SACU	Southern Africa Customs Union
SADC	Southern African Development Community
TDCA	Trade and Development Cooperation Agreement
US	United States
WTO	World Trade Organization

EXECUTIVE SUMMARY

The Southern African Development Community (SADC) rules of origin in the textiles and garments sector have been a source of considerable controversy and conflict within SADC. Provisional agreement was reached on a highly restrictive rule of origin that made separate and more lenient provisions for a number of the poorer Member States. However, the recent expiry of this provision, together with differences arising within the 'SADC group' in the recent Economic Partnership Agreements (EPAs) negotiations and major differences between the Common Market for Eastern and Southern Africa (COMESA) and SADC rules in this sector that would have to be resolved as part of any move towards a Tripartite Free Trade Area (FTA) have brought the issues to the forefront once again. This briefing note summarizes and explains some of the main issues, and possible ways to deal with them. It points out the critical role of SADC Member State tariff structures as an underlying source of continuing conflicts.

1. INTRODUCTION

The Southern African Development Community (SADC) rules of origin in the textiles and garments sector have been a source of considerable controversy and conflict within SADC. Provisional agreement was reached on a highly restrictive rule of origin that made separate and more lenient provisions for a number of the poorer Member States. However, the recent expiry of this provision, together with differences arising within the 'SADC group' in the recent Economic Partnership Agreements (EPAs) negotiations and major differences between the Common Market for Eastern and Southern Africa (COMESA) and SADC rules in this sector that would have to be resolved as part of any move towards a Tripartite Free Trade Area (FTA) have brought the issues to the forefront once again. This briefing note summarizes and explains some of the main issues, and possible ways to deal with them. It points out the critical role of SADC Member State tariff structures as an underlying source of continuing conflicts.

2. WHY RULES OF ORIGIN?

In a preferential trading arrangement (PTA) member countries agree to apply lower import duties (*preferential duty rates*) to goods imported from each other than they impose on imports from non-members (*most-favoured nation* (*MFN)* rates).

Differences in PTA members' MFN rate structures create an opportunity for traders to avoid a high MFN rate country's import duties by importing third country goods first into a lower MFN-duty partner and then bringing them into the high rate country under the preferential (usually zero) rates offered by the PTA. This is known as *trade deflection*.

The incentive for trade deflection clearly depends on differences in tariff rate structures among PTA members; the greater the differences in MFN tariff rates on important tradable goods the greater the incentive to engage in trade deflecting activities. If members' MFN tariff rates are low and relatively similar, there will be little incentive for trade deflection.

The simplest way to avoid the threat of trade deflection would be for partner countries to reduce and harmonize MFN tariffs—i.e. to make preferential tariff reductions part of a more general process of MFN tariff reform. This would expand the benefits of tariff reform and would also avoid the real danger and cost of diverting imports from low cost third country sources to higher cost ones in partner countries.[1]

For high MFN rate countries trade deflection can reduce the protection provided to local industries by tariffs on third country imports and/or erode customs revenues that otherwise would be collected on imports of such goods.

Rules of origin are an instrument for preventing trade deflection. They do so by setting out the criteria necessary for an import to be deemed to originate in a PTA partner country.

[1] Trade *diversion* occurs in which trade is diverted from a more efficient exporter towards a less efficient one by the formation of a free trade agreement.

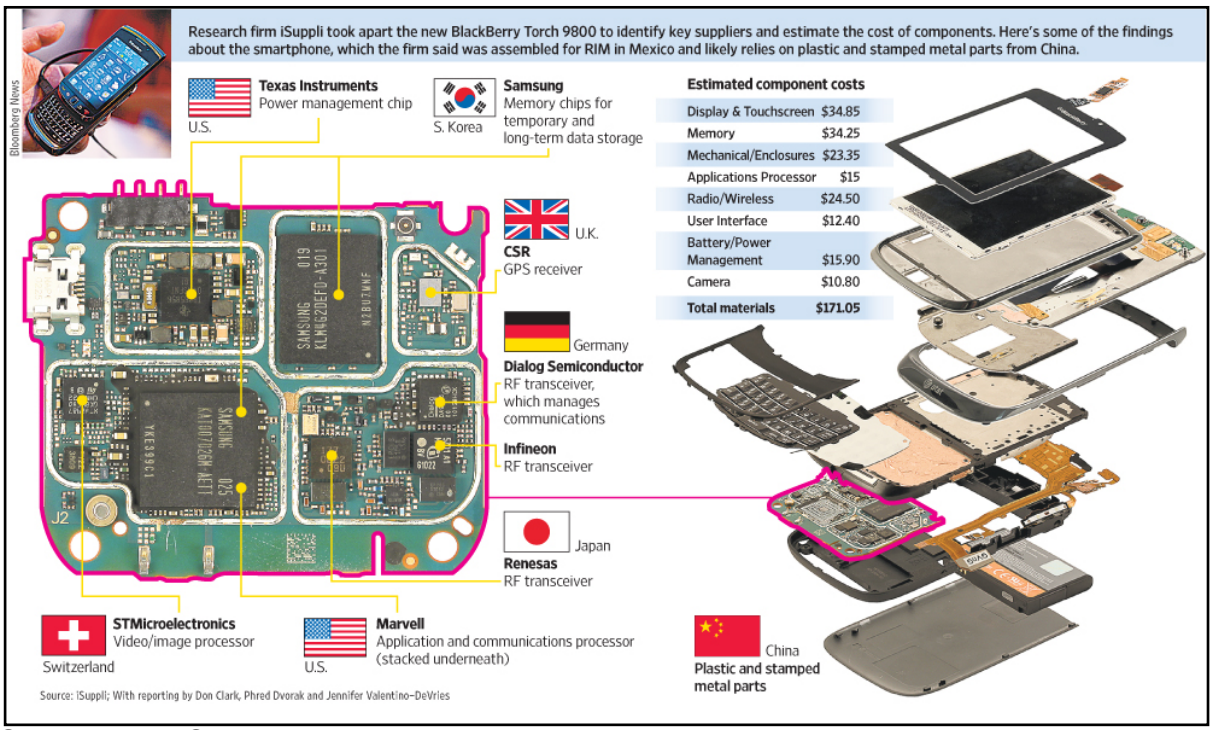
3. WHAT DO WE MEAN BY 'ORIGIN'?

For agricultural and other primary products 'origin' is generally a relatively straightforward concept. If corn is grown or a gold is mined in a particular country, it seems uncontroversial to deem it to have originated in that country and not elsewhere. Determination and certification of origin (as in the case of 'blood diamonds') might still pose problems; but the *concept* of origin is straightforward.

For manufactured goods, the concept of origin is more complex, especially in today's world of globally integrated value chains and production networks, in which final goods are designed in one (or more than one) place, assembled elsewhere, using components supplied from around the world.

The Blackberry Torch, for instance is a "Canadian" product, designed, produced and marketed by the Canadian company Research in Motion (RIM). However, as Figure 1 shows, the phone is assembled in Mexico and its key components are made all over the world by a wide range of international companies, presumably using materials sourced in an equally diverse set of locations.[2]

Figure 1. Where a Blackberry Torch is Made



Source: Wall Street Journal, 16 August 2010

Similarly, an iPod is assembled in China. However, less than 10 percent of its total final value actually originates there; the rest can be attributed to manufacturing and other activities that take place in many different locations all around the globe. The international

[2] Although the application and communications processor, the "brain" of the phone, is shown as a product of Marvell in the United States (US), it is most likely made in Taiwan. The investigators were not able to determine where the screen is manufactured.

fragmentation of global production chains, whether for sophisticated smart phones or basic garments, is inherent in modern manufacturing processes. As a result there is no simple way to describe most manufactured goods as coming from any particular location.

A common sense approach to rules of origin would be to require simply that a good must undergo some "significant manufacturing activity" in a partner country in order to qualify for preferential import status in another partner country. In addition, certain trivial operations such as labelling and repackaging should be clearly designated as insufficient to confer origin.

In practice, however, "significant manufacturing activity" is a broad term and is subject to arbitrary interpretation. To provide greater commercial certainty, therefore, rules have to be made more precise. Precision is generally provided by expressing the rules in terms of minimum amounts of partner country value-added, maximum amounts of third country content, or by defining certain necessary manufacturing processes. While such rules might sometimes increase certainty, there remains considerable room for administrative discretion. In addition, detailed rules and procedures almost always impose significant enforcement and compliance costs.

As a result, a considerable degree of arbitrariness is inherent in the design of any rules of origin regime. And the rules that are actually chosen are often costly to enforce and comply with.

This ambiguity in definition of origin for manufactured goods can make it tempting to use rules of origin to try to shape industrial development patterns or simply to stifle preferential trade. This is done through the imposition of rules that act as local or regional content requirements. Using rules of origin as a "development tool" to encourage development of local upstream components industries, however, is generally costly and often has exactly the opposite of effect to what is intended.[3] International experience with just-in-time production methods shows that companies prefer to source locally and regionally and will go to considerable lengths to induce suppliers to make this possible. However, there are always limits to the amount of local sourcing that is cost-effective. To impose additional local sourcing requirements raises costs, reduces competitiveness of local producers and discourages investment, to the detriment of both downstream and upstream industries that are the intended beneficiaries of the measures.

In today's world of fragmented manufacturing networks, with production of the inputs going into any final good taking place in many different places around the world, determining origin can be a tricky business. In fact, the whole idea of thinking of a good as originating in any particular place is fraught with danger.

For the purposes of administering a PTA, the real question is not whether a product claiming preferential treatment actually *originated* in a member of the PTA, but rather whether significant economic activity involved in its production occurred there. Was the supplying country in some meaningful sense a part of the global value chain for the production of the good claiming preferences?

Rules of origin regimes usually deal with this question in two ways. The first is to declare certain trivial activities such as packaging, labelling, and simple mixing of chemicals as

[3] Erasmus, Hennie, Frank Flatters and Robert Kirk 2006 "Rules of Origin as Tools of Development? Some Lessons from SADC"

insufficient to confer origin. The second, as a means of providing additional clarity, is to specify some minimal types of economic activity as being necessary to confer origin. This could be indicated by levels of local content, substantial transformation of products (often as determined by a change of tariff heading when moving from inputs to outputs), or specification of particular production activities that need to have taken place (such as cutting and stitching of cloth to make a garment).

4. RULES OF ORIGIN FOR TEXTILES AND GARMENTS: SOME INTERNATIONAL EXPERIENCE

Rules of origin in the textiles and garments sector are contentious. Existing rules are basically of two sorts.

- The first requires simply that products at each stage of the value chain be manufactured in an eligible country, with no restrictions on where intermediate products are sourced. Garments that are cut and sewn in an eligible country, for instance, are eligible for preferential tariff treatment regardless of where the fabric and yarn are sourced. This known as a “single stage transformation” rule. It corresponds to and does not impose undue restrictions on natural patterns of global supply chain management that characterize this sector.
- The second “standard rule” is much more restrictive, and requires that the fabric used in any garment also be manufactured in an eligible country. This is generally known as a “yarn forward” or “two-stage transformation” rule. This rule is generally imposed as a result of pressure from domestic industries in preference granting countries wanting to reduce the value of preferences granted to other countries and to deter competition in their local markets.

International experience in the garments and textiles sector illustrates some of the dangers of misuse of rules of origin.

In preferential arrangements with and among developed countries, special interests in the richer countries have often used rules of origin to diminish the value of preferences granted or to provide hidden protection for their own products. The garment industry is a classic example, where both the European Union (EU) and the US textile and garment producers have lobbied to insist that if preferences were to be granted to garments produced in poorer countries, they must be made from cloth and/or yarn produced in the preference-granting country or region. The only alternative was to use cloth and/or yarn produced in the preference-using country. Both of these criteria, of course, are an attempt to deny the whole process of global division of labour that characterizes the globalization of production over recent decades. In so doing these rules diminish and might even negate the value of the preferences being granted.

In the case of the African Growth and Opportunities Act (AGOA) an exception was made for a number of the least developed beneficiary countries to allow their garment makers to source fabric from third countries—i.e. with some restrictions and with a certain time limit (extended several times now, but not without creating troublesome uncertainty for producers) they were subject to a much less restrictive single transformation rule for garments. This turned out to be a great boon to a number of SADC countries, especially Lesotho and Swaziland. Because of this less restrictive rule of origin, AGOA preferences resulted in substantial exports and the creation of thousands of jobs in the beneficiary countries

The importance of the single transformation rule of origin was illustrated in a negative way by a bill passed by the US Congress requiring that garment makers in these countries source specific fabrics locally, but only if they were "commercially available" in the region. The first fabric chosen for this requirement was denim, for which there were several factories operating in Lesotho and South Africa. The stated rationale for the measure was to encourage the development of value chain linkages by giving investors in fabric production some assurance of local demand for their products once they became "commercially available." At the same time, garment producers would not be burdened with local content requirements for products that were not commercially available in the region.

The requirement turned out to be far less innocuous than had appeared. Although considerable amounts of denim were being produced in the region and were being used in jeans and other garments exported under AGOA, the quantities and qualities available were not always sufficient to meet the garment-makers' demands. The uncertainty created by the new requirement threatened to cause the closure of factories making both clothing and denim.

Of course the garment makers preferred to source locally; and in the early days of AGOA buyers and producers made considerable effort to develop local/regional fabric suppliers and do so where feasible. But to *require* them to do so under conditions set by a US government agency increased the costs and risks of their businesses. The 'denim rule' provided no more assistance to the local fabric producers than already was available as a result of the interests of the garment makers themselves. In other words, the requirement was either redundant, in which case it was unnecessary; or it increased costs for the garment makers and hence threatened the viability of their businesses.[4] Fortunately the Congress realized the dangers created by the denim requirement and repealed it before it caused serious harm.

In the case of South Africa's Trade and Development Cooperation Agreement (TDCA) with the EU the rules of origin are generally different from those under AGOA and reflect in large part the interests of EU producers wishing to diminish the value of tariff preferences. This was certainly the case in textiles and garments, for which the rule of origin requires that garments be made from fabric made in South Africa or in the EU—a highly restrictive two-stage transformation rule.

This approach to rules of origin was challenged in both rich and poorer countries during the EPA negotiations with the EU. The challenge met with considerable success and resulted in much less restrictive rules of origin for a number of sectors of importance to developing countries. In particular, in a triumph for economic rationality and for the interests of workers in poorer countries, the single stage transformation rule was agreed for textiles and clothing. This, however, left South Africa in the anomalous situation of still facing a more restrictive rule in its own agreement with the EU and it became one of the principal points of contention within the so-called SADC negotiating group. South Africa's complaint appears to have been not that it wished to have access to the less restrictive rule, but rather that it feared competition from "cheap" European garments entering the South African market through Southern Africa Customs Union (SACU) or SADC partner countries that benefited from the more lenient rule of origin. This issue remains under discussion in SACU and SADC.

[4] See Flatters 2007.

5. THE SADC EXPERIENCE

There has been a tendency in a number of south-south PTAs for complex and restrictive rules of origin to be justified as development tools—a way to stimulate the development of upstream-downstream production networks by making local or regional content a necessary condition for enjoying trade preferences.[5] It is well known from more general trade and development experience that this is a heavily flawed development model, and this is why local content and other performance requirements are outlawed in most MFN-based trade arrangements, and most importantly in the World Trade Organization (WTO).

Nevertheless, this approach heavily flavoured the difficult SADC Trade Protocol negotiations. As has been recounted elsewhere, the starting point for the SADC rules of origin was a set of relatively flexible and simple rules, with little or no attempt to fine tune differences across sectors. Largely as a result of South Africa's insistence the rules that were agreed were far more complex and had many similarities to those in the EU-South Africa TDCA.[6]

In the textile and garments sector the SADC negotiations resulted in a compromise. At South Africa's insistence SADC adopted the restrictive yarn-forward requirement as its standard rule. However, as a concession to poorer partner countries it agreed to a time- and quantity-limited single stage transformation rule that applied only to the MMTZ countries (Malawi, Mozambique, Tanzania and Zambia).[7]

Under this less restrictive rule a number of poorer SADC Member States were able to export garments to South Africa. For the period 2001-2009, MMTZ exports to South Africa hovered at 625 million USD primarily from Zambia and Malawi. Unfortunately there is some evidence as well of Asian-made garments being transhipped from some of these countries as "SADC-originating" products.

This concession was extended several times but expired at the end of 2009, resulting in the closure of a number of factories in these countries, and the movement of at least one of them to Swaziland (a member of SACU).

The insistence by SACU on two-stage transformation as the standard rule for this sector has been based on a number of arguments, of which the two key ones have been:

- To promote an integrated fibre-fabric-garments value chain by encouraging producers at each stage to source in the region.
- To prevent smuggling of cheap Asian garments through other Member States as happened in a number of cases under the MMTZ rule.

There is considerable evidence, internationally and in the region, that restrictions on the use of imported raw materials, in the form of 'strong' rules of origin or more direct local content requirements, are costly to and reduce the competitiveness of the raw material users and generally do little to assist the development of the raw material producing industries.

[5] Erasmus, Flatters and Kirk 2006

[6] See Flatters, Frank 2002, Rules of Origin and AGOA: Hard Choices for Textiles and Clothing in SADC Research Report prepared for USAID-funded SADC Trade Protocol Project, Gaborone Botswana and Erasmus, Flatters and Kirk 2006

[7] This was in return for a commitment by the MMTZ to provide improved market access for certain products of priority interest to the BLNS.

Following the introduction of AGOA American buyers and foreign investors invested considerable effort to find ways to source fabrics in the region. It was in their commercial interest to do so, regardless of rules of origin since, if could be done successfully it would shorten supply lines and reduce delivery times. For the same reason, regional garment producers, in South Africa and elsewhere have been trying for many years to develop regional supply chains. However, as interviews with South African garment producers made abundantly clear, their needs for even the local market, let alone more demanding and competitive global markets placed severe limits on their ability to source locally.[8]

One South African garment maker explained that if his firm had to satisfy the two-stage transformation rule in order to sell in the local and regional market they would not be able to do so; they would have to close their factory immediately (Flatters 2002). And this is in spite of the very high levels of protection against import competition that they enjoy in the local market.

The solution to the problem of smuggled and/or misrepresented Asian garments is to improve customs administration and enforcement. To solve the smuggling problem by imposing rules of origin that would make any legitimate imports impossible would be to destroy the whole point of any kind of regional trade agreement. Cooperation to improve administration of customs in general and rules of origin in particular is an ongoing activity in SADC.

A more fundamental reason for continued disagreement over rules of origin in textiles and garments is the wide diversity in SADC Member States' trade policies for the sector. The most serious problem in this regard is SACU's tariff structure, with tariff rates of 45 percent for many garments and around 20 percent for many domestically produced fabrics. This tariff structure reflects a strategy of trying to develop an integrated value chain based on heavily protected local and regional markets. This strategy is not shared among all Member States, with some of them much more interested in competing in much larger and lucrative global markets and others not willing to sacrifice low income consumers in a futile effort to compete in what they regard as dead end industry for their countries. Annex 1 provides a comparison table for SADC tariff rates in textile and garment sectors.

As long as SACU garment makers suffer the cost-raising impact of the fabric tariff they will suffer a cost handicap in competing in the domestic market against tariff-free SADC garments made in partner countries that do not protect their domestic textile industries (or at least not to the same extent as SACU). As long as SACU maintains this tariff structure there is unlikely to be agreement on rules of origin for this sector.

The first-best solution to this impasse would be for SACU to commit to liberalization of its import duties in these sectors. Failing this, rather than tying the rest of SADC to an otherwise difficult to defend two-stage transformation rule of origin, it might be preferable for SACUto exclude this sector from SADC free trade, and allow other Member States to trade according to a rule that would actually allow trade to take place.

6. EFFECTS OF TARIFFS, PREFERENCES AND OTHER INCENTIVES

SADC textile and garment industries are currently assisted or otherwise influenced by a number of key incentives. The most important of these are Member State import duties, duty preferences in a number of regional and global markets, rules of origin governing

[8] Flatters 2002; Erasmus, Flatters and Kirk 2006

eligibility for such preferences, and a production incentive (South Africa only at the moment) that recently replaced an export subsidy provided by a duty credit certificate scheme (DCCS). Ongoing policy differences concerning rules of origin in this sector cannot be understood or discussed independently of the impacts of these other incentives.

6.1 Import Duties

Import duty structures for the textile and garment industries differ considerably among Member States.

- Most Member States provide tariff protection to their local garment industries. However, as illustrated in Annex 1, tariff rates differ considerably. Among all SADC Member States SACU imposes the highest rates on garments. There is an import duty of 45 percent on a wide range of garments, including any products that are produced in South Africa or that might compete with products produced in South Africa. This duty was recently increased from 40 percent.
- The greatest differences however are in Member States' tariffs on yarn and fabric, with some countries providing little or no protection to these upstream sectors, while others and most importantly SACU impose relatively high tariff rates on these products. SACU import duties are about 20 to 25 percent on fabrics produced in or that compete with those produced in South Africa. Other fabrics are generally imported free of duty.
- Import duties on textile fibres are comparatively low.
- Fabrics and fibres that are imported for use in production of textiles and garments for export are eligible for full duty rebates on export of the final product.

6.2 Duty Preferences

- Textiles and garments meeting SADC rules of origin requirements are eligible for duty-free import when shipped from one SADC Member State to another. The magnitude of the resulting duty preference depends on the external duty charged on third country imports by the importing Member State. As mentioned above, these rates differ considerably among Member States.
- Qualifying African countries benefit from duty-free access to the US market under AGOA. The typical duty saving for most garments is 17 percent; however, for a few products the duty savings are even higher. Specified lesser-developed beneficiary countries (including Botswana, Lesotho, Namibia and Swaziland (BLNS) in SACU) face less restrictive rules of origin (but subject to overall annual export quotas) than do more developed countries (such as South Africa).

6.3 Production Subsidy

South Africa recently introduced a production subsidy for garment and textile producers to replace the previous DCCS export incentive scheme. The new program was inspired by a similar change in the incentives for the South African motor industry (previously the Motor Industry Development Plan (MIDP) and now rechristened as the Automotive Production and Development Programme (APDP)). While the precise details of the program are not yet clear, the main idea is to provide a cash subsidy based on actual production, most likely measured by some indicator of value added. Extension of the program to apply to all SACU producers is now under discussion.

6.4 Subsidies Given by Tariffs, Production Incentive and Duty Preferences

SACU import duties provide substantial subsidies to SACU producers selling in the customs union market.

These subsidies permit local firms to compete against foreign producers in the local market despite much higher manufacturing costs. Similarly, foreign tariff preferences allow SACU producers to compete in preference-granting markets on much more favourable terms than other exporters, thus allowing them once again to "compete" in spite of higher manufacturing costs. A production incentive adds to the value of subsidy regardless of the market in which the products are sold.

Non-SACU SADC producer that are able to meet SADC rules of origin requirements also benefit from the protection of the SACU tariff when they sell in the SACU market.

It is highly questionable whether open-ended subsidies such as these do much to encourage increased competitiveness or development of a sustainable industry—i.e. one that can survive in the absence of consumer and taxpayer subsidies. Rather, it might well do the opposite, by permitting the survival of non-competitive firms and activities.

Table 1 shows illustrative estimates of the size of the subsidy given to SACU garment producers when producing for the local market. It is based on the current import duties of 45 percent for garments, 20 percent for fabric and a production subsidy of 20 percent of domestic value added in production.[9] The subsidy is measured as a percentage of domestic value-added measured at world prices, i.e. as a percentage of the presumed manufacturing cost of globally competitive producers. It is estimated for two different cases—first assuming that the fabric is locally produced and hence protected by a 20 percent tariff and second assuming that the fabric is not produced locally and can be imported free of duty.

Table 1: Rate of Subsidy for SACU Garment Producers Selling Domestically (%)

	Subsidy Given By:	
	Tariffs Only	**Tariffs & Production Subsidy**
Fabric Dutiable	103	137
Fabric Non-Dutiable	150	184

Source: Own estimates.

Even when domestic garment producers suffer the full cost-raising effect of the tariff on imported fabric, the tariff structure alone is equivalent to a subsidy of 103 percent—i.e. domestic producers can be more than twice as costly (or half as efficient) as foreign competitors and still be able to sell profitably in the local market. If they use non-dutiable fabrics, the rate of subsidy rises to 150 percent. Providing a 20 percent production incentive as well increases the total rate of subsidy to 137 percent (if all fabrics used are dutiable) or 184 percent if they are not. In other words the production incentive and import tariff structure could allow local firms to compete in the local market even if their productivity were almost three times more costly than (or only 35 percent as productive as) their international competitors.

[9] This is measured as the difference between the value of output and cost of imported inputs at world prices. If the subsidy is based on value-added at domestic prices (which would probably have to be the case), it would be much larger, due to the much greater price raising effect of the import duty on garments than on fabric.

Non-SACU SADC garments producers that qualify for tariff preferences in the SACU market also benefit from the SACU tariff. Since most non-SACU Member States, and especially the MMTZ countries that until recently benefitted from the single stage transformation rule, have zero or at least very low import duties on fabric, their garment producers suffer no cost-raising effect. The subsidy they receive as a result of preferential access to the SACU market is the same as given to a SACU producer that uses non-dutiable imported fabric, i.e. 150 percent. This rate of subsidy is much higher than that received by SACU producers that rely on dutiable fabrics in producing for the local market. Without the production subsidy, the SACU producer's subsidy is "only" 103 percent. Even with a generous production subsidy the SACU producer is still at a significant disadvantage to non-SACU SADC producers that are able to access the SACU market under SADC preferences.

These estimates show quite graphically why SACU negotiators are reluctant to agree to any rule of origin that allows other SADC producers to enjoy preferences in the SACU market without having to source their fabric on the same, costly terms as local SACU producers.

Table 2 shows estimates of the implicit subsidy provided to eligible producers in SACU and in the rest of SADC by AGOA tariff preferences and by the SACU production incentive (for SACU producers only). It is assumed that exporters are able to take full advantage of normal duty rebate provisions on imported inputs used to produce goods for export. The estimates are done for goods normally subject to US import duty of 17 percent and for goods normally subject to US import duty of 30 percent. The latter obviously provides a higher implicit subsidy.

Table 2. Rate of Subsidy for Garment Producers under AGOA Preferences (%)

	Subsidy Given By:	
	Tariff Preference Only	**Tariffs & Production Subsidy**
US Duty of 17%	57	77
US Duty of 30%	100	120

Source: Own estimates.

Duty free privileges in the US market give eligible AGOA exporters a potential subsidy of as high as 57 percent for goods normally taxed at 17 percent when imported into the US and as high as 100 percent for goods normally subject to a tariff of 30 percent. The addition of a production subsidy (SACU producers only) increases these subsidy rates to 77 percent and 120 percent respectively. For non-SACU producers, it is clear that, despite the generosity of AGOA preferences duty free access to the SACU market is much more valuable. This would help to explain why producers in a number of poorer SADC Member States are so interested in continuation of the single stage transformation rule of origin in SADC.

The most critical determinants of eligibility for tariff preferences are rules of origin—the criteria for determining whether goods can be said to "originate" in a country eligible for such preferences.

7. Concluding Remarks

International experience and economic logic suggest that a single stage transformation rule of origin in the textiles and garments industries would be most appropriate for SADC. However, this runs into difficulties when faced with SACU's vision of the future of the

industry that is based primarily on production for the local market, supported by very high import duties (and also by a new “production incentive” and a variety of other assistance programs.) In these circumstances and in particular as long as SACU feels it necessary to grant high levels of import protection to its textiles industry, they are unlikely to agree to a rule that would give a significant advantage to other SADC producers in their own market.

Although there have been some signs of flexibility in South Africa’s approach, its reaction to the draft EPA agreement, and the decision to allow the so-called MMTZ rule in SADC to lapse recently, suggest that she continues to insist on the highly protective and restrictive two stage requirement in agreements with all countries, regardless of level of economic development of partner countries.

South Africa’s own producers admit that they could not meet such a requirement in any market, even its own highly protected domestic one. As long as SACU insists that producers in other Member States be required to meet the requirement continued deadlock is most likely. An alternative might be for SACU to declare this a sensitive sector and effectively opt out of SADC free trade in this sector—at least until it is prepared to change its trade and industrial strategy for this sector.

It is certainly difficult to understand why it would be in the interest of other SADC Member States to follow the SACU approach to industrial strategy in this sector, and thus penalizing their own consumers, especially the poorest of them, to support an industrial strategy in the narrow interests of only a small and uncompetitive segment of SACU’s industrial sector.

Frank Flatters, Bangkok
11 January 2011

ANNEX 1: SADC Tariff Structure in Clothing and Textiles (2009)

Cat	Product Description	Madagascar			Malawi			Mauritius			Mozambique			SACU			Tanzania			Zambia			Zimbabwe		
		MFN	Min	Max	MFN	Min	Max	MFN	Min	Max	MFN	Min	Max	MFN	Min	Max	MFN	Min	Max	MFN	Min	Max	MFN	Min	Max
50	Silk.	19.98	5	20	25	5	25	0	0	0	19.98	2.5	20	0	0	0	25	0	25	15	15	15	14.99	5	15
51	Wool	5.09	5	20	22.72	5	25	0	0	0	19.89	2.5	20	5.37	0	22	20.47	0	25	15	15	15	12.32	5	40
52	Cotton.	18.18	5	20	24.1	5	25	0	0	0	6.91	2.5	20	15.86	0	22	35.85	0	50	12.17	0	15	5.96	0	20
53	Other vegetable textile fibres	15.85	5	20	4.05	0	5	0	0	0	13.66	2.5	20	6.79	0	22	20.56	0	25	13.35	0	15	14.7	5	15
54	Man-made filaments.	13.21	5	20	14.93	5	25	0	0	0	11.88	0	20	12.83	0	22	23.08	10	25	6.97	0	15	6.57	5	15
55	Man-made staple fibres.	17.99	5	20	20.33	5	25	0	0	0	17.13	2.5	20	13.3	0	22	19.09	0	50	7.55	0	15	12.82	5	20
56	Wadding, felt & nonwoven;	18.99	10	20	11.55	0	25	1.43	0	30	5.68	2.5	20	14.47	0	20	11.56	0	25	21.2	5	25	19.79	5	40
57	Carpets and other coverings.	20	20	20	25	25	25	0	0	0	20	20	20	21.34	5	30	25	25	25	25	25	25	40	40	40
58	Special woven fab; tufted tex fab;	11.97	10	20	23.31	10	25	0	0	0	20	20	20	8.36	0	25	25	25	25	24.44	15	25	21.37	10	40
59	Impregnated, coated, textile fabr	15.71	0	20	21.22	10	25	0	0	0	7.6	2.5	20	9.67	0	22	10.35	0	25	9.07	0	25	8.91	5	40
60	Knitted or crocheted fabrics.	20	20	20	25	25	25	0	0	0	20	20	20	18.85	0	22	25	25	25	25	25	25	13.89	5	20
61	Art of app & clothing access, knitted	20	20	20	25	25	25	0	0	0	20	20	20	43.75	0	45	25	25	25	25	25	25			
62	Art of app & clothing access, not knit.	16.88	10	20	24.98	10	25	0	0	0	20	20	20	43.47	0	45	25.05	25	50	25	25	25	10	10	10
63	Other made up textile articles; sets;	15.48	0	20	22.93	10	25	5.35	0	15	19.62	2.5	20	27.57	0	60	25.78	0	50	21.43	0	25	17.77	5	40

Source: UN Trains Database