Monitoring REGIONAL Integration in Southern Africa

Yearbook Volume 9 - 2009

Anton Bösl, Gerhard Erasmus, Trudi Hartzenberg, Colin McCarthy

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Foreword

Regional integration and Regional Economic Communities (RECs) have been considered as important and successful instruments of political cooperation, economic growth, socio-economic development and general stability. Whilst globalisation with all its implications has taken its irreversible and speedy course, the dynamics of regional integration are slow – and RECs, especially in Africa, are not fully meeting their visions, not fulfilling all their promises, and not yet delivering the desired outcomes and services to the members of their communities and states.

Especially in the southern African region, with its comparatively small economies, it was hoped that regional integration would play a crucial role in pursuing common strategic interests for the successful socio-economic and political development of the countries involved. However, the latest developments surrounding the economic partnership agreements (EPAs) of some Southern African Development Community (SADC) member states with the European Union, and the current debate about the future of the Southern African Customs Union (SACU), already seem to be having a negative impact on achievements as regards creating common ground among SADC member states towards the EU and to the benefit of the SADC region as a whole. Although SADC was not affected by the global financial crisis to the extent suffered by other countries and regions in the world, it could have, as a strong REC, responded more effectively to it.

Regional integration and strong RECs in general and a strong SADC in particular could pay dividends – especially in the context of challenges which go far beyond the boundaries and the resources of individual states and regions. Global challenges like climate change with its expectedly huge impact on Africa, the globalisation of economic affairs, and the financial crisis (to name but a few) cannot be overcome by individual countries, but require the united efforts of regional blocs and continents. Global and regional challenges affecting Africa should stimulate regional integration, if anything, and lead to the strengthening of its organs. For the sake of regional integration, certain national interests and unilateral efforts should be abandoned – although the opposite seems to drive many of the stakeholders. Regional integration is still unfinished business, however, and needs fresh commitment and strong reinforcement.

The Yearbook 2009 provides important information on the status and development of regional integration in the southern African subcontinent. From 2000 to date, the Yearbook was intended – and has indeed served – not only as an essential source of well-researched information for academics and politicians alike, but it also stimulates constructive debate on regional integration and its potential to propel SADC – and even the continent itself – into the future with additional impetus.

The Konrad Adenauer Foundation shows both a keen interest and a deep involvement in regional integration. This reflects the very nature of the organisation – being named after Konrad Adenauer, the first Chancellor of the Federal Republic of Germany as well as being one of the founders of the European Union – but it also bears testimony to the Foundation's conviction that regional integration and its dynamics will lead to sustainable development for all.

In order to implement its programmes, the Konrad Adenauer Foundation relies on its qualified partners worldwide. In this instance, therefore, we are most grateful for the vital role played by the Trade Law Centre for Southern Africa (tralac) in their facilitation not only of this associated publication.

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Contents

Introduction

Monitoring the process of regional integration in Southern Africa in 2009

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The regional integration agenda in Southern Africa maintains a very high profile on the broader development agenda of this region. During 2009 several important developments highlighted specific challenges for policy makers in Southern Africa. It is of course also important to recognize that the global economic crisis continued to impact on the region in 2009. The fall out of the debt crises in the euro countries, initiated by the Greek debt crisis and the financial assistance this necessitated, are also having a negative impact on world financial markets which could be transmitted to real economic activity in the course of 2010. The open economies of southern Africa will not be isolated from these events.

Although the Southern African Customs Union (SACU) is not recognized as one of the eight building blocks of the African Economic Community, developments in this regional economic community have important implications for the broader Pan African integration agenda. All SACU members are also members of the Southern African Development Community (SADC), and with South Africa as the anchor member of SACU, its policy on regional integration can be expected to have an important impact on the broader Southern African region.

In June 2009 Botswana, Lesotho, Mozambique and Swaziland signed the Interim Economic Partnership Agreement (IEPA) with the European Union (EU). These four countries are members of the Southern African Development Community (SADC), while all except Mozambique are also members of SACU. Concerns have been raised over the effects the signing of the interim EPA will have on the Southern African Customs Union (SACU), recognizing that two SACU member states – South Africa and Namibia – chose not to sign the interim EPA. South Africa in particular raised concerns about its future membership of SACU should the three member states implement the IEPA. Arguably the strong glue keeping SACU together is the revenue sharing arrangement in terms of which South Africa argues that it is making transfers to the smaller SACU states.

The EPA negotiations have proved to very more challenging that could have been expected by any of the parties, and these negotiations have served to highlight the parlous state of regional integration, especially in Southern Africa. Given that the groups of countries constituting negotiating configurations cut across existing regional economic communities, they have added to an already complex regional integration agenda.

The demise of SACU would bring more problems than this could solve. The smaller countries rely heavily on the revenue from the SACU revenue pool, and with very few options for raising government revenue, are extremely vulnerable, should South Africa withdraw from SACU. This is however not to suggest that it should be business as usual for the future of SACU. SACU presents many challenges that other regional economic communities face too. While a review of the revenue sharing arrangement and indeed also other provisions of the 2002 SACU Agreement may well be necessary, there are other challenges too.

Implementation challenges continue to bedevil regional integration in Southern Africa and elsewhere on the continent. Agreements are often signed very enthusiastically, but implementation follows a much slower process. In the case of the 2002 SACU Agreement, key institutions provided for in the Agreement, including the Tariff Board and Tribunal, have not been established. Further, common policy development in key areas such as agriculture and industrial development has made very little progress. Without effective implementation the potential benefits of such agreements will not be realized.

SACU member states are well aware of the challenges that they face. At a Special Council Meeting on 17 September 2009 in Ezulwini, Swaziland, the Council of Ministers reviewed the challenges facing SACU and deliberated on the future of the SACU. They emphasized the importance of common policy development, the establishment of the institutions provided for in the Agreement, and the need to strengthen the Secretariat.

As the hegemonic member of SACU, South Africa plays an important role in the customs union. General elections were held in South Africa in April 2009, and important developments within South Africa following the election will have implications for the future of SACU, and the region's broader integration agenda.

The April election was followed by changes to Cabinet and the establishment of a new Government Department, the Department of Economic Development (DED) that has direct implications for regional integration. The relationship between this Department and the Department of Trade and Industry (DTI) is important in this regard. DED will be responsible for the oversight function for the International Trade Administration Commission (ITAC) which currently serves as SACU's Tariff Board, as well as the Competition Commission, and the Industrial Development Corporation. In the case of ITAC, this means, for example, that recommendations on tariff applications, which could result in changes to the common external tariff (CET), are to be referred to DED, rather than to DTI as was previously the case. Relevant to this change is the fact that South Africa's development strategy and its Industrial Policy Action Plan that was also launched in 2009, has a core focus on employment (job preservation or job creation) in South Africa. With an arguably more inward looking policy focus, the smaller SACU member states need to engage South Africa on trade and industrial development issues far more actively than has been the case.

Namibia which has chosen, along with South Africa and Angola, not to sign the Interim EPA with the EU, held Presidential and National Assembly elections in November 2009. Although nine opposition parties have taken a petition to the High Court (and in the meantime to the Supreme Court) of Namibia contesting the results of these elections (the case is still pending), the Chief Justice has already sworn in the President, the new members of Parliament and the newly appointed Ministers. The Cabinet however has hardly changed and the Minister of Trade and Industry remained in his position. It is therefore unlikely that there will be a radical change in policy and attitude towards the EPA negotiations and regional integration as such from the Namibian government.

Namibia´s capital Windhoek is also the seat of the SADC Tribunal which has been established in 1992 as one of the institutions of SADC and became operational in 2005. Its role in regional integration must not be underestimated and its judgements have an impact on the SADC legal integration. The SADC Tribunal judgement on "Campbell v the Republic of Zimbabwe" had been referred to the 2008 SADC summit for implementation but with no result and impact so far. In 2009 lawyers representing Zimbabwean farmers have therefore approached the SADC Tribunal again wanting the Tribunal to declare the Zimbabwe government in breach of the SADC Treaty. Although the Tribunal accepted the application and referred the matter to the 2009 SADC summit there was no official response and consequence. After all the lawyers representing the Zimbabwean farmers have now requested the SADC Tribunal to recommend that SADC either terminate or suspend Zimbabwe´s membership for ignoring its judgement. If the SADC Tribunal accepts this application the 2010 SADC summit (convened in Windhoek) has to put the issue on its agenda and calling Zimbabwe to order. It remains a subject of speculation if and how the 2010 SADC summit in Windhoek will deal with its (unruly) member.

With regard to Peace and Security significant developments took place in SADC in 2009. In order to more effectively deal with human and societal security in the region, especially in respect of human trafficking, money laundering and transnational crime, SADC strengthened the nascent security community. The most significant developments have been the formal recognition of the "Southern African Regional Police Chiefs Cooperation Organisation" (SARCPCCO), which also co-operates with Interpol, as a SADC institution. Moreover, SADC also recognized the Harare-based SADC Regional Peacekeeping Training Centre (RPTC) as a constitutive institution. The RPTC is now part of a SADC structure falling under the Directorate of Politics, Defence and Security of the Organ and has emerged as regionally recognized Centre of Excellence in Peacekeeping and Peace Support training. The RPTC provides and coordinates all training in the region for SADC and multi-national peacekeeping missions as mandated by the regional body.

SADC also decided in 2009 to align its security architecture with the 2000 Constitutive Act and Common Defence and Security Policy of the African Union (AU). In this context, the former SADC Brigade (SADCBRIG) has been renamed as the SADC Standby Force (SADCSF).

Following an earlier resolution of the 2006 SADC Summit, SADC also decided to conduct a strategic review of the SADC Strategic Indicative Plan for the Organ (SIPO). The review is expected to be tabled at the 2010 SADC Summit in Windhoek, Namibia.

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June 2010

Chapter 1

Redefining the relations between the African Union and regional economic communities in Africa

Richard Frimpong Oppong

1. Introduction

Africa is awash with regional economic communities (RECs). Indeed, as far back as 1976, Ajomo (1976: 101) picturesquely described the 'mercurial proliferation and disappearance' of regional economic institutions in Africa. For political, economic and strategic reasons many countries belong to more than one REC. The multiplicity of RECs and the concomitant multiple state memberships have created a complex patchwork that complicates decision making for states, community officials, individuals and businesses. In what is, to date, the only detailed continent-wide empirical study into the effect of the twin phenomena of many RECs and multiple memberships, the United Nations Economic Commission for Africa (UNECA) concluded that the phenomena impact negatively on the achievement of the goals of the African Economic Community (AEC).[1] In June 2009, some member states could not join the newly formed COMESA customs union due to the fact they belonged to other RECs. The phenomena also impact negatively on Africa's international trade relations. In the recent European Union led Economic Partnership Agreements negotiations, countries in Eastern and Southern Africa – the regions where the phenomena are most prevalent – had to form new regional groupings for the purposes of the negotiations (Jacobeit et al. 2005).

Against this background, a fundamental issue with Africa's economic integration is the relationship between the African Union (AU), RECs and the AEC. This is a complex matter. But, so far, it has not received any systematic examination in the discourse on Africa's economic integration.[2] Finding answers to it and clarifying the relationship are important for the success of economic integration in Africa.

[1] See UNECA (2006). See also Jakobeit et al. (2005).

[2] Senghor's (1993) commentary on the processes leading to the formation of the AEC suggests that there were some discussions on this question. Indeed, he suggests that the relationship between the OAU and the AEC was a theme of special study by experts. Arguably, the existing legal framework does not suggest that the question was thoroughly addressed. See Senghor (1993: 183).

The proliferation of RECs in Africa is part of a wider international phenomenon, the proliferation or increased density of international institutions. Against the background of this phenomenon, scholars have recently begun to discuss in great detail theories on 'regime complexes' (Raustiala and Victor 2004: 277) or 'international regime complexity' (Alter and Meunier 2009: 13). A regime complex is an 'array of partially overlapping and non-hierarchical institutions governing a particular issue-area' (Raustiala and Victor 2004: 279). The components of a regime complex are the 'elemental regimes' (Ibid.). International regime complexity refers to the presence of nested, partially-overlapping, and parallel international regimes that are not hierarchically ordered (Alter and Meunier 2009). International regime complexity empowers and disempowers (Drezner 2009: 65). It may work to the advantage of certain groups by providing opportunities for 'forum shopping' and arbitrage (Raustiala and Victor 2004: 280, 299-300). It may also disadvantage certain states or groups, such as on the basis of the sheer volume of information that has to be processed from the various regimes.

Studies on regime complexes help in understanding the relations between the many RECs in Africa. These RECs are non-hierarchical regimes with overlapping membership and jurisdiction. However, in terms of the focus of this paper, there is one limitation in the studies I have so far examined which is worth pointing out. The existing studies have focused mainly on the evolution and interactions between rules or norms generated by elemental regimes of a regime complex. However, this paper focuses principally on the institutional aspects of the co-existence of elemental regimes. In other words, the focus is mainly on institutions, not the norms generated by the institutions. Specifically, the paper addresses the issue: how do the RECs as regional institutions relate to each other and with the AU and AEC? Also, the issues discussed in this paper arise largely from the specific and apparently unique character of institutional density on economic integration in Africa. That is, the RECs ostensibly operate under an umbrella regime, the AEC, and their activities should be geared towards the realisation of one objective, namely the creation of an African Economic Community. Thus, unlike other complex regimes, what exists in Africa is a complex regime on economic integration consisting of many elemental regimes (the RECs) and an umbrella regime (the AEC) all working towards a common and singular treaty-mandated vision.

2. Existing regulatory legal framework

International regime complexity on many issues, such as intellectual property protection, human rights, international security and environment, do not have an overarching or umbrella regime that regulates the multiple regimes dealing with the particular issue. Arguably, as regards international trade in goods and services and regional trade agreements, an overarching regime apparently exists in the World Trade Organisation (WTO).[3] WTO law provides the legal foundation for regional trade agreements on goods and services. The WTO has mechanisms for notifying such agreements, reviewing them and for monitoring their compliance with WTO law. Such mechanisms do not affect the non-hierarchical nature of regional trade agreements. But, the mechanisms could have ensured a measure of coordination and harmonisation among them through their compliance with a higher norm – WTO law. However, as scholars have noted, the mechanisms are ill-equipped and ineffective, and the powers of enforcement and review have not been exercised rigorously (Devuyst and Serdarevic 2007–2008: 1).

Unlike with the WTO and regional trade agreements, international regime complexity on economic integration in Africa benefits from an umbrella regime, the AEC, and a modest regulatory framework under the Protocol on Relations between the African Union and the Regional Economic Communities (Protocol on Relations).[4] The framework aims at harmonising and coordinating the activities of the RECs (Protocol on Relations 2009: 3(a)(b)). This is important since, unlike regional trade agreements established with the imprimatur of the WTO, the aim of Africa's RECs is to evolve and ultimately be absorbed into the African Economic Community.[5] Article 3(a) of the Protocol on Relations aims to formalise, consolidate and promote close cooperation among the RECs, and between them and the AU through the coordination and harmonisation of their policies, measures, programmes and activities in all fields and sectors. Another object of the protocol is to establish a framework for coordinating

[3] See the General Agreement on Tariffs and Trade, art. XXIV; General Agreement on Trade in Services, 15 April 1994: 46, art. V; Decision on Differential and more Favourable Treatment, Reciprocity and Fuller Participation of Developing Countries, 28 November 1979, GATT B.I.S.D (1980 203, par. 2(c)).

[4] July 2007, (2010) 18 Afr. J. Int'l & Comp. L. (forthcoming) [Protocol on Relations]. This protocol replaces the *Protocol on Relations between the African Economic Community and the Regional Economic Communities*, 25 February 1998, (1998) 10 Afr. J. Int'l & Comp. L 157.

[5] See the *Treaty establishing the African Economic Community*, 3 June 1991: art. 88(1) [AEC Treaty].

the activities of RECs in their contribution to the realisation of the objectives of the Constitutive Act of the African Union and the AEC Treaty (Protocol on Relations 2009: art. 3(b)).

To ensure the realisation of these objectives, the parties to the protocol (namely the AU and the RECs) have undertaken to cooperate and coordinate the policies and programmes of the RECs with those of the AU (Ibid.: art. 4(a)). Specifically, the RECs have undertaken to establish an organic link with the AU with a view to strengthening their relations with the AU and provide for their eventual absorption into the African Common Market as a prelude to the AEC (Ibid.: art. 5). To enhance cooperation among the RECs, there are also provisions mandating or advocating entering into cooperation arrangements (Ibid.: art. 15(1)), and participation in each other's meetings (Ibid.: art. 16(1)). The RECs and the AU can, without voting rights, attend and participate in each other's meetings (Ibid.: art. 17;19). The Protocol of Relations establishes the Committee on Coordination and the Committee of Secretariat Officials as the institutions responsible for ensuring the coordination of policies and activities of the RECs and the implementation of the protocol (Ibid.: art. 6-10). The AU is also expected to open a liaison office at the headquarters of each REC (Ibid.: art. 21).

The regulatory framework under the Protocol on Relations is complemented by provisions in the founding treaties of the RECs dealing with their relations with other RECs and the AEC. For example, the EAC Treaty provides that the member states 'shall foster cooperative arrangements with other regional and international organisations whose activities have a bearing on the objectives of the Community' (EAC Treaty 1999: art. 130(3)). The COMESA Treaty (1993: art. 179(1)) also allows the organisation to 'enter into cooperation agreements with other regional communities'. A similarly worded provision is contained in the ECOWAS Treaty.[6] Obviously, these provisions are empowering, and some RECs have relied on them to establish cooperation arrangements with other RECs.

[6] See the Revised Treaty establishing the Economic Community of West African States (1993 art. 79(1)) [ECOWAS Treaty]. The Treaty of the Southern African Development Community (1992: 120) contains little detail on its relations with the AEC apart from a reference to the AEC in its preamble and a general reference to cooperation with regional and international organisations in article 24.

The first and perhaps the most historic was the COMESA-EAC-SADC Tripartite Summit of Heads of State and Government held in Kampala, Uganda in October 2008 under the theme, 'Deepening COMESA-EAC-SADC Integration'. In a joint communiqué issued after the summit,[7] it was noted that the Heads of State and Government reviewed the activities of the three RECs, agreed on a programme of harmonisation of their activities, and expressed their resolve to cooperate in the future. It was also resolved that the three RECs should immediately start working towards a merger into a single REC with the objective of fast-tracking the attainment of the African Economic Community. A taskforce was set up to design a roadmap for this merger. The Heads of State and Government also approved the expeditious establishment of a free trade area encompassing the member states of the three RECs with the ultimate aim of establishing a single Customs Union. In line with a mandate from the Heads of State and Government, a Memorandum of Understanding on Interregional Cooperation and Integration has been signed among the three RECs and joint meetings have been held since the Tripartite Summit.

As regards relations with the AEC, the founding treaties of the RECs acknowledge the existence of the AEC and undertake to facilitate its goals.[8] However, they do not provide much detail on what form their relations with the AEC are or should be. The COMESA Treaty (art. 178(1)), the most detailed as far as this issue is concerned, affirms that its ultimate objective is to facilitate implementation of the AEC Treaty. It enjoins member states to implement the provisions of the COMESA Treaty with due consideration to the provisions of the AEC Treaty (art. 178(1)(b)), and convert the organisation, at a time to be agreed between it and the AEC, into an organic entity of the AEC (Ibid.). It enjoins the Secretary General of the Community to coordinate the activities of COMESA with the AEC and report regularly to the Council of Ministers (art. 178(2)). Indeed, in the preamble to the COMESA Treaty, the foundation of COMESA is traced to article 28(1) of the AEC Treaty which called for the strengthening and creation of RECs as the first stage in the evolution of the AEC. Also, 'the establishment, progress and the realisation of the objectives of the African Economic Community' are stated among the aims and objectives of COMESA (art. 3(f)). These very generous provisions demonstrate a level of attention to problems of

[7] See Final Communiqué of the COMESA-EAC-SADC Tripartite Summit of Heads of State and Government (22 October 2008).
[8] ECOWAS Treaty, art. 78; EAC Treaty, art. 130(2)(3); COMESA Treaty, art. 3(f).

the relations between the AEC and COMESA. Admittedly, they still leave many hard issues unresolved. But, compared with those of other RECs, they are advanced. In the EAC Treaty (art. 130(2)), the EAC is described as 'a step towards' the achievement of the objectives of the AEC Treaty. In the ECOWAS Treaty (art. 78), members undertake to facilitate 'the coordination and harmonisation' of the community's policies and programmes with those of the AEC. However, none of the treaties provide concrete details on its relations with the AEC. In other words, they do not address specific issues such as: the legal nature of their relations with the AEC, whether they are bound by decisions of the AEC, and whether AEC law will prevail over their law in cases of conflict.

The above framework for regulating relations among the RECs as well as their relations with the AEC is short on detail and leaves many issues unaddressed. The next section discusses some of these issues and argues that, unless addressed, they could undermine the effectiveness of Africa's economic integration.

3. Unaddressed inter-community relational issues

3.1 Legal status: RECs within the AEC, AEC within the AU

Perhaps one of the greatest mysteries about Africa's economic integration is the legal status of the RECs within the AEC, and the AEC within the AU. The treaties do not shed much light on the issue and academic commentary on it is largely non-existent.[9] The starting point to unravelling this mystery, if it can be done at all, is the idea of legal personality.[10] All the RECs are endowed with legal personality in their founding treaties.[11] Although the AEC Treaty does not expressly say so, the legal personality of the AEC can be inferred from article 98(2), which provides that, in his capacity as the legal representative of the community, the Secretary-General may, on behalf of the community, enter into contracts and be a party to judicial and other legal proceedings. The Constitutive Act of the African Union [Constitutive Act] is silent on the legal personality of the AU. This may, however, be explained by the fact

[9] See generally M.A. Ajomo, "International Legal Status of the African Economic Community" in M.A. Ajomo & Omobolaji Adewale eds., *African Economic Community Treaty: Issues, Problems and Prospects* (Lagos: Institute of Advanced Legal Studies, 1993) at 40.
[10] See generally Amerasinghe 2005: 66-104).
[11] COMESA Treaty, art. 186(1); EAC Treaty, art. 138(1); ECOWAS Treaty, art. 88(1).

that, under the General Convention on Privileges and Immunities of the Organisation of African Union, the OAU (now AU) possesses 'juridical personality'.[12]

With these provisions, the legal separateness of the RECs, AEC and AU is established in international law. Accordingly, the legal status of one within the other should be defined by agreement to which both are parties, or, at least, in some definite and binding agreement. As regards the AEC and the AU, the AEC Treaty (art. 98(1)) is very clear that the AEC is an 'integral part' of the AU. The Constitutive Act further provides that its provisions take precedence over and supersede any inconsistent or contrary provisions of the AEC Treaty (art. 33(2)). If one envisions the AU as a political and umbrella organisation championing the cause of Africa unity – social, cultural, political and economic – then the AEC is that part of the AU solely devoted to the issue of economic integration. Comparatively, the relationship between the AEC and the AU is akin to that between the European Community (EC) and the European Union (EU). But, it must be admitted that even the relationship between the EC and EU is not without difficulty.

A difficult issue concerning the idea of the AEC as an integral part of the AU is how the idea appears to have been interpreted and applied. Like many words, 'integral' has multiple meanings. To the extent relevant here, the word describes component parts which, together, constitute a unity. It emphasises divisibility, separateness and unity at the same time. As regards the relations been the AEC and the AU, it seems unity has been overemphasised and this has led to the complete or near complete loss of the separateness or distinct identity of the AEC. Laws and policies dealing with AEC-related issues are adopted by the AU instead of the AEC.[13] Also, institutions of the AU have been coopted to perform the functions of institutions of the AEC. But, there has been neither a clear separation of mandates nor examination of whether, as designed, the AU institutions are effectively equipped to manage the economic integration agenda.

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[12] See the General Convention on Privileges and Immunities of the Organization of African Unity, 25 October 1965.

[13] See e.g. Protocol on Relations (which should in principle have nothing to do with the AU but is misleadingly titled as such and signed 'for the AU' not the AEC). Compare Protocol on Relations between the African Economic Community and the Regional Economic Communities (which was signed by the AEC).

An equally difficult issue is the legal status of the RECs within the AEC. Although the AEC Treaty contains over twenty references to 'regional economic communities', provides that the African Economic Community shall be established through the coordination, harmonisation and progressive integration of the activities of the RECs, and imposes many duties with exact timelines on them, there is not a single provision on the status of the RECs within the AEC. Are they mere institutional observers within the AEC? Are they its organs, members, agents or subjects? Commentators on Africa's integration have assumed, and rightly so, that the RECs are the building blocks of the AEC. But, so far, none has investigated this important issue. The Protocol on Relations does not address this issue either.[14] It is an issue of both theoretical and practical importance. For example, it is legally difficult to suggest that a REC is bound by decisions of the AEC[15] unless one is able to prove that the former is an organ, member, agent or subject of the latter.

The AEC Treaty does not set out a membership criterion, but it is implicit in article 2 that states which parties to the treaty are members of the AEC. There is no provision limiting membership of the AEC only to states.[16] However, membership of an international organisation cannot be inferred; there must be a conscious act on the part of a prospective member to become a member of an international organisation and an acceptance of its membership application by the organisation (Amerasinghe 2005: 104-114). In the absence of a definite agreement to that effect, it cannot be suggested that the RECs are members of the AEC. Nor can it be argued that the RECs are organs of the AEC; article 7 of the AEC Treaty clearly does not mention them.[17] From a purposive reading of the AEC Treaty (to which the RECs are not parties) and the Protocol on Relations (to which they are parties), it can, however, be argued that the RECs are subjects of the AEC. They are also agents of the AEC with a mandate to work towards the realisation of the AEC.

[14] Articles 18 and 20 deal with the status of the RECs at AU meetings and the status of the AU at the RECs meetings respectively.
[15] See AEC Treaty (1991: arts. 10(2) and 13(2)).
[16] There are international organisations that allow other international organisations to become members. See e.g. Statute of The Hague Conference of International Law, art. 3; Marrakesh Agreement Establishing the World Trade Organisation, art. XII; Constitution of the Food and Agriculture Organisation of the United Nations, art. II.
[17] It provides that the organs of the Community shall be the Assembly of Heads of State and Government, Council of Ministers, Pan-African Parliament, Economic and Social Commission, Court of Justice, General Secretariat and Specialised Technical Committees.

3.2 The Future merger of the Regional Economic Communities

The foundation of the AEC is the RECs; progress by the RECs is one step closer to the African Economic Community. This unique and hitherto unexplored approach to forming the AEC raises numerous legal challenges. The size of the AEC makes the approach of using RECs as its building blocks almost inevitable. But this approach comes at a price. For example, a recent UNECA (2006) study suggests that there is often tension between member states' commitment to the goals of the RECs and those of the AEC. Also, concurrent membership of RECs creates tension among member states and between the RECs (Ibid.).

The RECs are ultimately expected to merge or be 'absorbed' (Protocol on Relations, art. 5(1)(d)) to form the AEC. Under article 88(1) of the AEC Treaty, the African Economic Community 'shall be established mainly through the coordination, harmonisation and progressive integration of the activities of [RECs]'.[18] The simplicity of this provision masks the complexity of the engagement of merging or absorbing international organisations such as RECs. Firstly, it is a unique and quite complicated approach to economic integration. To my knowledge, it has not been experimented with anywhere else. Usually, countries form economic communities – free trade areas, customs union, economic unions, or complete economic integration. Indeed, to date, it appears the only known case of a successful 'merger' of RECs has been the merger of the European Community with the European Free Trade Area to form the European Economic Area.[19] A more recent attempt is the Union of South American Nations[20] which is a continent-wide free-trade zone that unites the Common Market of the Southern Cone and the Andean Community. Secondly, the status of the RECs after the formation of the African Economic Community is not free from doubt. Whether they will disappear entirely or would continue to operate as a

[18] Article 3 of the Constitutive Act of the African Union also underscores the need to 'coordinate and harmonise the policies between existing and future Regional Economic Communities for the gradual attainment of the objectives of the [African] Union'. Indeed, this is described as an 'objective' of the Union.

[19] See Riechenberg (1995:. 63).

[20] It consists of Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela. See Union of Southern American States Constitutive Treaty, 23 May 2008.

mid-level legal system is not dealt with in the AEC Treaty or any protocol.[21] Nor do the founding treaties of the RECs shed any brighter light on these issues.

The COMESA Treaty (art. 178(1)(c)) envisages the conversion of COMESA into an organic entity of the AEC. This suggests that COMESA does not envision the formation of the AEC as its demise. The treaty provides that the Authority of Heads of State and Government may, on the recommendation of the Council of Ministers, terminate the operations of the COMESA (art. 192(1)). This suggests that a legal mandate exists for bringing COMESA to an end, if that is what is envisioned under the AEC Treaty after the formation of the African Economic Community. Neither the ECOWAS Treaty[22] nor the EAC Treaty[23] contains any provision directly relevant to their status after the formation of the African Economic Community. Indeed, the EAC Treaty (art. 144) is of perpetual duration.[24] Also, some of the RECs have pursed and are pursuing objectives beyond economic integration such as conflict prevention and political unification. Accordingly, it is difficult to suggest that the formation of the AEC will represent the end of the RECs.

The founding treaties of the RECs were drafted after the AEC Treaty. Therefore one would have expected them to address the issue of their status after the formation of the AEC more comprehensively and, perhaps, uniformly. As organisations created by treaties, the state parties retain an inherent right to terminate the treaties (Vienna Convention on the Law of Treaties 1969: art. 54(b)) if that is what will be needed for them to merge and form the AEC. As the RECs are progressing further through the stages of integration, the merger issue should engage the attention of the AEC. A merger protocol is needed. Indeed, I would suggest that negotiating a merger protocol should start now, given the complexity and size of the undertaking. It should

[21] UNECA conceives the future relationship between the AEC and the RECs in this way: After the RECs have achieved a customs union and a common market, they will merge to form the African Common Market, and the fully-fledged African Economic Community intervention will follow. The African Economic Community will take the lead on dealing with member countries, and the functions and structures of the regional economic communities will be revised to serve as its implementation arms. See UNECA (2005: 94).

[22] Article 2(1) provides that the member states have decided that ECOWAS shall ultimately be the sole economic community in the region for the purpose of economic integration and the realisation of the objectives of the African Economic Community.

[23] In the preamble to the treaty, the member states affirmed their desire for a wider unity of Africa and regarded the Community as a step towards the achievement of the objectives of the Treaty Establishing the African Economic Community.

[24] This provision modifies the wording of article 92(2) of the Treaty for East African Cooperation (1967: 932), which provided that the treaty 'shall have indefinite duration'.

address *inter alia* issues relating to the post-merger legal status of the RECs, their assets and liabilities after the merger, whether the merger is compulsory or voluntary and, if compulsory, how that is going to be enforced, when the merger is to occur (simultaneously for all the communities or incrementally after each reaches the necessary stage of integration), status of their personnel and institutions such as the various community courts, and the status of active RECs which are not AU-recognised (such as the Southern African Customs Union), and, accordingly, will not, in my opinion, participate in the anticipated merger of the RECs.

The anticipated merger of the RECs to form the African Economic Community raises other issues. Some RECs, like the EAC, are at an advanced stage of development. It is difficult to predict whether they would willingly merge with the AEC or with their less progressive counterparts such as the Inter-Governmental Authority on Development. Indeed, one may query whether the AU has the political will, legitimacy and wherewithal to impose its vision of an African Economic Community on the RECs. They are not parties to the AEC Treaty. Additionally, the treaty provisions of some of them on issues such as the jurisdiction of their community courts, *locus standi* for private parties, supremacy of community law, and the relations between community courts and national courts are superior to those of the AEC Treaty. Arguably, these advancements in community law and economic integration could be lost when they merge with the AEC if AEC law is not amended to incorporate those advances.

It is also debatable whether a merger of the RECs will be supported by interest groups within the RECs. Public choice theorists characterise international organisations as bureaucracies that are more responsive to the demands of organised interest groups, including their staff. As Vaubel (2003: 319) notes, ‘like all bureaucracies, international organisations fight for their survival and for more powers and resources. Thus, it is more difficult to abolish an international organisation than to establish it, or to reduce its powers and resources than to increase them’. Indeed, already, an appreciable number of staff cases have appeared before the community courts. This is evidence of people trying to protect their ‘turf’.[25] The number of staff

[25] See e.g. Muleya v. Common Market for Eastern and Southern Africa (No. 3) (2004: 173); Muleya v. Common Market for Eastern and Southern Africa (No. 2) (2003: 623); Muleya v. Common Market for Eastern and Southern Africa (2003: 173); Ogang v. Eastern and Southern African Trade and Development Bank (2003: 217); Eastern and Southern African Trade and Development Bank v. Ogang (2001: 46); Eastern and Southern African Trade and Development Bank v. Ogang (No. 2)

cases and the tenacity with which they appear to have been litigated, lend some credence to Rasul Shams' (2005: 6-7) thesis that economic integration has become a job-generating venture for Africa's educated elite, and raises the prospect of obstructionist litigation before, during, and, perhaps, after the merger.

Additionally, the RECs are legal systems in their own right. Unlike the AEC, they are expressly endowed with separate legal personality.[26] Thus, even before the merger, there is the need to structure and manage the relations between the AEC and RECs' legal systems as well as among the RECs.[27] The current legal framework on the relations between the AEC and the RECs does not go very far in addressing these complicated issues.

3.3 Conflict of laws and jurisdictions

A central issue in the relations between the AEC and RECs' legal systems is the prospect of conflict of jurisdictions and laws. Alter and Meunier (2009: 16) have observed that international regime complexity, such as that which exists in Africa on the issue of economic integration, reduces the clarity of legal obligations by introducing overlapping sets of legal rules and jurisdictions governing an issue. To Raustiala and Victor (2004: 279), 'regime complexes are marked by the existence of several legal agreements that are created and maintained in distinct fora with participation of different sets of actors. The rules in ... elemental regimes functionally overlap, yet there is no agreed upon hierarchy for resolving conflicts between rules'. In the area of international trade, especially against the background of the proliferation of regional trade agreements, this is becoming a very prominent issue.[28]

The AEC appreciates the potential for these conflicts. The Protocol on Relations is meant to provide the institutional framework for coordinating and harmonising relations between the AEC and the RECs. It emphasises the coordination and harmonisation of their activities. However, characteristic of the minimal significance

(2002: 54); Tokunbo Lijadu Oyemade v. Executive Secretary of ECOWAS (2006); Executive Secretary of ECOWAS v. Tokunbo Lijadu Oyemade, (2006); Executive Secretary of ECOWAS v. Tokunbo Lijadu Oyemade (2006).

[26] See the COMESA Treaty art. 186(1); EAC Treaty, art. 138(1); ECOWAS art. 88(1); SADC Treaty, art. 3(1).

[27] See generally Udombana (2002: 222-24). A similar issue currently playing out at international law level is the relationship between the WTO and the various regional trade arrangements it sanctions under article XXIV of the GATT, 1994.

[28] See e.g. Graewert (2008: 287); Kwak & Marceau (2006); Davey & Sapir (2009: 5).

given to relational issues in Africa's economic integration processes, there are no definitive provisions in the protocol addressing the issue of conflict of jurisdictions and laws. Does AEC law enjoy supremacy over conflicting laws of the RECs? Are the RECs also enjoined to 'observe the legal system' (AEC Treaty, art. 3(e)) of the AEC? Are there any areas where only the AEC can legislate? How are breaches of AEC decisions and directives to the RECs to be enforced? (AEC Treaty, art. 3(e))[29] Are the RECs competent before the African Court of Justice and Human Rights? And can the AEC intervene in an action before an REC community court where the interest of the AEC is affected? The answers to these important questions remain largely unknown.[30]

The protocol's lack of attention to these complex relational issues is disheartening. This is because it explicitly recognises that external and internal policies of the RECs may conflict with the objectives of the AEC Treaty.[31] In this, we witness a manifestation of inattention to relational issues; the possibility of conflict of jurisdictions and laws is acknowledged, but concrete steps have not been taken to address them.

3.4 The relations between the Regional Economic Communities

An important issue for the RECs and AEC is the need to rationalise relations between the RECs in the light of the fact of their multiple memberships. It is arguable that this issue is short-term; as they progress along the stages of integration, a process of natural selection will take place. It will be difficult for a state to maintain membership of two custom unions – apply two different external tariffs – unless the policies of the customs unions are harmonised. At that stage, each state will have to decide, taking into account political, economic and geographic considerations, which community it wants to be part of. Thus, some scholars speculate that if the customs union of the Southern African Development Community (SADC) succeeds, the Southern African Customs Union (SACU) 'would fall away' (Draper et al. 2007: 20).

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[29] This article allows the Assembly or Council to give directives to the communities. Their decisions may include sanctions. A similar provision is in article 22 of the Protocol on Relations.
[30] The Protocol of Relations sheds dim light on some of these issues. For example, it allows the AU to sanction RECs or member countries that do not comply with its directives. It also includes a dispute resolution mechanism which gives RECs standing before the African Court of Justice and Human Rights.
[31] See Protocol on Relations, art. 28(1).

However, this is a too optimistic vision. The trajectory of Africa's integration suggests that it is not only legal and economic considerations that dictate membership of RECs.[32] A more dominant consideration is political. Indeed, the only case I know of, of REC demise, was that of the first East African Community in 1977. Even with this, its demise was due mainly to political mistrust between the members. Therefore it has to be accepted that unless there are structured mechanisms instituted and enforced to eliminate the problem of multiple memberships, the vision of some communities 'dying a natural death' will not materialise.

4. Addressing the problems – the two steps solution

Effectively and boldly addressing the problems resulting from multiple memberships and the troubling relational issues between the RECs and AEC requires legal imagination, economic thought, and strong institutional and political will. There is an urgent need for the AEC actively to rationalise the relations among the RECs, and between the RECs and itself. This is important for the development of the African Economic Community. The 2006 AU moratorium on the establishment and recognition of more RECs was an important first step.[33] So far, it has been heeded. Another important step is for the AEC to adopt a protocol founded on the principle of 'one country, one community' of the eight AU recognised RECs. With the help of national institutions and commissioned experts, countries should be guided to decide on predominately economic criteria, which REC best suits their needs taking into account the fact that the ultimate realisation of the vision of an African Economic Community may help address some of the needs. This should be viewed not as an inappropriate infringement on state sovereignty, but as a measure needed to pool state sovereignty effectively for the common good.

The legal foundation for this protocol can be found in article 5(1) of the AEC Treaty. In it, member states undertook to 'create favourable conditions for the development of the Community and the attainment of its objectives, particularly by harmonising their strategies and policies', and to 'refrain from any unilateral action that may hinder the attainment of the said objectives'. I argue that the unilateral decision of AEC

[32] UNECA has observed that 'countries seem to have barely analysed the economic rationale of belonging to a particular group'. See UNECA (2006: 36).
[33] See African Union (2006).

member states to be members of more than one REC creates unfavourable conditions for the development of the AEC.

Admittedly, getting support for and enforcing this protocol will be difficult. It will be the ultimate test not only of the enforcement powers of the AEC, but also member states' commitment to the realisation of its vision beyond their political rhetoric of support. It is suggested that non-complying states should be threatened with expulsion and, ultimately, be expelled from the AEC and all but one of the RECs of which they are members.[34] I dare say that the vision of an African Economic Community should not be founded on the ideal of all African countries as members. The European Community does not consist of all the states in Europe. The North American Free Trade Agreement does not include all countries on the North American continent. And the World Trade Organisation comprises fewer than all the countries of the world. There is no legitimate reason why an African Economic Community cannot consist of something less than all of Africa! For a continent consisting of 53 states, a few of them dysfunctional, collapsed or collapsing, and many with different levels of socioeconomic, legal and political development, the pursuit of this ideal will delay, indeed thwart, the timely realisation of a noble economic vision.

Writing in the context of the collapse of the OAU, Kufuor (2005: 133) perceptively observed that 'unrestricted access in the form of virtually no entry requirements led to the tragedy of the regional commons, the degrading of the OAU as an organisation of any value'. Wouldn't the stature, integrity and effectiveness of the OAU/AU be enhanced if it consisted of, say, twenty democratic, human-rights-respecting, socially- and economically-developed states which extend the benefits of the organisation to non-members on defined conditions? Like Kufuor, I argue here that Africa's economic integration is being devalued, delayed and diluted due to the fact that countries are able to sign up at will without strict, previously-defined and continuous commitments to implementation. An African Economic Community which consists of a few African states can extend, through conditioned agreements, the benefits of integration to other countries that need not necessarily be members. The expansion of economic space need not be a concomitant of the expansion of institutional space.

[34] These countries can still maintain their membership of the African Union, which is largely a political association of states.

The 'one country, one community' principle advocated above should be combined with full integration of the RECs into the legal framework of the AEC by making them members. It is unfortunate that neither the Protocol on Relations between the AEC and the RECs, nor the new Protocol on Relations, does this. For the RECs to become members of the AEC, it may demand an amendment to the AEC Treaty. Currently, the treaty does not have a membership provision or criterion, but it appears to assume that all African states are potential members. By becoming fully signed-up members of the AEC, the RECs will be bound by all AEC laws including laws aimed at rationalising and coordinating their activities. They will become subject to AEC-enforcement processes and active and interested participants in its decision-making processes. This will help eliminate, or at least minimise, the potential for conflicting laws, policies and jurisdictions.

The two steps advocated above, as solution to the problem of multiple memberships and multiple RECs, and the latter's relations with the AEC differ in material respects from the five potential solutions advocated by the UNECA.[35] Central to the two steps is the principle of 'one country, one community', the view that membership of RECs should be determined largely on the basis of an economic criterion, and a call to abandon the ideal of an AEC consisting of all African states. It should be emphasised that although the RECs have independent legal personality, they exist because they have states as members. Therefore any solution to the above problem should begin with the members, or at least pay very close and immediate attention to them. Although the two steps are radical and will demand a lot of political will to be mustered, in my opinion, it is the only sure and rapid path to achieving an African Economic Community using states and RECs that are genuinely committed to that objective.

5. Conclusion

In this paper, the complexity of the path to the formation of the African Economic Community has been discussed. The approach of using RECs as building blocks of the AEC is fraught with legal challenges most of which have not been adequately addressed by the existing legal framework. The paper provides means of overcoming

[35] These are: (1) maintaining the status quo; (2) rationalizing by merger and absorption; (3) rationalizing around rooted communities; (4) rationalizing through division of labour; and (5) rationalizing by harmonising policies and instruments. See UNECA (2006: 115-126).

some of the challenges. More generally, it shows that one of the ways of overcoming the challenges posed by international regime complexity is to provide for an umbrella regime responsible for coordinating and harmonising the activities of elemental regimes within the complex regime. However, providing for such a regime, if deemed necessary at all, comes with difficulty: defining the legal status and mandate of the regime and ensuring the binding effect and compliance with its laws are potentially difficult issues. The AEC as an apparent umbrella regime for the elemental regimes of African RECs is a case in point.

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Chapter 2

Beyond aid and trade: theoretical and practical perspectives on SADC external relations

Martin Adelmann

1. Introduction

The states of southern Africa share a history of political cooperation and solidarity dating back to the struggle against colonialism and apartheid – and beyond. The external threat of apartheid South Africa together with the prospect of receiving additional aid pushed and pulled the states of the region into a first institutionalised arrangement some 30 years ago – the Southern African Development Coordination Conference (SADCC). External influence also pushed the free trade agenda that has become the dominant theme in SADC integration in recent years. Yet, while dozens of scholars have analysed the pros and cons of the SADC Free Trade Area (FTA) and the SADC-EU Economic Partnership Agreement (EPA), the question of the organisation's external relations outside the field of trade and aid has hitherto by and large been left untouched.

This paper fills this gap by providing an overview on the theme of SADC's external relations. The subject will be explored from three different angles. Firstly, some theoretical observations on the relevance of the topic of external relations of regional organisations are presented. Secondly, the question of the actor quality of SADC (institutional and political framework) is analysed. Finally, the paper gives an overview of the development of SADC's external relations over time. While it is obvious that the region is far from having a common foreign policy, the paper sheds some light on the current status and future prospects of SADC's external relations.

2. Regional external relations in the age of globalisation

Looking at regional external relations in a comparative global perspective, Hänggi, Roloff, and Rüland (2006: 6) have found empirical evidence that over the last two decades 'regional organizations have began to develop their own external relations, in other words gradually became actors in their own right in international relations'. Hänggi has classified the forms that the external relations of regions take according to the counterpart. Firstly, in the classic case of inter-regionalism, regions establish bilateral relations with other regions, for example, the case of the SADC-EU Berlin Initiative. Secondly, a region may also interact in a quasi-interregional relationship with a single state as partner, such as in the case of the SADC-US Forum. Thirdly, trans-regional arrangements occur that involve more than one region and that have a more diffuse membership. The Indian Ocean Rim (IOR) and the Asian-African Sub-Regional Conference (AASROC) are two such examples. Finally, one could add to Hänggi's classifications the case of regions interacting with international institutions, such as the United Nations system or the World Trade Organisation. While in principle the nature of the partnership may influence the outcome, the practical implications are minor in the case of SADC. Hence, this paper summarises all the above-mentioned forms under the term SADC external relations.

The reasons for the emerging of the New Regionalism in the mid-1980s and also for the above-mentioned rise of regional external relations can be traced back to the structural force that has shaped international relations since the end of the Cold War: globalisation. The Windhoek Declaration, the founding document of the reformed 1992 SADC, reflects on this changing global environment when it states,

> integration is fast becoming a global trend. Countries in different regions of the globe are organising themselves into closer economic and political entities. These movements towards stronger regional blocs will transform the world, both economically and politically,

and further on,

> the countries of the region must (...) join together to strengthen themselves economically and politically, if the region is to become a serious player in international relations.

The Declaration shares the notion, that the classic Westphalian State, characterised by its sovereign control over a country's political and economic resources, will not have much leverage in the future, especially not if the state is small and underdeveloped. Hettne and others (1999) have in this regard described the New Regionalism as a defensive move by the states, as a 'second great transformation', an attempt to regain political control over global (economic) forces.[1] As one dimension in a multi-layered system of global governance, regional organisations can not only help countries to adapt to the new circumstances, but also actively shape the wider regional and global environment.

Political scientists have attributed various functions to regional external relations, depending on the school of thought they follow: realists suggest balancing or bandwagoning, liberal-institutionalists stress the function of international institution building and a rationalisation of international relations and agenda setting, while constructivists have added the spreading of ideas and identity building (Rüland 2006). But from the perspective of SADC states, the issues are less on a systemic or global level. Their concern is rather to demarginalise, in other words to gain access to markets, (aid) funds, and recognition of their concerns on the international agenda.[2]

In theory, SADC is well aware of the need to speak with one voice and to develop common policies vis-à-vis the outside world. Tanzanian President Benjamin W. Mkapa expressed this notably at the opening of the 2003 SADC Summit in his position as SADC Chair:

> Rapid and far-reaching changes in the world reinforce the need to act together with utmost urgency. Internationally, we face a world where aninterplay of global forces demands change and adaptability. Information and technological forces driving the process of globalisation have made the world a more complex place. This calls for concerted international and regional responses to the different challenges we all face. Only in regional unity can we face those challenges with confidence, and with a decent chance for success. ... SADC... enables us to speak to the globalising world with a united, firm negotiating power that dare not be ignored!

Yet, does SADC possess the actor quality to live up to its external relations goals?

[1] From a liberal economic view, regional integration (often reduced to FTAs) is often interpreted the opposite way, namely a fast track toward global free trade.
[2] Typically for Africa, the personal recognition of the leader (related to internal legitimacy) could be added as a further function.

3. The actor quality of SADC

To determine the ability of a fairly weak organisation to conduct external relations, the concept of actor quality may help to better understand the political and institutional framework of this policy field. Of the various theoretical actorness models, Sjöstedt's approach, developed for the European Economic Community (EEC) in 1977, seems to best fit SADC's reality of today.[3] He suggests looking at actorness from the legal point of view, taking into account the internal structure, and the de facto output an actor produces.

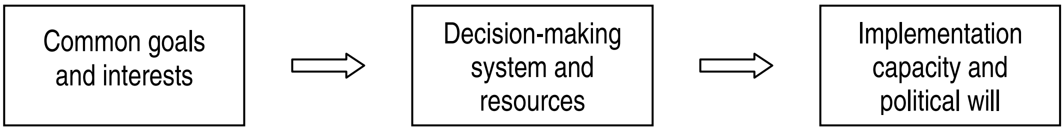
The first threshold condition is fairly easy to verify: SADC is a clearly defined unit, based on a treaty (SADC Treaty 1992), which has been registered with the United Nations (UN) and the Organisation of African Unity (OAU)/the African Union (AU). According to the treaty, SADC is an international organisation with legal personality (Article 3). As such, SADC has reached observer status with several UN organisations and is regarded as one of the regional organisations forming the building blocks of the AU. The organisation has also concluded various Memorandums of Understanding (MoU) with non-SADC states and other actors. Yet, its autonomy as an actor is clearly limited by the sovereignty of the member states, which have so far not made any attempt to replace the intergovernmental character of SADC with some supranational elements.

But more important than the legal structure is the question of whether or not SADC fulfils the internal prerequisites to be an actor in international relations. The first such prerequisite is the existence of common goals and interests, which are clearly expressed in the SADC Treaty and, in greater detail, in the Regional Indicative Strategic Development Plan (RISDP) and the Strategic Indicative Plan for the Organ (SIPO), as well as in the sector specific protocols. The goal to 'promote the coordination and harmonisation of the international relations of Member States' is notably included in the Treaty (Article 5.2). Yet, it is clear that despite all written and oral commitments the heterogeneity of the membership often foils joint approaches. The long struggle for an FTA and an EPA has markedly exposed the diverging economic interests: the cases of the Democratic Republic of Congo (DRC),

[3] More recent actorness models by, for example, Allen/Smith, Brethertan/Vogler, Ginsberg, Hill, Jupille/Caporaso were developed to analyse the more advance EU foreign policy and do not fit the reality of SADC's external relations.

Swaziland, and most importantly, Zimbabwe, have shed light on the diverging political values and interests of the member states. One of the few policy fields that SADC(C) could easily agree on throughout its history was the joint lobbying for donor funds, hence, this is the most, if not the only, successful field of SADC external relations until today (Adelmann 2007, 2008).

Internal structures: prerequisites for actorness



A second prerequisite of actorness is a functioning decision-making structure to transform goals into policies. The 2001 structural reform, especially the integration of the Organ for Politics, Defence and Security (OPDS) into the main SADC structure, was a reaction to the up to then inadequate institutional setup. With the Summit, the Council, the OPDS and the respective chairing Troikas, the organisation now has regularly meeting decision-making institutions in the field of external relations. But some problems in terms of decisionmaking structure remain. The first is the problem of decision making and follow-up in between Summit/Council meetings. The 2001 reform provision to double the number of meetings was never adhered to; only in cases of crisis (such as in the DRC or Zimbabwe) has SADC held additional meetings. It is therefore up to the Chair to fill this gap, which not all chairing countries live up to. Another fundamental problem remains the principle of unanimity, which gives a de facto veto right to members. The inactivity and often calm tone of the official documents (again, for example, in the case of Zimbabwe, where the often heated discussions behind closed doors are not reflected in the official communiqués) can be attributed to the unanimity principle. A further problem in past years, that was only recently reverted, was the 2001 replacement of sectoral ministerial committees by the Integrated Committee of Ministers (ICM), which lead to unclear decision-making structures and a lack of decision-making competence in thematic fields. Finally, the regional organisation has always suffered from a lack of human and financial resources. While the 2001 reform aimed to overcome this problem, the long years of internal restructuring have indeed increased the problem for some time. Insufficient preparation and follow-up of decisions on the side of the secretariat, as well as on the side of the chairing country, have many times delayed important resolutions. Decisions had to be postponed to the next meeting and were sometimes pending for several years. Thus, while in principle SADC has decision-making structures in place, the organisation has in the past often been slow or silent when it came to decide or comment on external affairs.

Finally, as a third internal prerequisite, any organisation needs the means to implement its own policies. The secretariat is the only permanent structure and has, according to the treaty, the mandate to coordinate policies. With regard to external relations the secretariat is mandated to the 'promotion of cooperation with other organisations for the furtherance of the objectives of SADC' and to 'diplomatic and other representation of SADC' (Article 15, c, j). In 1998 the Executive Secretary, as head of the secretariat, after many years of internal negotiations, received the so-called 'full powers' to negotiate and sign treaties on behalf of SADC (SADC 1998a: 269, 1998b: 145). He also regularly receives foreign diplomats and represents the secretariat at international meetings. Especially in the 1990s, the Executive Secretary undertook, some times together with the chair, long diplomatic tours to liaise with major western donors. However, the external representation of SADC through the secretariat faces two constraints: the political dependency on the council, which denies the secretariat a more independent role, and the lack of staff and resources to implement agreed decisions. Especially during the years of reform from 2001 onward, the secretariat did not have the capacity to follow up or initiate external affairs properly.

A second external relations structure is the Committees of Ambassadors, which exist in various strategic cities such as Addis Ababa or Brussels and coordinate the diplomatic positions of SADC states. The problem with the Ambassador Committees is again the weak capacity of the member states' embassies (in the 1990s, for example, not all SADC states even had a representative in Geneva where the World Trade Organisation (WTO) and many UN offices are based, and the existing ones were not well staffed; this has improved since then, see Adelmann 2007: 245) and the diverging interests of the member states. Much depends on the ability of the Chair to effectively coordinate the embassies. Aware of the need for a genuine SADC representation abroad, the secretariat lobbied in the 1990s for the establishment of permanent genuine SADC representations or at least the appointment of honorary representatives in foreign capitals (SADCC 1990: 374; SADC 1999:10). On a comparative note, the establishment of cultural liaison offices was one of the means of the old EEC to conduct international relations at times when it did not yet have the foreign policy mandate and the delegations abroad like today. But this idea could not win the support of the Council.

The Chair, and sometimes the Summit and the Council as a whole, are not only decision-making bodies but they also perform implementation functions in international relations. They issue diplomatic statements on behalf of SADC, negotiate international agreements, or interact with external diplomats. In the case of the Summit and the Council, these activities are restricted to the time of the meeting. Examples can be found where Summit or Council commented on international events that happened close before or during the meetings. In between meetings, it is up to the Chair or to a mandated person (such as Thabo Mbeki as SADC mediator in Zimbabwe) to speak on behalf of the regional organisation. In recent years, the Chair has often called double Troika meetings (SADC-Troika plus SADC-OPDS Troika) to discuss urgent matters and to bridge the time to the next Summit or Council meeting.

Under the OPDS, which is the political wing of SADC, the region has a specific sub-structure, the Inter-State Politics and Diplomacy Committee (ISPDC) that is tasked to deal with, among others, international questions.. Yet, this foreign ministers committee, which had a slow start and is only meeting more frequently in recent years, is more concerned with regional diplomatic topics than with the global agenda. An initially more specialised Sub-Committee on Diplomacy never materialised and the foreseen position of diplomacy officer at the secretariat was left vacant for financial reasons.

So, are the SADC institutions equipped to fulfil an international role? A look at the factual outcome can further clarify the actor quality of the organisation. The various SADC organs have so far mainly used four instruments to conduct external relations. The issuing of unilateral political statements on regional as well as international political questions is the most frequently used activity. Yet, while it seems at first glance easy to trace and analyse speeches and documents with regional origin, there is, in political reality, a thin line between regional and national action, which may at times not be easy to distinguish. When Thabo Mbeki, for example, spoke (or was silent on) the matter of Zimbabwe, did he do this in his position as appointed SADC Zimbabwe mediator, in his position as SADC Chair, or in his position as President of South Africa? Many times, the leading member, South Africa, has claimed in international affairs to speak on behalf of South Africa <u>and</u> the region (or Africa) as a whole. Although most of times the country had no official mandate to speak for the region, the South African position indeed often reflected regional concerns. Should one judge this as a regional instrumentalisation of a member state's resources in absence of own instruments, or is the leading country simply overstepping its competences here?

In addition to statements, diplomatic meetings with states and international organisations take place frequently, most notably at the biannual Consultative Conference, bilateral (interregional) fora or visits of diplomats to SADC institutions. This includes guest speakers at the Summit and observers from other institutions such as AU, East African Community (EAC) or Common Market for Eastern and Southern Africa (COMESA). Those diplomatic meetings have in the past often resulted in the conclusion of a formal MoU. Dozens of those have been signed by SADC since the mid-1990s with states, international organisations, and also non-governmental organisations (NGOs). In some cases, the relationship was even upgraded to the more formalised level of a Forum (SADC-Nordics, SADC-EU, SADC-US, SADC-India).

Finally, an outcome of SADC external relations can be seen in the coordination of positions in international organisations. While political coordination has happened at various issues and organisations (UN, WTO, AU), it is still more the exception than the rule. More successful has been the coordination of positions for the submission of jointly agreed candidates for international positions or for the hosting of international institutions. The latest move in this regard is the regional backing of Malawi's ambition to chair the AU. While not always successful in process and result, such coordinated activity can be seen as the beginning of a SADC voting block in international affairs.

Recently, two new regional instruments have emerged that could in future increase the role of SADC at least in its own region and potentially also in adjacent African countries. The first is the SADC peace-keeping brigade. While the member states still have the decision power whether to deploy their troops in a common effort or not, the existence of a joint planning element and the possibility of joint deployment will force the member states to closely align their national peace-keeping strategies to a regional one. The second new instrument is the SADC election observation mission. While the member states via the council, and especially the chair of the mission, have considerable political power on how to interpret the result (e.g. the SADC Election Observation Mission to Zimbabwe), this mission is a genuinely regional instrument. A critical judgement of the SADC mission could bring a deviant country onto the SADC political agenda or even serve as justification to sanction a member on the ground of violating the common SADC principles. While this refers primarily to intra-SADC affairs, it should be kept in mind that the inclusion or exclusion of a country into a regional organisation is one of the most important foreign policy decisions a region can make (Schmitter 1969).

So, how has SADC used its instruments to conduct external relations over time?

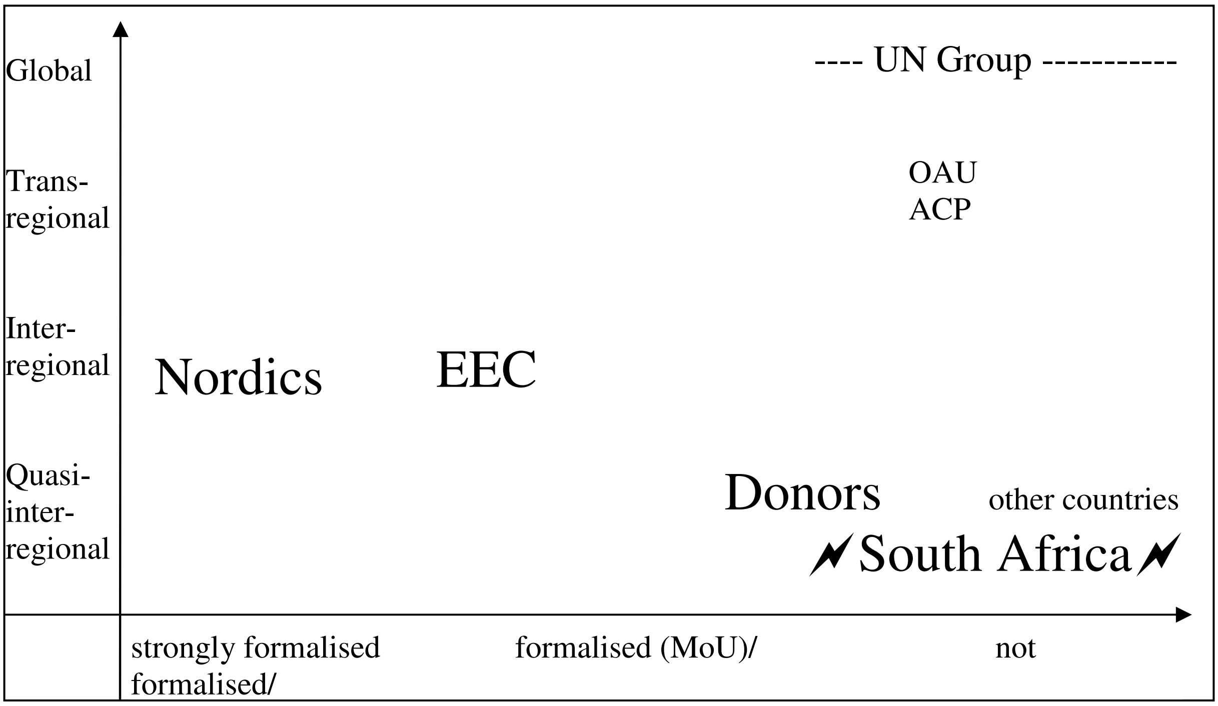
4. The development of SADC external relations: what has been achieved?

In the 1980s, SADCC external relations had by and large only two dimensions'. The first was the fight (rhetoric) against apartheid South Africa. While the Frontline States (FLS) were the main political platform, SADCC meetings were also used for demonstrating regional solidarity on this issue. The attendance of the South African and Namibian liberation movements at SADCC meetings reinforced the presence of this issue on the SADC agenda. Unilateral SADCC declarations on apartheid were frequent those days. But not only South Africa was addressed, SADCC also issued sharp statements against the political role of the US, for example on the occasions of discriminating funding to SADCC or Savimbi's 1986 visit to Washington. The grievance about apartheid was also taken to the UN were SADC chairs included the issue on behalf of the region in their official speeches.

The second external relations dimension was the relationship with the donor community, which was itself instrumental in the founding of SADC (Adelmann 2008; Mandaza and Tostensen 1994). The relationship with the Nordic countries was most advanced and resulted in the formation of the Nordic-SADC Initiative in 1986. The

European Community (EC) was also a major sponsor of SADC from the beginning and formalised its relationship through the 1986 signing of a Regional Indicative Program (RIP) with SADCC under the Lomé framework. From 1987 onward, other Western countries such as US, UK and West-Germany, but also the Eastern Block significantly increased their collaboration with SADC. While the financial aspect of receiving aid for regional projects was the main issue, the meetings with donors, for example at the Consultative Conference, always had the political function as well of formally and informally exchanging views on regional matters, most notably South Africa.

Figure 1 SADCC's External Relations in the 1980s



Conflictive Relationship

By the 1990s the regional and international situation had changed tremendously. The political enemy had faded away and became an important member of SADC. The forces of globalisation posed the challenge of a further marginalisation of the region. But most seriously, there was a real risk that after the end of apartheid and the end of the Cold War the donors could turn their backs on SADC(C) as they now pursued other priorities. The reform from SADCC to SADC was one answer to the problem. Another was the expansion and formalisation of the organisation's external relations.

With regard to the traditional donors, SADC embarked in the 1990s on four activities to keep the organisation on the donors' agenda: first, it undertook diplomatic lobbying tours through western capitals; second, it formalised the relationship with existing partners through the signing of MoUs; third, it upgraded some existing initiatives from the level of MoU to the level of an interregional forum, most notably the 1994 Berlin Initiative and later on the SADC-US Forum; fourth, from 1998 onward, SADC started to accredit foreign ambassadors to SADC as official representatives of their countries to the organisation.

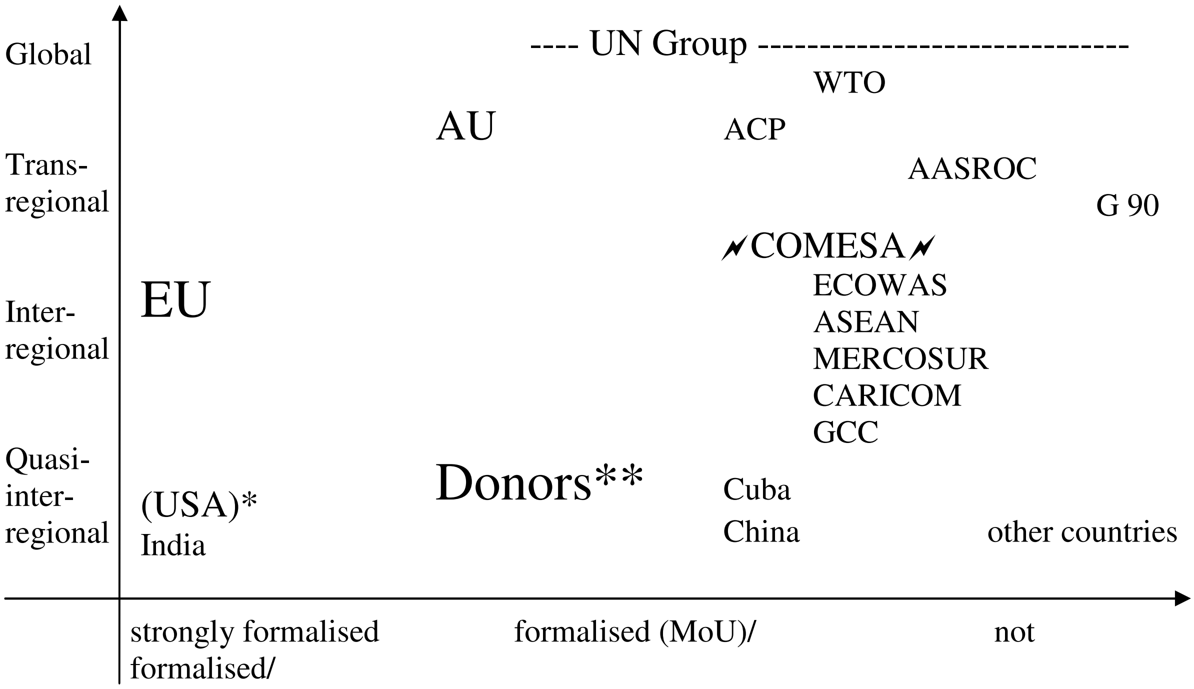
But SADC activities were not only directed to the global North, but also towards an intensification of South-South relations. On an inter-regional level, other regional organisations such as the Association of Southeast Asian Nations (ASEAN), the Mercado Común del Sur (Mercosur), or the Caribbean Community (CARICOM) were actively engaged. The secretariat undertook study tours, joint conferences were held, and the Chair and Executive Secretary addressed meetings of other regional organisations. In addition, the relationship to leading countries of the South, such as China, India or Cuba was intensified. The relationship with the OAU/AU was revived and SADC also showed presence at some trans-regional platforms such as Asian-African Sub-Regional Organisations Conference (AASROC).

But in retrospect the success of the increased external relations activities of the 1990s was only partial: the major platform of interaction with donors, the Consultative Conference, rapidly declined in profile and the MoUs with external partners remained by and large empty shells with no practical consequences. Also the inter-regional South-South dialogue mostly did not outlive one or two meetings. But most severe, in the beginning of the new millennium, the SADC-US Forum was put on ice and the Berlin Initiative was downgraded from an inter-regional Heads of States and Government meeting to a troika level.

The latter can be directly related to the Zimbabwe conflict and the personal sanctions the US and the EU had put on Robert Mugabe and his allies. Not only did the western countries want to avoid a direct meeting with Robert Mugabe at such gatherings, a downgrading of SADC and simultaneous pushing of rivalling COMESA by the EU must also be seen as a punishment of SADC for not distancing itself from Zimbabwe. Besides this particular case, the general sharp drop of SADC diplomatic activities is undoubtedly due to the internal restructuring process from 2001 and onward, which led to an inward-looking perspective and kept the external relations capacity to a minimum. Further on, the creation of the AU and the New Partnership for Africa's Development (NEPAD) initiatives fired back on SADC as an organisation. Much of donors' attention and money flew into the new continental initiatives, thereby putting the regions, which are de facto much ahead of the continental initiatives, on the backburner.

Thus, SADC external relations almost came to a standstill. Yet, in the second half of the decade, the region was again able to revive its international activities. The New SADC-ICP partnership, with its joint task force, thematic groups, and a revival of the Consultative Conference (Windhoek 2006) revitalised traditional donor relations. The South-South contacts were also renewed. At the 2006 Consultative Conference China showed a strong interest in SADC and a SADC-India Forum was inaugurated. The relationship to the AU and other African regional organisations has also improved.

Figure 2 SADC external relations in the New Millennium

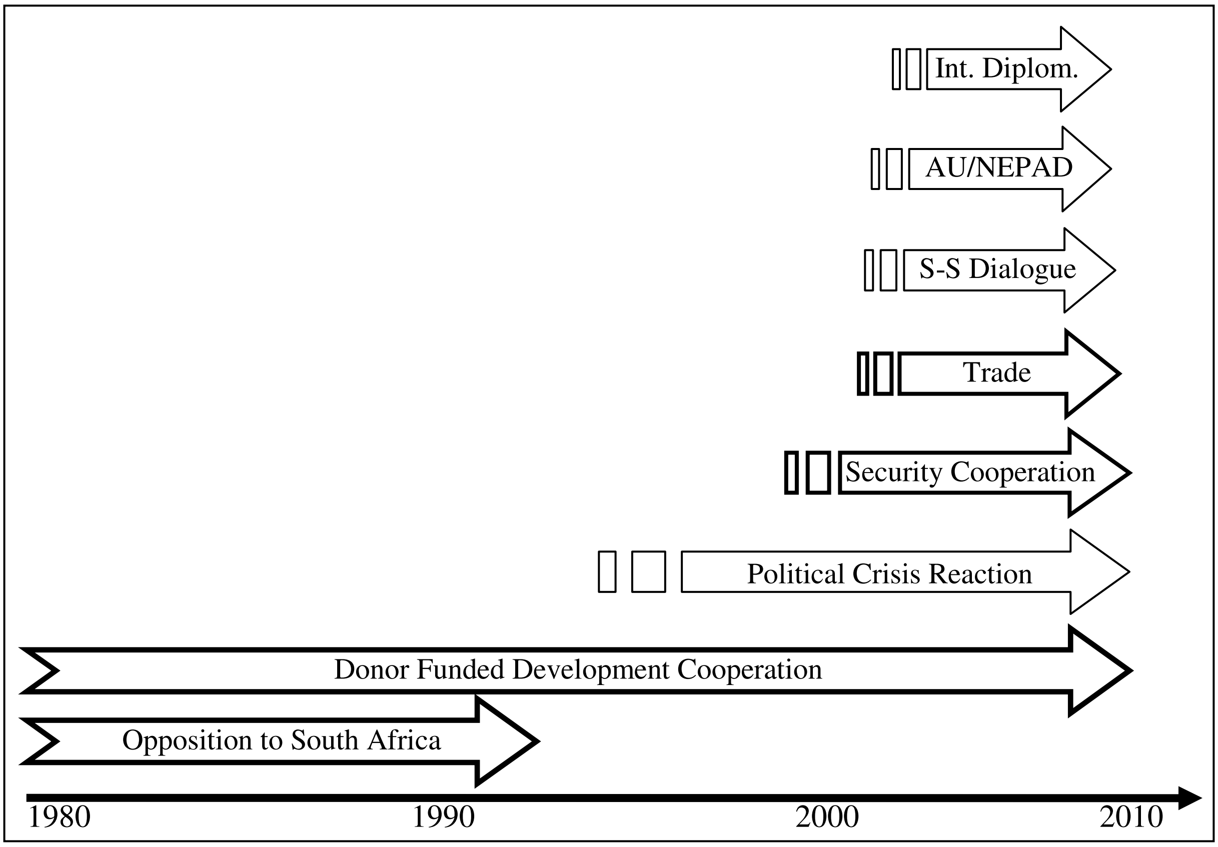


* The SADC-US Forum was put on ice because of the Zimbabwe crisis.
** The most important donors are: UK, Sweden, Germany, Norway as well as Japan.
⌿ Conflictive relationship.
Source: Own compilation.

Conclusion: What future for SADC external relations?

Looking at SADC's externally oriented activities in recent years, it is clear that aid and trade are the organisation's dominant concerns. Political crises also feature prominently on the agenda – however, only in cases were SADC member states are directly concerned (DRC, Lesotho, Zimbabwe, Madagascar) – which makes these activities part of the internal rather than the external agenda. The South-South, the Africa, and the international agenda still play a less prominent role in the SADC portfolio, even though some ad hoc activities in these fields are visible. As latest examples, the global financial crisis and, more importantly, the climate change debate have found their way into official statements and SADC documents recently.

Figure 3 The development of SADC external relations



Source: Own compilation.

In 1993 the secretariat (SADC 1993b: 465) had perceived that

> the Organisation needs to coordinate its positions at international fora with a view to ensuring that collective interests are safeguarded, that member States reflect positions that are consistent with decisions they have taken under SADC....developing common positions to issues should be extended towards the emergence of common approaches and positions on foreign policy. It should be possible to look forward, for example, to the delivery of a single SADC statement at such fora as the OAU, UN, Commonwealth, etc.

But so far, SADC could not live up to this expectation. External relations outside the aid and trade paradigm are conducted on an ad hoc basis and are seen rather as an extra than a core of SADC activities. The prioritisation exercise that SADC has recently undertaken to better structure its activities has put this issue further to the back of the agenda.

In principle, the prerequisites for SADC to be an international actor are in place: SADC enjoys international recognition, it has common interests on many international issues and it has some structures that could be used to put ideas into action. Yet, the implementation structure is still too weak at secretariat or diplomatic level to ensure adequate preparation and follow-up. Thus no systematic approach has emerged so far.

In addition, the double structure of potential external representation of member states by both SADC and the AU poses a structural problem. For SADC and its members it remains unclear what role SADC should play in international arenas in comparison to the AU as both have similar external agendas. The famous rhetoric concept of regions being pillars or stepping stones for continental integration has never been fully transferred into political reality, despite some efforts of the AU to formalise the relationship. While the AU is internationally more visible than SADC, it might be sometimes more effective to travel the sub-regional road in international relations.

By neglecting the issue of closer political cooperation in international relations, both the organisation and its member states miss an opportunity. A continuous debate on international issues could help the organisation not only to improve its external profile, but the process of negotiating joint positions would necessarily also lead to a constant internal reflection on regional political aims and values. Such self-awareness, generated by discussing often less controversial international topics, could lead to positive spillovers to other, more controversial, policy fields. For the member states, on the other hand, especially the weaker ones, a regionally based diplomacy might be the only feasible way to effectively take part in international affairs. Influencing the emerging global governance structures will be vital for the states of southern Africa if they want to demarginalise in the future. Yet, the thought of giving up national power and prestige now, in order to gain some joint international power in the future, seems still far from the reality of SADC regional integration today.

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Chapter 3

Trade remedies and safeguards in southern and eastern Africa

Willemien Denner

1. Introduction

Trade remedies are an important component for the achievement of overall trade liberalisation. Allowances are made for countries to temporarily suspend obligations for industries which are injured more significantly than negotiators anticipated due to increased liberalisation. Contingent protection measures can be seen as strategic tools for governments to reduce the political cost and internal domestic pressure involved in opening domestic markets to international trade. However, the implementation of these measures is often arbitrary, unilateral and lacking in transparency.

The aim of trade remedies is to increase the duty on a specific import product and to make the domestic market unattractive for foreign imports. Trade remedies traditionally consist of safeguards, anti-dumping duties and countervailing measures. However, seeing that safeguards provide temporary relief from import surges under 'fair', rather than 'unfair' trade conditions, this measure is strictly speaking not a trade remedy. Anti-dumping measures and countervailing duties (CVD), on the other hand, are trade remedies aimed at addressing 'unfair' low prices on import products and government subsidisation respectively.

Provision is made for the implementation of trade remedies in the General Agreement on Tariffs and Trade (GATT) 1994 and various WTO agreements on the multilateral level and in regional agreements on the bilateral level. Individual countries and regional configurations within southern and eastern Africa have not really played a role in the implementation of trade remedies or in disputes arising from their implementation. The lack of participation can be attributed to the complex rules and regulations involved in the system of trade remedies. Most African countries do not have the expertise, knowledge and financial and legal capabilities to implement these rules and regulations or to protect their exports from these policy instruments. Another possible factor contributing to the non-participation by African countries is that most trade remedies and safeguards are aimed at protecting industrial products. Production in most African countries is focused on primary products such as agricultural products and not industrially manufactured goods.

This study provides an overview of the rules and regulations applicable to the implementation of multilateral and regional trade remedies and problem areas that must be addressed to improve the capabilities of African countries for utilising trade remedy provisions and protecting their exports from these complex policy instruments.

The first part of the study evaluates the justification of trade remedies, the role trade remedies fulfil in regional trade agreements (RTAs) and the participation of African countries in the multilateral trade remedy and safeguard system. The second part provides an overview of the multilateral trade remedy provisions, the special and differential treatment applicable to developing and least developed countries and bilateral and regional safeguards. The third part analyses four trade agreements within southern and eastern Africa, the Economic Partnership Agreements (EPAs) with the European Community (EC) and the SACU-EFTA free trade agreement (FTA). The last part focuses on the capability of African countries to participate in the trade remedy and safeguard system.

2. Trade remedies and safeguards

Trade remedies, also known as contingent protection, are legal instruments which can be taken by a domestic industry to protect itself against foreign imports. Countries take trade remedy action when it has been established that foreign producers are resorting to unfair trade practices (Trade Law Chambers 2009). Contingent protection traditionally includes anti-dumping measures, countervailing duties and safeguards. However, strictly speaking, safeguards are not trade remedies because these mechanisms are actions against fairly, rather than unfairly traded imports.

Anti-dumping measures and countervailing duties counteract unfairly low prices being charged in the importing market. These low prices can either be the result of dumping by foreign firms or of subsidisation by governments. The first allows for the implementation of anti-dumping measures by the importing country, the second for countervailing duties. The aim of these measures is to limit either the size of the dumping or the subsidisation (Willkie Farr & Gallagher LLP 2006).

Anti-dumping measures are implemented to level the playing field between domestic and foreign producers in the same market, with the aim of promoting fair trade and thus enhancing economic growth and development. Dumping is not prohibited by any WTO agreement, but a problem arises when dumping causes or threatens to cause serious injury to the domestic manufacturers of products which are the same or similar to the imported products. Types of goods which are typically dumped are those produced by capital-intensive industries. The implementation of anti-dumping duties has been concentrated in the base metals, plastics, chemicals, textiles and electrical equipment sectors (Tsengiwe 2009).

Countervailing duties are imposed to restore fairness in international competition when a foreign competitor is being subsidised. Goods which are subsidised give foreign competitors an unfair competitive advantage over domestic manufactures, often undercutting domestic prices. Through the implementation of countervailing duties the duty applicable to subsidised imports is increased, restoring any imbalance caused by the subsidisation (Trade Law Chambers 2009).

Safeguard action can be taken when a surge of imports leads to domestic industries not being able to cope with an increase in competition. These temporary measures allow the domestic industry to adjust and improve its competitiveness (Tsengiwe 2009). Safeguard measures typically take the form of a quota or quantitative restriction on a specific import, rather than an increase in the tariff applicable to the import product (Trade Law Chambers 2009).

The argument has been made that the uilisation of trade remedies has minimal economic justification and that they are often used by governments and key industries to support an administered protection regime (Waincymer 2001). There is a large amount of empirical evidence to suggest that trade remedies are mostly used as non-temporary measures to benefit those with vested interests instead of protecting domestic industries from decline (De Cordoba et al. 2006).

According to Prusa and Skeath (2001) anti-dumping measures are simply a modern form of protectionism to improve the competitive position of the complainant against other companies instead of aiming to neutralise ’unfair’ trade. Waincymer (2001) found that although predation was the earliest justification for anti-dumping measures, it is not a significant factor in actual cases. It is mostly multi-national companies with significant worldwide market share which use anti-dumping measures in most jurisdictions.

According to Kohler (2001) the attention of trade remedy implementation is rather focused on the symptoms, like dumping or a surge in imports, than the source of the problem such as government intervention and ineffective industrial policies.

3. The role of trade remedies in regional trade agreements

The objective of regional trade agreements is the removal of barriers to intra-regional trade. In order for the process of regional trade integration to move forward, efforts for the reduction and removal of non-tariff barriers and the improvement of trade facilitation are required (Prusa and Skeath 2001). However, the elimination of intra-regional tariffs and non-tariff barriers may create new demands for the protective effects of trade remedies (Teh et al. 2007). Thus, in regional trade agreements there is a tendency to use trade remedies as a tool for the restriction of foreign imports (Prusa and Skeath 2001).

Trade remedy provisions are in most trade agreements designed to enhance the predictability and transparency of trade barriers. According to Kohler (2001) contingent protection measures are kept in agreements as a device to optimise liberalisation due to the mechanics of trade negotiations and incomplete information on the political costs involved in opening trade.

One explanation for the retention of trade remedy provisions in RTAs is the political economy of protectionism (Teh et al. 2007). The political science view is that trade remedies assist governments in administering protection in a manner which appears impartial, automatic and rule-based, but procedures may be biased towards a positive finding for the domestic industry (Waincymer 2001).

Tariff liberalisation has led to tariff rates being reduced to worldwide low levels. However, import-competing sectors continue to have an incentive to secure protection through non-tariff barriers. Trade remedies are administered through bureaucracies that can be indirectly influenced by political pressure. Administered protection is inherently biased in favour of import-competing sectors due to the fact that it is channelled through complaints regarding an excess of import competition. Retaining trade remedies in RTAs serves the purpose of obtaining political support for the agreement because import-competing sectors are given the assurance that they can protect themselves against the unanticipated consequences of increased intra-regional liberalisation.

A second explanation is that trade remedies are tools which can be used to deal with the political demands for protection due to an increase in regional liberalisation (Teh et al. 2007). Governments which are committed to reductions in trade restrictions may retain trade remedy provisions in regional trade agreements to ensure that domestic industries and import-competing industries have a place to turn to when in economic distress (Moore and Zanardi 2008).

Although the long-term benefits of trade liberalisation are well accepted, the process has associated short-term transitional and adjustment costs (De Cordoba et al. 2006). These costs can build political pressure to increase protectionism for domestic production and employment. The retention of trade remedies in RTAs can be seen as the anticipation of a difficult adjustment and an increase in political pressure for protectionism. This political pressure can be deflated by temporarily reversing liberalisation through the implementation of trade remedies. Trade remedies can have a cushioning effect by providing a specific set of conditions under which regional liberalisation can be temporarily suspended or partially reversed. This implies that the depth of liberalisation which can be achieved by an RTA may depend on the trade remedy provisions in the agreement which will allow governments to temporarily depart from liberalisation under specific circumstances and conditions (Teh et al. 2007).

The reduction or removal of trade remedy utilisation among regional trade partners will most likely lead to an increase in intra-regional trade; however, welfare might not necessarily be enhanced. This is due to the fact that preferential trade agreements have trade creation and diversion effects. Trade creation occurs when a decrease in trade barriers leads to an increase in imports from the RTA members, something that is beneficial to the exporting member countries. The net effect is beneficial for the importing country as consumers gain more than the domestic producers may lose. Trade diversion takes place when imports from non-member countries are replaced by imports from members, resulting in a gain for the exporting RTA member and a loss for the non-RTA exporting country (Brückner 2004). The preference given to intra-regional trade through the abolishing of intra-regional trade remedies can be at the expense of cheaper imports from non-members to the agreement. As intra-regional trade increases due to the elimination of intra-regional tariffs, protection can be directed towards the imports from non-member countries, possibly leading to trade diversion. Trade diversion can also take place if strict rules are adopted in an RTA regarding the implementation of trade remedies against member countries, but not regarding the trade with non-members. The RTA members can discriminate against non-members leading to intra-regional imports being substituted for cheaper sources of imports from non-members (Teh et al. 2007).

A widely cited argument for the retention of safeguard and anti-dumping provisions in agreements is that they facilitate greater tariff liberalisation during trade negotiations (Crowley 2006). Ethier (2002) developed a multi-country model including countries which grow at different rates. The model shows that trade liberalisation is constrained by the world's slow-growing countries and negotiations on tariff reductions are influenced by uncertainty regarding future growth. According to the model when countries negotiate a trade agreement which does not allow for temporary tariff increases and the negotiating countries are unsure about their future growth, they will only negotiate small tariff reductions. When safeguards are included in the agreement, countries are enabled to negotiate larger tariff reductions because if there is slow growth they can temporarily increase their tariffs (Ethier 2002).

However, it has also been argued that safeguards and anti-dumping measures reduce the credibility of a trade agreement. If governments are not fully committed to liberlisation, productive factors may not be relocated to more efficient industries due to the expectation that government will use safeguards in future. According to Staiger and Tabellini (1987) productive factors are not efficiently allocated where trade agreements contain safeguard and anti-dumping provisions. However, in a trade agreement without these provisions, the efficient allocation of productive factors will take place. Therefore there is a welfare loss associated with agreements which include these provisions.

4. Domestic legislation in SADC, SACU and COMESA

The WTO agreements applicable to trade remedies and safeguards allow for the utilisation of national laws, regulations and procedures. Domestic provisions need to be notified to the WTO and must be consistent with the qualifications and requirements set out in the various applicable WTO agreements.

The Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (Article 18.4 and 18.5), for instance, states:

> Each Member shall take all necessary steps, of a general or particular character, to ensure, not later than the date of entry into force of the WTO Agreement for it, the conformity of its laws, regulations and administrative procedures with the provisions of this Agreement as they may apply for the Member in question, and Each Member shall inform the Committee of any changes in its laws and regulations relevant to this Agreement and in the administration of such laws and regulations.

The Common Market for Eastern and Southern Africa (COMESA) Regulations on Trade Remedies and Safeguards also require the following:

> Even before initiating the first action, a member State should have established its procedures for taking action and identified a competent authority to carry out investigations into the existence of the pre-conditions for safeguard, countervailing or anti-dumping action.

In the Southern African Development Community (SADC), the Southern African Customs Union (SACU) and COMESA combined, only eight countries have notified domestic legislation, regulations or procedures. This is shown in Table 1 below.

Table 1: Notification of domestic legislation/regulations

Country	Legislation/Regulations
Egypt	Law 161 of 1998 Concerning the Protection of the National Economy from Injurious Effects of Unfair Practices in International Trade as amended by the Decree of the Minister of Trade and Industry No 569/2008
Kenya	Customs and Excise Act Section 125 and 126; no domestic legislation on safeguards
Malawi	Customs and Excise Act Section 85 and 86; no domestic legislation on safeguards
Mauritius	No domestic legislation on trade remedies and safeguards, but has formulated procedures for anti-dumping actions based on the Anti-Dumping Agreement
RSA	International Trade Administration Act 71/2002; Customs and Excise Act; ITAC Anti-Dumping Regulations and ITAC Safeguard Regulations
Uganda	COMESA Treaty Articles 51-53; The Customs (Dumping and Subsidies: Rates) Act of 1964 and the Customs (Dumping and Subsidies) Act of 1970; no domestic legislation on safeguards
Zambia	Customs and Excise Act Sections 72-75 and 198 and the Customs and Excise Regulations 54/1994; no domestic legislation on safeguards
Zimbabwe	Customs and Excise Act Part VI Sections 73 and 77-81 and Competition Regulations 266/2002; no domestic legislation on safeguards

Source: WTO Member States notifications[1]

South Africa is the only member state of SACU which has notified domestic legislation to the WTO. In SADC five member states and in COMESA seven members have notified some form of domestic legislation and procedures applicable. In SADC four of the five members (Malawi, Mauritius, Zambia and Zimbabwe) are also part of COMESA, with South Africa being the only additional country in SADC which has carried out WTO notification. In COMESA, apart from the four countries overlapping with SADC, Egypt, Kenya and Uganda made notifications. The majority of the notifications are in relation to the implementation of anti-dumping and countervailing duties. Only South Africa and Egypt have also notified domestic laws applicable to safeguard actions. Mauritius does not have any implemented legislation as such, but has notified the WTO of domestic procedures developed for the implementation of anti-dumping measures.

[1][Online].Available: http://www.wto.org/english/thewto_e/whatis_e/tif_e/org6_e.htm.

5. Africa's experience

The experience of African countries in the trade remedy system, whether multilateral or bilateral, has been limited. On the one side, exports of various countries have been the target of mostly anti-dumping investigations and final measures, while on the other side, only South Africa and Egypt have played a major role in the implementation of anti-dumping duties, countervailing measures and safeguards.

5.1 African countries as exporters

The exports of various African countries have been the subject of a limited number of anti-dumping investigations and final duties. Since 1995 eight countries have been investigated for alleged dumping, and of those eight, seven had final duties imposed against them. These include Libya, Mozambique, Zimbabwe, Malawi, South Africa and Egypt. According to the WTO, African countries have been the subject of 79 anti-dumping investigations since 1995, of which 49 final duties where imposed.

South Africa and Egypt are the two countries which have been the most frequent targets of anti-dumping investigations and final duties by other WTO members. Of the 79 investigations launched since 1995, 58 targeted South Africa and 12 targeted Egypt. This represents 89 percent of the anti-dumping investigations launched against all the African countries. Final anti-dumping duties which were implemented against Egypt and South Africa represent 0.23 percent and 1.74 percent respectively of the total 2.24 percent of final measures taken against African countries.

Final duties have mostly been implemented in the base metal and chemical products sector. This compares to the implementation of duties against the rest of the WTO members. Of the total of 2190 final measures imposed from 1995-2008, 29 percent were concerned with base metals, 21 percent with chemical products and 13 percent with plastic products.

Minimal countervailing measures have been implemented against the subsidised imports from African countries, with South Africa and Côte d'Ivoire the only two countries against which duties have been imposed. Final duties on South African exports have been concentrated in base metals and food, beverages and tobacco products; the one duty levied against Côte d'Ivoire concerned vegetable products (WTO 2009).

5.2 African countries as reporting countries

South Africa and Egypt have been active in the utilisation of anti-dumping investigations and the implementation of final duties. Egypt implemented 51 and South Africa 124 final duties in the 1995-2008 period. This represents 2.33 percent and 5.66 percent respectively of the total anti-dumping duties imposed by all the WTO member states. These duties have mainly been targeted at imports from China, India and the Republic of Korea.

Egypt has for the most part focused anti-dumping duties on plastic products (29%), machinery (27%) and base metals (18%). The main imports targeted by South Africa include base metals (25%), plastic products (21%) and chemical products (15%). The implementation of duties on these product sectors is compared with the sectors on which the rest of the WTO members have also been focusing their anti-dumping efforts.

South Africa is the only African country which has implemented countervailing measures. In the period 1995-2008, four countervailing duties were imposed against imports from India (three measures) and Pakistan (one measure) in the plastic products, textiles and base metals sectors. This represents three percent of the total final countervailing duties implemented by all WTO members.

Egypt, Morocco and South Africa have been responsible for initiating eight safeguard investigations, resulting in seven safeguard measures being implemented. Egypt implemented safeguards on live animals, animal products, chemical products, textiles and machinery. South Africa implemented a safeguard measure on chemical products while Morocco implemented safeguard measures on vegetable products and non-metallic minerals (WTO 2009).

6. Provisions on trade remedies and safeguards

Trade remedies and safeguards can be implemented on a multilateral or a bilateral level. The application of a multilateral trade remedy is governed by the provisions in Articles VI and XIX of GATT 1994 together with relevant WTO agreements. The applicable WTO agreements are the Agreement on Safeguards, the Anti-Dumping Agreement and the Agreement on Subsidies and Countervailing Measures (Willkie Farr & Gallagher LLP 2006). The various WTO agreements also make provision for the differential treatment of developing and least developed countries (LDCs) by WTO members when implementing anti-dumping measures, countervailing duties and safeguards.

Bilateral or regional trade remedies are provided for in regional agreements between member countries. These are measures which only apply within the regional configuration and must be implemented according to the rules and regulations provided for in the various agreements. Due to anti-dumping and countervailing measures being country-specific, provisions regarding the bilateral or regional application of these remedies are seen to be unnecessary. Safeguards, however, are the remedy which requires an indication of multilateral or bilateral application on account of the requirement that safeguards need to be applied on a non-discriminatory basis.

Special safeguard measures can also be implemented on a multilateral or bilateral level. These mechanisms provide additional protection to traditionally sensitive sectors, such as agricultural products and textiles and clothing. The Agreement on Agriculture regulates the special agricultural safeguard on a multilateral level and the Agreement on Textiles and Clothing regulated a transitional safeguard on certain textile products, but this expired in 2005. Bilateral special safeguards are also provided for in some regional trade agreements, but more prominent in North-South agreements than South-South agreements.

6.1 Multilateral trade remedy and safeguards provisions

In GATT 1994 the provisions regarding the implementation of anti-dumping measures and countervailing duties are contained in Article VI. The implementation of anti-dumping measures is further regulated by the Agreement on Implementation of Article VI of GATT 1994. This agreement is referred to as the Anti-Dumping Agreement (ADA) which has the aim of harmonising the anti-dumping practice among the major users of this trade remedy. Apart from Article VI of GATT 1994 the implementation of countervailing duties is also governed by the Agreement on

Subsidies and Countervailing Measures (SCM Agreement) with provisions on countervailing contained in Part V.

The substantive requirements for the implementation of anti-dumping and countervailing duties are quite similar. In order to succeed with an application for anti-dumping or countervailing duties, the applicant has to demonstrate that dumping by foreign firms or subsidisation by foreign governments has taken place, that material injury or the threat thereof to like products of the domestic industry exists, and that there is causation between the dumping or subsidisation and the material injury or threat.

Prior to GATT 1947, bilateral agreements contained a ‘safety valve’ which was safeguard measures. These safeguards provided trade partners with an alternative to withdrawing from trade agreements when their domestic markets were disrupted by foreign imports. The implementation of global safeguards is currently governed by GATT 1994 Article XIX and the Agreement on Safeguards.

The substantive requirements which must be shown prior to the implementation of safeguards are the following: an unforeseen increase in imports, serious injury or the threat thereof to the domestic industry, and causation between the surge in imports and the serious injury.

The Agreement on Agriculture came into force on 1 January 1995 with the aim of providing importing and exporting countries with more security and predictability. The agreement contains provisions regarding market access, domestic support and export subsidies. This agreement makes provision for a special safeguard (SSG) to be implemented on the imports of certain agricultural products. The difference between the SSG and other global safeguards are that the SSG does not require the importing member countries to prove serious injury or causation (Olsson 2006). The SSG can only be applied by countries which have undergone tariffication and reserved the right to use the SSG when a surge in imports of the agricultural products covered by Annex I to the agreement takes place.

Article 13 of the Agreement on Agriculture also contained a provision regarding the implementation of countervailing measures on domestic support and export subsidies for agricultural products, but expired in 2003.

6.2 Special and Differential Treatment

Special and differential treatment to developing countries and LDCs are aimed at meeting two criteria. It is intended to be a 'rule-based' system offering fair access and certain trading conditions for all to provide for efficient growth and to support development through favourable conditions for developing countries. Three types of special and differential treatment arrangements can be identified: (a) arrangements aimed at improving the access to developed country markets; (b) reducing the cost of the international trading system; and (c) permitting policies which will otherwise be against WTO rules since they reduce the benefits that other countries can receive from trade (Page and Kleen 2005).

The ADA, SCM Agreement and Agreement on Safeguards all provide for the special and differential treatment of developing countries and LDCs.

In terms of the ADA, the exporters of developing countries have the same rights and obligations as their counterparts in developed countries. Article 15 of the ADA provides for the special rules regarding developing countries and LDCs. Special regard must be given to the situation of developing countries and LDCs when developed countries consider the imposition of anti-dumping duties. If the application of the duties will affect the 'essential interest' of the LDC or developing country, 'constructive remedies' provided in the ADA must be considered prior to application. The only requirement for developed country members is to consider another remedy openly, willingly and actively.

In Article 27 of the SCM Agreement a distinction is made between countries referred to in Annex VII and other developing countries. Annex VII (Art. (a) and (b)) states that a country is least developed if it has been designated as such by the United Nations or if the Gross National Product (GNP) per capita is less than $1000 per year.

LDCs are exempt from the prohibition on export subsidies and import-competing subsidies in the SCM Agreement. However, these prohibitions are applicable to other developing countries. A countervailing investigation on the imports from developing members must be terminated if the level of subsidisation on the import product is less than two percent of the value of the product or if the volume of the subsidised imports is less than four percent of the total imports of the product for the importing country. If the imports of an individual country is below the four percent margin, but collectively more than a nine percent share in the total imports the termination of the investigation does not apply (Art. 27.10(a) and (b)). For Annex VII countries, the investigation is terminated if the level of subsidisation is less than three percent of the value of the imported product (Art. 27.11).

The Agreement on Safeguards Article 9 allows for the differential application of safeguards to and by developing members in certain circumstances. The imports from developing countries are excluded from safeguards if their share of imports does not exceed three percent of the importing country's imports of the product and if the total share of those developing countries which have less than a three percent share individually is not more than nine percent of the total product imports collectively (Art. 9(1)).

Safeguard measures applied by developed countries can be extended for four years after the initial implementation period of four years. Developing countries can extend the implementation for a maximum of six years after the initial four years. Safeguards imposed for more than 180 days can normally only be reintroduced after a period equal to the original duration of the safeguard measure. However, developing countries can implement a safeguard again after a period of only half the original implementation period has passed.

6.3 Bilateral and regional safeguard provisions

Bilateral and regional safeguards are only meant to apply to intra-regional imports. Regional and bilateral safeguards temporary relieve RTA members from their RTA obligations allowing domestic industries to adjust to intra-regional liberalisation (Teh et al. 2007).

Most regional and bilateral trade agreements concluded in recent years provide special and different safeguards which share the same grounds for implementation as global safeguards. However, bilateral safeguard mechanisms only address the effects of bilateral or regional liberalisation initiatives and are only applicable between the members of the Preferential Trade Agreement (PTA) for this reason (Kotera and Kitamura 2007).

Since the conclusion of GATT, bilateral and regional safeguards have become a remedy of a special and limited nature. When an increase in imports resulting in serious injury is the result of liberalisation initiatives under a PTA, importing countries are allowed to implement a bilateral or regional safeguard under the regulations provided for in the agreement.

The global and bilateral safeguard mechanisms are different institutions dealing with problems that arise from different free trade initiatives. Regional safeguards have systematic differences from the global safeguard of the WTO. Most bilateral and regional safeguards only allow for tariff increases or the suspension of further tariff reductions as the appropriate measure, while under the global safeguard mechanism there are also other measures (such as quantitative restrictions) available for the importing country to invoke (Kotera and Kitamura 2007). The bilateral safeguard mechanisms are also usually only a temporary measure that can just be used during the transitional period when intra-regional tariffs need to be eliminated. The implementation period of bilateral and regional safeguards is normally shorter than the initial period of four years allowed for in the Agreement on Safeguards (Teh et al. 2007).

The compatibility of bilateral safeguard measures with GATT 1994 Article XXIV is questioned. The issue relates to the fact that bilateral safeguards can only be implemented against the imports of members to the regional agreement and not all sources of the import product. The only parties affected by the safeguard mechanism are those that are a part of the regional deal. In this instance the dispute will be referred to a regional forum in terms of the agreement. The argument has been made that when intra-regional safeguards are imposed the regional deal does not comply with Article XXIV. This is so because the requirement that restrictions on 'substantially all the trade' in the region have to be eliminated is not met when intra-regional safeguards are implemented. Article XXIV:8 contains a list of the continuation of some restrictions on intra-regional trade within a regional agreement. GATT 1994 Article XIX is not listed within this article and for this reason intra-regional safeguards are not seen as a restrictive policy that can continue within a regional trade arrangement. Pauwelyn (2004), however, states that the list in Article XXIV:8 is not an exhaustive one. Article XXIV requires only that restrictions need to be eliminated on ‘substantially all the trade’ and not that the elimination of all trade restrictions (except those listed in the Article) must take place.

The flexibility provided in Article XXIV:8 allows for the application of intra-regional safeguards. Only if the safeguard is imposed on a significant percentage of the trade within the region, the question can arise whether the remaining trade that is free qualifies as ‘substantially all the trade’.

7. Trade remedy and safeguard provisions in RTAs

The rules of the WTO recognise that sometimes imports, fairly or unfairly traded, can cause harm to the domestic industry – which warrants temporary restraint. The elimination of anti-dumping measures in RTAs seems to be an exception rather than the rule. Most regional agreements allow for the use of anti-dumping and countervailing measures among the member states according to the WTO rules. RTAs have also dealt with safeguards in a range of ways. Some RTAs apply the WTO rules while others have strengthened their application. RTAs in which the implementation of safeguards among members has been prohibited are limited to a select few.

In most of the examined regional agreements it is either stated that member countries retain their rights and obligations under GATT 1994, the ADA and SCM Agreement to implement anti-dumping measures and countervailing duties or describe the requirements for the implementation of these measures which are identical to the WTO provisions. In a limited number of agreements the procedures are slightly varied or additional requirements are set out.

Of the examined regional agreements some provide different articles relating to global and bilateral safeguard mechanisms, while others combine these measures in one article. However, there is also agreements which only refer to the global safeguard mechanism. In some of the agreements a bilateral safeguard can be implemented for the protection of infant industries and food security, while only one agreement contains a special safeguard applicable to agricultural products.

7.1 Free Trade Agreement with the European Free Trade Association

The European Free Trade Association (EFTA) member states (Iceland, Liechtenstein, Norway and Switzerland) have negotiated trade agreements with various countries and regional arrangements. Here only the agreement with SACU is evaluated.

The parties retain their rights and obligations to implement countervailing measures, anti-dumping duties and safeguards in terms of GATT 1994 and the various WTO agreements covering these remedies (Art. 16, 17 and 18).

The SACU-EFTA FTA states that notification to the relevant parties must take place before countervailing, dumping and global safeguard investigations are initiated. The parties can also enter into consultation to find an accepted solution on request. A bilateral emergency safeguard measure is provided which allows the parties to take action to remedy difficulties in the form of the suspension of further duty reductions or an increase in the rate of duty which is applicable to a product. Before emergency action can be taken all the relevant information must be given to the Joint Committee which will examine the information to facilitate a solution. The bilateral safeguard can normally only be invoked for a maximum of one year, but under exceptional circumstances a maximum of three years implementation is possible. If the delay in the application of the safeguard will result in damage which will be difficult to repair, a provisional measure can be taken before consultations take place. This provisional measure must be terminated within six months of implementation (Art. 19).

Article 20 of the SACU-EFTA FTA provides for a special safeguard on agricultural products. The safeguard consists of either an increase in duties to the Most Favoured Nation (MFN) rate or a tariff quota for preferential trade based on historical trade volumes. The measure must be implemented according to the provision on bilateral safeguards and can be invoked for a maximum of one year.

The detailed provisions regarding the substantive and procedural requirements for the implementation of each trade remedy are not provided for in the agreement, but should be obtained from the GATT 1994 provisions, Agreement on Safeguards, ADA, SCM and Agreement on Agriculture.

7.2 Southern African Development Community

The SADC Trade Protocol contains very limited provisions regarding the implementation of trade remedies. The protocol provides that anti-dumping and countervailing duties can be implemented according to the WTO provisions (Art. 18,19). The agreement provides a detailed section on the implementation of safeguards which refers to and is quite similar to the Agreement on Safeguards. The conditions for implementing safeguard measures, the serious injury determination and the method of application are those found in various articles of the Agreement on Safeguards[2].

7.3 Southern Africa Customs Union

The 2002 SACU Agreement does not contain details regarding the implementation of trade remedies. Article 41 states only that the Council will develop the policy and instruments necessary to address unfair trade practices among member states.

In Annex C Article 8 of the agreement provision is made regarding what national bodies should consider and recommend in terms of trade remedies. The national bodies should ensure that the procedures and recommendations for the implementation of trade remedies are consistent with the Agreement on Safeguards, SCM, ADA and other trade arrangements by SACU. The national body can decide whether an investigation should be initiated into the alleged action which led to the application for remedial action. If an investigation is launched the SACU Secretariat must be notified immediately.

The agreement does not provide for requirements and procedures that need to be complied with for the implementation of trade remedies and it is mostly governed by the various WTO agreements, domestic legislation and authorities within each member state.

[2] SADC Trade Protocol Article 20 is the same as Article 2, 4 and 7 of the Agreement on Safeguards.

7.4 Common Market for Eastern and Southern Africa

The COMESA Agreement provides detailed provisions regarding the implementation of trade remedies and safeguards. Implementation is also subject to the regulations made by the Council, set out in the Trade Remedy and Safeguard Regulations.

Article 51 of the agreement provides for anti-dumping duties which can be implemented against other member states or the imports from third countries. Anti-dumping duties against a member country are allowed if the country causes or threatens material injury. The provisions regarding the determination of dumping and the procedures which need to be followed are identical to those provided in the ADA (Art. 51.1-51.4). Dumping by a third country is prohibited and the affected member can levy an anti-dumping duty according to the procedures for intra-COMESA dumping (Art. 51.5). The Trade Remedy Regulations determine the conditions for the implementation of anti-dumping measures. Dumping must be present, the dumping margin must not be less than two percent of the normal export price, serious injury or threat thereof and a causal link between the dumping and the injury must be demonstrated.

Countervailing duties can be implemented against the imports of a member country or third country to offset the effect of a subsidy (Art. 52.2 and 52.4 respectively). The duty must be equal to the estimated subsidy amount on the manufacture, production or export of the product. The preconditions which must be present for the invocation of the countervailing duties are supplied by the regulations. Article 53 states that countervailing duties can only be applied if the effect of the subsidy causes or threatens serious injury to a member state.

In Article 61 provision is made for safeguard measures when trade liberalisation and development cooperation cause serious disturbance, while Article 83 allows safeguards when there is an adverse effect due to financial and monetary cooperation. According to Article 61 the necessary safeguard can be implemented after other member states and the Secretary General has been informed. The safeguard can be implemented for a year, but can be extended through the approval of the Council. Article 83 states than this safeguard can only be implemented on the approval of the Council. For the implementation of an Article 83 safeguard or an extension in terms of Article 61, the member state must prove to the Council that the necessary and reasonable steps have been taken to overcome any imbalances caused and that the safeguard was implemented on a non-discriminatory basis. According to the regulations the measures which can be implemented are tariff type measures, including a levy, tariff increases or quantitative restrictions.

7.5 East African Community (EAC)

The EAC Agreement provides two clauses only with regard to the implementation of safeguards. Further, it states that a protocol regarding anti-dumping, subsidies and countervailing measures, safeguards, rules of origin and dispute settlement (Art. 75) will be provided. Annex IV (Implementation of subsidies and countervailing measures), Annex V (Implementation of safeguards) and Annex VI (Implementation of anti-dumping measures) to the Customs Union Protocol I (Protocol on the Establishment of the East African Customs Union) contain the rules and regulations regarding the implementation of the trade remedies. These requirements and procedures are identical to the provisions in the various WTO agreements.

If a member state incurs serious injury due to trade liberalisation within the region the necessary safeguard measure can be implemented after the Secretary General and other members have been informed (EAC Agreement Art. 78). Article 88 of the EAC Agreement allows for a safeguard to remedy adverse effects caused by monetary and financial liberalisation, including the removal of exchange rate restrictions on imports and exports, the liberalisation of the financial sector, harmonising tax policies, free movement of capital and integrated financial systems between EAC member States (Art. 83 and 86).

Dumping is prohibited if it causes material injury or a threat thereof to an established industry, retards the establishment of a domestic industry or frustrates the benefits which were expected from the removal of duties and quantitative restrictions. In exceptional circumstances the territory of the member states can be divided into two or more competitive markets with the producers in each market being regarded as separate industries (Customs Union Protocol I Art. 16).

Countervailing measures can be implemented according to Annex IV on imports from a foreign country to offset the effect of a subsidy. The duty which can be imposed must be equal to the estimated subsidy on the manufacturing, production or export of the imported product (Customs Union Protocol I Art. 18).

According to Article 19 of the Customs Union Protocol I safeguards can be implemented when a surge in imports occurs under conditions which cause or threaten serious injury to the domestic producers of the product or competing products. If a member country suffers serious injury due to the application of a common external tariff a safeguard can be implemented for a transitional period of five years after the protocol came into force. The Secretary General needs to be informed of the proposed measures prior to implementation. Article 36 provides a general safeguard provision. If the application of the protocol leads to the serious injury or threat thereof to the economy of a member state, the Secretary General needs to be informed after which a necessary safeguard measure can be implemented.

7.6 Economic Partnership Agreements

The relationship between the EU and the African Caribbean and Pacific Group of countries (ACP) was governed by the Cotonou Agreement until the end of 2007. Cotonou provided for the conclusion of reciprocal trade relations which led to the negotiations of individual bilateral treaties between the EU and the participating ACP countries. When the EPAs are concluded they will provide specific rights and obligations for the six defined clusters of countries. These clusters are West Africa, Eastern and Southern Africa, Central Africa, SADC, the Caribbean and the Pacific. The EPAs are aimed at being comprehensive FTAs based on reciprocity, differentiation, deeper regional integration and the coordination of trade and aid (tralac 2008).

The EPA negotiations are still continuing; only the Caribbean countries signed a full EPA in October 2008. The state of play regarding the EPA negotiations is the following:

- In Central Africa an interim EPA (IEPA) has been initialled by Cameroon;
- In West Africa IEPAs were signed by Côte d'Ivoire and Ghana;

- In East Africa an IEPA was initialled by Zimbabwe, Seychelles, Mauritius, Comoros, Madagascar and Zambia and one initialled by EAC countries Burundi, Kenya, Rwanda, Tanzania and Uganda;
- In SADC, Botswana, Lesotho, Namibia, Swaziland and Mozambique initialled an IEPA after which Botswana, Lesotho, Swaziland and Mozambique signed an IEPA; and
- Papua New Guinea and Fiji initialled an IEPA in the Pacific country cluster.

The text regarding trade remedies within the various EPAs is almost identical. Small differences occur in terms of the implementation periods of a trade remedy after the agreements come into force. The trade remedy provisions resort under the trade defence instruments or measures chapter within the agreements. In all the agreements provision is made for anti-dumping and countervailing measures, multilateral safeguards and bilateral safeguards. The application of bilateral safeguards for the protection of infant industries and food security is provided for in most but not all of the agreements.

The anti-dumping and countervailing provision allows the contracting parties to keep their rights and obligations in terms of the applicable WTO agreements. The EC must also consider constructive remedies provided in the WTO agreements before a definitive measure is adopted. Some of the agreements provide that when measures are imposed on more than one of the ACP states involved in a cluster, only one judicial review will take place and measures imposed by national and regional authorities cannot be imposed on the same product at the same time[3].

The multilateral safeguard clause in all the agreements is identical. The contracting parties retain their rights and obligations to implement safeguards according to Article XIX of GATT 1994, the Agreement on Safeguards and Article 5 of the Agreement on Agriculture. For a period of five years after the EPAs are enforced the EC will exclude the imports from the ACP contracting countries from any multilateral safeguard which the EC will invoke against a surge in imports.

[3] IEPAs with Cameroon, Pacific countries, eastern Africa and the EAC, and the final EPA with the Caribbean countries.

The requirements for the implementation of bilateral safeguards are the same for all the EPAs. Bilateral safeguards can be implemented if the imports from a contracting state cause or threat serious damage or disrupt a sector of the economy or markets for similar agricultural products in another contracting party. The measures which can be implemented are a suspension of further duty reductions, an increase in the customs duty to the MFN rate or a tariff quota on the product concerned. Safeguards can be implemented for a maximum of two years which can be extended for a further two years. If the ACP clusters as a whole or the individual signatories apply the safeguard measure or if the EC applies a measure only on the territory of the outermost regions, the measure can be implemented for four years and extended for an additional four years. If a signatory considers a bilateral safeguard the individual EPA Committee for each agreement must be notified. The Committee can then evaluate all the relevant information and can make a suitable recommendation. If no recommendation or satisfactory solution is made by the Committee the affected party can adopt the appropriate measure. When adopting a measure, priority must be given to an instrument which will solve the problem with the least distorting effect on the agreement. In exceptional circumstances, when a delay will cause damage not easily repaired, the contracting parties can take a provisional measure without complying first with all the procedural requirements. The EC can implement the provisional measure for 180 days and the ACP signatories for 200 days.

Most of the EPAs, except those with eastern Africa and the EAC, allow for a specific bilateral safeguard when the implementation of the EPAs leads to problems regarding the availability and access to foodstuffs necessary for food security. Thus, if the removal of trade barriers between the EC and ACP signatories leads to difficulties for ACP country producers in the sectors of agriculture, food and fisheries, bilateral safeguards may be implemented. The original SADC IEPA did not make provision for a food security safeguard, but in March 2008 new legal texts were agreed upon by the SADC EPA contracting parties. These will be included in the full EPA and contain Article 27(bis) allowing for food security protection identical to the other EPAs.

The biggest difference in the trade defence instruments of the EPAs is the provisions pertaining to bilateral safeguards for the protection of infant industries in the ACP signatories. The difference between the various agreements is due to the different implementation periods allowed for after the EPAs come into force. If an import product from the EC causes or threatens a disruption to the establishment of an infant industry or an existing infant industry in an ACP signatory country, a bilateral safeguard can be implemented in the production of a ‘like product’.

Most of the EPAs provide for a period of ten years in which the ACP signatories can utilise infant industry safeguards after the agreements come into force[4]. The EPA with Cameroon allows for an implementation period of 15 years, while the rest of the EPAs make a distinction between least developed and non-least developed countries. Article 21.5(b) of the eastern Africa EPA allows for a 15-year implementation for least developed countries and 10 years for other countries.

The Pacific countries’ signatories can implement an infant industry safeguard for the promotion of productive and sustainable industries to raise the standard of living. The measure may be implemented for 20 years after the agreement comes into force. The initial duration of the measure for the Small Island states and Pacific least developed states is 12 years – a period which can be extended for a further three years. The initial duration for the other countries is seven years which can also be extended for another three. The infant industry measure which is taken may not raise the tariffs on the EC imports for more than three percent of the tariff lines or 15 percent of the total value of imported goods from the EC[5].

The initialled SADC EPA text makes provision for the implementation of the infant industry safeguard for 12 years by Botswana, Namibia and Swaziland and 15 years for the least developed countries – which can be extended after the agreement comes into force (IEPA with SADC Article 34.5(b)). The new legal text has a stand-alone infant industry clause. Botswana, Lesotho, Namibia, Swaziland and Mozambique can temporarily suspend a decrease in customs duties or increase the current applied customs duties when the importation of a product from the EC causes or threatens disruption to an existing or new infant industry. This measure can be

[4] The IEPA with Côte d’Ivoire, Ghana and the EAC and the final EPA with the Caribbean.
[5] See the IEPA with the Pacific countries, Article 21.5(b)

implemented for eight years and can be extended by the Trade and Development Committee[6].

8. Capacity of African countries to participate in the trade remedy system

The requirements necessary for the successful application of trade remedies have resulted in most African countries not playing a major role in the invocation of anti-dumping and countervailing duties and safeguards on the multilateral and bilateral level. On the multilateral level, only Egypt and South Africa have played an active role in implementing trade remedies and safeguards. In the regional context, bilateral measures have only been implemented within COMESA through Kenya's implementation of bilateral safeguards on sugar and wheat flour imports from other member states.

African developing and least developed countries for various reasons do not implement or defend their exports against contingent protectionist measures. These countries are faced with three main constraints: (a) the necessary expertise; (b) financial resources; and (c) available manpower. The application of trade remedies requires substantial financial and human resources as well as expertise for the detailed investigations necessary to comply with all the relevant provisions of the WTO agreements and regional arrangements. Not all developing countries have these resources available to them and if there is no compliance with the various requirements a country runs the risk of being challenged before either the WTO dispute settlement or a regional body. These constraints, coupled with the lack of technical equipment, make it difficult for countries to defend themselves against the application of trade remedies. The expensive legal costs and long time periods involved in trade remedy disputes restrict the defence against allegations of dumping, subsidies or a surge in imports (Neufeld 2001). The complex economic and accounting considerations involved in the implementation of trade remedies need to be integrated into a legal system which provides for substantive and procedural rights and obligations. The legal system needs to be fair and efficient to ensure that trade remedies do not constitute indirect trade barriers (Waincymer 2001).

[6] New legal texts agreed upon in March 2008 to be included in the full EPA.

Small and medium-sized export companies have difficulty in defending themselves due to the complexity of the trade remedy system involved in participating in the investigation process. Governments of these countries can also only provide limited, if any, assistance to firms wanting to defend themselves against implemented action. The degree of complex procedures weighs highly against African countries due to less developed administration, incomplete knowledge of laws, regulations and administration practices of the importing countries and limited experience and expertise in dealing with allegations of dumping, subsidisation and a surge in imports.

The growing jurisprudence on the application and implementation of trade remedies makes it difficult for trade officials to master both substantive and procedural aspects of WTO law. Small administrations normally do not have the manpower to assign officers to a dispute because these officials can be busy with the process for up to two years. Also, small economies cannot endure the economic harm caused by the implementation of a trade barrier for the entire period of the dispute process. A trade remedy undermines the exports of developing countries, and if the remedy is found to be inconsistent, the withdrawal can sometimes only take place two to three years after the complaint was filed at the WTO (United Nations 2006).

These shortcomings create problems for developing countries to defend their rights and obligations which lead to some exporters withdrawing from the market rather than defending themselves (United Nations 2000).

9. Conclusion

The economic rationale for the retention of trade remedies in regional trade agreements has been the cause of debate among many economists. Those supporting the retention of trade remedies have argued that these measures are a method to maintain cooperation among member states in volatile trade periods, that international trade agreements are given a degree of acceptance by these ‘escape valves’ for trade protection, that tariff liberalisation is stimulated and that the negative effects of these trade defence instruments are due to the deficiencies in the legislation governing their implementation rather than the underlying concept. Others see the economic basis for these measures to be rather weak – with governing legislation often reflecting political rather than economic considerations and governments utilising trade remedies to support an administered protection regime. Using these instruments as protectionist tools is seen as being an inefficient strategy. Because anti-dumping and countervailing measures are country-specific, the gap created by a successful dumping or subsidisation investigation can be filled by alternative sources of supply and these measures create a dead-weight loss for the domestic industry in terms of recurring legal costs.

Most of the African countries against which measures have been taken lack financial resources and manpower. This is coupled with the complexity of the trade remedy system, the limited assistance by government and incomplete knowledge of the laws and regulations of the importing country. The result is that it is impossible for most African developing and especially least developed countries to defend themselves against an allegation of dumping, subsidisation or a surge in imports. Matters are also complicated by a lack of domestic legislation and regulations dealing with the implementation of trade remedies in many southern and eastern Africa countries and the vague and ambiguous language in many of the examined trade agreements. The 2002 SACU Agreement, for instance, contains no detailed provisions regarding the implementation of trade remedies and safeguards and requires the development of common policies regarding unfair trade practices. However, these common policies have not been developed and the agreement contains no provisions regarding the procedures to implement trade remedies against members or third parties. Therefore members are left with utilising the complex rules set out in the GATT 1994 and WTO agreements. South Africa is also the only SACU member which has notified domestic legislation to the WTO and has a national body to investigate allegations and make determinations in terms of dumping, subsidisation and import surges. In some of the agreements further complications are found in the fact that regulations are included in protocols and annexes to the agreements which are added to existing regulations. This requires member states of, for instance, COMESA and the EAC to have not only knowledge of their treaties but also about additional protocols and annexes in order to implement trade remedies successfully.

Currently, only South Africa and Egypt can successfully participate in the trade remedy system and defend their exports against allegations. Although the special and differential treatment available in multilateral trade remedy provisions protects developing and least developing countries from the implementation of global safeguards, countervailing measures and anti-dumping duties, this protection is limited. The EPAs also state that the implementation of global safeguards will not be applicable to the ACP contracting parties for a period of five years after the agreements come into force. This provides additional protection for the exports of developing African countries. However, after five years the imports from the ACP countries will also be subject to global safeguards under the EPAs, except if the imports are excluded under the Special and Differential Treatment clause in the Agreement on Safeguards. Developing and developed countries also have the same rights and obligations under the global anti-dumping provisions. Thus, developing and least developed countries are not to a great extent protected from anti-dumping measures, which have shown the highest level of increase since the second semester of 2008.

Capacity, domestic legislation and procedures and technical expertise need to be developed in eastern and southern African countries to address the increased implementation of contingent protectionism. As regional integration in Africa deepens there must be a focus on clear, simple and unambiguous rules to enable countries to participate in the trade remedy and safeguard system in accordance with WTO rules.

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Multilateral Agreements

Agreement on Agriculture

Agreement on Safeguards

Agreement on Subsidies and Countervailing Measures

Agreement on the Implementation of Article VI of the General Agreement on Tariffs and Trade 1994

General Agreement on Tariffs and Trade 1947

General Agreement on Tariffs and Trade 1994

Bilateral Trade Agreements

Agreement on the Global System of Trade Preferences among Developing Countries (1988)

COMESA treaty - The common market for eastern and southern Africa (1993)

EAC treaty – East African Community (1999)

Free Trade Agreement between the Arab Republic of Egypt and the EFTA States (2007)

Free Trade Agreement between the EFTA States and the SACU States (2006)

Southern African Customs Union Agreement (2002)

Southern African Development Community Protocol on Trade (1996)

Treaty of ECOWAS – Economic Community of West African States (1993)

Economic Partnership Agreements

Agreement establishing a framework for an Economic Partnership Agreement between the Central African States, of the one part, and the European Community and its Member States, of the other part (text initialled 2007)

Agreement establishing a framework for an Economic Partnership Agreement between the East African Community Partner States, of the one part, and the European Community and its Member States, of the other part (text initialled 2007)

Economic Partnership Agreement between the CARIFORUM States, of the one part, and the European Community and its Member States, of the other part (2008)

Interim Agreement establishing a framework for an Economic Partnership Agreement between the Eastern Southern Africa States, of the one part, and the European Community and its Member States, of the other part (text initialled 2007)

Interim Agreement establishing a framework for an Economic Partnership Agreement between the Pacific States, of the one part, and the European Community and its Member States, of the other part (text initialled 2007)

Interim Agreement establishing a framework for an Economic Partnership Agreement between the SADC EPA States, of the one part, and the European Community and its Member States, of the other part (text initialled 2007, signed 2009)

Interim Agreement establishing a framework for an Economic Partnership Agreement between the Ivory Coast, of the one part, and the European Community and its Member States, of the other part (text initialled 2007)

Chapter 4

Measuring the gains from currency union membership in southern Africa

Johan Fourie and María Santana-Gallego

African countries have latched on to growing empirical evidence that creating a currency union may result in large trade gains. This is based on the belief that lower transaction costs would lead to large increases in intra-regional trade volumes, augmenting growth. Yet there is growing evidence that not all countries may benefit from entering a currency union. This paper is an attempt to measure the gains from trade that are realised when entering a currency union. Using a standard gravity framework, we find that countries that decide to give up their currency and adopt an existing one or create a new common currency area stand to benefit significantly from a shared currency. However, these benefits are greater for a select few and the gains in terms of trade will depend on how open the country is and the intensity of trade flows with the other members of the currency union.

1. Introduction

African countries have latched on to growing empirical evidence that creating a currency union may result in large trade gains. This is based on the work by Andrew K. Rose and others over the last ten years, showing that the adoption of a currency union can increase trade by a factor of up to three. The central idea is that a common currency implies more than an elimination of exchange rate volatility among its members. It also reduces transaction costs, information asymmetries and uncertainty, increases transparency relevant to international trade and provides a commitment device for macroeconomic policies. Given the theoretical and empirical support for entering currency unions, African countries have set goals along a linear approach of regional integration with the aim of establishing a single currency for Africa by 2021.

Yet Rose's and others' results are mostly at the aggregated level, ignoring the diversity of countries that constitute a regional agreement. More recently, scholars have pointed to the large discrepancy in the potential gains from trade by establishing a currency union. In particular, McCarthy (2008) and Masson (2008) argue for a selective – rather than linear – approach in broadening integration in Africa. Apart from the political constraints in achieving the integration targets on time, these authors hypothesise that not all countries may benefit upon entering a currency union. The characteristics of the member countries, the co-movement of prices, the diversity of the export bundle, and the priorities of national governments are some of the reasons for this.

This paper is an attempt to measure the gains from trade that are realised when entering a currency union. Using a standard gravity framework, we find that many African countries stand to benefit significantly from a shared currency. We also report the trade gains for establishing a currency union within the five regional groupings within Africa. The results suggest that especially two of these – COMESA and SADC – would realise substantial gains, and these gains would be greater for a small number of countries within these groups. These results support McCarthy and Masson in advocating a selective approach to adopting a currency union, rather than the (politically untenable) objectives of the linear approach.

To that end, this paper is organised as follows. First, a brief review on the effect of currency unions on trade is presented. Second, specific papers that have analysed the impact of common currencies on trade are reviewed while Section 3 puts in context the debate on the creation of an African single currency. Section 4 presents the data and methodology used while Section 5 presents the main results of the analysis. Finally, some conclusions are drawn in the last section.

2. Currency unions and trade

Given the complexity of regional arrangements proliferating across the globe – aptly named the spaghetti bowl-effect – it is perhaps understandable that policy makers are often lost within the myriad of possibilities when considering regional integration. Currency unions are an increasingly popular target for countries that wish to move to closer regional integration, yet there is some ambiguity on the definition of a currency union. Whereas the linear approach in economic integration – moving from preferential trade agreements, followed by free trade agreements, customs unions, a single market, and economic and monetary union – implicitly assume a common currency to be part of the fourth step in the integration process, a currency union may occur much earlier in the process, as it may refer not to a common currency, but to a shared – or pegged – currency. In this case, a country would opt to link its currency to that of an anchor economy, i.e. a fixed exchange rate regime. For example, while Namibia and South Africa are part of the South African Customs Union, the Namibian dollar is linked to the South African rand forming a Common Monetary Area (CMA) with Lesotho and Swaziland as the other two member states.

Two types of 'currency union' are thus identified. The standard definition in the literature is that of a common (or single) currency, where the countries involved relinquish their monetary policy and unify under a common monetary institution with shared monetary policy, as in the case of the euro system within the European Union. The second 'currency union' refers to countries that link their own currencies to those of an anchor country, as in the case of the above Namibian example. The most extreme version of this is 'dollarization'. In the rest of this paper we will use the term 'common currency' to refer to the former and 'shared currency' to refer to the latter. 'Currency unions' will encompass both types.

Textbook reasons for entering a currency union, proposed by Mundell (1961), include lower transaction costs, larger markets, increases in price transparency and less uncertainty. These microeconomic factors are all determinants of international trade. In that sense, high transaction costs, low transparency and great uncertainty increase trade costs which reduce trade flows (Anderson and Van Wincoop 2004). The high variability of exchange rates when freely floating – while good when offsetting inflation differentials or when negating a supply-side shock – can thus have detrimental consequences for the real economy when it discourages trade and investment.[1] The key benefit of a currency union between two countries may therefore not be the standard expectation of lower inflation but rather an increase in trade and, consequently, welfare.

Rose and various coauthors have investigated this hypothesis empirically. In a seminal paper, Rose (2000) finds that being member of a currency union increases trade three times more than would have been the case had the currency union not

[1] The link between exchange rate fluctuations and trade and investment flows is still empirically ambiguous, also because it is difficult to use time-series data to compare exchange rate variability and trade statistics. See Edison and Melvin (1990) for an overview.

existed. Glick and Rose (2002), using a gravity equation of 217 countries from 1948 to 1997, find that, controlling for other variables, trade flows double between countries that adopt common currencies. Frankel and Rose (2002) provide further support, finding a strong link between adopting a common currency and income growth. Micco, Stein and Ordonez (2003) find that a common currency in the European Union increases trade, although not as much as in the findings of Glick and Rose (2002). While some have doubted these large magnitudes, Rose (2000) offers two additional explanations to the above why the results may be theoretically plausible: (1) firstly, a currency union may induce financial integration, which results in higher trade; secondly, a currency union may act as a signal to show a country's willingness to commit to long-term integration, which attracts investment, trade and growth. Revising his initial high estimates, Rose and Stanley (2004), in a meta-analysis of a large number of studies, calculate that the currency union effect is somewhere between 30 and 90%.

So, an important issue could be: which countries stand to gain most from entering currency unions? Rose (2000) acknowledges that his high estimates may be upwardly biased because of the inclusion of many developing countries in the analysis. This implies that the adoption of a common currency between developing countries would have a larger effect on trade than when developed economies adopt a common currency. Alesina and Barro (2002) find that countries with a history of high and volatile inflation and those with strong price co-movements with the anchor economy would gain the most from a common currency. These results suggest that smaller, developing economies may benefit more from entering currency unions than would industrial countries.

3. Currency unions in Africa

In contrast to the findings mentioned in the previous sections which hold that currency unions have a large impact on international trade, Masson and Patillo (2004) hypothesise that the costs of currency unions for African countries may outweigh the benefits. Because African countries are much less integrated than countries in Europe, these authors argue that the gains from economies of scale and lower transaction costs may not be similar to what is found in the rest of the world. African countries are also highly concentrated in their trade composition and can therefore suffer large terms of trade shocks. Having given up monetary policy under a common currency, few alternative policy measures exist for African governments to facilitate adjustment to these shocks (Masson and Patillo 2004).[2]

However, the empirical results for African countries do not support these propositions. Masson and Patillo (2004) find that African countries, after adopting a currency union, experience the same increases in trade as the rest of the world, with membership of a currency union increasing trade by a factor of three. In this context, it is important to note that they combine the effects of entering a free trade agreement and currency union. Tsangarides et al. (2006) build on their analysis, differentiating between free trade agreements and currency unions and splitting the sample to verify whether African countries perform differently. They find that 'African countries stand to benefit as much from currency union membership as countries in the rest of the world, and, therefore, currency benefits are not region specific'. A further significant finding is that the longer a country participates in a currency union, the greater the benefits it derives.

Given this, African heads of state seem eager to adopt a single currency by the year 2021. To achieve this target, African countries will follow a linear process of integration to a common market. In the South African Development Community (SADC), for example, the plan is to have a free trade agreement by 2008, a customs union by 2010, a common market by 2015, a monetary union by 2016 and a single currency by 2018 (McCarthy 2008). Yet the history of African economic integration suggests that these expectations are pipe dreams. Masson and Patillo (2004) document the complexity of African monetary integration initiatives over the course of the previous century. It is an account marred by unfulfilled promises and few successes. It is important to note that the reasons for these failures are not only economic; in fact, Baldwin and Wyplosz (2004) suggest that political considerations may outweigh economic factors in most economic integration failures.

There is therefore growing scepticism about the possibility of achieving the said targets, especially in Southern Africa. McCarthy (2008), a long-time advocate of greater regional integration in the SADC region, is critical of the linear approach

[2] Other measures would include labour mobility or intra-country fiscal transfers, both which are neither politically nor economically feasible.

chosen to attain a single currency and the short deadlines imposed for achieving the targets. in addition to Masson and Patillo (2004), McCarthy also points out that southern African countries – with the exception of South Africa – specialise in the production and export of few commodities, mostly primary goods, with few policy tools available other than exchange rate fluctuations in case of asymmetric shocks. According to McCarthy (2008), a currency union 'does not in itself create capacity to produce goods. Add to this the downside of reducing sovereignty with respect to monetary policy and the exchange rate for countries that face asymmetric external shocks and a single currency's benefits become doubtful, even if there are indicators that macroeconomic convergence is occurring'. He recommends adopting a gradual – or selective – approach, linking southern African countries piecemeal to the South African rand, for example, because of the independence and credibility of the South African Reserve Bank, thus in effect opting for a 'shared currency' rather than a 'common currency'. While a gradual process of expanding the existing Common Monetary Area may be the only workable alternative to the linear approach, McCarthy (2008) warns that 'only a supreme optimist' will expect the political changes required to deliver on these goals.

This is in line with more recent quantitative work by Masson (2008). While finding 'potential doubling of trade', he argues that there are large asymmetries in the benefits across countries. The results also depend on the institutional guarantees of the central bank's independence as well as the priorities of national governments, particularly their financing needs. His recommendations are similar to those of McCarthy in stressing 'selective expansion of existing monetary integration projects', rather than 'an all-encompassing project of a continent-wide strategy' (Masson 2008:545).

This paper aims to identify quantitatively which countries may benefit the most in terms of trade gains by joining an existing currency union, thus following the gradual or selective approach advocated by McCarthy (2008) and Masson (2008). To do this, we employ a standard gravity framework which has been traditionally used to study the determinants of trade flows across countries. Moreover, this specification is recognised for its good fit with the data.

4. Data and methodology

To quantify the potential gains of adopting a single currency in terms of trade for African countries, it is first required to estimate the effect of currency unions on bilateral trade flows. To that end, a standard gravity model for bilateral trade is estimated.

Gravity models represent trade between two economies as a function of their respective economic masses, commonly measured in terms of GDP, GDP per capital and/or population, the distance between the two economies, and a variety of other factors. In accordance with earlier literature, we begin by investigating the effect of currency unions on trade by defining the following augmented gravity model:

$$\begin{aligned}\ln Trade_{ijt} = \beta_0 + \beta_1(\ln GDPpc_{it} \ln GDPpc_{jt}) + \beta_2(\ln Pop_{it} \ln Pop_{jt}) + \beta_3(\ln area_i \ln area_j) \\ +\beta_4 \ln D_{ij} + \beta_5 Border_{ij} + \beta_6 Lang_{ij} + \beta_7 Colony_{ij} + \beta_8 ComCol_{ij} + \beta_9 Col45_{ij} \\ +\beta_{10} FTA_{ij} + \gamma CU_{ij} + \lambda_t + \alpha_i + \eta_j + u_{ijt}\end{aligned}$$

(1)

where ln denotes natural logarithms, *i* and *j* indicate each country in the pair and *t* is time. $Trade_{ijt}$ denotes the real bilateral trade in goods as the sum of exports and imports between countries *i* and *j* in year *t*; *GDPpc* is the real GDP in per capita terms; *Pop* denotes the population; *area* is the land area of the country; D_{ij} is the great circle distance between capital cities of countries *i* and *j*; *Border* is a binary which is unity if the country of origin and the country of destination share a common land border and zero otherwise; *Lang* is a binary variable which is unity if both countries have a common language and zero otherwise; $Colony_{ij}$ is a binary variable which is unity if one country ever colonised the other or vice versa and zero otherwise; *ComCol* is a binary variable, which is unity if *i* and *j* were colonies after 1945 of the same coloniser; $Col45_{ij}$ is a binary variable which is unity if countries have had a colonial relationship after 1945 and zero otherwise; *FTA* is a binary variable which is unity if *i* and *j* belong to the same regional trade agreement; while *CU* is a binary variable related to currency union which takes value 1 if both countries in the pair share a common currency and 0 otherwise. Finally, β_0 is the constant α_i,

η_j and λ_t refers to country *i*, country *j* and year fixed effects, γ is the parameter of interest and finally u_{ijt} is a well-behaved disturbance term.

The dataset includes 48 African countries as country i in the pair and 211 countries in the world, including the African countries, as country j in the pair for the period 1960-2006. Therefore the dataset covers 10,128 pairs of countries with gaps over 47 years. By doing that, we can make comparisons between the estimated effect of currency unions for the total sample and the two sub-samples African countries and the rest of the world countries.

The trade variable is measured in millions of US$ and is obtained from *Direction of Trade* dataset of the *International Monetary Fund* and the *OECD Statistics*. GDP per capita and trade need to be converted to real terms by using US GDP deflator. GDP per capita, population, area and US GDP deflator were obtained from the *World Development Indicators*. Distance and dummy variables *Lang*, *Colony, ComCol, Col45* and *Border* were collected from the *Centre d'Etudes Prospectives et d'Informations Internationales (CEPII)* dataset while *CU* and *FTA* were obtained attending to the classification presented in Tsangarides *et al.* (2006).

Moreover, GDP per capita is considered as a potential endogenous variable since trade might increase the market size of the countries promoting growth. Therefore instrumental variable methods are required to deal with this problem and lagged value of the endogenous variable is considered as instrument[3].

Gravity equations can be estimated by different econometric methods although the most common one is pooled Ordinary Least Squares (OLS). This method assumes that the error term is not correlated with the explanatory variables. This implies that only when there are neither cross-sectional nor temporal effects, we can pool data and run OLS. Despite its popularity, this method also has certain shortcomings. As an alternative, gravity equations can be estimated by fixed-effect (FE) because it avoids the inconsistent and inefficient estimates provided by OLS if unobserved heterogeneity exists. The fixed effect model is widely used when we want to control

[3] Lagged values of the endogenous variable are commonly considered as valid instruments. Exogeneity tests to analyse the validity of the instrument have been applied.

omitted variables that are constant over the period of time and vary across the unit that is called unobserved heterogeneity of fixed effect.

However, the fixed effect approach does not allow for estimating coefficients on time-invariant variables such as distance, border or common language dummies. Thus, estimation by using country-pair fixed effects cannot be applied in this analysis since observations of interest disappear.[4] A way to overcome this problem is the introduction of individual country fixed-effects for the importers and the exporters in the gravity model. Several papers have estimated gravity models including individual fixed-effects for each country (Mathias 1997; Cheng and Wall 2005; Kandogan 2008).

In that sense an auxiliary equation in the FE model can be estimated in which the time-invariant explanatory variables are regressed on the estimated country pair intercepts by using OLS. For this reason, α_i, λ_j and μ_t are introduced as destination, origin and year fixed effects respectively. This model is a special case of the FE model given that it has a unique value for each trading pair's intercept, with the restrictions that a country's fixed effect as an exporter or importer is the same for all of its trading partners.

5. Results

In this section, the results of the estimate gravity equation are presented. Eq. (1) is estimated for three different samples: the whole sample, intra-African trade and African trade with the rest of the world. The sum of these last two samples comprises the total sample.

First, we compare our aggregated results to those found in the literature (Table 1 provides the complete regression results). For the whole sample, the estimate coefficient of the currency union is 1.3014 which implies that entering a currency union would increase trade by a factor of 2.67.[5] This closely approximates the factor

[4] In other words, some currency unions cases in our sample remain time-invariant in many country pairs. For instance, the Economic and Monetary Community for Central Africa (CAEMC) and the West African Economic and Monetary Union (WAEMU) members belong to a currency union for the whole sample period.

[5] Because the dependent variable is expressed in logs, the way to obtain the elasticity of the CU dummy variables is by applying an exponential, in this case: exp(1.3014)-1=2.67.

of three that Rose (2000) estimates (for a large sample of countries) and the doubling of trade estimated by Glick and Rose (2002), Tsangarides et al. (2006) and Masson (2008). Related to the African trade with the rest of the world sample, a shared currency between an African and a non-African country yields much lower returns. The estimate coefficient is 0.68 which means that trade would increase by a factor of 0.97. Finally, related to the intra-African trade sample, the estimate coefficient of the currency union dummy variable is 1.13 which suggests that trade flows when entering an African currency union would increase by a factor of 2.2. This is consistent with Rose (2000) and Alesina and Bond's (2002) proposition that smaller, developing economies would benefit more from entering currency unions.

The estimate coefficient of the variable of interest, that is the currency union dummy variable, allows us to calculate the potential increase in trade associated with joining a currency union. Following the methodology proposed by Frankel and Rose (2002), we calculate the trade gains associated with adoption of a common currency. To that end, we firstly calculate the effect for African countries adopting the dollar or the euro. Secondly, we obtain the potential gains of joining one of the existing African regional monetary unions for each of the African countries which are not involved in a currency union. Finally, we calculate the potential effects in terms of a trade increase if the existing African free trade agreements decide to adopt a single currency.

Table 2 presents the predicted increase in African trade with non-African countries if the African countries decide to adopt the dollar or the euro. To calculate that, we need the percentage of trade carried out with countries of the dollar zone and the euro zone as well as the openness ratio of the African countries. We will observe how the magnitude of these trade gains will depend on who else is in the currency union and how open the economy is to trade.

In order to illustrate the effect of common currency on trade, Algeria is taken as an example from Table 2. Algerian trade with the eurozone is 48.16% and with the dollar zone 19.77%. The trade to GDP ratio of the economy is 65.32%. The data is for 2007. Previously, from the results in Table 1, we obtain the estimate coefficient of the CU dummy variable for the non-African sample (0.68), which means that by adopting a single currency, countries would increase trade flows by around 97%. So, the potential effect of adopting the euro on Algerian trade is 30.51 [0.4816*0.6532*0.97].

Similarly, if Algeria decides to adopt the dollar the potential increase in trade would be 12.53% [0.1977*0.6532*0.97]. Algeria would therefore benefit more if it decides to adopt the euro rather than the dollar because almost half of Algerian trade is with countries that belong to the European Monetary Union (EMU).

Table 3 reports the predicted percentage increase in trade flows for all African countries from entering one of the three currency unions that currently exist in Africa. The results reveal large differences in potential gains between countries. Entering the currency union of the Economic and Monetary Community for Central Africa (CAEMC) and West African Economic and Monetary Union (WAEMU) yields potentially small gains for other African countries, with the highest a 3% increase in trade. Entering the Common Monetary Area (CMA) of South Africa, Namibia, Lesotho and Swaziland, however, can yield potentially large gains for a number of neighbouring southern African countries. The Democratic Republic of the Congo (15.6%), Malawi (30.1%), Mauritius (13.7%), Mozambique (46.68%), the Seychelles (23.1%), Zambia (47.56%) and Zimbabwe (111.13%) would all see trade rise substantially when adopting the rand.[6]

In the same vein, by mid-2009, Zimbabwean policy-makers were considering pegging the Zimbabwe dollar to the South African rand (Cohn 2009; Doneva 2009).[7] The results reported in Table 2 and 3 shed some light on the possible trade gains from such a decision while also enabling a comparison between the predicted gains from adopting the US dollar, euro or the South African rand. As mentioned, adopting the rand would result in predicted trade gains of 111.13%, while Table 2 reports that adopting the euro would increase trade by 12.4% and 3.9% for the US dollar. From a trade perspective, adopting the South African rand would yield far greater benefits than either the euro or the dollar[8].

Tables 4, 5, 6, 7 and 8 report the currency union effects for each of the five economic communities in Africa. It is envisaged that these communities will later unite under

[6] Botswana, although not part of the CMA, is part of SACU and is therefore excluded from the analysis because its trade statistics are aggregated with those of the CMA countries.
[7] There was also speculation that Zimbabwe might 'dollarize' as the US dollar was widely accepted as medium of exchange within the country. However, as only notes (and not coins) are available in Zimbabwe, the US dollar would only be functional for larger transactions.
[8] There are of course many other reasons why Zimbabwe would want to peg the Zimbabwe dollar to a stable currency, not the least of which is lowering the exorbitant inflation ravaging the country.

the umbrella of a single African currency. Potential gains are not depreciable in the Arab Monetary Union (with a maximum gain of 12.4%), the Common Market for Eastern and Southern Africa (with a maximum gain of 27.6%) and the Economic Community of Central African States (with a very low maximum of only 6.0%). In West Africa the predicted gains are larger, although again there are wide disparities between countries. The same trend is observed in SADC, where adoption of a 'common currency' would increase trade for Malawi by 51.9%, Mozambique by 51.9%, Zambia by 64.2% and Zimbabwe by 149.9%. There would, however, be few gains for Angola (5.6%) or Botswana (4.4%). Factoring in the costs of relinquishing monetary policy, there is no indication that all SADC countries would immediately benefit from a 'common currency'.

This lends credence to the selective approach advocated by McCarthy (2008) and Masson (2008). While we do not consider the costs of adopting a currency, the results indicate that the combined potential gains are substantial. However, these are limited to large gains for a select few within the group; a number of countries display only negligible trade gains. Factoring in their loss of monetary sovereignty, there seems to be no reason why these countries should enter a currency union. The linear approach over a short time-span would, therefore, yield relatively small gains above those of a selective approach. Moreover, the linear approach – requiring greater negotiation diplomacy given the small (or even negative) benefits for some countries – is politically untenable.

6. Conclusions

Building on the glowing empirical results of early researchers, African governments – especially SADC countries – have embraced the linear approach to regional integration, setting exigent deadlines for each consecutive step in the integration process (which already concludes in 2018 with the adoption of a single currency).

Yet a growing number of scholars question whether these goals are, firstly, attainable, and secondly, worth pursuing. There is a growing scepticism about the large predicted gains from trade upon entering a currency union. The varied characteristics of countries, their vulnerability to asymmetric shocks, the reliance on a small number of export goods, and the political realities of losing monetary policy – a key policy tool in developing countries – point to divergent benefits when entering a currency union. Rather than following a linear approach to integration where countries are obliged to strictly adhere to predetermined goals, countries should selectively choose to enter a currency union when the gains (from trade or otherwise) outweigh the costs (of losing monetary sovereignty).

Our quantitative results support this view. Similar to the earlier literature, we show that, aggregated, countries stand to gain substantially from adopting a single currency. However, these benefits are greater for a select few. In the case of SADC, for example, Malawi, Mozambique, Zambia and Zimbabwe are countries that are predicted to benefit from larger trade flows with South Africa if they adopt the rand. Other regions in Africa, apart from the Economic Community of West African States (ECOWAS), show no real predicted gains from adopting a regional common currency. There are also relatively small gains from trade for African countries in 'dollarization' while adopting the euro can bring significant gains for some African countries such as Algeria, Libya or São Tomé and Principe.

The selective approach to integration as proposed by McCarthy (2008) and Masson (2008) is a better alternative than a strict linear approach. The results reported here provide some clue as to which countries may benefit more upon adopting a 'shared currency'. Even regional 'common currencies' seem to yield few benefits. The case for a single African currency in the next decade is extremely tenuous.

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Appendix

Table 1: Currency union effects on trade

	All Sample		Non-African countries		African Countries	
	2SLS	2SLS-FE	2SLS	2SLS-FE	2SLS	2SLS-FE
LnArea	-0.1951	0.2094	-0.2018	-17.0708	-0.2466	0.0606
	-52.47	2.42	-48.21	-6.91	-26.59	0.44
LnPop	1.1039	0.2531	1.1649	0.3128	0.9997	0.5565
	218.87	6.64	202.19	8.11	81.60	3.75
LnGDPpc	0.9585	0.5769	1.0213	0.6340	0.9324	0.4131
	215.14	37.94	178.54	34.32	76.14	13.88
LnDist	-0.8554	-1.0485	-0.7154	-1.0324	-0.9238	-1.1527
	-74.75	-71.51	-49.78	-45.69	-39.90	-49.70
Border	1.2018	1.2912	-	-	1.2556	1.2277
	30.17	33.71	-	-	24.93	25.58
Lang	0.4819	0.4403	0.5067	0.4282	0.2253	0.4375
	24.92	20.62	22.03	16.9	5.81	10.65
Colony	0.7828	0.7358	0.8527	0.6532	0.8648	1.7246
	7.03	7.19	7.32	6.22	2.96	6.26
ComColoniser	0.3847	0.4185	0.3854	0.2502	0.4983	0.4721
	16.62	16.92	12.33	7.34	12.76	10.87
Colony45	1.2616	0.9194	1.1500	1.0028	-	-
	10.03	7.86	8.88	8.52	-	-
FTA	0.9762	0.7894	0.7126	0.1849	0.7563	1.0674
	29.53	24.29	8.55	2.48	17.37	24.57
CU	0.8401	1.3014	0.8098	0.6767	0.7168	1.1754
	21.18	30.39	4.48	4.24	15.06	20.74
NºObserv	95170	95170	66554	66554	28609	28609
R^2	0.5125	0.619	0.5559	0.6681	0.3664	0.5006

Table 2: Predicted effect of adopting the dollar or the euro

Predicted effect of adopting euro and dollar for African countries					
Country	% Trade eurozone	% Trade dollar zone	Trade (%GDP)	Euro effect	Dollar effect
ALGERIA	48.16%	19.77%	65.32%	30.43%	12.49%
ANGOLA	15.16%	31.48%	89.98%	13.19%	27.40%
BENIN	16.99%	3.38%	35.00%	5.75%	1.14%
BURKINA FASO	27.39%	1.20%	35.31%	9.36%	0.41%
BURUNDI	35.05%	2.35%	54.14%	18.35%	1.23%
CAMEROON	0.00%	0.00%	37.46%	0.00%	0.00%
CAPE VERDE	31.64%	1.03%	47.63%	14.58%	0.48%
CENTRAL AFRICAN REP.	45.41%	7.72%	24.44%	10.74%	1.83%
CHAD	8.32%	68.10%	74.86%	6.03%	49.32%
CONGO, DEM. REP. OF	40.43%	4.50%	59.22%	23.16%	2.58%
CONGO, REPUBLIC OF	13.05%	31.59%	105.47%	13.31%	32.23%
COTE D IVOIRE	37.83%	6.26%	79.72%	29.17%	4.83%
DJIBOUTI	10.96%	2.94%	50.84%	5.39%	1.45%
EGYPT	28.30%	11.32%	31.92%	8.74%	3.49%
EQUATORIAL GUINEA	26.03%	24.70%	126.52%	31.86%	30.23%
ETHIOPIA	18.46%	4.31%	38.52%	6.88%	1.60%
GABON	26.31%	21.46%	75.16%	19.13%	15.61%
GAMBIA, THE	11.58%	2.37%	53.33%	5.98%	1.22%
GHANA	25.00%	5.23%	80.26%	19.41%	4.06%
GUINEA	25.35%	4.76%	60.55%	14.85%	2.79%
GUINEA-BISSAU	25.91%	1.91%	65.36%	16.38%	1.21%
KENYA	14.79%	7.46%	47.81%	6.84%	3.45%
LIBERIA	11.91%	2.62%	102.07%	11.76%	2.58%
LIBYA	66.96%	5.86%	91.01%	58.94%	5.16%
MADAGASCAR	31.30%	10.11%	50.12%	15.18%	4.90%
MALAWI	16.49%	7.55%	55.37%	8.83%	4.05%
MALI	22.54%	2.04%	57.44%	12.52%	1.14%
MAURITANIA	40.43%	5.18%	95.15%	37.21%	4.77%
MAURITIUS	29.54%	4.41%	94.06%	26.88%	4.01%
MOROCCO	53.07%	3.82%	55.95%	28.72%	2.07%
MOZAMBIQUE	42.47%	1.35%	75.43%	30.99%	0.99%
NIGER	29.26%	17.89%	40.53%	11.47%	7.02%
NIGERIA	23.13%	34.94%	54.84%	12.27%	18.53%
REUNION	-	-	-	-	-
RWANDA	20.27%	2.61%	22.27%	4.37%	0.56%
SAO TOME & PRINCIPE	77.41%	4.51%	60.50%	45.31%	2.64%
SENEGAL	35.19%	2.12%	54.20%	18.45%	1.11%
SEYCHELLES	32.18%	1.67%	146.80%	45.70%	2.37%
SIERRA LEONE	32.96%	11.19%	43.58%	13.90%	4.72%
SOMALIA	1.51%	2.05%			
SOUTH AFRICA	25.99%	9.31%	52.68%	13.25%	4.75%
SUDAN	12.16%	0.64%	37.72%	4.44%	0.23%
TANZANIA	15.14%	3.46%	42.25%	6.19%	1.41%
TOGO	26.63%	3.99%	83.95%	21.62%	3.24%
TUNISIA	69.20%	3.08%	85.19%	57.02%	2.54%
UGANDA	20.60%	2.88%	37.61%	7.50%	1.05%
ZAMBIA	5.51%	1.14%	62.88%	3.35%	0.69%
ZIMBABWE	10.53%	3.29%	122.00%	12.43%	3.88%
CU effect on trade with non-African countries: 96.73%					

Table 3: Predicted effect of entering one of the existing African currency unions

COUNTRY	% Trade CMA	% Trade CAEMC	% Trade WAEMU	Trade (%GDP)	CMA effect	CAEMC effect	WAEMU effect
ALGERIA	0.24%	0.04%	0.10%	65.32%	0.35%	0.0003%	0.0000%
ANGOLA	2.74%	0.03%	0.04%	89.98%	5.5292%	0.0033%	0.0000%
BURUNDI	2.05%	0.82%	0.04%	54.14%	2.4844%	0.0458%	0.0000%
CAPE VERDE	0.15%	0.25%	2.57%	47.63%	0.1646%	0.0009%	0.0001%
CONGO, DEM. REP. OF	11.75%	1.13%	2.92%	59.22%	15.5797%	0.3930%	0.0257%
DJIBOUTI	0.96%	0.00%	0.01%	50.84%	1.0895%	0.0000%	0.0000%
EGYPT	0.21%	0.05%	0.11%	31.92%	0.1532%	0.0002%	0.0000%
ETHIOPIA	0.77%	0.00%	0.00%	38.52%	0.6638%	0.0000%	0.0000%
GAMBIA, THE	1.09%	0.31%	15.14%	53.33%	1.3013%	0.0091%	0.0031%
GHANA	2.99%	0.86%	4.93%	80.26%	5.3722%	0.1034%	0.0114%
GUINEA	1.18%	0.30%	4.01%	60.55%	1.6060%	0.0108%	0.0010%
KENYA	4.94%	1.22%	0.11%	47.81%	5.2877%	0.1444%	0.0003%
LIBERIA	2.61%	0.07%	1.57%	102.07%	5.9667%	0.0097%	0.0003%
LIBYA	0.00%	0.00%	0.10%	91.01%	0.0000%	0.0000%	0.0000%
MADAGASCAR	2.92%	0.06%	0.09%	50.12%	3.2797%	0.0047%	0.0000%
MALAWI	24.30%	0.24%	0.07%	55.37%	30.1326%	0.1624%	0.0003%
MAURITANIA	0.72%	1.21%	5.22%	95.15%	1.5338%	0.0414%	0.0048%
MAURITIUS	6.51%	0.07%	0.13%	94.06%	13.7210%	0.0216%	0.0001%
MOROCCO	0.48%	0.28%	0.55%	55.95%	0.5976%	0.0038%	0.0000%
MOZAMBIQUE	27.63%	0.00%	0.00%	75.43%	46.6785%	0.0000%	0.0000%
NIGERIA	2.41%	0.93%	3.41%	54.84%	2.9643%	0.0616%	0.0047%
RWANDA	1.61%	2.61%	0.03%	22.27%	0.8054%	0.0471%	0.0000%
SAO TOME & PRINCIPE	0.54%	4.33%	0.15%	60.50%	0.7305%	0.0708%	0.0002%
SEYCHELLES	7.02%	0.03%	0.00%	146.80%	23.0680%	0.0151%	0.0000%
SIERRA LEONE	3.49%	0.40%	8.54%	43.58%	3.4041%	0.0306%	0.0059%
SOMALIA	0.07%	0.00%	0.07%				
SUDAN	0.68%	0.01%	0.00%	37.72%	0.5709%	0.0001%	0.0000%
TANZANIA	8.63%	0.64%	0.14%	42.25%	8.1654%	0.1166%	0.0004%
TUNISIA	0.08%	0.11%	0.52%	85.19%	0.1534%	0.0004%	0.0000%
UGANDA	4.99%	0.91%	0.12%	37.61%	4.2067%	0.0853%	0.0002%
ZAMBIA	33.78%	2.54%	0.01%	62.88%	47.5609%	2.7094%	0.0005%
ZIMBABWE	40.67%	0.62%	0.02%	122.00%	111.1309%	1.5508%	0.0008%

Common Monetary Area (CMA) members: Lesotho, Namibia, South Africa, and Swaziland
Economic and Monetary Community for Central Africa (CAEMC) members: Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon
West African Economic and Monetary Union (WAEMU) members: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo

Table 4: Currency union effects for members of the Arab Monetary Union (AMU)

MEMBERS	% Trade	Trade (%GDP)	CU effect
ALGERIA	1.16%	65.32%	1.70%
LIBYA	2.77%	91.01%	5.64%
MAURITANIA	2.92%	95.15%	6.23%
MOROCCO	2.20%	55.95%	2.76%
TUNISIA	6.48%	85.19%	12.36%

Table 5: Currency union effects for members of the Common Market for Eastern and Southern Africa (COMESA)

MEMBERS	% Trade	Trade(%GDP)	CU effect
ANGOLA	0.03%	89.98%	0.05%
BURUNDI	22.74%	54.14%	27.57%
CONGO	12.22%	31.04%	8.50%
CONGO, DEM. REP.	12.38%	59.22%	16.42%
DJIBOUTI	8.27%	50.84%	9.42%
EGYPT	1.62%	31.92%	1.16%
ERITREA	2.26%	40.22%	2.03%
ETHIOPIA	6.48%	38.52%	5.59%
KENYA	12.56%	47.81%	13.45%
MADAGASCAR	6.90%	50.12%	7.74%
MALAWI	17.89%	55.37%	22.19%
MAURITIUS	4.68%	94.06%	9.86%
NAMIBIA	0.81%	79.61%	1.44%
RWANDA	23.80%	22.27%	11.87%
SEYCHELLES	3.96%	146.80%	13.02%
SUDAN	5.31%	37.72%	4.48%
SWAZILAND	2.79%	182.68%	11.42%
UGANDA	32.31%	37.61%	27.22%
ZAMBIA	8.80%	62.88%	12.40%
ZIMBABWE	8.67%	122.00%	23.68%

Table 6: Currency union effects for members of the Economic Community of Central African States (ECCAS)

MEMBERS	% Trade	Trade(%GDP)	CU effect
BURUNDI	2.22%	54.14%	2.69%
CAMEROON	0.00%	37.46%	0.00%
CENTRAL AFRICAN REP.	10.93%	24.44%	5.99%
CHAD	3.56%	74.86%	5.97%
CONGO, DEM. REP. OF	1.76%	59.22%	2.34%
EQUATORIAL GUINEA	0.05%	126.52%	0.15%
GABON	1.82%	75.16%	3.07%
RWANDA	3.30%	22.27%	1.65%
SAO TOME & PRINCIPE	4.33%	60.50%	5.87%

Table 7: Currency union effects for members of the Economic Community of West African States (ECOWAS)

MEMBERS	% Trade	Trade(%GDP)	CU effect
BENIN	10.13%	35.00%	7.94%
BURKINA FASO	28.88%	35.31%	22.84%
CAPE VERDE	2.35%	47.63%	2.51%
CÔTE D'IVOIRE	26.22%	79.72%	46.81%
GAMBIA, THE	14.17%	53.33%	16.92%
GHANA	15.87%	80.26%	28.53%
GUINEA	4.09%	60.55%	5.55%
GUINEA-BISSAU	22.45%	65.36%	32.87%
LIBERIA	1.60%	102.07%	3.66%
MALI	22.14%	57.44%	28.48%
NIGER	20.31%	40.53%	18.43%
NIGERIA	5.00%	54.84%	6.14%
SENEGAL	19.89%	54.20%	24.14%
SIERRA LEONE	9.05%	43.58%	8.83%
TOGO	15.20%	83.95%	28.59%

Table 8: Currency union effects for members of the Southern African Development Community (SADC)

MEMBERS	% Trade	Trade(%GDP)	CU effect
ANGOLA	2.77%	89.98%	5.59%
BOTSWANA	2.85%	68.75%	4.39%
CONGO, DEM. REP. OF	19.13%	59.22%	25.37%
LESOTHO	0.51%	144.86%	1.67%
MALAWI	41.84%	55.37%	51.88%
MAURITIUS	7.38%	94.06%	15.55%
MOZAMBIQUE	30.73%	75.43%	51.91%
NAMIBIA	1.07%	79.61%	1.91%
SEYCHELLES	10.48%	146.80%	34.44%
SOUTH AFRICA	5.41%	52.68%	6.38%
SWAZILAND	1.89%	182.68%	7.72%
TANZANIA	15.59%	42.25%	14.75%
ZAMBIA	45.62%	62.88%	64.24%
ZIMBABWE	54.88%	122.00%	149.93%

Chapter 5

SACU and Mercosur: the implication of a free trade agreement for Botswana, Lesotho, Namibia and Swaziland

Ron Sandrey and Hans Grinsted Jensen

Summary and key points

The Southern African Customs Union (SACU) and Mercado Comun del Sur (Mercosur) have a partial trade arrangement that contains a provision for considering expending this into a free trade agreement (FTA). Sandrey et al. (2010) have used the Global Trade Analysis Project (GTAP) database to assess the welfare and trade gains from such an FTA, but concentrating upon the major economies of South Africa, Brazil and Argentina. In this paper we extend that analysis to examine the implications for the BLNS (Botswana, Lesotho, Namibia and Swaziland). We note that the analysis is mostly determined by merchandise goods access only, although we allow for some gains from services trade by proxying a 2% tariff-equivalent relaxation of barriers between the partners. We also build upon the tralac analysis by Sandrey and Jensen (2009) on the implications for the BLNS of an FTA between SACU and China to compare and contrast the current SACU/Mercosur FTA with a SACU/China FTA, and in particular possible revenue implications for the BLNS from the SACU revenue pool from these FTAs.

The results for a SACU/Mercosur FTA show that there are comfortable welfare gains to South Africa. Scrutinising the production and trade results reveals that South Africa loses in the agricultural sectors, but gains in the manufacturing sectors despite the motor vehicle and parts industry coming under considerable pressure from Brazil. The overall gains come about from efficiency gains and increased investment expanding the amount of capital employed in South Africa economy. The increased agricultural imports from Mercosur lead to a marginal reduction in the prices of all agricultural products (and a decreased value of agricultural output). While this is bad news for farmers, it translates into good news for consumers as the reduced agricultural prices across the board are enough to marginally reduce the consumer price index contributing positively to the overall welfare gains for South Africa.

Both Botswana and the rest of SACU (Lesotho, Namibia and Swaziland as one GTAP 'region') have imperceptible welfare gains as measured by GTAP. As with South Africa, most of the interest is in the agricultural sectors, and given that Mercosur is the global benchmark producer of cattle meat and sugar (both of which are important exports from the BLNS under EU preferences), this is to be expected. There are perhaps smaller reductions than feared in both of these sectors and limited changes in other agricultural products. For manufacturing and in concert with pressure on South Africa's vehicle sector there is also a similar small contraction seen here in the BLNS vehicles and parts sector. In trade, the direct effects are of less importance than the indirect effects as Mercosur imports in particular replace some trade between the BLNS and South Africa at the margin.

While similar macroeconomic factors as those that took place following an FTA with China are at work following an FTA with Mercosur, there are differences. The first is (a) a differences of scale in that the Mercosur impacts are more muted and (b) a difference in reallocations (while with China, the reallocations of BLNS trade and consequently production were in the manufacturing sectors, with Mercosur, they are in the agricultural sectors).

Finally, following an FTA with Mercosur, the SACU tariff revenue pool implications for the BLNS countries are substantial and sobering, although following an FTA with China they are even more substantial. Thus, it is not the direct trade effects from these FTAs that are of main interest to the BLNS but rather tariff revenue pool implications.

1. Introduction

In assessing the future trade policy options for SACU, Mercosur's increasing role as agricultural trading giant on the world scene has to be taken into account in these considerations. The focus in this paper is on how the SACU trading relationships with Mercosur may be advanced by the adoption of free trade agreements between SACU (that includes BLNS) and Mercosur (that includes the majors of Brazil and Argentina as well as Uruguay and Paraguay and, arguably, Venezuela). To assist with this analysis the internationally accepted benchmark Global Trade Analysis

Project (GTAP)[1] database and the associated general equilibrium model will be used as the analytical tool. In undertaking this analysis, the starting point is a simulation of the 'known' and best estimate conditions that will prevail at the end of a given period (2020 in this case) followed by an assessment of the difference that the selected policy change under consideration is likely to make. The implications of this FTA for South Africa are discussed in Sandrey et al. (2010). The objective of this paper is to discuss the implications for the BLNS countries.

In the 2008 MRI publication,[2] Sandrey and Jensen discussed the implications for the BLNS of FTAs between SACU and China and SACU and India. Given that the same model and its associated database are used for both China/India and Mercosur[3] this gives a good opportunity to compare and contrast what an FTA with Mercosur may mean for the BLNS with the FTAs discussed in 2008 with China and India. We will concentrate upon that analysis in the present paper.

In addition, as we reported, the FTA results for the BLNS as given by GTAP model output are relatively minor, and what happens to South Africa and its economy will have a significant spillover to the BLNS (Sandrey 2007). It therefore behoves us to consider the implications of these FTAs for South Africa. Again, the results between the 2008 Chinese FTA simulations and the current Mercosur work are directly comparable as the same model is used. An analysis of the overall results for South Africa and what this may mean for the BLNS will be presented to set the scene for analysis of the direct results for the BLNS.

2. The comparison between China and Mercosur for South Africa

China

Sandrey et al. (2008) reported that the China FTA results showed that there were comfortable welfare gains to South Africa of $295 million or 0.21% of real Gross Domestic Product (GDP). Negating these were the labour market-related losses to South Africa, where employment falls by 0.13% and the real wage declines by

[1] See the GTAP website at https://www.gtap.agecon.purdue.edu/ for a full introduction to the model.
[2] Monitoring Regional Integration in Southern Africa Yearbook, Volume 8 – 2008.
[3] The macroeconomic database used has, however, been updated by the World Bank to reflect the 2008/09 global downturn. This makes a limited difference to modelling results as presented for 2020, as the Bank is predicting that similar growth paths to those predicted before the downturn will be restored quite quickly.

0.37%, but where at the same time the Consumer Price Index (CPI) declines by 0.86%. These labour market related changes are a function of the unskilled labour market closures used in the model, so, although indicative, they do raise distributional concerns for South Africa about an FTA with China. The overall gains to South Africa derive from enhanced allocative efficiency and capital allocation in the economy, while losses derive from labour-related losses and terms of trade that go against South Africa.

Scrutinising the results reveals that South Africa gains modestly in the agricultural sector. Enhanced agricultural exports to China of $136 million are concentrated in vegetable and fruit products in primary agriculture and 'other foods' in processed agriculture. These increased exports are dominantly 'new' exports or trade creation rather than 'current' exports or trade diversion away from other destinations. Increased agricultural imports are minimal.

The great action, however, was in the manufacturing sector, where increased manufacturing imports from China are some $5,493 million – although some $3,569 million of this is trade diversion away from other sources (leaving new or trade creation imports of a much lower $1,924m). Nearly 40% of these enhanced imports from China are in the textile, clothing and leather (footwear) sectors (TCF), with around half of these TCF imports 'new' trade. Output in the South African apparel sector reduces by a massive 42% as a result of preferential access. Other increases in manufacturing imports from China are spread across all sectors, but with 'machinery' the largest single increase outside of TCF. Trade diversion away from other suppliers rather than new imports is more evident outside of the TCF sectors. Balancing this Chinese intrusion is the fact that manufacturing exports to China increase by $644 million, and, even better, manufacturing exports increase by $955 million to other destinations as the South African economy becomes more competitive. This gives an increase of $1,428 million in global manufacturing exports. These increases are concentrated in chemicals, plastics and rubber, non-ferrous metals, vehicles, general machinery and 'other manufacturing'.

In the final analysis, the situation that will eventuate in an FTA with China is for the South African economy to undergo a devaluation of the real exchange rate due to cheaper Chinese imports reducing domestic market prices in South Africa. This leads to a terms of trade loss in that exports become cheaper. This then results in South Africa being able to expand its exports not only to China but also to the rest of the world. In total, the South African economy gains from this devaluation (lower prices) because the value of total income (sum of primary factor income and indirect tax receipts) in South Africa declines by less (-0.68%) than the general market price reductions (-0.77 price index for disposition of income) giving rise to an increase in Equivalent Variation (EV) of US$295 million in fixed prices.

Mercosur

Here Sandrey et al. (2010) report that, following an FTA with Mercosur, a similar pattern emerges but that there is a much smaller reduction in South African real prices as the economy similarly becomes more efficient with better capital utilisation in response to more competitive Mercosur imports. This in turn also leads to a devaluation of the real exchange rate in South Africa, boosting exports albeit with a terms of trade loss (exports become relatively cheaper than imports). As from the FTA with China, the South African economy gains from this devaluation of the real exchange rate (-0.0579%), even though the value of total income (sum of factor income and indirect tax receipts) declines by -0.0676%, prices decline by more (-0.1391%). The final outcome is then giving rise to the increase in EV of 236 million US$ in fixed prices. Note that this welfare increase is almost as large as the $295 million welfare gain from the Chinese FTA.

However, an FTA with Mercosur is not good news for the South African agriculture sector. Imports of agricultural products increase dramatically: by $422 million from Mercosur (with $353 million of this from Brazil), but trade diversion away from other sources of (a) the BLNS which reduce by $34 million, (b) all other sources which reduce by $346 million limit, and (c) the overall increase in imports into South Africa to a lesser but still significant $140 million. New exports from the agricultural sectors are modest ($84 million) although they largely appear to be ‘new trade’ or trade creation rather than trade diversion. This is somewhat encouraging, but countering this is the finding that there are marginal reductions in the prices of all agricultural products. Overall, the decreased value of production in South African agriculture of $418 million is significant, with much of this coming from reduced chicken meats and vegetable oilseeds production. A final outcome is that there is a decline of 0.50% in land prices as a result of increased competition from Mercosur's imports into the region. While this is bad news for farmers, it translates into good news for consumers as the reduced agricultural prices across the board are significant enough to drive down the consumer price index, contributing positively to the overall welfare gains for South Africa. Therefore the gainers are the vast majority of South Africans who are consumers, and the main losers are the small number of commercial farmers.

Changes in the manufacturing sector are literally driven by vehicles. In the primary scenario, vehicle imports increased by $60 globally, with an increase of $621 million from Brazil – but this was countered by a decline of $616 million that represented trade diversion from other non-FTA partner sources. Overall, manufacturing exports from South Africa were up by $587, while global manufacturing imports were up by $190 million. Output in manufacturing increased by $388 million, but this result was tempered by a reduction in the vehicle sector of $146 million or 0.2% in the face of Brazilian competition. In the final analysis, the same macroeconomic factors are at work for Mercosur as they were for China. The big difference is that for China the vulnerable sector was the clothing sector with its consequential reduction in output and therefore employment whereas here for Mercosur the vehicle sector is less severely impacted. However, continuing to protect the vehicle sector against Brazilian competition reduces the overall welfare gains for South Africa, as a scenario simulating an FTA with no change to SACU vehicle tariffs shows.

3. Mercosur and the BLNS - the direct trade background

It is difficult to obtain a complete picture of the trade between the BLNS countries and Mercosur. Much of the import trade from 'outside' of SACU comes through South Africa, and the BLNS trade data itself tends to be dated. To proxy the direct trade between the BLNS and Mercosur we have used the Brazilian and Argentinean data as sourced from the World Trade Atlas (WTA). The data is shown in Table 1. Totals and the main trade items are given, starting with the total trade and then the main trade items where relevant.

Table 1: Direct trade between BLNS and Brazil/Argentina 2009, US$ million

Brazilian trade with BLNS, Calendar Year 2008 $m				
Imports from Botswana	**0.011**		**Exports to Botswana**	**1.995**
Telephone equipment	0.011		New tyres	0.662
			Stoves, etc.	0.502
			Sugar confectionery	0.394
Imports from Namibia	**0.066**		**Exports to Namibia**	**22.988**
Integrated circuits	0.022		Furniture	9.761
Frozen fish	0.021		Chicken meat	5.016
			Sugar confectionery	2.120
Imports from Swaziland	**0.178**		**Exports to Swaziland**	**2.055**
Wood pulp	0.109		Carboxylic acid	1.093
			Sugar	0.404
Imports from Lesotho	**0.052**		**Exports to Lesotho**	**0.000**
Electrical apparatus	0.051			

Argentinean trade with BLNS, Calendar Year 2008 $m				
Imports from Botswana	**0.000**		**Exports to Botswana**	**0.074**
			Sugar	0.051
Imports from Namibia	**0.002**		**Exports to Namibia**	**9.241**
			Wheat	5.544
			Chicken meat	2.220
			Molluscs	0.897
Imports from Swaziland	**0.000**		**Exports to Swaziland**	**2.827**
Wood pulp			Perfumes	1.093
Imports from Lesotho	**0.000**		**Exports to Lesotho**	**0.000**

Source: World Trade Atlas.

Table 1 shows that:

- Wood pulp from Swaziland is the only important import into Brazil from the BLNS, while there are significant Brazilian exports of furniture, chicken meat and sugar to Namibia, medium values of new tyres, stoves and confectionary from Brazil to Botswana, and exports of carboxylic acid from Brazil to Swaziland.

- There are effectively no imports into Argentina from BLNS, but there is a significant export of wheat and chicken meat to Namibia and some perfumes to Swaziland.
- And the combined imports from BLNS at $0.309 million are less than 1% of the combined exports of $39.18 million to the BLNS.

3. The GTAP database/model

GTAP is supported by a fully documented, publicly available, global database and underlying software for manipulating data and implementing the model. The framework is a system of multisector country economy-wide input/output tables linked at the sector level through trade flows between commodities used both for final consumption and intermediate use in production. The latest GTAP Version 7 database divides the global economy into 113 countries/regions with 57 commodities specified in the database. The Version 7 database represents the global economy/trade in the year 2004 measured in millions of 2004 US dollars. For a full discussion of the GTAP model as used in this paper, see Sandrey et al. (2010).

There is a distinct problem with using GTAP for the BLNS. Botswana is modelled as a country in its own right and therefore the results can be representative except for the problem that much of the import trade coming through South Africa, Lesotho, Namibia and Swaziland is modelled as for a composite region. These three countries have very different economic bases and trade profiles, so we are only able to deduce implications such as any changes to the beef sector means Namibia and any changes to sugar means Swaziland, for example.

The FTA primary scenario considered in this chapter entails the result from the removal of trade barriers between Mercosur and SACU as measured in the year 2020 in a world shaped by the baseline scenario. Differences between the so-called baseline scenario and this so-called primary scenario are therefore the results of implementation of the (mainly) goods-only SACU/Mercosur FTA. The ‘mainly’ qualification is that we proxied a potential change to services trade by modelling an equivalent to a two% tariff barrier on services trade for all partners and a reduction in non trade barrier represented by two% tariff barrier on all goods.

4. GTAP results for the SACU/Mercosur FTA

The big picture results

Table 2 shows the changes in welfare from the FTA assuming the eliminations of merchandise tariffs, with the data expressed in US$ million as one-off increases in annual welfare at the assessed end point of 2020. South Africa's gains are $236 million, a figure much lower than Mercosur's $996 million. Notable are the insignificant welfare results accruing to both Botswana ($4m) and the rest of SACU ($4m).

Table 2: Change in welfare (EV of income) due to SACU/China, US$ million at 2020

	Total	Allocative efficiency	Change in unskilled labour employment	Change in capital stocks	Term of trade
South Africa	**236**	**53**	**9**	**268**	**-94**
Botswana	3	0	0	2	2
Lesotho, Namibia, Swaziland	7	4	0	6	-3
Mercosur	**996**	**306**	**66**	**401**	**222**
Total including others	**474**	**83**	**34**	**357**	**0**

Source: GTAP results

In further examining the GTAP results we are able to decompose the results to find that:

- South Africa's welfare gains are from better access into Mercosur of $274 million (mostly gains into Brazil of $213m) but this was negated by losses of $79 million as Mercosur, following the SACU tariff eliminations, makes inroads into the South African market.
- Brazil's gains are overwhelmingly from SACU tariff reductions with better access into South Africa ($708m), with these augmented by gains of $121 million from an assumed 2% Non-Tariff Barrier (NTB) against its exports to South Africa. Argentina's gains are overwhelmingly from SACU tariff eliminations.

- The losses to the rest of the world (RoW) are mainly from enhanced South African competition to US exports in Brazil and losses to the EU and China from increased Mercosur competition in South Africa.
- For the total, GTAP is indicating that the FTA is welfare-enhancing for the world, as world welfare increases by $474 million (and, as shown in Table 2, this is mainly from increased investments/capital stocks but also from some allocative efficiency and to a lesser extent from labour effects overall).
- The factors contributing to the overall welfare changes for the BLNS countries are extremely marginal and reporting them in detail adds little to the GTAP issue.

Changes in trade flows

Table 5 introduces the aggregate overall changes to trade flows for the partner countries in 2020, expressed as percentage changes for both exports and imports, and then in US$ million for the trade balance. South Africa has increases in both exports and imports globally of 1.0% and 0.8% respectively once all markets are accounted for. There is, however, a deteriorating trade balance as imports were higher than exports to start with, which negates the relatively higher export percentage shown, and secondly, as mentioned before, the real exchange rate declined making exports relatively cheaper, reducing South Africa terms of trade. Botswana reduces both imports and exports by 0.1% with deterioration in its trade balance of one million dollars. The rest of SACU has increases of 0.1% in both exports and imports but a marginally higher deterioration of three million dollars in its trade balance. Not shown is that, for Mercosur, there is a modest increase in Argentina's trade balance despite imports increasing more than exports but deterioration in Brazil's trade balance with again imports increasing more than exports.

Table 5: Percentage change in the quantity of total import/export & trade balance, 2020

	Change in		
	Exports %	Imports %	Trade balance $m
South Africa	1.0	0.8	-57
Botswana	-0.1	-0.1	-1
Rest SACU (LNS)	0.1	0.1	-3

Source: GTAP results

The specific sector results

For both Botswana and 'rest of SACU' the interest is in the agricultural sectors. In **Botswana** there is a reduction of $6.5 million in agricultural production, with this coming mostly from 'other foods' ($2.3m), cattle ($1.6m) and consequently beef ($1.2m), and a minor reduction ($0.7m) from chicken production. There are price reductions in all agricultural sectors of generally 0.1 to 0.3 or 0.4%. The expected change in beef trade is muted, with exports declining by 1.1% as beef exports to South Africa are down, but this is balanced by a similar increase to the rest of the world (EU one presumes). Overall, Botswana's agricultural exports to South Africa are down by $5 million, but almost half ($2m) of this is balanced by increased exports to the rest of the world. The only change worth reporting in Botswana's manufacturing sectors is the $4.3 million or 10.3% decline in the value of vehicle parts production following a $10 million fall in exports to South Africa that is not compensated by exports to others. Overall, there is a consistent 0.1% decline in all manufacturing prices in Botswana.

For the **rest of SACU** the production and trade situation is a little more complex given the aggregation into one region, and here we have to assume that sugar refers to Swaziland and that beef and most other agricultural products refer mainly to Namibia. Lesotho's agricultural sector is certainly not export-oriented in any sector and its reliance on South Africa imports makes drawing conclusions from an FTA with Mercosur difficult.

Firstly, there are only minor changes for **sugar** (Swaziland). There is an increase of 0.2% in the quantity of output following a decline of 0.2% in the market price but no changes in trade. For the cattle and **beef** sector (Namibia), the result is similar to but more pronounced than the same results in Botswana. Overall, beef production is down by 2.6% or $7.9 million. This again results from a decline in $9 million in exports to South Africa that is only marginally compensated by exports to others (EU one presumes). There are also declines in the value of production in both ‘other meats’ (chicken) and ‘other foods’ of $5.7 million, beverages and tobacco of $1.6 million and ‘other agricultural products of $2.9 million. Overall, the reductions in agricultural market prices are slightly more than was the case with Botswana, with most reductions in the 0.2 to 0.9% ranges.

In the manufacturing sectors there is a similar decline of $4.6 million (0.4%) in the vehicles and vehicle parts sector, and a decline of $6.6 million in the forestry products sector (Swaziland one presumes) as imports of lumber from Brazil increase and displace domestic production at the margin. There is, however, an increase of $6.8 million or 0.3% in the chemicals, rubber and plastics sector despite a 0.1% fall in the market price following an increase in total exports of $5 million that is evenly split between South Africa and the non-partner destinations. This sector is most likely to be the sugar-based drink flavourings in Swaziland, a product where Swaziland is successfully diversifying its cane sugar production away from the raw sugar commodity.

Tariff reductions and the tariff revenue implications

Sandrey (2007) explores the implications of SACU trade agreements with respect to changes in tariff revenues, and highlights that there are large welfare transfers to the BLNS countries in that they are obtaining revenues over and above what they would have collected at their own borders if, in fact, there were no Customs Union. There are two pathways through which reduced tariff revenue will flow into the revenue pool from an FTA with either Mercosur or China. The first is the obvious one in that with an FTA all merchandise goods from the FTA partner would now all enter SACU duty-free. The second is the trade diversion. This occurs when trade is deflected away from previous sources that were paying duty but now become duty-free imports from the FTA partner, hence further reducing tariff revenue. This overall tariff revenue effect will almost certainly have a larger impact upon the BLNS countries than the direct production and trade impacts following an FTA with either Mercosur or China given the distributive formula of the current SACU Agreement.

This loss is not taken into account in the FTA results as reported, but further examination of the output data does provide the details of this tariff loss. Table 3 shows this data, and compares the losses from the revenue pool from, firstly, an FTA with China and, secondly, an FTA with Mercosur. Keep in mind that the data is in **US dollar millions** and not rand.

Table 3: Revenue loss effects following FTAs with China and Mercosur, $m

		of which from	
China FTA	**Total**	**China**	**Diversion**
Primary agriculture	1	1	0
Secondary agriculture	9	4	5
Resources	1	1	0
Manufacturing	1,639	1,167	472
Total	**1,650**	**1,173**	**477**
of which TCF	969	675	294
Mercosur FTA	**Total**	**Mercosur**	**Diversion**
Primary agriculture	47	30	17
Secondary agriculture	71	52	19
Resources	1	1	0
Manufacturing	206	109	97
Total	**324**	**192**	**133**
of which vehicles	146	72	74

Source: GTAP results

The table shows that:

- Total losses to the pool from an FTA with China are $1,650 million. Almost all ($1,639m) of this is from the manufacturing sector, with much of this in turn from the TCF sector ($969m). The direct revenue loss from allowing Chinese goods in duty-free is $1,173 million, while another $477 million is lost from trade diversion as China replaces previously tariff-paying sources.
- For the Mercosur FTA, the revenue loss at $324 million is considerably less than with the China FTA. Again, most ($206m) is from the manufacturing sector, and, here, some $146 million of this is from the loss in the motor vehicle and parts products. In contrast to the FTA with China, just over one-third

($118m) of the loss from Mercosur is in the agricultural products. As with China, most of this agricultural loss ($82m) is from the now duty-free imports from Mercosur rather than from trade diversion.

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Chapter 6

State of play in the SADC-EU EPA negotiations

Sean Woolfrey

1. Introduction

In June 2009, four members of the Southern African Development Community (SADC) Economic Partnership Agreement (EPA) negotiating group – Botswana, Lesotho, Mozambique and Swaziland – signed an interim EPA (IEPA) with the European Union (EU). This was a significant development for regional integration in southern Africa, and has led to considerable debate over the future of integration initiatives in the region. Concerns have been raised over the effects the signing of the IEPA will have on the Southern African Customs Union (SACU), two of whose members – South Africa and Namibia – chose not to sign the IEPA.

This paper aims to provide an update on the SADC-EU EPA negotiations, focusing in particular on some of the most contentious issues that have arisen during the negotiations. It begins by tracing the history of the EPAs through the various trade agreements and conventions that have regulated trade between the EU and the African, Caribbean and Pacific (ACP) states. The paper then highlights recent developments in the SADC-EU EPA, including the signing of the IEPA in 2009. The paper then focuses on the state of play in the SADC-EU EPA negotiations as of early 2010. In particular, it addresses the main sticking points in the negotiations, including the so-called 'MFN Clause', the coherence of the SACU common external tariff and the definition of the parties to the agreement. Finally, the paper concludes with some remarks on the significance of the current impasse in the negotiations.

2. Background to the EPA negotiations

Formal relations between the EU (and its former incarnation, the European Economic Community) and the ACP states date back to the 1957 Treaty of Rome which established the European Common Market and made provision for the creation of European Development Funds (EDFs) (EC, 2009a). These EDFs were created to provide technical and financial aid to colonies of the European states, and to those overseas countries and territories with which the European states had special historical links. The Yaounde Convention (Yaounde I), signed in 1963 and applied from 1964 to 1969, was the first association agreement between the European Economic Community (EEC) and 18 former colonies in Africa (Ibid). The convention, and its successor Yaounde II (1969-75), provided the majority of EDF financial assistance to Francophone Africa in order to improve infrastructural development following decolonisation.

In 1973 the United Kingdom (UK) became a member of the EEC. One of the results of UK membership was the signing in 1975 of the Lomé Convention (Lomé I) by the then nine EEC member states and 46 ACP countries, including members of the Commonwealth (EC, 2009b). Under Lomé I (1975-80) the EEC extended non-reciprocal preferences to exports from the ACP states (Ibid). Lomé I and its successors also established separate trading protocols for EEC imports of beef, bananas and sugar from the ACP states.

The Lomé Convention was renewed and renegotiated three times. Lomé II (1980-85) did not introduce any significant changes, other than a system to assist heavily mineral-reliant ACP countries suffering export losses, but extended the ACP group to 58 states (Ibid). Lomé III (1985-90), which extended the coverage to 65 ACP countries, shifted focus from the promotion of industrial development to development on the basis of self-sufficiency and food security. Finally, Lomé IV (1990-2000), the first convention to cover a 10-year period, emphasised human rights, democracy, good governance and economic diversification among other issues (Ibid). Under Lomé IV the ACP group increased to 70 countries.

With the expiry of Lomé IV in 2000, a new agreement between the EU and the ACP states was instituted. The Cotonou Partnership Agreement, concluded for a period of 20 years, attempted to improve ACP-EU cooperation in light of the fact that the ACP countries' share of the EU market had actually declined over the course of the successive Lomé Conventions (Ibid). The Cotonou Agreement, which has seen the ACP group swell to 78 states, also provided for the implementation of a new trade regime between the EU and the ACP states by the beginning of 2008.

This was necessary as during the 1990s certain aspects of EU trade with the ACP countries were successfully challenged under the General Agreement on Tariffs and Trade (GATT) (Sanoussi & Stevens, 2009: 14). By implication, the Lomé trade regime was found to be WTO incompatible as it involved discrimination by the EU in favour of certain developing countries (the ACP states) at the expense of others in ways that could not be justified under WTO rules. The EU was able to negotiate two waivers from WTO members to allow this discrimination to be continued first until 2000 and then until the end of 2007. From then on however, the EU-ACP trade regime would have to be WTO compatible.

The method chosen by the EU for ensuring WTO compatibility of its preferential access for ACP exports was to replace the non-reciprocal regime that had been in place since Lomé I with a regime based on reciprocity. Article XXIV of GATT, which establishes the conditions governing regional agreements, provides for an exception to the Most Favoured Nation (MFN) principle by allowing WTO members to provide preferential access to specific trading partners provided the countries concerned are all part of an FTA or customs union (Ibid: 14). A key requirement of such arrangements is that the each party liberalise trade with all the other parties. Because the EPAs provide for the removal of substantially all barriers to trade in goods between the EU and the ACP states, and not just barriers applied by the EU, they can be classified as a form of WTO-compatible FTAs.

On 27 September 2002 the EU and the ACP countries officially opened negotiations on EPAs in Brussels, and by late-2004 negotiations with each of the individual regions had commenced (Karl, 2002). The ACP countries were originally divided into six regional groupings: Caribbean states (CARIFORUM), Pacific states, West African states (ECOWAS), Central African states (CEMAC), East and Southern African states (ESA) and Southern African states (SADC)[1]. The EU's aim was to conclude EPAs with each of these six regional blocs by the time the Cotonou waiver expired at the end of 2007.

The EPAs were to be based on four pillars (EC, 2010). Firstly, they would reflect a partnership between the EU and the ACP states, one in which both sides would be

[1] Subsequently, certain countries from the SADC and ESA groups decided to negotiate a common EPA as the East African Community (EAC) group, bringing the total number of EPA groups to seven.

subject to rights and obligations. Secondly, the EPAs would support regional integration efforts among the ACP states. In other words, the EPAs would be based on pre-existing regional integration efforts among the ACP states and would keep step with these initiatives. Thirdly, the EPAs were to be understood ultimately as instruments for development, and would therefore be sensitive to the particular constraints and circumstances facing the ACP states. Finally, the EPAs were created to ensure that the EU-ACP trading regime complied with WTO rules. This, it was claimed, would aid in efforts by the ACP states to integrate into the world economy.

Somewhat controversially, however, the EU's negotiating mandate for the EPAs went beyond what was required to ensure that its trade regime with the ACP states was WTO compliant (an FTA covering trade in goods), and included other 'new generation' trade-related issues including trade in services, investment liberalisation, government procurement issues and competition policy rules (Sanoussi & Stevens, 2009: 14-15). These were particularly contentious issues for the African states, many of which did not feel that they were in a position to negotiate on such issues.

These and other contentious issues contributed to a particularly slow negotiating process. By early 2007 it was clear that little progress had been made in the negotiations, and that it would be impossible for the envisaged agreements to be completed by the 31 December deadline (Ibid: 15). The European Community (EC), the executive body of the EU mandated to negotiate the EPAs on behalf of the EU member states, therefore took the decision to split the process into two phases. The first phase would see the EU and ACP countries initial an IEPA – essentially an FTA on goods – by the end of 2007. Further negotiations towards full EPAs, which would include other trade-related issues, would then be continued at a regional level (Ibid: 15).

The EU offered duty-free quota-free market access for ACP exports (deferred for rice and sugar) to all ACP states that had initialled an IEPA by the end of December 2007[2] (Ibid: 15). This meant that these states would not lose their preferential access to EU markets when the Cotonou waiver expired. The rushing through of the IEPAs

[2] For ACP states that had not initialed an IEPA by this deadline, exports would revert to the 'next most favourable' regime for which they were eligible. For least-developed countries this was the EU's Everything But Arms (EBA) initiative, while for non-LDCs it was the standard Generalised System of Preferences (GSP).

did, however, mean that the goods offers were completed in a hurry, and it is likely that this haste accounts for at least some of the contentious issues that have arisen in the subsequent negotiations.

Despite concerns over a potential loss of preferences for their exports, by the end of 2007, only 18 of the 46 African states had initialled IEPAs (one more, Zambia, initialled in 2008) (Ibid: 19-21). In addition, only one of the African EPA groups – the EAC – was able to initial an IEPA as a region. By contrast, the 15 Caribbean EPA states had initialled a full EPA by the December 2007 deadline. A number of African states also continued to press the EU for guarantees that specific contentious issues would be revisited in future negotiations (Ibid: 16).

During 2008 the full CARIFORUM EPA was signed. Progress in the African EPA negotiations remained slow, however. Much of the discussion during the year focused on the contentious issues arising from the initialled agreements. These issues were highlighted during a meeting of the Ministers of Trade and Finance of the African Union in April 2008 (Sanoussi & Stevens, 2009: 17). The issue of contentious clauses in the EPAs was also included in the ACP Council's June 2008 Declaration and the ACP Heads of State summit in Accra in October 2008. The only African country to sign an EPA during 2008 was the Ivory Coast, a member of the ECOWAS EPA group.

Discussions over the contentious issues in the IEPAs as well as the various trade-related issues to be included in full EPAs continued to dominate the negotiating process in 2009. During the year, however, a number of African countries put their signatures to IEPAs. By December 2009 Cameroon (from the CEMAC EPA group), Madagascar, Mauritius, the Seychelles, Zimbabwe (all ESA), Botswana, Lesotho, Swaziland and Mozambique (all SADC) had joined the Ivory Coast as signatories to IEPAs.

3. SADC-EU EPA negotiations

EPA negotiations between the EU and the SADC EPA Group were launched in July 2004. Of the 15 members of SADC, seven agreed to negotiate as part of the SADC EPA Group: Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland and Tanzania (who later opted to join the EAC EPA Group). South Africa, also a member of SADC, initially participated in the negotiations only as an observer but became an official member of the SADC Group in 2007. The first couple of years of the negotiating process were largely devoted to addressing the issue of multiple trading arrangements with overlapping membership in the southern African region, and to formulating a framework for the negotiations. Central to this framework was the demand by South Africa to be included as a formal negotiating party to the EPA.

The SADC EPA Group presented its proposed framework for the negotiations to the EC at a meeting of SADC and EC senior officials in March 2006. Notable aspects of the SADC Group's proposal were a revision of the existing Trade and Development Cooperation Agreement (TDCA) between the EU and South Africa, with South Africa becoming an official member of the SADC EPA Group, separate treatment for individual SADC members, including Everything But Arms (EBA) treatment for LDCs, and the exclusion of new generation trade-related issues such as investment and trade in services from the SADC EPA negotiations (Julian, 2006). These proposals necessitated the EC to request an amended negotiating mandate from the EU member states – always a lengthy process – and the Commission was only able to respond to SADC at a meeting in March 2007.

At the March 2007 meeting, the first between EC negotiators and the SADC EPA Group, a revised SADC EPA roadmap was adopted, with the aim of concluding negotiations by the end of the year (Julian, 2007a). This roadmap saw the focus of the negotiations shift towards trade in goods, development issues, trade in services and investment. It also emphasised the establishment of common regional policies. SADC used the meeting to press the EC for the inclusion of a development chapter in the EPA.

In the months following this meeting, tensions arose within the SADC Group over the sensitivities of Botswana, Lesotho, Namibia and Swaziland (BLNS) to SACU's market access offer, which was largely based on the TDCA. A split also appeared within the SADC Group over the inclusion of trade in services provisions in the EPA. The position of the majority of the group's members was that they would be willing to cooperate with the EU on new generation trade issues, but would not undertake any binding commitments other than in the area of trade in services (Julian, 2007b). South Africa, however, did not want to see services included in the negotiations at all.

At the end of 2007 Botswana, Lesotho, Mozambique, Namibia and Swaziland initialled an IEPA with the EU (Julian, 2008a). Namibia did so only after assurances that certain unresolved issues would be re-opened for negotiation during 2008. A statement containing a list of issues to be resolved before signature accompanied the initialled agreement. South Africa chose not to initial the IEPA due to disagreement over key provisions in the text, while Angola did not initial as it had not presented a market access offer to the EC.[3] As a result the initialling countries secured duty-free, quota-free (DFQF) access to the EU market, South Africa's trade with the EU continued to be conducted under the TDCA and Angola continued to receive EBA preferences (Ibid). The main features of the IEPA were a single goods market deal between the EU and the initialling SADC states, a commitment to continue negotiations towards a full EPA in 2008 and a development cooperation chapter (Ibid).

The split between those countries wishing to push ahead with the second phase of negotiations and those prioritising a resolution of contentious issues was highlighted when Angola, Namibia and South Africa (ANSA) submitted a joint list of concerns relating to the IEPA at a meeting between SADC and EC negotiators in June 2008 (Julian, 2008b). ANSA wanted these issues addressed in the full EPA. It was decided that the ANSA concerns and other trade-related issues would be discussed in a process parallel to the second phase of EPA negotiations, and in September, the then EU Trade Commissioner, Peter Mandelson, stated that the EC was ready to address these contentious issues in the framework of the full EPA negotiations, but only once the IEPAs had been signed (Julian, 2008c).

Mandelson was replaced as Commissioner by Baroness Catherine Ashton in October 2008, however, and the new commissioner appeared to take a more conciliatory approach in the negotiations. This was exemplified in a letter to Action Southern Africa (ACTSA) dated 15 December 2008 in which she stated:

> With SADC our objective remains to consolidate the regional integration and if possible include South Africa in the EPA. To that effect we have started to negotiate the concerns that have been expressed by South Africa, Namibia and Angola. Our objective is to reach agreement on all these issues that would be

[3] Angola's intention was to accede to a full EPA once such an agreement had been concluded.

acceptable to the region as a whole, including those who have not raised these concerns (Roux, 2009).

Furthermore, on the issue of services and investment in the IEPA she stated that '[o]nly those countries wishing to negotiate in these areas will do so', while on the issue of competition and government procurement, '[n]egotiations will only be envisaged once adequate regional capacity has been built' (Ibid).

Although ongoing discussion on the contentious issues and the market access offers meant that the 31 December 2008 deadline for the signing of the IEPA was missed, December did see the EU take a considerable step towards addressing ANSA concerns by releasing a 'non-paper' proposing a tariff alignment deal aimed at preserving SACU tariff coherence (Julian, 2009a). The non-paper proposed that South Africa should align its tariffs with the commitments made by the BLNS in the IEPA. In exchange South Africa would receive improved access to the EU market. This proposal was welcomed by ANSA in a joint démarche to the EU member states as a positive acknowledgement that the IEPA in its original form would undermine the SACU common external tariff.[4] Nevertheless, it was seen as an inadequate solution as it did not resolve the problem of two differing legal instruments covering trade between the two regions, namely the IEPA and the TDCA.

In addition, ANSA raised four further concerns in the démarche. The first was the fact that the EPA negotiating process would result in four separate EPAs being established between the EU and members of SADC, thereby undermining regional integration efforts in southern Africa. A second, related, concern was that these four EPAs would involve varying commitments in a number of trade-related areas, such as investment and competition policy, and that this would also undermine regional integration efforts. A third concern was related to the implications for Angola's accession to an EPA given its vulnerable LDC status. Finally, ANSA raised the concern that the IEPAs would result in legal frameworks which would be difficult to alter after the fact.

[4]The démarche is available at:
http://www.acp-eu-trade.org/library/files/ANSA%20_EN_070109_Demarche-to-EU-MS.pdf.

A special negotiating session between the EC and the SADC EPA Group was held in Swakopmund, Namibia from 9 to 12 March 2009. At this meeting, the EC addressed a number of concerns that had been submitted by the SADC Group following a meeting of SADC EPA Ministers in February (Julian, 2009b). At the Swakopmund meeting, the EC accepted a number of SADC proposals, and agreed to: i) a simple reaffirmation of the rights and obligations of the WTO Agreement on Quantitative Restrictions, ii) a provision on food security in the IEPA, iii) a requirement that free circulation be effected in accordance with national customs legislation and iv) a stand-alone clause allowing all SADC EPA Group members other than South Africa to impose duties for infant industry protection (Ibid).

The EC also backed down on its opposition to the use of export duties by the SADC states, settling for a provision calling only for export duties not to be in conflict with WTO rules. Any new export taxes, however, would require the agreement of the EC. On the issue of market access, the EC agreed to base the EPA schedule on the TDCA and to allow a freeze on TDCA liberalisation of 54 tariff lines considered sensitive by the BLNS (Ibid). This proposal did not address the differing rules of origin between the EPA and the TDCA.

Two contentious issues were not resolved at the Swakopmund meeting, however. Firstly, the EC appeared unwilling to back down on the issue of the MFN clause, instead proposing an even more restrictive version of the clause (Ibid). Similarly, no final agreement was forthcoming on the issue of the definition of parties in the IEPA. The EC continued to insist that the SADC EPA Group act collectively, while the SADC countries insisted there was no legal basis for doing so as the SADC EPA Group is not a legally constituted entity (Ibid). It was decided that a temporary declaration would be drafted by the SADC EPA Group but that the issue would be fully resolved during negotiations towards a full EPA. In addition, a number of smaller issues were not discussed, with the EC indicating that it would only be willing to address these in the context of full EPA negotiations.

Because the EC had already submitted the IEPA to the EU Council, it was decided following negotiations that the text of the IEPA would not be changed to incorporate the concessions agreed to at the Swakopmund meeting. Instead, the EC confirmed it would provide the best possible political and legal assurances that these concessions would be included in the full EPA (Julian, 2009c). These would take the form of declarations inserted into the final act of the IEPA and a letter of confirmation outlining the details of the deal reached in Swakopmund. It was also indicated that the IEPA and SACU tariff schedules would be aligned at the earliest opportunity. South Africa, however, voiced concerns over the legal status of these assurances.

Despite these concerns, Botswana, Lesotho and Swaziland finally signed the IEPA on 4 June 2009, with Mozambique following suit on 15 June. South Africa immediately raised concerns as to the effect this would have on the operations of SACU given the fact that two different trade agreements with differing rules of origin were now applicable to the region (Julian, 2009d).

In the months following the signing of the IEPA, work has continued on three tracks: aligning the EPA and TDCA tariff schedules, resolving outstanding issues and, for the signatories, negotiating services and investment issues. Discussion between SADC EPA officials has largely centred around these issues as well as the ratification and implementation of the agreement, notification of the agreement to the WTO, the way forward for finalising a full EPA and the treatment of Namibia given that it initialled the IEPA (and thus gained duty-free quota-free access to the EU market) but has decided not to sign the agreement (Julian, 2010a). The most significant development since the signing of the agreement, however, was the decision taken by the SACU members early in 2010 to move forward on the EPA negotiations as a bloc, and to delay ratification and implementation of the IEPA until all the outstanding issues between the EC, South Africa and Namibia have been resolved (Julian, 2010b).

4. The main sticking points in the SADC-EU EPA negotiations

The events surrounding the SADC-EU EPA negotiations raise the question of why there has been a split in the SADC EPA Group, with Botswana, Lesotho, Mozambique and Swaziland signing the interim agreement and Angola, Namibia and South Africa preferring not to sign. There are clearly numerous factors at play here, and the thinking behind each country's decision almost certainly entails a number of considerations relating to the interests of various sections of their respective economies as well as the goals of regional integration in southern Africa.

For instance, it is clear that a major factor behind the decision by the four signees to sign the IEPA was to ensure the uninterrupted flow of their exports to the EU market. These countries took seriously the EU's threat to revoke their duty-free quota-free access should they not sign the IEPA. Conversely, this threat was not relevant to South Africa, which already has a bilateral agreement with the EU (the TDCA), and was therefore not concerned about a potential loss of preferential access. Similarly, Angola knew that it would still receive duty-free quota-free access to the EU market under the EBA programme, even if it did not sign the IEPA.

The aim of this section, however, is not to provide a full explanation of why certain SADC EPA Group members signed the IEPA while others did not. Indeed, this would be a very difficult task given the numerous factors at play as well as the shifting attitudes prevalent during the negotiating process. Instead, the aim is merely to analyse three of the most significant issues that have been used as justification by ANSA, and in particular South Africa, for not signing the IEPA, and to show why these issues have fuelled a belief that the EPA process is detrimental to regional integration in southern Africa.

The 'MFN Clause'

One of the main concerns raised by ANSA with regard to the IEPA relates to Article 28 of the agreement, and in particular to Paragraph 2 of Article 28, which states:

> [T]he SADC EPA States shall accord to the EC Party any more favourable treatment applicable as a result of the SADC EPA States or any Signatory SADC EPA State becoming party to a free trade agreement with any major trading economy after the signature of this Agreement.

This clause, which has become known as the 'MFN Clause', essentially means that if any SADC EPA Group signatory to the IEPA were to offer more favourable market access to a third party 'major trading economy' through an FTA with that party, then it would have to offer the same access to the EU (Bursvik, 2010: 285).[5] Currently, this would only apply to trade in goods, but is possible that a similar provision for trade in

[5] More favourable access in this case applies to all of the provisions of Chapter 4 of the IEPA which covers tariffs, rules of origin, standstill and safeguards.

services could be included in the final SADC-EU EPA.[6] The definition of a major trading economy, meanwhile, is provided in Paragraph 5 of Article 28:

> For the purposes of this Article, 'major trading economy' means any developed country, or any country accounting for a share of world merchandise exports above 1 percent in the year before the entry into force of the economic integration agreement referred to in paragraph 2, or any group of countries acting individually, collectively or through an economic integration agreement accounting collectively for a share of world merchandise exports above 1.5 percent in the year before the entry into force of the economic integration agreement referred to in paragraph 2."

According to 2008 data from the International Trade Centre's online *Trade Map* database, developing countries that would be so classified include China, Mexico, Malaysia, Brazil, India and Thailand among others.[7] In addition, key regional blocs of the 'South' such as the Association of East Asian Nations (ASEAN) and the Common Market of the South (Mercosur) would also be classified as major trading economies.

As it stands, the MFN clause would only apply to *free trade agreements* concluded with third parties.[8] Under WTO rules, regional trade agreements including a developed country must be notified under Article XXIV of GATT, while those between developing countries should be notified under what is commonly known as the 'Enabling Clause' (Ibid: 287). Article XXIV requires that free trade agreements lead to an elimination of duties on 'substantially all trade' within a 'reasonable length of time' (Ibid: 287). There is no exact definition of 'substantially', but in practice an agreement liberalising around 80% of goods trade is generally considered a free trade agreement.

Things are further complicated, however, by the fact that there is no exact definition of 'developing' or 'developed' country in the WTO, as members select their own status. South Africa is currently identified as a developed country in the WTO, and this might explain why the SACU and SADC agreements were notified under Article

[6] This is the case, for instance, in the CARIFORUM-EU EPA.
[7] See http://www.trademap.org.
[8] During the Swakopmund negotiating session in March 2009, the EC proposed to extend the coverage of the MFN Clause to preferential trade agreements with countries accounting for 1.5% or more of world merchandise trade. The SADC EPA states did not agree to this amendment, however, and it has not been reflected in the IEPA.

XXIV (Ibid: 287). While it is widely believed that South Africa would like to have its status changed to that of a developing country, thereby making it possible for SACU to notify any future trade agreements it concludes with other developing countries or regional blocs under the Enabling Clause, there is no guarantee that such a change would be accepted by other WTO members (Ibid: 288).

It is therefore not entirely clear whether the MFN clause would apply to a PTA or partial scope agreement that SACU might enter into with another developing country or region. If it was possible for such agreements to be notified under the Enabling Clause, it could be argued that they do not constitute free trade agreements, and should therefore not be subject to the MFN Clause provisions (Bilal & Stevens, 2009: 87). If, however, SACU agreements with the likes of Mercosur are required to be notified under Article XXIV, which seems to be the case, then, according to WTO rules, such agreements would have to be interim agreements leading to a free trade agreement or customs union. In this case, the MFN Clause would ultimately apply.

South Africa in particular has made the claim that the MFN Clause is one of the main reasons why it has not signed the IEPA. The country is concerned that the clause would limit its policy space for concluding future regional trade agreements (presumably as part of SACU) with large emerging economies such as China and India. This is because SACU would be unable to offer these and other potential partners anything that could confer any trade advantage over the EU. Concluding regional trade agreements with key emerging economies of the South appears to be very much part of South Africa's trade policy going forward, and the South African government is therefore wary of any factors that would undermine its efforts to diversify its trade relations through the conclusion of such South-South agreements.

Furthermore, because of SACU dynamics – SACU member countries are supposed to negotiate trade agreements with third parties as a bloc[9] – and the fact that three SACU members are now party to the IEPA, South Africa and Namibia are likely to be indirectly affected by the MFN clause even if they do not become party to the SADC-EU interim or full EPA (Bursvik, 2010: 286-287). Any regional trade agreements that South Africa and Namibia enter into with a major trading economy would involve Botswana, Lesotho and Swaziland (BLS) as well. BLS would then have to provide

[9] See Article 31 of the 2002 SACU Agreement.

any more preferential access to the EU. This would create a situation whereby members of the same customs union (SACU) would be offering different levels of market access to a third party (the EU), thus undermining SACU's common external tariff.

Nonetheless, it is debatable whether the MFN clause would really have that significant a limiting effect on SACU's ability to conclude future trade agreement, as the IEPA and the TDCA already provide the EU with significantly liberalised access to the SACU market (Ibid: 297). Those goods on which high duties for EU imports remain tend to be in sensitive sectors of the South African economy, such as automobiles, clothing and textiles and certain agricultural products. Because these sectors are considered critical to South African industrial policy, they are unlikely to be liberalised as part of any future regional trade agreement with the likes of China, India or Mercosur, especially given the fact that these economies compete internationally with South Africa in a number of those sensitive sectors.

Tariffs and rules of origin in SACU-EU trade

Another widely levelled criticism of the EPA process has been the charge that the agreement will serve to undermine the workings of SACU, as it will create two separate legal frameworks governing trade between SACU members and the EU. On the one hand the provisions of the IEPA will govern BLS trade while on the other hand the TDCA will continue to apply to trade between the EU and South Africa. One of the main concerns with the existence of two separate frameworks has been that it will undermine the SACU common external tariff, with the BLS applying the IEPA tariff to EU imports while South Africa applies the TDCA tariff.

This concern is largely unfounded, however, as the EC agreed at the Swakopmund meeting in March 2009 to accept the TDCA as the basis for SACU-EU trade, precisely so as to avoid the problem of conflicting tariff schedules within SACU (SADC, 2009). To this end a joint declaration was annexed to the IEPA confirming that the parties would meet at the earliest possible opportunity to amend the IEPA tariff schedule accordingly.[10] Furthermore, the EC also agreed to freeze TDCA liberalisation on a number of products deemed sensitive by BLNS, and to extend this

[10] See http://trade.ec.europa.eu/doclib/docs/2009/july/tradoc_143982.pdf.

to South Africa via an amendment to the TDCA (Ibid). In this way the EC has addressed both the sensitivities of the BLNS and the concern over conflicting tariff regimes governing SACU-EU trade.

A potentially more pertinent issue, however, is that of differing rules of origin (RoO) between the IEPA and the TDCA. Although a recent analysis has concluded that the there is little difference in the RoO of the two instruments, there are a couple of areas where such differences as do exist might be significant (Pant, 2009: 45-46). One such area is that of the clothing and textiles trade. The RoO in the IEPA are largely based on those of the Cotonou Agreement, but one area in which they have been significantly relaxed is that of clothing and textiles (Naumann, 2009).

Previously, clothing and textile products exported to the EU would have had to undergo two stages of transformation within an ACP country (or shared between ACP countries) in order for that export to qualify as originating in the exporting country (Ibid). For example, a shirt made in Lesotho would have to have been made largely from fabric made in Lesotho. This two-stage transformation rule has been replaced by a one-stage transformation rule in the new EPAs, meaning that a shirt made in Lesotho from fabric imported from China would qualify as originating in Lesotho should it be exported to the EU under the IEPA (Ibid). Similarly, a shirt made in the EU from fabric imported from China would qualify as originating in the EU should it be exported to Lesotho under the IEPA.

While the more relaxed clothing and textile RoO in the IEPA reflect a more realistic view of the realities of international trade in these products, they do also conflict with the RoO requirements of the TDCA. That is because under the TDCA a two-stage transformation is still required to confer originating status on clothing and textile products (Pant, 2009: 45-46). A shirt made in South Africa therefore needs to have been made from South African fabric to qualify as originating in South Africa. This also applies to EU exports to South Africa. The problem is that different rules apply to countries from the same customs union (SACU), where in theory goods should be circulating freely. This could potentially necessitate the strengthening or rules of origin controls within SACU, and is certainly not consistent with efforts to strengthen regional integration in southern Africa (SADC, 2009).

The definition of parties

A third contentious issue relating to the IEPA is that of the definition of the parties to the agreement. Article 97 of the agreement states that 'the term "Parties" shall refer to the SADC EPA States acting collectively and the EC Party'.[11] The EC has pushed for the SADC EPA Group to be defined as a single party to the IEPA, while the SADC EPA Group member states have been unhappy with this proposal, and would prefer each member state to be an individual party to the agreements. At the Swakopmund meeting in March 2009 the EC continued to insist that the SADC EPA Group act collectively. The SADC EPA Group members opposed this on the grounds that there is 'no legal basis to act collectively given that [the] SADC EPA Group is not a legally constituted [entity] with established legal institutions and common decision making processes' (Ibid).

At the Swakopmund meeting the EC agreed to draft a declaration that would make collective action under Article 97 a 'best endeavour', and that would confirm that the EC would not treat the SADC EPA Group as a single entity when imposing retaliation in trade disputes (SADC, 2009). The SADC EPA Group also agreed to draft a declaration to be discussed later. These declarations would be temporary, however, and the issue would ultimately be resolved during negotiations towards the full EPA (Ibid).

It would appear, however, that this treatment of what is a deceptively complex issue has not served to allay the concerns of all the SADC EPA Group members, with officials from both South Africa and Namibia referring to the 'definition of the parties' as an issue influencing their respective countries' decision not to sign the IEPA.[12] Indeed, there is a serious concern that the current definition of the SADC EPA Group as a single party to the IEPA could have negative consequences for regional integration efforts within SACU.

Although the EC has indicated its flexibility on the matter with regard to retaliatory trade measures, some of the SADC states worry about the legal status of such

[11] A copy of the IEPA is available online at http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2009:319:0003:0658:EN:PDF.

[12] See for instance http://www.mg.co.za/article/2009-08-25-sa-wary-of-eus-new-trade-pacts or http://www.namibian.com.na/index.php?id=28&tx_ttnews[tt_news]=56809&no_cache=1.

promises, especially considering no such indication has been included in the IEPA or annexed to the agreement. In addition, it is possible that the EC could simply continue to push for the SADC EPA Group to be defined as a collective party in the full EPA. The SADC EPA states understandably are demanding more concrete assurances from the EC on this matter.

A number of complications would arise if the SADC EPA Group was to be defined as a collective party to the agreement. Firstly, it would mean that the group would need to establish the institutions necessary for such a bloc to act collectively, such as a secretariat to monitor the implementation of the EPA. Secondly, such a move might have a destabilising effect on SACU by creating a situation whereby Mozambique and Angola become *de facto* members of SACU.

Finally, it is unclear how the SADC Member Group can be treated as a single party if only some of its constituent members sign the IEPA. If only those countries that did sign where taken to constitute the group, a related problem arises. SACU member states are required to act collectively on a number of issues by the 2002 SACU Agreement, yet they would be unable to do so under the IEPA, where some of them would constitute the SADC EPA Group party, but others would not be party to the agreement. Clearly such a situation makes regional integration in southern Africa more difficult than it already is.

5. Conclusion

The economic partnership agreements were intended to usher in a new era of trade relations between the EU and the ACP states, one that would serve to bolster regional integration efforts among the ACP countries. In the case of the SADC-EU IEPA, however, this process has been fraught with difficulties, and has, if anything, complicated rather than facilitated regional integration in southern Africa.

From the outset of the SADC-EU EPA negotiations, overlapping membership of regional integration initiatives and the existence of the SA-EU TDCA have created problems for the EPA process. Ultimately the negotiations have resulted in a split in the SADC EPA Group, and what appears at the time of writing (March 2010) to be an impasse in the whole process. One way this impasse might be resolved is if South Africa and Namibia were persuaded to sign the IEPA. If their governments are to be believed, however, such a move will only occur once a number of controversial issues have been satisfactorily resolved.

The three issues highlighted in the previous section are certainly not the only issues that are relevant in this regard. Indeed other issues such as the effect on regional integration in SADC (given the possibility that four separate and distinct EPAs could ultimately apply to the members of SADC) and the inclusion of ‘new generation’ trade-related issues such as services, investment and government procurement have also been raised as reasons not to sign the IEPA.

Nevertheless, the three concerns analysed in this paper provide a good indication of why the process has become so controversial, and why the IEPA has been widely perceived as threatening regional integration initiatives in southern Africa. The issues themselves are not irresolvable, however, and a number of simple solutions have been proposed in order to facilitate the EPA process. For example, it has been suggested that the MFN Clause would be far less of a concern to South Africa and Namibia if it could be amended to specify that it would not cover South-South agreements, or if it could be changed so that any extension of more preferential treatment would not be automatic but would be subject to consultation between the relevant parties, as is the case in the SA-EU TDCA (Bilal & Stevens, 2009: 90).

The EC has already indicated some flexibility in its apparent acquiescence to certain SADC Group demands during the Swakopmund meeting in March 2009. More concrete assurances that the compromises reached at that meeting will be included in the full EPA, and further flexibility on those issues that remain outstanding would go a long way towards winning over the EPA doubters and ensuring a more positive outcome for EU-SADC trade relations.

Similarly, South Africa and Namibia must recognise that in negotiations compromise is often required of both sides. By refusing to sign the IEPA, even though their fellow SACU and SADC members have done so, these countries are themselves complicating regional integration in southern Africa. In addition, it is important that South Africa and Namibia do not put too much emphasis on the importance of policy space for South-South agreements and complex regional integration configurations. The bulk of SACU’s international goods trade is still conducted with the EU, and the

EU is likely to remain the region's most significant export market for the foreseeable future. As important as it is to diversify export markets and deepen regional integration, this should not be done at the expense of harming relations with existing markets.

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Chapter 7

Tourism liberalisation in southern and eastern Africa

Paul Kruger

Introduction

Given the increasingly important role of tourism and travel exports in African countries, and the traditional high barriers for trade in African goods (both within Africa and in the rest of the world), this paper investigates whether significant trade barriers exist in one of the fastest growing industries on the continent. The openness of the domestic industries will determine the policy parameters within which countries in southern and eastern Africa have to manoeuvre. Given that the reversal of liberalisation commitments is an elaborate and costly process, the following questions can be asked: How far have these countries liberalised their tourism industries and how much policy space remains for these countries? The main aim of the paper is to examine the conditions and restrictions concerning tourism and travel in the Southern African Development Community (SADC) and East African Community (EAC) countries. This collective represents all the countries – geographically speaking – in southern and eastern Africa, most of which have significant tourism potential.

The key question is how much freedom foreign tourist suppliers are afforded when investing and operating in each of the southern or eastern African states. The GATS schedules are used as the benchmark to determine the treatment of foreign suppliers in the tourism and travel sector because for many African countries, particularly those in the initial stages of services liberalization, the schedules are the most important benchmark to determine their degree of openness. Each sub-sector comprising the tourism and travel activities is examined individually to determine the degree of liberalisation. In addition, the examination evaluates the relative importance of the individual sub-sectors for foreign suppliers. Sometimes the schedules do not paint the complete picture, either because not all travel and tourism activities have been included in the schedule, or because unilateral changes have been made which are not reflected in the country schedules. Where applicable, domestic policies and legislation are taken into account to clarify commitments made at the multilateral level. Finally, the paper also considers related legislation of general application which has an impact on the entry or operation of foreign suppliers.

Tourism growth and regulatory barriers

Tourism is one of the fastest growing industries worldwide. What is even more significant, over the last decade, is that African countries have exhibited the highest growth rates of all regions in the tourism industry, albeit from a low base. It is not only the strongest African economies that have grown; tiny, landlocked African countries, those that have for long struggled to find a non-resource intensive export, have shown strong growth.

For example, tourism expenditure (excluding transport) in Angola (11.4%), Cape Verde (25.2%), Ghana (39.1%), Libya (23.7%), Madagascar (11.7%), Sudan (11.8%), Tanzania (20.7%) and Zambia (14.4%) grew at higher rates than the average growth in the four leading tourism export countries (Egypt (6.2%), Morocco (10.1%), South Africa (9.5%) and Tunisia (5.1%)).[1]

[1] Compounded annual growth rates from 1990 – 2006 available from the UNCTAD Handbook of Statistics 2008.

Table 1: Compound annual growth rates (1990 – 2006) for tourism expenditure in southern and eastern Africa (millions US$)

Country	Tourism expenditure (including transport)	Tourism expenditure (excluding transport)
Angola	7.9%	11.4 %
Botswana	9.4 %	10.0%
Burundi	-6.7%	-5.8%
DR Congo	N/A	N/A
Kenya	4.6%	2.5%
Lesotho	N/A	3.0%
Madagascar	10.5%	11.7%
Malawi	3.1%	2.7%
Mozambique	N/A	6.8%[2]
Mauritius	7.9%	7.2%
Namibia	N/A	9.8%
Rwanda	N/A	18.7%[3]
South Africa	9.3%	9.5%
Swaziland	4.9%	5.9%
Tanzania	6.6%[4]	20.3%
Uganda	N/A	16.8%[5]
Zambia	N/A	14.4%
Zimbabwe	7.2%	N/A

Source: UNCTAD Handbook of Statistics 2008

The causes of such growth are not entirely clear: there are various demand- and supply-side factors which may influence the flow of goods and services[6]. However, trade restrictions may also influence the flow of goods and services, mainly because low trade barriers reduce transaction costs and enable freer trade. While this is often true for trade in goods, international trade in services is also constrained by trade barriers, in particular regulatory barriers which are maintained in domestic legislation. The General Agreement on Trade in Services (GATS), enacted with the establishment of the World Trade Organisation (WTO) in 1995,[7] was the first

[2] Compound annual growth rates from 1995 – 2006.
[3] Compound annual growth rates from 1995 – 2006.
[4] Compound annual growth rates from 1997 – 2006.
[5] Compound annual growth rates from 1993 – 2006.
[6] See Fourie (2009) for an investigation into the sources of African countries' comparative advantage in tourism.
[7] Under the GATS a universal template was adopted which provided member states with a framework to undertake liberalisation commitments in specific services sectors and modes of supply. These

multilateral agreement of its kind, aimed at reducing barriers that restrict international trade in services.[8] Can there possibly be a correlation between the growth in tourism expenditure and the state of liberalisation in each of these countries? An examination of the barriers will also reveal the progress of services liberalisation in each of the countries, as well as provide insight into the amount of policy space available when conducting future negotiations.

Travel and tourism under GATS

In contrast to other services industries, travel and tourism services are characterised by the consumer of the service. The suppliers of the service are bound to the host country and it is the consumer (tourist in this case) who travels to that country in order to enjoy the services and facilities. The industry should therefore include all goods and services that are consumed by tourists during their stay. Considering the scope of the travel and tourism sector, the classification accorded under the W120 Classification system[9] is, however, limited The core sector entitled '*Tourism and travel related services'* includes the sub-sectors:

- A. Hotels and restaurants (including catering);
- B. Travel agencies and tour operator services;
- C. Tourist guide services; and
- D. Other.

Tourism activities which are part of the more general services activities (most notably transport services, but also including certain business, distribution and recreational, cultural and sporting services) have typically been placed within those general services categories (WTO Secretariat 2000).

specific commitments would only apply to the services sectors and sub-sectors listed in each member's schedule and to the extent to which the countries committed themselves.

[8] For many African countries, the GATS is the only example of their progress in services liberalisation. Liberalisation efforts at the regional and bilateral level have, however, intensified with the completion of the EAC Common Market Protocol and its schedule of commitments on the progressive liberalisation of services. Implementation, or elimination as stated in the schedules, will, however, only happen from 2010 onwards. Liberalisation in the context of the Economic Partnership Agreements (EPAs) is also ongoing with services being part of the second phase of the negotiations.

[9] WTO Secretariat (1991).

9.	**Tourism and travel related services**	
A.	Hotels and restaurants (including catering)	CPC 641 - 643
B.	Travel agencies and tour operator services	CPC 7471
C.	Tourist guide services	CPC 7472
D.	Other	

Initially compiled in 1991 to identify the various services sectors during the GATS negotiations, the sectoral classification list became generally known as the W/120 List. It is a condensed version of the United Nations Central Product Classification (CPC)[10] listing for services which was regarded as too comprehensive at that time. The vast CPC list was reduced to twelve core services sectors with some 160 sub-sectors classified under the W/120 system. This was then applied when negotiating the GATS and other subsequent trade agreements which contained a services component. Negotiating partners have no obligation to use a specific set of classifications when negotiating trade in services; parties only need to be in agreement regarding the description of the supplied services and the agreement must be expressed in clear and unambiguous language. Parties are therefore free to include any services, regardless whether these are contained in the W/120 of CPC lists.

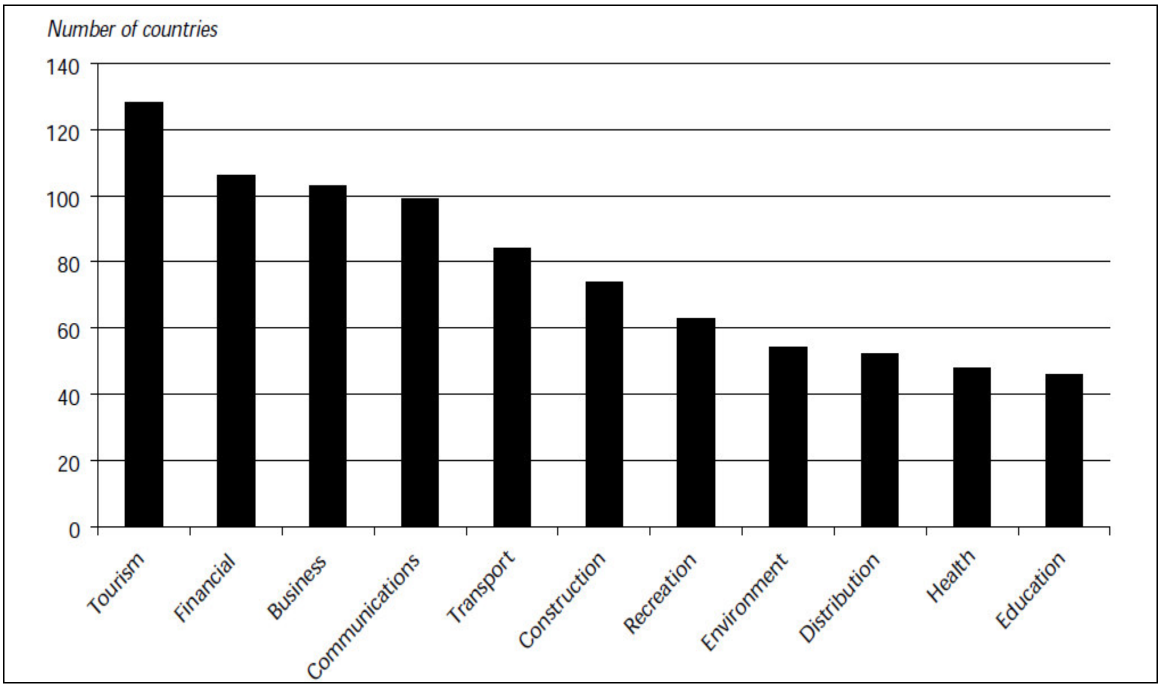
At the time of services negotiation in the Uruguay Round, it was unclear to most of the developing world exactly what services liberalisation entailed and how it should be implemented. Few countries included additional sub-sectors under the W/120 system, despite the cardinal importance of those unstated activities. Of the SADC countries, only Mauritius included new sub-sectors under the travel and tourism sector. 'Car rental', 'Yacht chartering and cruising' and 'Tourist duty-free shops' were categories created by Mauritius to regulate these associated tourism activities. Tanzania made slight changes to the 'A. Hotels and restaurant (including catering)' sub-sector by adding 'Hotels of four stars and above'. The commitments would then exclusively apply to four-star hotels and above as defined by Tanzanian legislation.

[10] The CPC was the first international classification covering the whole spectrum of outputs from the various services sectors.

As countries grow more aware of the significance of regulating specific tourism activities, these new headings will be more clearly defined[11]. This is evident from the services negotiations of the recently concluded CARIFORUM Economic Partnership Agreement (EPA). In addition to the traditional tourism activities[12] the parties also specifically listed the following tourism related activities: hotel development; hotel management; marina and spa services. The EAC schedule on services also included categories such as hunting and sport fishing. These examples are consistent with a trend towards a clearer and more detailed description of services activities. The tourism sector is the focus of this paper, but these issues also hold true for other services sectors. As services industries evolve and the understanding thereof is deepened, countries will strive for more detailed descriptions in an effort to regulate their industries more efficiently.

Tourism commitments under the GATS have been made by 128 WTO members, more than in any other services sector. The graph below illustrates the number of WTO members that made at least one commitment in each of the relevant sectors. Given the membership composition, these scheduling preferences largely reflect the negotiating position of developing countries. This move towards scheduling tourism commitments comes as no surprise since those activities are the most important foreign exchange earners in many developing countries. It can be argued that developing countries made the large number of tourism commitments in order to encourage and facilitate foreign investment in the sector and to stimulate travel and tourism activities. This is consistent with the rationale for the GATS to create a more transparent and predictable legal framework in order to improve the investment climate and attract foreign investors in the services sectors. Another argument is that the sector traditionally carried low levels of protection and that certain segments, particularly hotels, have already been open to foreign investment[13].

[11] The World Tourism Organisation has also indicated that it is not satisfied with the current GATS definition of the travel and tourism sector and has tried to revise it in the successive rounds of services negotiations.
[12] The travel and tourism activities are set out in the W/120 classification system of A. Hotels and restaurants (including catering); B. Travel agencies and tour operator services; C. Tourist guide services; and D. Other.
[13] Adlung et al. (2005).



Source: Hoekman et al 2002

The graph, however, presents only part of the picture. WTO members just have to make a partial commitment in any of the tourism sub-sectors to be included in the results of the graph. It is therefore impossible to ascertain the depth and importance of the commitments without examining the individual schedules of the selected WTO members.

SADC and EAC Countries [14]	A. Hotels and restaurants	B. Travel agencies and tour operators	C. Travel guides	D. Other
Angola	X (extensive)			
Botswana	X (partial)	X (partial)		
Burundi	X (extensive)	X (extensive)	X (extensive)	X(extensive)
DR Congo	X (extensive)	X (extensive)	X (extensive)	
Kenya	X (extensive)	X (extensive)	X (extensive)	
Lesotho	X (partial)		X (extensive)	
Madagascar				
Malawi	X (extensive)	X (extensive)	X (extensive)	X (extensive)
Mozambique				
Mauritius	X (partial)	X (partial)	X (partial)	X (partial)
Namibia	X (full)	X (full)		
Rwanda	X (extensive)			
South Africa	X (partial)	X (extensive)	X (partial)	
Swaziland	X (extensive)			
Tanzania	X (partial)			
Uganda	X (partial)	X (partial)		
Zambia	X (extensive)	X (extensive)	X (extensive)	X (extensive)
Zimbabwe	X (extensive)	X (partial)	X (partial)	

All of the examined countries, except Madagascar and Mozambique, made some kind of tourism commitment under the GATS. The countries that made tourism commitments clearly favoured the hotels and restaurant sub-sector with ten of them making 'extensive' or 'full' commitments. In this context an 'extensive commitment' means that the scheduled sub-sector is completely liberalised in Mode 1, Mode 2 and Mode 3 and that there are no restrictions on market access and national treatment in these modes. See example below:

[14] Seychelles is not a WTO member and therefore made no specific commitments under the GATS. Seychelles is, however, in the process of acceding to the WTO.

11.TOURIST GUIDE SERVICES – ***Example of 'extensive' commitment***	**Limitations on Market Access**	**Limitations on National Treatment**
A. Hotel and restaurant services (including catering)	1) None 2) None 3) None 4) Unbound except as indicated in the horizontal section	1) None 2) None 3) None 4) Unbound except as indicated in the horizontal section

This is in contrast to a 'full commitment' which would denote the complete liberalisation of a sub-sector in Mode 1, Mode 2, Mode 3 *and Mode 4*. See example below:

11.TOURIST GUIDE SERVICES – ***Example of 'full' commitment***	**Limitations on Market Access**	**Limitations on National Treatment**
A. Hotel and restaurant services (including catering)	1) None 2) None 3) None 4) None	1) None 2) None 3) None 4) None

This is an important theoretical distinction to make but can be argued that the current practical consequences, especially when dealing with Mode 4, are insignificant.[15] On

[15] Horizontal disciplines have an important role to play in the liberalisation of Mode 4 and in most cases govern the coverage, definitions, categories, measures and criteria of natural persons when moving to a host country. Even when 'None' is indicated in a sectoral section, this must be read as meaning '*none except the conditions set out in the horizontal section'* (WTO 2001). So the horizontal section will be applicable regardless of the inscription in the schedule. This is of particular relevance in Mode 4 where most of the restrictions and conditions relating to the movement of natural persons are typically inscribed in the horizontal section. It can be argued that there is little difference between the general approach and the more liberal one, since the horizontal commitments will nevertheless be applicable to all the committed sectors and modes, even despite full liberalisation. The theoretical distinction between the two approaches is clear – a country stipulating 'unbound' (no liberalisation) in its schedule wishes to remain free to introduce or maintain market access or national treatment restrictions while an inscription of 'None' (full liberalisation) denotes no limitations or restrictions in the given sub-sector or mode of supply. Practical problems will arise when countries that made full

the other hand, 'Partial' commitments refer to the situation where countries left certain modes of supply unbound[16] or where specific commitments were made, either under GATS Art. XVI (market access) or GATS Art. XVII (national treatment).

Hotel and restaurant services (CPC 641 – 643)

In the 'Hotel and restaurant' sub-sector, almost all of the countries fully liberalised Mode 1. It was only South Africa and Lesotho that left hotels and restaurants 'Unbound' in Mode1; both countries, however, fully liberalised the sub-sector of 'Catering'.[17] The technical feasibility of Mode 1 (cross-border) supply of hotels and restaurants services can nevertheless be questioned. The promotion and advertising of hotels and restaurants can be supplied cross-border, but these services should rather be classified under 'Advertising services' (CPC 871) under the core sector of 'Business services'. Some countries, for example Kenya, recorded an inscription of 'Unbound*' in Mode 1. The asterisk as a rule refers to a footnote which states 'Unbound due to a lack of technical feasibility'. Many European Union (EU) countries made the same inscription of 'Unbound*' in their initial GATS schedules. In their revised GATS offer of 2005 and in the CARIFORUM EPA negotiations this was changed to 'Unbound'. Clearly EU countries are of the opinion that these services can be supplied to through Mode 1. Supply in this mode can possibly refer to

commitments – like Namibia in the example above – modify or add market access or national treatment limitations to their horizontal section. Will these additional obligations as inscribed in the horizontal section be applicable to the committed sub-sectors and modes of supply, even if already fully liberalised? If so, can this not be a means to evade the fully liberalised sectoral inscriptions ('None') by introducing new and related restrictions in the horizontal section? As seen from the EPA negotiations, countries are moving towards detailed, and in some instances, more restrictive descriptions in their horizontal sections. How will this process of horizontal additions be managed? The GATS schedules in some examined countries (Angola, Mozambique, Swaziland, Rwanda, Tanzania, Uganda, and Madagascar) have no horizontal sections, making the effective management and understanding of these overall measures still more relevant.

[16] If a government enters the word 'Unbound' in its schedule, it wishes to remain free in that given sector and mode of supply. This means that a country can introduce or maintain measures inconsistent with market access or national treatment in the sub-sector where the government indicated 'Unbound'.

[17] Despite its Least Developed Country (LDC) status Lesotho made extensive initial commitments during the Uruguay Round. Lesotho only joined the Uruguay negotiations at a late stage after it was recognised that it would become more difficult to negotiate favourable terms of accession after the establishment of the WTO. Manduna (2005) argues that at that time Lesotho had no clear idea what the WTO was about and did not put forward specific proposals to address national concerns. Manduna's research reveals that there was a lack of understanding on the technical aspects of scheduling while the responsible branch of government had limited capacity to deal with services negotiations. The schedules of South Africa and Lesotho are suspiciously similar in many respects and it almost seems as if both countries have been working off the same blueprint. This has left Lesotho with a schedule of commitments containing some errors which in certain instances do not accurately reflect government policy or domestic regulation.

sleeping-car services on trains, ferries and boats or meal servings on airplanes, boats and trains. However since 25 of the 27 EU countries made no commitments in Mode 1 under hotel and restaurant services[18], services such as online bookings and online reservation for hotels may be part of their strategic reservations.

Botswana made a number of specific restrictions in the hotel and restaurant sub-sector. Under Mode 2 ('Consumption abroad'), the Bank of Botswana limits the amount of local and foreign currency entitled to permanent residents for each trip. Limits on foreign currency were, however, removed effective from 8 February 1999 by the Bank of Botswana, following the abolition of exchange controls. Permanent residents are now allowed to export an unlimited amount in cash or in any other form subject to the completion of a declaration if it is in excess of 10 000 pula. There is no limit regarding the selling of foreign currency for pula provided that the foreign exchange is legally earned and transferred, and that it is declared at the port of exit (Bank of Botswana 2002). Botswana also made specific market access and national treatment commitments under Mode 3 ('Commercial presence'). In the market access column, Botswana stipulates that the service must be supplied through commercial presence. This is in fact stating the obvious since the only way to supply services in Mode 3 would be through commercial presence. This type of restriction should rather be listed in Mode 1 in order to limit the cross-border supply of the services.[19] On the national treatment side it is stipulated that the services supplier must meet all residency requirements. At the time[20], no specific residency restrictions relating to hotels and restaurants were found. It is more likely that the restriction refers to the immigration laws, regulations, guidelines and procedures of employment in Botswana[21]. This is, however, already stated in the horizontal section of Botswana's schedule: 'For a foreign natural person to work in Botswana a residence and work

[18] The inscription recorded by the EU countries was 'Unbound except for Catering: None'. This indicates that only catering services have been fully liberalised while these countries are free to maintain or introduce restrictions the rest of the sub-sector.
[19] Identical restrictions were recorded in a number of other sectors in Mode 3. 'The services should be supplied through commercial presence' can be valuable in sectors where cross-border supply is possible. A more accurate way would be to schedule this type of restriction under Mode 1.
[20] The Botswana Tourism Regulations 2006 reserved a number of tourism enterprises for Botswana citizens or companies wholly owned by Botswana citizens. However, at the time when the schedules were recorded there were no residency restrictions. See the full discussion on Botswana Tourism Regulations on page 152 below.
[21] This nevertheless provides Botswana with the opportunity to clearly define these restrictions when negotiating their services schedules in future. The EU has already submitted a GATS request in 2002 to "clarify the requirements which a foreign services supplier must meet and to what extent they constitute a limitation to national treatment".

permit is required'; and 'entry and residence in Botswana of foreign natural persons is subject to immigration laws, regulations, guidelines and procedures'. Identical restrictions[22] appear frequently in the rest of the schedule, but again seem unnecessary. The horizontal section will apply automatically, even if not explicitly so stated.

Mauritius recorded the most comprehensive restrictions of the countries in the selected group. It separated the hotel and restaurant sub-sector in order to make different commitments in both sectors. Disregarding the possible technical infeasibility of Mode 1, Mauritius made commitments under market access and national treatment on cross-border supply. In terms of the Hotel Management Act of 1982, hotel operators have to incorporate a company. This seems to support the notion that hotels should only be supplied through commercial presence. In addition, Mauritius provides for the free repatriation of profits which is governed by the Bank of Mauritius Act and the Income Tax Act. Although strictly speaking this is not a commitment that should be scheduled, it was presumably included as a guarantee to foreign investors. More importantly, Mauritius made influential commitments under Mode 3 to restrict foreign investment to a certain extent, but at the same time stimulating the development of the local hotel sector. Foreign investment in hotels with fewer than a hundred rooms is limited to 49 percent while foreign investment in hotels with more than a hundred rooms is unrestricted. A further requirement is added to secure employment for locals: it is stipulated in the national treatment column that foreign establishments must predominantly be staffed by Mauritians. This policy towards foreign investment ensures that big resorts and hotels are continuously being developed with foreign capital, while the participation of the locals is guaranteed through joint ventures and secure employment. The same policy is employed in the restaurant sector where foreign projects are only allowed if the investment is greater than 10 million rupees (US$325 000)[23] with foreign establishments to be staffed predominantly by Mauritians. This ensures the sustainable involvement of locals in the development and growth of the hotel and restaurant business.

[22] The restriction stipulates that 'the services supplier should meet all residency requirements'.
[23] Converted from Mauritius rupees to United States dollars, September 2009.

Tanzania made a similar kind of commitment in an effort to engage locals in the development of the hotel industry. Only four-star hotels and above[24] were partially liberalised. Acquisitions of domestic hotels and mergers by foreign firms are subject to approval when foreigners are considering investing in the hotel sector of four stars and above. In addition, the acquisition of land by foreign individuals or foreign companies is also subject to approval. Tanzania is the only country mentioning land property laws, an issue which is of crucial importance, particularly in the hotel and resort industry. Sections 19 – 20 of the Land Act 1999 (including the Amendment of 2004) limit the rights of non-citizens when occupying land in Tanzania. Non-citizens are only allowed occupancy rights, derivative rights, or joint venture rights if the investment project is approved under the Tanzania Investment Act of 1997. The Investment Act requires a minimum investment of 300 000 US dollars for foreign investors and the submission of a formal application in order to enjoy the benefits and protection afforded under the Act. Tanzania has made no commitments on national treatment in Mode 3, leaving it free to introduce discriminatory regulations in the hotel sector.

The only restriction Uganda maintains in the hotel and restaurant sector is similar to the investment directives contained in the Tanzanian schedules. Government approval is required in accordance with the Investment Code of Uganda and the regulations contained within. Section 10(1) of the Uganda Investment Code 2000 obliges foreign investors to obtain a licence before commencing operation in Uganda. The application procedure and requirements for a licence is set out in Section 11 and must include the proposed capital structure, amount of investment and the projected growth over at least the next five years. Investment is not limited to a certain sector – according to Section 13(1) an investor may engage in any type of business. These kinds of scheduled limitations provide a country with some extent of control to screen potential foreign investors. In addition, the procedural and other requirements contained in the relevant acts for potential investors can be changed without withdrawing or modifying the scheduled commitments.

It is evident that the hotel and restaurant sector in the SADC and EAC countries are already fairly liberalised. It is only Madagascar and Mozambique that have not bound

[24] The commitments would only exclusively apply to four-star hotels and above as defined by Tanzanian legislation.

the hotel and restaurant sector, so these countries remain free to introduce more restrictive or discriminatory measures on foreign suppliers. Mozambique has, however, signed the interim SADC EPA in which it committed in Art. 67 'to a standstill as specified in Article V.1.b(ii) GATS, for all services sectors'. GATS Art. V.1(b)(ii) prohibits new or more discriminatory measures, either at the entry into force of the agreement, or on the basis of a reasonable time frame. Barriers to services are created and maintained by domestic legislation and regulations; therefore the reference to the prohibition of new or more discriminatory measures is included to control the loading of additional discriminatory legislation. But the disparity between the GATS provision and the provision in the interim EPA is its scope and timing. The GATS provision only encompasses the specific sectors that have been committed, while, in contrast, the commitment in the SADC interim EPA spans all services sectors, even before they have been committed. On a literal reading of this provision, parties to the interim SADC EPA will not be able to introduce any additional or new domestic legislation or regulations that deny market access for foreign suppliers or discriminate against them in any way.[25] This provision in the EPA can prevent Mozambique to load the tourism sector with any restrictive or discriminatory measures which are not currently contained in domestic legislation.[26] Madagascar has not yet signed the interim Eastern and Southern African (ESA) EPA, although it initialled the document at the end of 2007. Yet, the second phase of the negotiations (or Rendezvous clause) as described in the ESA and EAC EPA is not as detailed as the provision contained in the SADC EPA. No mention is made in the ESA or EAC EPA of a standstill clause prohibiting new or more restrictive or discriminatory measures. The remainder of the SADC and EAC countries partly or completely liberalised the hotel and restaurant sector. Besides Madagascar and Mozambique, it is in fact only Mauritius, Tanzania and Uganda that maintain significant restrictions denying market access for foreign suppliers. According to the schedules, it should be permissible in all the other countries to commercially establish any type of hotel,

[25] At best, a contextual interpretation may be construed to imply that specific reference to Art. V.1.b(ii) requires compliance with the GATS. In line with the GATS, the standstill will only apply to the committed sectors and not to all sectors. The fundamental idea here is clear – when a commitment is made, countries are prohibited from introducing discriminatory or restricting measures affecting the access or operation of foreign services suppliers.

[26] This has been duly noted by the SADC EPA Member States and the issue will be addressed during the second phase of the EPA negotiations.

motel, guesthouse, rooming houses, boarding houses, cabins, apartments, bungalows, caravan site, camp site or restaurant.[27]

Foreign investors are nevertheless obliged to observe the relevant domestic legislation and regulations in the tourism sector. These include measures relating to the need to obtain a licence, register a company, transfer property, the recognition of qualifications, technical specifications, safety permits and standards. Domestic regulations provide the framework for participation – every company operating in that country must comply with these obligations, regardless whether they are foreign or local. Typically, the only obligation government has, is to ensure that these domestic measures are administered in a reasonable, objective and impartial manner (GATS Art. VI). The intention with this obligation is to prevent countries from denying, nullifying or impairing the rights of foreign suppliers through the use of onerous domestic administrative measures. The identification of the domestic regulations associated with the establishment and operations of hotels and restaurants is not within the scope of this study. It is, however, possible that poor and onerous domestic legislation can make it more difficult to invest in certain countries.[28] This stifles not only foreign investment but also activity in the local business sectors. In this context the efficiency of domestic regulation can be an important link to the amount and quality of foreign investment.

Travel agencies and tour operator services (CPC 7471)

These services are defined in the CPC product classification list as ‘services rendered for passenger travel by travel agencies tour operators, and similar services; travel information, advice and planning services; services related to the arrangement of tours, accommodation, passenger and baggage transportation; and ticket issuance services’. Travel agencies and tour operators are known as key intermediaries because they play a crucial role in connecting the consumer with destination services in the host country. The tourist receipts in comparison to the hotel and restaurant sector are insignificant, but efficient linkages between the two are necessary to exploit the tourism markets. The creation of services (or travel packages as they are

[27] Or any other type of accommodation or restaurant specified under CPC classification 641 – 643.
[28] Other countries, again, make it more attractive for foreign investors in invest in certain sectors. In many countries investors are eligible for some type of preferential treatment if they comply with the specified requirements.

known in the industry) is central to the development of tourism; without intermediaries to promote, market and sell services in the destination markets, the travel and tourism industry will not able to show sustainable growth. However, the travel and tourism industry in many of the leading tourism markets is dominated by a number of large agencies that organise tours and trips to various destinations. The characteristics of such a value chain will undoubtedly impact on the liberalisation process in many African countries. Foreign tourists, especially from the large tourism markets of Asia, Europe and the United States, will primarily use their own domestic agencies for international travel.[29] Generally speaking, local providers in developing countries still pick up overflow business from tourists looking for a more personalised and unique travel package while servicing the needs of outbound travellers. Some business is also generated from ad hoc or impulse decisions, once the tourist is already in the host country. This sector is considerably smaller than the hotel and restaurant sector, providing a rationale for the relative low penetration of foreign investment. In developing countries, travel agency and tour operator services are predominantly provided by local small and medium enterprises. Travel agencies have also gradually declined in importance, mainly due to technological changes. Most bookings today can be done online, reducing the need for travel intermediaries. Regrettably, Africa has been slow to take advantage of this phenomenon.[30]

Of the eighteen examined countries, five countries made 'extensive' commitments while only Namibia made a 'full' commitment.[31] Botswana made a specific commitment under Mode 1 in the national treatment column relating to exchange control regulations. It is stipulated that 'permanent residents should not purchase tickets to enable foreigners to visit Botswana and accept payment outside of Botswana'. As mentioned above, exchange controls were abolished in 1999 and permanent residents can export unlimited amounts subject to the submission of a declaration. In the case of Botswana, its domestic legislation is more liberal than indicated in the published GATS schedule. This can be distinguished from the situation in Zimbabwe where the domestic legislation is *more restrictive* than

[29] One way of circumventing the traditional value chain is to employ e-tourism to facilitate the access of local operators in foreign markets.
[30] According to E-Tourism Africa (http://www.e-tourismafrica.com), travel is the number one selling commodity online and is generating more than $110 billion annually in sales; however, very little African tourism is sold online.
[31] See page 139 above for a discussion on the distinction between 'extensive' and 'full' commitments.

recorded in its schedule.[32] Botswana unilaterally decided to relax its exchange control regulations by removing the restrictions on foreign exchange. The result is that the GATS schedules are not always a reflection of the current domestic situation. There is no mechanism in the GATS to automatically update unilateral improvements made in services industries. The GATS makes provision for modifying or revoking commitments, but it can be interpreted only to refer to more restrictive or discriminatory commitments.[33] The existence of no current discriminatory domestic legislation can primarily be explained by a shift in policy thinking. The GATS schedules were negotiated during the Uruguay Round in the early nineties, more than 15 years ago. Today, Botswana pursues a different investment and foreign policy than at that time. The country gradually liberalised its invest regime, ending in the complete abolishment of all exchange control regulations in 1999. The result is that there are currently no exchange control restrictions, even though it is stated so in the schedule. This kind of discrepancy provides Botswana with two main benefits: 1) if Botswana decides to introduce similar discriminatory regulations restricting exchange controls, the country will not violate its GATS obligations; and 2) the recorded restrictions in the schedule will provide Botswana with more bargaining power in the next round of services negotiations. Similar discrepancies also exist in the schedules of other WTO members – such a result is inevitable considering the length of time that has elapsed since the initial negotiations and the progress that has been made in successive negotiations. It can be argued that from a negotiating point of view the schedules are useful, but from a practical point of view the schedules are insufficient to determine the real conditions in the domestic sphere.

Mauritius made sensible commitments illustrating their sophisticated understanding of the tourism sector. Its schedule requires travel agencies established outside of Mauritius to work through a local established agency. In a perfect world such a restriction would be ideal to ensure the participation of local travel agents in the global value chain, but in reality it would be arduous, if not impossible, to enforce. Mode 1 covers cross-border supply where the service supplier is not present within the territory of the country where the service is delivered. Or in other words, the service supplier is not present within the territory of the country making the

[32] For a comprehensive discussion on the inconsistency between the Zimbabwean schedules and its domestic legislation, see page 149 below.
[33] See GATS Art. XXI (Modification of schedules) and the discussion on p 150.

commitment. In essence, a country may only impose restrictive measures affecting its own suppliers and consumers, or on the activities taking place within its jurisdiction. Foreign suppliers can therefore be regulated when they establish a commercial presence under Mode 3 because they are operating within the sovereign jurisdiction of the host country. A host country will find it more difficult to regulate foreign suppliers if only the service, and not the actual supplier itself, crosses the border.[34] The service itself (for example mobile cellular services) can be restricted, but it is not possible to restrict every service in this way. The host country can restrict its own citizens receiving services under Mode 1, but in the case of Mauritius it is the foreign supplier established outside of Mauritius that is being regulated. This argument is further confirmed by the fact that no such restriction was found in Mauritian domestic legislation.

Foreign travel agencies establishing themselves in Mauritius require a bank guarantee and a licence. Clearance also has to be obtained from the Ministry of Tourism and the Ministry of Internal and External Communication. In 2006 Mauritius promulgated the Tourism Authority Act with the object of establishing a more efficient framework for regulating activities within the tourism sector. The current act repealed and replaced all the previous laws governing tourist enterprises. The Act makes no distinction between foreign and local tourist suppliers – no person may run or carry on a tourism enterprise without a licence.[35] The Minister of Tourism can, however, restrict the number of tourist enterprise licences for any particular activity if it is for public security or in the public interest to do so. In practice, the Ministry of Tourism must first grant clearance to an investor[36] before the licence application can be submitted to the Tourism Authority.

[34] The service itself can be restricted in Mode 1 (for example mobile cellular services under telecommunications services), but it is not possible to restrict every service in this way. Monitoring and tracking the delivery of certain services in Mode 1 can be challenging and time consuming. With modern technology, it will be impossible to prevent the supply and consumption of a number of services without serious disruptions.

[35] The First Schedule of the Tourism Authority Act 2006 describes tourism enterprises as tourist accommodation; places where food, beverage and entertainment services are provided; and tourism activities which include eco-tourism, golf, hawking, helmet diving, carting, operating a boat house, operation of cable car, scuba diving, tour operator, tourist guides, travel agents, and rental agencies for bicycles, buses, minibuses, cars, motorcycles and quads,

[36] An investor is defined as a person who is not a citizen of Mauritius or an association or body of persons, whether corporate or incorporate, the control or management of which is vested in persons who are not citizens of Mauritius.

Uganda's schedule contains a similar restriction as in the hotel and restaurant sector. Government approval is required from the Uganda Investment Authority. Although this is slightly different than the restriction in the hotel and restaurant sector which requires 'government approval in accordance with the Investment Code of Uganda', the approval process seems to be the same. In terms of the Invest Code, prospective tourism suppliers need to apply for a licence in terms of Section 11. The Uganda Investment Authority is the institution responsible for the appraisal of all licence applications. The Investment Code lists a number of objectives that this authority must consider when making the appraisal decision. These objectives are far-reaching and include the following: a) the generation of new earnings or savings of foreign exchange through exports, resource-based import substitution or services activities; b) the utilisation of local materials, supplies and services; c) the creation of employment opportunities in Uganda; d) the introduction of advanced technology or upgrading of indigenous technology; e) the contribution to locally or regionally balanced socioeconomic development; and f) any other objectives that the Authority may consider relevant for achieving the objectives of the Investment Code.[37] The tourism industry is identified in the Investment Code as a priority area in the Second Schedule of the Code. This means that an applicant for a licence who wished to engage in any activity in the tourism industry will be accorded additional benefits. The Code does not elaborate on the sort of benefits but one can assume that applicants in priority areas will be treated more favourably in the appraisal process.[38]

Zimbabwe made some commitments in Mode 3 of which the practical value can be questioned. Tour operators operating a vehicle of over three tonnes or using more than 20 vehicles must pay an annual levy for each park. This restriction is recorded in the market access column but does not in any way deny market access for foreign suppliers. This must rather be seen as a domestic regulation which can be omitted from the schedule. A similar type of regulation requiring foreign tour operators to pay park entry in foreign currency was recorded in the national treatment column. GATS Art. XVI ('Market access') contains an exhaustive list consisting of five quantitative

[37] See Section 12 of the Uganda Investment Code 2000. Also see the full discussion on investment related regulations on page 158 below.
[38] The Tourism Profile issued by the Uganda Investment Authority also identified tour operators as a priority area for investment. The profile is available on the website of the Uganda Investment Authority.

restrictions and one restriction pertaining to the legal composition of the entity.[39] Other measures outside of this classification would not fall within the scope of market access. If such a measure is discriminatory in the sense of GATS Art. XVII ('National treatment') in that it discriminates against foreign services or foreign services suppliers, to the extent that it modifies the conditions of competition in favour of domestic services or domestic suppliers, then the measure must be listed in the National Treatment column. All other measures would fall under the realm of GATS Art. VI ('Domestic regulation'). All market access limitations, discriminatory or not, covered by one of the specific limitations defined by Article XVI; and all measures that discriminate against foreign services or services suppliers in the sense of Article XVII, are trade restrictive measures which must be listed in the schedules. All other measures pertain to domestic regulation and the only obligation of members is to ensure that these measures are administered in a reasonable, objective and impartial manner.

If Zimbabwe feels the need to include administrative regulations of this kind in the schedule, it is best to record them in the 'Additional commitments column'. GATS Art. XVIII ('Additional commitments') can only cover measures affecting trade in services not subject to scheduling under Articles XVI and XVII. Commitments scheduled under 'Additional commitments' can include, but are not limited to, undertakings with respect to qualifications, technical standards, licensing requirements or procedures, and other domestic regulations that are consistent with GATS Art. VI (WTO Secretariat 2001).

A more accurate inscription in the Zimbabwean schedule relates to hunting licences. Only locally registered safari operators may obtain concessions through leasing or auctions by which hunting areas are leased out. This restriction is rather vague and it can be argued that even foreign tour operators who are locally incorporated can receive hunting concessions. Of far more significance is the sweeping restrictions Zimbabwe maintain in certain reserved sectors. Section 25 (2) of the Zimbabwe

[39]Restrictions on the number of service suppliers; restrictions on the total value of service transactions or assets; restrictions on the total number of service operations or the total quantity of service output; restrictions on the number of natural persons that may be employed in a particular section; measures that restrict or require supply of the service through specific types of legal entity or joint venture; and percentage restrictions on the participation of foreign capital, or restrictions on the total value of foreign investment.

Investment Authority Act 2006 allows the Minister of Industry and International Trade to specify the sectors of the economy available for investment by domestic and foreign investors. The minister may also specify the sectors of the economy reserved exclusively for residents for the purpose of promoting equitable participation in the economy. Zimbabwe has identified three priority sectors in which foreign investors can acquire 100 percent ownership. The three sectors are manufacturing, mining, quarrying and mineral exploration, as well as the development of infrastructure for tourism. One can argue that the establishment of hotels and restaurants can be classified as tourism infrastructure development, although the same cannot be said for other travel and tourism providers. Investment in the services sector is restricted to a maximum of 70 percent, while specific reservations[40] are made for certain sensitive sectors.[41] Foreign investors wishing to participate in any of these sensitive sectors can only do so by entering into a joint venture arrangement with a Zimbabwean, with the foreign partner only allowed to take a maximum of 35 percent shareholding in the venture. These are serious market access impediments which Zimbabwe is obliged to include in its schedule. Zimbabwe has fully liberalised the travel and tourism sector except for the restrictions indicated above. The scheduled commitments constitute legally binding obligations on member states which are enforceable through the WTO's binding dispute settlement process. Here the domestic legislation is in conflict with the GATS schedules of Zimbabwe – the current situation leaves the country vulnerable to dispute settlement under GATS Art. XXIII.[42]

The only legal means for Zimbabwe to revise its commitments is to abide by the procedure set out in GATS Art. XXI ('Modification of schedules'). According to the provision, a country wishing to modify or withdraw any commitment in its schedules can do so three years after the commitment entered into force. The country must notify its intention to change the commitment at least three months before implementing the change. This will give WTO Members affected by the change an opportunity to identify themselves as affected Members, and to notify their claim of interest for compensation. Countries will then enter into a consultation process to

[40] Statutory Instrument 108 of 1994.

[41] Road haulage services, rail operations passenger transportation, tourist transportation, wholesale and retail services, hairdressers, employment agencies, estate agencies and valet services are the specific services sectors reserved for local investors.

[42] Although there have been a few GATS dispute settlement cases, none involved discrepancies in the GATS schedules.

determine the necessary compensatory adjustments due to the affected country. Reaching an agreement on compensation is a critical aspect of the process but no explanation is provided on the nature of compensation or the manner in which it should be determined. The compensatory calculation is further complicated by a lack of historical precedents on the use of GATS Art. XXI.[43].

The situation in Zimbabwe can be contrasted with a recent inconsistency in the schedules. After a review of its tourism policy,[44] Botswana promulgated a new set of tourism regulations in 2006 in which reservation was made for a number of tourist enterprises. The Botswana Tourism Regulations of 2006 stated in its Third Schedule that the following tourist enterprises are reserved for citizens of Botswana or companies wholly owned by citizens of Botswana: a) camping sites including caravan sites, b) guest houses, c) mekoro operations,[45] d) mobile safaris, e) motorboat safaris, and f) transportation. Certain reservations were, however, in conflict with the commitments made by Botswana in its GATS schedules. The only significant restrictions made by Botswana relate to exchange control regulations and movement of natural persons under Mode 4; the remainder of the hotel and restaurant sector and the travel agencies and tour operators sector have been fully liberalised. The hotel and restaurant sector includes camping and caravan services (CPC 64195) and guesthouses (CPC 64193) while travel agencies and tour operators include passenger travel by tour operators and passenger transportation. As with Zimbabwe, some of these newly promulgated domestic reservations were clearly in conflict with the undertakings in the GATS schedules. This inconsistency was pointed out by commentators, and credit must be given to Botswana for revoking the contradictory regulations in 2007. The whole section reserving tourist enterprises was revoked without stipulating additional reservations[46]. Actions such as this truly demonstrate the

[43] To date only two countries – the EU and United States – have invoked the procedures of GATS Art. XXI.
[44] The review revealed that of the 567 licensed enterprises only 250 are citizen owned.
[45] Also known as canoe safaris.
[46] Although all the whole section (camping sites including caravanning sites, guesthouses, mekoro operations, mobile safaris, motorboat safaris and transportation) was revoked, only the reservations relating to camping sites, caravanning sites and guesthouses were in conflict with Botswana's GATS schedules. The remaining services (mekoro operations, mobile safaris, motorboat safaris and transportation) are rather classified as tourist guide services (CPC 7472) and can legally be maintained. In fact, mekoro operations, mobile safaris and motorboat safaris are activities reserved for professional and specialist guides as stated in Part VI of the Wildlife conservation and National Parks (Hunting and Licensing) Regulations 2001.

dedication of countries such as Botswana to the spirit and responsibilities of the GATS.

The eight remaining SADC and EAC countries excluded the travel agency and tour operator sub-sector from their schedules. If a service sector is omitted from a schedule, that country has no obligations on market access and national treatment in that specific sector. In other words, these countries are free to maintain or introduce new measures to deny market access or the operation of services in those omitted sectors.[47] The only way to determine the exact extent of liberalisation in these countries is to examine each piece of legislation and regulation in the travel agencies and tour operators sector in order to determine whether it limits market access for foreign suppliers or if it discriminates against them in any way once they operate in the market. Even then, the current state of affairs cannot be used as a prevailing standard since countries are permitted to introduce new discriminatory measures.[48] It is, however, expected that there would be relatively few restrictions on travel agencies and tour operators. These activities are vital in attracting tourists and facilitating various elements of their stay once in the host country. Regulations restricting the accessibility or selection of such operators can have a negative ripple effect on the rest of the tourism industry.

Tourist guide services (CPC 7472)

Tourist guide services by tourist guide agencies and own-account tourist guides are included in this definition, while own-account hunting guides and personal escort services are excluded. The definition of tourist guides differs between countries but South African legislation provide a good general description: A tourist guide can be defined as someone who for reward, whether monetary or otherwise, accompanies any person who travels within the country and who furnishes such a person with information or comment with regard to any matter.[49]Due to the unique position that they occupy in the tourism value chain, tourist guides, through their commentary and interpretation, are in a position to enhance a tourist's experience and perception of the richness and diversity of a country's cultural and natural heritage. As a result, the

[47] One has to bear in mind the EPA standstill clause as discussed on page 143 above.
[48] If Botswana had not substantially liberalised the tourism sector, it would have been allowed to introduce the new discriminatory tourism regulations in 2006.
[49] See Section 1 (x) of the South African Tourism Act 72 of 1993

professionalism, services quality and excellence of tourist guides can elevate a country's competitiveness as a popular tourist destination.[50] This has prompted some countries to introduce detailed provisions regulating tourist guides' activities.

In South Africa, the Second Tourism Amended Act of 2000 prohibits any person to carry on business for reward unless he/she has been registered as a tourist guide in terms of Section 21A ('Procedures relating to the registration of tourist guides'). The amended Act further requires all tourist guides to comply with the requisite competence as determined by the South African Qualifications Authority. The tourist guide must therefore first complete training or recognition of prior learning with an accredited institution before being allowed to register with the Provincial Registrar of Tourist Guides. Such qualification requirements are typical domestic regulations which only need to be administered in a in a reasonable, objective and impartial manner (GATS Art. VI). The GATS explicitly recognises the right of member states to regulate, and introduce new regulations, on the supply of services within the territories in order to meet national policy objectives. This was further confirmed in the CARIFORUM EPA where it was stated that the 'attached Schedule of commitments may not include measures relating to qualification requirements and procedures, technical standards and licensing requirements and procedures when they do not constitute a market access or a national treatment limitation within the meaning of Articles 6 and 7 and 15 and 16 of Title II of the Agreement. Those measures (e.g. need to obtain a license, need to register with the Registrar of Companies, universal service obligations, need to obtain recognition of qualifications in regulated sectors, need to pass specific examinations, including language examinations, non-discriminatory requirement that certain activities may not be carried out in environmental protected zones or areas of particular historic and artistic interest), even if not listed, apply in any case to service suppliers of the other Party'.[51]

The Second Tourism Amendment Act also contains an important restriction reserving tourist guide activities for South African locals. Section 21A (3)(b) prohibits anyone to register as a tourist guide if the person "loses his or her South African citizenship or right of permanent residence or work permit in the Republic". By implication, foreign

[50] See the Gauteng Guides Association (http://www.guidessa.org).
[51] See the explanatory note on the Schedule of Commitments on services of Cariforum States. December 2007.

tourist guides without South African citizenship, permanent residence or a work permit are excluded from registering as a tourist guide and thereby preventing them to legally provide tourist guide services in South Africa. In practice, a foreign tourist guide must be accompanied by a local tourist guide when operating in South Africa. Most of the activities of foreign tour guides will take in place in Mode 1 and Mode 4, both of which has been left ‘unbound’ by South Africa, in which case these restrictions are allowed.

Similar regulations concerning the competencies of tourist guides are contained in Tanzanian legislation. Section 42 of the Tanzanian Tourism Act of 2008 regulates the licensing conditions and requires every tour guide to be registered in accordance with the Act. No person can register for a tourist guide unless he/she has adequate knowledge of the area and has knowledge in the field applied. The minister can also specify other qualifications as a prerequisite for registration. Furthermore, the tourist guide must at least complete an ordinary level of education (secondary school) and hold a first aid certificate. These requirements are included in legislation to ensure that tourist guides have the appropriate skills and ability to inform and educate tourists. Similar to the situation in South Africa, the Tourism Act also reserve tourist guide activities for Tanzanian citizens. Tanzania made no commitments in the tourist guide sub-sector and is therefore allowed to introduce or maintain discriminatory restrictions. The intention of the legislator was only to restrict tourist guide activities, but not the activities of *tour operators*. A tourist operator is defined in the Tanzanian legislation as a ‘tourist agent or photographic safaris operator or any person who for reward conduct an activity or operate a facility, or undertakes to provide services for tourists and other members of the public in relation to tours and travel within or outside the country’ (Tourism Act of Tanzania 2008 Section 1). Many tour operators operate across borders especially in Africa. Imagine a scenario where an overland company takes its tourists from the north to the south of Africa, zigzagging through various African states. If a country restricts the activities of these operators, they would simply avoid travelling through that country by plotting a different route to the south. Countries can strive to preserve some tourism supply activities for citizens, but not at the expense of tourist arrivals.

The six countries that fully liberalised this sector are only allowed to maintain regulations aimed at regulating and protecting the tourist guide industry. The ten countries, on the other hand, that made no commitments in this sub-sector (as is the case with Tanzania) can maintain or introduce market access restrictions or discriminatory measures without violating their GATS obligations. The remaining two countries, Mauritius and Zimbabwe, recorded specific commitments in the tourist guide services sector. Zimbabwe has tried to schedule tourist guide services, but strangely enough, only recorded tour operator restrictions in the appropriate columns. Once a sub-sector has been scheduled, all applicable restrictions on foreign suppliers must be included as these scheduled commitments will be regarded as the only limitations. It is accepted that the scheduled sector contains a complete reflection of the related domestic situation. The outcome in this instance is that Zimbabwe fully liberalised tourist guide services, whether it intended to do so or not.

The only other country which recorded specific restrictions in the tourist guide sub-sector is Mauritius. Tourist guide services in Mode 1 are limited to Mauritian nationals, but an exception is made for languages not spoken by Mauritians. In addition, the tourist guide services in Mode 1 are governed by local immigration laws. Mode 1 specifically refers to the supply of services from the territory of one country into the territory of another country, so in the case of tourist guides this will most likely refer to foreign tourist guides accompanying tour groups travelling to Mauritius. This activity is reserved for Mauritian citizens, except if they cannot speak the language of the foreign tour group. In this instance the foreign tourist guide accompanying the group must be issued with a work permit as per the immigration laws of Mauritius. In Mode 3, Mauritius allows the establishment of tourist guides only in 'linguistic scarce' areas. This commitment is rather vague and only makes sense if read together with the restriction recorded in Mode 1. The schedule further stipulates that Mode 3 be governed by Income Tax laws. The same restriction is also maintained in the horizontal section, so it will nevertheless apply automatically notwithstanding the inscription in this sub-sector. See the relevant extract from the Mauritius schedule below:

11.TOURIST GUIDE SERVICES - *MAURITIUS*	Limitations on Market Access	Limitations on National Treatment
C. Travel guide services	1) Limited to Mauritian nationals. Exception made for languages not spoken by Mauritians. 2) None 3) Only allowed in linguistic scarce areas 4) Unbound except as indicated in the horizontal section	1) Governed by Immigration laws 2) None 3) Governed by Income Tax laws 4) Unbound except as indicated in the horizontal section

Relatively little attention was given to the tourist guide sector when the examined countries scheduled their specific commitments in the Uruguay Round. All six of the countries that liberalised the tourist guide sub-sector also liberalised the rest of the travel and tourism sector. It can therefore be argued that the tourism sector has been considered as a whole, while little awareness exists of its separate components. This sub-sector can also be considered small in comparison with the other tourism sub-sectors while in many instances tourist guides are employed by tour operators. It is unlikely that a foreign tourist guide will only supply tourist guide services without the tour operator component which makes for an uneasy overlap between the two categories. Another reason might be that tourist guides are purely domestic in focus, and export opportunities in this sub-sector are of little interest. In many countries tourist guides are referred to as *local guides*, confirming their domestic scope. This can, however, also be the driver to develop the sub-sector further for the benefit of the locals, even without any restrictions or discrimination. The perception of tourists is that locals have insider information and specialist knowledge of a specific country or region. For that reason tourists would prefer the company of an indigenous tourist guide over a foreign tourist guide. Ensuring the competency and adequate knowledge and training of tour guides are therefore more important than simply reserving this industry for local guides.

Related legislation to be considered

The GATS schedules and domestic services legislation do not exist in a vacuum, so it is necessary to consider related legislation that also has an influence on foreign investment in order to determine the exact requirements of entry into each of the sectors. Particularly important is the investment regulations that will be taken into consideration once the foreign supplier has decided to establish a commercial presence in the host country.[52] Most countries have some kind of investment code or legislation aimed at promoting and facilitating local and foreign investment. This legislation needs to be read together with the specific domestic services legislation in order to arrive at a better understanding of the investment conditions for foreign tourism suppliers.

Investment legislation typically includes the establishment and powers of the respective investment institutions, procedural obligations for prospective investors and clarification on investment incentives. In general, any foreigner wishing to invest must follow the set procedures in order to obtain the prerequisite permission to make an investment in the host country. This eligibility will enable a foreign investor, amongst other things, to acquire the necessary licences for the establishment of local operations, receive legal protection for the investment, access dispute settlement procedures, obtain compensation in the event of expropriation and be eligible for the various investment incentives. The contrast between a foreign and a local investor is best explained in the Kenyan Investment Promotion Act of 2004: while a local investor *may apply* to the Authority for an investment certificate, a foreign investor *shall apply* to the Authority (Kenya Investment Promotion Act 2004 Section 3). This is further confirmed by Section 6(3) which states that no foreign investor shall invest in Kenya unless the foreign investor has been issued with an investment certificate.

Mechanisms to control the entry of foreign investors are contained in the domestic legislation of all countries; if not in the relevant investment legislation, such procedures will be incorporated elsewhere. For instance, a foreigner wishing to establish, or invest in a business in South Africa, must apply for a business permit issued by the Department of Home Affairs. In most cases, the amount of money

[52] According to some estimates more trade is conducted through Mode 3 ('Commercial presence') than all the other modes combined.

invested by a foreigner must also be substantially more than that invested by a local investor. For example, the minimum investment capital required by a foreigner to enjoy protection and benefits under the Tanzanian Investment Code is US$300 000 in comparison to the US$100 000 required by a local investor. In Mozambique, the minimum value of direct foreign investment is pegged at US$50 000 compared to minimum value of direct national investment of US$5 000. Similarly, the minimum amount to be invested by a foreigner in Kenya is US$500 000 while a local investor is obliged to invest 5 million Kenyan shillings (roughly US$65 000).[53] Not all countries specify a minimum threshold for investment, but it is evident from the procedural provisions that the capital amount will play a role in the appraisal process. In the case of Botswana, no minimum amount is stipulated, but financial institutions like the Botswana Development Corporation and the National Development Bank require a minimum of 25% of the total cost from the foreign investor.

To apply for permission to invest in a host country, approval must be obtained from the relevant investment institution. An application must be submitted in the prescribed form and will typically include the following information: details of the enterprise, the nature of the proposed business activity, proposed location of establishment, the proposed capital structure, the investment amount, projected growth, number of employees, qualifications and experience, the prospects of technology transfer, environmental impact assessment, annual turnover, and any other relevant information.[54] The application must also be accompanied by the prescribed fees and any such documents as required by the institutions. The institution will then carry out an appraisal to determine the viability of the proposed investment. All foreign investors have the right to apply to the investment institution for permission to establish their business, but there is no guarantee that the investment application will be granted.

In considering the application, the institutions must take into account a number of factors which in many cases are stated in the legislation. For example, the Investment Board of Zimbabwe must regard the following: the extent to which skills and technology will be transferred, the extent to which the proposed investment will

[53] Currency converted on 4 August 2009.
[54] These requirements are only listed by way of example. Investors must comply with the provisions set out in the applicable legislation in order to submit a correct and complete application. Additional information might also be required in some instances.

lead to the creation of employment opportunities and the development of human resources, the extent to which local raw materials will be utilised and beneficiated, the issue of whether the project complies with the prescribed requirements, the value of the convertible foreign currency transferred to Zimbabwe in connection with the project, the impact the proposed investment is likely to have on the environment, the measures proposed to deal with any adverse environmental consequences, the impact the investment is likely to have on existing industries in the economy, the possibility of transfer of technology; and any other considerations that the board considers appropriate (Zimbabwe Investment Authority Act 2006 Section 14). Similar factors are contained in the Ugandan Investment Code Act 2000 (Section 12), the Namibian Foreign Investment Act 1990 (Section 6), the Mozambique Investment Decree 3/93 (Section 7) and the Kenyan Promotion Act 2004 (Section 4).

In most cases the institution retains some kind of discretion to grant or refuse prospective applications. However, in some cases these powers are far-reaching and include a number of prerequisites to be taken into account. It can therefore be argued that prospective investors can be denied market access even in a sector where full liberalisation has taken place. The rights of sovereign states to introduce and maintain regulations to meet national policy objectives are recognised in international law. The only obligation a country has is to ensure that such regulations are administered in a 'reasonable, objective and impartial manner' (GATS Art. VI.1). This is to prevent members from denying, nullifying or impairing the liberalisation benefits to other WTO members through the use of onerous domestic administrative measures, as could be the case if the selection criteria were too harshly applied. The discussion nevertheless illustrates the contention that the GATS schedules or services liberalisation commitments never exist in a vacuum and must be considered together with other applicable legislation. This situation is accurately highlighted in the Madagascar Investment Law 2007-036 which states that '[a]ny natural person or legal entity, Malagasy or foreign, is free to invest and settle down on the national territory, in accordance with the laws and regulations in force, subject to provisions applicable to some activity sectors which are also subjected to specific regulations'.

Conclusion

The chapter finds that relatively few barriers in travel service exports exist, which may explain the relatively strong growth in this industry (increasing its comparative advantage) vis-à-vis other industries. The analysis shows that the travel and tourism sector in southern and eastern Africa is already fairly liberalised. In particular, hotels and restaurant services (CPC 641 – 643) – the sub-sector which is by far the most strategic to foreign investors – are completely liberalised in the majority of the southern and eastern African states. Even if it were not the intention of some countries to liberalise their markets to such an extent, these governments must deal with the consequences of inexperienced decisions as best they can. For most countries, it would therefore be difficult to attract more investment in the sector by simply lowering barriers to services trade. There is still some space to manoeuvre and restrict foreign suppliers in the remaining sub-sectors. Careful consideration, however, is necessary when protecting local travel agencies and tour operators (CPC 7471) from foreign competition since these services play a key intermediate role in connecting the consumer with destinations. Liberalisation of these services can lead to better developed global linkages with greater potential to facilitate interaction with prospective visitors. These sub-sectors make a minor contribution to the tourism receipts of a country and it can therefore be argued that liberalisation efforts alone will not be enough to sufficiently attract foreign investment and develop the tourism industry. Related policies, including regional strategies, will have to be articulated and implemented in order to further stimulate tourism development in sub-Saharan Africa.

Regional integration processes involving trade in services are still in the initial stages of development in most southern and eastern African states. An important first step to prepare for future negotiations and liberalisation is to identify all relevant restrictions in domestic law which affect the supply of tourism and travel services. All relevant legislation, amendments, regulations, rules and charters must be reviewed in order to arrive at a clear portrayal of the sector. Countries that have fully liberalised the sector must ensure that there are no conflicting measures restricting the access and operation of foreign suppliers. It is also important to monitor newly promulgated legislation and regulations to avoid a situation similar to what happened in

Botswana.[55] Improving and updating the GATS enquiry points in each member state will go a long way towards increasing transparency and administration of current and future measures. For countries still in the process of liberalisation, these preparations are equally crucial. The identified restrictions will form the base line for countries wishing to further liberalise their services sectors. It will give them a clear idea of the policy space available within which future commitments are to be made. At the moment, most of the countries in southern and eastern Africa are in process of completing, or have completed, services sector inventories to determine the state of play in their services industries. Officials and negotiators must study these regulatory audits to increase their understanding of the respective services sectors and be familiar with the non-conforming measures. Such a comprehensive overview of the regulatory regime can also highlight regulations in need of reform (as is the case in Zimbabwe)[56] and assist with the formulation of negotiating offers.

[55] See page 152 above for a discussion on the amendments to the tourism regulations in Botswana.
[56] For a discussion on the restrictions in the Zimbabwean services industries, see page 150 above.

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Chapter 8

Regional integration in SACU's agricultural sector

Nick Vink and Ron Sandrey

Key points

In considering regional integration in southern Africa there is no better place to start than the Southern African Customs Union (SACU), the world's oldest customs union, and there is no better sector to examine than the vital agricultural sector in SACU. This paper will do just that and draw some conclusions and lessons for the future of regional integration. The report starts with an overview of production and input use trends in the five member states of SACU. The following conclusions were drawn from this analysis:

- While agriculture in the five member countries contributes on average less to the Gross Domestic Product (GDP) than the average for the Southern African Development Community (SADC) countries, it remains an important sector, contributing more than 10% in Lesotho, Namibia and Swaziland, and less in Botswana and South Africa;
- Only South Africa has been able to maintain a positive growth in per capita output from agriculture since 1990. In this regard, per capita output declined by as much as 25% in Botswana, 16% in Lesotho, 14% in Swaziland, and 9% in Namibia;
- In the case of Botswana, Namibia, Lesotho and Swaziland, the increase in the physical output of maize has been largely the result of expansion in the area under cultivation rather than an improvement in yields. In the case of sorghum, however, yield increases have played the major role;
- Similarly, beef output has increased rapidly, but not as rapidly as the case with the production of poultry meat. Namibia and Botswana have made the largest relative contribution to beef production, while South Africa has made the largest relative and absolute contribution to poultry production.

This analysis is followed by a section that briefly enumerates the agricultural situation and policies in each of the member states, followed in turn by sections on the sugar sector and on international competitiveness. The general conclusion from the discussion of competitiveness is not encouraging: the SACU countries have not succeeded in building competitiveness in 'new' agricultural industries, but have rather concentrated on traditional export sectors, such as fruit and wine (South Africa), beef (Botswana and Namibia), sugar (South Africa and Swaziland).

Overall, we consider that there are five issues that should form the basis of further discussions on regional integration in SACU agricultural policy circles. These are:

1. The role that the (lack of) SACU-wide institutions play in agricultural and trade policies.
2. Future policy towards the sugar sector in particular.
3. The particular actions of Namibia with respect to a range of products such as small stock and horticultural products.
4. The impact of competition policy on agriculture in SACU.
5. The sharing of land reform lessons among members.

1. Introduction and objectives

Central to the new 2002 SACU Agreement is Article 39 (Agricultural Policy), which states (1) that member states recognise the importance of the agricultural sector to their economies; and (2) that member states agree to cooperate on agricultural policies in order to ensure the coordinated development of the agricultural sector within the Common Customs Area. Linked to this is Article 31, Trade Relations with Third Parties, which states that (inter alia**)** member states shall establish a common negotiating mechanism for the purpose of undertaking negotiations with third parties. The objectives of this paper are:

- To outline the role of agricultural production and trade in SACU;
- To briefly discuss agricultural policy in the member countries and to outline where these policies seem to be diverging from the suggested coordinated SACU approach.

2. The performance of agriculture in SACU

Table 1 shows the relative size and structure of the SACU member countries. South Africa dominates, contributing 92% to the regional economy of SACU, 70% to the regional economy of SADC, and 40% to the sub-Saharan economy. There are also large disparities in per capita income, with Lesotho at $516 per annum at the one extreme, and Botswana with almost $3400 at the other. The distribution of income within each of the member countries is also highly skewed. Finally, the economies of the member countries are structurally different, with agriculture making a small GDP contribution in Botswana and South Africa (countries with a relatively large mining sector). However, agriculture's contribution in all five countries is smaller than the average for the SADC region.

Table 2: The economic structure of the SACU economies, 2000-2004 averages

	GDP (constant 2000 US$m)	GDP per capita (constant US$)	Agricultural value added (% of GDP)	Manufacturing value added (% of GDP)
Botswana	5798.7	3396.5	2.5	4.5
Lesotho	917.8	516.4	17.4	18.6
Namibia	3616.3	1831.0	10.7	11.5
South Africa	141368.3	3132.4	3.7	18.9
Swaziland	1451.7	1337.3	14.0	38.5
SADC	203826.1	1606.6	20.2	14.3
Sub-Saharan Africa	356554.8	517.2	17.0	13.9

Source: World Development Indicators database http://devdata.worldbank.org/query (Accessed 25 March 2008)

Table 3 shows some basic indicators of agriculture in the SACU region, using data from 2002. The first five rows show that of the BLNS (Botswana, Lesotho, Namibia and Swaziland), the two largest BLNS countries (Botswana and Namibia) are each roughly one-third the size of South Africa, while Lesotho and Swaziland are far smaller. Botswana and Namibia are situated in the drier west of the region and Lesotho and Swaziland in the higher-rainfall east, while South Africa has, on average, a better agricultural resource endowment than the other SACU members. This is clear from the higher proportion of land that is available for agriculture, the higher proportion of land that is arable, and the higher availability of arable land per person. Only Swaziland has a higher proportion of irrigated land.

The level of agricultural production can be deduced from the next three rows: South Africa leads in fertiliser use per hectare of arable land and in cereal yields per hectare, followed by Swaziland and Lesotho, whose climate is more conducive to crop production than that of Botswana and Namibia. Nevertheless, value added per worker and exports as a proportion of merchandise exports were higher in South Africa, Swaziland and Namibia, which have a higher proportion of commercial farmers (in Swaziland this is largely restricted to the sugar industry). South Africa is also less dependent on food imports than the other SACU member countries.

Table 3: Agriculture in SACU (2002)

	Botswana	Lesotho	Namibia	South Africa	Swaziland
Agricultural land (sq. km)	259800	23340	388200	996400	13920
Agricultural land (% of land area)	45.84	76.9	47.15	82.04	80.93
Arable land (% of land area)	0.67	10.87	0.99	12.15	10.35
Arable land (hectares per person)	0.21	0.18	0.42	0.33	0.16
Irrigated land (% of cropland)	0.26	0.9	0.98	9.53	26.04
Fertilizer consumption (100gm per ha of arable land)	122.02	342.42	3.68	654.17	393.26
Cereal yield (kg per hectare)	349.9	1053.7	412.6	2772.2	1020.7
Agriculture value added per worker (2000 US$)	406.03	423.17	1073.4	2455.88	1142
Food imports (% of merchandise imports)	16.04		12.48	4.98	18.24
Food exports (% of merchandise exports)	3.54		37.48	10.64	14.61

Source: World Development Indicators database http://devdata.worldbank.org/query (accessed 25 March 2008)

Finally, in examining the performance of agriculture in the five member countries in global perspective (taking an index of per capita output as indicator), it is evident from the data that member countries have all fared worse than the global average, and worse than the average for Africa as a whole over the past 16 years. The poorest performance was posted by Botswana, whose per capita production has declined by 25% over this relatively short period. Botswana is followed by Lesotho, Swaziland and Namibia. Only South Africa has been able to maintain per capita output, but at a lower rate than the global average.

2.1 Output

In this section the output performance of a number of agricultural commodities of importance to the SACU region is summarised.

Maize is the staple food of most people in eastern and southern Africa, and the region is one of the largest producers of white maize for human consumption. Production has increased in each of the member states, and South Africa has produced more than 95% of the region's maize output for the past five decades. As the crop is mostly non-irrigated, production is highly variable and the influence of the region-wide droughts of the early 1980s and of the early 1990s is evident. With respect to area planted, while South Africa has maintained its dominance, it has done so using about a third less land than was the case in the 1970s. Swaziland shares this trend, while in contrast the other three members have increased the area under maize over the period. This is balanced by industry average yields that have more than doubled since the early 1960s in Swaziland and South Africa, while they have been static in Lesotho and Namibia and declining in Botswana.

SACU is a net importer of **wheat**. In South Africa production (more than 95% of the total) which increased from 1961 to more than 2 500 000 tonnes in 1986-1990, but has since declined to lower levels. The area planted with wheat has declined by over 50% from almost two million hectares in 1981-85 to less than 900 000 hectares, but this has been compensated by a rapid increase in wheat yields.

Sorghum is an important staple food in southern Africa, and is relatively important in Botswana and Lesotho although production is dominated by South Africa.

South Africa and Swaziland are the only **sugar cane** producers in the region, with Swaziland's share doubling from less than 8% in 1961-65 to around 17% in 2000-04. South Africa's total production has doubled since the early 1960s, while production in Swaziland increased by more than fivefold. The increase in both countries is largely due to increased acreage as average yields have been declining. As discussed in

Chapter 9 in this publication, this sector has not undergone the policy reforms in South Africa that all other sectors have, and it consequently becomes one of the most important issues to be dealt with within SACU's agricultural policy framework.

The data shows that the production of **vegetables** in the SACU region increased by well over double since the 1960s, with this increase largely due to the increased production in South Africa.

Although both Botswana and Namibia specialise in **beef** production, with both countries recording impressive increases in production since 1960, South Africa again dominates overall production. The yield of meat per animal slaughtered has declined in Botswana and Lesotho, while it has hardly increased in Swaziland or Namibia – only in South Africa has there been a significant yield increase.

Since 1961 Botswana and Swaziland have seen **sheep and goat** numbers increase over the years, with both countries experiencing an increase in flock size up to 1996-00 and then a subsequent decline. Flock size peaked earlier: in Lesotho in 1986-90, in Namibia in 1975-80, and in South Africa in 1966-70 before retreating, and the trend suggests that regional numbers of goats and sheep will continue to decrease. Changes in productivity have meant that production overall has remained relatively stable over the period.

The production of **hides and skins** has been relatively stable in Swaziland and South Africa, but in contrast has increased by almost fourfold in Namibia, and by 80% in Lesotho and 52% in Botswana.

One of the main reasons for the decline in sheep numbers discussed above has been the long-term decline in **wool** production, where output in Lesotho has declined by a third, in South Africa by two-thirds and in Namibia by half.

The highest growth in the production of **fresh milk** was recorded by Lesotho, followed by Botswana, then Swaziland, South Africa and Namibia. Unfortunately, the data on milk yield per cow is patently inaccurate, rendering it difficult to provide any insights into an increase, if any, in productivity.

The increase in SACU **poultry** production has been dramatic: whereas total poultry production was less than 10% of total beef production in 1961-65, it was 20% higher in 2001-04, having overtaken beef production as recently as 1996-00. Even Lesotho, where growth in total poultry production lagged behind that of the other members, growth of some 270% was recorded over the period. The rate of growth was highest in Botswana, followed by Namibia, South Africa and Swaziland. South Africa has continued to produce more than 97% of the total since the 1960s.

2.2 Conclusion

These trends illustrate important features of agriculture in the SACU area. These include:

- While agriculture in the five member countries contributes on average less to GDP than the average for the SADC countries, it remains an important sector, contributing more than 10% in Lesotho, Namibia and Swaziland, and less in Botswana and South Africa (both countries with a large mining sector);
- Only South Africa has been able to maintain a positive growth in per capita output from agriculture since 1990. In this regard, per capita output declined by as much as 25% in Botswana, 16% in Lesotho, 14% in Swaziland, and 9% in Namibia;
- In the case of Botswana, Namibia, Lesotho and Swaziland, the increase in the physical output of maize has been largely the result of expansion in the area under cultivation rather than an improvement in yields. In the case of sorghum, though, yield increases have played the major role. This is important for Botswana, whose sorghum harvest is nearly three times larger than the maize harvest;
- Similarly, beef output has increased rapidly, but not as rapidly as the case with the production of poultry meat. Namibia and Botswana have made the largest relative contribution to beef production, while South Africa has made the largest relative and absolute contribution to poultry production.

3. Botswana

Agriculture's contribution to the economy, in terms of GDP and exports, is overshadowed by diamonds. The contribution of agriculture to Botswana's exports is very low at about 1% in case of raw materials and 3% in case of food exports. The beef sector used to be the major agriculture product of importance to exports, but now accounts for about 7% of total export revenue, compared to about 70% from diamond. Although the country is a net exporter of beef, it has always been a net importer of staple food commodities, such as sorghum and maize, which together account for over 90% of domestic cereal production.

The dualistic agriculture sector consists of commercial and traditional subsistence subsectors; each undertakes both crop and livestock activities. Commercial agriculture covers about 30% of arable land, comprising mainly cattle grazing on freehold or leased holdings. The major subsistence crops are sorghum, maize, millet, and pulses. Beans, groundnuts, sunflowers, cotton, and horticultural crops, such as cabbages, tomatoes, and potatoes, are also grown. Although the economic significance of subsistence agriculture is declining, it remains important for many people, particularly in rural areas where there are few alternatives. Botswana is about 20% self-sufficient in grains, 15% in vegetables, 25% in fruits and 3% in dairy products. It produces almost all of its poultry requirements, and is a net exporter of beef, exporting some 90% of production to the EU under preferences and to South Africa behind a 40% SACU tariff.

A controversial feature of policy is that the beef sector has been the state's monopoly over exports, implemented by the Botswana Meat Commission (BMC). The role of the BMC may have been important to the beef sector's export success in early years, but it has recently come under increased criticism in light of its continuing (and sometimes heavy) losses. Meanwhile, the BMC continues with monopoly control over beef exports and the export of live cattle into South Africa.

Before 1991, food self-sufficiency was a key objective of agricultural policy, despite the fact that only a small proportion of the country is suitable for crop production. This policy was replaced in 1991 with a food security policy, stressing the need for diversification within the rural sector and shifted the focus of attention from raising cereal production to raising rural incomes. Rather than promoting food self-sufficiency through trade controls, the government invested heavily in domestic crop production and Botswana has been unusual in the degree to which the government has invested in the agricultural sector – spending on agricultural support schemes has reached over 40% of agricultural GDP - close to the highest in the world.

With respect to trade policies, imports of fresh pork are banned and poultry imports are permitted only when there is a shortfall in the domestic market. In a normal year Botswana produces only about 30% of its annual cereal demand. Imports of maize, wheat, sorghum and related products, pulses, fresh milk, major fruits (e.g. oranges, watermelons) and vegetables (e.g. cabbages, rape, spinach, potatoes, and tomatoes) are restricted; through to early 2008 imports required a permit from the Ministry of Agriculture, but this has been abolished. This system is designed to protect an infant horticultural industry, which meets about 20% of requirements.

4. Lesotho

Lesotho, a small mountainous and land-locked country is not only resource-poor, but it also faces considerable problems associated with environmental degradation and soil erosion on its nine% (and shrinking) portion of the total land that is classified as arable. The only substantial natural resource is water. Agriculture is the dominant sector in Lesotho, as 80% of the population of around two million live in rural areas deriving their livelihood from agricultural crop and animal production. The sector is dominated by crop production, with maize as the main staple crop. Wheat, sorghum, beans and peas are also cultivated. Other higher-value crops include sunflower, asparagus, garlic, paprika, soya beans, potatoes, fruits and other vegetables. Livestock production (around 30% of agricultural value-added) includes cattle, goats, sheep, donkeys and horses under extensive range management systems, with wool and mohair the only significant agricultural export. Cattle exports have traditionally accounted for around one-third of agricultural exports, but to rural people livestock functions as a store of wealth and is used to perform cultural activities. While this sector plays an important role in rural income, the uncontrolled numbers have an adverse impact on rangeland and water resources, and the cattle herd in Lesotho is far from the international 'norms' for beef or milk production.

One cannot isolate agricultural policies in Lesotho from its food security, and a disturbing aspect of its agricultural performance is that in recent years Lesotho has been a regular recipient of food aid[1]. Furthermore, accentuating the problems, there

[1] Downloaded from World Food programme at http://www.wfp.org/interfais/2007/xls/Table15.xls.

are no open commercial land markets[2]; and because of the role of inheritance in land allocation, it is difficult to match land 'ownership' with investment opportunities because of security issues. Thus, Lesotho's communal land tenure system is generally seen as a major constraint to development and land tenure reform is a necessary condition to move towards a situation where food security no longer becomes a dominating aspect of Lesotho's political economy. Meanwhile, perhaps 60% of the population is considered to be below the poverty line, and that percentage has actually increased over the last decade as increasingly Basotho are 'living on the edge' – perilously close to chronic and irreversible food insecurity, poverty and depredation.

After independence (October 1966) agricultural policies were shaped by the need to obtain a greater degree of food self-sufficiency. By the late 1970s there was extensive state intervention in the production, marketing, processing and pricing of agricultural commodities in response to the very real fear that Lesotho may have to survive a situation whereby its only land borders with apartheid South Africa were closed. This inevitably led to distorted market signals, an inefficient allocation of resources and a weakened private sector. The general failure of these interventionist policies led to their revision in the late 1980s through to the mid-1990s. The specific commodities with remaining supporting policies (including import protection) that are being investigated are bread, fruit and vegetables, pulses, poultry meat and eggs, dairy products, wool and mohair, and, to a lesser extent, sugar packaging.

5. Namibia

Commercial farming is undertaken by some 4,500 farmers and focuses mainly on beef production for export to the EU under preferential arrangements and live cattle, sheep, and goats to South Africa, while some maize, wheat, and cotton is also produced. Communal farming supports 95% of the nation's farmers, and covers about half of total agricultural land. This sub-sector is home to 65% of the population, and in a normal year produces grain and supports around half of the beef and small

[2] There is currently a dual land tenure/administration system in Lesotho, whereby urban land administration is based upon a formal Dutch-Roman law while rural areas operate on a customary system. This creates problems at the urban/rural interface as urbanisation is spreading into the better land around the major towns. In addition, the rights of women and non-Basotho are in need of modernisation.

livestock populations. Overall, beef production accounts for about 80% of Namibian meat production and for 40% of total agricultural output and cereals provide about 50% of the total calorie intake. The country imports about half of its cereal requirements and imports of sugar and dairy products are important.

Namibia has recently introduced a set of measures in support of downstream processing of meat and of the local production of horticultural products and fruits. Export levies are imposed on the export of live slaughter cattle and unprocessed hides and skins, and recently a scheme was introduced to increase the local slaughtering of sheep. For fresh product imports of fruit, the National Horticulture Market Share Initiative imposes a levy on fresh produce imports and currently requires fresh produce importers to source 25% of their purchases locally. The government recognises that output price fixing, guaranteed prices and price controls create market distortions. Import restrictions on controlled crops of wheat and maize result in higher staple food prices than would be the case if the government allowed market forces to determine prices of domestically produced and imported food and agricultural products. But it also places a high priority on maintaining and increasing national food security, and it continues to use border controls to protect strategic food production industries such as UHT milk, poultry and horticultural products.

Imports are prohibited for white maize meal, yellow maize meal, wheat flour (a SACU agreement), honey and bees' eggs from overseas and African sources (except when imported through South Africa), fresh apricots, cherries, peaches, plums and sloes from overseas destinations, coloured, polished, steamed or additive-coated coffee beans, coffee substitutes containing less than three-quarters of its mass of coffee, and wines, other fermented, beverages, spirits and vinegar not conforming to the provisions in the Liquor Act (with larger volumes subject to taxation).

6. South Africa

In 2002, agriculture employed 9.7% of employment in the formal sector (451,000), plus a similar number (459,000) of casual and seasonal workers. Agricultural exports have declined as a percentage of total exports – from 35.21% in 1965-69 through to 8.18% on 2000-2005. About one-third of agricultural production is exported, and processed agricultural exports have overtaken unprocessed exports in recent years to the extent that around 65% of all agricultural exports are processed products. At the same time, South African agriculture is highly dualistic with a small number of commercial operations run predominantly by white farmers and large numbers of subsistence farms run by black farmers. In 2002, fewer than 2500 farmers (6.6% of the total) earned more than 50% of the total gross farming income of the sector.

By the late 1970s, the racial segregation of South African agriculture was complete, subsidisation of commercial farming peaked and the productive base of the farming sector in the homelands ceased to provide any meaningful income opportunities to all but a handful of farmers. In the period around 1980, however, farm policy started to change. After 1994, South Africa adopted a policy of openness and limited intervention in markets. The policy objective was to promote trade and therefore competition that would result in efficient allocation and use of resources as well as increased economic activities. This led to the deregulation of both agricultural and trade policies as supports were reduced, markets deregulated, border tariffs reduced and export subsidies eliminated. These changes were dramatic and South Africa now has a very lightly protected (but still very dualistic) agricultural sector.

With the implementation of a programme that started in 1994 land reform has become an issue. These reforms were to consist of land restitution, redistribution and tenure reform programmes. To date, however, the net effect has been limited, as after almost 14 years of state sponsored land reform less than four million hectares of agricultural has been transferred through the formal programme. While applauding the concepts of the reforms, we caution that there is a danger of locking small farmers in the realities of an open market system and that efforts to provide more support to these farmers may compromise SACU's agricultural policy harmonisation. The Comprehensive Agricultural Support Programme (CASP)[3] is designed to provide agricultural support to targeted beneficiaries of the land reform and agrarian reform programme within six priority areas, yet questions regarding its efficacy remain, largely because the small farmers who need the most support (i.e. those in the former homelands) have been designed out of the programme.

An area where regional agricultural cooperation is working well is the general regulatory aspects of the management and reduction of risks such as those that are

[3] See NDA 2004).

related to animal disease, food safety standards and developing of agricultural risk and disaster management strategies. Here the South African Department of Agriculture generally plays a lead role and the BLNS countries operate beneath this umbrella.

7. Swaziland

Swaziland has all the characteristics of a dual economy and is a small land-locked country with high levels of poverty and income inequality (Sandrey and Vink 2007). Agriculture is the backbone of the economy, but yet again the sector is acutely dualistic. A dynamic commercial sub-sector occupies 26% of the land, holds an estimated 90% of available irrigation infrastructure, and uses modern technologies to produce mainly cash crops (sugar). A traditional sub-sector involves semi-subsistence smallholder agriculture with communal grazing and low-productivity subsistence agriculture and animal husbandry.

Sugar and sugar-related products are the major export, and these are heavily dependent upon preferential access into the European Union (EU). Around 60% of agricultural production is focused on the sugar sector and it contributes some 11% of the GDP. Swaziland has not been self-sufficient in cereal production since 1980, and by the early 2000s the food production had further declined to only 40% of the nation's needs. Many people are vulnerable and food-insecure in the country, with the main contributing factors the high poverty rate, inequality of income distribution, the high incidence of HIV/AIDS, chronic drought, widespread soil erosion and land degradation, lack of agricultural land, isolation from markets, limited alternative income generating opportunities, gender restrictions for women to access land and resources, and lack of implementation of appropriate policies. Achieving a productive and competitive agriculture sector will require addressing this complex set of constraints. Meanwhile, there is an issue of opportunity cost when, on the one hand, economic rents from preferential access to the protected EU sugar market are reducing and, on the other hand, there is a major food security concern in the country, it might be appropriate for Swaziland to reconsider devoting its prime land and irrigation resources to the production of sugar.

In pursuit of achieving its mission and vision of seeing every household in the country attain food security, the Ministry of Agriculture and Cooperatives has developed various policies as well as an institutional framework for the implementation of these policies. The Comprehensive Agriculture Sector Policy focuses on the contribution of the agriculture sector to the realisation of the country's aspiration of Vision 2022 and to the achievement of national development goals. Specific objectives to be pursued by CASP are to increase agricultural output and productivity, to increase the earnings for those engaged in agriculture by promoting adoption of diversification and sustainable intensification and use of appropriate technology, to enhance food security, to ensure sustainable use and management of land and water resources and to stabilise agricultural markets. The National Cooperative Development Policy promotes the provision of an environment for the development of a viable cooperative movement, while the guiding vision of the National Rural Resettlement Policy (NRRP), adopted in 2003, is to establish a durable, practical and participatory framework for the planning and sustainable management of land and the appropriate application of resettlement strategies in rural Swaziland.

8. Trade policies

The relevance of SACU in South Africa's trade policy cannot be ignored, but, conversely, given South Africa's regional dominance in virtually all facets of the trading relationships, the role of South Africa in SACU's trade policy similarly cannot be ignored. Thus we have examined trade policy in a separate section rather than as part of South Africa's policy as the new SACU Agreement represents an important element in the reshaping of the southern African region. Prior to this, the external trade relations of SACU were driven by bilateral and regional alliances of individual members despite being a customs union for well-nigh a century.

Of importance in trade policy is the issue of SACU tariff pool revenues for the BLNS countries as Free Trade Agreements (FTAs) and tariff concessions are either negotiated or kick in from earlier agreements. Currently these revenues contain a large transfer element from South Africa to the BLNS, and they constitute over half of the total government revenues for Swaziland and Lesotho in particular. As tariff concessions reduce the tariff revenue pool, this erosion of revenue poses a special problem for these countries (Sandrey 2007).

In discussing the trade policy regime for SACU/South African agriculture, it is useful to place these policies into a framework of the 'four pillars':

- Unilateral policies (what South Africa in particular does to its own policies);
- Bilateral policies (in particular the Trade, Development and Cooperation Agreement (TDCA));
- Regional (the SACU and SADC dimension and the way ahead); and
- Multilateral (the World Trade Organisation (WTO)).

Unilateral policies

After 1994, South Africa adopted a policy of openness and limited intervention in markets. The policy objective was to promote trade and therefore competition that would result in efficient allocation and use of resources as well as increased economic activities. This led to the deregulation of trade policies as border tariffs reduced and export subsidies were eliminated. South Africa now has a very lightly protected agricultural sector. This is the policy that informs South Africa's offensive approach in all the trade negotiations with third parties and within the multilateral institutions. This policy approach provides opportunities for cooperation areas where the BLNS do not have production capacity and rely on imports; but divergences will occur where the BLNS wants protection for some of their industries that South Africa might not need to protect.

Bilateral policies

The Trade, Development and Cooperation Agreement for merchandise trade between South Africa and the EU entered into force on 1 January 2000 with a transition period of twelve years for South Africa and ten years for the EU, on a time path that will eventually lead to trade becoming almost duty-free. Exceptions are concentrated in agricultural imports into the EU (and motor vehicles imports into South Africa), and by year nine any significant duties into the EU from South Africa will almost exclusively remain on agricultural products and fish. Demonstrating the blur between bilateral and regional policies, the agreement did not technically cover imports from the European Union into BLNS, although it does *de facto* apply to their imports from the EU.

Regional policies

The SACU member states, together with Mozambique and Angola, are negotiating with the EC towards an Economic Partnership Agreement (EPA). The negotiations have raised some difficulties on issues that complicate SACU's unity. The issues include mainly text provisions, such as the proposed Most Favoured Nation clause, free circulation of goods, duties, taxes and other charges on exports[4], customs duties and the infant industry protection clause. Although these are advanced negotiating issues at present, the outcomes could potentially impact on SACU's policy environment. Meanwhile, the EC has offered duty-free, quota-free market access for all products originating in Botswana, Lesotho, Namibia and Swaziland (except sugar and rice which will be phased over a transitional period), but not to South Africa. As part of SACU, South Africa submitted its offer as part of the SACU offers to the EC to ensure that it did not undermine the integrity of the customs union. It is difficult to see how, in practice, the BLNS can do anything other than acquiesce to the TDCA on imports. Note also that the interim EPA removes the BLNS infant industries policy tool, which undermines any effort to include this principle in a common SACU industrial policy.

SADC is currently ostensibly working towards an FTA by 2008, but, to date, any sign of meeting that deadline is rather one-sided. At this stage only SACU has made a definite policy change or even really shown any inclination towards the FTA deadline. In other regional agreements, negotiations have been concluded between SACU and Mercosur[5] and SACU-EFTA (Iceland, Liechtenstein, Norway and Switzerland), while they are ongoing between SACU and India under the initial stewardship of Namibia.

Multilateral policies

More than three-quarters of WTO members are developing or least-developed countries (LDCs), with many of the latter situated in Africa. Members have recognised that liberalisation in these developing countries' own markets needs to be more gradual than for developed countries, but this is tempered where least developed countries are an integral part of a common external tariff (CET) arrangement. Such is the case within SACU, with Botswana, Namibia and Swaziland,

[4] Namibia uses export taxes to address the challenges facing their economy.
[5] Mercado Comun del Sur (Argentina, Brazil, Uruguay and Paraguay).

along with South Africa itself, developing countries, while Lesotho is a least developed country. Currently South Africa has been mandated to coordinate the SACU team at the WTO, but there appears to be some (perhaps minor) differences in policy stances in areas such as the food security, food aid and state trading nexus, definitions and conceptualisation of special products[6] and in the Lesotho request that bottled water be bound at 200% rather than the current RSA zero. These differences generally have a genesis in the different WTO groupings that SACU members belong to in Geneva such as the G-20 for South Africa and the LDC group for Lesotho, along with the interesting policy position that the BLNS, with generally preferential access to many markets, always have an eye on preference erosion as a threat.

9. Agricultural policies lessons from other agreements

In searching for a precedent on how to create fully operational customs unions we are left with SACU and the EU as examples. Problems in SACU's agricultural trade policies were highlighted in the negotiations between the African Caribbean and Pacific (ACP) countries and the EU during the EPA negotiations where there has been a conspicuous lack of a coordinated focus from the SACU side. Can the EU provide some pointers, and therefore how did the EU evolve from the original six members to 27 and counting? The EU example clearly demonstrates that the integration process will not succeed without a) the political will to integrate; and b) the financial means to contribute to the establishment of regional institutions or to implement regional policies. The lessons for SACU are that the EU is regulated by a system of primary legislation, secondary legislation and case law. Primary legislation consists of the various treaties, while secondary legislation consists of regulations, directives, decisions and recommendations. Treaties and regulations are binding upon the member states of the EU and need not be incorporated into the national law of each state through the process of ratification, as is the norm regarding international agreements. Directives are binding only to the extent of dictating what has to be achieved or done and by when, although it is up to the individual state to decide on how the goal is to be achieved.

[6] It can be anticipated that both dairy and sugar will become 'special' products, along with perhaps some of the TDCA/EPA products above. Swaziland is concerned that the nexus between special products and special safeguard measures (SSM) may be ignored by South Africa, as may the whole issue of preference erosion compensation for preference receiving countries.

11. Areas of concern for suggesting regional integration

Namibia (and to a lesser extent Botswana in the case of beef) has been somewhat innovative in a range of policy measures taken to protect the beef, sheep, horticulture, wheat flower and other industries. While there are certainly arguments for and against the 'legality' of such policies within the Customs Union Agreement, these carry the potential risk of eventually splitting SACU via its influence on e.g. the EPA negotiations, and by extension the potential WTO position of SACU. It can also be argued that these moves are not within the spirit of the agreement, even if they are within the law. They are, at least potentially, symptoms of divergence rather than convergence.

The South African Competition Commission has recently investigated a number of cases of alleged breaches of the Competition Act in the agricultural sector. These include the fixing of bread prices (for which penalties have been imposed), participation in a cartel in the grain milling industry, and alleged abuse of market power in the grain storage and dairy industries. This has obvious impacts on the South African market for consumer products that originate from these industries. It is, however, unclear to what extent these actions will impact on the SACU market, and is an issue that requires further investigation.

Agriculture in the SACU region is characterised by the dualism between commercial crop and livestock farmers and crop and livestock farmers on communal lands. In South Africa and Namibia, at least, this divide formed the basis of grand apartheid policies.– therefore there was also an ethnic divide. In practice, this ethnic divide is also found in other member countries, despite the land reform policies and programmes that have been implemented. This issue, which has been made more explosive because of the way in which it has been dealt with in neighbouring Zimbabwe, cannot be left untended. We caution that BEE policies in South Africa may be locking in protection to the sugar industry, and may be used as an argument for protection in other industries in South Africa.

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Chapter 9

Sugar in South Africa and Swaziland

Ron Sandrey and Nick Vink

Abstract

The SACU Agreement calls for members to recognise the importance of the agricultural sector to their economies and to cooperate on agricultural policies. Analysis of this sector finds that cooperation is indeed taking place with one notable exception: sugar – a crop important to both Swaziland and South Africa. While South Africa's agricultural pricing and trading structure have been liberalised in the past few years, sugar has not had to adjust to the same extent as other sectors. An outline is provided of how this anomaly remains an outlier in SACU's agricultural policies. However, it is acknowledged that computer modelling shows the regime to be beneficial to SACU.

1. Introduction

Sugar is a key issue in agricultural trade between South Africa/SACU and Brazil, and any assessment of the implications of a freer trading regime between these two parties must reflect this. South Africa is the world's 13th most important producer of cane sugar and sugar is an important export. Similarly, but even more so, sugar dominates Swaziland's agricultural production by value and is currently a crucial export to the EU under preferences which bestow considerable economic rents upon Swaziland given the distorted nature of the EU sugar sector. However, these rents to Swaziland are decreasing and will decrease further as the EU reforms its sugar policies to bring the internal price down to around double the general world price. Partial compensation for falling rents may be forthcoming if the EU provides Swaziland and other non-South African African countries with quota- and duty-free access for sugar under the terms of the Economic Partnership Agreements (EPAs).

Meanwhile, Brazil, the world's top producer and exporter, could potentially be competing on a more level playing field with both South Africa and Swaziland in the SACU market. Importantly, the Brazilian sugar sector operates in a virtually unsubsidised environment. In South Africa, by contrast, the sugar sector remains the only agricultural sector that has not undergone substantial policy reform and continues to operate under a protectionist cloak. Much of this protection exists despite the SACU Agreement, which has as its underlying philosophy the free movement of domestic products whereby goods grown, produced or manufactured in the Common Customs Area are meant to be free of customs duties and quantitative restrictions within the Union (Article 18).

The objective of this paper is to examine the sugar sectors in the SACU countries more closely and to seek some clarity on what unfettered access for Brazilian imports may mean for the South African and Swazi sugar sectors. Associated with this is the issue of the integration and coordination of agricultural policies within SACU, and what reform of the sugar trading arrangement within SACU may mean for regional integration.

2. The production background

South Africa was behind the Philippines but ahead of Argentina as the 13th largest sugar cane producer globally in 2007, while Swaziland was ranked at number 27. Egypt is the only other African country ranked in the top twenty (16th place) in a list headed by Brazil, India and China. Africa's share of global sugar production is around 5.7%; this share is similar for exports but higher for imports, making the continent a net importer of sugar.

Table 4 shows that sugar cane production in the SADC region as a whole has increased by some 30% since the early 1970s. South Africa is the largest cane producer in the region, with a production pattern that dominates regional production. However, South African production increased by 26% over the period, while production in Swaziland increased by 217%. As a result, South Africa's share of regional production has declined from 90% to 85% of SACU output. The increase in both South Africa and Swaziland is largely due to increased acreage under the crop, because average yields have been declining in South Africa and have been stagnant in Swaziland. The most recent data from the Food and Agricultural Organisation (FAO) reports that South African production in 2007 was 20,300,000 tons while production in Swaziland was around 5,000,000 tons. Thus, production in South Africa fell slightly from the 2000–2005 average while that in Swaziland increased marginally.

Table 4: Sugarcane production in eastern and southern Africa (average annual tons)

	1970s	1980s	1990s	2000–2005
South Africa	17 043 561	18 518 672	18 201 730	21 470 657
Swaziland	1 834 834	3 548 664	3 828 993	3 980 767
Total SACU	18 878 395	22 067 336	22 030 723	25 451 424
Total SADC	34 686 406	39 048 440	39 275 491	44 949 710
South Africa as a % of SACU	90.28	83.92	82.62	84.36

Source: FAOSTAT database

2.1 The South African sugar sector

By value of production, sugar cane ranks as South Africa's fifth largest agricultural commodity, following cattle meat, chicken meat, grapes and milk, but ahead of maize, eggs and wheat. The industry operates in the deep rural areas of some of the poorest provinces in South Africa – KwaZulu-Natal, Mpumalanga and the Eastern Cape. Direct employment totalled approximately 77 000 jobs, or about 8% of South Africa's agricultural workforce in 2001. Average sugar production is around 2.5 million tons, which generates exports earnings of around R2 billion annually from sugar itself plus the supporting contribution to export industries such as canned fruit. McDonald et al. (2004) reported that the sector has around 50,000 farmers, of whom 48,000 are small-scale growers based in deep rural areas and farming on tribally owned land producing only some 14% of the crop in 2003. Despite concerted attempts to facilitate the transfer of resources to previously disadvantaged farmers, the situation does not appear to have changed much since then. As of 2009 the South African Sugar Association reports that the number of registered sugar cane growers has reduced to some 38,200, with around 1,600 large scale farmers and the rest small farmers on mostly tribal lands. Some 370 of the larger farmers are black emerging farmers. The large farmers and the mill-owned lands produce between 88 and 90% of the cane, with the remaining 10 to 12% produced by the small-scale farmers (SASA 2009).

In South Africa, the entire agricultural sector that had been subjected to some form of market intervention was reformed in the 1990s through trade liberalisation under the Uruguay Round Agreement on Agriculture and then through domestic market deregulation under the Marketing of Agricultural Products Act, 1996 and other similar processes – with the exception of the sugar industry. Perhaps it is significant that sugar is the only agricultural sector that has remained under the wing of the Department of Trade and Industry (DTI) and not the Department of Agriculture. Whatever the reason, the arguments employed by the sugar sector, namely that it faces a distorted international trading environment, and that the sector contributes to the general economy through its employment and income multipliers, hold equally true for many of the sectors that have been fully exposed to international competition in South Africa. Conversely, the OECD (2005) considers that in South Africa

> sugar, maize, and eggs are the most supported commodities. A high support level for sugar is particularly notable given that this commodity is one of South Africa's key exports (around one half of sugar production is exported). The situation is explained by the double-pricing system, whereby South African sugar producers are effectively compensated for export losses by higher prices for domestic sales compared to that destined for exports.

This high level of support to the sugar sector is reinforced by Kirsten et al. (2009) who assess the protection levels to South African agricultural sectors using the nominal rate of assistance (NRA) measure. They find that sugar and sugar products have had NRA values of around 40% or higher since 1980 and by 2000–2005 the NRA was still at 44.4. This level was significantly above the weighted average of 3.6 for the products that they analysed, and considerably higher than the 19.7 for yellow maize, the next highest support level. This sugar support was caused by the tariff levels of the period and by the pricing parity mechanism that enabled import parity pricing despite sugar being an export product. This is the dollar-based reference price administered by the DTI upon which the protection is based. This mechanism operates when world prices drop below what is purported to be the world long-term price plus an adjustment upwards of $60/tonne for 'distortions to the global market'. It was implemented by the former Board on Tariffs and Trade in September 2000 after a comprehensive tariff review. Given the higher sugar price, the tariff is currently zero.

2.2 Swaziland's agriculture

Swaziland is a small landlocked country with an area of 17,364 square kilometres, of which 15-20% is estimated to be arable. The total population is about 1.1 million and the current population growth rate close to zero, with more than 70% of the population living in rural areas and a similar percentage living below the poverty line. The agricultural sector of Swaziland is acutely dualistic, with a dynamic commercial sub-sector established on Title Deed Land (TDL) that occupies 26% of the land, holds an estimated 90% of available irrigation infrastructure, and uses modern technologies to produce mainly cash crops (primarily sugar) and a traditional subsistence sector, based on communal tenure in the Swazi Nation Land (SNL) that involves smallholder agriculture with communal grazing.

Swaziland has not been self-sufficient in cereal production since 1980: in the 1990s it produced only 60% of domestic food requirements for its staple food (maize), and in the early 2000s food production further declined to only 40%. Currently, 12% of the population is malnourished, and nearly one-third needs food aid to survive. Persistent shortages in satisfying domestic food requirements have caused a significant proportion of the population to suffer from malnutrition, which has the greatest impact on children. It is estimated that up to 348,000 people are vulnerable and food-insecure in the country, with the main contributing factors the high poverty rate, inequality of income distribution and the high incidence of HIV/AIDS[1]. Other factors specific to rural areas include chronic drought and consequent water shortages resulting in death of animals and crop failures, widespread soil erosion and land degradation, lack of agricultural land and isolation from markets, limited income generating opportunities, gender restrictions for women to access land and resources, and lack of implementation of appropriate policies. The current rate of HIV prevalence also has enormous implications for the development of the agricultural sector and its capacity to contribute to economic growth.

A major challenge for attaining food security and reducing poverty in Swaziland is to create an enabling environment for increasing rural and agricultural productivity and competitiveness. However, achieving a productive and competitive agriculture sector

[1] On the impacts of HIV/AIDS in rural Swaziland Masuku and Sithole interviewed 847 households and found that 'Most households were vulnerable to food insecurity'.

will require addressing a complex set of constraints. For example, there is no doubt that the HIV/AIDS pandemic is seriously increasing poverty and hunger and reducing the capacity for accelerating economic growth. Moreover, the land is being denuded of its topsoil as a result of poor land management, overgrazing and soil erosion. This has exposed the country to serious ecological and environmental degradation. Increasing agricultural productivity depends, among other factors, on reliable access to water. Water shortage, however, is still an impediment to intensifying and diversifying agriculture and bringing new land into production, particularly on SNL. Irrigation's potential is constrained by international obligations[2] and high demand on financial, water and human resources. Smallholder agriculture, which is the predominant source of livelihood for most of the population, is characterised by limited access to mechanisation and technology. A similar situation exists in the livestock subsector: the large number of livestock of substandard quality, together with land mismanagement, has had a deleterious effect on grazing land.

For Swaziland a fundamental question remains to be considered. This questions are: Is the EU indirectly contributing to the abject rural poverty and malnutrition in Swaziland by ensuring that the Kingdom is using a very high percentage of its limited quality agricultural land for sugar production? Does the use of most of the best land in the Kingdom for sugar production in a highly distorted global regime represent the ideal outcome for Swaziland under conditions where a large percentage of the population live in poverty in the subsistence sector on very poor land? The opportunity cost to Swaziland of concentrating much of the available resources for agriculture in sugar production must be considerable.

2.3 The Swazi sugar industry[3]

Sugar production increased from an annual average of 214,305 tons per annum in the 1970s to 405,343 tons in the 1980s, to 480,154 tons in the 1990s and 587,621tons since 2000. The average for the years 2006/07 and 2007/08 is 627,297 tons, and is expected to grow to 767,000 by 2012 through normal annual expansion as well as on account of the two new irrigation schemes that are being developed. Sugar cane growing contributes 66% to total agricultural output, 35% to total

[2] Swaziland is downstream of South Africa but upstream of Mozambique.
[3] This section is based on information provided to tralac by the Swaziland sugar industry.

agricultural employment and 25% to total manufacturing output. About 20% of cane production is through smallholder production, and is poised to increase under the new irrigation projects. The industry as a whole (i.e., sugar cane growing and milling) contributes 12% to national output and 10% to national formal employment. Gross proceeds from sugar sales are approximately €2 billion per annum. Since 2000, an annual average of 51% of total sales has been going to SACU, 25% to the EU, 3% to the US and 21% to the world market (mainly the east African region). Sugar sales outside SACU contribute seven% to the country's foreign exchange earnings.

At the domestic level the sugar industry is closely linked to many other sectors in the Swazi economy, from both the input or upstream side (e.g., chemicals, transportation, packaging, banking, etc.) and output or downstream side (pre-packers, sweets, chocolates, jams, confectionary, etc.). Accordingly, it plays a crucial strategic and multifunctional role in promoting economic growth and development in the overall Swazi economy. In 2006, the government approved a National Adaptation Strategy (NAS) to assist the sugar industry in adapting in the wake of the reform of the EU sugar sector and thereby to enhance its sustainability.

3. Sugar and the SACU Agreement

The underlying philosophy of the SACU agreement is that of **free movement of domestic products.** Goods grown, produced or manufactured in the Common Customs Area are meant to be free of customs duties and quantitative restrictions (Article 18). Also, with respect to agricultural policies, the Agreement in Article 39 (Agricultural Policy) states:

1. Member states recognise the importance of the agricultural sector to their economies; and
2. Member states agree to cooperate on agricultural policies in order to ensure the coordinated development of the agricultural sector within the Common Customs Area.

Before 1999 the DTI was the only responsible authority regulating the sugar industry in terms of the Sugar Act. Amendments to Section 31 of the Competition Act in 1999 now allow for concurrent jurisdiction by the Competition Commission, as well as '*other regulatory authorities*' on an industry or sector in terms of Chapter 2 ('Prohibited Practices') and Chapter 3 ('Merger Control') of the Competition Act. This led to an inter-departmental committee consisting of representatives from the Competition Commission, the Department of Agriculture as well as the Agricultural Marketing Council. The act is currently under review with the aim of optimising the level of competition that can be generated within the policy restrictions imposed on it by a severely distorted global market for sugar. This will foster a competitive environment that will contribute to the optimal development of the industry within the accepted framework of the Strategy for the Sugar Sector in the SACU and SADC contexts.

The SACU sugar industry is protected against import competition through a dollar-based reference price (DBRP) tariff system that grants import protection against low world prices. In assessing agricultural policy harmonisation in SACU the following points are relevant for (a) where there is policy harmonisation and coordination:

- Common External Tariff
- SACU market access granted to non-SACU SADC sugar producers[4]
- Single export channel for raw sugar exports
- Coordinated inputs on trade negotiations with third countries
- Equitable exposure for millers and growers to the world market and to the SACU market[5]
- Preferential access to the US market. In the case of South Africa the benefits derived goes to small-scale growers (which would seem to be a subsidy to these growers).

And (b) areas where there is no harmonisation:

- Preferential access only for Swaziland to the EU under the EPA and to the Common Market for Eastern and Southern Africa (COMESA)

[4] Due to fact that Swaziland still administers import control, none of the sugar imported in terms of the agreement goes to Swaziland.
[5] Based on reforms introduced in terms of Industry Agreement 2000, milling companies compete for market share

- Restructuring funds received by Swaziland from the EU[6]
- Swaziland applies import and export controls by way of a permit system
- The Swaziland Sugar Association has monopoly marketing of both raw and refined sugar (other than in small packs)
- Swaziland's sugar marketing arrangements are not subject to competition laws
- Swaziland maintains price controls for sugar
- Swaziland has non-reciprocal access into SACU's sugar market
- South Africa actively applies a Black Economic Empowerment (BEE) policy and legal framework in its sugar sector.

The South African industry argues that the lack of harmonisation in the sugar policies between South Africa and Swaziland discriminates against South African sugar millers and cane growers and impacts negatively on BEE initiatives that need to ensure sustainable land reform. It is an interesting policy development whereby land reform may well become a factor in locking in protection to just one agricultural sector in South Africa. According to the Swazi sugar industry the main obstacles to policy harmonisation are the ordering of competition between the two industries in the SACU market (where market-sharing arrangements were abandoned because of the South African Competition Act) and delays in effecting desired changes due to the need to consult with respective government authorities, as the process is long and complicated. It would seem evident therefore that policy harmonisation in the sugar industry should be given priority under the terms of the SACU Agreement, and we note that the main disadvantage of the sugar regime in SACU is that it imposes a cost on consumers in the region. This is especially unfair to Botswana, Lesotho and Namibia, where consumers get limited benefits from the regime, but carry a part of the costs.

[6] This constitutes a special payment to a specific sector in Swaziland regardless of the source of these funds.

4. SADC

SADC's own special provision in the SADC Sugar Arrangement (Annex VII to the SADC Protocol on Trade), states that the end goal is full reciprocal liberalisation of SADC sugar trade after 2012. But Article 3 contains the proviso that 'liberalisation will be dependent on a positive review of conditions prevailing in the world sugar market'. Furthermore, liberalisation by any date after 2012 depends upon 'sufficient normalisation of the international sugar market'. The justification for this protection is given in the agreement as

> the world sugar market is highly distorted and conscious of the fact that the world price for sugar is a dumped or subsidised price resulting in the continuing need for most sugar producing countries to impose tariff and non-tariff barriers against the free importation of sugar in order to protect their domestic industries; Recognising, therefore, that for as long as the world sugar market remains highly distorted, sugar will be a product requiring special dispensation within the framework of the Protocol on Trade so that no sugar industry within SADC will suffer injury.

Thus, full liberalisation in SADC is contingent upon a sufficient normalisation of the international sugar market, with this determined by a 'positive review' by SADC with 'sufficient normalisation' not defined. The implication is that the continuation of the current SADC sugar regime is likely to remain.

There is no doubt that the sugar sector is heavily protected in the rich countries, that this protection distorted the global trading regime, and that these distortions place a burden on the sugar industry in developing and least developed countries. According to the Organisation for Economic and Cooperation Development (OECD) data the average Nominal Assistance Coefficient (NAC) is 1.96 for sugar. This means that rich country producers are receiving nearly double the world market price for their sugar. This is not the highest – rice has a NAC of 3.96. This means that OECD rice producers are getting four times the world price for their rice. Other products are not that far behind sugar: sheepmeat at 1.74, beef at 1.54, milk at 1.41 and wheat at 1.50. These products have all been substantially liberalised in South Africa, the country that dominates SACU agricultural production. So why not sugar?

Meanwhile, lobbyists for the SACU sugar sector are arguing for sugar to be excluded from the preferential trade agreement with Brazil/Mercosur due to the vast size and competitiveness of the Brazilian sugar industry. They argue that the Brazilian sector is supported and enhanced through government regulatory support for ethanol production from sugar cane, including mandatory blending for ethanol. However, the OECD (2005) debunks the myth that Brazilian sugar is protected, and, using the standard analysis that takes all support contributions into account, comes up with support levels of just under 2%[7]. Importantly, it does not consider that ethanol production constitutes a subsidy to the sugar sector. Similarly, according to OECD, data producers in Australia receive no more than token Producer Support Estimate (PSE) supports for their sugar. In addition, there is a single desk exporting arrangement for South African sugar, and these single desk arrangements are extremely controversial in the WTO as many argue that they constitute distortions to a market.

In summary, the notable exception in the effects of trade reform on field crop production in South Africa is the sugar industry, which still enjoys high levels of protection, partly because of the large investment required in the processing of sugar, partly because the industry argues that the world market in sugar is even more heavily distorted by the protectionism of the OECD countries than other agricultural products, partly because of the large number of small-scale sugar producers, and partly because of the greater lobbying power of the industry. Sugar producers even enjoy protection from producers in other SACU and SADC countries. While the domestic pricing structure has been liberalised to some extent in the past eight years, the sector has not had to adjust to the same extent as maize and wheat.

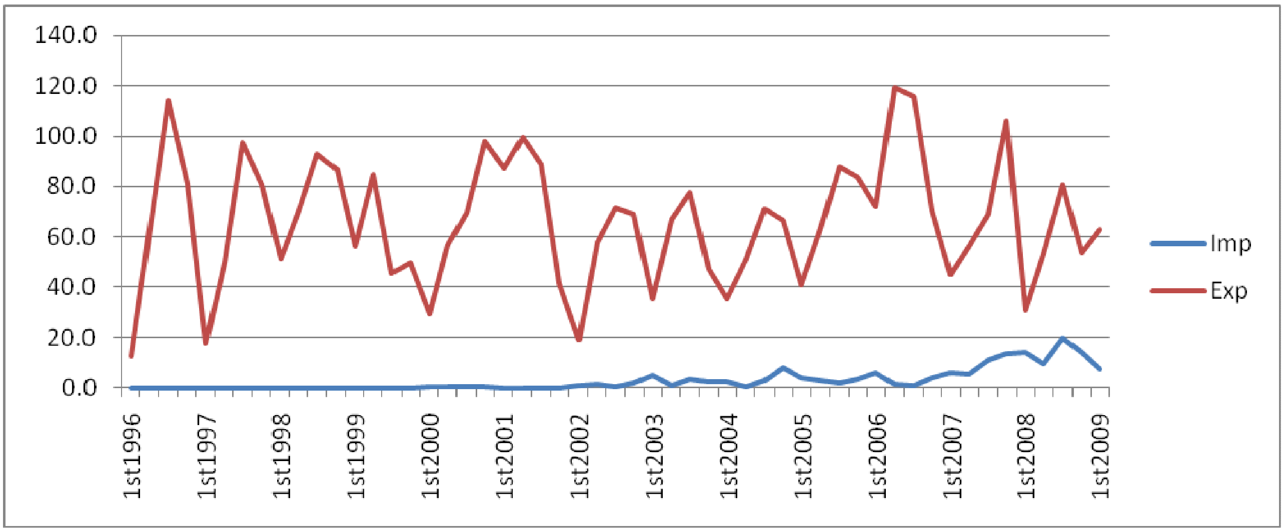
5. South African sugar trade

While South Africa is a major exporter of sugar (as shown in Figure 1), imports of sugar as are currently arriving from Brazil. Over recent periods the quarterly **exports** peaked at $119 million in the second quarter of 2006. South African imports of sugar from outside of SACU only really started in the first quarter of 2002, and through until

[7] This OECD measure is the Producer Support Estimate, and is the benchmark measure for international support. It is an indicator of the annual gross transfers from consumers and taxpayers to support agricultural producers, measured at farm gate level, arising from policy measures which support agriculture (regardless of its nature), objectives or impacts on farm production or income.

the first quarter of 2005 these imports were dominated by the SADC sources of Zimbabwe, Malawi and Zambia, with a contribution from both India and the EU. Since 2004 Brazil has displaced SADC as the main import source (Figure 3). Recent **imports** peaked during the third quarter of 2008 at just on $20 million. In addition, imports of 'other sugars', molasses and sugar confectionary have been at this $20 million level per quarter over the last few years. This level of sugar imports should serve as a 'wake-up' call to South Africa.

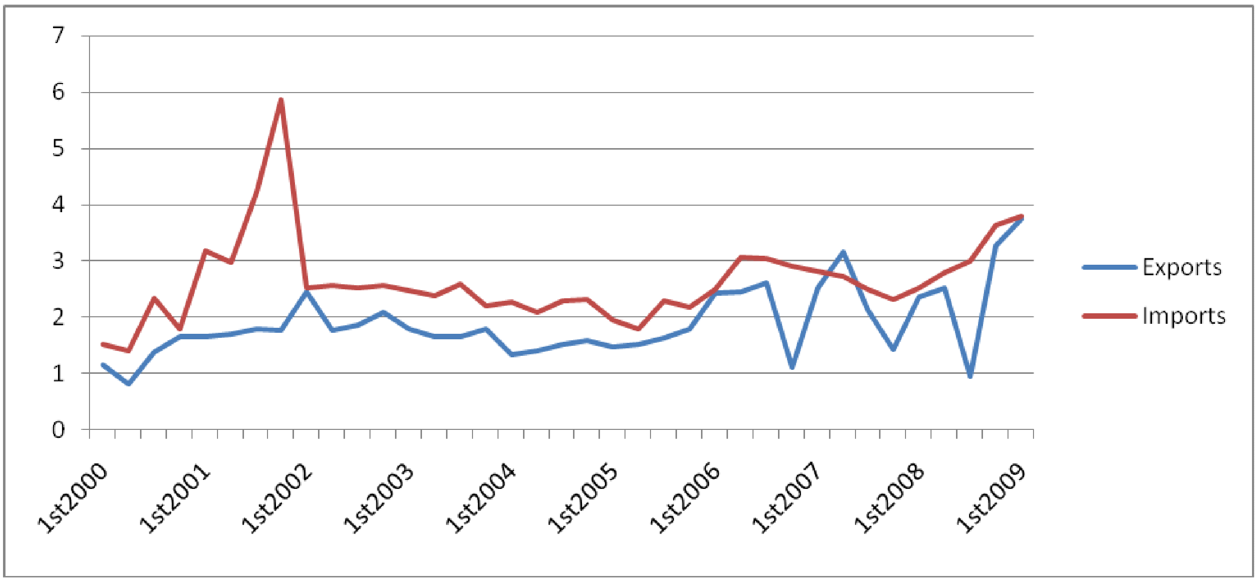
Figure 1: South Africa (non-SACU) sugar trade; 1996 to 2009, US$ million



Source: World Trade Atlas

Another interesting feature of the sugar imports is the relative price between South African exports and imports of raw sugar. Figure 2 shows the average price per kg of the South African sugar trade since the first quarter of 2000 when the imports in general started to feature. Here the import price expressed in rand per kg is generally above the export price (we suggest that the peak at fourth quarter 2001 is an outlier as there were limited imports during that quarter). Note also that South African import data does not include freight and insurance costs, which if added would raise these average import values even higher relative to export values.

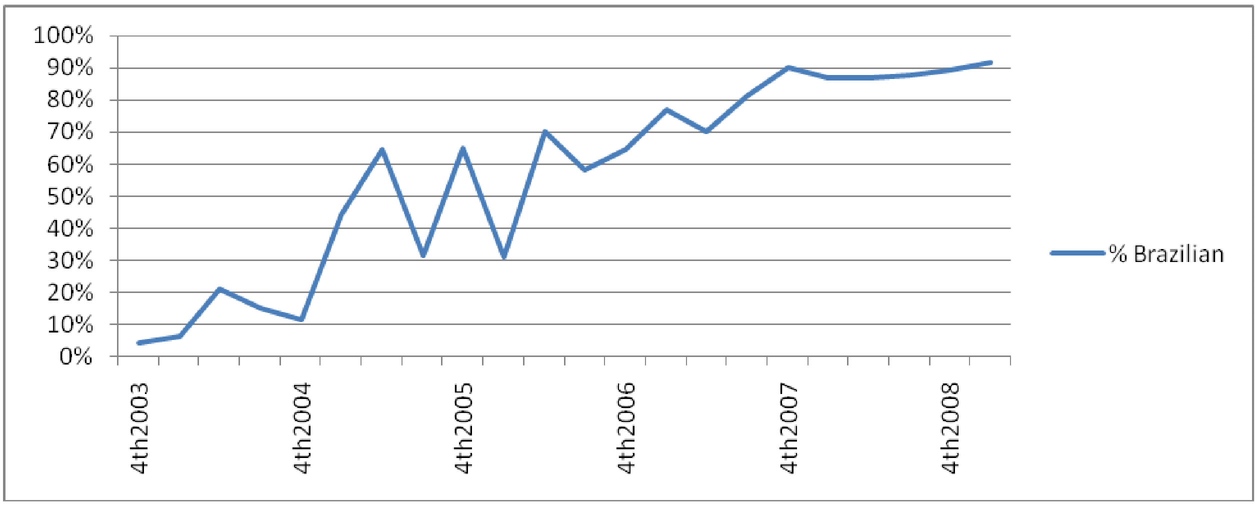
Figure 2: South African sugar trade price, rand per kg



Source: World Trade Atlas data

The imports from Brazil started in the fourth quarter of 2003, and by the fourth quarter of 2007 they had a market share of over 80% of imports – with a high of 92% in the first quarter of 2009 and 87% for the second quarter of 2009. This is shown in Figure 3 through to the first quarter of 2009.

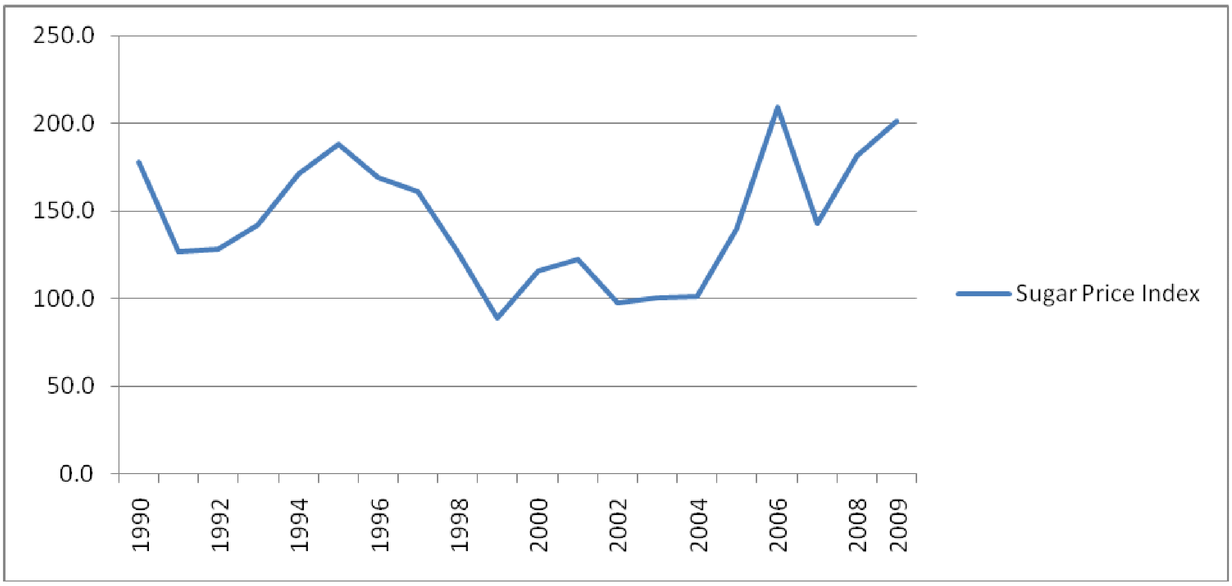
Figure 3: Brazilian market share of South African sugar imports



Source: World Trade Atlas data

In updating the trade data for the June 2009 quarter we find that sugar exports over this quarter were $75.37 million and imports $11.28 million (with $9.82 million of the imports from Brazil and effectively nothing from SADC countries). The price difference continues, with the average export price of $0.35 per kg below the import price of $0.40 per kg. Currently the world sugar price is strong, with the price index at the highest point over the last twenty years as shown in Figure 4. As of September 2009 the indications were that these high prices would continue, as both Brazil and India are experiencing difficult climatic conditions. Analysts are suggesting that global demand may be greater than projected output (thus draining inventories).

Figure 4: Global sugar price index, 2002–2004 = 100.



Source: FAO database

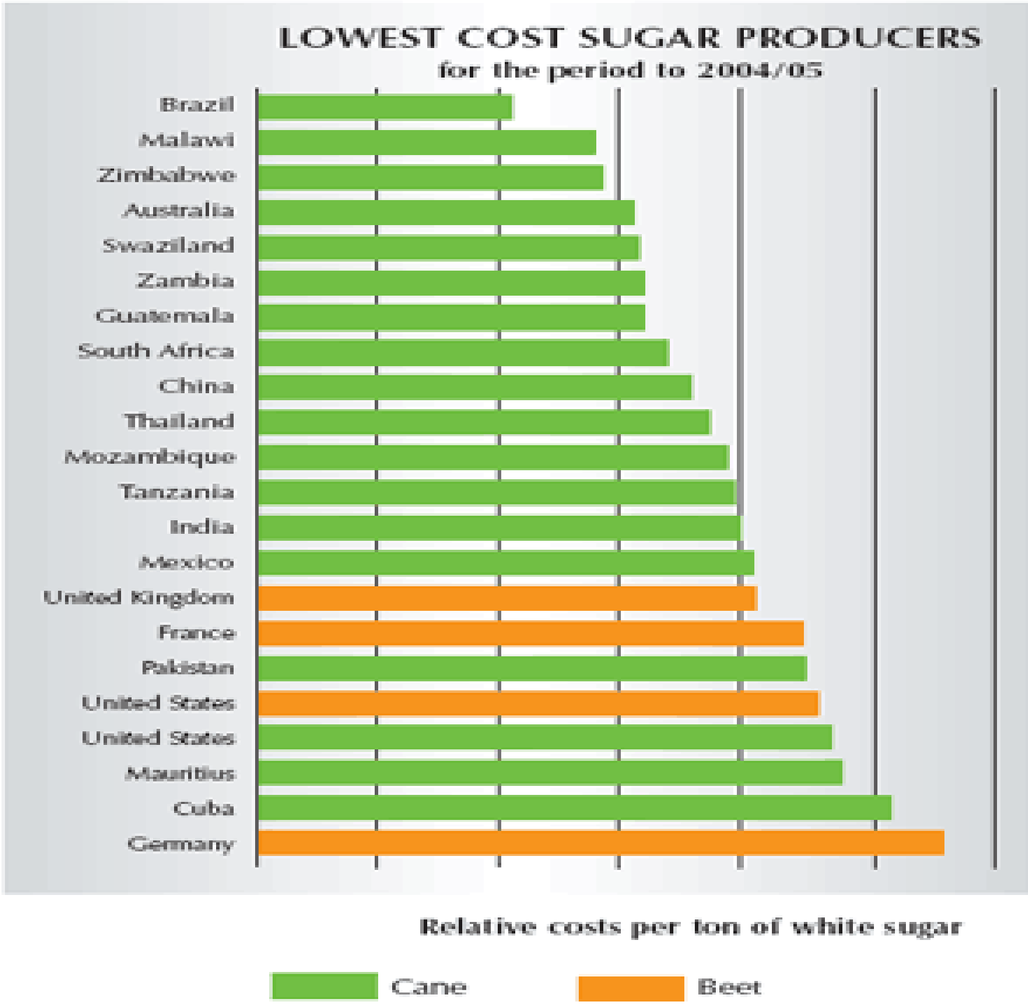
6. International competitiveness of SACU sugar

The theory of comparative advantage traces back to David Ricardo in 1815. This theory supplanted Adam Smith's absolute advantage theory: if a country can import a commodity at a cheaper price, then it should be bought instead of being produced locally. Ricardo's theory suggested that international trade was not governed by absolute advantage in price but by comparative advantage whereby a country can still gain from producing and trading certain goods that it can produce 'comparatively' more cheaply. This theory held sway for around two centuries. In the 1980s, Michael Porter (1990) proposed the doctrine of 'competitive advantage' as an alternative to comparative advantage in economic analysis of international competitiveness. Porter argued that the 'key' factors of production are created, not inherited. Specialised factors of production are skilled labour, capital and infrastructure, and these can be influenced in a pro-active way by government. In essence, comparative advantage is what you have but competitive advantage is what you do with it.

This can be taken a step further by using the concept of productivity, and more specifically, the real exchange rate to examine what a country should be best suited to producing and exporting. The real exchange rate (RER) is a concept which embodies the competitiveness of the tradable (export or import competing) sectors of an economy relative to the non-tradable sector in the economy. Crucial to this is a suite of factors such as currency levels, inflation rates, agricultural tariffs and supports (both domestically and abroad) and many general government policies that act as 'flanking' or supporting policies. In general, export market share is the benchmark for international competitiveness. In other words, if a country is actively exporting a product, then it is, by definition, internationally competitive. However, in highly distorted markets such as the global sugar markets, this generalisation cannot hold true.

An indication of global sugar production costs is provided in Figure 5 for the period 2005/2006. This highlights both the absolute cost advantage of Brazil, the favourable position of many African countries (including South Africa and Swaziland) and the high cost structures of the EU and US sugar beet production. Updating this same data for the 2005/06 year suggests that while Brazil is still the benchmark, the other low to medium cost cane producers are moving nearer to Brazil. Both Swaziland and South Africa are relatively well placed should trade opportunities open up.

Figure 5: Global production costs of sugar



Source: Illovo website: http://www.illovosugar.com/worldofsugar/internationalSugarStats.htm

In interpreting this discussion on sugar productivity in southern Africa, it is important to consider that a relatively large proportion of the total output of refined cane sugar in the region is produced by a single firm, namely Illovo. This firm has produced 35% of Swaziland's national output, 25% of Mozambique's, all of Malawi's and 50% of Tanzania's over the past few years[8], and it is also a large producer in South Africa. Future investments by the firm and its ultimate owners are likely to be based in part on their estimate of the extent of trade concessions that these countries are able to retain, especially into the EU and indeed in SACU/SADC.

[8] See www.agritrade.cta.int.

7. What benefits is the sugar industry likely to derive from trade liberalisation ?

In examining the literature on the gains from trade liberalisation to Africa generally and South Africa in particular from the Doha Development Agenda (DDA) of the WTO we find warnings that projected gains from the DDA are not what they were initially expected to be. This is so because an updated model database enables factors such as tariff revenue loss to be factored into recent research dashing the hope of anything approaching a comprehensive DDA agreement. Many analysts are talking of the ‘disappearing gains from trade liberalisation’ (Ackerman 2005; Anderson and Martin 2005; Hertel and Winters 2005; Polaski 2006; Kirkpatrick et al. 2006; the (Swedish) National Board of Trade 2006; and Sandrey et al 2007) as they detail how the gains are becoming both smaller and skewed towards the developed countries rather than leading to poverty alleviation in the developing world. Why are the gains shrinking? Part reason for this is that some of the assumptions such as employment are being revisited, while the newer version of the GTAP database in particular enables analysts to use better trade and tariff data and incorporate both the EU expansion and China’s WTO accession into their now-updated base work. In addition, the DDA negotiations are based upon the so-called bound tariff rates that are the maximum countries can impose and these bound rates are often considerably above where actual rates apply. But a real concern is that the use of special and sensitive products neuters an agricultural outcome from the DDA as countries shield their sensitive sectors from meaningful liberalisation, and this in particular means sugar (along with rice and perhaps dairy). Thus, it is increasingly apparent that potential gains from trade liberalisation for most developing countries in general and Africa in particular from a possible outcome of the WTO DDA are a mirage, and it is unlikely that South Africa will obtain meaningful gains for sugar access from the DDA in its current framework.

Furthermore, it is even doubtful that these potential gains do exist at all for sugar. The World Bank’s World Development Report for 2008 reports their estimates of price changes for all commodities under complete liberalisation. The largest increase was for cotton (20.8%) and the average was 5.5%. Sugar’s price increase under global liberalisation was only 2.5%, while the increase in sugar trade was only 9%. While intuitively these figures seem very low given the distorted nature of world sugar regimes, they give little credence to the argument that the high level of support to the South African sugar sector as reported by both the OECD (2005) and Kirsten et al. (2009) is justified on the basis of these global distortions.

But South Africa may benefit from the liberalisation of its own sugar industry. Such a liberalisation does not seem to have been analysed in detail, and dedicated modelling research that has been done on the industry, such as that of McDonald et al. (2004), looks at the implications for an increase in world prices following global trade liberalisation. Given the global sensitivities of sugar and the probable abilities of countries to shield the sector from meaningful liberalisation in the DDA, it seems unlikely that such liberalisation will happen in the near future in the sugar industry. However, the general outcome from trade policy research is that the big beneficiaries of trade liberalisation are the very countries doing the liberalising. Therefore given the distortions to the import regime, the pertinent questions relate to the implications of South Africa liberalising its own (or SACU's) import regime. We report upon an examination of this in the following section.

The economic implications of the sugar regime

In ongoing research tralac is modelling the implications of a free trade agreement between South Africa (SACU) and Brazil (Mercosur[9]), and given the special case of the South African/SACU sugar regime, liberalisation of this sector is being examined by proxying the sugar protection as a 20% non-tariff equivalent. We acknowledge that this 20% has elements of an arbitrary figure, but given the high levels of support to the sector outlined by both the OECD and Kirsten et al., we consider that this is a useful starting point to proxy the non-tariff protection. We also note that while the tariff level may be zero in times of high world prices such as we are witnessing, it does constitute a non-tariff measure in that there is uncertainty about future tariff levels. Details of this model and the simulation analysis of an FTA between SACU and Mercosur are contained in Sandrey et al. (2010). The results, measured as welfare increases at the end of the simulation period and expressed in real US dollars, therefore gives an estimate of the effects of the sugar regime in SACU if indeed this regime did represent a 20% NTB.

[9] Mercado Comun del Sur (Argentina, Brazil, Uruguay and Paraguay).

Thus, the new baseline becomes one in which all other parameters in the model as discussed in Sandrey et al (2010) for the main analysis were held constant, and the only change was an increase to 20% in the NTB on sugar imports into SACU. The simulation scenario now becomes one of reducing that NTB 20% tariff equivalent to zero. The expectation is that this elimination of the NTB on sugar imports would enhance welfare in SACU.

This is not the case. Liberalisation of the sugar section as proxied in the model actually reduces welfare in both South Africa and rest of SACU (which includes Swaziland). Using the standard Armington elasticities the model results suggest that welfare reduces by $13.5 million in South Africa and by $6.9 million in the rest of SACU. Conversely, there are gains to Brazil of $15.8 million as sugar exports to SACU increase, and overall this is beneficial to the world as total welfare increases ever so marginally by $1.3 million. Increasing the Armington elasticities or making sugar less of a differentiated product merely increases the losses to South Africa. With the standard run, imports of sugar into South Africa from Brazil increase by $38 million, but as some $18 million of this is displacing imports from Swaziland (rest of SACU), the final result is an increase of $17 million or 6.6%.

The main driving force behind the negative result for South Africa/SACU is that the reduction of the NTB tariff equivalent to zero reduces the price of imported sugar which lowers the returns to capital/labour employed in the sugar sector of the South African economy. Capital/labour employed in this sugar industry is reduced slightly, with some of it being reallocated in other industries. But due to the reallocation of capital/labour in the South African economy, the rental/wage rate declines slightly, reducing the total amount of capital/labour employed in the South African economy. In other words, the modelled NTB in this simulation is creating income (increasing total factor income and indirect taxes (rents) generated by the NTB tariff equivalent) in South Africa. The reallocation of resources away from the sugar industry does not find a better efficient allocation in the economy which could have given a more efficient production structure in South Africa. The 20% non-tariff barrier against imports is therefore welfare enhancing for South Africa when modelled as an ad valorem tariff equivalent at the border, with agents capturing rents on the restrictions imposed.

Changing the modelling approach and instead modelling the NTB as ‘sand in the wheels’ of trade where we assume that NTB policies only generate efficiency losses (with no rents being generated), still results in a welfare loss to South Africa ($2.8 million) when we increase sugar import efficiency by 20%. Once again we find that increased efficiency in the handling/administration of sugar imports into SACU reduces import prices in the market place which feeds back to the sugar industry reducing slightly the amount of capital and labour employed in South Africa. This has a negative impact on the economy.

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Chapter 10

Regional trade agreements and South-South FDI: potential benefits and challenges for SACU-MERCOSUR investment relations

Nicolette Cattaneo *

1. Introduction

In December 2004, the countries of the Common Market of the South (MERCOSUR) and the Southern African Customs Union (SACU)[1] signed an initial preferential trade agreement (PTA) as a step towards the eventual formation of a free trade area. The PTA was expanded and consolidated during subsequent negotiations that took place between 2004 and 2008, and the new agreement, signed by SACU ministers in April 2009 and MERCOSUR in December 2008, is expected to enter into force at the beginning of 2010.

At present, the PTA provides for preferences on a limited range of products, and includes annexes relating to rules of origin, safeguards, dispute settlement, sanitary and phytosanitary measures and customs administration.[2] While trade between MERCOSUR and SACU comprises only a small proportion (1-2%) of each bloc's total trade, bilateral trade has trebled since 2001 (Woolfrey, 2009). From SACU's perspective, this trade largely involves the export of primary products in exchange for higher value-added goods from MERCOSUR, effectively reinforcing North-South trade patterns (Roberts, 2004: 10).[3] The rationale for the PTA thus appears to rest on trade and investment potential and, more broadly, on growing moves to intensify South-South trade and investment cooperation. Such moves have gathered momentum with the increasing influence of emerging economies such as the BRIC

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[1] MERCOSUR comprises Argentina, Brazil, Paraguay and Uruguay, while Bolivia, Chile, Colombia, Ecuador, Peru and Venezuela are associate members. SACU is a customs union between South Africa and the smaller countries of Botswana, Lesotho, Namibia and Swaziland (the BLNS countries).

[2] MERCOSUR grants preferences to SACU in about 1000 HS8 product categories, mainly under organic chemicals, electrical machinery and equipment, and pharmaceutical products; SACU's preferences to MERCOSUR also cover approximately 1000 HS8 categories, primarily electrical machinery and equipment, boilers, machinery and mechanical appliances, and plastics (CUTS-CITEE, 2005; MERCOSUR and SACU, 2008).

[3] SACU's main exports to MERCOSUR include mineral products, chemicals and basic metals, while its main imports are machinery, vehicles and parts, and chemicals.

countries[4], lack of progress in the Doha Development Round of multilateral trade negotiations, and the view that ongoing changes in the balance of power in the global economy offer renewed prospects for the development and diversification of the countries of the South. In the SACU-MERCOSUR case, it has been argued that the PTA could provide impetus to the India-Brazil-South Africa (IBSA) Trilateral Development Initiative (Roberts, 2004: 7).[5]

Developing countries have been active in what has been termed the "new generation" of PTAs[6] which grew out of frustration with the stalled Doha Round and the imbalances and inequities of the multilateral trading system. A distinguishing feature of many of these PTAs, in both North-South and South-South configurations, is the increasing consideration that has been given to services and investment aspects of regional trade agreements. This is a result of dramatic increases in services trade in recent years and renewed recognition of the importance of the services sector in development, both in its own right and with respect to its role in facilitating development through industrialisation. Investment agreements have proliferated with increased capital mobility and a re-examination of the costs and benefits of FDI, both as part of broader regional and bilateral accords and as independent agreements. Although the SACU-MERCOSUR PTA has not yet addressed these issues, it is instructive to explore the services and investment relations between the two blocs, given the intention to increase economic cooperation between the two regions and to move towards the formation of a free trade area (FTA).

Against this background, the purpose of this paper is to explore the levels, growth and structure of foreign direct investment (FDI) in South Africa and Brazil and, in the light of this, to consider the implications of intensified South-South FDI between SACU and MERCOSUR for development and diversification in the SACU region. The paper's focus on South Africa and Brazil rests on these countries' dominance of their respective blocs in terms of trade, population and economic size (CUTS-CITEE,

4 Brazil, Russia, India and China.
5 The IBSA Trilateral Development Initiative was launched in Brasilia in 2003 by the Foreign Ministers of India, Brazil and South Africa as a dialogue forum to foster cooperation between the three countries in a wide range of fields including trade, investment, poverty alleviation, social development, education, health, science and technology, and climate change, amongst others (see http://www.ibsa-trilateral.org/index.html; Dube, 2009).
6 See, for example, Aggarwal (2008: 1-3).

2005: 2; Woolfrey, 2009). Further, it is evident that despite this dominance, South Africa and Brazil both have comparatively low ratios of domestic savings to GDP (Table 1). This suggests that FDI is likely to be of particular importance for development in these countries, and that the prospects for stronger bilateral FDI flows may be weak in the absence of appropriate accompanying policies.

The rest of the paper is organised as follows. The following section reviews the importance of FDI to developing countries, and explores the potential development benefits of South-South FDI. Section 3 examines aspects of the theoretical literature on the impact of regional integration on FDI. Section 4 considers inward and outward FDI trends and patterns in South Africa and Brazil, and the importance of current bilateral flows between the two countries. In the light of this discussion, the remainder of the paper discusses the opportunities presented by increased investment flows between SACU and MERCOSUR, and the inferences for development. Section 6 concludes by considering the major challenges the blocs face in harnessing the potential benefits of greater South-South FDI.

2. The importance of FDI to developing countries and the potential benefits of South-South FDI

2.1 The importance of FDI

The potential benefits of inward FDI for a middle-income developing country such as South Africa are well-known. These include technology transfer, acquisition of managerial and other skills, as well as job creation and the provision of capital needed for investment and growth. Additional advantages are the impact on foreign exchange and the balance of payments (Rusike *et al.*, 2007: 2). FDI could also stimulate competition in the host country's domestic market, and potentially provide access to foreign export markets and global production-sharing networks (Agosin, 2008: 7; UNCTAD, 2004a: 2).

Many sub-Saharan African countries, including South Africa, have very low domestic savings rates. South Africa's gross domestic savings as a proportion of GDP is about 17%, significantly less than the southern African countries of Angola, Botswana, Namibia and Zambia (two of which belong to SACU), and far below Argentina, Chile and China (Table 1). It is interesting to note that Brazil is in a comparable position, although its domestic savings to GDP ratio exceeds South Africa's at 19%. In such instances, FDI takes on particular importance as a possible way of acquiring the capital needed for development. It also, however, influences the prospects for improving bilateral investment flows between such countries.

Table 1: Gross domestic savings as a proportion of GDP (%), 2006

South Africa	17.1
Angola	49.5
Botswana	52.5
Lesotho	-15.0
Malawi	11.2
Mauritius	17.5
Mozambique	13.3
Namibia	28.4
Swaziland	12.0
Tanzania	12.0
Zambia	32.7
Argentina	28.6
Brazil	19.7
Chile	34.9
India	31.1
China	52.5

Source: World Bank (2008).

The purported benefits of inward FDI for development have nonetheless been widely questioned. FDI flows may have inappropriate or negative effects on the host economy, depending on the type or motive for which the FDI is undertaken. Certain types of resource-seeking FDI, for example, have been criticised as encouraging low value added activity and inducing little spending on plant and equipment (Rusike *et al*., 2007: 6; Narula and Dunning, 2000: 151). Prospects for employment creation in certain skill categories may be low if FDI results in the use of technology that does not complement the country's factor endowments. Beneficial technological spillovers may be limited if research and development is not conducted in the host economy, or if there are demands for highly restrictive protection or fees for technology use. In addition, high profit and dividend remittances could negate potential balance of payments benefits. Excessive tax and other concessions and possible adverse income distribution effects are other concerns (Gammeltoft, 2007: 3). In contrast to the view of increased competition in host country markets, South Centre and ActionAid (2008: 9) point to the disadvantages for developing country producers and consumers of the market power of multinational corporations in commodity supply chains, with increasing market concentration downstream in the value chain, particularly in foodstuffs industries.

Even the key attraction of FDI as a supplement to low domestic savings has been subject to intensive debate. Kok and Ersoy (2009: 109) discuss evidence that FDI displaces domestic savings, possibly further increasing reliance on foreign capital. Agosin (2008) explores the circumstances in which FDI may "crowd in" investment from local firms (i.e. stimulate local investment that would not have been undertaken in the absence of FDI), "crowd out" domestic investment (i.e. supplant local investment that would have occurred in the absence of FDI) or have a neutral effect (whereby a dollar increase in FDI also raises total investment by a dollar) (Agosin, 2008: 2-3). Conditions favourable to crowding in domestic investment include FDI in goods and services not already produced in the host market, whether for local consumers or for export. The idea is that FDI and domestic investment are more likely to complement one another where such foreign investment occurs in less developed economic sectors. This view could be countered with reference to an infant industry argument – namely that possible future local investment by emerging domestic firms (assisted by temporary government support) could be displaced.

Agosin (2008: 4-5) argues that crowding in of domestic investment could also be assisted by the existence of strong forward and backward linkages from the foreign firm to local enterprises. Further, it has been suggested that the impact would be more favourable (though not necessarily positive) for Greenfield investments than mergers and acquisitions. The argument is that mergers and acquisitions often simply involve ownership transfer with no increase in host country capital formation. However, there is survey evidence of beneficial effects from modernisation, rationalisation and investment in technology following mergers and acquisitions in Argentina and Chile. Nonetheless, large mergers and acquisitions may be accompanied by macroeconomic effects that could result in crowding out. The net impact is ultimately an empirical question, and host countries would need to ensure that the necessary selective policies are in place to encourage crowding in (or at least prevent crowding out), while at the same time ensuring that the essential features of a stable investment environment (such as guaranteed property rights) are in evidence.[7]

Developing countries' ability to profit from the potential growth benefits of FDI are said to rest on a range of factors including education, macroeconomic, financial and political stability, as well as the extent to which the knowledge and technology diffused through FDI can be assimilated (Gammeltoft, 2007: 3). While it has been argued that technological spillovers would be more substantial the greater the difference in technological sophistication between foreign and local firms, Gammeltoft (2007) suggests that larger gaps could instead prevent such spillovers from occurring effectively. If so, then it could be proposed that

> South-South FDI may…offer better development potentials than North-South FDI by applying more 'appropriate' technologies, business models, and managerial and organisational techniques, which are better attuned to developing-economy circumstances (Gammeltoft, 2007: 3).

2.2 South-South FDI

FDI flows from emerging markets have been growing rapidly since the early 1990s, although they still form a small proportion of global outward FDI (19% in 2008, up from 17% in 2006). Strong growth in outflows from emerging economies in 2006-2007 of around 40% was followed by much weaker, but still positive, growth in 2007-2008 of close to 4% in the context of the global financial crisis (UNCTAD, 2009a: 16)[8]. Investment flows from emerging markets to other developing countries have grown even faster than total outflows from these markets, increasing from US$6.5 billion in 1990 to US$59.8 billion in 2004 (UNCTAD, 2006: 118)[9]. They have also grown faster than flows from developed to developing countries in the last decade (UNCTAD, 2004a: 6).

[7] In the case of South Africa, Fedderke and Romm (2006: 758) find evidence of crowding out in the short run, but complementarity between foreign and domestic investment in the long run, implying positive spillover benefits for capital and labour (and hence growth) in the longer term.
[8] By contrast, outflows from developed countries fell in 2008, following record growth in 2007 (UNCTAD, 2009: 15).
[9] If flows to offshore financial centres are included, the figures effectively double in magnitude (UNCTAD, 2006: 118).

FDI outflows from developing countries as a whole[10] grew at 33% in nominal terms in 2006-2007, with much lower but still positive growth in 2007-2008 of 2.53% (Table A1 in the Appendix). For the period 1990-2007, the average annual growth rate of FDI flows from developing countries was 20.6% per annum compared to 13.8% per annum for global flows. The share of developing country outflows in global outward FDI was 13% in 2007 and 16% in 2008.[11]

Increased South-South FDI has been facilitated by the liberalisation of financial flows and greater financial integration between emerging economies, as well as rising wealth and rapid industrialisation (UNCTAD, 2004a: 3; Gammeltoft, 2007: 3). Strong competition for FDI among developing countries and more active investment promotion agencies in many of these countries, as well as reductions in foreign aid have also reinforced the attractiveness of greater South-South investment cooperation. It has been argued that such investment flows have been both prompted and facilitated by the proliferation of developing country regional trade agreements (RTAs), preferential trade and investment accords (PTIAs), bilateral investment treaties (BITs) and double taxation treaties (DTTs)[12] (see Section 3).

MIGA (2008: 2) notes that increased trade among developing countries is, in itself, another driving force behind South-South FDI, especially where it is linked to trade between multinationals and their affiliates, and between affiliates in different countries. Further, geographical proximity, trade and cultural ties are factors encouraging cross-border investment by smaller firms in developing countries, as they lower transaction costs for such firms relative to other destinations. In addition, the experience that developing country multinationals have acquired in their domestic markets implies that they will be more adaptable to conditions in poorer economies, could function with lower overheads than developed country firms, and would have more appropriate technology for developing host economies (Gammeltoft, 2007: 4).

[10] The emerging economies group in the United Nations classification used by UNCTAD includes only the following countries: Argentina, Brazil, Chile, Mexico, Peru, Malaysia, Republic of Korea, Singapore, Taiwan Province of China and Thailand (UNCTAD, 2009b). It does not include China, India or South Africa.

[11] Shares and growth rates for developing country and global outward flows have been computed from the data in Table 7.

[12] According to UNCTAD (2004: 6-8), the number of South-South BITs more than quadrupled between 1990 and 2004. By 2009, South-South BITs accounted for 26% of all such treaties globally (UNCTAD, 2009c: 5). Growth in South-South DTTs has been steady but less spectacular, while PTIAs are fewer and tend to be more modest in the depth and scope of their provisions.

The rationale for South-South FDI includes the conventional market-seeking, resource-seeking and efficiency-seeking FDI motives (MIGA, 2008: 1-2; UNCTAD, 2004a: 2-3). For example, the search for new markets drives South African retail firms into Africa; Chinese, Russian and Brazilian companies look to Africa and central Asia to address their energy requirements; and East Asian manufacturing firms seek efficiency gains through production-sharing in regional networks. Gammeltoft (2007: 5-6) analyses shifts in the characteristics of outward FDI from emerging markets since the 1980s. He finds that while market-seeking and efficiency-seeking remain the first and second most important motives for South-South FDI, especially where there is a regional dimension, FDI from emerging economies into developed countries has, by contrast, been increasingly of the asset-seeking variety, in pursuit of technological and other capabilities that may not be available at home.

For developing country MNCs, while Greenfield investment was the dominant mode of entry in the 1980s, mergers and acquisitions are gaining in importance. The sectoral structure of outward FDI from emerging economies has changed significantly in the past two decades, with a shift towards services and away from manufacturing and natural resources. The latter nevertheless remains particularly important in South-South flows. The destination of outward FDI from developing countries has also broadened considerably since the early 1990s. Such investment initially took place close to the home country market (to take advantage of existing trade, cultural and other relationships), but has since grown significantly beyond the source country's neighbouring region. While other developing country destinations still dominate, entry into developed country markets appear to be increasing more rapidly (Gammeltoft, 2007: 10). The implications of this apparent shift in the destination of developing country outward FDI for the promotion of South-South investment relations requires further research.

Notwithstanding the general trends in the characteristics of outward FDI from developing countries noted above, it is evident that the characteristics of South-South FDI differ significantly according to the source country in the South from which the outflows emanate. Such differences in motive, mode of entry, sectoral structure and destination need to be examined, as they will have diverse implications for development.[13] In this regard, Section 4 considers the characteristics of South Africa and Brazil's FDI in more detail, in a comparative developing country framework.

The discussion in this section suggests that the attraction of South-South FDI lies in its potential to offer more appropriate ways for developing countries to stimulate the productive capacity needed for development. Cross-border FDI among developing countries may facilitate integration into regional supply chains as a stepping stone to participation in global production networks. South-South FDI could be of some importance for low-income developing countries that may not attract FDI from the North, but may receive investment from developing country multinationals investing in countries with similar or lower GDPs than their own for comparative advantage reasons (UNCTAD, 2004a: 3). Further, the growing importance of the services sector in FDI flows from emerging markets to other developing countries coincides with a renewed recognition of the importance of a growing and efficient services sector in development. Developing countries could explore ways to harness the benefits for development from FDI flows related to the services sector.

If South-South FDI is a desirable goal, then the essential question to be considered is how such investment is to be promoted among developing countries and, in particular, whether RTAs, PTIAs and other types of trade and investment agreement could be useful vehicles for increased investment cooperation of this kind. In order to explore this further, it is instructive to consider the theoretical literature on the impact of economic integration on FDI, with a focus on the developing country context.

3. The impact of regional integration on FDI, with particular reference to South-South regional agreements

The theoretical analysis of the impact of economic integration on foreign direct investment considers three channels through which integration may affect FDI flows. The first is via the trade provisions of the agreement, the second is via any particular investment provisions that may be contained therein, and the third is through other cooperation provisions of the agreement and institutional changes that could accompany the integration process (Blomström and Kokko, 1997; Aggarwal, 2008).

[13] Henley *et al.* (2008), for example, investigate similarities and differences in the characteristics of FDI from China, India, South Africa and the North into sub-Saharan Africa. Their findings are considered further in subsequent sections.

These channels of influence are examined from both static and dynamic perspectives.[14] Although the SACU-MERCOSUR PTA could not currently be classified as a new generation preferential trade and investment agreement (PTIA), it is important to contemplate whether the inclusion of explicit investment provisions in the future could make a significant difference to the prospects for SACU and MERCOSUR to attain the potential development benefits of greater South-South FDI.

3.1 The reduction of intra-regional trade barriers

When considering the trade provisions of economic integration agreements, it should be noted that regional trade liberalisation may have a differential impact on foreign investment originating within the region and that from outside the region, depending on the motive for the FDI. Firstly, intra-regional FDI flows of the tariff-jumping variety are likely to fall with the removal of intra-area tariffs since exporting replaces FDI as the best way of operating in the regional market (i.e. trade and FDI are substitutes). However, Blomström and Kokko (1997: 4) note that trade creation and the accompanying changes in the production structure of member countries following integration may increase intra-regional FDI in parts of the RTA.[15] The removal of intra-regional tariffs may also result in an inflow of FDI from the rest of the world,[16] if external suppliers lose export markets as a result of trade diversion.[17] External FDI inflows may also increase if they were initially restricted by inadequate national market size. In the presence of internal free trade, the location of new FDI into the region will depend on the comparative advantages of the member countries. In the FTA case specifically (where there will be internal free trade but no common external tariff), foreign investors may move funds to countries with lower tariffs on raw materials and intermediate goods, resulting in "investment deflection" (El-Agraa, 1989: 49).

Secondly, if the motive for FDI is internalisation of firm-specific intangible assets rather than the avoidance of trade barriers, the removal of tariffs will not reduce the incentive to engage in FDI, and may in fact stimulate overall investment flows between member

[14] Dynamic effects are of particular importance in the development integration approach.
[15] Kindleberger (1966) terms this "investment diversion".
[16] Termed "investment creation" by Kindleberger (1966).
[17] Investment diversion is therefore a response to trade creation, while investment creation is a response to trade diversion. Conventionally, trade creation refers to the replacement of relatively less efficient domestic production with lower cost imports from a partner country, while trade diversion refers to the replacement of lower cost imports from outside the integrating area with relatively less efficient partner country imports.

countries by facilitating the more efficient operation of multinationals across regional borders.[18] Although, in this case, integration seems likely to exert a positive effect on aggregate FDI flows both into and within the region, it is possible that some member countries will experience a reduction in investment, as FDI will tend to concentrate in countries in which investment conditions are most favourable. More specifically, countries with less protected and efficient markets prior to integration are likely to experience the greatest increases in foreign and domestic investment. This is because countries with lower trade barriers will be less likely to be hosting tariff-jumping FDI that may be withdrawn or diverted on integration. At the same time, those sectors characterised by high levels of protection and weak locational advantages may experience a reduction in both foreign and domestic investment.

The actual outcome is ultimately an empirical question, and will depend on the degree to which trade and investment flows are liberalised in the regional agreement, on the locational advantages of the countries in question, and on the motivation for FDI. In sum, the reduction or removal of regional tariffs will have conflicting impacts on intra-regional FDI flows, but is likely to raise FDI inflows from outside the region.

3.2 Investment provisions and other effects

Key provisions of investment agreements include “national treatment” provisions to ensure that foreign and domestic investors received comparable treatment, FDI protection and promotion, minimisation or elimination of performance requirements, property rights guarantees and dispute resolution mechanisms (Aggarwal, 2008: 3; UNCTAD, 2004;: 6-8; Blomström and Kokko, 1997: 6-7). The impact of these provisions will be contingent on the extent to which restrictions were in place prior to integration. An important consideration in regional agreements among low- and middle-income developing countries is that the adoption of investment provisions at an international level will signal to investors that the policy environment is predictable and stable (Velde and Bezemer, 2006).

[18] Internalisation via the establishment of foreign affiliates will occur when the alternatives of exporting or licensing carry comparatively high transactions costs. For more discussion, see Dunning (1981), whose eclectic theory of FDI suggests that a country's net international investment position is determined by three sets of factors: ownership, locational and internalisation (OLI) advantages.

Other cooperation provisions of integration agreements may have a positive impact on the investment environment. These include services provisions of regional agreements, cross-border movement of people, and the establishment of regional projects and joint ventures (Aggarwal, 2008: 3). The formation of regional institutions (such as a regional development bank) may also contribute to an environment which is more conducive to intra-regional investment flows.

3.3 Dynamic effects

While the dynamic effects of economic integration are far more difficult to analyse and quantify than the static effects, it is generally argued that they have a significantly stronger impact and are of particular importance in the developing country context (Jaber, 1970-71: 256; Lundahl and Petersson, 1991: 197). The dynamic effects of economic integration that may affect FDI flows include improved competition, dynamic economies of scale in a larger regional market, higher growth rates and the formation of new intangible assets (Aggarwal, 2008: Blomström and Kokko, 1997: 8). Such effects would be expected to encourage FDI flows within and from outside the regional grouping.

However, adverse polarisation effects may outweigh any positive dynamic effects in a regional integration arrangement among countries at unequal levels of development (Vaitsos, 1978: 739,746; Lundahl and Petersson, 1991: 202). Such concerns have been raised in the literature on both SACU and MERCOSUR. While Blomström and Kokko (1997: 8) note that FDI itself may be a critical channel through which the dynamic benefits of economic integration are realised, various factors may lead to a concentration of investment in some parts of the region that could exacerbate any tendency towards polarisation within the area. Nonetheless, even with integration among unequal partners, polarisation is not inevitable. Krugman's (1991: 96-7) core-periphery analysis suggests that closer integration will draw production to the periphery while partial integration will concentrate industry at the core. This suggests that developing countries should carefully consider the depth of integration and the need for a regional industrial development policy. For example, the FDI flows that could follow the promotion of production-sharing networks in a regional integration arrangement may mitigate adverse polarisation effects.

The discussion in this section suggests that regional integration agreements impact on both intra-regional and extra-regional investment flows to the integrating area. From a static perspective, the impact on intra-regional flows depends on the motivation for the FDI, while extra-regional investment into the area is likely to increase. There is a danger, however, that investment will be attracted to the most developed parts of the union, exacerbating polarisation of industrial development. A regional industrial policy that incorporates policies to promote investment flows to less developed areas and countries, as well as the inclusion of explicit investment provisions in the agreement, are likely to enhance the investment benefits of regional integration.

4. FDI trends and patterns in South Africa and Brazil

In order to facilitate an analysis of the opportunities and challenges relating to the promotion of investment relations between SACU and MERCOSUR in a regional integration context, the present section explores the characteristics of South Africa and Brazil's inward and outward FDI, and the extent and growth of their bilateral investment flows in a comparative setting.

4.1 Trends in inward FDI

Inward foreign direct investment (IFDI) flows to developing countries grew faster than global IFDI flows in the first half of the 1990s and 2000s (Table A1 in the Appendix). Annual flows grew strongly in 2005, 2006 and 2007, but did not match world growth. As the global financial crisis broke in 2008, world IFDI contracted by 14%, but growth in developing country IFDI remained high, exceeding 17% in nominal terms.[19] Developing economy IFDI stocks have, for the most part, consistently accumulated more rapidly than global IFDI stocks. This section examines how South Africa and Brazil have performed in attracting FDI in a comparative developing country context.

[19] It is estimated that developed country IFDI flows contracted by 30-50% in the first half of 2009, compared to the second half of 2008. Developing country IFDI flows began to fall in late 2008 as the effects of the crisis began to take hold (UNCTAD, 2009a: 4).

Table 2: Flows and stock of inward FDI (millions of current US$)

		1990	1995	2000	2004	2005	2006	2007	2008
South Africa	**IFDI flow**	**-78**	**1241**	**888**	**799**	**6644**	**-527**	**5687**	**9009**
	IFDI stock	9207	15005	43462	64444	78985	87782	110383	119392
Botswana	**IFDI flow**	**96**	**70**	**57**	**391**	**279**	**486**	**495**	**-4**
	IFDI stock	1309	1126	1827	982	806	805	836	699
Lesotho	**IFDI flow**	**16**	**23**	**32**	**53**	**57**	**92**	**106**	**199**
	IFDI stock	83	179	330	480	537	629	735	934
Namibia	**IFDI flow**	**30**	**153**	**186**	**226**	**348**	**387**	**733**	**746**
	IFDI stock	2047	1708	1276	4120	2453	2786	3854	3472
Swaziland	**IFDI flow**	**28**	**43**	**106**	**71**	**-50**	**36**	**37**	**10**
	IFDI stock	336	535	536	930	813	827	889	619
SACU	***IFDI flow***	***92***	***1530***	***1269***	***1540***	***7278***	***474***	***7058***	***9960***
	IFDI stock	*12982*	*18553*	*47431*	*70956*	*83594*	*92829*	*116697*	*125116*
Brazil	**IFDI flow**	**989**	**4405**	**32779**	**18146**	**15066**	**18822**	**34585**	**45058**
	IFDI stock	37143	47887	122250	161259	181344	220621	309668	287697
Argentina	**IFDI flow**	**1836**	**5609**	**10418**	**4125**	**5265**	**5537**	**6473**	**8853**
	IFDI stock	7751	25463	67601	52507	55139	60253	67574	76091
MERCO SUR	***IFDI flow***	***2937***	***10274***	***43575***	***22641***	***21232***	***26026***	***42532***	***56436***
	IFDI stock	*45983*	*75120*	*193265*	*217026*	*240608*	*286602*	*385822*	*374974*
Chile	**IFDI flow**	**661**	**2956**	**4860**	**7173**	**6984**	**7298**	**12577**	**16787**
	IFDI stock	16107	24437	45753	60541	74196	80297	99488	100989
India	**IFDI flow**	**237**	**2151**	**3585**	**5771**	**7606**	**20336**	**25127**	**41554**
	IFDI stock	1657	5641	17517	38183	44458	70282	105429	123288
China	**IFDI flow**	**3487**	**37521**	**40715**	**60630**	**72406**	**72715**	**83521**	**108312**
	IFDI stock	20691	101098	193348	245467	272094	292559	327087	378083
Angola	**IFDI flow**	**-335**	**472**	**879**	**5606**	**6794**	**9064**	**9796**	**15548**
	IFDI stock	1024	2922	7978	13437	12133	12095	11202	26750
Develop-ing econo-mies	**IFDI flow**	**35087**	**115973**	**256883**	**290397**	**329292**	**433764**	**529344**	**620733**
	IFDI stock	529593	852489	1736167	2338132	2722292	3363925	4393354	4275982
World	**IFDI flow**	**207273**	**341144**	**1381675**	**734892**	**973329**	**1461074**	**1978838**	**1697353**
	IFDI stock	1942207	2915311	5757360	9607801	10050885	12404439	15660498	14909289

Source: UNCTAD (2009b).
Notes: IFDI refers to inward FDI. **See Table A2 in the Appendix for definitions and data issues.**
Note that 1990 falls in the pre-democracy era for South Africa.

Tables 2 and 3 illustrate the current dominance of South Africa and Brazil in SACU and MERCOSUR respectively with respect to their share of each region's IFDI. For example, South Africa's IFDI flows as a proportion of SACU's total IFDI flows exceed 80% for most of the period after 2004.[20] As Table 3 indicates, South Africa's share of SADC's IFDI is significantly less, particularly in terms of flows, largely because of the surge in IFDI flows into Angola from the early 2000s (see Table 2). Since 2000, Brazil's position in MERCOSUR has been more consistent than South Africa's position in SACU and SADC, with 70-80% of IFDI flows into MERCOSUR destined for Brazil. Brazil has also consistently held 60-80% of the region's IFDI stock since 1995. Argentina's IFDI flows exceeded Brazil's in 1990 and 1995 (see Table 2), but the position was reversed by the late 1990s, so much so that Brazil's flows have exceeded Argentina's by a factor of five in the last two years.

[20] The exception is 2006, when South Africa experienced negative IFDI flows related to the sale by foreign investors of holdings in a domestic gold mining company (Rusike *et al*, 2007: 13).

Table 3: South Africa and Brazil: Percentage share in global and regional inward FDI flows and stocks

	1990	1995	2000	2004	2005	2006	2007	2008
South Africa								
% SACU IFDI flows	**-84.78**	**81.11**	**69.98**	**51.88**	**91.29**	**-111.2**	**80.58**	**90.45**
% SACU IFDI stock	70.92	80.88	91.63	90.82	94.49	94.56	94.59	95.43
% SADC IFDI flows	**-144.4**	**50.22**	**28.09**	**9.56**	**43.43**	**-4.62**	**26.51**	**28.98**
% SADC IFDI stock	49.47	54.21	64.98	63.67	70.01	70.46	72.39	65.59
% Developing IFDI flows	**-0.22**	**1.07**	**0.35**	**0.28**	**2.02**	**-0.12**	**1.07**	**1.45**
% Developing IFDI stock	1.74	1.76	2.50	2.76	2.90	2.61	2.51	2.79
% World IFDI flows	**-0.04**	**0.36**	**0.06**	**0.11**	**0.68**	**-0.04**	**0.29**	**0.53**
% World IFDI stock	0.47	0.51	0.75	0.67	0.79	0.71	0.70	0.80
Brazil								
%MERCOSUR IFDI flows	**33.67**	**42.88**	**75.22**	**80.15**	**70.96**	**72.32**	**81.32**	**79.84**
% MERCOSUR IFDI stock	80.78	63.75	63.26	74.30	75.37	76.98	80.26	76.72
% Developing IFDI flows	**2.82**	**3.80**	**12.76**	**6.25**	**4.58**	**4.34**	**6.53**	**7.26**
% Developing IFDI stock	7.01	5.62	7.04	6.90	6.66	6.56	7.05	6.73
% World IFDI flows	**0.48**	**1.29**	**2.37**	**2.47**	**1.55**	**1.29**	**1.75**	**2.65**
% World IFDI stock	1.91	1.64	2.12	1.68	1.80	1.78	1.98	1.93

Source: Own computations from UNCTAD (2009b).
Notes: IFDI refers to inward FDI; negative shares for South Africa reflect years in which IFDI flows were negative.
Note that 1990 falls in the pre-democracy era for South Africa.

South Africa's IFDI as a proportion of developing country IFDI is very low, with flows generally ranging from 1-2% in the years depicted in Table 3, and stocks ranging from 1.5-3% of developing country IFDI stocks. By contrast, Brazil's IFDI flows and stocks as a proportion of developing country flows and stocks average around 6% and 7% respectively for the years surveyed. Brazil's share of world IFDI flows and stocks lies between 1% and 3% over the years in question, while South Africa's are much lower (merely a fraction of a percent), particularly in the case of IFDI flows (Table 3).

A key feature of the data in Tables 2 and 3 is the extent to which it demonstrates South Africa's inability to attract a steady stream of IFDI flows since democratisation in 1994, relative to Brazil, Argentina (in most years), Chile, India, and even Angola (since 2004). China's IFDI flows, depicted in Table 2, exceed South Africa's by over tenfold in recent years.

The picture in terms of inward flows is reinforced when economic size is taken into account. Table 4 depicts IFDI flows and stocks as a proportion of GDP for the various years. IFDI flows as a proportion of GDP have been high in recent years in Lesotho and Namibia, Chile, and, in particular, Angola.[21] The corresponding ratios for Argentina, Brazil, China and India have largely ranged from 2.0-3.5%, although the ratio in Brazil was slightly lower at around 1.7% in 2005 and 2006, and India's was below 1% (although in excess of 0.5%) in the decade prior to 2006. In South Africa, by contrast, IFDI flows as a proportion of GDP were less than 0.9% in every year in the table except for 2005, 2007 and 2008 where they ranged from 2.0-3.3%. The higher ratios in these three years correspond to spikes in South Africa's IFDI flows related to particular M&A deals (see Table 2).[22]

South Africa's IFDI stock, however, has grown steadily at an average annual rate of 17% per annum between 1995 and 2008, in excess of the growth rate of Brazil's at 15%. Further, South Africa's IFDI stock as a proportion of GDP is higher than Brazil's, and significantly exceeds that of India and China (Tables 2 and 4). As noted earlier, however, South Africa's IFDI stock remains small as a proportion of developing country IFDI stock, compared to Brazil's.

[21] In Lesotho and Namibia the inflows relate to AGOA, while Chinese investment in Angola has grown exponentially since the early 2000s.

[22] In 2005 there was a large inflow following the Barclays acquisition of ABSA Bank, while the 2007 inflow followed the acquisition of South African firms by private equity funds (Rusike *et al*, 2007: 13). In 2008, the Industrial and Commercial Bank of China bought a 20% stake in Standard Bank (UNCTAD, 2009a: 44). Such IFDI spikes are also evident in the data in 1997 and 2001 (years that do not appear in the table) (see Note 23).

Table 4: Inward FDI as a percentage of GDP

		1990	1995	2000	2004	2005	2006	2007	2008
South Africa	**IFDI flow**	**-0.07**	**0.82**	**0.67**	**0.37**	**2.74**	**-0.21**	**2.01**	**3.27**
	IFDI stock	8.22	9.93	32.71	29.83	32.59	34.14	39.00	43.28
Botswana	**IFDI flow**	**2.75**	**1.59**	**1.17**	**4.60**	**3.06**	**5.24**	**4.58**	**-0.03**
	IFDI stock	37.53	25.46	37.36	11.56	8.85	8.68	7.74	5.98
Lesotho	**IFDI flow**	**2.61**	**2.51**	**3.69**	**4.04**	**4.02**	**6.16**	**6.61**	**12.86**
	IFDI stock	13.37	19.21	38.64	36.39	37.68	42.10	45.39	60.38
Namibia	**IFDI flow**	**1.26**	**4.37**	**5.46**	**4.00**	**5.57**	**5.57**	**9.89**	**10.44**
	IFDI stock	87.48	48.75	37.39	72.93	39.29	40.16	52.02	48.54
Swaziland	**IFDI flow**	**3.27**	**3.19**	**7.62**	**2.92**	**-1.94**	**1.33**	**1.30**	**0.36**
	IFDI stock	38.55	39.24	38.63	38.56	31.78	30.35	30.89	21.92
SACU[1]	***IFDI flow***	***0.08***	***0.95***	***0.89***	***0.66***	***2.78***	***0.17***	***2.31***	***3.32***
	IFDI stock	*10.88*	*11.50*	*33.07*	*30.33*	*31.94*	*33.45*	*38.17*	*41.83*
Brazil	**IFDI flow**	**0.21**	**0.57**	**5.08**	**2.73**	**1.71**	**1.76**	**2.63**	**2.90**
	IFDI stock	7.76	6.23	18.96	24.30	20.56	20.57	23.56	18.53
Argentina	**IFDI flow**	**1.30**	**2.17**	**3.66**	**2.69**	**2.87**	**2.58**	**2.47**	**2.68**
	IFDI stock	5.48	9.87	23.77	34.29	30.10	28.12	25.76	23.05
MERCOSUR	***IFDI flow***	***0.46***	***0.97***	***4.56***	***2.70***	***1.95***	***1.98***	***2.64***	***2.93***
	IFDI stock	*7.26*	*7.12*	*20.21*	*25.93*	*22.09*	*21.79*	*23.94*	*19.44*
Chile	**IFDI flow**	**1.97**	**4.10**	**6.46**	**7.50**	**5.91**	**4.98**	**7.67**	**9.90**
	IFDI stock	48.07	33.91	60.84	63.29	62.75	54.83	60.69	59.54
India	**IFDI flow**	**0.07**	**0.58**	**0.77**	**0.84**	**0.94**	**2.23**	**2.20**	**3.32**
	IFDI stock	0.51	1.53	3.74	5.53	5.50	7.72	9.24	9.84
China	**IFDI flow**	**0.86**	**4.96**	**3.41**	**3.13**	**3.14**	**2.62**	**2.46**	**2.49**
	IFDI stock	5.12	13.36	16.21	12.68	11.82	10.55	9.62	8.69
Angola	**IFDI flow**	**-3.25**	**9.46**	**9.62**	**28.35**	**22.18**	**18.26**	**18.75**	**21.66**
	IFDI stock	9.95	58.50	87.35	67.95	39.61	24.36	21.44	37.27

Source: UNCTAD (2009b).
Note: IFDI refers to inward FDI.
[1]Own computations from UNCTAD (2009b) for SACU.

Although South African policies to attract FDI since 1994 have been wide-ranging (see Section 5), inward flows have been erratic and have not been particularly large when viewed in a comparative middle-income developing country context. Further, the flows that have occurred have not necessarily been of the most appropriate type. Significant recent inflows have mainly been related to M&As, which have overwhelmingly dominated IFDI flows in the past decade.[23] According to Gelb and Black (2004: 210), just below half of IFDI in South Africa in the 1990s involved acquisitions as opposed to Greenfield investments or joint ventures, with little resulting benefit for employment creation. In Brazil the share of M&As in IFDI exceeded 50% in1996-98 and again in 2000, 2003 and 2006 (Hiratuka, 2008: 5; UNCTAD, 2009b). It was, however, below 40% for most of the intervening years. From a development perspective, it is often argued that Greenfield investment is to be preferred, since M&As do not necessarily result in the creation of new productive capacity in the economy (Hiratuka, 2008: 5).

4.2 Sectoral distribution of inward FDI

Table 5a depicts the sectoral structure of South Africa's IFDI stock for various years since 1996.[24] Currently, the services sector accounts for 36.6% of IFDI stock, followed by manufacturing at 32.4%, and mining at 30.9%. While the top panel of the table indicates a steady increase in IFDI stock in the services sector, the sector's share is somewhat lower than it was in the early 2000s. This is due to faster growth in the IFDI stock in mining in particular and also in manufacturing between 2002 and 2007. IFDI stock contracted rather dramatically in mining in 2008, while continuing to grow, albeit at a much slower rate, in services and manufacturing. The share of the services sector in South Africa's IFDI stock is largely accounted for by the finance, insurance, real estate and business services subsector. However, this has not been the fastest growing services subsector in terms of inward investment. IFDI stock in wholesale and retail trade (and for some years transport and communications) has grown significantly faster, but off a much lower base. Important manufacturing subsectors for IFDI in the early to mid-2000s included motor vehicles and parts, steel and other metals, paper, food and beverages, and chemicals (Thomas and Leape, 2005: 12-13).[25]

[23] IFDI into South Africa was negligible in 1985-93 as a result of the political situation, then increased slowly in 1994-96 with the political transition. IFDI spikes followed in 1997 and 2001, with foreign involvement in Telkom's partial privatisation (Thomas and Leape, 2005; Rusike *et al*, 2007: 12-13). The country has attracted more foreign portfolio inflows than FDI flows in recent years (see SARB Quarterly Bulletin, December 2009).

[24] Sectoral data does not appear to be available for South Africa's IFDI flows. The stock data was unavailable for 1995.

[25] Data on South Africa's FDI by manufacturing subsector does not appear in the SARB dataset. Data of this nature was collected by the BusinessMap Foundation from 1994 until the mid-2000s when its

Table 5a: Sectoral structure of South Africa's IFDI stock

IFDI stock in current R millions	**1996**	**2000**	**2002**	**2005**	**2006**	**2007**	**2008**
Agriculture	**356**	**457**	**655**	**734**	**888**	**858**	**935**
Mining	**2897**	**91540**	**80617**	**168271**	**250361**	**332254**	**195365**
Manufacturing	**25422**	**86783**	**67248**	**136028**	**165432**	**197099**	**204754**
Services	**30033**	**150079**	**107317**	**184284**	**195041**	**221714**	**231565**
Electricity, gas and water	-	-	30	28	29	29	29
Wholesale & retail trade, catering & accomm	7619	11895	13312	14722	16172	27766	30990
Transport, storage & communication	534	8521	10131	9449	13809	12840	15525
Finance, insurance, real estate & business serv.	21622	129162	81634	157590	162521	178580	182420
Construction	158	314	1858	1977	1983	1972	2033
Community, social & personal services	100	187	352	518	527	527	568
Total	**58708**	**328859**	**255837**	**489317**	**611722**	**751925**	**632619**
% Share of each sector	**1996**	**2000**	**2002**	**2005**	**2006**	**2007**	**2008**
Agriculture	**0.61**	**0.14**	**0.26**	**0.15**	**0.15**	**0.11**	**0.15**
Mining	**4.93**	**27.84**	**31.51**	**34.39**	**40.93**	**44.19**	**30.88**
Manufacturing	**43.30**	**26.39**	**26.29**	**27.80**	**27.04**	**26.21**	**32.37**
Services	**51.16**	**45.64**	**41.95**	**37.66**	**31.88**	**29.49**	**36.60**
Electricity, gas and water	-	-	0.01	0.01	0.00	0.00	0.00
Wholesale & retail trade, catering & accomm	12.98	3.62	5.20	3.01	2.64	3.69	4.90
Transport, storage & communication	0.91	2.59	3.96	1.93	2.26	1.71	2.45
Finance, insurance, real estate & business serv.	36.83	39.28	31.91	32.21	26.57	23.75	28.84
Construction	0.27	0.10	0.73	0.40	0.32	0.26	0.32
Community, social & personal services	0.17	0.06	0.14	0.11	0.09	0.07	0.09
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: SARB Quarterly Bulletin, various issues. Own computations for shares.

The structure of IFDI into Brazil has also been characterised by a shift from services to manufacturing and (except for 2006) mining in recent years (Table 5b).[26] The share of services in IFDI flows fell to 46.92% in 2007, while the shares of manufacturing and the primary sector increased to 39.3% and 13.8% respectively. An examination of the data at a more disaggregated level reveals that the rise in the share of the primary sector is overwhelmingly accounted for by increased IFDI into

FDI database was discontinued (see Thomas and Leape, 2005: C3-C6 for more detail on the BusinessMap Foundation database).

[26] In the case of Brazil, stock data was available by sector for 1995 and 2000, and flow data by sector thereafter.

non-agricultural primary sectors (WTO, 2009a: 159). In contrast to South Africa, it is reported that IFDI into the primary sector in Brazil tripled in 2008 raising the sector's share to 34% of IFDI while manufacturing largely maintained its previous level, accounting for 35% of inflows (UNCTAD, 2009a: 66). Within the services sector in Brazil, growth in finance and business services was consistently high until 2007 (Table 5b). The most important manufacturing subsectors in terms of IFDI flows were similar to South Africa's: foodstuffs and beverages, basic metallurgy, chemical products and automotive products (WTO, 2009a: 159).

Table 5b: Sectoral structure of Brazil's IFDI stocks and flows

	IFDI stock		**IFDI flows**			
IFDI in US$ millions	**1995**	**2000**	**2003**	**2005**	**2006**	**2007**
Agriculture and Mining	**925**	**2401**	**1484**	**2194**	**1542**	**4751**
Manufacturing	**27907**	**34726**	**4355**	**6529**	**8462**	**13481**
Services	**12864**	**65888**	**7247**	**12915**	**12702**	**16114**
Electricity, gas and water	0	7116	651	3958	2332	1055
Wholesale and retail trade	2801	9811	985	1571	1527	2759
Telecommunications[1]	399	18762	2999	1438	1377	938
Finance and business services[2]	6591	21690	1790	4200	5620	7469
Others	3072	8509	822	1748	1846	3893
Total	**41696**	**103015**	**13086**	**21638**	**22706**	**34346**
% Share of each sector	**1995**	**2000**	**2002**	**2005**	**2006**	**2007**
Agriculture and Mining	**2.22**	**2.33**	**11.34**	**10.14**	**6.79**	**13.83**
Manufacturing	**66.93**	**33.71**	**33.28**	**30.17**	**37.27**	**39.25**
Services	**30.85**	**63.96**	**55.38**	**59.69**	**55.94**	**46.92**
Electricity, gas and water	0.00	6.91	4.97	18.29	10.27	3.07
Wholesale and retail trade	6.72	9.52	7.53	7.26	6.73	8.03
Telecommunications	0.96	18.21	22.92	6.65	6.06	2.73
Finance and business services	15.81	21.06	13.68	19.41	24.75	21.75
Others	7.37	8.26	6.28	8.08	8.13	11.33
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: Hiratuka (2008: 4) for 1995 and 2000; WTO (2009a: 159) for 2002-2007.
[1]Includes Transportation for 2002-2007.
[2]Includes Real estate and Insurance for 2002-2007.

4.3 Geographical sources of inward FDI

By geographical source, IFDI stocks in South Africa have been overwhelmingly dominated by the UK since the late 1990s.[27] In 2008, the UK was the origin of 54% of South Africa's IFDI stock, followed by the US, Germany, the Netherlands and Switzerland at 7.46%, 7.42%, 5.09% and 4.62% respectively (Table 6a). As far as developing country sources go, only Malaysia has been in the top ten in the 2000s, with the exception of China in 2008 (see Note 22). Generally, less than 1% of South Africa's IFDI stock originates in the rest of Africa, with more than half of this proportion coming from Zimbabwe and Mauritius. The position of Brazil, Argentina, India and China is considered in detail in Section 4.5.

Although the top five geographical sources in Table 6a have consistently dominated IFDI stocks in South Africa since the mid-1990s, countries such as Japan, France and Luxembourg have shown an increasing presence, while others appear to engage only in occasional large deals.

[27] This is related to the change in domicile of prominent South African multinational corporations, including Anglo-American, BHP Billiton, Old Mutual and SABMiller (Rusike *et al.*, 2007: 17; Thomas and Leape, 2005: 10-11).

Table 6a: South Africa: Geographical sources of inward FDI stocks: selected countries

IFDI stock in R millions	**1996**	**2000**	**2003**	**2005**	**2007**	**2008**
UK	19377	242926	188411	350459	524170	342472
US	8594	19625	29521	32139	46346	47165
Germany	11001	19090	22858	29903	41359	46960
Netherlands	4584	11006	16066	14120	28952	32224
Switzerland	4146	10263	6102	10636	21338	29235
China	..	..	209	340	480	26760
Japan	530	1533	7127	9887	12934	17036
Malaysia	..	6816	10043	2348	2343	12750
France	3226	2531	4069	7699	12304	9228
Luxembourg	..	766	1840	2170	8569	8419
AFRICA	631	2279	4659	3989	5711	5225
Zimbabwe	..	..	2138	2138	2138	2138
Mauritius	..	..	1966	1265	1982	1910
BLNS[1]	264	270	424	419	1397	693
India	..	..	170	188	548	..
Brazil	..	..	98	181	213	..
Argentina	..	..	12	32	20	..
Total	**58708**	**328859**	**303545**	**489317**	**751925**	**632619**
% Share of country/region	**1996**	**2000**	**2003**	**2005**	**2007**	**2008**
UK	33.01	73.87	62.07	71.62	69.71	54.14
US	14.64	5.97	9.73	6.57	6.16	7.46
Germany	18.74	5.80	7.53	6.11	5.50	7.42
Netherlands	7.81	3.35	5.29	2.89	3.85	5.09
Switzerland	7.06	3.12	2.01	2.17	2.84	4.62
China	..	..	0.07	0.07	0.06	4.23
Japan	0.90	0.47	2.35	2.02	1.72	2.69
Malaysia	..	2.07	3.31	0.48	0.31	2.02
France	5.49	0.77	1.34	1.57	1.64	1.46
Luxembourg	..	0.23	0.61	0.44	1.14	1.33
AFRICA	1.07	0.69	1.53	0.82	0.76	0.83
Zimbabwe	..	..	0.70	0.44	0.28	0.34
Mauritius	..	..	0.65	0.26	0.26	0.30
BLNS	0.45	0.08	0.14	0.09	0.19	0.11
India	..	..	0.06	0.04	0.07	..
Brazil	..	..	0.03	0.04	0.03	..
Argentina	..	..	0.004	0.007	0.003	..
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

Source: SARB Quarterly Bulletin, various issues; SARB (2009). Own computations for shares.
[1]BLS for 1996 and 2000.
.. not available.

IFDI in Brazil has been dominated by the Netherlands and the US in the past decade, with the share of the Netherlands (21.4%) exceeding that of the US (19.3%) in terms of cumulative flows in 2003-2007.[28] The Cayman Islands and Bermuda became the third and fourth most important sources of IFDI into Brazil in terms of cumulative flows in 2003-2007, with shares of 7.2% and 7.0% respectively. Spain has been a consistently important country of origin for Brazil's IFDI, ranking fifth in 2003-2007 with a share of 6.0% of cumulative IFDI flows. Germany, France and Luxembourg are other significant source countries. By contrast with South Africa, the UK only accounted for 1.9% of cumulative inward flows into Brazil in 2003-2007. Inflows from Latin America are generally small, and appear to have diminished in importance in recent years from countries such as Argentina, Panama and Uruguay. Mexico, however, accounted for 2.6% of cumulative inward flows in 2003-2007. There are no significant inflows from Africa, and neither China nor India feature as inward investors of any importance in 2003-2007. The increasing role of offshore financial centres such as the Cayman Islands and Bermuda as conduits for Brazil's IFDI is evident from the data. The position of South Africa as an investor in Brazil is considered in Section 4.5.

[28] The US dominated in terms of IFDI stock in 1996 and 2000, with shares of 25.6% and 23.4% respectively. Note that, as in the case of sectoral structure, stock data by geographical source was available for Brazil for 1995 and 2000, and flow data by geographical source thereafter.

Table 6b: Brazil: Geographical sources of inward FDI: selected countries

US$ millions	IFDI stock		IFDI flows			
	1996[2]	2000	2003	2005	2007	2003-07
Netherlands	2061	11055	1444	3208	8129	23992
United States	12828	24500	2383	4644	6073	21599
Cayman Islands	1547	6225	1909	1078	1604	8087
Bermuda	887	1940	630	39	1497	7892
Spain	838	12253	710	1220	2202	6750
Germany	6040	5110	506	1388	1801	5357
France	3002	6931	825	1458	1233	4765
Luxembourg[1]	1368	1691	238	139	2857	4728
Canada	1938	2028	117	1437	819	4250
Switzerland	2924	2252	336	342	905	3607
Japan	2851	2468	1368	779	501	3550
Mexico	45	132	45	1661	409	2958
United Kingdom	1884	1488	253	153	1053	2160
British Virgin Islands	2097	3197	550	255	371	1707
Uruguay	955	2107	154	167	212	931
Chile	238	228	..	103	717	869
Panama	1352	1580	147	166	141	745
Argentina	424	758	..	112	70	388
Total	**50195**	**103015**	**13087**	**21638**	**34335**	**112031**
% Share in total	**IFDI stock**		**IFDI flows**			
	1996[2]	**2000**	**2003**	**2005**	**2007**	**2003-07**
Netherlands	4.11	10.73	11.03	14.83	23.68	21.42
United States	25.56	23.78	18.21	21.46	17.69	19.28
Cayman Islands	3.08	6.04	14.59	4.98	4.67	7.22
Bermuda	1.77	1.88	4.81	0.18	4.36	7.04
Spain	1.67	11.89	5.43	5.64	6.41	6.03
Germany	12.03	4.96	3.87	6.41	5.25	4.78
France	5.98	6.73	6.30	6.74	3.59	4.25
Luxembourg[1]	2.73	1.64	1.82	0.64	8.32	4.22
Canada	3.86	1.97	0.89	6.64	2.39	3.79
Switzerland	5.82	2.19	2.57	1.58	2.64	3.22
Japan	5.68	2.40	10.45	3.60	1.46	3.17
Mexico	0.09	0.13	0.34	7.68	1.19	2.64
United Kingdom	3.75	1.44	1.93	0.71	3.07	1.93
British Virgin Islands	4.18	3.10	4.20	1.18	1.08	1.52
Uruguay	1.90	2.04	1.18	0.77	0.62	0.83
Chile	0.47	0.22	..	0.48	2.09	0.78
Panama	2.69	1.53	1.12	0.77	0.41	0.66
Argentina	0.84	0.74	..	0.52	0.20	0.35

Source: WTO (2009a: 158) for 2003-2007; UNCTAD (2004c: 171-2) for 1996 and 2000.
Own computations for shares.
[1]Belgium/Luxembourg for 1996 and 2000.
[2]1995 data for Chile and Mexico.
.. not available

4.4 Outward FDI: destination, type and motivation

As noted in Section 2.2, there has been increasing research on the growing importance of outward FDI from developing countries (see Gammeltoft, 2007; Henley *et al*., 2008; UNCTAD, 2006). Brazil, India and China have all become important sources of OFDI, together accounting for 16.4% and 11.7% of developing country outward FDI flows and stock respectively in 2007. The corresponding shares for 2008 were 30.9% and 15.8% for flows and stock respectively, due to large additional outflows from Brazil and China that year.[29]

If South Africa is included, the proportion of developing country outward FDI stock accounted for by the group rises to 14.9% and 18.4% for 2007 and 2008 respectively (see Table 7).

[29] Shares and growth rates in this section have been computed from the data in Table 7 unless otherwise indicated.

Table 7: Flows and stock of outward FDI (millions of current US$)

		1990	1995	2000	2004	2005	2006	2007	2008
South Africa	**OFDI flow**	**27**	**2498**	**271**	**1352**	**930**	**6067**	**2962**	**-3533**
	OFDI stock	15004	23288	32333	39078	37705	50835	65859	62325
Botswana	**OFDI flow**	**7**	**41**	**2**	**-39**	**56**	**50**	**51**	**3**
	OFDI stock	447	650	517	950	796	758	1323	1060
Lesotho	**OFDI flow**	**0**	**0**	**0**	**0**	**0**	**0**	**0**	**0**
	OFDI stock	0	0	2	2	2	2	2	2
Namibia	**OFDI flow**	**1**	**-1**	**3**	**-22**	**-13**	**-12**	**3**	**5**
	OFDI stock	80	15	45	101	26	7	16	11
Swaziland	**OFDI flow**	**3**	**30**	**10**	**-1**	**-24**	**2**	**3**	**-5**
	OFDI stock	38	135	87	110	74	69	72	59
SACU	***OFDI flow***	***38***	***2568***	***286***	***1290***	***949***	***6107***	***3019***	***-3530***
	OFDI stock	*15569*	*24088*	*32984*	*40241*	*38603*	*51671*	*67272*	*63457*
Brazil	**OFDI flow**	**625**	**1096**	**2282**	**9807**	**2517**	**28202**	**7067**	**20457**
	OFDI stock	41044	44474	51946	69196	79259	113925	136103	162218
Argentina	**OFDI flow**	**35**	**1497**	**901**	**676**	**1311**	**2439**	**1504**	**1351**
	OFDI stock	6057	10696	21141	21804	2334	25897	27544	28749
MERCOSUR	***OFDI flow***	***660***	***2598***	***3188***	***10507***	***3870***	***30649***	***8668***	***21817***
	OFDI stock	*47422*	*55534*	*73427*	*91272*	*81908*	*140230*	*164209*	*191539*
Chile	**OFDI flow**	**8**	**752**	**3987**	**1563**	**2183**	**2742**	**3009**	**6891**
	OFDI stock	154	2774	11154	17413	21359	26596	32695	31728
India	**OFDI flow**	**6**	**119**	**509**	**2179**	**2978**	**14344**	**17281**	**17685**
	OFDI stock	124	495	1859	7759	10033	26799	44080	61765
China	**OFDI flow**	**830**	**2000**	**916**	**5498**	**12261**	**21160**	**22469**	**52150**
	OFDI stock	4455	17768	27768	44777	57206	73330	95799	147949
Angola	**OFDI flow**	**1**	**-1**	**-21**	**35**	**221**	**194**	**912**	**2570**
	OFDI stock	1	0	2	52	273	467	1127	3696
Developing economies	**OFDI flow**	**11909**	**55007**	**134799**	**120445**	**122707**	**215282**	**285486**	**292710**
	OFDI stock	145179	329927	862358	1116030	1283694	1731557	2360772	2356649
World	**OFDI flow**	**239111**	**361679**	**1213795**	**929641**	**878988**	**1396916**	**2146522**	**1857734**
	OFDI stock	1785584	2941724	6069882	10093115	10603662	12953546	16226586	16205663

Source: UNCTAD (2009b).
Note: OFDI refers to outward FDI. **See Table A2 in the Appendix for definitions and data issues.**

OFDI flows from South Africa have been erratic for the years depicted in Table 7, and were negative in 2008 due to the divestment of Richemont and Remgro from British

American Tobacco (UNCTAD, 2009a: 46).[30] There has generally been steady growth in South Africa's OFDI stock however, with some significant growth periods, particularly in 2005-2007. The average annual growth rate in South Africa's OFDI stock for the period 1995-2007 was 9% per annum in nominal terms. Outward investment from Brazil has been significantly higher than that from South Africa in flow and stock terms in most years. Brazil's OFDI stock, however, grew at much the same rate as South Africa's at an average annual rate of 9.8% per annum in nominal terms for the period 1995-2007.

In 2007, South Africa's OFDI stock was primarily located in Luxembourg (27.2%), the UK (20.1%), China (7.4%), Mauritius (7.38%), and the US (5.3%). In regional terms, Europe accounted for 62% of South Africa's OFDI stock, followed by Africa at 19% (SARB Quarterly Bulletin, December 2008; SARB, 2009). South America received only 0.6% of South Africa's OFDI stock in 2007.[31] In 2008, the picture differed slightly at the country level, with the UK as the destination of 24.8% of South Africa's OFDI stock, Luxembourg 11.7% and Mauritius 9.51%. China was next in importance, followed by Austria, with the US falling to sixth place. The share of Europe in 2008 was 54.8%, while that of Africa was higher at 21.8%.[32] South America's share more than doubled to 1.39% but was still very low (SARB Quarterly Bulletin, December 2009). The geographical destination of South Africa's outward investment has shifted significantly since 1996, when Europe accounted for 90% of OFDI and Africa only 4% (SARB Quarterly Bulletin, December 1997).

Brazil's OFDI stock resides primarily in other Latin American countries, and is mainly oriented towards offshore financial centres (Gammeltoft, 2007: 11; UNCTAD, 2004b: 7). In 2003, the Cayman Islands was the location of 40.5% of Brazil's OFDI stock, followed by the Bahamas (12.6%) and the British Virgin Islands (12.2%).[33] This suggests that Brazil's OFDI is strongly driven by tax shelter or currency transaction motives, rather than an intention to engage in international production. The UNCTAD

[30] Thomas and Leape (2005: C3) note that the change in domicile of large South African multinationals in the late 1990s (see Note 27) would have raised South Africa's OFDI as well as IFDI, as shares held in these companies by South African residents would have been re-classified as foreign assets.
[31] South Africa's OFDI to Brazil, Argentina, India and China is considered further in Section 4.5.
[32] In 2008 Mozambique (with a share of 1.68%) overtook the Netherlands (at 1.64%) in importance as a destination for South Africa's OFDI. The BLNS shares were very low at 0.6% in 2007 and 0.73% in 2008.
[33] Shares have been computed from the data in UNCTAD (2004b: 8, Table 4).

(2004b: 1) report comments, however, that the offshore financial centres may to some extent be acting as conduits for investment to other countries. Uruguay, the US, Luxembourg, Spain and Argentina are other important hosts of Brazil's OFDI stock. Africa, China and India have not been significant destinations.

Brazil's outward investment stock is concentrated in services (with a share of 96.8% in 2003), mainly in finance and business activities, in accordance with the high proportion of OFDI in offshore financial centres (UNCTAD, 2004b: 9). Manufacturing sector OFDI (at 2.7% of the total OFDI stock) was concentrated in food, beverages and tobacco, petroleum and other fuel products, and metals in 2003. More recently, trade, resource extraction and construction have increased in importance (UNCTAD, 2006: 114). It is reported that the preferred mode of entry of Brazilian firms in these areas is through Greenfield investments (UNCTAD, 2004b: 5).

According to Gelb and Black (2004: 181), South Africa's South-South OFDI into Africa has been market and resource-seeking in nature, with mining, finance, retail and infrastructure as key sectors. Market-seeking motives appear to have become more dominant by the mid-2000s, with the increasing importance of outward FDI in certain services subsectors like IT and telecommunications (Gelb, 2005; Henley *et al*., 2008). Using data based on UNIDO's 2005 Africa Foreign Investor survey (see UNIDO, 2007), Henley *et al* (2008: 5) report that more than 60% of outward foreign investors from South Africa into sub-Saharan Africa are to be found in the services sector, while investors from China and India operate mostly in manufacturing. Acquisitions are a significant mode of entry for South African firms.[34] In manufacturing, food and beverages is a significant subsector for South Africa's OFDI. UNCTAD (2006: 125) also points to the importance of industrial chemicals, metals and paper.

The discussion in Sections 4.2 to 4.4 indicates that the investment relations of South Africa and Brazil are oriented to and from other countries and regions. However, an examination of the sectors that are important in inward and outward FDI in each country is suggestive. There may be prospects for increased FDI between the two countries related to particular services and manufacturing subsectors. For example,

[34] It should be noted that the absence of Angola and Mauritius from the UNIDO survey is a major shortcoming in Henley *et al*.'s use of the database to analyse OFDI from China and South Africa in sub-Saharan Africa.

foodstuffs and beverages, metals and chemicals are important in both South Africa's manufacturing OFDI and Brazil's manufacturing IFDI. A clearer and more recent picture of each country's FDI at a more disaggregated sectoral level is necessary to investigate this further. This is an area for future research.

4.5 South Africa and Brazil: bilateral FDI levels and trends

In order to assess the aggregate levels and recent trends in FDI between SACU and MERCOSUR, this section explores South Africa's inward and outward FDI stocks vis-à-vis Brazil from a comparative perspective, with reference to its bilateral FDI relations with Argentina, India and China. Argentina is included as it is the other relatively large member of MERCOSUR, while India is chosen as a comparator country because of its involvement in the IBSA Trilateral Development Initiative, and China because of its emerging position in the global economy and its increasing importance as a trade and investment partner in Africa.

As Table 8a indicates, South Africa's inward FDI stock from Brazil more than doubled in nominal terms between 2002 and 2007, but has remained a mere 0.03% of South Africa's total IFDI stock and less than 1% of its IFDI from other developing countries. South Africa's IFDI stock from Argentina is negligible at a tenth of that from Brazil. In both cases, IFDI stock resides solely in the private non-banking sector of the economy.[35]

[35] The sectoral structure of the IFDI stock by geographical origin in terms of mining, manufacturing and services was not available for the countries in Table 8.

Table 8a: South Africa's inward FDI stock from selected countries by institutional sector

Stock in current R millions	2001	2002	2003	2004	2005	2006	2007
Brazil	**-**	**96**	**98**	**114**	**181**	**180**	**213**
Public corporations	-	0	0	0	0	0	0
Banks	-	0	0	0	0	0	0
Private sector	-	96	98	114	181	180	213
Argentina	**0**	**9**	**12**	**12**	**32**	**23**	**20**
Public corporations	0	0	0	0	0	0	0
Banks	0	0	0	0	0	0	0
Private sector	0	9	12	12	32	23	20
India	**158**	**152**	**170**	**183**	**188**	**271**	**548**
Public corporations	0	0	0	0	0	0	0
Banks	137	131	138	146	151	179	266
Private sector	21	21	32	37	37	92	282
China	**169**	**219**	**209**	**319**	**340**	**486**	**480**
Public corporations	0	0	0	0	0	0	0
Banks	140	182	147	159	181	218	317
Private sector	29	37	62	160	159	268	163
Total IFDI stock	**370695**	**264419**	**311208**	**362858**	**499586**	**611722**	**751925**
Public corporations	5072	4923	12207	650	-	-	-
Banks	3622	3984	4265	7759	46047	57497	63417
Private sector	362001	255512	294736	354449	453539	554225	688508
% Share in total	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Brazil	**-**	**0.036**	**0.031**	**0.031**	**0.036**	**0.029**	**0.028**
Public corporations	-	0.000	0.000	0.000	0.000	0.000	0.000
Banks	-	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	-	0.036	0.031	0.031	0.036	0.029	0.028
Argentina	**0.000**	**0.003**	**0.004**	**0.003**	**0.006**	**0.004**	**0.003**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	0.000	0.003	0.004	0.003	0.006	0.004	0.003
India	**0.043**	**0.057**	**0.055**	**0.050**	**0.038**	**0.044**	**0.073**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.037	0.050	0.044	0.040	0.030	0.029	0.035
Private sector	0.006	0.008	0.010	0.010	0.007	0.015	0.038
China	**0.046**	**0.083**	**0.067**	**0.088**	**0.068**	**0.079**	**0.064**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.038	0.069	0.047	0.044	0.036	0.036	0.042
Private sector	0.008	0.014	0.020	0.044	0.032	0.044	0.022
Total IFDI stock	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**
Public corporations	1.368	1.862	3.922	0.179	-	-	-
Banks	0.977	1.507	1.370	2.138	9.217	9.399	8.434
Private sector	97.655	96.631	94.707	97.683	90.783	90.601	91.566

Source: SARB Quarterly Bulletin, various issues; SARB (2009).
Own computations for shares.

IFDI stock from India was two-and-a-half times that from Brazil in 2007 and grew significantly more rapidly in nominal terms in the period 2002-2007, at an average annual rate of 29% compared to 17% in the case of Brazil. South Africa's stock of IFDI from China was at least twice as large as that from Brazil for most of the years in the table. While the average annual growth rate of China's IFDI stock in South Africa was marginally less than that of Brazil for the period 2002-2007, the picture changed dramatically for 2008 as a result of the ICBC/Standard Bank deal (see Note 22). By contrast with the IFDI stock from Brazil and Argentina, South Africa's IFDI from India and China is primarily found in the banking sector for most of the years surveyed. In 2007, the shares of India and China in South Africa's total inward stock were 0.07% and 0.06% respectively (compared to Brazil's share of 0.03%), and their shares in South Africa's IFDI from developing countries were about 1.9% and 1.7% respectively (while Brazil's was less than 1%).

Table 8b depicts South Africa's outward FDI stock to the same countries. While South Africa's OFDI stock in Brazil doubled between 2002 and 2007, it is only a small fraction of the size of the country's inward stock from Brazil, just 0.007% of South Africa's total outward FDI stock, and about 0.02% of South Africa's outward FDI stock in other developing countries. However, UNCTAD (2009a: 47) reports that in 2008 Aspen Pharmacare Holdings Ltd of South Africa acquired 50% of shares in Strides Latina in Brazil in a deal worth $153 million.

Table 8b: South Africa's outward FDI stock in selected countries by institutional sector

Stock in current R millions	2001	2002	2003	2004	2005	2006	2007
Brazil	**13**	**15**	**17**	**18**	**23**	**23**	**31**
Public corporations	0	0	0	0	0	0	0
Banks	0	0	0	0	0	0	0
Private sector	13	15	17	18	23	23	31
Argentina	**96**	**20**	**22**	**24**	**26**	**30**	**23**
Public corporations	0	0	0	0	0	0	0
Banks	0	0	0	0	0	0	0
Private sector	96	20	22	24	26	30	23
India	**71**	**8**	**44**	**46**	**67**	**11**	**13**
Public corporations	0	0	0	0	0	0	0
Banks	0	0	0	0	0	0	0
Private sector	71	8	44	46	67	11	13
China	**12**	**19**	**19**	**2155**	**4326**	**15894**	**33353**
Public corporations	0	0	0	0	0	0	0
Banks	0	0	0	0	0	0	0
Private sector	12	19	19	2155	4326	15894	33353
Total OFDI stock	**213184**	**189911**	**180507**	**220036**	**238490**	**354254**	**448629**
Public corporations	4414	6766	4707	3764	3779	4149	6032
Banks	7284	3411	3758	2818	1173	1038	488
Private sector	201486	179734	172042	213454	233538	349067	442109
% Share in total	**2001**	**2002**	**2003**	**2004**	**2005**	**2006**	**2007**
Brazil	**0.006**	**0.008**	**0.009**	**0.008**	**0.010**	**0.006**	**0.007**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	0.006	0.008	0.009	0.008	0.010	0.006	0.007
Argentina	**0.045**	**0.011**	**0.012**	**0.011**	**0.011**	**0.008**	**0.005**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	0.045	0.011	0.012	0.011	0.011	0.008	0.005
India	**0.033**	**0.004**	**0.024**	**0.021**	**0.028**	**0.003**	**0.003**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	0.033	0.004	0.024	0.021	0.028	0.003	0.003
China	**0.006**	**0.010**	**0.011**	**0.979**	**1.814**	**4.487**	**7.434**
Public corporations	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Banks	0.000	0.000	0.000	0.000	0.000	0.000	0.000
Private sector	0.006	0.010	0.011	0.979	1.814	4.487	7.434
Total OFDI stock	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**
Public corporations	2.071	3.563	2.608	1.711	1.585	1.171	1.345
Banks	3.417	1.796	2.082	1.281	0.492	0.293	0.109
Private sector	94.513	94.641	95.310	97.009	97.924	98.536	98.547

Source: SARB Quarterly Bulletin, various issues; SARB (2009).
Own computations for shares.

South Africa's outward FDI stock in Argentina and India was miniscule in 2002-2007, and does not show a discernible trend for the years covered in the table. Of the countries under discussion, only China has become a significant destination for South Africa's outward FDI. South Africa's OFDI stock in China grew spectacularly between 2003 and 2007, and in the latter year accounted for 7.4% of South Africa's total OFDI stock and about a quarter of the country's OFDI stock in developing countries. South Africa's OFDI stock resided only in the private non-banking sectors of the four countries.

As seen in Sections 4.3 and 4.4, South Africa's IFDI stock primarily originates from Europe and the US, while the country's OFDI is overwhelmingly oriented towards Europe and Africa, and more recently China. With respect to the countries considered in the present section, it is evident that India and China are currently more important partners than the MERCOSUR countries of Brazil and Argentina in terms of South Africa's IFDI stock. In terms of the destination of OFDI, neither Brazil, Argentina nor India were of particular significance for South Africa over the years for which bilateral data was available. However, there are indications that this picture may change with respect to Brazil and India as recent deals and initiatives are taken forward.

5. Opportunities for South Africa and Brazil / SACU and MERCOSUR

It was argued in Section 2.2 that there are potential benefits for developing countries of increased South-South FDI, particularly in the current global economic climate. Since South Africa and Brazil are among the top 10 outward investor developing countries in terms of OFDI stock, the potential for promoting FDI in SACU-MERCOSUR economic relations should be explored. There could be potential for the promotion of FDI related to production networks and other sectors that are important for manufacturing trade between the two countries. Research is needed on the comparative industrial and manufacturing export structures of South Africa and Brazil to identify sectors of importance for investment promotion, such as food processing, pharmaceuticals and autos. In this regard, information on the sectoral structure of current bilateral FDI flows between the two countries at the manufacturing subsector level is necessary.

It is evident that some significant FDI flows have been related to the growth of the services sector. The services sector is critical for development in terms of its contribution to GDP and employment[36] and its crucial role in support of manufacturing production and trade. The rapid growth of services trade has raised the importance

[36] The contribution of services to GDP is around 66% in both Brazil and South Africa, and the sector's share in employment is even higher (World Bank, 2008; WTO, 2009a, 2009b).

of services in multilateral, regional and bilateral trade negotiations. A framework for investment cooperation between SACU and MERCOSUR should explore ways in which to harness the benefits for development from FDI flows related to the services sector. In this regard, SACU could draw on the experience of Latin American countries, where services provisions of South-South regional cooperation agreements have proliferated.

As noted in Section 2.2, the critical question is how South-South investment is to be promoted between SACU and MERCOSUR, particularly in the light of the recent growth in outward FDI from developing to developed economies, the strong orientation of South Africa's outward FDI to Europe and the rest of Africa, and the extent to which Brazil's outward FDI is destined for offshore financial centres. It is evident that both countries need to consolidate existing policies and measures geared towards the promotion of FDI in their respective national economies and regional blocs. Further, cooperation should be developed and enhanced between investment promotion agencies in the two countries. The IBSA Trilateral Development Initiative is an existing forum that could be used in this context.

An important question is the role that regional integration has to play in the promotion of South-South investment flows. The discussion in Section 3 suggests that the trade provisions of a PTA between SACU and MERCOSUR could, on their own, potentially promote FDI between the two regions, depending on the motivation for existing and new flows between the blocs. The theory also suggests that the prospects for increased FDI flows are improved in the presence of explicit investment provisions in a PTA, even if such provisions simply provide a framework for investment cooperation without major disciplines. Given the small size of current bilateral flows between South Africa and Brazil, it is likely that investment relations between SACU and MERCOSUR would benefit from the inclusion of an investment framework in the PTA in the future. The IBSA Trilateral Development Initiative could be an important platform from which such investment provisions could be formalised. The more extensive experience of Latin American countries in South-South PTIAs would be useful to investigate in this regard.

South Africa has employed a range of policies since 1994 to promote FDI. These have included macroeconomic stabilisation policies through GEAR; industrial development zones to attract export-oriented FDI to the manufacturing sector; the strategic investment programme, foreign investment grant and motor industry development programme; bilateral investment agreements, as well as mining sector incentives. In addition, there have been changes in exchange control regulations to influence both outward and inward FDI, although exchange rate volatility remains a concern for investors (Rusike *et al.*, 2007: 10-11; Gelb and Black, 2004). While Trade and Investment South Africa (TISA), housed within the Department of Trade and Industry, has taken on an active role with respect to further efforts to promote sector-specific opportunities, greater policy coordination of existing investment promotion programmes is important, as South Africa's IFDI flows are still low relative to GDP and to inflows into similar developing countries.[37]

6. Conclusions and challenges

South-South cooperation and integration has long been seen as a vehicle for the promotion of development through industrialisation. Appropriate investment flows are recognised as a key aspect of such a cooperation strategy. If South-South FDI between SACU and MERCOSUR is to be promoted, both South Africa and Brazil need to take cognisance of shifts in the motives for IFDI and OFDI, particularly when considering future policies at the sector level. The orientation of FDI towards development objectives is crucial. In the SACU-MERCOSUR context this suggests that attention needs to be paid to policies that facilitate Greenfield investments and explore ways in which development benefits from M&As could be enhanced. In the case of Brazil, the orientation of outward FDI towards offshore financial centres is a constraint to exploiting FDI for development purposes.

Given the small but growing bilateral FDI flows between South Africa and Brazil, an enabling environment for enhanced investment relations between SACU and MERCOSUR could result from the progression of the current preferential trade agreement (PTA) to a preferential trade and investment agreement (PTIA) in the future, drawing on the lessons and experiences of South-South PTIAs in Latin

[37] Brazil's Federal Government has programmes to facilitate FDI, particularly in infrastructure and technology-intensive sectors. According to WTO (2009a: 16) there are no specific incentives, but policy is directed towards improving the regulatory and business environment. In principle, foreign investors receive national treatment, but FDI can be restricted by particular laws and is constrained in this way in areas such as rural property, health, and maritime and air transport.

America. Language barriers and a lack of familiarity with the business environment remain key factors in South Africa's low investment profile in South America. An appropriate institutional framework is necessary to address these constraints.

South Africa has entered into over 40 bilateral investment treaties (BITs) since 1994, with an approximately even spread of developed and developing country partners (UNCTAD, 2008: 599). A recent assessment of BITs by the South African Department of Trade and Industry was critical of their role in a developing country context (the dti, 2009). The document argues that the terms of the BITs that South Africa entered into after 1994 did not contain the necessary safeguards to protect the country's development policy space. The importance of linkages between trade, industrial and investment policy was emphasised in the document, as was the fragmented nature of South Africa's current policy with respect to both IFDI and OFDI. Against this background, it is likely that negotiations on improved investment relations between SACU and MERCOSUR would be most effective if conducted in the context of a PTIA which takes cognisance of the mutual development goals of each region.

Appendix

Table A1: Average annual growth rates (%) of global and developing country IFDI and OFDI

		1990-1995	1995-2000	2000-2004	2004-2005	2005-2006	2006-2007	2007-2008
Developing economies	**IFDI flows**	**27.01**	**17.24**	**3.11**	**13.39**	**31.73**	**22.04**	**17.26**
	IFDI stock	9.99	15.29	7.73	16.43	23.57	30.60	-2.67
World	**IFDI flows**	**10.48**	**32.28**	**-14.60**	**32.45**	**50.11**	**35.44**	**-14.22**
	IFDI stock	8.46	14.58	13.66	4.61	23.42	26.25	-4.80
Developing economies	**OFDI flows**	**35.80**	**19.63**	**-2.78**	**1.88**	**75.44**	**32.61**	**2.53**
	OFDI stock	17.84	21.19	6.66	15.02	34.89	36.34	-0.17
World	**OFDI flows**	**8.63**	**27.40**	**-6.45**	**-5.45**	**58.92**	**53.66**	**-13.45**
	OFDI stock	10.50	15.59	13.56	5.06	22.16	25.27	-0.13

Source: Own computations based on UNCTAD (2009b).

Table A2: FDI definitions and data issues

Flows	Stock
According to UNCTAD (2009b), "FDI inflows and outflows comprise capital provided..by a foreign direct investor to a FDI enterprise, or capital received by a foreign direct investor from a FDI enterprise". The flows comprise equity capital, reinvested earnings and intra-company loans. Equity capital refers to the investor's "purchase of shares of an enterprise in a country other than that of its residence". Reinvested earnings are the investor's "share of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor". Intra-company loans or debt transactions are "short- or long-term borrowing and lending of funds between direct investors (parent enterprises) and affiliate enterprises". The data are in net terms; a net increase in liabilities is recorded as a credit (with a positive sign).	UNCTAD (2009b) defines FDI stock as "the value of the share of their capital and reserves (including retained profits) attributable to the parent enterprise, plus the net indebtedness of affiliates to the parent enterprises".
UNCTAD FDI data is collected from official national sources where available, or otherwise from a variety of international sources, such as the IMF, World Bank and OECD. For South Africa, UNCTAD data on FDI flows and stocks are sourced from the South African Reserve Bank (SARB)(see Thomas and Leape, 2005: C9-C10 for a discussion of the exchange rate measure used by UNCTAD to convert Rand values to US Dollars in comparison to other international sources like the IMF). The SARB defines FDI as an ownership stake of 10% or more. According to Thomas and Leape (2005: C2-C3) the SARB reconciles annual changes in the FDI stock with flow data and valuation changes that firms report. The lag in disseminating flow data is three months and the stock data twelve months.	

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