

**PRESENTATION AT THE MINISTERIAL TASK FORCE
ON REGIONAL ECONOMIC INTEGRATION**

LUSAKA, AUGUST 13TH 2007

SADC CUSTOMS UNION STUDY
**ASSESSMENT OF COMPATIBILITY
OF NATIONAL TRADE POLICIES**

DRAFT FINAL REPORT

VOLUME I: MAIN REPORT
VOLUME II: EXECUTIVE SUMMARY
VOLUME III: ANNEXES

SUBMITTED TO
SADC SECRETARIAT

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EXECUTIVE SUMMARY

Introduction

1. The post WWII period has witnessed increased attention being paid to issues of economic integration its various forms. Much more recent, regional economic integration has captured the attention of policy makers following the various problems faced with multilateral liberalization under the World Trade Organization (WTO). Regional Trading Arrangements (RTAs) have over time shifted from focusing only on trade issues to a more broader development agenda focusing on socio-economic aspects. This shift in emphasis implies that although tariff reduction remains a key aspect of RTAs, the broader implication is how to reduce overall trading costs within and outside the trading block. The Southern Africa Development Community (SADC) is one of such cases.
2. SADC countries are determined to pursue deeper cooperation and integration as a means of addressing the region's economic and social problems. There are wide variations with regard to sizes of the countries, incomes and poverty levels. These variations notwithstanding, the formation of a regional integration scheme is a dynamic one and requires constant review to ensure that the gains from the process are shared equitably by member states.
3. Each country has own trade policy (having general objectives and country-specific objectives). In addition, the member states belong to multi blocks, some with own Customs Union.
4. SADC faces a number of socio-economic development challenges. A major challenge is that of poverty. Almost 50 per cent of the people live below the poverty line. The highest poverty rates are found in countries that have also experienced low economic growth in the past two decades. Fortunately the crusade against poverty has acquired global dimensions and involves multi players including the World Trade Organization.
5. SADC as a regional block based on a Free Trade Area, intends to move to a deeper integration that includes attainment of a Free Trade Area in 2008, establishment of a Customs Union by 2010, a Common Market by 2015, and a Monetary Union by 2016. progress towards these requires the commitment of member states.
6. Viability of a SADC Customs Union depends critically on its compatibility with current member trade regimes as well as current trade arrangements of member countries. It also requires decision on multi CU belongings. There are also choices to be made over how to

compensate member states who will lose in the process of creation of a Customs Union. At the same time the compensation process should not derail the process.

7. It is for the foregoing concerns that a study is being commissioned, with specific Terms of Reference (TORs), to shed light through informed assessment. The Economic Research Bureau of the University of Dar Es Salaam, Tanzania was commissioned to conduct the study.
8. This Draft Final Report has gone through a number of key processes and steps. First, an inception report was presented to the Client who gave comments that were incorporated in both the revised inception report and design of work. Second, the interim report was presented at three key SADC meetings, all held in July 2007: SADC Customs Union Task Force (Officials), Senior Officials on Regional Economic Integration and Ministerial task Force on Regional Economic Integration. Further incorporation of comments, analysis and consultations culminated in the Draft Final Report. The report is presented in three Volumes: I: Main Report; II: Executive Summary and III: Statistical Annexes..

Macroeconomic situation

9. SADC countries differ greatly in terms of macro economic indicators and industrial structure as well as overall poverty situation. However, the region has vast resources which can be harnessed and traded within the block and the rest of the World to address poverty and achieve the Millennium Development Goals and enhance regional cooperation.

Analysis of member states trade policies

10. Foreign trade is key to regional integration. One of the main issues affecting trade policy in individual SADC countries and in SADC as a whole is the fact that SADC member countries participate in various common trade arrangements including EAC, SACU.
11. While almost all members ratified the SADC Trade Protocol, not all are implementing it fully. This is a commitment issue which was raised earlier. If a meaningful and significant progress towards the creation of a CU in SADC is to be made, member states will have to honour all the commitments made.
12. Tariff Phase down offers by most member states are heavily back-loaded. The speed of regional trade liberalization will have to accelerate.. While increased trade liberalization within SADC is desirable the process of creation of a CU needs to take into account the initial need to protect sensitive commodities in some countries.

13. A CU calls for:

- ❖ Re-orientation from inward to outward trade policies: most SADC countries have made progress towards more trade liberalization
- ❖ Export diversification and the role of non-traditional exports - there is need for SADC countries to build new comparative advantage in non-traditional exports
- ❖ Pursuit of regional integration: already SADC has certain milestones “road map”

Additional trade policy related measures required to improve trade:

- ❖ anchoring export - orientation on competitive and stable currencies
- ❖ making trade policy more credible and effective
- ❖ integrating trade policy reforms with national development strategies
- ❖ implementing complementary measures, beyond trade reform, for lowering costs and risks
- ❖ efficient delivery of stable macroeconomic policy strong incentives, rule of law and basic infrastructure.

National Export Strategies will need, in response, to chart the way forward in the following areas:

- ❖ Identification of priority export sectors and priority external markets
- ❖ Strengthening market positioning of the priority export sectors and products
- ❖ Policy reform (trade, investment and private sector development) to enhance incentives for exporting activities and to improve external market access
- ❖ Export-related business services for eliminating constraints to exporting activities
- ❖ Initiating specific assistance programmes for enhancing export competitiveness and exploiting export opportunities
- ❖ Exploitation of production sharing opportunities - production clusters and marketing networks

Assessment of trade patterns of SADC countries

14. All SADC countries (with the exception of Angola) import more from the rest of the World (ROW) than they export to ROW. Overall SADC trade with ROW and within the block is low. This calls for a greater push for increased trade especially the search for new trade niches.

15. Top five exporters and importers are South Africa, Angola, Mauritius, Botswana and Namibia. A close look at what is exported by these countries and SADC in general shows

agricultural products followed by mineral-based commodities to be dominant and manufactures follow in fewer countries.

16. Degree of openness is small. This ratio is slightly higher in South Africa. Trade with ROW is small compared to intra-SADC trade. This observation is in line with the observation in (12) and points to the need for promoting trade activities in the (SADC) region.
17. In terms of structure of trade within SADC, South Africa is more dominant, followed by Angola. What this implies is that the country is key to any integration process in the region.
18. Trade is, in comparative terms, more intensive between SADC and ROW than between SADC countries. There is need for SADC countries to work towards more integration at industry level with a view to enhancing trade among member states.
19. South Africa's trade intensity with the ROW (0.29) is the highest among SADC countries. Even with an intensity of 0.29 with ROW, South Africa's trade is low globally and need to be increased.
20. Average trade intensity for SADC trade with ROW is 0.131 compared to 0.048 for inter-SADC trade. The implication being that in relative terms SADC countries trade more with ROW than they trade among themselves. This is not very healthy for a trade block that aspires to create a CU.
21. Revealed Comparative Advantage for SADC countries with ROW is in mineral based and agricultural commodities (aluminium, base metals, fish, essential oils, sugar, tobacco, coffee, tea and copper). In some countries (Zambia and Malawi) the RCA is as high as above 150 percent. SADC's RCA with ROW is relatively higher than for intra-SADC trade. Commodity-wise there is no difference in SADC's RCA with world and within SADC trade. The exception is in Namibia, South Africa and Mauritius

Assessment of impact of envisaged customs union: fiscal and monetary aspects

22. Analysis shows the dominance of customs and excise revenue. Import VAT is the second dominant source of revenue. The high dependence on trade-related taxes among some SADC countries has implication on the speed of progress towards creation of a CU for fear of revenue losses. However, this should not constraint the creation of a CU. SADC has a broader development agenda surpassing revenue considerations only.
23. Sacrificing sovereignty in use of fiscal and monetary policy instruments will be necessary for a successful integration.

Assessment of impact of SADC FTA on revenue, consumption, welfare, trade creation, trade diversion.

24. Removal of tariffs and quotas is a key feature of any Regional Trade Agreement (RTA) not least SADC But modern RTAs like what SADC is striving to become, are designed to achieve more than just tariff reductions. Trade policies are just one element and most often an elementary one. The essence for SADC is to work towards the reduction of the *overall cost of trade* within and outside the regional trading block. Logistical, institutional, delays at borders and regulatory barriers are often more costly than tariffs and generate no offsetting revenue. It is advantageous for all SADC member states to put more efforts to improve custom procedures, reduce transport costs and to minimize the trade distorting impact of standards.. Some of these factors which SADC has to address include:

- ❖ tariffs, quantitative restrictions and other border barriers such as taxes on trade that raise the price of imported goods relative to those produced domestically
- ❖ high transport costs.
- ❖ high costs incurred when crossing a boarder (due to documentation, bribes, delays etc.
- ❖ complications in compliance with national product standards and technical regulations
- ❖ insurance against risks especially credit risks

There are four important messages for improving SADC trade which go beyond tariff reduction. The messages being the need for member countries to:

- ❖ align customs codes with international standards
- ❖ simplify and harmonize customs procedures
- ❖ bring all tariff structures in line with international harmonized classification (HS)
- ❖ strive for transparency in customs procedures
- ❖ adopt and effectively implement WTO Valuation Agreement

Conclusion

25. Combining the criteria of model simulation results, minimum cost of adjusting to new tariffs and experiences elsewhere, this study proposes the following CET that consists of 4 bands as follows.

- (a) 0% -to cover capital goods

- (b) 10% to cover intermediate goods
- (c) 25% to cover finished manufactured products.
- (d) Over 25% – for a special category of sensitive goods to meet special revenue and other policy requirements.

All the above are MFN applied tariffs. Members of SADC may be persuaded to use specific and other non *ad valorem* tariffs.

Four bands introduce greater flexibility and is better able to capture degree of processing, sophistication of industries and level of industrial linkages.

- 26.** The issue of low tariff-high excise that may arise should not be a problem once a country is implementing the Trade protocol.
- 27.** The Study on Evaluation of an Appropriate Model for a SADC Customs Union recommended low or no duties on capital and intermediate goods, low (5-10 per cent) flat duty on consumer goods. However the methodology used differs- hypothetical CETs were used: a uniform tariff of 10 per cent, current SACU CET, the lowest MFN Schedules (Mauritius) and the Simplest MFN schedule in SADC (DRC). If our recommended CET is used different magnitudes will be obtained **though the direction of magnitudes and overall conclusions will not change.**