

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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Abbreviations and Acronyms

ACP	African, Caribbean and Pacific
AGOA	Africa Growth Opportunities Act
AIDS	Acquired Immune Deficiency Syndrome
AU	African Union
BEDIA	Botswana Export Development and Investment Authority
BIDPA	Botswana Institute for Development Policy Analysis
BNLS	Botswana, Namibia, Lesotho, Swaziland
BOT	Bank of Tanzania
CB	Central Bank
CET	Common External Tariff
CIF	Cost, Insurance, Freight
CMI	Christen Michelsen Institute
COMESA	Common Market for Eastern and Southern Africa
CRTA	Committee on Regional Trade Agreement
DDA	Doha Development Agenda
DRC	Democratic Republic of Congo
EAC	East African Community
EBA	Everything But Arms
EFTA	European Free Trade Area
EPAs	Economic Partnership Agreements
ESA	Eastern and Southern Africa
EU	European Union
FDI	Foreign Direct Investment
FOPRISA	Formative Process Research on Integration in Southern Africa
FTA	Free Trade Area
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GLI	Grubel-Lloyd Index
GNP	Gross National Product
GSTP	Global System of Trade Preferences
HIV	Human Immunodeficiency Virus
HS	Harmonized System
ICT	Information and Communication Technology
IIT	Intra Industry Trade
IOR	Indian Ocean Rim
MFN	Most Favoured Nation
MoU	Memorandum of Understanding
NEPRU	Namibian Economic Policy research Unit
NGOs	Non-Governmental Organizations
NTBs	Non-Tariff Barriers to trade
NTMs	Non-Tariff Measures
PFI	Portfolio Foreign Investment
RETOSA	Regional Tourism Organisation of Southern Africa
RIFI	Regional Integration Facilitation Forum
RISDP	Regional Indicative Strategic Development Plan
RoO	Rules of Origin
RoSADC	Rest of SADC
SACU	Southern Africa Customs Union
SADC	Southern Africa Development Community

SADCC	Southern Africa Development Coordinating Conference
SAIIA	South African Institute for International Affairs
SAPP	Southern Africa Power Pool
SCUs	Sector Coordinating Units
SEAPREN	Southern and Eastern Africa Policy research Network
SNCs SADC	National Committees
SPA SADCC	Plan of Action
SPS	Sanitary and Phytosanitary Measures
SQAM	Standardization, Quality assurance, Accreditation and Meteorology
STEM	Short Term Energy Market
STP	SADC Trade Protocol
TBT	Technical Barriers to Trade
TIFI	Trade, Industry, Finance and Investment
TNF	Trade Negotiating Forum
TRALAC	Trade Law Centre
TRASAT	Telecommunications Regulators' Association of Southern Africa
TSG	The Service Group
UNIVISA	Universal Visa
VAT	Value Added Tax
WTO	World Trade Organization

I: INTRODUCTION AND BACKGROUND

1.1. Background

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.

SADC was crafted out of the Southern Africa Development Co-ordination Conference (SADCC) in Lusaka, in 1980. At the beginning, the organization focused on functional cooperation in key sectors and used a decentralized structure of sector coordinating units and commissions for managing its program of action. The Sector Coordinating Units were directly coordinated by Member States and reported through the Secretariat to the Ministers responsible for the sectors and to the Summit. In 1992, the Summit transformed SADCC into SADC to pursue deeper cooperation and integration as a means of addressing the region's economic and social problems.

The SADC Block comprises fourteen member states: Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, United Republic of Tanzania, Zambia and Zimbabwe, each with own trade policy (having general objectives and country-specific objectives). In addition, the member states belong to multi blocks, some with own Customs union.

There are wide variations with regard to sizes of the countries, incomes and poverty levels as shown in Table 1.1.

Though the figures are good for comparison reasons, a caution has to be drawn that the processes that generate these data (population census and household budget surveys are not carried out uniformly in the countries in terms of years. However it suffices to point out to challenges such as poverty.

Country/indicator	Population 2006 (Million)	Poverty (Basic Needs 2003)
Angola	15.86	68
Botswana	1.57	30.3
Congo DR	57.5	--
Lesotho	2.40	58 (95/5)
Madagascar	18.37	72
Malawi	13.12	65.3
Mauritius	1.25	12.1
Mozambique	20.04	54
Namibia	2.05	--
South Africa	47.39	57
Swaziland	1.15	40
Tanzania	38.20	35.7
Zambia	11.87	67
Zimbabwe	11.73	34.9

Progress in Meeting Millennium Development Goals (MDGs)

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.

SADC Trade issues

There are a number of Trade issues that the SADC block has to deal with:

- SADC member states have since agreed to cooperate in the area of trade (through the implementation of the Protocol on Trade) so that by 2012 all products will be tradable duty-free in the region.
- However, already by 2008, over 85 percent of SADC Trade will be duty-free.
- The dependency of some countries on tariffs revenue from SADC imports has resulted in them phasing out their tariffs during the 2004-2008 period in order to allow time for alternative sources of revenue like value added tax to be explored as well as strengthening tax administration and modernizing customs procedures.
- In this regard, member states have followed the principle of asymmetry, which takes into account the different levels of development in the region. These are
 - the Southern African Customs Union (SACU)
 - Member States outside SACU have two tariff reduction schedules under the SADC Trade Protocol. One (the General Offer) applies to South Africa only whilst a Differentiated Offer applies to all the other SADC countries plus imports from the BLNS countries. However SACU (SA+BLNS) has one tariff offer to the rest of SADC
 - Malawi, Mozambique, Tanzania and Zambia, the least developed economies in the block, are in the third category.

The relatively well-developed SACU group was requested to front load its tariff reductions while Mauritius and Zimbabwe mid-loaded and the least developed economies back-loaded. In other words, the SACU countries are going to phase down their tariffs earlier (by 2006) and faster than the rest of the member states. The states have also set up a sub-committee on Customs Cooperation, which aims at devising measures for facilitating intra-SADC trade flows by ensuring that products comply with the rules of origin. In this regard, the sub-committee has been working on the development of a sustainable and effective system for Customs Cooperation and putting in place harmonized and simplified customs procedures that would facilitate the transit of goods. Intra-SADC trade, which is currently 22 percent of total SADC trade, was projected to increase to 35 percent by 2005. This meant that between 2003 and 2005 the productive and supply capacity of SADC as a region had to improve as long as appropriate policy measures and of resources to sectors that will contribute to enhancing trade are undertaken.

For investors, SADC Free Trade Area brings several benefits. Many SADC countries have found that their economies are too small to support a large range of viable productive investments. Therefore, it has become essential to view SADC as a single enlarged domestic market in order to allow investors establish entrenched regional market positions that would give them an access to a market of more than 200 million people. Not only would the 'domestic' market be large, but also investors would find it easier within the region and gain wider market access and invest.

Commitment to World Trade Organization (WTO)

Trade liberalization is largely determined by the commitment of the region to the WTO (Annex 2). Thirteen of the fourteen countries in SADC are members of the WTO. In the year 2002, SADC member states opted to notify its SADC Trade Protocol under Article XXIV of GATT 1994 rather than under the Enabling Clause in order to lock-in their commitment to comply with the multilateral trading rules. The notification process has now been finalized following discussions on the SADC Trade Protocol during a meeting of the Committee on Regional Trade Agreements (CRTA) held on 14 – 16 May 2007. After the session the Chairperson of the Committee declared consideration of the Protocol by the CRTA finalized thereby completing the examination process.

Trade is the most prominent form of integration within SADC. The recent progress in negotiating better market access between member states is expected to encourage intra-regional trade, entailing substantial economic benefits for all member countries. In addition to the focus on removing tariff and non-tariff barriers, attention will be focused on the market-segmenting effects of domestic regulatory policies. This includes such policies as health and safety-related product standard regulations, national competition policies, professional licensing and certification regimes, prudential supervision requirements, and administrative procedures that are associated with the enforcement of regulation (e.g. conformity assessment procedures and customs clearance practices).

Overlapping membership in regional arrangements

Several regional arrangements are already in place in the Eastern and Southern Africa region. These are COMESA, EAC, IOR, SADC, SACU and most countries are members of more than one such organization. E.g. seven countries are members of both COMESA and SADC. One member of the EAC is a member of SADC while two members belong to COMESA (Annex 3).

Multi belonging to regional arrangements have costs. Resources and capacity for negotiation become stretched. There are administrative costs related to often complex rules of origin. Multiple membership fees are expensive to pay and maintain. Conflicting objectives among rival arrangements have the potential of slowing progress in some areas.

This notwithstanding, within the Abuja Treaty (1995) framework a common market for Africa is envisaged within thirty years (a moratorium for establishing new blocks was imposed). This calls for harmonization of arrangements among the trade blocks. The Treaty thus implicitly allows a country to belong to more than one block. In order to move to an all Africa common market harmonization of regional integrations is inevitable. It is in this spirit that SADC, COMESA and EAC Blocks have begun to cooperate and harmonize certain policies.

1.2. Objective of consultancy

SADC is 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 (with a road map already agreed upon), a Common Market by 2015, and a Monetary Union by 2016.

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.

It is for the above concerns that this study was commissioned, with specific Terms of Reference (TORs), see Annex 1, to shed light through informed assessment. The Economic Research Bureau of the University of Dar Es Salaam, Tanzania was commissioned to undertake the study. A related study on “An Appropriate Model for SADC Customs Union”, with specific TORs was commissioned to Development Network Africa

1.3. Approach

A number of institutions, officials and personalities were consulted during field work that culminated into this report. Some of the institutions included those with greater focus on SADC and integration: BIDPA, CMI, Development Network Africa, FOPRISA, NEPRU, TRALAC, TRIPS.

An important part of the data gathering process was missions to individual SADC countries to dialogue with key stakeholders. The SADC Secretariat and in particular SADC Statistical Unit was also consulted. The main objective of the missions was to update and validate information as well as gain specific country insights. Extensive navigation of Websites supplemented the process.

Typical sources of information included:

- (i) International Monetary Fund (IMF): Direction of Trade Statistics, International Finance Statistics,
- (ii) World Bank: World Development Indicators
- (iii) World Trade Organization (WTO)
- (iv) Reserve Banks of SADC countries (Angola, Botswana, DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe)
- (v) National Bureau of Statistics of member countries (Angola, Botswana, DRC, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, Zimbabwe).
- (vi) SADC headquarters, Botswana (Statistical Unit)
- (vii) Research institutions
- (viii) Revenue Authorities
- (ix) Relevant Ministries such as Foreign Affairs, Trade, Industries etc
- (x) National Customs Union Task Force
- (xi) Universities and other research institutions
- (xii) The EAC, SACU, COMESA
- (xiii) SADC “contact point”/”desk” in each member country
- (xiv) CSOs
- (xv) Private sector associations

1.4. Challenges with respect to SADC data

The Statistical Unit of SADC maintains data for individual members and aggregate SADC data. The Unit maintains basic selected socio-economic statistics for all member states and generates trends and discerns how the trends evolve over time. The unit has as first priority trade statistics though certain initiatives have been taken on prices, national accounting and how census is organized, with emphasis on harmonization (facilitating process of harmonization so that the data are comparable). The quality of data (accuracy, compatibility and timeliness) depends on what the individual member countries supply to the Unit.

TIPS collaborates with the SADC Statistical Unit. The former develops some statistics to be transferred to the Unit. As a typical NGO, TIPS faces certain limitations such as ease of accessing “sensitive” information.

At the level of individual countries great care was taken when we compared information and analyzed aggregate SADC data. First there were data inconsistencies such as due to inflation, differences in financial years, etc. Second, in some years not all SADC countries were covered in the aggregate. In fewer cases some country data were missing. In addition other countries did not relay the data in good time to enable SADC Statistical Unit compile an up-to-date data base. Our study took care of all these potential problems through supplementing information on what other SADC countries report on trade with the countries with missing data and missions to individual countries.

1.5. About this report

This is a Draft Final Report. The 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. The main report is organized into seven chapters, including the introductory part. Section two provides a brief discussion of comparative analysis of SADC economies while an analysis of member states trade policies is presented in section three. The fourth section is devoted to an assessment of trade patterns of SADC countries and the fifth to assessment of fiscal and monetary impacts. Section six presents results of the analysis of impact of SADC FTA. The concluding section crowns the report.

II: COMPARATIVE ANALYSIS OF SADC ECONOMIES

2.1. Macro economy

Table 1.2 shows selected indicators of macro economic performance. As can be seen, SADC countries differ greatly in all indicators.

Table 2.1: Selected Macroeconomic Indicators in SADC Countries, 2006 (%)

Country/indicator	GDP growth (real)	Per capita GDP growth (2005)	Per capita GDP US\$	Domestic Investments/GDP
Angola	19.5	12.3	2,547.0	11.3
Botswana	-0.8	4.1	5,997.2	27.5
Congo DR	5.1	3.1	89.5	17.7
Lesotho	6.2	0.9	254.1	31.4
Madagascar	4.9	1.6	299.0	24.8
Malawi	8.5	-0.3	232.9	16.3
Mauritius	5.0	2.1	5,180.0	23.8
Mozambique	8.5	5.7	374.4	21.3
Namibia	4.6	1.1	3,297.3	23.7
South Africa	5.0	4.4	5,319.0	17.3
Swaziland	2.8	2.2	2,310.9	17.8
Tanzania	6.2	4.9	322.3	18.9
Zambia	5.8	2.8	766.6	22.9
Zimbabwe	-1.8	-7.6	440.0	7.3
SADC	5.7		1,856.4	

*= 2006 Sources: SADC, Country Reports

As reflected in Table 2.1, in terms of real GDP growth eight of the countries (57.1 per cent) experienced growth rates below the average for SADC. The highest growth rate was 19.5 per cent and lowest -0.8 per cent. Per capita income in nominal terms also varied greatly from highest nominal US\$ 5,997.2 to a low US\$89.5

Performance vis a vis SADC Convergence Targets for 2008

FOPRISA (2007) compares these ratios with SADC convergence targets for 2008 and finds that with respect to primary convergence indicators:

- Eight out of fourteen countries have met the inflation target in advance; Malawi and Zambia are expected to meet it before 2008;
- Ten out of thirteen countries for which data are available have met the budget deficit target in advance, with three others very close to meeting it;
- Five out of eight countries for which data are available have met the debt target in advance; Mozambique is expected to meet this target before 2008, while Malawi will not meet it in the same year; and
- Eight out of fourteen countries have met the current account target in advance; Malawi, Mozambique and Zambia are likely to miss this target in 2008 as they did in 2004; while Lesotho, which met it in 2004, is expected to miss it in 2008.

With respect to secondary macroeconomic targets progress was slow:

- Twelve out of fourteen countries had not met the 2008 growth target by 2004; no improvement in this scenario is expected by 2008;
- Six out of ten countries had not met the 2008 target for foreign exchange reserves by 2004;
- Six out of seven countries had met the target for net central bank credit to the government by 2004;
- Ten out of thirteen countries had not met the target for domestic savings by 2004; and

A similar number had not met the target for domestic investment by 2004.

2.2. Industrial Structure

Table 2.2: GDP Structure in SADC Countries, 2005 (%)

Country/indicator	Agriculture	Industry	Manufacturing	Services
Angola	7.2	74.0	3.6	18.7
Botswana	2.3	53.3	3.9	44.4
Congo DR	46.0	25.3	5.5	28.7
Lesotho	17.3	41.4	18.5	41.3
Madagascar	27.9	15.8	14.0	56.4
Malawi	34.7	19.4	12.5	45.9
Mauritius	6.1	28.2	20.2	65.7
Mozambique	22.3	29.8	14.2	47.9
Namibia	9.9	31.7	13.5	58.4
South Africa	2.5	30.3	18.6	67.1
Swaziland	11.5	47.6	36.9	40.9
Tanzania	44.5	17.8	7.5	37.6
Zambia	18.5	25.1	11.7	56.3
Zimbabwe	18.1	22.6	12.8	59.3

*= 2006 Sources: SADC, Country Reports, World Development Indicators

The structure of SADC economies shows a high degree of heterogeneity: countries which rely much on agriculture to the tune of close to 50 per cent of GDP to countries which rely much on on services by more than half of GDP. Industry, broadly defined to include mining is dominant in four of the countries.

The implication of such a heterogeneity is that while tariff issues may be important, effect of a CET needs also to consider industrial policy.

III ANALYSIS OF MEMBER STATES TRADE POLICIES

3.0. Preamble

Foreign trade is key to regional integration. The objective of this section is to provide analysis that will facilitate harmonization of trade policies, in preparation for the envisaged Customs Union. In particular the analysis covered, among others, tariff issues (structure, bound and applied rates), trade commitments (bilateral, regional, WTO) and Trade remedies, regulations and practices. .

3.1 TRADE POLICIES IN SADC COUNTRIES

3.1.1. The context of trade policies

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. Membership in these arrangements however, varies across the 14 member states. The organizations involved in these arrangements include the sub-regional economic integration groups of SACU, COMESA and ECA. In addition most individual members have bilateral trade arrangements of their own. These include the Development and Cooperation Agreement between the EU and South Africa. All the other members are negotiating EPAs as either SADC or ESA with the EU under the Cotonou Agreement. Furthermore South Africa is negotiating setting up of FTAs with the USA, China, India and the European Trade Area. As Sub-Saharan countries the other SADC members qualify to participate in the American sponsored AGOA scheme and quite a few of them are already beneficiaries of this preferential trade arrangement.

SADC countries also benefit from GSP and some may be beneficiaries of the Agreement on the Global System of Trade Preferences among Developing countries (GSTP).

At the continental level the AU which established the African Economic Community under the Abuja Treaty in 1991 which *inter alia* provides for the creation of a Pan-African economic market and political set up over a period of 34 years.

Finally as members of WTO the SADC countries have obligations to fulfill and honor commitments in the area of trade liberalization especially in the context of the Doha Development Agenda (DDA). Trade developments in SADC must be harmonized with the trade developments in the WTO.

While showing possible areas of challenges, emphasis in this study has been placed on areas of coordination and harmonization in the spirit of the Abuja Treaty.

SADC countries are involved in trade liberalization measures intended to generally meet the requirements of export-oriented development strategies on the one hand and on the other, commitment to WTO and membership in economic integrating schemes like SADC. There is need, however, to synchronize these various liberalization efforts to ensure that conflicts do not arise or at least are minimized.

The study has looked at both policies for imports and exports by measure and sector. Due to relative importance of imports over exports (e.g. as sources of revenue and main means of economic protection) the study dwelt more on policies related to imports especially those related to tariffs, other charges on imports and NTBs.

3.2 The major thrust of trade policies

The common feature of trade policies in SADC is the similarity of the contents of the trade policy documents. The content of these policies may be summarized as follows: Trade policy defines the guiding principles, the objectives and priorities of trade development based on the regulating and facilitating role of the state.

3.3 Objectives of trade policy

Most trade policy in SADC put emphasis on the role of trade in contributing towards the growth of industrial and agricultural production so as to contribute to the supply of goods including food commodities to the internal market. In the production of food commodities some countries aspire for food self – sufficiency but others openly recognize the role of imports in contributing to food security. In order to increase output trade policy also aims at promoting the expansion of economic infrastructure such as transport and storage facilities so as to facilitate the movement of commodities – notably to move food commodities from surplus to deficit areas and export crops from producing areas to sea ports and onwards to export markets.

In the external trade sector the objective is to aim at an increase in exports so as to improve the balance of trade between exports and imports of goods and services. Currently most countries in SADC suffer from balance of trade deficits. Most of them are also net importers of services and income earnings. This means that the overall balance of payments are in big deficit.

3.4 Trade policy priorities

Each country tries to earmark trade policy priorities for both the domestic and external trade. Most member countries in SADC put priorities in the rehabilitation and improvement of rural infrastructure in order to develop domestic trade. This is accompanied by an attempt to improve the working of the agricultural marketing sub sector.

In the external trade sub-sector, the priorities include an increase and diversification of exports especially the so called non-traditional products. Economic integration is given a new emphasis as a means of increasing economic output including exports through enhanced exports among participating countries in integration schemes such as SADC. In many member states economic reforms include enhancing the role of the private sector and the state's role becomes that of creating an enabling environment including the promotion of the initiatives initiated and implemented by the private sector. The state and private sector become collaborating partners.

3.5 Trade Policy Instruments and Practices

The most important instrument for the implementation of trade is the import tariff. This is also the most important instrument for trade integration among integrating countries like those in SADC. In addition there are customs procedures and trade facilitation measures. Below, we discuss these instruments and procedures in the context of the SADC trade protocol and future more enhanced integration arrangements in SADC

3.6 Tariffs and other charges on imports

In all countries imports are subjected to further charges besides tariffs for protective or revenue generation purposes but mostly for both purposes. For some individual commodities the revenue purpose may be more prominent while for others the protective purpose may be more dominant. Some countries, however, levy extra charges on imports to discourage consumption or as an instrument of income redistribution.

Imports may be subjected to two main types of charges – customs duties (often referred to as tariffs) and other charges - excise duties, levies, VAT or sales tax. These are added to the customs duties charged on the commodity. Custom duties (tariffs) may be classified mainly as *ad valorem* tax charged on the percentage of the value or *specific* (by each unit or unit weight, e.g. per 1,000 kilograms). In addition the calculation used may be mixed or compound or may be based on a particular formula.

3.7 Profile of Tariff Charges

Table 3.1 Shows a Summary of the profile of tariffs by each SADC member country. The table shows Simple Average Final Bound as opposed to Simple MFN Applied Tariffs. According to GATT Article II “signatories may bind tariff duties by including them in their schedules of tariff concessions annexed to the General Agreement on Tariffs and Trade”. This is taken as an irrevocable commitment not to raise tariff once bound. It is noted that there is a big gap between simple average applied MFN tariffs and the Simple Average Final Bound Tariffs. It can be observed from Table 3.1 that this gap is quite big for some countries for all sectors. On the other hand some countries have Simple Average Applied MFN averaging below 10 percent.

Averages whether simple or complicated weighted averages tend to hide the extreme values. The maximum duty is therefore also shown and as can be seen from Table 3.1 in some cases it is quite high - over 1,000 percent in two cases.

The number of Distinctly Duty Rates refers to non-*ad valorem* specific duty rates. *Ad valorem* tariffs are more transparent and thus easier to deal with, than specific and other more complicated types of rates like compound, mixed or formula tariffs. It would make things easier to trade partners if the *ad valorem* equivalents of these more complicated rates were provided. Some SADC countries have comparatively more specific tariffs and one country has the highest number of 418.

UNCTAD defines tariff peaks as those above 15 percent. Even developed industrialized economies still maintain these tariff peaks despite the otherwise much lower tariff rates charged on most imported goods averaging five percent or less. Unfortunately for

developing countries these peaks are mostly related to some imports of trade importance to developing countries - they are on products either also produced in developed countries at least some of the time e.g. flowers or they are imported as raw materials or semi - processed products and then made into final products in developed countries (e.g. coffee). The finished competing goods from the developing countries meet higher tariffs than the imported raw material. This is called tariff escalation. Some authors claim that tariff escalation is related to the fact that developing countries were not participants in the pre-Uruguay multilateral negotiations and therefore “missed” the chance to prevent this tariff escalation from taking place. Whatever, the reason, these tariff peaks have no place in the world of economic liberalization. On the other hand some developing countries including some SADC countries have a long way to go in their liberalization efforts. To attract investments equitably there must be convergence in this respect too. Without convergence towards lower tariffs the common external tariff envisaged under a customs union will be difficult to contemplate let alone to devise and implement.

Table 3.1: Tariffs Summary 2006: Final Bound and Applied MFN Averages											
	Simple Average Final Bound			Simple Average MFN Applied			Maximum Duty (all products)		No. of Distinct Duty Rates(all products)		No. of MFN Applied Tariff Lines(all products)
Country	Total	Ag	Non-Ag	Total	Ag	Non-Ag	Bound	MFN Applied	Bound	MFN Applied	
Angola	59.2	52.8	60.1	7.2	9.6	6.8	80	30	5	50	5,385
Botswana	18.8	38.4	15.7	8	9.3	7.8	597	504	56	237	6,664
DRC	96.2	98.2	95.9	12	12.8	11.9	100	30	8	18	5,794
Lesotho	78.5	200	60	7.9	9	7.8	200	96	2	237	6,664
Madagascar	27.4	30	25.3	13.3	14.7	13.1	30	20	13	4	6,145
Malawi	75.9	121.3	42.4	13.5	14.7	13.3	125	>1000	10	7	5,596
Mauritius	93.7	119.6	19.1	3.5	7.1	3	122	219	5	418	6,485
Mozambique	97.4	100	6.6	12.1	16.4	11.4	100	25	3	5	5,377
Namibia	19.1	40.8	15.7	8	9.2	7.8	597	343	57	237	6,664
S. Africa	19.1	40.8	15.7	8	9	7.9	597	>1000	57	237	6,664
Swaziland	19.1	40.8	15.7	8	9.3	7.8	597	504	57	237	6,664
Tanzania	120	120	120	12.7	19	11.7	120	100	1	20	5,425
Zambia	106.4	123.3	42.2	13.9	18.8	13.2	125	25	7	4	6,203
Zimbabwe	91.9	139.6	10.8	n	n	n	150	N	46	N	n

Source: World Tariff Profile 2006; ITC and UNCTAD

3.8 Distribution of Tariff Lines by Commodity Group and Country

Table 3.2 shows the distribution of tariff lines by country and commodity groups among SADC members. It is noted that while some countries have more than 50 percent of their MFN tariffs zero rated (i.e. duty free) – Botswana, Mauritius, Namibia and South Africa, other countries have no zero-rated lines at all.

Angola, DRC, Zimbabwe and some have less than 20 percent of their tariff lines 0-rated (Madagascar and Mozambique). While some countries have relatively low tariff rates including having fifty percent of their commodities zero rated, all countries have some commodities that attract quite high tariff rates: Table 3.3 shows the distribution of high tariff rates (over 30 percent) by country and by commodity groups.

3.9 Implications of the tariff analysis: the conclusions from that emerging from the tariff analysis are as follows.

- For those countries with still high average tariff rates, the revenue losses may constrain their trade liberalization in the WTO and in SADC in the context of their obligation under the SADC protocol. In the case of the SADC protocol the fact that some of these countries have heavily back-loaded their tariff reductions, means that the revenue problem has been postponed and will have to be dealt with sooner or later.
- The present tariff structure and profile may be used as a simple way of arriving at the kind of CET that may be appropriate for the envisaged customs union in SADC. From the above analysis we note that the present tariff structure in SADC countries has the following main characteristics.
 - (a) Most countries have some 0-rated tariff lines. The share of these lines sometimes exceeds 50 percent of the total applied tariff lines.
 - (b) Cumulatively the tariff lines rates that do not exceed the 25 percent rate account for a high percentage of total applied rates.
 - (c) In all countries, in some sectors including sectors related to some agricultural commodities, minerals and manufactured products there are relatively higher tariffs. These higher tariffs may be a result of revenue constraints but may also serve to advance the sector policies of these countries. The important sector policies here include, industrial and agricultural policies (e.g. food security, poverty eradication in rural areas).

3.10 The relevance of the experience of other integration Blocks in setting a CET

In addition to the present tariff structure currently prevailing in the SADC countries, the experience of setting up a CET in other schemes especially those schemes which involve some of the SADC members i.e. EAC and COMESA, but also experiences from other African schemes e.g. ECOWAS may also be useful in guiding SADC in the attempt to come up with a CET for the envisaged customs union. A more quantitative analysis of the envisaged CET is proposed in the next section.

BOX 3.1 East African Community Common External Tariff

Five countries form the EAC: Kenya, United Republic of Tanzania, Uganda, Burundi and Rwanda. The member countries are at different levels of economic development, Kenya being the relatively more developed. Using rigorous analytical model and experiences elsewhere a CET was arrived at. The EAC CET comprises two Schedules, 1 and 2. Schedule 1 has 0, 10 and 25 per cent rates, while Schedule 2, Sensitive Items has rates of 40, 50, 60, 75 and 100 per cent. In schedule 2 some applicable duty rates reduce by 5 per cent annually from 55 in 2005, to 50 in 2006, to 45 in 2007 to 40 in 2008 and to 35 in 2009. Duty rates in Schedule 2, for fabrics etc.) are to be reviewed within three years. *Source EAC 2007.*

Country	Frequency Distribution	Tariff lines								Non Advalorem (in %)
		Duty free	0=5	5=10	10=15	15=25	25=50	50=100	>100	
ANGOLA	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	1.5	3.8	0	0	94.7	0	0
	<i>ii. MFN Applied</i>	0	42.3	27.5	22.8	2.5	5	0	0	0
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	0	100	0	0
	<i>ii. MFN Applied</i>	0	70.1	10	9	8.1	1.8	0	0	0.9
BOTSWANA	Agricultural Products:									
	<i>i. Final Bound</i>	22.4	2.4	1.8	1.5	14.3	35.3	18.7	3.3	0
	<i>ii. MFN Applied</i>	44.8	10.5	13.4	6.7	15.6	8	0.6	0	15.1
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	13.6	5.4	21.4	20.9	19.7	15	0	0	0
	<i>ii. MFN Applied</i>	58.8	5.5	6.1	9	12.8	7.9	0	0	0.4
DRC	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0.3	1.9	0	97.8	0	0
	<i>ii. MFN Applied</i>	0	18.7	43.3	0	37.6	0	0	0	0.3
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0.9	0	0.2	3.4	0.5	95	0	0
	<i>ii. MFN Applied</i>	0	31.7	33.1	0	34.8	0	0	0	0.3
LESOTHO	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	0	94.7	0	0
	<i>ii. MFN Applied</i>	0	42.3	27.5	22.8	2.5	5	0	0	0
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	0	0	100	0
	<i>ii. MFN Applied</i>	44.8	10.8	13.9	6.1	16.3	7.2	0.4	0	15.1

Country	Frequency Distribution	Tariff lines								Non Advalorem (in %)
		Duty free	0=5	5=10	10=15	15=25	25=50	50=100	>100	
MADAGASCAR	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	100	0	0	0
	<i>ii. MFN Applied</i>	2.5	18.8	19.4	0	59.2	0	0	0	0
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0.1	1.1	1.4	4.5	11.8	0	0	0
<i>ii. MFN Applied</i>	1.8	10.9	49.2	0	38.1	0	0	0	0	
MALAWI	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	3	1.5	95.5	0
	<i>ii. MFN Applied</i>	11.9	6.2	36.4	0	39.7	0	0	0	0
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	19.1	1.5	0	0
<i>ii. MFN Applied</i>	8.2	36.8	18.3	0	36.2	0	0	0	0	
MAURITIUS	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	2.3	1	96.7	0
	<i>ii. MFN Applied</i>	66	0	8	16.5	0	14.4	0	0	0.1
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	3.7	0	0	0	0	0	1.6	0	0
<i>ii. MFN Applied</i>	86	0.4	1.1	5.8	0.8	6.6	0.2	0.1	3.2	
MOZAMBIQUE	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	0	100	0	0
	<i>ii. MFN Applied</i>	0.6	25.3	15.8	0	58.3	0	0	0	0
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0.4	0	0.1	0	0	0	0	0
<i>ii. MFN Applied</i>	2.4	34.9	31.2	0	31.5	0	0	0	0	
NAMIBIA	Agricultural Products:									
	<i>i. Final Bound</i>	23	2.4	1.8	1.5	9.8	35.7	22.2	3.3	0
	<i>ii. MFN Applied</i>	44.8	10.6	13.2	6.7	16	7.7	0.6	0	15.1

Country	Frequency Distribution	Tariff lines								Non Advalorem (in %)
		Duty free	0=5	5=10	10=15	15=25	25=50	50=100	>100	
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	13.6	5.4	21.5	20.9	19.7	15	0	0	0
	<i>ii. MFN Applied</i>	58.8	5.5	6.1	9	12.8	7.8	0	0	0.4
	Agricultural Products:									
S. AFRICA	<i>i. Final Bound</i>	23	2.4	1.8	1.5	9.8	35.7	22.2	3.3	0
	<i>ii. MFN Applied</i>	44.8	11.4	12.8	6.6	16.3	7.3	0.3	0	15.1
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	13.6	5.4	21.5	20.9	19.7	15	0	0	0
SWAZILAND	<i>ii. MFN Applied</i>	58.8	5.5	6.1	9	12.8	7.9	0	0	0.4
	Agricultural Products:									
	<i>i. Final Bound</i>	23	2.4	1.8	1.5	9.8	35.7	22.2	3.3	0
	<i>ii. MFN Applied</i>	44.8	10.5	13.4	6.7	15.6	8	0.6	0	15.1
TANZANIA	Non-Agricultural Products:									
	<i>i. Final Bound</i>	13.6	5.4	21.5	20.9	19.7	15	0	0	0
	<i>ii. MFN Applied</i>	58.8	5.5	6.1	9	12.8	7.9	0	0	0.4
	Agricultural Products:									
TANZANIA	<i>i. Final Bound</i>	0	0	0	0	0	0	0	100	0
	<i>ii. MFN Applied</i>	17	0	16.9	0	62.6	0.6	1.7	0	1.2
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	0	0	0.1	0
ZAMBIA	<i>ii. MFN Applied</i>	39.4	0	23.4	0	36.6	0.4	0	0	0.1
	Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	2.1	0.1	97.8	0
	<i>ii. MFN Applied</i>	1.9	17.3	0	22.3	58.6	0	0	0	0
ZAMBIA	Non-Agricultural Products:									
	<i>i. Final Bound</i>	0	0	0	0	0	3.5	0.5	0	0
	<i>ii. MFN Applied</i>	21.3	15.9	0	33.5	29.3	0	0	0	0

Table 3.2: TARIFF LINES IN SADC, 2006										
Country	Frequency Distribution	Tariff lines								Non Advalorem (in %)
		Duty free	0=5	5=10	10=15	15=25	25=50	50=100	>100	
ZIMBABWE	Agricultural Products:									
	<i>i. Final Bound</i>	1.3	3.2	0.1	0	2.9	0	0	92.5	2.7
	<i>ii. MFN Applied</i>	n	n	n	N	n	n	n	n	n
	Non-Agricultural Products:									
	<i>i. Final Bound</i>	1.8	3	1	0.7	1.7	0.7	0	0	0.2
	<i>ii. MFN Applied</i>	n	n	n	N	n	n	n	n	n

Source: World Tariff Profile 2006

3.11 Tariff liberalization of intra-SADC Trade

The idea of economic integration among the former Front Line States (FLS) gained momentum with the change in orientation from FLS to Southern Africa Development Community in 1980. However, it was not until change of SADCC to SADC that the current efforts for economic integration really took shape. The SADC Treaty signed in 1992 aims at developing regional cooperation and integration in order to bring about balanced economic growth and development for all members of the Trade Block.

As a main strategy for achieving the goals, the Trade Protocol was signed in 1996 aimed at establishing a WTO compatible FTA which was implemented in 2000 after eleven members ratified it. Under the FTA, products are divided into A, B, C categories. Category A products consist mostly of capital goods and equipment and were to be fully liberalized (zero-rated) in the first year. Category B consisted of commodities deemed important by member countries as sources of revenue and were to be liberalized gradually to 2008. Category C consisted of the so called “sensitive products” that were limited to 15 per cent of each member’s export merchandise and were to be liberalized between 2005 and 2012. Finally commodities in Category E were excluded from liberalization mainly on security concerns. By 2012 about 98 per cent of SADC merchandise trade would be subject to zero tariff.

Tariff phase down

The principle of asymmetry was accepted and the member countries were grouped into three for implementation purposes:

- i. Developed SACU members of South Africa, Botswana, Namibia, Lesotho, Swaziland
- ii. Developing Mauritius and Zimbabwe
- iii. Least developed Angola, DRC, Malawi, Mozambique, Tanzania, Zambia.

The SACU countries were expected to front-load their tariff reduction while the other SADC members were expected to mid-load and in some cases back-load their reductions. The tariff reduction offers made by the non-SACU members – Malawi, Mauritius, Mozambique, Tanzania, Zambia and Zimbabwe to one another and the offers these countries made to South Africa are shown in Tables 3.3 and 3.4.

Country	Tariff lines	2001	2005	2006	2007	2008	2112
Malawi	5,443	33.4	33.4	48.7	85.3	85.3	99.7
Mauritius	5,479	69.7	90.5	90.5	90.5	90.5	100.0
Mozambique	5,246	30.1	30.1	30.1	30.1	94.0	99.6
SACU	7,802	63.9	94.6	99.3	99.3	99.3	99.3
Tanzania	6,215	17.5	24.4	42.8	43.1	86.3	99.3
Zambia	6,066	54.2	54.2	95.9	95.9	95.9	100.0
Zimbabwe	7,167	30.7	30.7	72.2	72.2	89.8	98.7

Source: SADC 2007 Daft Audit Study on the Implementation of the SADC Protocol: Trade

Country	Tariff lines	2001	2005	2006	2007	2008	2112
Malawi	5,443	33.4	33.4	34.8	34.8	84.9	99.7
Mauritius	5,479	69.4	69.7	69.7	90.5	90.5	100.0
Mozambique	5,246	28.1	28.1	28.1	28.1	92.6	92.6
Tanzania	6,215	15.7	15.7	15.7	15.9	84.6	99.3
Zambia	6,066	32.1	32.1	40.0	40.0	95.9	100.0
Zimbabwe	7,167	32.1	44.0	48.4	55.4	71.6	82.1

Source: SADC 2007 Daft Audit Study on the Implementation of the SADC Protocol: Trade

The mid-term review and the currently on-going audit of STP indicate quite a number of problems in the implementation of the Protocol, most serious issue is the delay in implementing the various offers made by member countries especially the non-SACU members. This is serious because it tempts some anti-liberalization stake holders to gain support for their agitation against liberalization. The second issue relates to the anomalies that have arisen where MFN rates are lower than the SADC preferential rates and even where the MFN rates are higher the preferential margins are small or negligible.

The issue of NTBs has also surfaced. It looks like NTBs are now assuming the place of tariffs in hampering free trade in SADC. Rules of origin are a main problem in this respect. These and other issues need to be tackled to smoothen the way towards a Customs Union and beyond.

3.12: Realigning trade policy in SADC after introducing a CET

Strategies for improving trade performance

- ❖ 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

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 strong and stable macroeconomic policy incentives, ensuring rule of law and improving basic infrastructure.

Export strategy: way forward

It is important for SADC member states and the regional trading block in general to deepen the process of:

- ❖ 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
- ❖ Exploring production sharing opportunities
- ❖ Strengthening production clusters and marketing networks

IV: ASSESSMENT OF TRADE PATTERNS OF SADC COUNTRIES

4.1. Overview

In each of SADC member state the existing data base was used to work out indicators which will facilitate an analysis of the structure and trade patterns of each country. In case the indicators already exist focus was on projecting future trade patters using agreed trade protocols.

Apart from the SADC countries, data have to include a control trade block, such as the EAC for comparative analysis. This will answer two questions: By how much would intra-trade have changed if the SADC replicated some of the characteristics of other blocks? Even if there are changes in SADC trade, in which direction will the change take?

Another major reason for including other blocks derives from the fact that prior to the formation of the trading block members of the regional trade blocs had not been trading with themselves but also with some other countries. In the existence of a regional block the historical trade-flow data prior to the formation of the union are used to estimate the post-integration trade flows of the region. One of the widely used measures of intra-industry trade (IIT) is the Grubel-Lloyd Index (GLI).

4.2. Structure and Pattern

4.2.1. Structure

Table 4.1 shows the value of intra-SADC trade for selected years and reveals issues worth noting.. First, intra-SADC trade is still low. Second, that most SADC countries have a trade deficit with each other. Third, only a few countries have significant trade surplus with other SADC countries. The creation of a SADC FTA will certainly have an impact on trade flows within the block. One indication of the magnitude of the impact of the SADC FTA on trade flows is a simulation of the existing tariff bands under different scenarios beginning with the maximum applicable rate and moving gradually to the zero rate.

4.2.2. Pattern

Tables 4.1 and 4.2 show the pattern of SADC trade .

Table 4.1: SADC Trade 2005 Exports

Value (US millions dollars)																Year (Available data)
	World	Angola	Botswana	Congo Dr	Lesotho	Madagascar	Malawi	Mauritius	Mozambique	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe	
Angola	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Botswana	4,449.65	0.41	0.0	0.63	0.12	0.00	0.52	3.58	0.17	7.95	400.80	0.35	0.85	12.65	184.81	2005
Congo DR	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Lesotho	473.59		0.06	-	-	-	0.00	0.00	-	-	91.84	0.00	0.00	0.00	0.00	2003
Malawi	459.84	0.18	2.10	0.11	4.20	1.33	0.01	0.51	16.61	0.00	68.17	0.34	4.78	8.85	8.73	2004
Mauritius	2,033.22	0.05	0.37	0.00	0.59	118.02	0.13	0.00	1.31	0.11	27.33	0.11	2.72	0.54	1.80	2005
Mozambique	1,744.94	0.82	0.06	0.00	0.12	-	48.81	0.58	0.00	0.01	282.84	3.88	0.45	1.34	51.20	2005
Namibia	1,279.47	319.61	8.99	0.00	0.00	0.01	0.02	0.55	1.58	2.75	404.18	1.00	0.62	0.05	0.66	2003
South Africa	291,129.00	24,910.75	2,932.09	0.00	1,329.13	0.00	1,713.28	1,481.41	4,924.36	0.00	218.82	0.00	2,187.60	0.00	4,74.69	2004
Swaziland	1,780.84										1,283.34	0.01	15.18	10.18	9.22	2004
Tanzania	949.97	0.38	0.05	8.37	0.00	1.99	7.54	0.37	2.93	0.01	110.39	2.79	0.00	8.24	0.83	2004
Zambia	1,461.30	0.39	2.88	101.80	2.23	0.00	42.93	3.51	1.51	4.24	374.51	0.48	101.56	0.00	85.25	2004
Zimbabwe	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	2004

Table 4.2: SADC Trade 2005 Imports

Value (US 000 dollars)																Year (Available data)
	World	Angola	Botswana	Congo Dr	Lesotho	Madagascar	Malawi	Mauritius	Mozambique	Namibia	South Africa	Swaziland	Tanzania	Zambia	Zimbabwe	
Angola	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Botswana	3,271,689.50	2.13	0.00	5,812.15	278.88	0.00	1,311.33	6,790.93	511.12	14,583.54	2,769,932.27	204.66	695.04	17,994.24	48,092.17	2005
Congo DR	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Lesotho	1,106,700.25	0.00	3.06	0.00	0.00	249.72	0.00	443.24	24.74	12.97	908,651.41	0.00	0.00	16.38	745.69	2003
Malawi	92,469.13	0.00	2,892.21	9.14	1.29	0.00	0.12	1,375.84	125,293.65	90.65	293,367.31	5,093.95	21,202.87	35,800.91	43,870.69	2004
Mauritius	3,204,245.80	0.00	3.66.75	6.73	790.16	14,964.25	85.92	0.00	15,807.61	312.32	274,561.24	6,694.18	2,652.07	8,729.07	2,888.75	2005
Mozambique	2,407,098.51	42.28	2,017.30	0.00	10.52	-	29,435.01	5,612.70	0.00	22,253.12	1,043,722.74	15,570.83	4,361.80	2,982.42	16,963.68	2005
Namibia	1,402,000.64	4,448.27	1,848.69	13.74	16.44	21.66	11.95	267.46	24.15	14,434.25	1,127,861.79	280.98	54.10	454.93	6,367.50	2003
South Africa	47,775,829.30	267,070.56	366.73	6,989.80	163.54	1,621.22	10,193.72	68,092.86	31,725.99	205.11	4.57	32,272.11	163,865.07	155,266.64	435,717.60	2004
Swaziland	1,501,565.56	-	-	-	-	-	-	-	-	-	1,433,470.62	0.00	46.44	0.00	16.00	2004
Tanzania	2,426,530.85	0.53	585.61	663.90	0.00	66.12	2,865.39	4,300.44	1,5697.26	207.92	323,990.17	17,396.53	3.09	6,071.02	1,896.20	2004
Zambia	2,009,629.82	111.81	9,159.69	13,052.83	14.11	0.00	7,740.16	2,735.99	2,159.28	5,338.56	932,912.65	5,211.20	27,685.95	0.00	120,582.91	2004
Zimbabwe																

Source: SADC Trade Database, TIPS

Tables 4.1 and 4.2 show that:

- (i) All SADC countries (with the exception of Angola) import more from ROW than they export to ROW. These countries have a trade deficit with ROW
 - (ii) Top 5 exports and importers are South Africa, Angola, Mauritius, Botswana and Namibia.
 - (iii) Degree of openness, in SADC expressed as a share of exports and imports as a ratio of total world trade is small. This ratio is slightly higher in South Africa
- Trade with ROW is small compared to intra-SADC

In terms of structure of trade within SADC, South Africa is more dominant, followed by Angola (Table 4.3). What this implies is that the country is key to any integration process in the region.

Table 4.3: Structure of SADC Trade 2005 (%)		
Country	Share of Exports	Share of Imports
Angola	23.4	8.1
Botswana	4	3.2
DRC	1.9	2.2
Lesotho	0.7	1.4
Madagascar	0.9	1.6
Malawi	0.4	0.9
Mauritius	2	3.2
Mozambique	1.6	2.6
Namibia	2.3	2.8
South Africa	56.3	65.3
Swaziland	1.8	2.1
Tanzania	1.4	2.7
Zambia	1.9	2.1
Zimbabwe	1.5	2.1
SADC	100	100
<i>Source:</i> SADC Statistical Unit		

Most export-intensive (measured as export per capita of in SADC counties in 2004 were

Mauritius	\$2,732
Botswana	\$2,056
Swaziland	\$1,512
South Africa	\$1,069

- SITC (3) Mineral fuels, lubricants dominated total African export (48%) in 2004
- SITC 0 (food and live animal) dominated Eastern Africa's export structure

Southern Africa is the most diversified sub-region but is also the region where manufactured export group SITC 6, 7, 8 together account for as much as 42% of total exports

4.3. Measure of trade intensity

The analysis of patterns will follow the commonly used method that of computing the Grubel-Lloyd index:

$$IIT = \frac{|X_{ij} + M_{ij}| - |X - M|}{X_{ij} + M_{ij}} \dots \dots \dots (1)$$

Where

- X_{ij} = export of industry i of country j
- M_{ij} = import of industry i of country j
- $|X_{ij} - M_{ij}|$ is net trade
- $X_{ij} + M_{ij}$ is total export and import trade
- $i = 1, 2, \dots, n$.

Under this, an assessment will be made of the structure of intra-SADC trade and impacts of SADC FTA on intra-trade flows.

(a) *Analysis of general intra-SADC trade*

The activity will involve analysis of intra-SADC trade (e.g. exports, imports and balance of trade) and trade with the rest of the world. The analysis will show top import sources and export destinations and major trading blocks (e.g. EAC, EU, NAFTA etc). Trends in exports and imports within SADC and with the rest of the world will be analyzed.

(b) *Analysis of Composition of Trade*

The composition of trade broken down by the Harmonized System (HS) of classification will facilitate the determination of individual country's share of total imports from the world, region including SADC and from the rest of SADC (RoSADC). The breakdown into HS chapters will facilitate the determination of the fastest growing export and import commodities from the world, by regions and from the rest of SADC. Similarly the exercise will lead to the determination of the fastest growing exports to the world, RoSADC and to a particular country.

(c) *Determination of trade intensity within the SADC region*

Trade intensity, measured as a country's total exports or imports in relation to its exports to the rest of the world or to SADC region is an indicator of how the country's trade is dependent on the region. A country's export and import intensity with rest of the world and SADC can thus be assessed.

Trade intensity is measured using the Grubel-Lloyd Index (GLI) as

$$GLI_{ij} = \frac{\sum_k 2 * \min(\text{export}_{ijk}, \text{import}_{ijk})}{\sum_k \text{export}_{ijk} + \sum_k \text{import}_{ijk}}$$

Where i and j are country indices and k refer to industries

- (i) Country's total exports
Country's total exports to rest of world (excluding SADC)
- (ii) Country's total exports
Country's exports to SADC
- (iii) Country's total imports
Country's imports from rest of world (excluding SADC)
- (iv) Country's total imports

Country's imports from SADC

Country	with World	with SADC
Mozambique	0.080	0.090
Zambia	0.100	0.098
South Africa	0.290	0.010
Swaziland	0.170	0.020
Namibia	0.240	0.060
Lesotho	0.050	0.070
Botswana	0.020	0.006
Tanzania	0.032	0.050
Mauritius	0.193	0.027
AVERAGE	0.131	0.048

Table 4.4 shows that:

- Trade is in comparative terms more intensive between SADC and ROW than between SADC countries.
- South Africa's trade intensity with the ROW (0.29) is the highest among SADC countries.
- Average GLI 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.

(d) *Intra-Industry trade*

The starting point in the determination of intra-industry trade is the identification of product groups with most intra-industry trade and from these, work out the Grubel-Lloyd Index (GLI) as

$$GLI_{ij} = \frac{1}{2} \times \frac{\sum_k \min(\text{export}_{ijk}, \text{import}_{ijk})}{\sum_k \text{export}_{ijk} + \sum_k \text{import}_{ijk}}$$

$$\sum_k \text{export}_{ijk} + \sum_k \text{import}_{ijk}$$

Where: i and j are country indices and k refers to industries

(e) *Tariff Analysis*

Commencing with HS 2 classification of imports of a country from SADC and rest of the world the task will be to analyze and determine their concentration (or otherwise) on particular tariff bands (e.g. five per cent, 10 per cent etc) and hence degree of structure of liberalization of trade with respect to SADC.

(f) *Revealed Comparative Advantage*

This activity will be facilitated by HS 2 classification to identify sectors within a country or products that a country can and has produced more efficiently compared to other goods. Top 10 and bottom 10 products representing efficiently produced and inefficiently produced goods respectively will be chosen.

Revealed Comparative Advantage (RCA)

The formula for the index for country i , good j is $RCA_{ij} = 100(X_{ij} / X_{wj}) / (X_{it} / X_{wt})$ where X_{ab} is exports by country a (w =world) of good b (t =total for all goods).

From Table 4.5, RCA 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 4 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.

SADC Trade: Beyond Tariff Considerations

Removal of tariffs and quotas is a key feature of any regional trade agreement (RTAs) 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 as 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.

This is because logistical institutional and regulatory barriers are after 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. Studies including the World Bank (2003) have showed that trading can be costly in cases where various policies and factors isolate national economies from world markets and hence raise the cost of international trade. 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 standard and technical regulations
- ❖ insurance against risks especially credit risks

The World Bank study (2003) further showed that border delays tax trade heavily. For example each day lost in transport delays is equivalent to a tax of about 0.5%. The situation in crossing borders between developing countries is much worse. In the specific case relating to SADC countries the study noted that in Southern Africa delays at the main border-crossing between South Africa and Zimbabwe (Belt Bridge) amounted to six days in 2003 leading to an estimated loss of earning per vehicle of the \$ 1,750 equivalent to the cost of a shipment from Durban to the United State.

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 standard.
- ❖ simply 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

V: ASSESSMENT OF IMPACT OF ENVISAGED CUSTOMS UNION: FISCAL AND MONETARY; AND REQUIRED ADJUSTMENTS

The objective of the analysis in this chapter is to determine revenue and thus fiscal aspects and monetary issues linked to the envisaged SADC Customs Union.

5.1. Fiscal performance

Funds for government expenditure come from among others, taxes, and non-tax revenue (domestic and foreign borrowing, investment incomes, grants, disposal of assets).

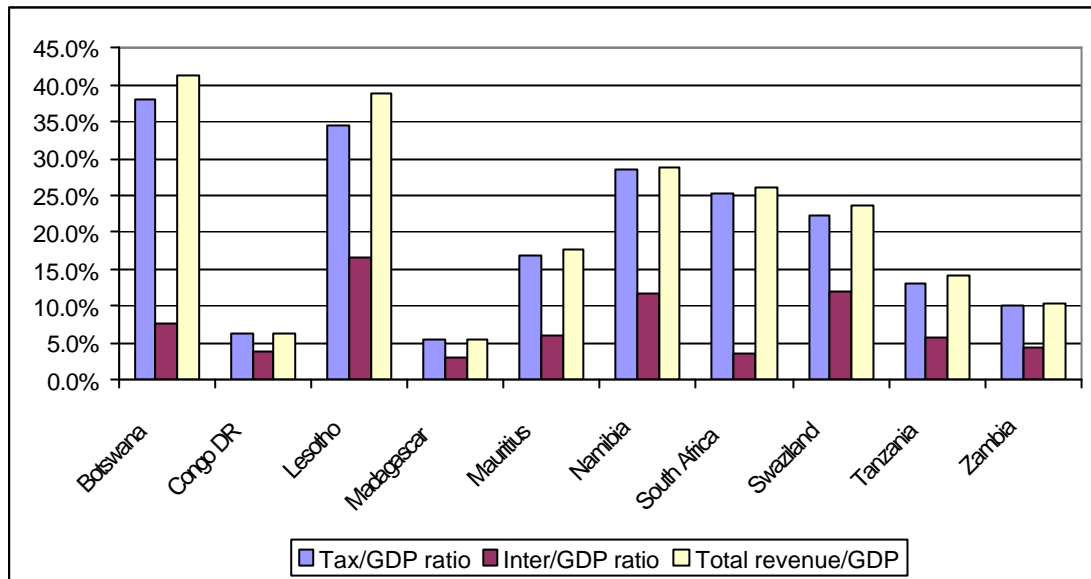
A common feature in most of the SADC is a low share of tax revenue in GDP compared to the developed countries. Revenue as a proportion of GDP averaged 21.3 per cent in 2005. The highest ratio was 41.4 per cent. Tax revenue as a proportion of GDP varies considerably among SADC countries and ranges from a low 5.4 per cent to a high 38.2 per cent. The average as shown in Table 5.1 was 20.0 per cent.

Taxes on international trade account for 7.4 per cent of GDP on average with the highest value of 16.6 per cent and lowest being 3.0 per cent

Table: 5.1: Revenue and Tax Effort in the SADC 2006 (%)			
Country	Tax/GDP ratio	Inter/GDP ratio	Total revenue/GDP
Botswana	38.2	7.6	41.4
Congo DR	6.3	3.8	6.4
Lesotho	34.5	16.6	38.7
Madagascar	5.4	3.0	5.6
Mauritius	16.7	6.0	17.7
Namibia	28.7	11.5	28.9
South Africa	25.3	3.4	26.0
Swaziland	22.3	12.1	23.6
Tanzania	12.9	5.7	14.1
Zambia	10.1	4.3	10.4
SADC	20.0	7.4	21.3

Source: IMF International Financial Statistics, 2007

Figure 5.1: Proportion of revenue in GDP: SADC Countries 2006



There a number of channels through which implementing CU will impact the fiscal stance of SADC economies. The new tariff schedule will change domestic prices of imported goods and thus demand for imports by consumers and supply by domestic producers of such goods. Customs revenue will be affected by changes in tariff rates for MFN and regional imports, together with the change in import flows. Whether the formation of the CU has positive or negative effects will be determined by the aggregate effects.

When MFN tariffs are changed, downwards, import prices decline and imports expand. The extent to will depend on import demand elasticities. If MFN tariffs are increased, the opposite is observed i.e. a decline in imports.

If regional tariffs are reduced on a preferential basis, the effect is less straight forward since it may not necessarily have an effect on domestic prices of the imports. When regional imports for any given tariff line are only a small fraction of total imports and thus dominated by third country imports on which MFN tariff is applied the domestic price for the imported good will be determined by the market price and the MFN tariff rate. Under such circumstances, regional tariff preferences will thus not lead to a decrease in import prices or a change in import demand. If imports of certain tariff terms are predominantly sourced from CU partners, the regional tariff preference will lead to a reduction in the import price for such goods and a demand expansion.

The effect of forming a CU on customs revenue is in general undetermined – it depends on a country’s tariff levels prior to joining a CU, the CET, import demand elasticities, and export supply elasticities in the CU member state.

There are two effects, the effect on customs duty revenue from the change in tariff rate and the effect on domestic tax receipts (excises and VAT) collected on imports.

Box 5.1: Revenue Impact of a FTA	
Trade Policy Change	Revenue Effect
Customs duty	
Reduction in third country MFN rates	Ambiguous. Positive if the tariff base (CIF value) increases significantly to compensate for the tariff rate reduction negative otherwise
Elimination of intraregional tariffs Domestic tax revenue on imports Change in the tax base for excises (CIF input value + tariff duties) and for VAT (CIF import value + tariff duty + excises)	Negative. If tariffs are completely eliminated, collection of tariff revenue from regional imports is 0, if the CU is complete the effect is ambiguous but likely to be still negative ambiguous. Positive if imports increase by enough that the increase –ur -
Elimination of discriminatory surcharges	Negative
<i>Source: Castro et al (2004)</i>	

To compute the effects of the SADC CU implementation on revenue collection we have to know the changes in tariff protection and the changes in import flows that will be triggered by the change in trade policies. By comparing the current tariff schedules with the planned, we can calculate the change in tariff protection.

5.2. Importance of international trade taxes

As Table 5.2 indicates, tax revenue and taxes on international trade contribute a significant share to tax revenue (the highest is 63.6 per cent and lowest is 13.7 per cent. The base customs revenue consists of three categories:-

- (i) Tariff revenue (current CET schedule applied on CIF value of imports)
- (ii) Excise revenue on imports (current excises rates applied on CIF value plus tariffs); and
- (iii) VAT revenue on imports (VAT rates applied on CIF value plus tariffs plus excises/suspended duties-suspended duty to be included if it is permanent or significant fraction of customs revenue)

The relative importance of customs revenue (customs duty collection) and domestic tax collection on imports as a source of government revenue, the SADC is given in Table 5.2.

Country	% tax revenue	% taxes on international trade revenue	% income tax	% VAT	% other tax	% non tax revenue
Botswana	87.7	29.22	18.85	19.16	20.42	12.35
Congo DR	99.3	63.57	34.14	1.54	0.05	0.69
Lesotho	87.4	49.78	22.35	15.02	0.23	12.62
Madagascar	97.6	60.68	12.96	23.19	0.79	2.38
Mauritius	94.3	35.87	15.85	42.53	0.05	5.70
Namibia	99.2	40.19	38.44	19.65	0.90	0.82
South Africa	97.4	13.68	55.54	27.92	0.30	2.56
Swaziland	96.2	33.83	15.30	46.92	0.11	3.84
Tanzania	92.2	39.33	23.62	20.83	8.37	7.85
Zambia	96.4	41.66	44.08	10.68	-	3.59

Source: IMF GFS Manual Book 2006; Central Banks Publications (various)

Fig 5.2 Tax Revenue Share on Total Revenue in the SADC: 2004/05

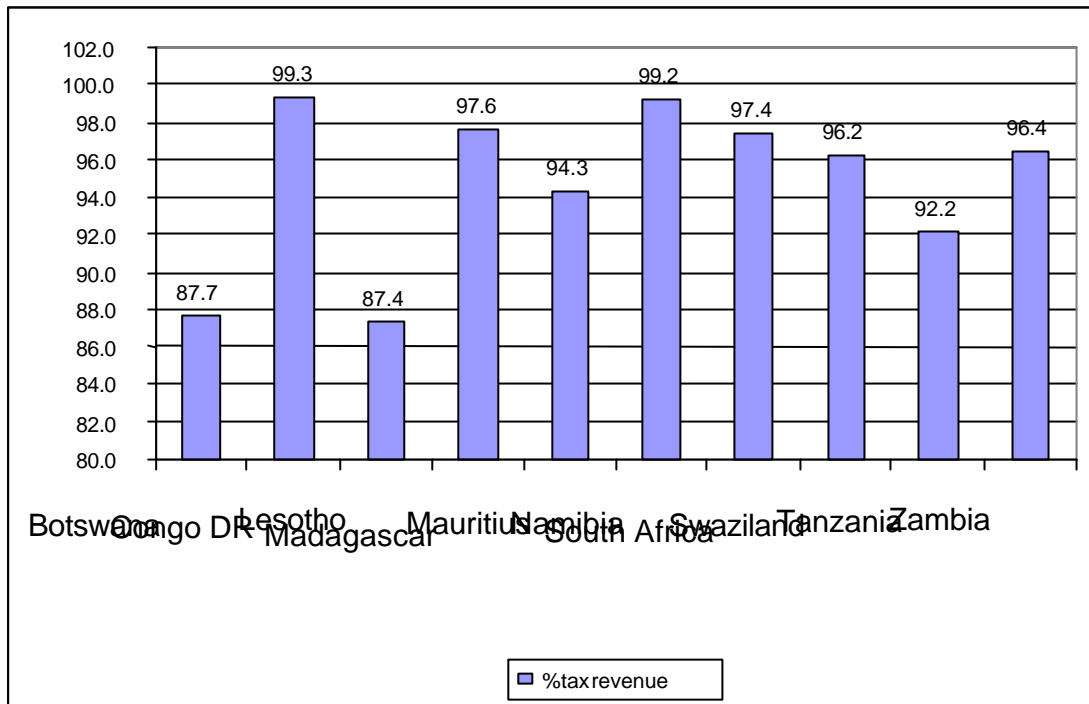
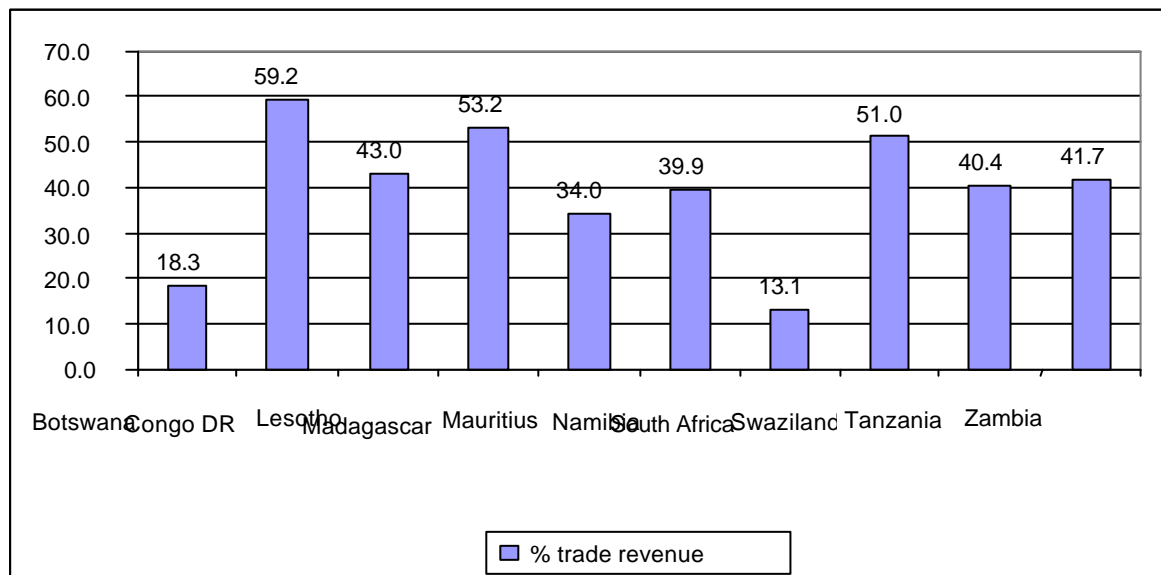


Fig 5.3 Share of taxes on international trade in the SADC (% of revenue): 2004/05



5.3. Revenue Implications

Apart from cheaper imports for consumers and producers following a CU, another effect is on revenue - implications of changes in trade policy. An additional step is required for calculation of the revenue effect of CU implementation to that of changes in import flows. The results are shown in Section 6.

5.4. Fiscal Policy and CU

Taxation in a member country increases the domestic prices while those of the partners are left unaffected. In the absence of a CU, protective measures could be applied, but to counteract the increased imports of cheap goods from member countries producing the same goods. High taxation can also affect investments as business is likely to move to the country with lower rate of taxation. Hence the difference between the rates of taxation on business profits for example, in member countries can only be limited.

5.5. Monetary Policy and CU

Internal monetary policy may influence prices and export – import performance of member countries. For example if one of the trading partners pursues an inflationary policy while the other does not prices in the importing country rise thus decreasing imports. The country pursuing the inflationary policy can counteract this unfavourable development of the balance of payments by increasing import duties, introducing quotas, devaluing etc. But, under a Customs Union, this cannot be done.

External monetary policy, exchange control in particular by one of the customs union countries is not possible without the same exchange control by the other. Devaluation is one of the means of protection, and a country within a CU should not be permitted to devalue alone.

Monetary Union and its single currency presumes a common monetary policy with a common interest rate and exchange rate which in turn requires more or less similar levels of the budget deficit and national debt ratio, and inflation rates that are not divergent.

After a review of the current SADC macroeconomic convergence initiatives, -inflation, interest rates and exchange rates, it is seen that there is a convergence group (the rand-based Common Monetary Area-South Africa, Lesotho, Swaziland, Namibia and outside CMA –Botswana, Mauritius, Mozambique and Tanzania) whose macroeconomic performance satisfies some of the criteria of monetary union. Countries that cannot be considered as converging are Angola, DRC, Zambia and Zimbabwe

Country	Inflation rate	(Deficit)/ Surplus/GDP	M2/GDP	M2 growth rate	Public Debt as % of GDP	Current Account Balance as % of GDP
Country	2006	2006	2006	2006	2006	2006
Angola	12.2	(3.4)	19.1	57.3	25.5	16.4
Botswana	11.6	8.1	31.7	8.8	3.8	20.9
DRC	18.2	(0.7)	11.1	58.9	133.4	-7.5
Lesotho	6.0	13.3	33.8	35.4	49.9	4.3
Madagascar	10.8	(10.3)	19.2	25.6	30.0	-8.8
Malawi	13.9	(1.5)	16.0	17.4	28.5	-31.2
Mauritius	8.9	(5.3)	90.7	10.0	57.9	-9.5
Mozambique	13.2	(1.0)	27.7	23.3	47.7	-8.0
Namibia	5.1	2.1	48.4	2.6	31.4	18.3
South Africa	4.6	0.04	67.0	22.5	33.3	-6.4
Swaziland	5.3	(2.1)	21.7	9.3	17.1	1.8
Tanzania	6.2	(5.5)	21.3	13.7	50.0	-10.9
Zambia	8.2	(1.9)	21.9	45.0	25.8	-1.2
Zimbabwe	1281.8	(5.5)	108.0	1,416.5	76.2	-7.9
SADC*	10.4	(1.0)	169.6	250.2	41.0	-2.1

Notes: * without Zimbabwe. The convergence criteria are single digit inflation by 2008; deficit less than 5% by 2008; Public Debt less than 60% of GDP Current Account Deficit not wider than 9% of GDP.
Source SADC(2007) : Integrated Paper on Recent Economic Developments in the SADC

VI ASSESSMENT OF IMPACT OF SADC FTA ON REVENUE, CONSUMPTION, WELFARE, TRADE CREATION, TRADE DIVERSION.

In this section we report the results of the simulations as given in Appendix 6. A total of 140 equations were estimated, ten for each country.

6.1. Effect on Import Flows

Using the partial equilibrium model, specified in detail in Annex 4 the import flow changes are computed. We use data collected from the governments of the SADC member states, on trade flows MFN tariff rates, preferential tariff rates, customs revenue, suspended duties and excises at the 9 – digit its level. This included the negotiated CET and a list of “sensitive” and other products for which the SADC countries have so far not decided tariff classification. The simulations use 2005 as base line.

Model Framework

We use a partial equilibrium framework to analyze the potential trade and revenue effects of introducing SADC FTA preferential trade agreement, along the lines suggested by Mckay *et al* (2000) See Annex 5.

Basic assumptions:

1. Markets are perfectly competitive
2. There is perfect substitutability between imports and domestically produced goods (of similar type)
3. Prices for imports from SADC are higher than prices of the rest of the world (ROW)

6.2. Trade creation and trade diversion among partner states

For an analysis of trade creation or trade diversion, we need to include domestic supply functions and change the assumption that the MFN CET determines all import prices. As it was argued earlier, regional tariff preferences would have an effect on import prices and import demand only if a large fraction of imports is sourced regionally. We can check whether this assumptions realistic by looking at the composition of imports.

In all countries regional imports are dominated by imports from third countries. Close to 100 per cent of all regional trade flows are in goods where importing countries source predominantly from third countries, and only a small proportion where SADC partners are sole suppliers of import products. It is this likely that all increases in regional trade are driven by substitution of regional for third country imports, that is trade diversion

6.3. **Welfare effect**

Simulation of the effect of tariff charge on welfare and shows a rapid decline in welfare resulting from tariff reduction from 40 percent to 25 percent. Tariff reduction below 25 percent will lead to unacceptable welfare losses.

Welfare effects are in theory equal to production effects. However it is important for SADC countries to consider adjustment measures aimed at increasing domestic production especially non traditional products. Likewise, it is vital for countries to acquire new production technologies for boosting domestic production and eventually export to other SADC member states and ROW.

A tariff reduction of up to 25 percent can be considered in conjunction with introduction of welfare protection measures.

6.4. **Winners and Losers**

Insights on winners and losers and the distribution of benefits from integration are obtained from our simulations of changes import flows from implementation of the CET and the calculation of the revenue collection consequences.

Imports from third countries will increase in (countries) resulting in consumer surplus and producer surplus for producers using imported inputs. Producers of import competing goods may see their profit margin shrink under the competition of imports. The overall effect will be increased welfare for the economies as a whole although there will be winners and losers. Imports of goods consumed by the poor, and those for subsistence farmers will be cheaper and this help poverty reduction.

If some economies will lose

- Possible need for a compensatory fund
- A compensatory mechanism for the SADC
- Adjusting revenue generation
- Leakages and exemptions
- Harmonizing exemptions

Effect on Import Flows

GATT Article XXIV does allow for the negotiation of customs unions or free trade areas that offer preferential treatment to member countries, subject to certain conditions. The most important of these is that free trade area should 'eliminate duties and other restrictive regulations of commerce on substantially all the trade between constituent territories in products originating in such territories' [GATT Article XXIV, paragraph 8 (b)].

The full establishment of a free trade area shall include a plan and schedule for the formation of such a customs union or such a free trade area within a reasonable length of time (but not more than 10 years). However, there do not seem to be any symmetry

requirement on the speed of liberalization (“reasonable length of time” criterion). Some asymmetry is likely to be desirable.

Simulation of the impact of tariff reduction on revenue and the results show that e.g for Tanzania:

- (i) A reduction of tariff from 40 percent to 25 percent leads to a reduction in revenue more gradually than the drastic/steep revenue loss emerging when tariff is reduced from 25 percent to 15 percent.
- (ii) At tariff rates between 25 percent and 30 percent revenue loss is 576,058 units or 40 percent this makes the 25 percent rate to be preferred both in the simulation of consumption and revenue effects.
- (iii) Rates below 25 percent will lead to drastic revenue losses among SADC effects

Simulation of the effect of tariff changes on consumption using the maximum tariff rate band (40%) applicable in SADC. The resulting effects which have implications on proposals for an applicable CET in SADC are that:

- (i) A tariff reduction from 40% to 35% and to 30% results into a small consumption effect of 9.2 and 11 per cent respectively.
- (ii) A resulting of tariff from 25 percent to 15 percent should not be considered due to its high 34.8 per cent reduction in consumption
- (iii) The minimum CET rate for SADC is 25 percent as other lower rates will lead to reduced consumption effects. This is within CET’s applicable in other RIS in East and Southern Africa.
- (iv) If this 25 percent rate is acceptable protection measures for products with high RCA’s will be needed in order to protect them from global competition.

6.5. Trade Diversion and Trade Creation

Trade diversion is simply replacement of imports from other trade partners not party to the preferences by imports from “new” partner. In essence it is diversion of trade from more efficient (extra-regional) (ROW) suppliers to less efficient (extra-regional) suppliers. This occurs when the formation of the FTA reduces the efficiency of resource allocation when trade between partners expands because of the preferential market access given to one partner compared to ROW. Under this phenomenon, imports are shifted from the most efficient source to a more expensive one. Trade diversion is not driven by competitive advantage and therefore leads to a distortion in resource allocation, with no or little change in consumer prices, a decline in tariff revenue and a decline in welfare. The reduction in the country’s welfare could be due to reduction in consumer surplus, reduction in producer surplus and a reduction in government revenue as a result of tariff revenue loss by a home country. Reduction in government revenue in turn may reduce government spending or raise government debt. Trade diversion is also associated with costs of enforcing rules of origin, loss of foreign direct investment in sectors affected by trade diversion, and unemployment in some sectors as a result of situational and short-term dislocation of local private business. Trade diversion is not often preferred because it leads to a reduction in welfare (though not always the case).

Trade creation, on the other hand, is simply replacement of inefficient local producers by more efficient foreign producers. It is in essence displacement of less efficient home products by globally efficient extra-regional imports or more efficient extra-regional imports. In this case trade expands due to expansion in output following international comparative advantage and a more competitive producer (partner) replaces a less competitive domestic one, leading to an increase in allocation efficiency and thus reduction in consumer prices, and increase in welfare. The revenue effect may be negative or positive. However, trade creation or trade substitution effect, together with loss in producer surplus for home country exporters, allow consumer surplus on this component of trade effect to increase. The benefits associated with trade creation include lower price of imports from partners leading to consumer surplus, greater variety of goods, saving on real resources, expansion of business due to ready and cheap availability of imported inputs, possible increase in exports, reduced cost of trading due to preferential access, and increased foreign direct investment if opportunities arise due to harmonized credible policy environment over a larger market. However, apart from revenue loss, the costs of trade creation may include temporary dislocation or competing-out of local producers of similar products leading to negative production effect and loss of employment, and costs of enforcing rules of origin. Trade creation is desirable.

The analysis is often undertaken at an aggregate level, assuming a homogeneous single sector economy.. However, in practice there is both product and tariff rate heterogeneity to accommodate in any application of the framework. As a result, in specific sectors there may only be one of the trade effects. We thus, adopt a framework that distinguishes between those sectors where the ROW is the dominant supplier prior to FTA formation. We focus on three particular cases, namely: consumption effect with trade diversion, welfare effect with trade diversion and welfare effect with trade creation

6.6. Comparison of results with results of recent studies on SADC

Draper et al (2006) made an analysis of the impact on South Africa, indispensable for any economic integration in the SADC region, accounting for about 60 per cent of SADC total trade and about 70 per cent of SADC GDP.

Results of the analysis of trade creation and trade diversion showed the products with highest trade diversion to be tobacco, cotton, apparel articles and vehicles. The results are not surprising given that in all these products the SADC tariff was much lower than the MFN rate. High MFN tariffs protect producers from potential more efficient ROW exporters, thus leaving the South African consumer to bear the cost.

In terms of trade creation the authors found no net trade creation, only lower trade diversion implying no new trade created and no significant displacement of South African producers. Total trade creation was R 300 million, trade diversion R670 million and net trade diversion R370 million.

Study on Evaluation of an Appropriate Model for a SADC Customs Union

This study, commissioned along our study, 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.**

VII CONCLUSIONS AND RECOMMENDATIONS: TOWARDS A CET

7.1. Conclusion

The analysis of this study has shown (and thus recommends) a CET of 25 per cent. Countries thus need to harmonize their trade policies in preparation for the Customs Union

Conclusions

- Formation of a CU requires members to
 - dismantle all barriers to trade (tariff and non-tariff) between each other
 - implement a harmonized customs administration, including commodity classification, customs valuation system, customs procedures, documentation and Rules of Origin, and agree on the modality of sharing tariff revenue and the CET.
- The SADC has made some progress on some of these aspects comprising of:
- phasing out internal tariffs
 - putting in place Rules of Origin that are compatible with WTO
 - harmonizing Nomenclature as well as documentation procedures
 - adopting the Customs Valuation according to WTO rules and regulations
- The impact of Union formation on each SADC member country depends on whether or not the positive trade creation effect outweighs the negative trade diversion effect with other members
 - Decline in customs revenue (tariffs and domestic taxes on imports) - most SADC countries depend on customs revenue as a source of tax revenue
 - Winners and losers
 - Implementation of the CU will lead to increases in welfare driven by the reduction in import prices, which will benefit consumers and producers using imported inputs.
 - However, there are several economic conditions that can make a net welfare gain more likely for a Union.
 - Where the initial tariffs are large in the member countries it is more likely that trade creation will outweigh trade diversion.
 - The more efficient members are, relative to the world, the lower the trade diversion effect
 - Tariff schedule with top rate at 25percent should be the preferred choice. Simulation results of production and revenue effects show that with a top rate of 25%, costs and benefits of CU implementation are more balanced
 - Establish a limited list of “sensitive” products that will receive further protection in addition to the top rate of 25% depending on the share of sensitive goods in total imports (tariff revenue) and other considerations.
 - Options to offset revenue loss
 - Losers/Winners – richer member states will have to compensate the not so rich (following lessons from the EU on the formula used to distribute Customs Union revenue)

- Under a CU the SADC countries will have a good opportunity to revamp their customs administration and increase efficiency to reduce customs leakage, which would serve to reduce customs revenue losses.
- Economic convergence is a condition for the survival of the integration (M2 growth, budget deficit/GDP, inflation, interest rate spreads etc. A good proportion of SAD member countries are still to meet convergence features
- Sacrificing sovereignty in use of policy variables is necessary for integration. (the interest rate and exchange rate in the case of monetary policy and the import tariff for the case of industrial policy).

7.2. Recommendations

A Proposed CET for SADC;

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.

The issue of low tariff-high excise that may arise should not be a problem once a country is implementing the Trade protocol.

Deeper analysis at country level

While our results have pointed out the desired CET, at the level of individual countries there will be losers and winners. The losers will need to be compensated. Identification of losers and winners will have to be made at the country level using a general equilibrium framework such as Computable General Equilibrium (CGE) model or Social Accounting Matrix (SAM). Countries for which such an analysis has been done show very interesting policy insights.

Tanzania 2004

Mbelle et al (2004) made a simulation of the impact of a reduction in tariff charged on imports from the EU using four scenarios; 50 per cent, 80 per cent, 90 per cent and 100 per cent reduction. The starting point of the analysis in the institution block, government (in SAM) and import tax and price block in the CGE. Sectors/activities with unambiguously negative impact were found to be growing of paddy, wheat, cotton,

tobacco, cashew nuts, sisal, sugar; Mining and quarrying; processing of meat and dairy products, grain milling; processing of food; wood, paper, printing; manufacture of basic and industrial chemicals; manufacture of fertilizers and pesticides; rubber, plastic and other manufacturing; glass and cement; transport and communication and business and other services.

In general domestic production suffers especially agriculture, manufacturing and mining.

Impact on households

1. A large section of households suffer on consumption, especially urban households.
2. Real household consumption suffers.
3. Factor incomes decline in paddy, wheat, cotton, tobacco, sisal, sugar etc.

The core results of the CGE simulations showed that the impact on sectors of the economy is unambiguously negative with each subsequent reduction. For some sectors the negative impact occurs after a reduction in excess of 50 per cent. The implication is that the economy experiences the greatest shock if the EPA impacts adversely more on activities and commodities compared to aspects of government and taxes (import duties).

Madagascar (2007)

Hallaert (2007) used a CGE framework to simulate the impact of SADC FTA on the Republic of Madagascar. The results suggested that the SADC FTA had a limited impact because of the small share of SADC imports. Textile and clothing sector benefits. However gains become substantial with multilateral liberalization.

Required adjustments

The attention on impact should be directed to losing activities. As such adjustments at the country level need to be made with respect to:

1. Economic policy (exchange rate, employment)
2. Sectoral policy
3. Trade policy

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.**

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