

Evaluation of an Appropriate Model for a SADC Customs Union

Overview of Report & Implications for Mozambique

17 September 2007



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Scope of work

- Identify appropriate options and modalities for a CU
- Suggest a tariff collection and distribution mechanism
- Assess the potential **economic** impact on SADC

International experience



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Forms of economic integration

- **Preferential Trade Arrangement (PTA)**
 - preferential (but not necessarily free) access to each others markets
- **Free Trade Area (FTA)**
 - tariffs and quantitative restrictions (QRs) are abolished
- **Customs Union (CU)**
 - common external tariff (CET) on imports from non-members
 - No rules of origin
- **Common Market**
 - free movement of capital and labour
 - common trade policy
- **Economic Union**
 - harmonise economic policies

Examples of type and scope

- The EU which has gone further than any other regional integration scheme.
- CARICOM, which contains both more and lesser developed countries, has a partly regionalised trade policy negotiation system.
- The EAC, which has a limited membership and a clearly articulated plan to complete the CU within a relatively short period of time.
- The CACM, which has made substantial progress in recent years around a common, low-tariff policy.
- MERCOSUR, which serves to build a large and protected regional market.

Lessons for SADC

- Transition periods are long and in most instances implementation is partial.
- Variation still exists on nominal and effective CETs.
- Intra-regional trade is not always free.
- The removal of physical and administrative barriers is slow.
- Most CUs have (limited) provisions on competition.
- Formal SDT is rare.
- Agreement on trade in services is even rarer.



**[Options for revenue
collection and distribution]**



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Revenue Options for SADC

Option	Collection		Ownership		Allocation	
	Destination	Entry	Change	No Change	Fund	Formula
A	X			X		

Revenue Options for SADC

Option	Collection		Ownership		Allocation	
	Destination	Entry	Change	No Change	Fund	Formula
A	X			X		
B		X		X		

Revenue Options for SADC

Option	Collection		Ownership		Allocation	
	Destination	Entry	Change	No Change	Fund	Formula
A	X			X		
B		X		X		
C		X	X			X

Revenue Options for SADC

Option	Collection		Ownership		Allocation	
	Destination	Entry	Change	No Change	Fund	Formula
A	X			X		
B		X		X		
C		X	X			X
D		X	X		X	X



Revenue impact analysis



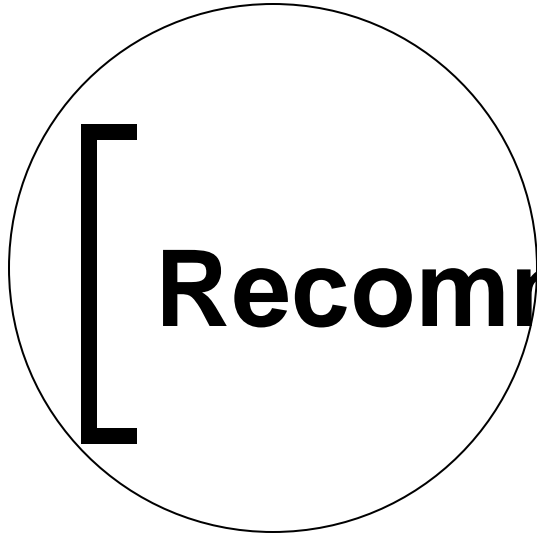
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Change in government revenue

% change in total revenue	SACU		10%	<i>Maur.</i>	<i>DRC</i>
	<i>Min.</i>	<i>Max.</i>			
Angola	-0.9	1.6	2.7	-1.0	2.8
Botswana	-3.5	0.0	-2.6	-7.8	-2.1
DRC	-6.9	4.1	-3.5	-11.1	0.0
Lesotho	-14.6	0.0	-19.6	-32.4	-5.6
Madagascar	-16.1	-0.6	1.8	-15.9	7.9
Malawi	-29.0	-23.7	-7.1	-32.3	-7.4
Mauritius	11.3	19.7	24.4	0.0	29.0
Mozambique	-7.8	2.0	-0.6	-11.2	1.8
Namibia	-7.0	0.0	-5.5	-8.2	0.1
South Africa	-4.7	0.0	2.3	-6.3	2.9
Swaziland	-6.7	0.0	-2.6	-27.1	11.0
Tanzania	-32.0	-17.8	-13.8	-37.8	-11.1
Zambia	-21.9	-7.8	-6.5	-22.8	-3.6
Zimbabwe	-33.7	-26.0	-22.3	-35.1	-22.6

Net fiscal impact

	Collected			Loss (-)		VAT		
	MFN	Est	10%	MFN	Est	Current ⁽¹⁾	MFN	Est
Angola	434	455	646	212	191	10.0	8.7	8.9
Botswana	396	673	298	-98	-375	10.0	11.1	14.4
DRC	115	207	98	-18	-110	13.0	13.7	17.2
Lesotho	238	312	132	-106	-181	14.0	18.2	21.1
Madagascar	114	171	120	6	-51	17.0	16.8	19.1
Malawi	146	42	121	-25	79	17.5	19.4	11.4
Mauritius	95	250	364	269	115	15.0	10.3	13.0
Mozambique	167	142	161	-5	19	17.0	17.1	16.5
Namibia	351	612	250	-101	-362	15.0	16.6	20.7
South Africa	5105	1709	6346	1241	4637	15.0	14.2	11.9
Swaziland	217	430	200	-17	-230	14.0	14.5	20.5
Tanzania	624	524	444	-180	-80	20.0	24.4	22.0
Zambia	320	371	257	-63	-114	17.5	19.1	20.4
Zimbabwe	465	76	217	-248	141	15.0	25.9	8.8



Recommendations



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Contribution of the report

- There is no single or simple model for a customs union
- A SADC CU can generate real economic gains for the region but this depends on:
 - The level and complexity of the CET
 - The additional contribution of a CU to trade facilitation
 - The choice of revenue sharing and distribution mechanism

Main recommendations

- A **low and simple common external tariff**
- Customs **duties collected on entry** into the customs union and then distributed according to a simple revenue sharing formula
- The establishment of a **development fund** to support regional projects and assist with adjustment in particular industries or countries
- The **elimination of rules of origin** and the development of a concerted programme of action to simplify and harmonise border rules and procedures across the region

[Minimum requirements for a CU]

- Agree a phased CET
- Agree an approach to revenue sharing
 - How is revenue transferred?
 - How are short-term losers compensated?
- Establish institutions
 - Decision making
 - Dispute settlement

Core policies for membership

- Implement the SADC Trade Protocol
- Adopt the common tariff for *most* goods
 - MFN
 - EPA
- Leave any other customs territory
- Transfer customs revenue collected according to agreed approach



**Economic Analysis: Trade
and development in SADC**



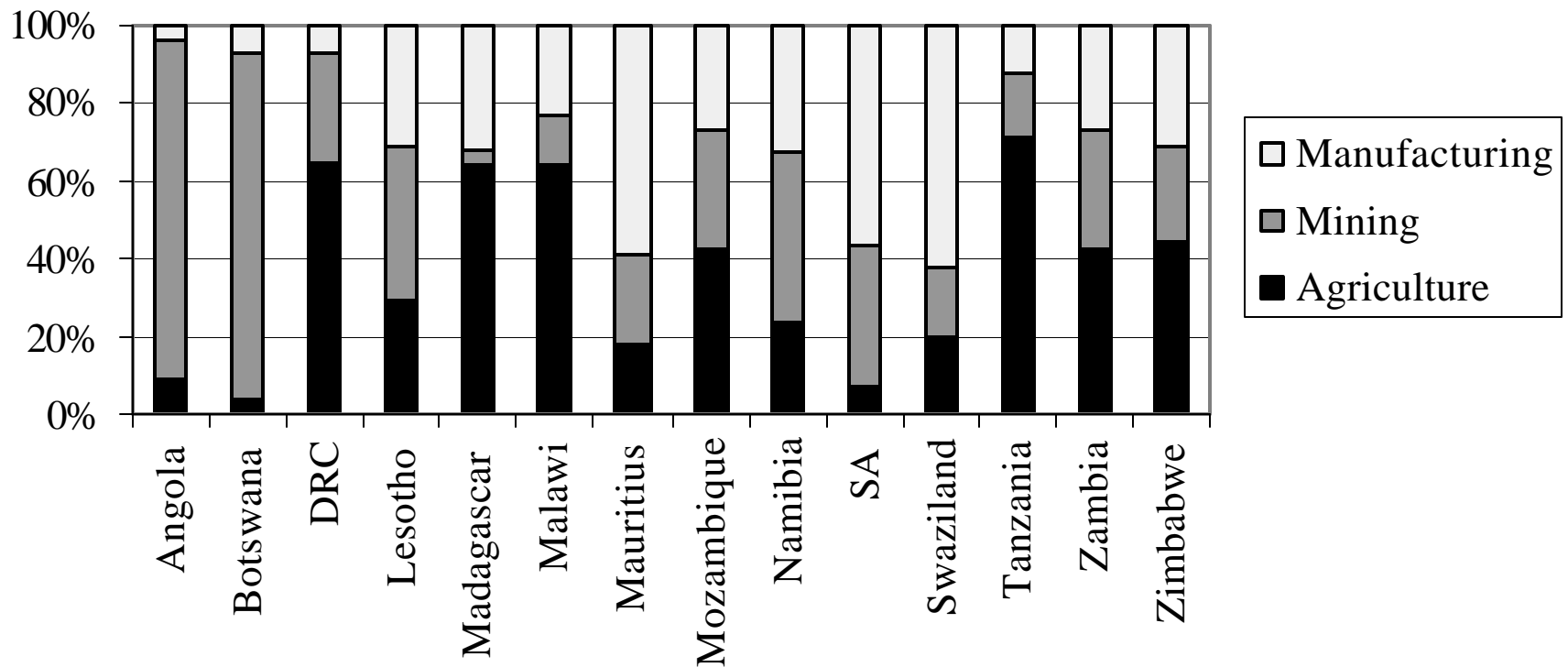
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Wide differences in size, development level...

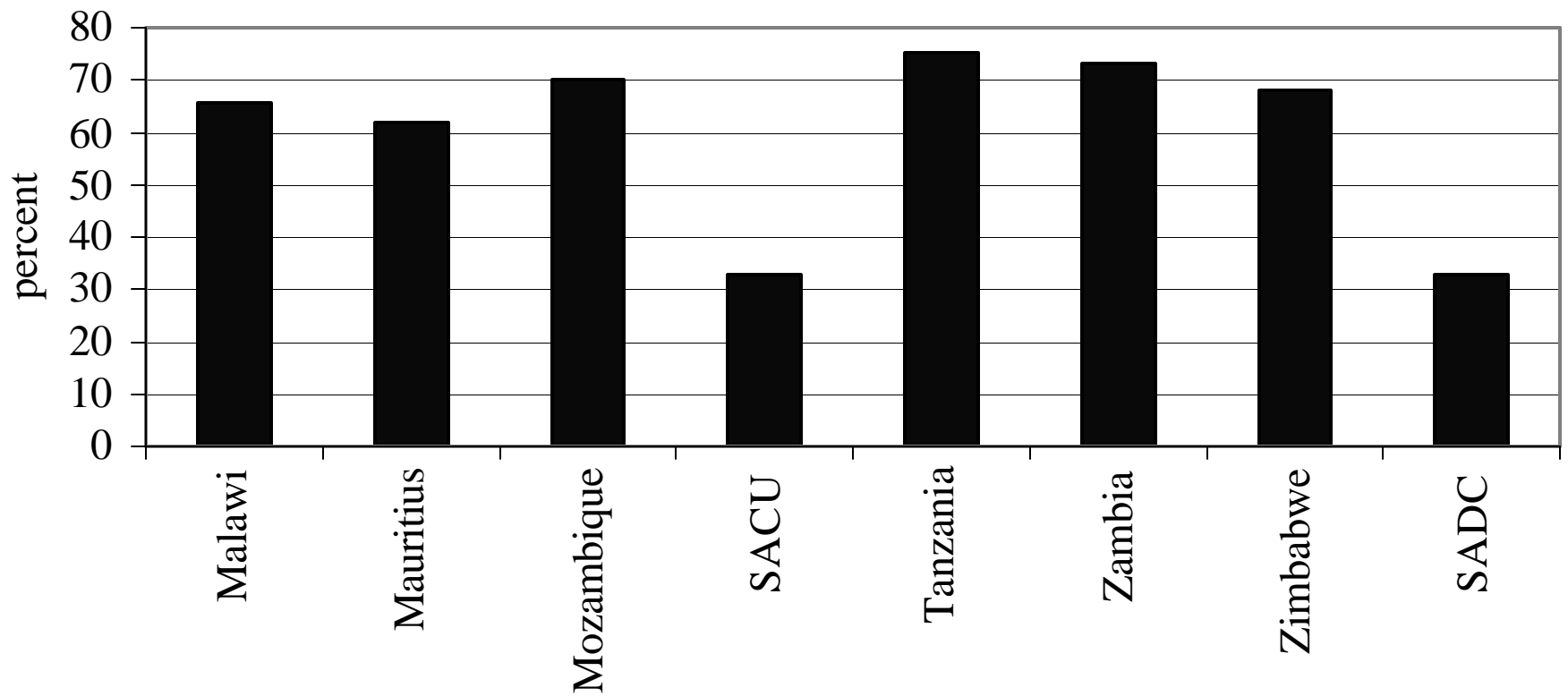
	Population (m)	Urban population (% of total)	Surface Area (sq km)	Aid (% of GNI)	GDP per Capita (PPP)
Angola	15.9	53.3	1,246,700	1.5	2,335
Botswana	1.8	57.4	581,730	0.7	12,387
DRC	57.5	32.1	2,344,860	26.9	714
Lesotho	1.8	18.7	30,350	3.9	3,335
Madag.	18.6	26.8	587,040	18.7	923
Malawi	12.9	17.2	118,480	28.4	667
Mauritius	1.2	42.4	2,040	0.5	12,715
Moz.	19.8	34.5	801,590	20.7	1,242
Namibia	2.0	35.1	824,290	2.0	7,586
SA	46.9	59.3	1,219,090	0.3	11,110
Swaziland	1.1	24.1	17,360	1.7	4,824
Tanzania	38.3	24.2	945,090	12.5	744
Zambia	11.7	35.0	752,610	13.9	1,023
Zimbabwe	13.0	35.9	390,760	11.4	2,038

...and industrial structure

Distribution of GDP: Traded sectors



Intra-SADC trade highly concentrated...



[...and dominated by SACU (SA)]

Source of intra SADC exports	1980	1985	1990	1995	1999	2003
Angola	0.2	0	0	0	0.9	Na
DRC.	0.4	0.1	0.1	2.7	0.1	Na
Malawi	11.1	6.1	0.5	1.9	2.3	1.8
Mauritius	2.2	0.1	1.4	0.6	0.6	0.7
Mozambique	1.8	0.1	0.1	1.4	0	4.7
SACU	64.2	50.5	56	76.5	77.8	71.4
Tanzania	9.6	0.1	0.2	0.3	1.3	1.4
Zambia	4.4	4.1	1	1.3	2	7.0
Zimbabwe	6	38.9	40.7	15.4	14.9	13.0
Total	100	100	100	100	100	100

[...roughly triangular flows]

- South Africa imports from the rest of the world.
- South Africa exports to SADC (especially the BLNS, Malawi, Mozambique, Zambia and Zimbabwe)
- Rest of SADC exports to rest of world
- Implications for revenue sharing

Tariffs on external trade vary

	Ang	DRC	Mad	Mal	Mau	Moz	Tan	Zam	Zim	SACU
Number of tariff lines	5,224	5,224	5,222	5,112	5,224	5,224	5,212	5,224	5,224	6420
Number of bands	7	5	4	7	21	5	11	4	17	100
Duty free lines (% total)	0	0	2	9	86	2	37	22	15	53
Non-ad valorem (% lines)	0.8	0.3	0	0	2.8	0	0.2	0	-	2.9
Binding coverage (%)	100	100	29.7	31.2	17.8	13.6	13.4	16.7	21.0	96.6
Simple average	7.1	12.0	13.3	13.1	3.1	12.1	12.7	13.9	15.0	8.2
Weighted average	6.3	11.4	9.1	10.3	2.0	9.2	9.2	10.6	16.2	7.4
Maximum rate	30	30	20	30	30	25	100	25	100	108
Minimum rate	0	5	0	0	0	0	0	0	0	0
Agricultural products	11.4	14.1	16.1	15.3	6.8	18.9	21.6	20.0	24.4	9.4
Non- agricultural products	6.5	11.7	12.8	12.8	2.5	11.0	11.2	12.9	13.5	8.0

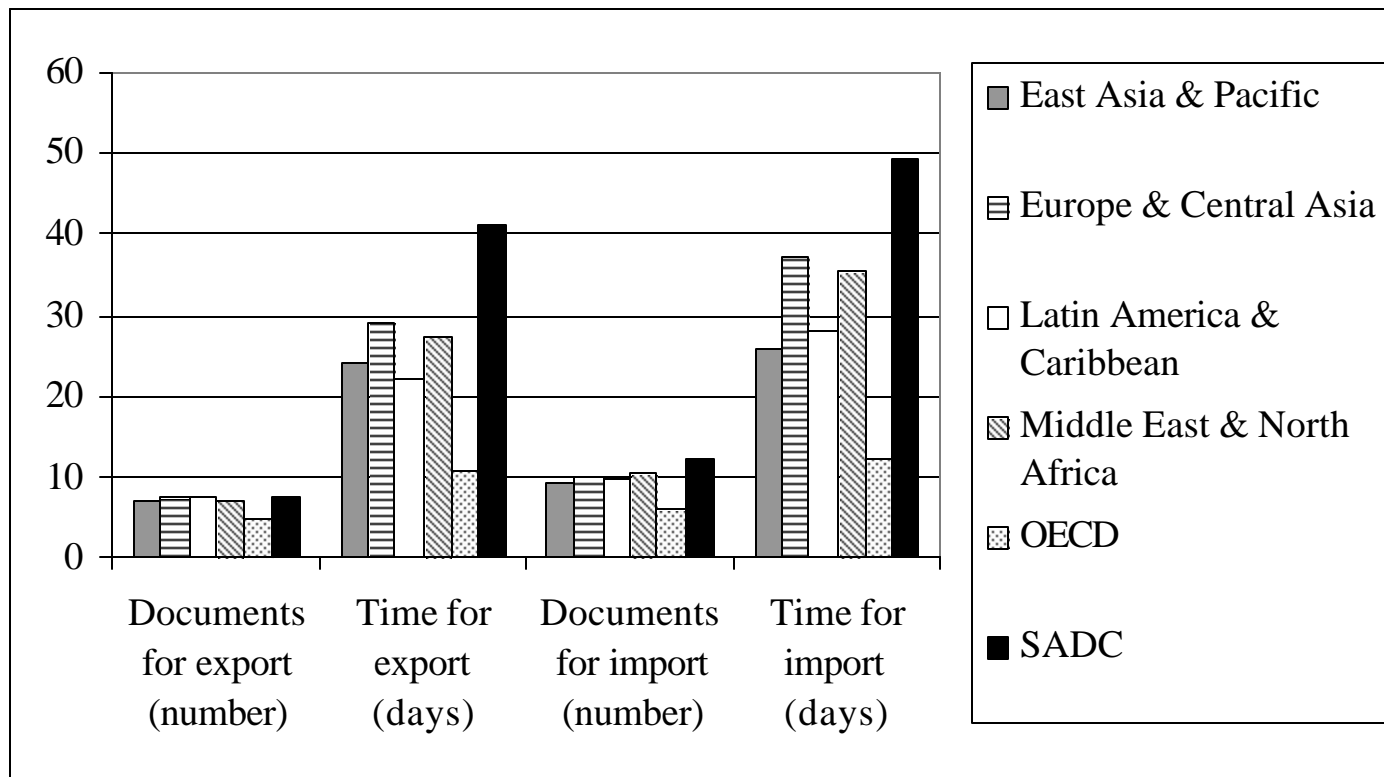
Significant exemptions and evasion

- In South Africa, actual tariff revenues are 56% of the theoretical take due to exemptions.
- In Mozambique, total imports were estimated to be around 20% higher than official figures due to evasion (with evasion concentrated in more highly taxed products).
- Best evidence that these are examples not outliers.

[Barriers on internal trade remain]

- Rules of origin are complex
- Lack of capacity and equipment at many borders
- Transit costs and delays are significant

Days Required to Comply with Procedures



Implications for the CU

- Differences in industrial structure and level of development pose challenges for the determination of a CET...but also imply that industrial interests and competition may not derail the formation of a CU.
- Deep integration likely to contribute to enhanced intra-regional trade.
- Gains are likely to be more substantial if the CU is used as a mechanism to facilitate greater openness to and competitiveness in the global economy.
- Existing trade patterns suggest that the retention of high MFN tariffs within a more integrated CU may lead to increased trade diversion, particularly in relation to South Africa.

[Implications for the CET]

- Impossible to define a CET that matches the precise needs of each member.
- Any CET applied across SADC will imply that at least some members will have to change their external tariff structure substantially.



Economic impact analysis



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Incremental Impacts of Moving from a FTA to a Customs Union

- Changes to external tariffs of each country through application of a common external tariff (CET),
- Revenue gains/losses from the CET and the adoption of a revenue sharing rules,
- Gains from the elimination of rules of origin, and
- Deep integration encompassing issues such as institutions, foreign direct investment, infrastructure, and domestic regulatory impediments to trade, among others.

[Analytical Approaches]

- Descriptive
- Trade indicators
- Partial equilibrium analysis
- Econometric analysis
- Country CGE modeling
- Global CGE modeling with country detail

Model and methodology

- GTAPinGAMS model and database
 - South Africa, Botswana, Mozambique, Tanzania, Zambia, Malawi, Zimbabwe
 - Rest of SACU
 - Rest of SADC
- Global general equilibrium model
 - Complete picture of production and trade
 - Relative impacts are important
 - Static, perfectly competitive model

Simulations – shallow integration

Identifier	Description
FTA	Implementation of a free trade area within SADC
MFN	SADC FTA plus reductions in all other tariffs by 25%
Unif10	A SADC customs union with a 10% uniform common external tariff
Unif5	A SADC customs union with a 5% uniform common external tariff
ZAF	A SADC customs union with common external tariffs as in SACU

Results – welfare impacts

	FTA	MFN	Unif10	Unif5	ZAF
Botswana	0.0	0.6	0.6	1.4	0.4
Malawi	1.6	1.4	0.6	0.7	1.9
Mozambique	-0.4	-0.2	-0.2	0.1	-0.4
Rest of SACU	1.6	1.7	1.8	1.6	0.9
Rest of SADC	-0.3	0.4	1.6	1.4	1.1
South Africa	0.4	0.3	0.8	0.3	0.2
Tanzania	-0.2	-0.2	0.0	-0.1	-0.3
Zambia	-0.4	-0.3	-0.6	-0.1	-0.3
Zimbabwe	0.1	0.2	0.2	0.2	0.3
Total (\$ million) ¹	285.8	330.3	824.9	489.3	331.0

Results – terms of trade

	FTA	MFN	Unif10	Unif5	ZAF
Botswana	-0.4	-0.1	-0.5	0.0	-0.2
Malawi	2.0	1.4	0.2	-0.1	2.1
Mozambique	-0.9	-0.8	-0.5	-0.6	-0.9
Rest of SACU	1.5	1.2	1.2	0.7	1.0
Rest of SADC	-0.6	-0.8	-0.7	-1.2	-1.1
South Africa	0.6	0.1	1.1	-0.1	0.3
Tanzania	-0.6	-1.2	-0.9	-2.0	-1.5
Zambia	-0.7	-0.6	-0.8	-0.5	-0.6
Zimbabwe	-0.2	-0.3	-0.7	-0.8	-0.3

Results – tariff revenue impacts

	FTA	MFN	Unif10	Unif5	ZAF
Botswana	-0.2	-0.2	0.4	-0.1	-0.1
Malawi	-2.6	-2.8	-2.2	-3.0	-3.0
Mozambique	-2.5	-2.7	-1.5	-2.4	-2.8
Rest of SACU	-0.2	-0.4	1.1	-0.2	0.0
Rest of SADC	-1.8	-2.7	-2.7	-4.9	-5.4
South Africa	0.0	-0.3	0.9	-0.2	0.0
Tanzania	-0.7	-1.2	-0.6	-1.8	-1.7
Zambia	-2.2	-2.3	-1.5	-2.1	-2.4
Zimbabwe	-1.7	-1.8	-1.4	-1.8	-1.9

Results – employment

- Model indicates possibility for mild employment creation in most SADC regions under most scenarios
- Domestic labour market policies are very important drivers of employment

Results - trade

- For all countries, intra-SADC trade grows, sometimes dramatically.
- For non-SACU SADC, exports and/or imports shift from the rest of the world to SACU (trade creation/diversion).
- In terms of total exports and total imports of SADC members, all scenarios increase the total value of trade with the exception of Unif10

Results – deep integration

	unif10	unif5	zaf
Botswana	2.2	2.9	2.0
Malawi	1.2	1.2	2.4
Mozambique	0.5	0.8	0.3
Rest of SACU	3.0	2.9	2.2
Rest of SADC	1.7	1.6	1.2
South Africa	0.9	0.4	0.3
Tanzania	0.0	-0.1	-0.2
Zambia	0.0	0.4	0.2
Zimbabwe	0.4	0.5	0.5
Total (\$ million)	1023.8	686.4	528.8

Assumption:
trade facilitation
efforts and
infrastructure
investment
reduce regional
transactions
costs by 25%.

Economic analysis - summary

- A SADC customs union provides the possibility for substantial gains due to:
 - Rationalization of external tariff structures (low and flat but with revenue considered),
 - Enhanced possibilities for trade facilitation, especially elimination of rules of origin and financing of regional infrastructure investments, and
 - Enhanced policy credibility.

Implications for Mozambique

- International evidence points to openness as a strong contributor to growth and poverty reduction *in the long run*.
- Mozambique likely to be a particularly large beneficiary
 - Long coastline
 - Harbors and transport corridors
- *The open regionalism strategy advocated is strongly in the long run interests of Mozambique.*

Short term adjustment issues are relevant

- Terms of trade (trade diversion)
- Revenue losses
- Industrial adjustment
- These come with the FTA to which Mozambique has already adhered.
- *Proposed customs union advocates a revenue sharing formula and adjustment funds.*

[Policy Implication]

- The proposed customs union is superior in both the near and long terms.
- Mozambique should be a strong supporter.