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**Deepening integration in SADC**  
**South Africa's international trade diplomacy:**  
**Implications for regional integration**

Peter Draper, Mmatlou Kalaba and Philip Alves

**1. Introduction**

Deepening processes of economic integration requires a willingness on the part of member states involved in such processes to pool sovereignty. It is not clear whether members of the Southern African Development Community (SADC) are willing to cede real sovereignty, or at least a sufficient quantum to construct a real customs union by 2008, as proposed under the Regional Indicative Strategic Development Plan (RISDP). Furthermore, it is well known that the region is divided on this question with a number of member states 'hedging their bets' through membership of other regional bodies.

South Africa has expended much political and institutional capacity in re-establishing the Southern African Customs Union (SACU) as the core platform from which to integrate into the global economy. So the extent of the South African government's political commitment to the SADC Customs Union project is not clear. If South Africa were an 'ordinary' SADC member state this need not necessarily constitute a problem. But it is not. In order to understand why this matters, a brief theoretical excursion is necessary.<sup>1</sup>

Broadly speaking, there are two ways to think about economic integration in southern Africa: classical free trade theory, or the 'New Economic Geography' framework. Proponents of the latter argue against promoting economic integration schemes amongst developing countries<sup>2</sup> only. The theory suggests that, because one or two countries in a region will experience less of a comparative disadvantage in manufacturing than the rest, industrial activity will tend to relocate to the relatively advantaged country at the expense of the others. This effect will be aggravated by

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<sup>1</sup> See Draper and Khumalo (2005) for more background to this discussion.

<sup>2</sup> For an exposition of this logic see World Bank (2000).

agglomeration economies, which promote industrial concentration in the relatively advantaged country. Furthermore, as tariff levels decline overall within the regional integration arrangement (RIA), so those countries suffering from industrial relocation will also experience trade diversion effects -- importing relatively expensive goods from the growing industrial centre rather than from more efficient global producers, thereby lowering their overall welfare. Meanwhile, the favoured country will gain as regional industry relocates to its soil and real wages rise as a result. Clearly these effects would generate substantial political tensions over time which in turn would undermine economic integration processes.

The implication is that classical 'North-South' integration holds greater potential for mutually beneficial outcomes. North-South integration reinforces specialisation based on comparative advantages, and promotes income convergence over time through investment and knowledge and technology transfers from developed to developing countries (particularly when the latter are guided by constructive and accommodating integration policy frameworks).

South Africa dominates the region economically (accounting for about 60% of SADC total trade and about 70% of SADC GDP)<sup>3</sup>, and possesses by far the most diversified and capable industrial base. In a regional context, it is far more than just the 'least disadvantaged manufacturer'. As such, there are significant 'North-South' complementarities between the South African economy and the region, implying that the commercial relationship between the two under freer trade and investment regimes should yield mutually beneficial, politically palatable outcomes. In short, only South Africa has the requisite economic capability to drive economic integration in a mutually beneficial manner.

However, just as South Africa is integrating with the region, it is also conducting an active trade diplomacy agenda across the world. Agreements currently under negotiation at various levels and in different forums have the potential to substantially alter the playing field: in South Africa, regionally, and internationally. Therefore, in

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<sup>3</sup> World Bank (2005).

order to better understand the trajectory of regional economic integration it is necessary to get to grips with South Africa's trade diplomacy.

To do so, the chapter is structured as follows. First, regional development priorities, particularly relating to trade and foreign direct investment (FDI), are discussed. An associated assessment of whether South Africa's expanding African footprint is in consonance with those priorities is then presented. Third, a qualitative overview of South Africa's trade diplomacy is provided and its regional implications assessed, notably its potential impact on the goals set by the RISDP. Finally, a quantitative examination of these same issues is undertaken, focusing on key products exported from the region into South Africa. Are these links threatened by South Africa's non-African trade agenda?

## **2. African development priorities: FDI and trade**

Conventional wisdom has it that poor countries suffer from a development 'vicious circle': predominant subsistence production inhibits accumulation of savings; low savings mean low investment; low consumption further inhibits investment; and because investment is low, economic growth is stagnant (UNCTAD, 2004: 2-3). This scenario is applied to Africa, where economies are typically small and subsistence-based.

In this view the problem is exacerbated by market access barriers in developed country markets, further inhibiting the incentive to invest, particularly for export. Exports, in turn, are characterised by commodity-dependence, which has led to a long-term decline in these countries' terms of trade. And supply-side deficiencies, principally poor physical and financial infrastructure and low levels of human resource development further inhibit market integration and investment prospects. Problems are compounded by chronic balance of payments difficulties, characterised by large current account deficits (Nnadozie and Elhiraika, 2005: 8)<sup>4</sup>. This inhibits afflicted countries' ability to import goods critical to domestic production and consumption, further entrenching the circle (Nnadozie and Elhiraika, 2005: 5).

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<sup>4</sup> Out of 51 African countries for which data were available 14 had current account surpluses and 37 had deficits, of which 25 had deficits exceeding 5% of GDP, in 2003.

External financing alleviates balance of payments constraints by supporting the current account. It is also critical for boosting domestic savings and investment, thereby inserting the economy into a higher growth plane. In the African context, however, the dominant source of external financing has historically been official development assistance (ODA) (Nnadozie and Elhiraika, 2005: 6). The Millennium Project, the UK's Africa Commission and the G8 have all emphasised boosting ODA flows to developing countries, especially Africa. This is the essence of Jeffrey Sachs's recommendations (Sachs et al., 2004)<sup>5</sup>.

However, this situation is reflective of generally weak capital markets and shallow financial systems as there is no shortage of capital for emerging markets globally. Furthermore, Bauer (2000: ch. 5) argues that aid inflows, presently the dominant source of external financing for many African countries, are not without problems<sup>6</sup>.

Attracting FDI is an appealing alternative. Most economists are agreed on this point, but sustained FDI inflows into poor countries remain elusive. The full range of disincentives to FDI in Africa specifically need not detain us here. However, Africa's developmental challenges, to which those disincentives are closely linked, provide the crucial backdrop for understanding the generally positive economic impact of South African FDI on the continent, and Southern Africa in particular.

## 2.1 Africa in global trade and FDI

Today's global economy is dynamic and increasingly intertwined. International trade and investment flows are on an absolute order of magnitude never seen before; even if in relative terms the global economy is not as integrated as it was by the end of the nineteenth century. This integration affords those countries plugged into mobile

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<sup>5</sup> Sachs et al. (2004) advance the argument that the primary cause of Africa's underdevelopment is chronically low savings, and therefore massive infusions of external capital via development assistance are required to break out of what they describe as a 'poverty trap'. See also Peter Draper, column in *The Exporter*, a *Business Day* supplement, February 2005, for an analysis of the UK's Africa Commission, the Sachs Report, and the Sutherland report on the future of the WTO for their implications for Africa's development.

<sup>6</sup> He identifies four: one, the assumption that poor countries cannot develop in the absence of Western largesse is condescending and undermines domestic initiative. Two, aid creates a vicious circle of dependence (on Western largesse), thereby defeating its own objectives. Three, large inflows of aid can generate a 'Dutch disease' effect of nominal exchange rate appreciation thereby undermining domestic (and most likely nascent) industrial development. And four, channeling aid through governments accords rulers extended powers of patronage. Central to this is his concern that in many poor countries governance is part of the development problem; aid might only exacerbate it.

flows of trade and investment the opportunity to leverage external resources for domestic development. The issue is how to access external resources on a sustainable basis in a manner that complements domestic development strategies. For, as Stiglitz (2002) soberly reminded us in the aftermath of the 1997--1998 Asian financial crisis, opening up to these flows, especially on the financial front, is fraught with dangers and needs to be carefully managed.

Crucially, this requires strong states capable of managing markets prone to failure, collecting and directing resources to areas where it is most needed. Unfortunately this is a circumstance mostly lacking in the African context where governance problems and incapacities abound. Worse still, globalisation has largely passed Africa by—far from having experienced too much of this complex process, the continent is marginalised from it. Nowhere is this more evident than in trade and FDI flows.<sup>7</sup>

Developing countries as a group continue to rely on exports of commodities to developed country markets in order to generate the requisite foreign exchange for importing advanced manufactures from the developed world. But the World Trade Organisation (WTO) Secretariat notes that the contribution of commodities to the aggregate basket of exports from developing countries has declined 'dramatically' since 1955, when they accounted for more than 90%, to below 30% at the end of the 1990s. They note further that this decline accelerated 'sharply' from the mid-1980s, roughly coinciding with the onset of extensive trade liberalisation in the developing world. They attribute this positive story to the decline of the contribution of fuels on the one hand, but more importantly to the rise of office and telecoms equipment exports.

This positive picture is qualified by regional variations: Africa and the Middle East continue to rely on commodity exports for more than two-thirds of their total exports; Latin America has substantially reduced its reliance although at 40% it is still high; whilst developing Asia's share stands at approximately 15%. And the WTO

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<sup>7</sup> See, for example, UNIDO (2006: V): 'They [Sub-Saharan African countries] are increasingly marginalised from global production networks and the failure to provide the correct policy framework and enabling environment has raised the risk premium investments.'

Secretariat notes that a handful of countries drove this overall transformation within each region (WTO, 2002: ch. 2). Hence developing country success in world trade is concentrated in a few, principally East Asian, high performers.

Thus Africa (including North Africa) is by and large incorporated into the global economy as an exporter of commodities, primarily to the European Union, and importer of manufactures and services.<sup>8</sup> This reflects both history and comparative advantages. Domestic markets remain small, dispersed, and primarily subsistence-based, and this will likely change relatively slowly over time. And as noted above it is not clear that regional integration by itself will favourably change this picture for most countries—quite possibly the reverse will occur.

The picture is similar on the FDI front: Africa attracts marginal FDI flows compared to the rest of the developing world, consistently in the region of 2 to 3% of total outward flows (UNCTAD, 2005a). These flows are proportionate to Africa's relative economic weight in the global economy. And they are concentrated—the top ten recipients consistently account for more than three-quarters of FDI flows into the continent (UNCTAD, 2005b: 7). Concentration in FDI destinations is matched on the source-end as only three countries (France, the UK and the US) accounted for 70% of FDI inflows in the period 1980--2000 (UNCTAD, 2005b: 9).

This pattern is very different to the one that has taken shape in East Asia, especially China, for which the bulk of developing country FDI flows are destined. That investment is both market-seeking and efficiency-seeking, and more broadly spread, thereby entrenching the region's emergence as a twenty-first century economic powerhouse.

FDI inflows into Africa are predominantly resource-seeking, reinforcing commodity-dependent export profiles. UNCTAD notes that this lends FDI into Africa a peculiarly enclave character, whereby predominantly greenfields and capital-intensive investment are delinked from the domestic economy and profits are not reinvested

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<sup>8</sup> Of course this aggregate picture requires some nuancing. For example, Kenya is emerging as a regional manufacturing hub for East Africa, exporting increasingly substantial quantities of manufactures to its neighbours. South Africa, the focus of this report, does not readily fit this bill either.

(UNCTAD, 2005b: 9). They argue that this holds a further danger of state capture by powerful multinational corporation (MNC) interests geared towards resource-extraction at the possible expense of manufacturing interests, thereby undermining diversification strategies.<sup>9</sup>

The fact that most foreign investment in Africa is resource-seeking, and therefore does not improve the diversification of African economies, poses obvious challenges to regional integration in Southern Africa. This is because the latter implicitly assumes that the countries concerned produce a wide enough range of products to make intra-regional trade and investment viable. At present this is not necessarily the case; the severe supply constraints in both agriculture and manufacturing in most SADC countries will necessarily mute the response to initiatives that seek to take integration further, and do so more rapidly.

Taking account of the patterns of Africa's insertion into global trade and FDI flows identified here, as well as the challenges SADC faces in improving intra-regional trade and investment, what implications does this hold for our analysis of South Africa's economic engagement with Southern Africa?

## **2.2 South Africa's evolving southern African footprint: patterns and impact**

The origins of South Africa's corporate expansion into Africa lie primarily in the conjuncture of two simultaneous and related processes: the demise of Apartheid and the end of the Cold War and associated triumph of the 'Washington consensus' development paradigm pursued by the Bretton Woods institutions (BWIs) globally. This process has afforded unprecedented opportunities to select African countries, especially in Southern Africa, although it is not without problems. The impact is dealt with below. First we consider some patterns of the outward thrust.

It is primarily in Southern Africa that South African FDI and trade is beginning to change the patterns of concentration noted above. The potential scale of this expansion is impressive: South Africa had over 900 TNCs by the end of the 1990s.

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<sup>9</sup> There is also the possibility that large-scale profit repatriation could undermine the balance of payments.

Seven of those were among the top 50 non-financial developing country TNCs in 2002. A further 2044 foreign affiliates were based in South Africa by the end of 2002, indicating South Africa's position as a launching pad for foreign investment into the rest of Africa...only eight of those companies and their subsidiaries did not have an Africa focus (Grobelaar, 2004a: 93).

Daniel et al. (2003) note that in the 1994--2000 period the stock of South African FDI in SADC exceeded UK and US stocks combined. And, according to a report by the erstwhile South Africa Foundation<sup>10</sup> (2004: 9), outward FDI flows accelerated in the 2000--2004 period without peaking. Daniel and Lutchman (2005: 485), however, note that in 2004 outward flows did in fact peak and in some sectors (aviation, banking and road construction) declined for the first time. This seems to have been linked to stagnant export sales into Africa' although it is not clear whether this was a consequence of the strong rand or evidence of market saturation. Meanwhile new competitors, particularly for energy resources in the form of China, India and Brazil, have emerged on the African scene.

Resources still feature prominently in aggregate South African FDI into the continent. The Business Map Foundation finds that, taking a value-of-investment measure, the resources sector still dominates South Africa's FDI stock in SADC (Rumney and Pingo, 2004). Grobelaar (2004a: 92) concurs, noting that whilst a mix of motivations behind FDI outflows is discernible resource-seeking and strategic asset or capability-seeking are dominant motivations. The latter is reflected in participation in privatisation processes, but also reflects a diversification of FDI flows beyond commodities and into a range of backbone infrastructure sectors.

Recent South African FDI flows into the continent are also more diversified than those sourced from the three dominant developed countries. UNCTAD argues that these are driven more by merger and acquisition activity than greenfields investment, implying that on aggregate they are more market or asset rather than resource-seeking (UNCTAD 2005b: 11). According to the South Africa Foundation (2004: 16) market-seeking FDI, measured on the basis of number of projects, is concentrated

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<sup>10</sup> The organisation was rebranded Business Leadership South Africa in December 2005.

on SADC markets, whereas FDI into non-traditional markets is targeted primarily at the mining and energy sectors (South Africa Foundation, 2004: 17).

While concerns about deindustrialisation or crowding out of domestic companies must be carefully addressed and are considered below, the so-called 'new scramble for Africa' by South African companies, according to recent studies based on interviews with South African companies operating on the continent, is yielding substantial benefits for the continent. These include job creation<sup>11</sup>; upgrading of existing and building of new infrastructure including investment in backbone services<sup>12</sup>; technology transfer through human resource development (McGregor's, 2004)<sup>13</sup>; increased tax revenues; increased consumer choice; and boosting general investor confidence in host countries (Games, 2003; Grobbelaar, 2004a). These benefits are reportedly linked to a general view amongst the South African corporate community that they are in Africa for the long-term and hence need to play their part in sustainable investment. This view has helped them to unseat European competitors who, according to McGregor's (2004: 2), have a reputation for dumping inferior technology and quality at premium prices. South African companies are quite prepared to adapt products to local market conditions, and in many cases already do so in the domestic market (McGregor's, 2004: 3).

What then are the costs involved for countries hosting South African FDI? There is a growing literature that is increasingly critical of the behaviour of South African firms on the continent. Concrete examples include the citing of twelve South African

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<sup>11</sup> 24,355 jobs are said to have been created in Mozambique by SA companies from 1998–2002 (Grobbelaar, 2004b). Similarly, in a survey of 40 top South African companies invested on the continent McGregor's (2004: 2) found that a total of 71,874 people were employed across 232 investments outside of South Africa. Of these, only 2,257 were South African expatriates, mostly in managerial and technical positions. It is not clear whether M&A's associated with these investments have led to retrenchments. If so, such job losses would have to be offset against the employment numbers cited here. Furthermore, UNIDO (2006: IX) found that South African investors pay the highest wages, on average, of all foreign direct investors in Africa. This is partly due to the skill-intensive nature of South African subsidiaries.

<sup>12</sup> For example MTN, the South African telecommunications MNC, has had to build roads to service rural coverage requirements stipulated by telecommunications licensing conditions in several countries (McGregor's, 2004: 2). The South Africa Foundation (2004: 12) notes that 27% of projects covered in their survey are in the infrastructure sector, especially power, whilst telecommunications accounted for 5%. South African banks have also expanded rapidly into the continent, in the process upgrading often antiquated financial systems (*Financial Mail*, May 2005) Otherwise, South African parastatals dominate fixed infrastructure investments.

<sup>13</sup> The report notes that most South African investors have a policy of transferring skills to local employees over a period of three to five years from the initial investment. South African companies are particularly sensitive to such concerns given the centrality of black economic empowerment policies to their bottom line in South Africa.

companies for looting mineral resources in the Democratic Republic of the Congo (UN, 2002, cited in Daniel et al., 2003: 386), and alleged flouting of labour standards by some companies (Pillay, 2004). There is also anecdotal evidence of alleged corporate malfeasance and arrogant behaviour reminiscent of Apartheid attitudes. This is in line with concerns within the South African government, based on evidence sourced through its missions across the continent that the South African corporate community in general is not behaving like good corporate citizens in host markets<sup>14</sup>.

There is also the risk of domestic market dominance: some 17% of South African investments in Africa enjoy a market share of greater than 75%. However, this is offset by the finding that 67% of investments held less than 25% market share (McGregor's, 2004: 2). So whilst host governments must be vigilant, it appears from this evidence that the risk is overstated. And it is worth bearing in mind that the total stock of South African FDI in Africa accounts for no more than 7% and no less than 3% of its global FDI stock (Grobelaar, 2004a: 94). Furthermore, the majority of South African investments are small – it is generally the large-scale projects that capture the headlines.

What of the problem of enclave investment associated with resource-extractive FDI? As noted above, South African FDI is increasingly more diversified than that traditionally sourced from developed countries. Furthermore, the Business Map Foundation notes that in the case of the Mozal aluminium smelter in Mozambique, for the first time on the continent a serious and successful attempt was made to build linkages to the local economy, thereby minimising the potential for enclave development (Rumney and Pingo, 2004: 21). This indicates a degree of sensitivity on behalf of the South African government to regional concerns, a matter we return to in the following section. Furthermore, the pattern of greater market-seeking FDI is building host country markets, thereby enhancing the long-term prospects for economic diversification. Crucially, this process is driven substantially by economic reforms in host countries (South Africa Foundation, 2004: 20), thus qualifying (although not necessarily nullifying) the conventional wisdom that structural adjustment packages have caused the continent's deindustrialisation.

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<sup>14</sup> Discussions with government officials.

Turning to trade, the South Africa Foundation (2004: 9) notes with respect to South Africa's exports to the continent:

There is a high proportion of value-added exports to the rest of Africa, with machinery, mechanical appliances, iron and steel articles, transport goods, chemicals, and plastics and rubber goods accounting for close to 70% of the total. This is an important consideration, as it ties in with South Africa's domestic economic structure, based traditionally on mining, agriculture, engineering and chemical products, and their allied industries. These are also the areas that are attracting the most (investment) interest in other African countries.

South Africa's outward FDI thrust is linked to its exports to the region. It is clear that South African companies operating in Africa do not source much locally, with the majority of companies surveyed by SAIIA indicating they source less than 10% of their goods in regional markets (Grobbelaar, 2004a: 98). But this needs to be viewed in perspective. During the sanctions period many countries in the region sought to prevent trade with South Africa for political reasons. Hence the current wave is at least partly to do with a natural, once-off correction to the removal of artificial barriers. Furthermore, the bulk of the region's commodity exports are destined for developed country markets, whereas South Africa possesses many of those commodities and hence does not need to import them from the region.

Also, on the assumption that the goods exported by South Africa to African countries are not available locally in recipient markets, the bilateral deficits are not a problem per se. Rather, African economies benefit from the division of labour associated with South Africa's growing commercial presence.

Clearly this does not negate political concerns associated with rising trade imbalances and perceptions of 'recolonisation'. There is a long history behind these fears, most notably the Apartheid state's destructive destabilisation of its neighbours from the late 1970s. However, we are focused here on the economics of this set of contemporary relationships. To blame South Africa for this structural dynamic amounts to political grandstanding, as there is little economic rationale underpinning it. Even the charge that this trade imbalance implies exclusively negative

consequences should be challenged: what matters are the drivers of these imbalances, rather than the fact of their existence (Corden, 1997: ch. 17--18)<sup>15</sup> In the region's case, many useful productive inputs and capital equipment items that aren't domestically produced are sourced from South Africa. While it is not possible to generalise here about the product mix with respect to individual countries, it is our contention that critics need to prove their case on the grounds of economic, not political, logic.

Therefore in our view South African corporate expansion is a necessary process for building viable regional economic integration. However, given South Africa's domestic growth problems and the relatively small size of its economy there are limits to this process. Most significantly, South Africa's African trade and FDI are concentrated in SADC, with only Kenya featuring in the top ten non-SADC African destinations for both (South Africa Foundation, 2004: 10 & 15). Consequently South Africa's expansion into the continent in the long run is unlikely to result in the same dramatic development benefits which Japanese FDI wrought in Southeast Asia.

Nevertheless, South Africa is described as an engine of growth in Africa in the sense that its economic growth is believed to have substantial impact on growth in other African countries (Arora and Vamvakidis, 2005). The impact is due to reasons mentioned earlier including South Africa's relatively large economic size and its growing linkages with other African economies. And in some quarters there is a view that South Africa's role on the continent has not reached its potential because it is a relative newcomer owing to its economic and political isolation in the pre-1994 apartheid period, and because South Africa does not dominate the trade of most African countries.

However, the South African government's pursuit of strategic partnerships through FTA negotiations with non-SADC countries around the world, discussed in more

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<sup>15</sup> The basic point is that if the deficit is driven by imports of productive equipment and other inputs, there is little cause for concern in the long-term. Deficits become problematic when finished consumer products are their principal drivers. But even here qualifications are needed, as some small (service-based) economies run consistently large trade deficits. Examples include Iceland (whose exports are overwhelmingly dominated by fish and fish products, aluminium, and ferro-silicon) and New Zealand. The primary concern of these countries is macroeconomic stability, not the displacement of local production. Clearly macroeconomic stability is a key concern in African economies too, but should not be used as a reason to curb much-needed imports.

detail in Section 4, will influence in important ways the growing commercial links between South Africa and the rest of Africa. First, as the South African/SACU market opens up to imports from these partners, so Southern African countries will find it increasingly difficult to compete there. The scant prospects they currently have for developing manufacturing industry could be undermined by these processes. Second, it is likely that the little manufacturing FDI destined for our region will continue to concentrate in South Africa given its market size and emerging network of market access arrangements. And third, these negotiations will stretch the South African government's scarce diplomatic and negotiating resources, which may distract its attention from Southern Africa.

### **3. South Africa's trade agenda: implications for regional integration**

This section focuses on how the South African government's trade diplomacy is evolving. It is clear that South Africa's economic interests extend far beyond Africa. Hence the purpose here is to establish whether the Government's trade agenda supports regional economic integration in Southern Africa. Section 3.1 dissects the government's global trade agenda as the crucial backdrop to a discussion of its African and Southern African agendas in Section 3.2.

The Uruguay Round was complete when the ANC came to power in 1994, so the trade liberalisation trajectory turned to bilateral and regional tracks. Relations with the EU were high on the agenda given the preponderance of EU markets in South Africa's export basket. When the new government realised that the EU was not going to grant it full access to Lomé preferences it opted instead to negotiate a comprehensive agreement covering trade, aid and political cooperation.

Trade negotiations in South Africa, as in many countries, have become intertwined with foreign policy. In the multilateral system, for example, the foreign policy imperative revolves around how to mesh South Africa's economic interests with the positions taken by the Africa group in the WTO given that resolving Africa's problems is the central foreign policy terrain (Draper and Khumalo, 2005). And in keeping with global trends, a new wave of bilateralism has broken out. This is broadly guided by the Department of Trade and Industry's (DTI) "Global Economic Strategy", and is

divided into three tracks: first the US, the European Free Trade Area (EFTA) and Mercosur; second India and China; third (mooted but not under discussion) Singapore/ASEAN, Japan, South Korea, Nigeria and Kenya. Track one is currently underway with EFTA recently completed and Mercosur close to completion. But negotiations with the US have run into serious difficulties. This reflects major differences between South Africa and the US concerning trade liberalisation in general and the US 'WTO-plus' approach to bilateral negotiations. To some extent it also reflects the South African government's desire, in common with Brazil, to pursue strong alliances with key developing countries in order to balance US power. Track two has yet to commence, although it is anticipated that negotiations will get underway next year, whilst track three is likely to be considerably delayed owing to DTI capacity constraints.

### **3.1 South Africa's African strategy**

Officially, South Africa's vision for Africa is embodied in the African Union (AU) initiative and the New Partnership for Africa's Development (NEPAD), which forms one of the AU's most important pillars. NEPAD is an attempt to embody, in a coherent programmatic framework, a collective action by African states to address development on the continent in the context of challenges globalisation presents.

The underlying philosophy of South Africa's vision—the idea that South Africa's destiny is inextricably linked to that of the region and the rest of Africa—has remained unchanged since 1994. As such, the South African government has always had a developmental rather than narrowly mercantilist approach to the region and Africa more generally. This much is confirmed by remarks made in 2005 by the DTI's then Acting Director General, Tshediso Matona:

South Africa's economic strategy in Africa was guided by asymmetry and the country needed to make bigger concessions in trade and economic dealings with African partners. This strategy needed to be multi-faceted by promoting trade and supply-capacity as well as being conducive to promoting investment and infrastructure development. Finally this strategy had to be located within the Nepad framework and should emphasise the

importance of partnerships on the continent (Parliamentary Monitoring Group, 2005: 5).

According to Davies (2002:52) (now South Africa's Deputy Minister of Trade and Industry) the original vision for SADC was not confined narrowly to trade per se, but 'what is needed in the Southern African region is not a programme of trade integration alone, but one combining trade integration, sectoral cooperation and policy coordination in ways that address the major challenges of developing production structures and infrastructure as well as promoting mutually beneficial trade'.

This outlines neatly the broad regional integration imperative that we know is high on the political agenda in Sub-Saharan Africa. Ultimately, the DTI wishes to see the establishment of integrated regional manufacturing platforms capable of competing globally.<sup>16</sup>

Thus the question is not *whether* to construct RIAs, but rather *how to make them effective* and minimise political complications arising from the inevitable polarisation effects likely to ensue.

Economic integration in Africa is beset with a range of problems. First, African countries produce a small range of export commodities which are almost entirely traded with developed countries and, increasingly, China. Without the diversity of a more open South African economy, the basis for meaningful exchange so crucial to constructing RIAs is not there. Second, there is a proliferation of regional economic arrangements on the continent, at different stages of integration. Many countries, notably in our region, are members of several arrangements. Furthermore, these schemes are typically supported through donor-funded secretariats, raising questions about their long-term viability.

Lastly, security issues throughout the continent militate against the more ambitious schemes, and threaten to divide region-specific arrangements. Of course this could

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<sup>16</sup> And, to get there, it is clear that building institutional strength in order to effectively negotiate with external actors, and effectively implement and maintain any ensuing regional plans, is a crucial first step.

also constitute an argument in favour of greater regional integration, given the political roots of such arrangements worldwide.

Considerable immediate benefits may however be derived from economic integration in as far as it promotes the building or upgrading of trade-supporting infrastructure across the region. As already mentioned above, this is an area where Africa lags behind and it is heartening to note that both SADC and NEPAD have put the development of infrastructure high on the agenda.

Nonetheless, the point is that it is difficult to see how the more ambitious schemes could be realised except perhaps within a very long-term horizon. In our view, to the extent that RIAs are actually likely to work in Sub-Saharan Africa, it is likely that over a period of time a small set of regional leaders will emerge around which regional economies will increasingly concentrate.

In Southern Africa, integration is arguably already evolving along these lines. Since July 2004, when the new SACU Agreement came into force, South Africa's trade strategy has had to pay much more serious attention to its customs union partners<sup>17</sup>. This agreement democratises SACU for the first time: all decisions over tariffs and trade remedies will now be taken at the SACU level by a Council of Ministers<sup>18</sup>, advised in turn by a new SACU tariff body and a commission of senior officials.

Specifically, Articles 4 and 31 of the 2002 Agreement legally require each and every SACU member to be fully involved in all current and future negotiations. South Africa's history of unilaterally pursuing its own interests in trade negotiations is therefore no longer legally possible. This will serve to integrate SACU—at least as a trading, negotiating and institutional entity—much more rapidly than SADC.

Furthermore, Section 8 of the Agreement outlines a range of areas on which the partners are required to coordinate policy. If this gathers momentum, SACU will integrate more rapidly than SADC in more areas than just trade and trade

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<sup>17</sup> The partners are Botswana, Lesotho, Namibia and Swaziland (the BLNS).

<sup>18</sup> Historically finance ministers constituted the Council given the dominance of revenue issues in SACU. Now both trade and finance ministers participate in the Council and trade ministers schedule additional focused meetings on broader economic and trade issues.

negotiations. However, it remains to be seen to what extent South Africa's customs union partners will embrace this new framework.

Further complications arise from the role played by external partners in the region, especially the EU<sup>19</sup> and US. In recent years this has coincided to some extent with South Africa's trade strategy, resulting in South Africa being first choice for these external powers in separate bilateral FTA negotiations. However, the EU's EPAs are causing angst amongst regional policy-makers as many countries are members of several regional groupings and are being forced to make hard choices about their regional alignments through the process<sup>20</sup>.

Partly in response to these external initiatives, the South African government is interested in expanding SACU. This is an indication of its thinking regarding how best to move the regional integration agenda forward. Currently Mozambique and Zambia are considering their options in this respect. If it works well, an expanded SACU could absorb SADC's trade integration mechanisms (at least).

Negotiating agreements with external players as part of SACU constrains South Africa more than would be the case if it were negotiating alone. As such, South Africa may be forced to settle for negotiating positions that are not in its best interest. So there is a much narrower space to develop consensus around an offensive agenda, making it likely that defensive concerns will dominate. This is in line with South Africa's own imbalances in that regard—its defensive agenda is far more sophisticated than its offensive counterpart.

In light of this, and although certain initiatives are provided for in the new SACU Agreement, it is not surprising that the SACU has not taken substantial steps forward regarding further internal liberalisation of trade and deeper economic integration. Furthermore, the BLNS have an interest in retaining high tariffs because of their dependence on customs revenues. This could potentially provide a convenient

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<sup>19</sup> With regard to the EU, the outcomes of EPA negotiations seem poised to fundamentally change the pace and nature of regional integration processes in Africa (Szepesi, 2004; Berthelmsman-Scott, 2005); and Bertelmsman-Scott, 2005).

<sup>20</sup> For a useful overview of this problem and potential scenarios around its resolution, see Hess and Hess (2004) and Jakobeit et al. (2005).

smokescreen behind which South African negotiators could hide should the South African government wish to prevent further liberalisation. That may have negative implications for other Sub-Saharan African countries seeking greater access to the South African (and SACU) market(s), and may reduce South Africa's leverage in continental trade negotiations. Worse, it would undermine regional economic integration in Southern Africa.<sup>21</sup>

To avoid this, and taking seriously the words of Tshediso Matona, mentioned earlier, South Africa has to lead by example. First and foremost, this entails opening its market to exports from the region, notwithstanding concerns regarding the ability of SADC exporters to take advantage of that opening. Secondly, in order to give its poor neighbours an advantage in the South African market, the South African government should put in place a generous preferential access scheme along the lines of the EU's 'Everything But Arms' initiative. Unlike the EU, though, this should be accompanied by liberal, easy to administer, rules of origin, complemented with substantial investment in South Africa's Customs Administration to ensure implementation, compliance, and to minimise transshipment.

As things currently stand South Africa has offered improved and asymmetrical access to its market through the Southern African Development Community (SADC) FTA. This has led to a substantial tariff phase-down. However, liberalisation through the FTA has been offset by strict rules of origin in particular sectors in South Africa (Flatters, 2002). Also, much work remains to be done in the area of trade facilitation, and institutional capacity in the region is very weak. So it remains to be seen whether SADC member states will be able to take full advantage of the tariff concessions obtained to date.

But taking the view, as we do, that what South Africa does with external partners has important implications for regional integration initiatives, perhaps the most important issue is that this additional market access is potentially threatened by South Africa's

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<sup>21</sup> Of course, an equally important concern is the ability of African countries to respond to greater access to SACU markets. The existing dearth of manufacturing capacity in non-South African SADC countries, coupled with the fact that those manufacturers which do exist tend to struggle against third country suppliers in the SACU market, raises important questions concerning the effectiveness of SACU opening more effectively to SADC. However, this does not detract from the fact that a more open SACU (to the region) is a necessary first step.

broader FTA agenda outlined above. Focusing on goods trade only, this is the thrust of the rest of the paper.

#### **4. SADC member state exports to South Africa**

In this section South Africa's imports from SADC member states are analysed as a first step towards examining the extent of South Africa's integration with the region. Next we consider imports into South Africa from its current and prospective FTA partners. These two analyses are brought together in later sections to assess competition and complementarities for key SADC exports into the South African market.

##### **4.1 Methodology**

The analysis was undertaken at HS4-digit level: approximately 1200 product groups. Due to the relative aggregation in HS4 data—meaning that many products fall into each group—some of the 'products' discussed below should not be read at face value. And, in SACU's case, there is always a risk that the intra-SACU trade data does not fully account for all re-exports into South Africa.

Table 1 and Table 2 report the top three products exported into South Africa by SADC countries and non-SADC FTA partners, respectively, based on average shares over the period 2000 to 2004 (where data is available).<sup>22</sup> In cases where member states have data up to 2003 only, the average share is calculated from 1999. Botswana, Namibia and Lesotho fall into this category.

Data on SADC member states comes from the Southern Africa Trade Database, which uses data provided by the SADC member states.<sup>23</sup> Data for non-SADC members was taken from the South African Customs and Excise database.

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<sup>22</sup> Average values are used, as this smoothes out any outliers for a particular year.

<sup>23</sup> See <http://www.sadctrade.org>.

## 4.2 Results

### **SADC member state export flows**

The focus here is on the broad overview of individual SADC member exports to South Africa. Table 1 shows the top three products according to the criteria explained above.

SACU exports to South Africa show a degree of processing but also high levels of concentration. According to the data, Botswana's exports to South Africa are led by tractors, vehicles and carbonates, accounting for 37% over the period. Lesotho's main products were TVs, footwear and bottled water, accounting for over 40% of the total. The top three products from Namibia and Swaziland also account for more than 40%. In the case of Namibia, these products include stationery materials, gold and diamonds while Swaziland's main products are processed agricultural commodities.

**Table 1: Top three SADC Member States exports to South Africa and market shares, % (2000 -- 2004)**

<b>Member State</b>	<b>Top three products exported to SA and their shares (%)</b>
Botswana	Tractors (18), vehicles (12) and carbonates (7)
Lesotho	TVs (16), footwear (14) and bottled water (13)
Malawi	Tea (13), sugar products (11) and clothing (11)
Mauritius	Diamonds (24), cotton (16) and clothing (6)
Mozambique	Electricity (34), fish (10) and machinery (8)
Namibia	Stationery (20), Diamonds(17) and gold (6)
Swaziland	Essential oils (33), sugar products (8) and wood pulp (7)
Tanzania	Gold (78), other precious stones (8) and coconuts (2)
Zambia	Refined copper (40), cobalt (14) and cotton (11)
Zimbabwe	Ores (22), iron and steel products (21) and cotton (7)

Source: Southern Africa Trade Database and own calculations

Malawi's top products (tea, sugar and clothing) account for more than a third) of exports while Mauritius's gold, cotton and clothing reflect high concentration and dependence on the primary sector. Mozambique is exporting a different basket from other member states, constituting electricity, fish and machinery.

Tanzania shows the highest concentration of exports with gold exports alone accounting for about 80% of all exports to South Africa. Zambia is also trading according to its comparative advantage in copper mining; the same can be concluded with respect to Zimbabwe.

In general, SADC's trade with South Africa is concentrated in primary products. SACU exports show some diversity; this is attributed to the growing integration that is taking pace as a result of the improving relations within the Customs Union.

### ***Non-SADC FTA Negotiation Partners exports***

South Africa's current and prospective FTA partners are: China, Mercosur<sup>24</sup>, India, the United States and the European Free Trade Association (EFTA)<sup>25</sup>. The aim of this analysis is to observe the patterns and structure of exports from these partners to South Africa and then compare them to SADC exports.

We begin with China. Trade between South Africa and China is reported to be in China's favour associated with a large trade imbalance (Willcox and Van Seventer, 2005). However, over the last five years, growth in South Africa's exports to China has improved, indicating that the gap may be narrowing. Compared to imports from SADC, South Africa's imports from China comprise sophisticated and dynamic products, with the exception of footwear. Furthermore, the top three products account for just 15% of exports to South Africa.

An FTA with EFTA was concluded in 2005. Despite small populations their OECD status suggests their exports will be made of high tech, advanced manufactured goods. Table 2 reveals that the top products exported to South Africa included printing machinery, medicine and diamonds. The three products accounted for less than 30% of total exports to South Africa, suggesting a relatively high degree of concentration compared to China. Recall, however, that the HS4 level will aggregate a relatively large range of manufactures into one product group (this is less of a problem with less complex products).

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<sup>24</sup> Brazil, Argentina, Uruguay and Paraguay. Venezuela has recently joined, but its status at this stage is unclear.

<sup>25</sup> Iceland, Liechtenstein, Norway and Switzerland.

India's major exports are in agriculture (rice) and mining (petroleum oils), as well as medicines. India shows a similar pattern to SADC exports, although the concentration levels are far less with the three products contributing less than 20%.

In contrast, Mercusor is the most concentrated of the five non-SADC partners with more than a third of exports contributed by three products. Furthermore, agricultural products that directly compete with SADC exports are at the top of the list.

Last, products exported by the US include aircrafts, vehicles and vehicle components. US exports are fairly diversified throughout the product groups.

**Table 2: Top three non-SADC Members exports to South Africa and market shares, % (2000 -- 2004)**

<b>Non-SADC Members</b>	<b>Top three products exported to SA and their shares</b>
China	Computers (7), footwear (5) office machines (3)
EFTA	Printing machinery (13), medicines (10) and diamonds (5)
India	Rice (9), medicines (5) and petroleum oils (4)
Mercusor	Vehicle components (16), soybean oil (16) and sunflower oil (4)
USA	Aircrafts (12), vehicles (4) and engines (3)

Source: South Africa Trade Customs and Excise and own calculations, 2006

In conclusion, exports from these five partners consist of a different mix of goods compared to SADC exports to South Africa. The two sets of trade partners should complement each other, with the possible exception of Mercosur, China and India, which specialise in agriculture, clothing and textiles. These are sectors in which SADC member states specialise in their exports to South Africa. This issue is discussed in detail in the next section.

## **5. Complementary and competing products**

This section identifies possible threats and opportunities that may arise for SADC member's states if South Africa concludes preferential trade arrangements with the non-SADC countries mentioned above. Complementary products refer to the *top* products (by share and growth) exported by SADC member states to the rest of the world (RoW), but which South Africa currently imports from non-SADC sources. In

principle South Africa could substitute its imports from RoW to imports from SADC countries.

Competing products refer to prominent SADC exports to South Africa that are also exported to South Africa by the five non-SADC FTA countries or country groupings.

The results in Table 4 indicate that the top exports from Lesotho, Malawi, and Zimbabwe to RoW are also exported to South Africa. This implies little scope for South Africa to increase its imports from these countries (by switching away from other sources). On the competition side, these countries' exports of textiles and clothing, tea and cotton are under threat in the South African market from India, China and fellow SADC member states.

Botswana and Namibia's opportunities appear to be in vehicles, precious metals and medicines, while Swaziland could take advantage of furniture and machinery. However, in the case of Botswana there is a risk of relocation of motor manufacturers to the consumer market of South Africa<sup>26</sup>, which makes long-term competitiveness seemingly unsustainable. Tanzania and Mauritius have opportunities in diamonds, Zambia in copper and cobalt. The data indicates that there is potential in Mozambican petroleum oils—these are most likely natural gas products.<sup>27</sup>

All member states face the same competition from non-SADC suppliers to the South African market. The main threat comes from India and China, due to their presence in textiles and clothing, but also agricultural products. The latter is also important to Mercosur.

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<sup>26</sup> See Salkin and Kgakge-Tabengwa (forthcoming) for more details.

<sup>27</sup> The same would presumably apply to Angola, since it is a big exporter of petroleum oils to RoW, but not to South Africa. Unfortunately, there is no data to substantiate this.

**Table 3: Summary of SADC member states' complementary and competing products plus competitors**

Member State	Complementary products	Competing Products	Competitor
Botswana	Medicines, precious stones and vehicles	Vehicles, meat, confectionaries and electronics	India, US, Mercosur, Namibia and China
Lesotho	None	Textiles and clothing	India, China and other SADC members
Malawi	None	Textiles and clothing, tea, cotton and tobacco	India, China and other SADC members
Mauritius	Diamonds	Textiles and clothing	India, China and other SADC members
Mozambique	Petroleum oil	Textiles and clothing, fish and oilseeds	India, China and other SADC members
Namibia	Vehicles, printed materials and precious metals	Meat products	Mercosur and Botswana
Swaziland	Furniture and machinery	Textiles and clothing	India, China and other SADC members
Tanzania	Diamonds	Precious metals, medicines, tobacco and oilseeds	Mercosur, India and SADC members
Zambia	Copper and cobalt	Cotton and tobaccos	Mercosur, India and SADC members
Zimbabwe	None	Tobacco, tea and cotton	India and other SADC members

Source: SA Customs and Excise and Southern African Trade database plus own calculations

The five FTA negotiating members threaten a range of SADC exports. The case for China and India goes beyond textiles and textiles articles: China is an exporter of machinery and mechanical appliances, while India is competitive in medicaments. The latter is also of interest to the US. EFTA and the US provide South Africa with high tech products and none of the SADC members have shown any strength in supplying those. Finally, as mentioned, Mercosur is a threat to the region's trade with South Africa by virtue of its strong agricultural sector.

## **6. Preferential Market Access: linking tariff liberalisation to trade flows**

One of the objectives of the SADC Trade Protocol is to promote intra-SADC trade by means of intra-SADC tariff liberalisation. This process is designed in such a way that South Africa, and therefore SACU, spearheads the reduction of tariffs while other

SADC members 'backload' their reduction commitments. Consequently, a comprehensive analysis linking intra-SADC tariff liberalisation to intra-SADC trade flows for all of SADC is probably not possible at this early stage.

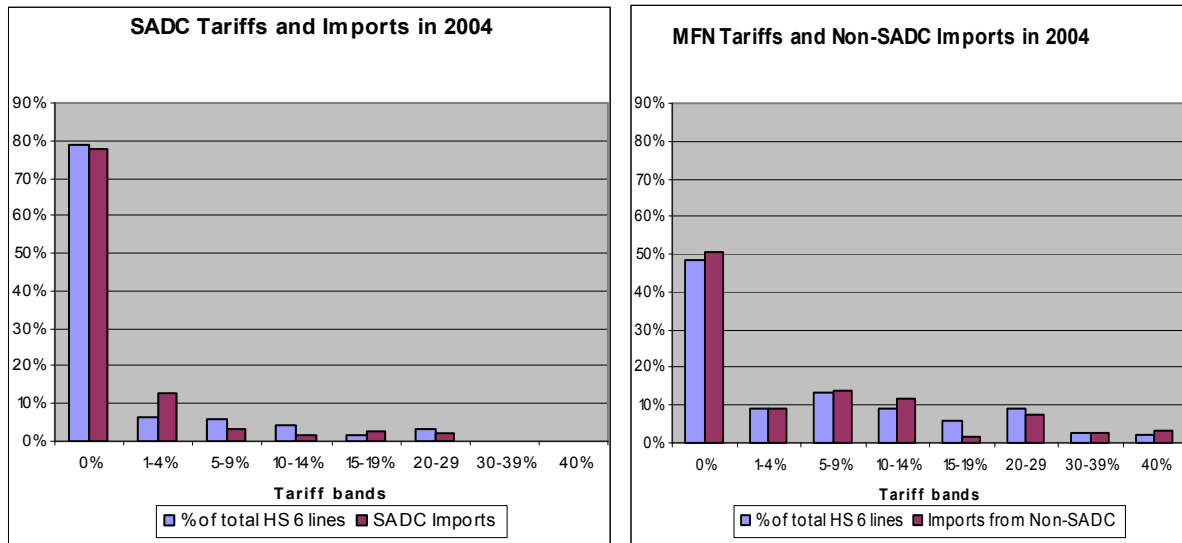
Hence in this section we limit ourselves to an attempt to analyse the link between South Africa's tariff liberalisation and its imports from SADC (excluding SACU). A descriptive analysis is presented. We consider 2004 tariff levels and their reductions since 2000 (the inception year of the SADC Trade Protocol for SACU). The analysis is undertaken at the HS6 level of detail.

By way of background, in 2001 South Africa's share in intra-SADC total imports (i.e., imports from the region (but excluding imports from SADC by Mozambique, Lesotho, Angola and the DRC, due to lack of data) was low at just under 5%.

Figure 6 shows South Africa's tariff schedules and imports from the two sets of partners. The left-hand chart shows that South Africa's SADC schedule is dominated by zero tariffs—about 80% of the tariff lines are zero rated. Unsurprisingly, almost 80% of South Africa's imports from SADC are in this category. Less than 10% of tariff lines were between 1% and 4%, but the share of imports was slightly higher than 10%. Very few tariff lines are higher than 4%; however, given the concentration in South Africa's imports from SADC, it is possible some of the high tariffs greatly influence SADC exporters' prospects in the South African market.

The most favoured nation (i.e. non-preferential) schedule presented in the right graph shows that less than 50% of tariff lines are set to zero; half of all imports from the five partners (China, EFTA, India, Mercosur and US) came in at that rate. It is clear, therefore, that the South African tariff regime is biased in favour of regional partners. However, despite facing lower tariffs, SADC imports represent a mere 2% of South African total imports.

**Figure 1: Comparison of South Africa’s tariff schedules for imports from SADC and the five non-SADC trade negotiating partners in 2004.**



Source: Customs and Excise

More detailed analysis—presented in the lengthier version of this report—yielded the following insights. The main imports by South Africa from SADC—minerals and ores—do not face a high tariff. South Africa’s SADC tariffs on processed foods have come down since 2003 and are now relatively low. Similarly, imports into South Africa from SADC have risen, notably in tea and fish. Tariffs on tobacco and sugar remain high, but trade flows have nevertheless increased, although in the case of the former not as much as from the rest of the world.

Tariffs on textiles and clothing have also been reduced but remain at a relatively high level. Growth in trade flows has decelerated compared to the period prior to the inception of the SADC Trade Protocol. This is possibly due to the expiry of the WTO Agreement on Textiles and Clothing (ATC). In footwear the reduction in tariffs over the period 2000–2003 has been less and the current levels are relatively high while trade flows have declined.

SADC exports to South Africa in basic metal products show varied growth rates, even though protection is very low. The picture regarding machinery and electrical machinery is also mixed with the former showing a decline in imports from SADC while tariffs came down.

There is some evidence of tariff escalation in wood products where tariffs remain relatively high for furniture, while SADC's unprocessed and semi-processed wood products have seen tariffs in South Africa reduce and trade flows increase.

On the whole, total South African imports from SADC have increased at a higher pace compared to imports from RoW and have also recorded an acceleration compared to the previous four years. Nevertheless, in spite of a substantial amount of products SADC exports to South Africa facing zero tariffs, many have not gained market share. The source of imports often appears to switch to the rest of the world even if tariffs charged are higher than in the region.

It is clear, therefore, that tariffs do not explain this trend and one probably has to look to other considerations, such as supply constraints and competitiveness problems in SADC countries. The earlier discussion on investment in Africa and the importance of improving diversification and productivity in agriculture and manufacturing, is therefore clearly very important. There is perhaps a case to be made that for the SADC Trade Protocol to benefit non-South African SADC exporters more, consideration for something like the current WTO aid for trade framework is appropriate. This could conceivably tie into NEPAD and AU initiatives on regional infrastructure, tapping concerns that non-tariff barriers in SADC are increasingly becoming or already are the biggest constraint on improving intra-regional trade.

Another problem, however, could be the rules of origin in the SADC Trade Protocol, to which we now turn.

## **7. SADC rules of origin**

Rules of origin in SADC remain one of the most contentious and as yet unresolved issues within the regional integration agenda. They are considered to be relatively complex and prohibitive (Brenton et al., 2004) Initial rules were considered simple, unrestrictive and consistent with those of developing countries in a preferential trade agreement. However, they were considered insufficient to confer origin, and specific rules setting out minimum levels of economic activity in the region were developed.

The current specific rules stipulate that goods would qualify for SADC tariff preferences if they:

- underwent a single change of tariff heading, or
- contained a minimum of 35% regional added value, or
- included non-SADC imported materials worth no more than 60% of the value of total inputs used.

For agricultural and primary products to be eligible for preferences they need to be wholly produced or obtained in the region. This is a more general rule and common in many preferential trading arrangements (PTAs) in many parts of the world (Brenton et al., 2004). If this rule is properly enforced, it can sufficiently prevent trade deflection. As indicated above, most of South Africa's imports from the region are in this category.

Even though these rules appear less complex, there are still areas of contention, especially in the areas of wheat, wheat flour and their products where there is still no agreement, coffee, tea, and spices, as well as in textiles and garments. These are analysed below.

## **7.1 Rules of origin on selected commodities**

### ***Wheat, wheat flour and their products***

Rules of origin have not yet been agreed for wheat and flour or for the products of wheat and flour. The main differences among the proposed rules for flour hinge on the amount of local or regional wheat that is required. One proposal is that 70% of wheat used (by weight) be sourced from the region. An opposing proposal suggests that no reference be made to the source of wheat and just require that the flour be milled in the region. The latter proposal is a simple form of the change in tariff heading requirement. The basis of the differences to proposals for downstream flour products is similar.

Proponents of the complex rules argue the need to protect regional grain growers from unfair, subsidised international competition, as well as downstream millers.

However, an interesting fact is that all SADC member states are net wheat importers. Few members produce a significant amount of wheat. Furthermore, until rules are agreed, no tariff preferences will be offered. This must be remedied swiftly if intra-SADC wheat trade is to grow.

### ***Coffee, tea and spices***

The member states that are significant producers of these raw materials generally maintain high external tariffs on these products, and thus seek protective rules of origin in the form of high regional content requirements. The intention is to increase demand for the regional agricultural product and encourage downstream processing. The agreed rules of origin on these products states that:

- For tea, coffee and spices at least 60% by weight of raw materials must be wholly originating from the region, and
- For curry and mixtures of spices, there must be a change of tariff heading and all cloves used in such mixtures must be wholly originating in the region

The problem with these rules is that many relevant spices are not available in the region (Flatters, 2002). The rules are therefore unlikely to achieve the intended goals. If any thing, they are likely to have unintended consequences of preventing potential intra-SADC trade. Furthermore, they will impede and not encourage development of downstream processing activities.

Arbitrary and restrictive rules of origin have a potential to limit flexibility in raw materials sourcing. This will not only reduce the competitiveness of processing and distribution industries, but will also harm regional consumers. Also, member states that might have a comparative advantage in tea, coffee or spice blending by virtue of local availability of only *some* of the necessary ingredients would be deprived of preferential access to SADC markets.

### ***Textiles and garments***

Textiles and garments are of particular interest in SADC due to the fact that it is one of the manufacturing sectors in which there is significant production in a number of countries. Differences in labour intensity at various stages of textile and garment

value chain mean that there are potential complementarities among member states which might enhance the region's overall global competitiveness (and, *as a region*, take better advantage of the African Growth and Opportunity Act, or AGOA).

However, negotiations on textiles and garments were prolonged. On the insistence of SACU and a directive from the Committee of Ministers responsible for Trade, Member States agreed on product-specific rules of origin on some goods whilst general rules will apply to others.

The most important textiles and clothing products proved to be HS50 to HS63, which were of great interest to the less developed Member States, i.e. Malawi, Mozambique, Tanzania and Zambia (MMTZ countries). The *special agreement relating to trade in clothing and textiles* is based on a two-stage substantial transformation rule of origin. MMTZ countries are allowed access to the SACU market under a one-stage transformation rule, but are subject to quotas. These quotas are based on current production capacity. This dispensation was put in place for a period of five years, during which the MMTZ countries were expected to graduate to the two-stage transformation rule of origin where there are no limits on market access. The dispensation period ended in 2005; the double transformation rule was supposed to apply to MMTZ countries as from 2006<sup>28</sup>.

Restrictive rules of origin are not only a barrier to regional trade and international competitiveness, but are also costly in terms of ensuring conformity. Traders have to comply with complex certification requirements, and customs authorities have to satisfy themselves as to the proof of origin of goods, which requires relatively costly administrative systems. The situation is likely to be worse in cases where countries are members of multiple trade agreements, especially when rules are not harmonised.

Added to the strict rules of origin is the 'backloading' of tariff reduction schedules for textiles and garments, especially by SACU countries. This will inhibit SADC from taking full advantage of AGOA, and international markets in general. To take

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<sup>28</sup> These countries sought and obtained a temporary derogation from this rule, expired in July 2006.

advantage of international export opportunities, producers would benefit from flexibility in sourcing raw materials and intermediate inputs. Any constraints on these choices increase costs and hence reduce international competitiveness. SADC's double transformation rule must thus be seen as a deterrent to regional integration and economic development.

## **8. Conclusions**

The comparative structure of the South African economy relative to the region is most appropriately characterised as North-South. South Africa is the largest and most dynamic economy in the region. Given the nature of Africa's developmental needs, South Africa's role in the region is therefore crucial, and commercial relationships between South Africa and regional economies should, on balance, deliver mutually beneficial outcomes. South Africa's expansion through FDI is particularly important, as it has tended to be more diverse in both type and activity than the traditional resource-seeking investment, whose developmental impact is likely to be more constrained.

But there are significant challenges to more meaningful regional integration. South Africa aside, the fact that most SADC members specialise in primary products and a limited range of basic manufactures implies minimal scope for trade expansion and economic integration. Overlapping memberships is another complex challenge, as are institutional weaknesses at the regional and national levels.

Most important, the evolving external trade agenda of the region's biggest economy is continually opening and closing opportunities for SADC producers in the South African market. South Africa's priorities are also arguably with SACU, not SADC, at least as far as trade is concerned. As such, it must be recognised that ambitious integration schemes such as that envisaged under the RISDP will necessarily take a very long time.

In the meantime, smaller, more manageable arrangements such as SACU may bear more fruit. If so, however, they may also detract from the legitimate need to focus on broader regional goals. So while they should therefore be encouraged and

supported, their development should be managed with a view to complementing rather than undermining broader SADC processes.

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