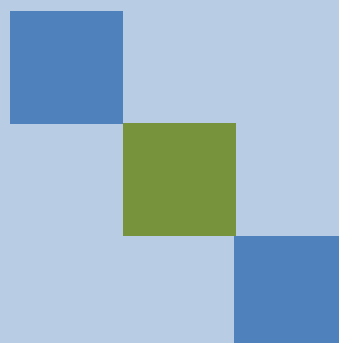




Africa Trade Policy Notes

Note #9



Deepening Regional Integration to Eliminate the Fragmented Goods Market in Southern Africa

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November, 2010

Introduction

This note summarizes new studies that identify the most restrictive barriers to regional goods trade in Southern Africa. It also illustrates the costs associated with these barriers using information gathered from some of the largest firms engaged in cross-border trade. The note concludes by providing practical policy recommendations to deepen regional integration in the goods market and increase competitiveness.

A recent and important trend in global trade has been the proliferation of regional trade agreements (RTAs), and Southern Africa is no exception. Regional integration efforts in Southern Africa, such as COMESA, SADC and SACU, have all sought to liberalize trade between countries so as to increase bilateral trade flows, diversify exports by overcoming the limits of small markets, and deepen specialization through achieving economies of scale. Harnessing regional integration more effectively, for both goods and services, would help all countries lower their cost base thereby enhancing global competitiveness. For the smaller Southern

African countries, regional integration also offers the prospect of improved access to neighboring markets as well as the potential to attract greater SADC-orientated FDI. In some of these countries (e.g. Lesotho) greater exploitation of the regional market is critical to reduce reliance on exports of a single product to a single market (e.g. clothing to the United States under AGOA). For the larger countries, especially South Africa, regional integration offers opportunities to enhance the sustainability of existing exports (e.g. light manufacturing) on world markets by lowering costs through specialization within the context of integrated regional value chains.

However, while Southern African countries have largely succeeded in increasing their trade with the rest of the world (more than tripling in value between 2000 and 2008 from US\$50 billion to US\$153 billion), increased regional trade has only played a relatively small role. Opportunities for export growth and diversification therefore remain unexploited at the regional level. While efforts to reduce tariffs have largely

been met with success, other forms of trade restriction remain widespread. These barriers affect *considerably more* than one-fifth of regional goods trade, and are hindering the competitiveness of domestic firms and their ability to export to regional and global markets, so must now be urgently addressed.

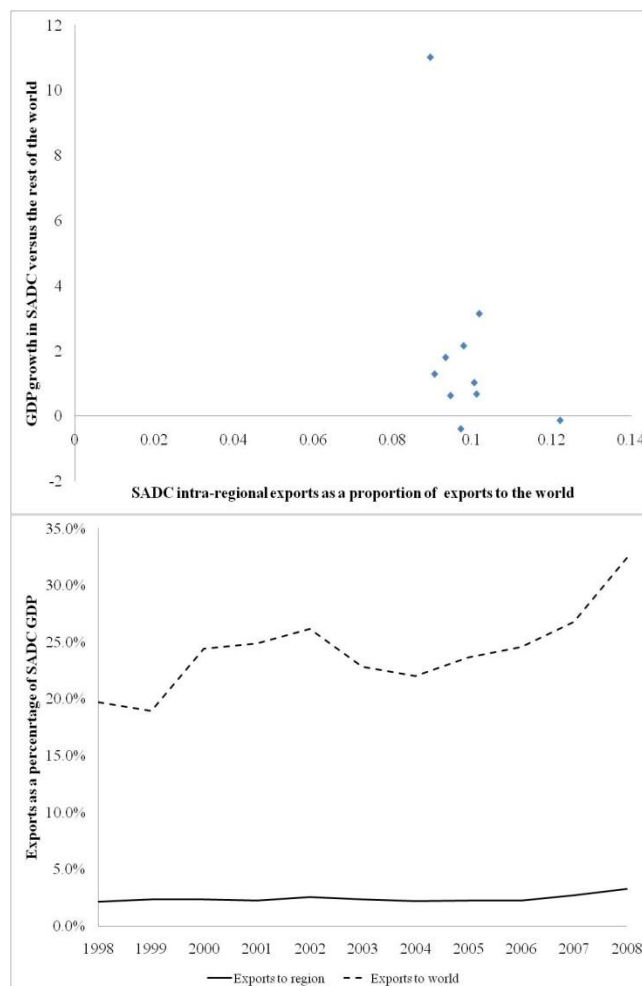
Despite Southern African economies often growing faster than the world average, regional trade has remained relatively constant

The share of intra-regional exports in SADC has remained relatively steady at around 10 percent of total exports over the last decade despite Southern African countries often achieving higher annual GDP growth rates than the world average over this period (particularly 2003-2007). In contrast, the most successful RTAs in Asia and Latin America (e.g. ASEAN; MERCOSUR) have reached and maintained relatively higher degrees of regional trade (typically over 20 percent of their total trade), often through intensified intra-industry linkages. While SADC's merchandise exports to the world as a proportion of its GDP have increased dramatically, the share of exports to the region have grown more slowly and account for just 3 percent of GDP (see Figure 1). Furthermore, traditional exports of agricultural raw materials and minerals continue to dominate regional trade in Southern Africa. Cases of diversification into higher value-added manufacturing exports to the region remain limited e.g. Mauritian clothing to South Africa, and strong trade imbalances persist between South Africa and the smaller countries. Regional production chains, for exports to the world market, remain virtually non-existent.

The key policy issue for regional integration in the Southern African goods market is why

these trade outcomes have been so limited and what can be done to consolidate the various RTAs to increase regional trade?

Figure 1: Regional trade has lagged behind SADC income growth while exports to the rest of the world have boomed (1998-2008, annual values)



Source: IMF Direction of Trade Statistics.

While efforts to reduce tariffs have largely been met with success, other barriers are critically hindering regional trade

Regional integration efforts in Southern Africa have made significant progress in lowering tariff barriers to regional trade. For example, SADC has been trading on preferential terms since 2000 and, based on the implementation of tariff phase down commitments under the SADC Trade Protocol, formally launched a free trade area¹ (FTA) in August 2008. Under this, 85% of intra-SADC merchandise trade flows are now duty-free with most of the remaining 15% comprising sensitive products² scheduled to be liberalized by 2012 (2015 for Mozambique). A sub-set of five SADC members have already established a customs union under SACU. COMESA has also had an FTA since 2000. Trade between FTA³ and non-FTA⁴ COMESA countries is conducted on reciprocal terms under the Preferential Trade Agreement.

The next step in COMESA's regional integration agenda is the formation of a customs union which was formally launched in June 2009.⁵ There are also a number of

¹ The FTA is being implemented by Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

² The remaining sensitive products mostly comprise textiles and clothing, cotton, cereals, dairy and motor vehicles.

³ Burundi (since 2005), Comoros, Djibouti, Egypt, Kenya, Libya (since 2006), Madagascar, Malawi, Mauritius, Rwanda (since 2005), Sudan, Zambia, Zimbabwe.

⁴ DR Congo, Eritrea, Ethiopia, Seychelles, Swaziland, Uganda.

⁵ After five years of negotiation, COMESA member states agreed to a common external tariff in May 2007 with four bands for raw materials (0%), capital goods (0%), intermediate goods (10%) and final goods (25%) although, for some products, discussions continue on which category they will be

bilateral trade agreements between Southern African countries, most of which were signed and implemented long before the SADC and COMESA FTAs came into effect.

The lesson from successful regional integration experiences elsewhere in the world is that tackling tariff barriers is not enough to enhance trade. Countries must also aim to facilitate regional trade by addressing non-tariff barriers (NTBs), such as restrictive product standards or complex rules of origin. In the Southern African context, borders remain thick as major obstacles to regional trade remain. A mapping of the various NTBs reported by firms in SADC countries to trade flows in the affected sectors shows that these barriers impacted US\$3.3 billion of regional trade in 2008, or one-fifth of regional exports (see Table 1). In other words, even those barriers which have been reported (and many others may yet to be notified) are affecting products in which there is already significant regional trade. This is also a least cost estimate of the impact of NTBs on trade in the region since some barriers are so restrictive that preferential trade is effectively prohibited (e.g. wheat flour) and, of course, others which affect all trade and not just individual products (e.g. customs delays, transport costs) which are not captured here. So NTBs are widespread in their effect on regional trade, even more so than these figures suggest.

classified under. All tariff lines carrying a rate above or below its common external tariff have been placed on sensitive product lists, which should be adjusted to the CET in a period of no more than five years.

Table 1: NTBs that have been notified to SADC affect at least one-fifth of regional trade

Barrier	Examples of products affected	Volume of intra-SADC trade potentially affected (% of total)
Import bans, quotas & levies	Wheat, beer, poultry, flour, meat, maize, UHT milk, cement, sugar, eggs, pasta, sorghum, pork, fruit & vegetables	6.1%
Preferences denied	Salt, fishmeal, pasta	0.4%
Import permits & levies	UHT milk, bread, eggs, sugar, fruit & vegetables, livestock, liquor, cooking oils, maize, oysters	5.4%
Single marketing channels	Wheat, meat, dairy, maize, tea & tobacco, sugar	5.3%
Rules of origin	Textiles & clothing, semi-trailers; palm oil; soap; cake decorations; rice; curry powder; wheat flour	3.0%
Export taxes	Dried beans, live animals, hides, skins, sugar, tobacco, maize, meat, wood, coffee	4.8%
Standards/SPS/TBT	Milk, meat, canned tuna, beer, honey, maize bran, cotton cake, poultry, batteries, sugar, coffee, ostriches	2.5%
Customs-related	Wine, electronic equipment, copper concentrate, salt, cosmetics, medicines	5.2%

Source: Authors calculations based on NTBs reported to the SADC-EAC-COMESA Non-Tariff Barrier Monitoring Mechanism.

The remaining barriers are also costly. On average the tariff equivalent of NTBs is 40 percent, which for most products is much higher than the MFN tariff applied by most countries (Carrere and De Melo, 2009a, b). Assuming 40 percent ad valorem equivalence on those NTBs cited above, which affect US\$3.3 billion of Southern African regional trade, would imply a crude cost estimate of US\$1.3 billion per year. Consequently, NTBs significantly increase costs both for firms that source intermediate inputs from the region as well as for consumers. For example, in SADC, Woolworths reports that prices in its franchise outlets in non-SACU SADC countries are 1.8 times higher than those within SACU because of higher

expenditures associated with sending goods to these markets as well as the higher costs of doing business in them.

What are the main types of barrier that remain and how much do they cost?

There are, therefore, opportunities for Southern African firms to trade across regional borders which currently remain unexploited due to policy constraints that serve to raise trade costs. Five main types of barrier can be broadly identified as follows:

Inefficiencies in transport, customs and logistics raise trade costs: In order for RTAs to be effective, it is critical that intra-regional trade be able to move without hindrance. Many Southern African countries

are landlocked, making road and rail networks very important in linking these countries to both regional and global markets. However, high transactions costs are being incurred from inadequate transport infrastructure, inefficiencies in customs procedures (including delays at road checks, borders and at ports) as well as poor quality and costly logistics due to weak competition among service providers. For example, Shoprite reports that each day one of its trucks is delayed at a border costs US\$500 (Charalambides, 2010). And at Durban, the Citrus Growers' Association in South Africa estimates that delays there cost its growers US\$10.5 million per season (on approximately US\$400 million of exports). A related source of delay within the region concerns work permit regimes for foreign truck drivers. In South Africa, visitor visas used to be accepted for this purpose but foreign drivers will soon be required to obtain work permits. This necessitates companies proving that the skills being sought outside of South Africa are not available domestically and involves each post being advertised locally. There are between 1,600 and 2,000 foreign drivers in South Africa who will require these permits, affecting 6,000-8,000 deliveries per month. While ostensibly designed to protect employment opportunities, the new approach does not take into account prospects for South African drivers operating in regional markets and may hamper regional integration. In particular, it risks South Africa's neighbors reciprocating with similar measures that will force South African drivers working in these countries to also apply for work permits. For example, Angola has already signaled its intention to put in place a similar requirement for South African drivers crossing its border. Such restrictions could significantly impede the movement of trucks in and out of countries

and make trade even more difficult for regional exporters than it is now.

Cumbersome fiscal arrangements necessitate borders: Fiscal borders between Southern African countries are unnecessarily complicated and inefficient and contribute to higher trade costs. The three main reasons SACU retains internal border posts, even though it is a customs union, are to capture data on intra-SACU trade for revenue sharing purposes; administer NTBs e.g. infant industry protection; and, because domestic sales taxes have not yet been harmonized, requiring refunds and payments. The costs and delays associated with these procedures reduce trade flows between Southern African countries. Those costs attributable to the differences in VAT alone have been estimated to be up to 2 percent of the value of each transaction on intra-SACU trade (Jitsing and Stern, 2008).

Restrictive rules of origin limit preferential trade: Onerous local content requirements in rules of origin (ROOs), particularly in labor intensive sectors (e.g. clothing) that use capital intensive inputs not produced competitively in the region (e.g. fabrics), and high compliance costs with administering certificates of origin reduce the utilization of tariff preferences offered by RTAs and therefore the incentive for Southern African firms to trade regionally. A recent example of the costs associated with meeting ROOs involves SACU moving to more restrictive rules (double transformation) on selected clothing imports from Malawi, Mozambique, Tanzania and Zambia following the expiration of the MMTZ-SACU Market Access Arrangement at the beginning of 2010. This has resulted in some clothing producers in these countries (e.g. Bidserv in Malawi) being no longer able to compete in the regional market. It has also further distorted investment decisions as some of these firms

have relocated to the BLNS countries as a result of the change to avoid the loss of preferences in supplying the South African clothing market. For other products where ROOs have been so contentious (e.g. wheat flour) or simply not agreed (e.g. certain electrical products for which rules were only finalized in April 2010), preferential trade within the region has been effectively prohibited (Naumann, 2008). Further costs arise from the administrative requirements for certificates of origin which can account for nearly half the value of the duty preference. For example, Shoprite spends US\$5.8 million per year in dealing with red tape (e.g. filing certificates; obtaining import permits) to secure US\$13.6 million in duty savings under SADC. Woolworths does not use SADC preferences at all in sending regionally-produced consignments of food and clothing to its franchise stores in non-SACU SADC markets. Instead it simply pays full tariffs because it currently deems the process of administering ROO documentation to be too costly!

Poorly designed technical regulations and standards limit consumer choice and hamper trade: Standards regimes in Southern Africa are often characterized by an over-reliance on mandatory inspections and certifications; unique national (rather than regional or international) standards and testing; overlapping responsibilities for regulation; and, occasional heavy government involvement in all dimensions of the standards system. These factors create unnecessary barriers to trade, especially when technical regulations and standards are applied in a discriminatory fashion against imports. International best practice is to use technical regulations only to ensure core public policy objectives such as maintaining safety. Voluntary standards should be used in all other cases, including indicating quality attributes. But in several Southern African countries, scarce public

resources are being wasted on developing and enforcing technical regulations that go well beyond issues of purely public interest. One example is shoes in Mauritius where the Chamber of Commerce has proposed the development of a regulation to govern their quality to prevent the entry of low-cost Chinese sandals that are perceived to have a tendency to wear more quickly than domestically-produced ones. However, these are often the only shoes that the poorest people in Mauritius can afford to buy. Similarly, in most Southern African countries there are also no procedures by which technical regulations are assessed in terms of their consistency with public policy objectives; whether countries and the private sector have the capacity to implement them; or, their impact on trade and competitiveness. The main objective, therefore, should be to make regulations more efficient at achieving public policy objectives while minimizing their impact on trade. In particular, no 'Office of Regulatory Reform' exists in any Southern African country to review the justification for both new and existing technical regulations. This absence of regulatory impact assessment causes problems and raises costs. For instance, the environmental levy on plastic bags in South Africa was introduced to reduce problems associated with litter, but the technical regulation governing it also affects unrelated issues such as the minimum thickness of the plastic to be used as well as the size of the text that could be printed on the bags. While regional efforts to harmonize standards in SADC are under way (i.e. SADCSTAN), application remains lacking. Only Namibia and Swaziland have adopted all 78 (to date) of the SADC-defined harmonized standards for the region, of which some have been developed without any real sense of prioritization and so are unlikely to bring significant increases in

regional trade (e.g. frozen peas and dried apricots).

Other non-tariff barriers restrict opportunities for regional sourcing: Other barriers such as trade permits, export taxes, import licenses and bans also persist. Shoprite, for example, spends US\$20,000 per week on securing import permits to distribute meat, milk and plant-based goods to its stores in Zambia alone. For all countries it operates in, approximately 100 (single entry) import permits are applied for every week; this can rise up to 300 per week in peak periods. As a result of these and other documentary requirements (e.g. ROOs) there can be up to 1,600 documents accompanying each truck Shoprite sends with a load that crosses a SADC border. Lack of coordination across government ministries and regulatory authorities also causes significant delays, particularly in authorizing trade for new products. Another South African retailer took three years to get permission to export processed beef and pork from South Africa to Zambia.

In SACU, national protection for infant industries has often been used to justify import bans. Namibia has used the provision to protect a pasta manufacturer and broilers and maintains protection on UHT milk even though its eight year limit to do this recently expired. Botswana has recently limited imports of specific varieties of tomatoes and UHT milk. Seasonal import restrictions on maize, wheat and flour also ensure that domestic production is consumed first. For example, Swaziland's imports of wheat flour were effectively prohibited for half of 2009 since no import permits were issued since June of that year. Export taxes also impose costs and inhibit the development of regional supply chains. A case in point is small stock exports from Namibia. Since 2004 the Namibian Government has limited exports to encourage local slaughtering.

Quantity restrictions were originally used but have recently been replaced by a flexible levy of between 15-30 percent, effectively closing the border for the export of live sheep to South Africa. The impact of this restriction is affecting the small stock industry in *both* Namibia and South Africa. In the former, exports of live sheep declined by 84 percent between 2004 and 2008 as farmers have switched to alternative activities like cattle and game farming. For those sheep farmers that remain, they have become almost entirely dependent on the four Namibian export abattoirs while they were previously able to sell more sheep to the South African market where they received higher prices (PWC, 2007). There have also been cases of livestock smuggling to avoid the tax. In South Africa, 975 full-time jobs are at risk because of the scheme, especially in the bigger abattoirs in the Northern and Western Cape that focus on slaughtering Namibian sheep during the low season to better utilize their capacity (Talijsaard *et al.*, 2009).

The implication of the current system and the barriers remaining to regional trade in Southern Africa is that it imposes unnecessary costs for producers that limit trade and raise prices for consumers. Many of these barriers are simply wasteful and do not serve any real purpose. Import bans and delays create uncertainty over market access and limit investment. Thick and fragmented borders limit possibilities for regional production chains in which countries can exploit their comparative advantage in specific tasks and intra-industry trade. Finally, the heavy bureaucratic burden imposed on all regional trade flows ties up regulatory and customs resources, limiting their attention on achieving the most pressing public policy objectives such as effective border management to ensure security. Instead of scrutinizing all consignments, border checks should be

focused on those for which the risks are greatest for circumventing national trade policy measures.

Priorities for regional merchandise trade reform and implementing them

There are, therefore, a wide range of barriers that persist on regional merchandise trade in Southern Africa. Which among these are the most pressing in terms of their restrictive effect, or perhaps easiest to deal with, that should be prioritized and tackled early on by policymakers?

First, one of the biggest issues for regional trade integration in Southern Africa, especially for manufactures and agro-processed products, is undoubtedly ROOs. The issue has gained particular prominence in light of the planned Africa-wide Tripartite FTA where one set of rules for all countries will have to be agreed. This is generally accepted by all member states in SADC, COMESA and EAC. Harmonization of the different rules among the regional groups will not be possible for all products because process requirements, employed for example under SADC, cannot be easily harmonized with the value addition criteria under, for example, COMESA. So a new set of ROOs will need to be agreed, either based on one of the existing arrangements or completely redesigned. Characteristics of ROOs that would encourage the development of new export industries would include:

- Providing exporters with a *choice* as to which rule (defined simply and transparently) they apply e.g. either a change in tariff heading test (ideally at a disaggregated product level) *or* a reasonable value-added rule (20 percent);
- eliminating process-specific ROOs which set out how a product is to be

made for originating status to be conferred;

- removing the requirement for certificates of origin for products with nuisance tariffs i.e. those with preference margins below three percentage points;
- enforcing these simplified rules more consistently and effectively at customs to mitigate any concerns over leakage or trade deflection; and,
- greater use of risk assessment, especially for large, trusted regional traders who should not require a certificate of origin for each consignment but, instead, should be able to submit these electronically per batch.

Secondly, resolving the other types of NTBs, both existing and curtailing the development of new ones, is also vital as these are also critically restricting trade in the region particularly for primary agricultural commodities. Among these, the most serious barriers are import bans, quotas, permits and licensing, often implemented by countries with little or no consultation with their trading partners. In dealing with these types of restrictions, the existing framework to remove NTBs in the region (the non-tariff barrier monitoring mechanism) is not used as much as it should be. The use of regulatory impact assessment should also be extended.

Thirdly, while tariffs have been reduced across the region barriers arise in those sectors where tariff peaks persist. One advantage with addressing remaining tariffs is that tariff reform can often be dealt with by “a stroke of the pen” approach, as opposed to some of the other barriers where reform will be complex, perhaps more costly and certainly more involved. High tariffs are especially restrictive because concerns

of leakage from third countries can create the need for additional barriers at the regional level (e.g. ROOs) as well as affecting regional trade in all sectors as border checks are intensified to check for transshipments of these products. Lower, more uniform, external tariffs would significantly reduce the need for many of the barriers which persist on regional trade in Southern Africa as would the development of policies that directly address the difficulties that protected sectors may be facing such as assisting labor in these industries to retrain in tasks where employment opportunities are much better.

Fourthly, reducing bureaucratic requirements, streamlining border management procedures and implementing trade facilitation measures, including one-stop border posts (OSBPs), have significant potential to lower border crossing times and reduce transport costs, at least along the main corridors in Southern Africa. There is also increasing political willingness among the member states for this type of reform to go ahead sooner rather than later. For example, the South African Government has recently identified OSBPs as one focus area it wishes to develop for regional integration in the next twelve months. However revenue concerns among the smaller SACU countries risk impeding reform. Overcoming this challenge will require the development of better ways to capture trade flows across SACU borders than those currently employed as well as an open discussion about alternatives to the current revenue sharing arrangement that might be more effective and sustainable in the long-term.

In which areas of trade reform would regional approaches be most appropriate? One reason RTAs have become so prolific has been due to their convenience in dealing with more complex and modern trade barriers (e.g. NTBs) in a simpler setting

involving fewer countries. Another argument is that adjustment costs of trade reforms may be easier to deal with by opening up to a subset of countries initially before to all later on. In other words, regional trade reform can be used strategically to support unilateral trade reform that might otherwise be too difficult on the grounds of adjustment.

Nevertheless, not all reforms need wait for regional agreement either and much can be done both unilaterally and bilaterally to increase regional trade. For example, regional harmonization is just one way to deal with restrictive product standards. Countries retain significant scope to unilaterally improve both the quality of their technical regulations and the way these are applied. Another example is trade facilitation which can be, and is being, promoted at the regional level in SADC but countries can still push ahead with reforms bilaterally to increase cooperation and share customs facilities at their borders. Some reforms may even be best tackled outside the regional process. Cooperation on indirect taxes might be more feasible bilaterally instead of regionally. And the issue of tariff peaks must be dealt with unilaterally, particularly by South Africa which under the current SACU arrangement is able to export a diverse range of goods to SADC but behind high and complex external barriers to trade which are costly to consumers and producers in neighboring countries alike.

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Ian Gillson is an Economist in the Africa Region of the World Bank. This work was part-funded by the Multi-Donor Trust Fund for Trade and Development supported by the governments of Finland, Sweden, Norway, the United Kingdom, and the Bank Netherlands Partnership Program (BNPP). The views expressed in this paper reflect solely those of the author and not necessarily the views of the funders, the World Bank Group or its Executive Directors.

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