International Trade Agreements

South Africa's Current and Future Trade Agreements

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Summary

South Africa initiated the first trade agreement with the European Union (EU) at the turn of the 21st century. Whilst the Trade and Development Cooperation Agreement (TDCA) was put into place following prolonged negotiations, this was followed by the implementation of the Trade protocol with neighbouring member states of the Southern African Development Community (SADC). Agreements with the European Free Trade Area (EFTA) and the Common Markets of the South (Mercosur) were subsequently concluded. In between, trade negotiations with the United States (US) were initiated but eventually collapsed; discussions with India and China were also engage but a formal trade agreements are yet to be launched formally.

The aforementioned agreements as well as the many of the attempts to initiate a trade agreement involve market access and therefore primarily focus on trade in goods. There are exceptions however: the negotiations between the US and SACU sought a more comprehensive package that included intellectual properties, labour, investment, services and other aspects such as procurement and competition. This was not acceptable to the SACU members and eventually the parties found themselves to be too far apart to pursue the negotiations. Another arrangement that seeks to go beyond trade in goods is the Economic Partnership Agreements (EPAs). Whilst some SACU members have initialled to conclude such agreements, tensions has arisen within SACU: the new agreement of 2002 established or formalized a common area with comment external tariffs, common monetary area (partial, as Botswana is not a member) and just established institutions with the view to adopt common policies in many areas.

Focusing on other agreements, the SADC agreement has resulted in the formation of a free trade area (FTA), with up to 85% of trade taking place free of customs duties. Some challenges remain around the implementation and achievements of some of the bloc's objectives. One of these challenges is with the commitments (or lack of it) shown by other bloc members as they have not ratified the trade protocol and have not bothered to lower the tariffs to the required levels to fulfil the FTA status. As such, some members are not participating in the FTA. The second set of problems is with regards to relatively unchanged trade volumes, in spite of tariffs being lowered. Low trade flows are attributed to a range of factors, including low supply side capacities, absent or weak infrastructure plus miscellaneous macroeconomic challenges which are faced by this bloc that is made up of developing and least developing countries.

With regards to the TDCA, South Africa's exports have not shown the kinds of improvements and gains that were expected at the launch of this agreement. This is despite the EU reducing its industrial tariffs by almost 90% over their initial levels. By the end of 2009, 99% of these industrial tariffs would have been at zero. South Africa still has three more years to drop its tariffs by 85%.[2] In terms of patterns of trade, it should be noted that exports started to accelerate in the last five years of the deal. However, the export increases were mostly for primary products and backed by high commodity prices. On the import side, the EU has lost substantial share on the South African market, mainly to China and to lesser extent to India and Mercosur.

Mercosur and SACU concluded a preferential trade agreement (PTA), a less comprehensive deal than a FTA. The PTA involves the selection of a few products to be liberalized for the two main negotiating parties. Whilst this arrangement is weak,[3], the fact that it has only recently been concluded renders its impact on trade hard to analyse. Whilst the same issue applies for the FTA between SACU and the EFTA which came into effect in May

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[2] This was because South African was given more time to liberalise its trade relative to the EU, and because it opted to backload most of these tariff cuts.

[3] Parties typically liberalise sectors that may not be threatened by global trade or which are already opened up.

2008, the most interesting part of this agreement is that the EFTA removed all industrial tariffs when the agreement came into force. SACU opted to reduce its tariffs over a five year period.

There are currently no formal agreements in place or negotiations taking place between South Africa or SACU with India or China. These two Asian countries have seen their trade expand markedly over the recent past decades. They have both achieved consistently high economic growth rates while being strong on the trade front. These two partners follow different approaches towards trade however: China is dominant in manufactured goods, and tends to import raw commodities like coal, oil and base metals to support its growth. In the process, it has heavily invested abroad while still able to attract large levels of inward foreign direct investment. India has, in contrast, shown its competitiveness in services, mainly in the IT sector and general technological services. In addition, it has remained a strong competitor in global trade in other sectors such clothing and textiles, footwear and pharmaceutical products.

China and India will generate interesting trade dynamics should a trade agreement be considered with either one or with both of these partners. There have been talks about the possible launch of official negotiations with SACU, but that has not happened yet. These two countries are not only the dominant global players, but they are also direct competitors to South Africa and its neighbours in more low-skills and labour intensive activities. They are also low cost producers of clothing, textiles and footwear, areas in which developing countries have in the past had comparative advantages and also job opportunities. The strategy to be adopted when dealing with these two giants must be well-thought out and clear. The objectives of a trade deal with either or both of the aforementioned partners should be clearly framed and stated in terms of what is to be achieved.

South Africa's trade flows since 2000, including with the trade partners mentioned above are reported in the table below. The table shows that between 2004 and 2008, South Africa's imports and exports have been growing at an average annual rate ranging between 10% and 47% depending on the partner considered. The fastest growth on the exports side has been with China - an average growth of 47%, followed by exports to India with 36%. Exports to Mercosur came in third position - with a 26% annual growth. The high growth rates were recorded with developing countries, which may be an important sign of trade relations even in the absence of formal trade agreements; exports to the EU and the US were growing at an average annual rate of 12% and 17% respectively.

On the import side, the fastest growing partners to South Africa were SADC with an annual growth of imports from South Africa of 46%, followed by India (33%) and China (29%). Once again this reflects growing trade with developing countries, while imports from the EU and US increased at an annual average of 10% and 15%, respectively. While this may be considered to be an important shift in trade or diversification, one needs to be cautious to fully establish the drivers of the main trends at hand.

There are two reasons for some cautious interpretation of the trade trends. Firstly, what is clear is that growth for most developing countries is coming from a low base; therefore high growth rates are yet to imply high trade volumes. China is however an exception; it has also overtaken the US as an important market for exports from South Africa. Secondly, commodity prices may have been responsible for the high growth rates observed. This is especially on the export side because South Africa's export basket is still to a large extent dominated by commodities or light manufactured from those commodities. However, also on the import side, imports from SADC are on the basis of commodity trade, which has been accelerated by the stability as well as further extraction of commodities in particular SADC member states – e.g. the Democratic republic of Congo as well as Angola.

Another interesting development in the trade data is that, China has taken over as the country with which South Africa has the highest deficit. This was until very recently the case with the EU. Whilst a growing trade surplus is with the USA, it is still below the trade surplus which South Africa has with SADC.

Table 1; South Africa's Trade with main trade partners, 2000-2008 (US$ m and % annual growth rates).

Partner/Year	2000	2004	2005	2006	2007	2008	Average Annual Growth (in % for 2004 to 2008)
EU							
SA Exports	9 326	14 562	16 618	17 993	20 583	22 936	12%
SA Imports	10 893	19 408	21 000	23 699	26 857	27 545	10%
Trade Balance	-1 566	-4 846	-4 381	-5 705	-6 274	-4 609	
SADC							
SA Exports	2 941	3 889	4 667	4 894	5 965	8 178	19%
SA Imports	362	1 182	1 900	2 319	4 268	5 283	46%
Trade Balance	2 579	2 706	2 767	2 574	1 697	2 895	
EFTA							
SA Exports	561	1 147	1 080	1 562	1 410	1 743	12%
SA Imports	694	538	786	698	866	945	13%
Trade Balance	-133	608	295	864	543	798	
Mercosur							
SA Exports	279	310	407	510	612	816	26%
SA Imports	504	1 563	1 760	2 377	2 737	2 719	17%
Trade Balance	-225	-1 253	-1 352	-1 867	-2 124	-1 903	
China							
SA Exports	587	1 003	1 328	1 981	3 481	4 271	47%
SA Imports	996	3 597	4 924	6 816	8 575	9 870	29%
Trade Balance	-409	-2 594	-3 596	-4 835	-5 094	-5 599	
India							
SA Exports	426	570	913	758	1 313	2 180	36%
SA Imports	254	714	1 102	1 590	1 775	2 303	33%
Trade Balance	171	-144	-189	-832	-462	-123	
United States							
SA Exports	3 592	4 558	4 789	5 930	7 382	8 053	17%
SA Imports	3 183	4 037	4 286	5 152	6 118	6 931	15%
Trade Balance	409	521	503	778	1 264	1 122	

Source: SA Customs and Excise and own calculations.

Having described some basic on the pattern of trade, future agreements should consider non-trade related gains from miscellaneous trade arrangements, including cooperation, investment as well as technological advancements. Pure market access objectives are unlikely to yield significant gains in an arrangement with giants such India and China. What needs to be considered from those is the possibility of technology adoption, prospects for building the capacity of local industries and manners in which such trade arrangements could support, or even boost, industrial development. Trade in services could also be considered and possibly fast tracked with developing partners, especially with SACU and SADC. Amongst the range of considerations, trade arrangements should pay particular attention to the threats and opportunities they generate on other members of the SACU; large developing partners are capable of taking market shares from developing as well as from developed and industrialised countries.

1. Introduction

South Africa and its Southern African Customs Union (SACU) partners have been involved in several special trade relations with a number of regional trade partners. After prolonged negotiations during the late 1990s, the Trade and Development Cooperation Agreement (TDCA) between South Africa and the European Union (EU) as well as with the Trade Protocol (TP) of the Southern African Development Community (SADC) were concluded. The new SACU agreement was signed in 2002. A Preferential Trade Agreement (PTA) between SACU and Mercosur[4] was hammered out in 2004. The negotiations between SACU and the European Free Trade Area (EFTA)[5] were concluded in 2005 and the agreement came into effect in May 2008. The talks between SACU and the United States (US) were recently called off due to major differences between the parties. In between all these, discussions took place with India and China but so far no official talk has been initiated.

It is generally established, in trade theory, that regional trade agreements are a second-best option over multilateral trade liberalization. In particular, there is the danger, in bilateral or regional deals, of trade being diverted away from low-cost non participating suppliers. In addition, regional negotiations draw scarce negotiating resources away from multilateral trade negotiations. Regional trade deals also add considerable monitoring costs and administrative onto government staff. Overlapping memberships in Southern Africa compound these problems (Hess & Hess, 2004). On the other hand, regional trade agreements can pave the way towards positive multilateral outcomes as preferences granted (and eroded) become more widespread and break down resistance to multilateral liberalization.

While the foundations for the two main agreements that are currently in operation in South Africa were put in place during the late 1990s, they only came to fruition at the beginning of the next decade. Initial analyses of the impacts these have had on trade and on other dimensions of economic growth are only now becoming available. This report takes a closer look at the trade and the trade agreements between South Africa and its free trade agreement (FTA) partners. Although the pace of unilateral trade reform has slowed, trade liberalisation has occurred through the negotiation of a number of bilateral trade agreements.

We look in what follows at these agreements, where they have been concluded, in depth (Section 2). We then examine the pattern of trade between South Africa and the respective FTA partners (Section 3). A final section (Section 4) reflects on future agreements, should they be deemed necessary.

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4 Mercosur is made up of Brazil, Argentina, Paraguay and Uruguay with Chile and Bolivia as associate members.

5 The EFTA bloc consists of Iceland, Norway, Liechtenstein and Switzerland.

2. International Trade Agreements in force

This section focuses on the trade agreements which have been concluded by South Africa and SACU. These include the TDCA with the EU, the formalisation of SACU through the 2002 Agreement, the SADC Trade Protocol with southern African member states, the EFTA and, finally, the preferential trade agreement (PTA) with Mercosur. All these agreements, with the exception of SACU, mainly involve market access, that is trade in goods. The SACU agreement involves deeper integration commitments including establishment of regional institutions and common monetary area (CMA).

2.1 The Trade, Development and Co-operation Agreement with the European Community

2.1.1 Background

South Africa (without SACU partners) signed a free trade agreement with the European Community (EC) in October 1999. The Trade, Development and Co-operation Agreement (TDCA) agreement bound South Africa into a fairly comprehensive FTA – it involves a grouping with gross domestic product of US$7.9 trillion, compared to South Africa's GDP of US$128 bn in 2000. In other words, in income terms, the EC was about 62 times larger than South Africa.

Whilst at its heart the agreement focuses on tariff provisions, the TDCA also includes articles on trade in services, investment, customs co-operation and development. There are no obligations placed on either party however: Article 29 on services only says that the parties will commit to strict observance of GATS. Article 30 of the TDCA provides for a comprehensive agreement on services to be agreed upon by the Co-operation Council, a council of the two parties, after the agreement has been signed. No such agreement has been set up however.

In terms of competition, the TDCA agreement specifies that parties that do not have a legislative competition framework are committed to implementing a competition policy within three years of the agreement. South Africa complied with these provisions before the TDCA was signed.

Article 52 of the TDCA covers investment. Somewhat similarly to the articles on services there this article contains few concrete provisions and obligations on either partner.

Intellectual property provisions are contained in Article 46. Although the EC attempted to include intellectual property rights stricter than those in the relevant WTO agreement (e.g. the Trade Related Aspects of Intellectual Property Rights - TRIPS), South Africa rebuffed these efforts. Article 46(6) contains an offer from the EC to help South Africa draft new intellectual property legislation but according to Kruger (2006), this offer would probably only apply if the proposed legislation would lead to so-called TRIPS-plus stipulations. The most contentious intellectual property provisos are contained in an attachment to the TDCA, prohibiting South African producers from labelling their products as either Port or Sherry as these terms are considered to be geographical indicators.[6] Producers were allowed to use the terms for 5 years in export market, 8 years for SADC exports and 12 years in the local market. The EC and South Africa both have to agree to the replacement term. In the case of Port, South Africa winemakers have recently stopped using the term – so that wine previously labelled "Cape Tawny Port" is now marketed as "Cape Tawny".

[6] It was argued that Port can only be labelled as such if it had passed over the bar of Oporto harbour in Portugal. Similarly, Sherry can only be produced in Jerez, Spain.

2.1.2 Tariffs

As noted above, the TDCA is mostly concerned with trade in goods. The agreement on trade was asymmetrical as the European Union committed itself to faster tariff cuts over more goods than South Africa. The EU was to reduce tariffs to zero on 94.9% of trade (1994-1996) over 10 years while South Africa was to reduce tariffs over 12 years and over 86.3% of trade (Carim, 2005). Agricultural goods are covered in a special section of the agreement.

From Table 2 and Table 3 which each summarise the EU and South Africa's tariff phase down, EU tariffs are in general also lower than South Africa's tariffs. Virtually all industrial tariffs on EU imports from South Africa will have been free by 2010. Agricultural trade is significantly less free than other trade. Liberalisation occurred in 3 major stages: when the protocol entered into effect; in year 3; and in year 6. The EC effectively completed its tariff obligations by year 6.

Table 2: Summary of the EU Tariff Phase Down under the TDCA, 2000-2009

		Base Rate	Years 0 - 2	Years 3 - 5	Years 6 – 9
All Tariffs	Number of Free Tariffs	587	2,916	4,167	4,711
	Number of Tariffs	5,113	5,113	5,113	5,113
	Share	11%	57%	81%	92%
Agricultural Tariffs	Free Tariffs	166	254	341	341
	Number of Tariffs	704	704	704	704
	Share	24%	36%	48%	48%
Industrial Tariffs	Free Tariffs	421	2,662	3,826	4,370
	Number of Tariffs	4,409	4,409	4,409	4,409
	Share	10%	60%	87%	99%

Source: Own calculations from the Phase Down Schedule.

South Africa took the option of liberalising both its agricultural and industrial products. Liberalisation was back loaded quite significantly in agriculture however. In contrast, nearly half of all industrial tariffs were reduced to zero in the first year, largely in line with South Africa's most favoured nation (MFN) tariff schedule with the World Trade Organisation (WTO). A large part of the tariff liberalisation occurs in year 12 for South Africa.

Table 3: Summary of SA Tariff Phase Down under the TDCA, 2000-2012.

		Years 0 -2	Years 3 - 5	Years 6 - 9	Years 10 - 11	Year 12
All Tariffs	Free Tariffs (number)	2,350	2,468	2,988	3,029	4,205
	Number of Tariffs	5,120	5,120	5,120	5,120	5,120
	Share	46%	48%	58%	59%	82%
Agricultural Tariffs	Free Tariffs (number)	235	327	397	397	544
	Number of Tariffs	713	713	713	713	713
	Share	33%	46%	56%	56%	76%
Industrial	Free Tariffs	2,115	2,141	2,591	2,632	3,661

Tariffs	Number of Tariffs	4,406	4,406	4,406	4,406	4,406
	Share	48%	49%	59%	60%	83%

Source: Lee (2002), quoted in Assarson (2005).

2.1.3 Impacts

Ranking commodity groups defined at the HS4 level reveals that high value imports from the EU are found to be in the transport equipments and electronic products - such as HS9801 *Original equipment components*, HS8703 *Motor vehicles for transport of persons (except buses)*, HS8802 *Aircraft, spacecraft, satellites* and HS8525 *Radio and TV transmitters, television cameras*. While most growth rates of the top 50 HS4 product groups in value terms are around the average, imports of HS8802 *Aircraft, spacecraft, satellites* is one of the fastest growing commodities in the top 50 imports recording growth rates with over 100% per annum in the five year period in nominal terms.

South Africa's 50 largest export commodity groups to the EU are concentrated more on primary commodity groups like minerals, basic metals and chemicals. The fastest growing commodity groups are HS2619 *Waste, scale, dross, slag of iron or steel industry*, HS7606 *Aluminium plates, sheets and strip, thickness > 0.2 mm*, HS8407 *spark-ignition internal combustion engines* and HS8704 *motor vehicles for the transport of goods*.

The high growth rates of both imports and exports of motor cars and motor-related products may be a reflection of the impact of Motor Industry Development Programme (MIDP).

The trade intensity index[7] shows that the EU has become a more important partner for South African exports in the mid 1990s, while at the same time, South Africa remains a relatively unimportant market for EU exporters (their trade is relatively more focussed on other markets).

As illustrated above, the majority of protected sectors in the EU schedule are either in agricultural or in food-processing. The two most protected chapters, HS 19: *Preparation of cereals, flour* and HS 2: *Meat*, have remained fairly heavily protected with calculated average *ad valorem* equivalent average tariffs of over 20% - and nearly 30% in the case of HS 19: *Prep cereal, flour* - in the last year of the phase down schedule. Looking at the average tariff across all chapters, EU tariffs are quite low, even in the base year. Most of the phase down occurs in the first 3 years, with the majority of tariffs either zero or of nuisance value by 2004.

South African tariffs, by contrast, declined slowly throughout the longer phase down period, that is over 12 years as opposed to the EU's 10 years. Some chapters retain significant protection; HS 98: *Special classification of parts for motor vehicles* is the major culprit with a simple average tariff of 49% and no reduction at all. 11 other chapters would have average tariffs of more than 10% in Year 12.

It can be argued that even though it appears that the EU has made greater tariff cuts, this is not in fact the case once the number of traded products is taken into account. Indeed, prescribed EU tariff changes impact only on 25% of currently traded goods and their weighted average tariff is only 2.7%. South African tariff changes, on the other hand, will affect 40% of currently traded goods in a context of a weighted average tariff of 10%.

In addition to traditional trade flow analysis an initial attempt was made to undertake a preliminary quantitative assessment of the impact of the FTA on South Africa's trade with the EU. This helps address the question of the degree to which the phase down of EU tariffs had a positive impact on South Africa's exports to the EU. Three distinct but related methodologies can be employed for this purpose: the first methodology entails plotting the pattern of EU tariff reduction on imports from South Africa to enable a visual examination of the relevance of the

[7] This is a measure that examines bilateral trade in relation to the respective country's export to the rest of the world.

tariff cuts. The second approach involves a detailed examination of the data to look for major trade patterns by product groups. The final methodology applies the relatively new concept of trade deepening versus trade widening; deepening refers to trade having increased in the products that were traded at the start of the period. Widening refers to a growing range of products being traded. We report the main findings when using these methods in what follows.

Kalaba *et al.* (2005) found weak evidence to the claim that changes in the border price of South African exports in the EU as the result of the tariff phase down have actually increased the share of these exports in the total export basket of South Africa. Although, broad categories such as textiles and clothing and machinery seem to have responded, a number of other categories saw their share decline *in spite of more favourable border prices*, including vegetable products, processed food and beverages and paper and wood products. *For a number of important categories no significant change* in the share of total exports destined for the EU could be observed over the period of study, in spite of significant changes in the border prices, notably for chemicals and plastic products and to a lesser degree transport equipment. Trade in the latter may well be driven by global supply chain considerations and less to by changes in tariffs.

More detailed analysis confirms the aggregated result that the tariff phase-down is not necessarily always associated with an increase in the importance of the EU as the market (the "right way"). In particular, in a number of clothing, some chemicals and some electrical machinery groups, exporters have shifted their exports away from the EU towards the rest of the world in spite of the tariff preferences offered by the EU. Other isolated occurrences of this are in metal and food products.

Using EU import data it is possible to focus on the relationship between the EU phase-down on imports from South Africa and the share of these imports in the EU market. The first observation to make is that the shares of South African exports in the various markets for HS product groups are very small - rarely above 0.1%. Combined with the results noted above it can be concluded that there is very weak evidence that South African exporters are shifting to the EU markets but where this did happen this has not resulted in significant increases in market shares in the EU following the tariff preferences offered. At the HS2 level, machinery and transport equipment exports by South Africa is the only product group of significance that has increased its market share in the EU. Food products, chemicals, wood products and base metals have all lost market share in the EU since 2000, in spite of tariff preferences, while textiles and clothing and plastic products just managed to maintain their position.

We can look into whether trade between South Africa and the EU has intensified in existing product lines (deepening) and/or in new product lines (widening).

We found that South African exports to the EU became less spread out during the second half of the 1990s, just before the inception of the FTA. (That is the largest product groups represented a rising share of the export basket to the EU.) Interestingly these patterns reversed after 2000 with a marked trade widening taking place while it became shallower: the HS6 product lines that represented bottom 10% of the value of trade in 2000 doubled their share in 2003. This coincided with the unweighted average tariff on imports from South Africa in these products declining in the EU phasing down by about two thirds (from 6.5% to 2%). The top 40% of South African exports to the EU was carried by not more than 14 HS6 product groups in 2000 and they accounted for just over 30% of exports in 2003. The unweighted tariff on these 14 HS6 product groups declined at a considerably lower pace (from 5.8% in 2000 to 4.2% in 2003).

The trade widening and reverse deepening of South Africa with the EU should be considered in parallel to that of trade patterns with the rest of the world over the same period. The same HS6 product groups that represented the bottom 10% of South African exports to the EU in 2000 account for more than 40% of exports to the rest of the world while the top 40% accounted for less than 15%. These include a large number of product groups with zero exports to the EU and suggest that South African exports to the rest of the world is much wider and much less deep compared to exports to the EU. Trade to the rest of the world widened a little but deepened considerably after 2000.

To summarise this part of the analysis, it would appear that at halfway stage of the implementation of TDCA there is very little evidence of the EU – SA FTA having had a positive impact on trade directly. There may be isolated cases in particular in machinery and textiles and clothing where there has been a shift by South African exporters to the EU away from the rest of the world but such shifts have also taken place the other way around. We do notice a trend toward a wider basket of products being exported to the EU since the inception of the FTA. New, smaller product groups also turn out to benefit from more tariff preference than the top product groups in terms of value.

Andriamananjara & Hillberry (2001), who modelled the effects of the TDCA using a GTAP model, found that the TDCA would result in increased output and employment for the South African economy. However, they identify small impacts of the deal: only 2% of South African GDP growth over the next 18 years could be ascribed to the TDCA. The long implementation period of the agreement works against the productivity effects needed to achieve higher levels of growth. Next, focusing on the liberalisation of agricultural products, McDonald & Walmsley (2003), also using a GTAP model, find that because the EC is so large relative to the SACU, an optimum agricultural tariff for the EC could not be zero. In other words, the EC would be maximising its own welfare by not fully liberalising agricultural trade. Noting this, they find that South Africa would gain more from agricultural trade through the liberalisation of such products while the gains for the EU would mainly derive from industrial products.

More recently Holden and McMillan (2005) show, in a gravity framework,[8] that SADC has made a statistically significant and positive impact on South Africa's trade. In particular, their panel analysis supports the view that the EU-SA FTA stimulated both exports and imports.

2.2 SACU

The Heads of State of South Africa, Namibia, Swaziland, Botswana and Lesotho signed the new Southern African Customs Union (SACU) agreement in October 2002. The new agreement enabled the setting up of new institutions to formalise closer integration of the world's oldest customs union. The original agreement had been signed between South Africa and Great Britain, representing the protectorates of Bechuanaland, Basutoland and Swaziland in 1910 - although the predecessors of the agreement can be traced to 1889 (WTO, 2003) -. Following the independence of the protectorates, the agreement was renegotiated in 1969. Namibia joined in 1991 upon its independence as well. The advent of democracy in South Africa prompted a review of the Agreement leading to the 2002 protocol (Kirk & Stern, 2003).

The new agreement provides for a new institutional structure which should lead to decisions being made on a SACU-wide basis, instead of all decisions being made by South Africa. The SACU Council of Ministers, consisting of one Minister from each member state, is the highest decision making body. All resolutions of this and all other SACU bodies is reached by consensus, implying that all countries have a *veto*, indicative of the democratic nature of the new structure. The Customs Union Commission, consisting of senior civil servants from the member states, apply the resolutions of the Council of Ministers. Day to day administration of the customs union are the responsibility of the SACU Secretariat, based in Windhoek, Namibia.

As for changes to the SACU tariff schedule, these are to be approved by the Council of Ministers after recommendations from the Tariff Board, a committee with one expert from each country. All technical work on

8 They use GDP, population and distance as well as variables for the introduction of the various trade agreements.

issues such as trade remedies against dumping and subsidised exports are undertaken at the individual country level. South Africa's International Trade Administration Centre is the only organisation with the ability or experience to carry this out however. This is a significant challenge for the SACU partners (Kirk & Stern, 2003).

Liaison Committees have been established for agriculture, customs, trade and industry and transport. These reflect the in-principle agreement to establish common agricultural and industrial policies, although this harmonisation is not based on annexes to the agreement. The member states, as opposed to the secretariat, are mandated with synchronising policy (Kirk & Stern, 2003; SACU Agreement). In terms of industrial policy, only Botswana, Lesotho, Namibia and Swaziland (the BLNS states) are permitted to use tariffs to protect infant industries from other members. South Africa is not permitted to do.

Dispute resolution is intended to take place firstly, through direct engagement between the partners in the dispute and then secondly, through the SACU Tribunal. Though this Tribunal has not yet been established, the rules required for its proper functioning are rather unclear (Erasmus, 2005).

A contentious aspect of SACU is the revenue sharing formula. The formula divides the excise and duties revenue pool up according to shares of intra-SACU trade. The formula is controversial for two reasons: firstly, because the trade data as collected by the various SACU partners often contradict one another. Secondly, the revenue payments are important to some of the partners' fiscal situation. In 2005/6, Swaziland received 68.5% of total government revenue from the customs pool which also provides Namibia with over 30% of government revenue and Lesotho with nearly half of all revenue. Botswana and South Africa then obtained only 12.1% and 3.4% of government revenue respectively from the common pool. The size of the revenue pool in 2005/6 was R25 billion. Under the old revenue sharing formula, the BLNS states were claiming a growing share of the pool, with South Africa's share likely to fall to zero in about a decade. This situation has been amended in the new formula (Kirk & Stern, 2005).

The new formula is as follows:

$$R_i = C\frac{M_i}{M_{SACU}} + 0.85E\frac{GDP_i}{GDP_{SACU}} + \frac{0.15 * E}{n}\left[1 - \frac{(GDPpc_i / GDPpc_{SACU} - 1)}{10}\right]$$

Where:

R_i	=	revenue share of SACU country *i*
n	=	the number of participants
C	=	all customs duties actually collected on goods imported into SACU, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less the customs duties rebated or refunded
M_i	=	c.i.f. value (at the border) of imports of SACU country i from all other SACU members, less re-exports
M_{SACU}	=	total c.i.f. value (at the border) of intra-SACU imports, less re-exports;
E	=	all excise duties actually collected on goods produced in the SACU area, less the cost of financing the Secretariat, the Tariff Board, and the Tribunal, less the excise duties rebated or refunded
GDP_i	=	gross domestic product of SACU country *i*;

GDP_{SACU}	=	total gross Domestic product of SACU members
$GDPpc_i$	=	gross domestic product per capita of SACU country *i*
$GDPpc_{SACU}$	=	(unweighted) average gross domestic product per capita of all SACU members (WTO, 2003).

The formula stipulates that the revenue pool is divided according to three components: the customs, excise and development component. The customs duty share depends on the shares in intra-SACU trade, while the excise duty pool depends on the shares of GDP. The shares in the development component differ from equal (effectively 20%) shares in accordance to the country's deviation of their per capita GDP from the unweighted average of the SACU members' per capita GDP. The custom duty shares are such that Botswana and Namibia appropriate about 50%, South Africa about 20% and the rest is more or less equally divided between Swaziland and Lesotho (15%). South Africa obtains the majority of the excise component given their high share in GDP and distinct fiscal base, while Lesotho, Swaziland and to a lesser degree Namibia obtain a higher than equal (20%) share of the development component due to lower than average per capita GDP. More revenue stability was expected to flow from the new agreement.

Kirk & Stern (2005) argue that although the new agreement is a move in the right direction in that at least a more democratic institutional arrangement has been shaped through the formula, which allows for more transparent trading and revenue sharing arrangements. Some difficult issues such as industrial policy through tax harmonisation, services and labour movement were then not tackled however; the only issues where the members are forced to collaborate on are those imposed upon from outside, e.g. the EU-SADC Economic Partnership Agreement (EPA).[9] Yet, the SACU-US agreement, the SACU-EFTA agreement and the SACU-Mercosur PTA (discussed below) and the broader WTO discussions have brought about a level of collaboration that had not occured prior to the mid 1990s.

SACU overlaps to a large extent with the Common Monetary Area (CMA), comprising South Africa, Namibia, Lesotho and Swaziland with Botswana the only SACU member that is not party to the CMA. The CMA allows the free flow of funds between the member states. The Rand is the *de facto* currency of the Area and the smaller members have access to South African capital markets. In effect, these countries have adopted South Africa's monetary policy (WTO, 2003).

Unity within SACU was tested during the EPA negotiations. Although by the time the EPA negotiations started, the new Agreement was already in force, members had to negotiate initially because South Africa had already signed the TDCA with the EU. This created serious problems and tensions within the members states which ended up with some members initialling an EPA (Botswana, Lesotho and Swaziland) and others not (Namibia and South Africa). These tensions are likely to deepen with the implementation of the comprehensive EPA. SACU will need to find a solution to this problem.

2.3 SADC

The history of SADC in essence reflects the history of Southern Africa, moving from an era of the region as a Cold War and Independence battleground to the current more peaceful but economically-challenging times. In 1975, Angola, Botswana, Mozambique, Tanzania and Zambia, allied themselves with the liberation movements in South Africa, Namibia and Zimbabwe and formed the grouping of "Frontline States", arguing that they were on

9 The discussions over this were rather complex given the overlap with the existing SA-EU and SACU agreements.

the battle front in the wars of liberation taking place in their neighbours. This initiative was strengthened by the attacks on some frontline States by the pre-democracy South African military (SADC, 2003).

The Southern African Development Co-ordination Conference (SADCC) was formed in April 1980 following the independence of Zimbabwe to promote economic development of the member states but also to foster economic independence from South Africa. The SADCC was plagued by a weak institutional structure in that co-operation between members was not mandated by legal requirement. Although one of the key principles underlying SADCC's founding was pan-Africanism, the association was focussed more on co-operation and co-ordination than on economic integration (SADC, 2003).

By the early 1990s, the political conditions in the region had changed considerably from the era when the SADCC was founded. The independence of Namibia ended the struggle against colonialism in the region and the negotiations towards the end of Apartheid promised to usher in an era of peace in Southern Africa. A fundamental realignment took place as member states began to realise that South Africa could be a partner in development rather than a common foe, which united the region in opposition to it. Thus in August 1992, at a meeting in Windhoek, Namibia, the heads of state of the old SADCC opted for closer integration in the form of the Southern African Development Community (SADC) (SADC, 2003).

The highest body of SADC is the Summit of Heads of State. The Summit meets every year (in August or September) in a member state with all decisions made by consensus. In addition to policy matters, the Summit also elects a Chairman and a Vice-Chairman. (In practise the Vice-Chairman is usually promoted to the Chair.) In between Summits, the organisation is run by the Troika, consisting of the Chairman, the Vice-Chairman and the previous Chairman. The Organ on Politics, Defence and Security oversees security in the region.[10] The Organ on Politics, Defence and Security is also managed by a Troika. The Council of Ministers, as the name implies, consists of one Minister from each member state and is responsible for implementation. The Tribunal, once it is established, will be the dispute settlement body. The protocol contains the provisions for the Tribunal.

Whilst SADC has evolved into more than just an economic community, Tjønneland (2005) notes that a major weakness of SADC has always been the willingness of the member states to engage in economic and political integration and co-operation. A case in point of this is the Trade Protocol, which was signed in 1996 but only ratified in 2000. During the first four years of the Protocol coming into effect, only SACU and Mauritius applied their tariff offers. The Democratic Republic of Congo (DRC) and Angola are yet to make offers.

SADC launched an FTA in 2008, with 85% of trade being duty free. This was an important milestone, although the main challenge remains in the improvements of intra-SADC trade. The impact of the SADC FTA will be hard to establish given that it has recently been launched. However, it is expected to be limited given that during the seven years of the implementation of the trade protocol, very little improvements were evident. One main reason for the impact being limited lies with the lack of supply capacity in the member states. One research piece that considers the effect of the FTA is that of Lewis *et al.* (2001); the authors, who used a Computerised General Equilibrium (CGE) model to examine the effects of the TDCA and the SADC FTA on the SADC economies, found that the benefits from a hypothetical SADC-EU FTA are much larger than those of the TDCA and of a SADC FTA, with the former scenario generating a 4.5% increase in SADC GDP, while the latter has an impact of less than 0.1% of GDP.

One of the most important decisions taken by SADC recently was to abandon or postpone the establishment of Customs Union in 2010. This will provide an opportunity for a FTA to be tested and supported towards achieving the intended outcomes. At the time of writing of this paper, there is another project of combining SADC with

[10] At the time of writing of this paper, the Organ oversaw SADC's involvement in the Democratic Republic of Congo and the activities of SADC's election observers.

Common Markets for Eastern and Southern Africa (COMESA) into one major FTA. It appears as if the latter has political commitments and support. It therefore makes sense to utilise resources in that manner, rather than move to a complicated customs union whose value is yet to be determined.

2.4 EFTA

The European Free Trade Area (EFTA) consists of Switzerland, Norway, Iceland and Liechtenstein. In terms of income, the group is dominated by Switzerland and Norway, which together make up over 95% of the area's GDP (measured on a purchasing price parity basis), with Switzerland contributing over half of the total using IMF data.[11] It should be noted that, according to these figures, South Africa's GDP alone (i.e. ignoring the SACU partners) is about 30% larger than that of the EFTA region, as can be seen in Table 4.

The EFTA economies are significantly more advanced than the SACU economies, as can be seen when examining the GDP (at PPP) per capita figures in the second column of the table. Income per capita in the EFTA countries varies from about two and a half times SACU income per capita to more than 20 times higher when you compare Norway to Lesotho.

Table 4: GDP of the SACU and EFTA Member States, 2005.

Country	GDP (at PPP) 2005 US $ bn	GDP (PPP) 2005 US $ per capita
Iceland	10.5	35,586
Norway	195.1	42,364
Switzerland	236.9	32,571
EFTA	442.6	
Botswana	18.1	11,410
Lesotho	5.0	2,113
Namibia	15.1	7,101
South Africa	570.2	12,160
Swaziland	5.7	5,245
SACU	614.1	

Source: IMF World Economic Outlook

The agreement between the two regions took the disparity of income into account in that the provisions are asymmetrical. The EFTA undertook to immediately liberalise all trade in HS chapters 25 to 99 (i.e. on all non-agricultural trade). SACU is also completely liberalising the majority of its non-agricultural trade with EFTA, although in certain cases tariffs are being reduced over an extended 9-year period. Special exemptions are created for certain goods such as textiles, clothing and motor vehicles, which will still have positive tariffs after the nine year period. Table 5 below reports the tariff phase downs relating to various groups of commodities or "lists"[12].

[11] Liechtenstein does not report national accounts data but according to the CIA Factbook (2006), its economy is about a tenth of the size of Iceland's, which itself is quite small compared to Norway and Switzerland. Thus, the omission of the data for Liechtenstein will not change the conclusions.

[12] The "lists" refer to different categories of goods to be liberalised at certain periods. List 1 was liberalised over a transitional period of 3 years (2000 to 2003). It was fully liberalised in 2003. Lists 2, 3 and 4 will be fully liberalised in 2010. List 5 includes processed agricultural products subject to partial liberalization. List 6 includes products subjected to quota. List 7 is a reserve list including products that are excluded from liberalisation subject to a review of the agreement. List 8 is an omission list, including products permanently excluded from liberalisation as they are protected EU denominations for geo graphical indications (GI) or designation of origin for agricultural products. (NDA, 2009)

Table 5: Phase down of Tariffs on EFTA Goods Exported to SACU (% of SACU MFN Tariffs, Lists 0-4).

	List 0	List 1	List 2	List 3	List 4
Entry	0	0	67	90	100
Year 1	0	0	33	80	100
Year 2	0	0	0	70	88
Year 3	0	0	0	60	75
Year 4	0	0	0	50	63
Year 5	0	0	0	40	50
Year 6	0	0	0	30	38
Year 7	0	0	0	20	25
Year 8	0	0	0	10	13
Year 9	0	0	0	0	0

List 5 and 6 are substantially different from the other lists. Tariffs on List 5 goods will not necessarily be zero rated after the 9-year period. List 5 goods are broken down further, as can be seen in Table 6.

Table 6: Phase down of Tariffs on EFTA Goods Exported to SACU (% of SACU MFN Tariffs, Lists 5).

Commodity	Year 1	Year 2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	
PAP 1	3	3	3	3	3	3	3	3	3
PAP 2	5c/kg	5c/kg	5c/kg	5c/kg	5c/kg	5c/kg	5c/kg	5c/kg	5c/kg
PAP 3	17.5	15	12.5	10	7.5	5	5	5	5
PAP 4	18.33	16.66	14.99	13.32	11.65	10	10	10	10
PAP 5	22.92	20.84	18.76	16.68	14.6	12.5	12.5	12.5	12.5
Footwear and	14	12	11	10					
Footwear and	27	26	25	24	22	20			
Motor 1	12	11							
Motor 2	23	20	19	18	16	15	13	12	10
Motor 3	7	6							
Motor 4	17	16	16	15	14	13	12	11	10
Motors partial 1	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp
Motors partial 2	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp	Minus 5pp
Textiles - clothing	31	29	26	23	20	(1)			
Textiles - fabrics	17	15	13	12	10	(1)			
Textiles - household	26	24	21	18	15	(1)			
Textiles - yarns	12	10	8	7	5	(1)			
Tyres 1	19	17	15						
Tyres 2	12	11	10						
Tyres 3	14	12	10						
Tyres 4	21	18	15						

Notes: PAP goods are Processed Agriculture Products. Motor 1-5 are typically motor vehicle components, while Motors partial 1 include tractors, commercial transport and other transport equipment and Motor partial 2 includes off-road logging vehicles. Pp: percentage point.

In the period from year 6 to year 9 SACU would provide imports from EFTA with a preference margin of around 40% compared to MFN applied rates. List 6 goods have no liberalisation specified. After 5 years this will be reviewed with the intention of providing preferential access to the EFTA member states, although this is not guaranteed.

Overall, 52% of tariff lines will be zero rated when the agreement is implemented. By year 9, this rises to nearly 80%. The chapters with the fastest liberalisation are mainly commodities and basic manufactures such as *HS 25:*

Salt; sulphur; stone; & cement, HS 26: Ores, slag and ash, HS 31: Fertilizers and *HS 41: Raw hides, skins and leather.* The chapters that are not subject to complete liberalisation are the usual suspects, clustered in a few sectors - namely textiles, clothing, vehicles (no liberalisation listed for vehicle parts), machinery and some plastics products -.

EFTA has no uniform agricultural policy. The SACU states thus had separate agreements with each EFTA state regarding trade in chapters 1 to 24, except for fish products which have their own annex to the agreement. Both parties are allowed to levy tariffs to compensate for the difference between the prices the good sells at in the domestic market and the import price. EFTA individually undertook to give South Africa access equal to that it accords to the EU. As such, in general, Norway and Iceland grant freer access than Switzerland, consistent with Switzerland's reputation as having one of the most protected agricultural sectors. SACU has been granted virtually free access to Iceland's agricultural market. Norway and Switzerland mostly granted preferential but not free access. South Africa uses the list process in the agricultural agreement with Switzerland.

The most contentious aspects of the agreement, such as intellectual property right and trade in services, are mentioned in the agreement but without obligation on either party. As with many of the sticking points in the negotiations, resolution of these issues has been delayed till the review of the agreement, which is scheduled to take place less than five years after it enters into force.

TIPS identified the products with the most offensive potential in the EFTA markets. He found that tariffs are not a significant barrier to trade as only 145 of the 1,285 HS 6 commodity groups (out of roughly 5,000) with high potential faced a tariff and this is typically low. The goods with potential were mainly in processed foods, agriculture, clothing or textiles. Modelling the once-off effect on exports to a full FTA revealed that the effect of the agreement would not be large. Market access gains for South Africa were only US$147,000 in the Norwegian market and US$1.7m in the Swiss market. Due to data constraints, the effects of the removal of non-tariff barriers could not be modelled but most of the gains from the agreement would probably come from this area.

2.5 Mercosur

SACU has also recently concluded an agreement with Mercosur (an abbreviation of the Spanish term for Common Market of the South), a grouping of Argentina, Brazil, Paraguay and Uruguay, with Chile and Bolivia as associate members. The negotiations for this agreement which is a PTA were concluded and an agreement signed in October 2004. However, the smaller members of both groupings argued that the concluded agreement had no material benefit to them. The PTA is thus being renegotiated with this in mind (DTI, 2005).

A comparison of tariff protection by Willcox & Kalaba (2004) under Mercosur shows that 51.9% of South African tariffs are zero rated but otherwise relatively widely dispersed. Also, 19.5% of tariffs are above 20%. Imports from Mercosur do not seem to be overly affected by tariffs although the commodity lines with the largest number of imports lie between 30% and 39%, accounting for 29.3% of all imports from Mercosur. In contrast, imports from the world are concentrated in the free tariff lines. In terms of sectors, the most protected industry from Mercosur imports in South Africa is clothing and textiles. Only three of the ten HS 2 product categories with the highest tariffs are not in clothing and textiles.[13] These are some obvious targets for offensive action by Mercosur.

Mercosur tariffs are more concentrated than South African tariffs in that all commodities attract between 0% and 20% with 73.4% of these tariffs between 10% and 20%. South African exports to Mercosur are directed towards the lower tariff lines. Looking at protection by industry, the most protected sector seems to be the clothing and textile sector. The leather industry is also strongly protected as are various manufactured goods. The obvious

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13 These are HS 87: Vehicles, except railway or tramway, and parts etc, HS 2: Meat and edible meat offal and HS 64: Footwear, gaiters etc. and parts thereof for which imports are high.

targets for offensive action are HS 72*: Iron and steel* and HS 38: *Miscellaneous chemical product*s, which combine relatively large exports and tariffs greater than 10%.

Despite the lack of ambition in the agreement, there is the potential for gains from trade. There are 256 commodity groups at the HS 6 level that have the potential for greater export levels. These products are mainly from the machinery sector, inorganic chemical, electrical machinery, organic chemicals and iron and steel.

Market access gains for Mercosur exporters would be of the order of US$104m compared to US$26m for their South African counterparts (Willcox & Kalaba, 2004). However, Stern (2005) indicated that the Preferential Trade Agreement that was eventually concluded has little to offer: the Mercosur offer to SACU is limited to less than 1000 product lines with less than 10% qualifying for the maximum tariff reduction of 5%. Just over 50% can expect a tariff cut of between 2.5% and 5% while the rest, about 40%, would settle for cuts of only 2.5% or less. More importantly, there is almost no trade in those products that will experience meaningful liberalisation under this agreement except for one or two commodities (in the broad groups of chemicals and electronics). More importantly Stern (2005) points out that for a number of product categories MFN tariffs are relatively high and South Africa's supply capacity is significant in that there are considerable exports to the rest of the world. These commodities could have been a target for South Africa's negotiators. The potential benefits to Mercosur are calculated to be much higher and much wider spread over , although still relatively modest in the larger scheme of South African imports or Mercosur exports.

The low intensity of the SACU-Mercosur PTA notwithstanding, a closer comparison of industrial structures and further considerations by Roberts (2004) suggest that there are some future benefit to be expected from closer economic ties. For the metals industry this could mean more competition and as a result a disciplining effect on local producers (see below for more discussion of "behind the border" issues), although high transport costs and low current tariffs limit the impact. Motor vehicles could benefit from more specialization but this depends on agreements within large multinational players. Limited opportunities are suggested by Roberts (2004) for electrical equipment, machinery and clothing. Niches may be available in the latter for South African exporters but capital equipment appears to suffer from a local content ruling. The largest risk for local producers may well be in agriculture and food where Mercosur has distinct advantages around economies of scale, in particular with regard to beef, wheat and sugar.

With a trade balance in favour of Mercosur and with non-tariff measures at stake, South African exporters of food products will find the going tough except perhaps for some niches such as wine. Generally, this arrangement is the least ambitious of the five, and mainly due to the potential competitiveness that is likely to occur between SACU and Mercosur. This will mainly be in the area of motor industry and agriculture. Brazil is quite strong in the auto sector and has a strong offensive interest in agriculture and agro processing. These are also sectors which SACU members prefer to shield from global competitiveness for the time being.

3. Trade Flows between South Africa and FTA Partners

The following section analyses South Africa's trade with various FTA partners in no particular order. The analysis is based on data that are disaggregated up to the 23 Sections level. This provides some detail about the composition of trade without overwhelming the reader. All the data which are summarised in a table towards the end of this section presented are in millions of US Dollars. Trade in services is not included in this analysis.

3.1 The European Union

The European Union is South Africa's largest regional trading partner, absorbing 30% of South Africa's total exports and providing 31% of total imports. At the introduction of the TDCA, the EU was supplying about 40% of total South African imports. China and India have captured most of that space (as will be explained later). The majority of imports from the EU are of advanced manufactured goods with *Ch. 16: Machinery, Ch. 23: Vehicle Parts* and *Ch. 17: Vehicles* making up over 60% of imports from the EU. Growth has been especially strong in vehicle imports, partly as the result of the MIDP and of rules of origin under the TDCA which give the EU a supplier advantage over other suppliers. Overall, the average growth of imports is 10% per annum, mirroring the fast growth of total South African imports. Imports of agricultural products are relatively small, though *Ch. 4: Prepared Foods* has increased its share of imports over the period of observation.

South African exports to the EU are growing faster than trade flows in the opposite direction. South Africa's largest exports to the EU are the usual suspects, i.e. Ch. 5: *Mineral Products*, Ch. 14: *Precious Metals* and Ch. 15: *Base Metals*. The goods driving the trends are coal, diamonds, platinum and steel. The large export share of Ch. 16: *Machinery* is mainly due to two products that fall under the MIDP, catalytic converters and car engines. The fastest growing product categories are Ch. 7: *Plastics* and Ch. 13: *Stone & Glass*. This could be due to exporters taking advantage of preferences gained in the TDCA. Ch. 8: *Leather* and Ch. 23: *Vehicle Parts* had a fall in exports over the 5 year period examined above. This may be again due to the MIDP focus on exports of vehicles rather than parts.

Despite the slightly higher growth of exports, the trade balance is in favour of the EU and large. The deficit fluctuates with the largest decline occurring in 2008. It is expected that lower consumption demand around the world and in South Africa, this will continue to decrease.

3.2 The Southern African Development Community

South Africa's trade with SADC is typical of that between a middle-income country and less developed countries. SADC exports mineral products and commodities to South Africa and in return, South Africa exports more advanced goods, while South Africa is mainly an exporter of commodities with the rest of the world.

Two commodity categories, namely Ch. 14: *Precious Metals* and Ch. 5: *Mineral Products* account for 63.2% of all imports from SADC. Behind these categories are imports of crude oil from Angola and diamonds from Namibia and especially Botswana. (Of note is that these diamond imports only entered into the trade data in 2005, having previously been classified elsewhere.[14] Thus, the growth in imports of Ch. 14: *Precious Metals* should be considered with caution.) The same could apply to the high growth in total imports from SADC. Besides the two chapters mentioned above, the other important chapter which has shown strong growth is Ch. 15: *Base Metals.*

SADC is the destination for 15% of South Africa's *HS 84: Machinery* exports and 22.7% of *HS 85: Electric machinery* exports but on average SADC only accounts for 10% of total exports.[15] South African exports of *Ch. 5: Mineral Products* to SADC are mainly due to South Africa exporting refined petroleum products to the region and some exports of coal. Iron and steel exports are largely responsible for the large share of *Ch. 5: Mineral Products. Ch. 6: Chemicals* exports are largely made up of fertilizers and some advanced chemicals. The trade balance with SADC is positive and large and has remained stable over the period of observation.

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[14] South Africa and SADC trade data is highly distorted by the confidentiality of intra-SACU trade. This information is kept away from the public by SACU members, especially South Africa. Although there are various methods which one can apply to have a sense of the magnitude of particular trade data, those will remain estimates and without a benchmark. Most of the estimates arrive at intra-SACU trade figure of between 5 and 10% of intra-SADC trade.

[15] Again, at best this can be treated as an estimate due to problems explained earlier.

3.3 The European Free Trade Area

EFTA is a relatively minor trade partner to South Africa, absorbing only 2% of total exports and providing 1% of total imports while imports from EFTA are only growing slowly. Over half of imports from EFTA are in Ch. 16: *Machinery* and in Ch. 6: *Chemicals*. This is mainly due to advanced machinery and advanced chemicals and drugs, all imported from Switzerland and Norway. The large imports of Ch. 5: *Mineral Products* stem from petroleum oils from Switzerland.

Virtually all South African exports to EFTA are in Ch. 14: *Precious Metals* being exported to Switzerland. The main metal is platinum but diamonds, silver, gold and palladium also feature in the list. Ch. 14: *Precious Metals* are growing very strongly, probably partly due to high commodity prices which ended in 2008. This has led to high growth of total exports to EFTA which, in turn, has led to the trade surplus with EFTA first growing and then consolidating from 2004, although this is not sufficiently large to offset deficits with other trading partners.

3.4 Mercosur

Mercosur is also an insignificant trade partner, with imports from the area supplying 3% of South Africa's imports but absorbing only 1% of exports. Imports from Mercosur are fairly diversified. The largest category of imports, Ch. 23: *Vehicle Parts* contributes 21.3% of imports. South Africa also imports a range of agricultural products from Brazil, the largest Mercosur economy, including soya and chicken products.

Imports from Mercosur, which grew between 2004 and 2008 at 17% per annum, were not driven by one product in particular but by a whole range of products: the largest contributor to growth is Ch. 23: *Vehicle Parts* but this was only responsible for a quarter of export growth. Ch. 1: *Live Animals*, Ch. 17: *Vehicles,* Ch. 16: *Machinery* and Ch. 4: *Prepared Foods* were the other largest drivers of import growth.

Table 7: South Africa's Trade with main trade partners, 2000-2005 (US$ m).

Partner/Year	2000	2004	2005	2006	2007	2008	Average Annual Growth (2004-08)
EU							
SA Exports	9 326	14 562	16 618	17 993	20 583	22 936	12%
SA Imports	10 893	19 408	21 000	23 699	26 857	27 545	10%
Trade Balance	-1 566	-4 846	-4 381	-5 705	-6 274	-4 609	
SADC							
SA Exports	2 941	3 889	4 667	4 894	5 965	8 178	19%
SA Imports	362	1 182	1 900	2 319	4 268	5 283	46%
Trade Balance	2 579	2 706	2 767	2 574	1 697	2 895	
EFTA							
SA Exports	561	1 147	1 080	1 562	1 410	1 743	12%
SA Imports	694	538	786	698	866	945	13%
Trade Balance	-133	608	295	864	543	798	
Mercosur							
SA Exports	279	310	407	510	612	816	26%
SA Imports	504	1 563	1 760	2 377	2 737	2 719	17%
Trade Balance	-225	-1 253	-1 352	-1 867	-2 124	-1 903	
China							
SA Exports	587	1 003	1 328	1 981	3 481	4 271	47%
SA Imports	996	3 597	4 924	6 816	8 575	9 870	29%

Trade Balance	-409	-2 594	-3 596	-4 835	-5 094	-5 599	
India							
SA Exports	426	570	913	758	1 313	2 180	36%
SA Imports	254	714	1 102	1 590	1 775	2 303	33%
Trade Balance	171	-144	-189	-832	-462	-123	
United States							
SA Exports	3 592	4 558	4 789	5 930	7 382	8 053	17%
SA Imports	3 183	4 037	4 286	5 152	6 118	6 931	15%
Trade Balance	409	521	503	778	1 264	1 122	

Source: Customs & Excise and own calculations.

As was the case with imports, exports to Mercosur are also relatively well diversified. Although Ch. 15: *Base Metals* and Ch. 6: *Chemicals* make up half of exports at the 23 chapter level, no one good dominates at the HS 6 level. Exports to Mercosur are about a third of the size of imports, leading a to trade balance in Mercosur's favour.

3.5 China

China is probably South Africa's most interesting trading partner, though this is possibly true for a number of countries that trade with China. The reason for this is the remarkable rise in South African imports from China. Imports from China grew by an annual average rate of 29%. In 2000, imports from China were 3.6% of total imports but by 2005, they were nearly triple this level at 8.9%. The latest import figure shows that this has stabilised at around 11%.

The comparable figure for exports was only 2.6% in 2000, which increased to 3% in 2005. In 2008 China accounted for 5% of South African exports. South African exports to China were growing at an annual average rate of 47% between 2004 and 2008. However, this difference in growth rates has done very little to reduce the trade deficit South Africa is experiencing with China. The main reason for this is that South Africa's recent export surge is coming off a low base. The most concerning aspect about this trade pattern is in the fact that South African exports are dominated by commodities while imports are those of manufactured products with machinery and textiles dominating.

Nearly 40% of imports are in Ch. 16: *Machinery*, with Ch. 11: *Textiles* the next largest category. Most of these goods are computer parts and accessories and home appliances. This is where the majority of growth of imports from China has taken place, not just in the clothing and textile cluster. In fact, imports from China have grown very quickly across the whole spectrum of goods.

Generally a quarter of exports to China is in iron ore, explaining a large part of the high share of Ch. 5: *Mineral Products*. Exports of Ch. 15: *Base Metals* include steel, aluminium and copper. Some manufacturing categories, such as Ch. 4: *Prepared Foods*, Ch. 20: *Misc. Manufactures* and Ch. 18: *Scientific Equipment* have registered high growth rates but they are off very low bases. The trade balance is heavily in China's favour and the deficit is growing.

3.6 India

Trade with India contributes about 3% of South Africa's imports and roughly the same for exports. Imports from India have tripled their share of South African imports from less than 1% in 2000 to 3% in 2005. Imports from India are relatively diverse with 4 chapters making up half of imports. These chapters, namely Ch. 17: *Vehicles*, Ch. 6: *Chemicals*, Ch. 5: *Mineral Products* and Ch. 11: *Textiles* are also growing very fast. Ch. 17: *Vehicles* exports occurred associated with the entry of Indian cars into the South African market. Ch. 6: *Chemicals* is mostly driven by pharmaceuticals. Most chapters are recording double- or even triple-digit growth rates.

South Africa's largest export category is Ch. 6: *Chemicals*. This is driven by a number of advanced chemicals. Besides these goods, the exports are either commodities or commodity-based manufactures. Examples of this include, coal, gold, wood pulp, steel and aluminium, listing the largest HS 6 exports. Export growth is moderate, being led by Ch. 15: *Base Metals* and Ch. 14: *Precious Metals*. The fastest growing export is Ch. 4: *Prepared Foods* but this was off a low base. South Africa's trade balance with India has been moving against South Africa throughout the period. Although the balance was in surplus in 2000, it had reached a deficit by 2003 and the deficit continued to grow in the following years. Positively however, the deficit is being narrowed.

3.7 The United States

The United States is one of South Africa's most important trading partners being the third largest importer and exporter to South Africa. In terms of shares, the US imports 8% of South Africa's exports and supplies 10% of imports. It appears that, in South Africa, the US is losing market share slowly to India and China. In addition, the trade balance is moving in South Africa's favour as exports have grown slightly more rapidly than imports. Typical of an advanced middle income country trade pattern, South Africa's main imports from the USA are in Ch. 16: *Machinery,* Ch. 17: *Vehicles* and Ch. 6: *Chemicals*, that is in relatively advanced goods. These categories make up two-thirds of imports from the USA. At the disaggregated product level, three of the four largest import goods are related to aircraft. The high-growth import categories, such as Ch. 14: *Precious Metals*, Ch. 3*: Animal or Vegetable Fats* and Ch. 23: *Vehicle Parts* all come off relatively low bases.

Over half of South Africa's exports to the US are part of two chapters, Ch. 14: *Precious Metals* and Ch. 15: *Base Metals*. The largest exports at the HS 6 level are platinum group metals, occupying the three top spots. Aluminium and steel exports are also significant. In terms of growth, Ch. 14: *Precious Metals* is also the fastest growing category but a significant portion of this growth is due to the fact that platinum exports were moved from Ch. 22: *Unclassified* to Ch. 14: *Precious Metals*. Ch. 15: *Base Metals* exports grew moderately while Ch. 11: *Textiles* and Ch. 15: *Base Metals* exports declined (in US$ terms). The weak performance of Ch. 15: *Base Metals* is surprising, given how well this category has performed in trade with other partners. The trade balance with the US has been growing very strong. The surplus has virtually doubled between 2004 and 2008 in South Africa's favour.

3.8 Summary of Aggregate Trade Flows

In summary, it would seem that South Africa trade with China and India has taken some market share away from the EU and the USA. Between 2000 and 2008 the two developed members lost 9% and 4% of the South African imports, respectively. On the other hand India and China gained 7% and 2% respectively. While trade with India remains modest in absolute terms, South Africa's imports from China are now above those from the US. Trade with Mercosur and EFTA remain relatively insignificant but imports from SADC have grown considerably, in particular in recent years.

South Africa's trade balance is also showing an interesting trend that seems to suggest catching up is possible over time. At the turn of the century and most of the period, the largest deficit was with the EU. This deficit has declined very recently years. South Africa also had a trade deficit with EFTA which has since been turned into a surplus, and growing. On the other hand, the trade surplus South Africa has with the USA is three times what it was in the year 2000. All these perceived progress is reversed when China comes into the picture: in 2000 the trade deficit with China was a mere US$ 0.4 billion; it has since increased by fourteen fold, and becoming the largest trade deficit with all trade partners.

South Africa's export average annual growth rate in the last five years was higher than the rate of imports with all partners except SADC and EFTA (marginally, by a mere 1%). The driving force behind South Africa's export growth appears to be commodity boom in the previous five years. The South African export basket to partners where this trend is observable is dominated by commodities. If this is the case, then a serious knock on exports is expected in the next few years as that run of high commodity prices just ended at the time of writing of this paper.

4. Future Bilateral Agreements

It is important to look back at the trade negotiations that failed before looking forward to the new ones. In addition to the existing agreements mentioned above, SACU engaged in a potential trade agreement with the USA. The most important part is that the USA is the source of 8% of South Africa's imports and a market for 10% of its exports. This is an important trade partner compared with some of the partners which have already concluded the negotiations. In addition, some studies of the pattern of trade between South Africa and the USA suggest that, despite the importance of this trade, there is still significant untapped trade potential. Specifically, South African exports to the USA could be higher (ITC, 2006).

The failure of the talks could be attributed to many factors but from the South African side it appears that the USA demanded too much liberalisation in too many areas and too quickly. The USA has a template for a FTA used in other agreements such as the North American Free Trade Agreement (NAFTA), the Central American Free Trade Agreement (CAFTA) and bilateral agreements such as those with Australia and Singapore (Willcox, 2005). This template covers areas that SACU does not usually include in FTAs – e.g. investment, labour and intellectual property rights. For example, the CAFTA agreement disallows the signatories from engaging in trade in generic medicines and extends the protection period of patented drugs. SACU would also have to enter into negotiations on trade in services, even though the SACU agreement itself has no services protocol. Thus, the USA would have had to negotiate separate services agreements with each SACU member. The negotiations were put on hold for the USA elections before they were completely called off within five months of the new USA administration having been in place.

In parallel, Netshitomboni *et al.* (2006) have pointed out that AGOA only accounts for just over 20% of SACUs exports to the US. With 15% covered under the Generalised System of Preferences (GSP) and 60% entering duty free, the remaining (less than) 5% of exports faces non-preferential access. Any future agreement should therefore be more focussed on securing and deepening existing preferences as there is limited scope for extending. The authors indicated that the textiles items that fall outside AGOA and the GSP that SACU is exporting under high tariffs are one area that could benefit from an FTA with the USA.

In terms of the trade-creation trade-diversion debate, Adams & Horridge (2004) using a dynamic version of a GTAP framework with expanded agriculture but aggregated manufacturing, came to the conclusion that the former outweighs the latter. The results of the implementation of an FTA were evaluated in various configurations. Overall, it appears that exports of oil seeds, sugar and sugar cane, other crops and related food processing sectors are expected to benefit from an FTA between SACU and the USA; but wheat and meat and related agriculture such as cattle and other animal farming would be faced with higher competition, perhaps because of existing domestic support in the USA.[16] The lower degree of trade diversion observed by Adams & Horridge (2004) may be linked to the modelled supply being more readily available than what is suggested by Netshitomboni *et al.* (2006) closer to the ground.[17]

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[16] AGOA and general GSP preferences as well as agriculture domestic support are in principal captured by the GTAP data base (Bouët *et al.*, 2005; Huang, 2005), although the details of these is not discussed.

[17] Other important issue in the policy debate that can be examined with the type of analytical framework employed by Adams and Horridge (2004) is whether skill shortages in the labour market have a significant impact on the results. The authors only allow for unskilled labour shortages to be evaluated but it would be interesting to check whether the easing of skilled labour shortages has any significant impact on the results.

In brief, there may be possible benefits with the USA, especially considering the potential highlighted above. The fact that the USA is already an important market for South Africa may imply that removal of further barriers is likely to improve these benefits. The main challenge is also in the areas where both parties should consider making concessions for these negotiations to possibly be resuscitated in future.

In future, SACU may consider negotiations with China and India. Given India's history, the agreement with India is likely to be negotiated along PTA lines. This again will be the least ambitious arrangement as it will be driven more by what "not to give access to" rather than concerns about the gains from trade. It will most likely be covering at best about 1000 tariff lines. Due to the high tariffs prevalent in India, a thorough agreement could lead to relatively large gains for South African exporters, although this potential is limited to only a select number of commodity groups. The sectors that stand to benefit would be precious metals, machinery, chemicals and plastics. Market access gains for Indian exporters would only be US$51million, much smaller than the estimated US$943 million for South African exporters (Willcox, 2005). The reason for the difference is that South Africa's tariffs on imports from India are already relatively low.

A useful complement to the quantitative analysis of trade between South Africa and India, described above are the studies by Alves (2004) and by Soko (2006). Both authors note that there is a perception that India's interests in a SACU – India trade agreement is less driven by the benefits of trade and more by ensuring political support in multilateral fora. Trade between the two entities is currently too small and local interest groups in sensitive products, textiles in South Africa and manufacturing in general in India too powerful to ensure a comprehensive agreement. At most, SACU can hope for discussions around a positive list along the same lines as the agreement that it has conducted with Mercosur. Agreements on investment may, however, be more important to India than other areas. South Africa should be keen on an extended positive list at a minimum as average tariffs are on the whole much higher in India while the large markets offers significant opportunities for a range of products. India has recently concluded a similar type of agreement with Mercosur and hopes to forge a triangle with South Africa.

There are few indications as to what an agreement with China would look like noting that China's involvement in Africa has been on the investment as well as on the trade fronts. Exports from China, as was noted earlier, involves manufactured goods, while it imports raw materials to support its high economic growth. It will be very important to have a well thought and prepared negotiations with a partner like China.

Contrary to expectations, an analysis by Willcox and Van Seventer (2004) found that there was significant potential for South Africa exporters to exploit in an agreement with China. 1,113 HS 6 commodity groups were identified as having the potential to increase exports. Exports of machinery, chemicals, base metals and scientific equipment have the potential to grow, especially if negotiators can provide a tariff preference.

The general trade patterns of South Africa with developing members seem to show more competitive trends, while the trend is more complementary with the developed world. Draper et *al.* (2006) showed that the developing countries of Mercosur will compete fiercely with South Africa in agriculture and in auto sectors. India and China will add to that competition in manufactured goods as well as in labour intensive activities. These threats will also go beyond South Africa's borders affecting SACU members - such as Lesotho and Botswana - by eroding their existing clothing and meat markets. On the other hand, developed countries are suppliers of advanced manufactured goods and will introduce technologies which are not available in the country/regions. Trade negotiations in this regards should consider cooperation and joint activities so that knowledge and processes can be transferred from the developed to developing countries.

5. Conclusion

South Africa has implemented several trade agreements since the turn of the century. Two of them have been with developed countries; three others are with groups of developing countries. One of these trade arrangements has developed into a complete free trade area and another one is just one year from achieving that status. In between there was one failed arrangement, which could have been very significant considering that it was with the largest single economy in the world. There was also a completion of what is usually considered the shallow agreements with Mercosur, with the hope of improving on that agreement in future.

The trade flow patterns following from these agreements have not changed significantly over the time of implementation. What seems to be the trend on the South African export side is the consolidation of exports of the same category, a phenomenon also referred to as trade deepening. These imply that very few products have been added to the trade basket since the introduction and implementation of trade arrangements. Another important feature with the recent trends is that while South Africa's exports have started to increase, the trade balance has generally not improved. What seems to happen is a shift of trade deficit from the developed partners to developing members.

Evidence of changes of trade patterns, of trade direction or of trade structure are not clearly present. The changes seem to be driven by particular exogenous factors such as rise in commodity prices and the continued prominence of some developing countries in global trade. One possible explanation of what is observed is with the fact that a major trade agreement with the EU took place when South Africa was facing already low tariffs. However, a major shift on the import side is that developing countries have eroded the EU's and the USA's market shares. This also suggests that trade relations with developing countries have already started to improve, even in the absence of formal agreements.

South Africa's export growth has outstripped that of imports in some cases: this is the case with some developed and with some developing countries, not with China. While this is positive move that needs to be supported and built upon, a major concern is that these exports are mostly comprised of commodities and driven significantly by the commodity boom. Imports, in contrast, consist of finished manufactured goods and to a certain extent of some capital goods.

In terms of future agreements, consideration should be given to gains other than those related to trade from such arrangements, including cooperation, investment as well as technological advancements. Trade in services should also be considered with developing partners, especially with SACU and SADC. There are benefits which are currently not captured due to limitation and other non tariff barriers which goods continue to face. Trade arrangements should also consider threats and opportunities for other member of the SACU and try to overcome some of those.

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