The TDCA and the Proposed SACU-USA FTA:

Are Free Trade Agreements with Industrialised Countries Beneficial for the SACU?

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I. List of Abbreviations

ACP	African, Caribbean and Pacific
AGOA	African Growth and Opportunity Act
BLNS	Botswana, Lesotho, Namibia, Swaziland
GDP	Gross Domestic Product
EFTA	European Free Trade Association
EPA	Economic Partnership Agreement
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Area
GSP	General System of Preferences
MERCOSUR	Mercado Común del Sur (Common Market of the South)
MIDP	Motor Industry Development Plan
NAFTA	North American Free Trade Area
NGOs	Non-Governmental Organisations
SACU	Southern African Customs Union
SADC	Southern African Development Community
SMEs	Small and Medium Sized Enterprises
TDCA	Trade, Development and Co-operation Agreement
USA	United States of America
WTO	World Trade Organization

1. Introduction

Since the Free Trade Area (FTA) between South Africa and the EU, named “Trade, Development and Co-operation Agreement” (TDCA) came into force, enterprises from third countries have faced a disadvantaged access to the South African market in comparison to European firms. This resulted in corresponding offers towards the SACU from the USA, the European Free Trade Association (EFTA), MERCOSUR, India, China, and Nigeria. The SACU responded positively to these offers and is currently negotiating FTAs with the USA and the EFTA, while exploring negotiation options with the latter ones.

The TDCA can be declared as multipurpose novelty that has an announcement effect for future trade relations among industrialised and developing countries. So, the TDCA means

a. the farewell of industrialised countries to one-sided preferential trade vis-à-vis developing countries;
b. that a bilateral negotiated FTA rules also for third parties, namely Botswana, Lesotho, Namibia, and Swaziland, the so-called BLNS countries, that are together with South Africa in the Customs Union SACU;
c. a challenge for SACU countries future trade relations vis-à-vis industrialised and developing countries

SACU’s approach towards FTAs with industrialised countries raises the question about myths and reality of benefits. While the theory describes harmful as well as beneficial effects of FTAs between developing and industrialised countries, the experience of the TDCA offers the option to address certain areas of concern before entering into a US-SACU FTA.

This paper is designed as follows: after the introduction, section two gives a brief economic overview about the SACU. Because South Africa and the BLNS countries are economically very diverse, this also results in different interests when entering into trade arrangements with third countries. Section three names chances and risks that generally occur from regional integration and in a North-South FTA in particular. The relevance of theory is highlighted in section four where SACU’s trade relations with the EU and the USA are investigated. Section five studies the motivations and goals of a SACU-USA FTA for the SACU countries and the USA respectively. Chances and risks will be considered, taking lessons from the experience of the TDCA. Based on the named options and concerns, areas that need to be addressed in a SACU-USA FTA will be formulated in section six. The last section seven summarises the main findings and efforts to formulate policy recommendations for a SACU-USA FTA.

2. Brief Economic Background of the SACU countries

The BLNS economies are characterised by huge disparities opposite to South Africa. South Africa, the economic giant is responsible for almost 93% of SACU's GDP (AfDB 2002) and by far the most sophisticated economy; its manufacturing exports accounted for 58% of its total exports in 2001 (DTI 2001).[1] Contrary, the BLNS countries depend highly on primary goods for their export earnings, which are mainly destined for the EU. The main export commodities are diamonds and beef for Botswana and Namibia and sugar and beef for Swaziland. Within the BLNS countries, Lesotho can be described as an exception regarding its structure and location of exports. Due to Lesotho's lack of primary resources, it exports above all textiles and garment, mainly destined for the US market.

All BLNS countries show a large trade deficit vis-à-vis South Africa, as the latter provides between 78% and 90% of total BLNS imports (WTO 2003a). The high levels of BLNS imports from South Africa can be explained by both, South Africa's comparative advantages (e.g. its proximity to the BLNS countries) and SACU's still comparable high common external tariff that results in trade diverting effects, as imports from the rest of the world are substituted by South African products (GoN 2003:18). Furthermore, it has to be taken into account that goods destined to the BLNS countries and recorded as a South African origin could have also been sourced elsewhere due to imperfect supervision of the rules of origin. Unrecorded imports from third countries are a problem for all BLNS countries, as they receive the vast majority of their imports *via* South Africa (WTO 2003b:A5-312).

Next to their dependency on South Africa for imports, the BLNS countries also are dependent on the income from the SACU Revenue Pool,[2] that accounted between 13% (Botswana), 28% (Namibia) and 51% (Lesotho and Swaziland) of total government income in 2001 (WTO 2003b:7).

Due to their different economic development, South Africa and the BLNS countries also pursue different industrialisation strategies. While e.g. South Africa wants to protect its capital-intensive industries, such as the automotive industry, this is not in the interest of the BLNS countries that would like to benefit from cheaper inputs and consumer goods. On the other hand

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[1] Manufacturing products are primarily stones and metals, steel, mineral products and automotives, including components (DTI 2001).

[2] The SACU Revenue Pool consists of the customs, excise, sales and additional duties collected on goods imported in the SACU.

the BLNS countries want to maximise their earnings from agricultural products, such as cattle, while South Africa is interested to source cheap raw materials, including subsidised beef from industrialised countries (Goodison 1999:34). In the past, the BLNS countries had to accept certain policies applied by South Africa, such as extensive anti-dumping and safeguard duties, which imposed an anti-export bias on their industries (WTO 2003b:A5-315). These unilateral policy approaches are going to be abolished with implementation of the democratised SACU Agreement 2002. However, the varying interests of the SACU economies make it difficult to negotiate an FTA that is supposed to be of advantage to all parties.

Before investigating the trade relations of the SACU countries with the EU and the USA, the following section provides a theoretical explanation of an FTA between developing and industrialised trading partners.

3. Economic Integration among Unequal Partners from a Theoretical Point of View

When countries enter into an FTA changed trade flows due to changed conditions of competition arise. Viner (1950) classified these processes as trade creation and trade diversion. Trade creation occurs if domestic products are replaced by more competitive regional products. This results in increased consumption of the cheaper substitutes, at the expense of the local production. Trade diversion means the directional change of trade: products, which were formerly imported from the rest of the world, are now imported from regional producers as their production costs are lower than the production costs of the rest of the world plus customs duty. Thus, the producer surplus of the regional supplier increases. Viner classified trade creation as positive and desirable as it shifts production towards the more competitive regional producers, resulting in an optimal factor allocation within the region. Contrary, trade diversion was judged as welfare decreasing as it promotes inefficient production. According to these assumptions, it depends on the dominance of trade creation over trade diversion whether an FTA is globally beneficial.[3]

The dominance of trade creation is, according to Viner, the more presumable the more the countries were trading with each other before entering into an FTA. In this case, ineffective domestic producers will be replaced by regional producers (trade creation) and only little trade

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[3] However, Meade (1956, cited in Robson 1998) pointed out that trade integration cannot be judged as beneficial *per se* as one must take also customs losses into account. The compensation costs of customs losses must therefore be deducted from the effects of trade creation to identify the welfare effect of the FTA.

from the rest of the world can be replaced by regional producers (trade diversion). Furthermore, a substituting production structure should dominate, i.e. the two countries should stand in direct competition to each other. That means successful economic integration requires a similar level of industrial development, competitive industrial sectors and a potential for complementary development of industrial sectors.

Although Viner's model experienced numerous criticisms,[4] it is still used when explaining the static effects of regional trade integration. However, along side of the static effects of regional integration, there are also several dynamic effects that can occur. In contradiction to static effects, dynamic effects of regional integration regenerate. For instance this is the case when economies of scale are exploited that are occurring due to increased market size. Companies are able to expand their production and fully load their capacities. In addition to this, the increased competition of the FTA results in an efficient factor allocation and thereby, c*eteris paribus*, to price reductions. This again increases the demand for goods and results in growth effects. Further dynamic effects of regional integration are learning and technology effects, both, due to the close cooperation with other members of the FTA, and through investors from third countries. This is in turn stimulated by an increased market and increased economies of scale (Hoeller et al. 2000, Krugman 1991).

So, what happens if a developing and an industrialised country enter into an FTA? According to the classical considerations of Viner, trade diversion effects vis-à-vis third countries are likely to dominate due to the complementary production and trade structure that generally determines North-South trade. This appraisal was criticised by some authors (see for example Piazolo 2001, Collier and Gunning, 2000, and Venables 1999) who argued that developing countries would benefit from an FTA with an industrialised country due to their different factor endowment. As a result, the FTA would enable them to import cheap, capital-intensive inputs and export labour-intensive manufactures, thus, stimulating the division of labour.

For developing countries, regional integration with industrialised countries offers another positive aspect, as it might help them to develop their industrial capacities due to protected access to a larger market and strong cooperation (Kreinin and Plummer 2002:30). Besides this, the increased competition could result in a more effective usage of resources and stimulate

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[4] E.g. by Gehrels (1956-7, as cited in Kreinin and Plummer 2002:8-9) who demonstrated that trade diversion can also be welfare enhancing, depending on the state of the indifference curve and the level of the intra-regional tariff rate, or by Copper and Massell (1956, as cited in Robson 1998:51-5) who argue for unilateral trade liberalisation to avoid trade diversion effects. However, this thesis ignores a country's individual motivation for discriminating customs reductions. Although the global welfare maximum might not be reached, a single country can be better off when discriminating third parties (Goldstein und Quenan 2002:47, Kreinin und Plummer 2002:5).

innovational effects. Next to these economic dynamics, regional trade agreements might also offer political dynamics, such as an advanced relevance in bi- and multilateral trade negotiations due to the bundling of interests. Furthermore, the contractual agreement with an industrialised country might increase the economic and political reputation of the respective developing country and help to attract foreign direct investment (FDI) (Padoan 2001, Collier and Gunning 2000).

So, from a theoretical point of view, either the dominance of positive or of negative effects is possible. Or, as formulated by de Melo et al. (1993:160): *"The literature on RI [Regional Integration] is full of the ´anything may happen´ type of results".*

What kind of effects are likely to happen in a SACU-EU and SACU USA FTA will be analysed after investigating the volume and structure of trade between the single SACU countries and the EU and the USA respectively.

4. SACU's Trade Relations with the EU and the USA – Similarities and Differences

4.1 SACU – EU Trade Relations

The EU is South Africa's largest trading partner and accounts for 36.8% of its exports and 40.4% of its imports in 2001 (ABSA 2002). For the EU, on the other hand, South Africa is only a median important trading partner, comparable to India or Israel. In 2001, the EU transacted 1.4% of its total trade with South Africa (European Parliament 2002:22).

Depending on the source, there are considerable differences regarding the South Africa – EU trade figures: the EU stated a trade surplus of € 3.2 million in favour of South Africa in 2002 (GD Trade 2003), whereas the Department of Trade and Industry of South Africa (DTI) calculated a trade deficit, accounting for around € 870.2 million (R 7,486 million, DTI 2003a).[5] According to the United Nations Statistical Division (UNSD), South Africa showed a trade deficit to the EU of US$ 600.5 million in 2001. As Table 1 shows, South Africa was able to increase its exports to the EU considerably and dropped its trade deficit by more than 80% in the period 1997-2001.

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[5] According to Smalberger (2003) these disparities can be explained by a*) differences in export figures* (South Africa's exports of precious metals are not classified according to their export destination), b*) differences in import figures* (the EU accounts CIF prices and South Africa FOB prices), and c) *the possibility of re-exported vegetables and minerals by EU importers*. A harmonisation of European and South African trade statistics is not planned.

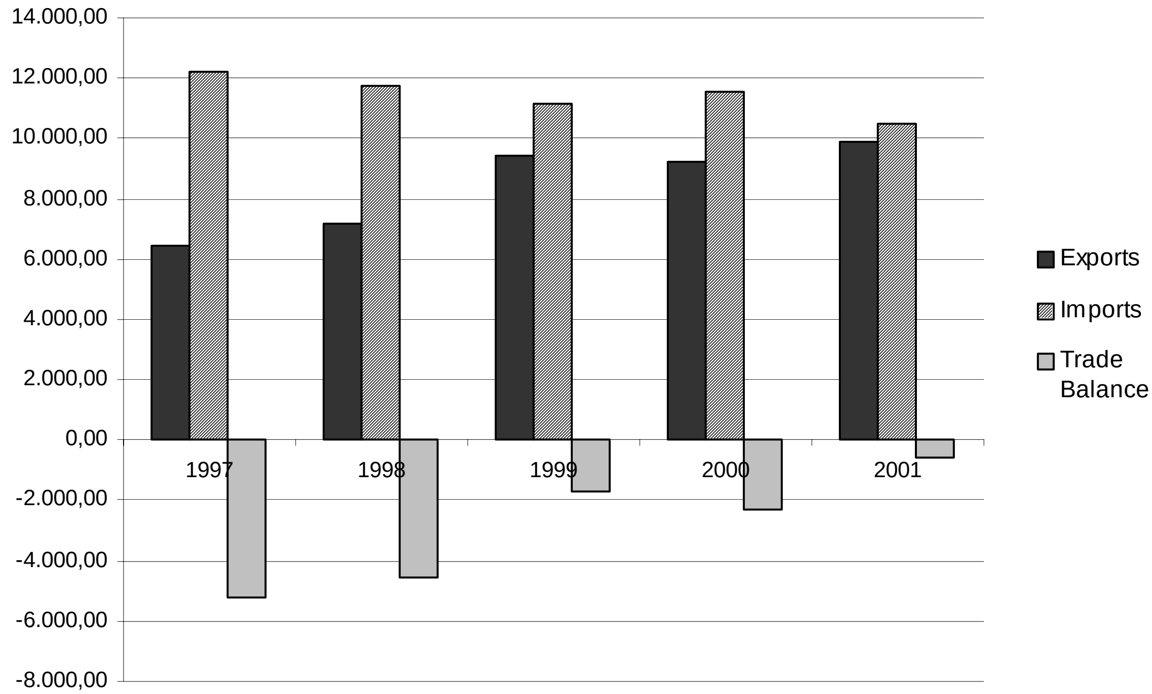

Figure 1: South Africa's trade balance with the EU (in million US$)

Source: Based on data by UNSD (2003).

For the BLNS countries, with exception of Lesotho, which trades almost exclusively with South Africa and the USA, the EU is the second largest trading partner after South Africa. The majority of Botswana's and Namibia's exports, which are mainly diamonds and cattle, are destined for the EU. Swaziland that exports above all sugar, sugar products and beef to the EU, benefits highly from the EU Sugar Protocol that guarantees the purchase of 116,000 tons of sugar p.a. at fixed prices.[6] Botswana, Namibia and Swaziland benefit furthermore from the EU Beef and Veal Protocol that allows them to export guaranteed quantities at reduced duties of 92%.[7]

For the EU, BLNS countries are only a marginal trading partner, responsible for around 0.1% of total European imports and receive less than 0.05% of total European export goods (European Commission 2001b). All BLNS countries show a positive trade balance towards the EU:

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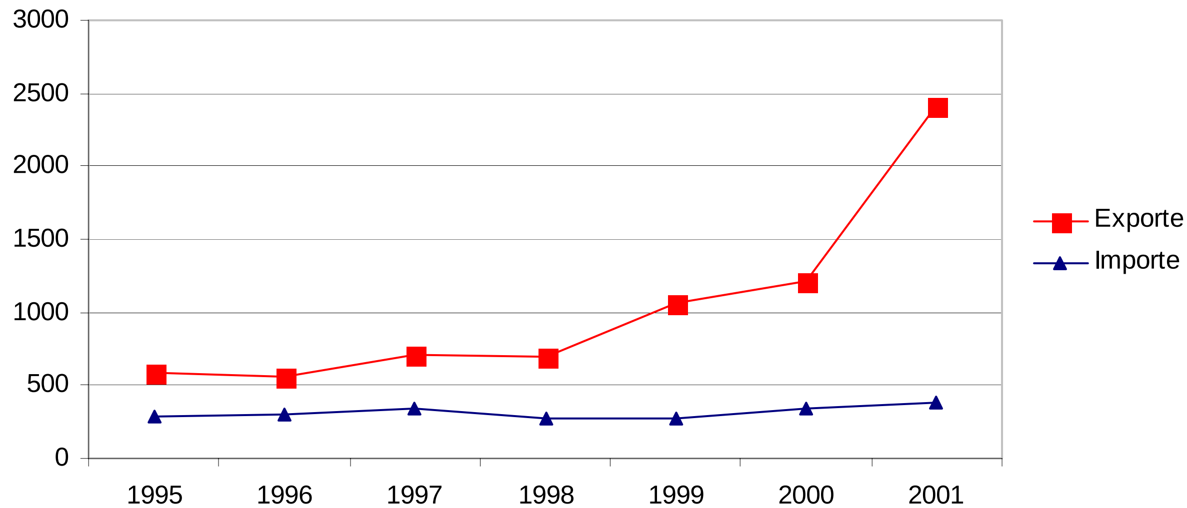
[6] Sugar prices are subject to annual negotiations. The Sugar Protocol runs without expiration but can be cancelled with two years' notice from 2005 on (European Commission 2000, Protocol 3).

[7] However, the countries were almost never able to fulfil the quotas due to strict European health and sanitary standards (Davenport et al. 1995:17-8).

in 2001, BLNS countries' exports to the EU accounted for € 2,419 million and were six times higher than their imports (European Commission 2001b).[8]



Source: Eurostat 2000 (1995-1998) and European Commission 2001b (1999-2001).

4.2 SACU – USA Trade Relations

SACU's trade with the USA has been growing by more than 300% since 1994 and accounted for 10.2% in 2001 (DTI 2003b:2). In 2002, SACU received US-imports accounting for around US$ 2.9 billion and exported commodities of around US$ 4.8 million to the USA. As Figure 3 shows, the lion's share of SACU's trade with the USA was realised by South Africa, which was responsible for 89% of exports and 96% of imports in 2002. In the BLNS countries, Lesotho made the largest trade surplus with the USA, with growing tendency. Swaziland has taken also advantage from the "African Growth and Opportunity Act" (AGOA) so far and doubled its exports to the USA almost in the period 2001-2002.[9]

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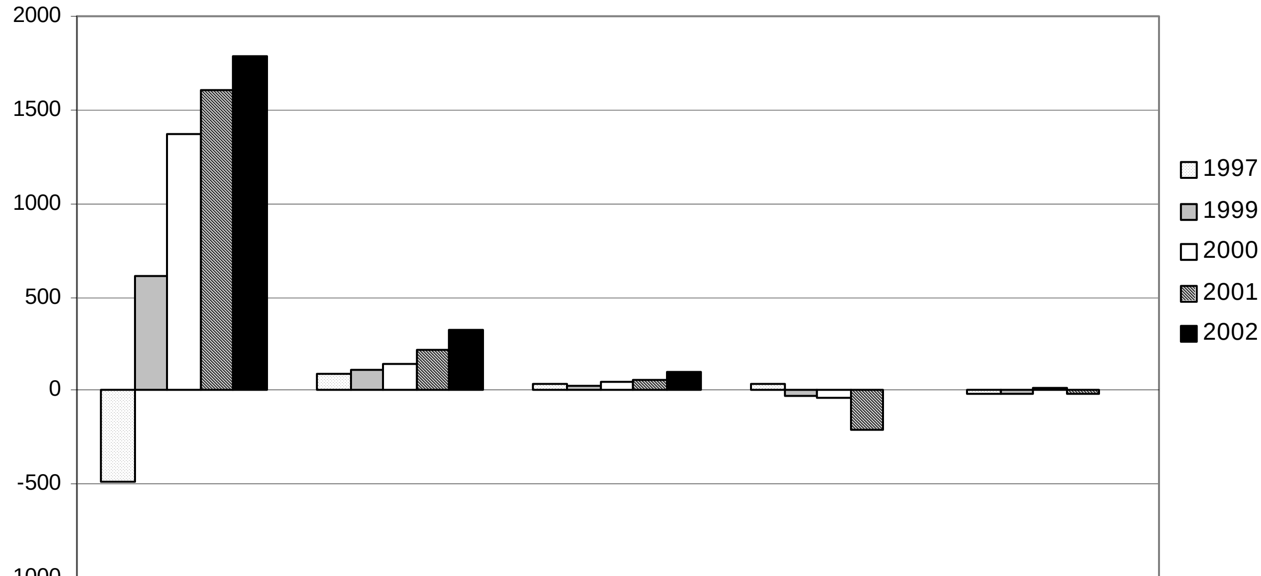
[8] The sharp increase in exports since 2000 can be explained by an increase in diamond prices from which Botswana and Namibia benefited highly (European Commission, 2001c). Besides this, it was the depreciation of the Rand that signed responsible for BLNS countries' export increase to the EU. In fact, BLNS countries' export value to the EU was shrinking in 2002. Besides to the appreciation of the Rand, Botswana and Namibia had to accept an obsolescence of 50% for diamonds (Tralac news, 05/02/2003).

[9] The US-initiative AGOA that started in 2001, provides a non-reciprocal duty and quota-free market access to the USA for a range of products destined from 38 eligible African countries, including all SACU countries. With AGOA, the USA expanded the list of products eligible for duty free access under the General System of Preference (GSP) so that an additional product line of 1,835 products can enter the USA free until the end of September 2008 (USTR 2002).

Namibia and Botswana, whereas, showed predominantly trade deficits with the USA and reached only a slight trade surplus in 2002. This improvement was due to their declaration as "Lesser Developed Countries" under the AGOA initiative in 2002 that allows them to utilise third country inputs to manufacture eligible wearing products until September, 2004.[10] Thus, Botswana and Namibia expect a growing trade surplus with the USA in the next years.



	South Africa	Lesotho	Swaziland	Namibia	Botswana
1997	-487	84,1	38,9	38	-18,5
1999	608	110,1	28,3	-25,7	-16,4
2000	1374	139,3	44,8	-36,3	9,3
2001	1607	216,3	57,6	-211,5	-21,9
2002	1790	319,7	103,4	3,6	1,8

Figure 3: SACU countries net exports to the USA (in thousand US$, customs value)

Source: Based on data by the US Department of Commerce (2003).

[10] African countries with a per capita income below US$ 1,500 p.a. are defined as "lesser developed beneficiary countries" under AGOA and do not have to meet the strict rules of origin but are allowed to use inputs from anywhere in the world until September 30th, 2004 (USTR 2002). Although Botswana and Namibia have higher per capita income, they show great income disparities within the country. Thus, their application to the status as "lesser developed country" has been accepted under AGOA II in 2002 (WTO 2003a:17). All African countries, including the "lesser developed beneficiaries" have to use an "applicable percentage" of inputs from the USA. The "applicable percentage" took 2% in the period 2002-03 and is rising in stages to 3.5% until 2007 (WTO 2003b:A2-141).

For the USA, SACU countries are only of minor importance, although South Africa is the largest sub-saharan African export market of the USA. The SACU economies accounted for 0.42% of US imports in 2001 (USTR 2003). For the SACU economies, the relevance of the USA as an export and import market is very different. The USA can be classified as middle level trading partner for South Africa but is important for the manufacturing export strategy of the country. In 2001, South Africa shipped 8.6% of its exports to the USA and sourced 11.9% of its imports from the country (DTI 2001). For Botswana, Namibia and Swaziland the USA is a less relevant trading partner. In 2001, they received between 0.9% and 1.8% of their total imports from the USA and shipped 0.7% (Botswana), 3% (Namibia) and 12.8% (Swaziland) of their exports to the USA (WTO 2003b). However, since the start of the AGOA initiative in 2001, the USA has become an increasingly attractive export destination for all SACU countries. An extreme case is Lesotho, which delivers, with growing tendency, around 74% of its goods to the USA and sources around 8% of its import from the US-Americans. However, South Africa is the only African country that benefited from the AGOA initiative in segments other than textiles/apparels and energy-related products due to its comparable diversified export range (Naumann 2003).

Relating to the type of trade there are large similarities between SACU's trade with the EU and the USA as Table 1 and 2 show. South Africa, Botswana and Namibia export primarily stones, minerals and metals, while Lesotho and Swaziland, which do not have any mineral resources, respond above all to special trade provisions, namely the Cotonou Agreement of the EU (sugar and beef) and the US-AGOA initiative (textiles and apparels). SACU's main import products are capital and knowledge intensive goods, such as transport equipment, machinery and electronic products.

It can be summarised that trade between the SACU countries and the EU and USA respectively, is to a large extent characteristic for trade relations between developing and industrialised countries. So, SACU's exports to the EU and the USA are dominated by primary and labour-intensive manufactured goods and its import products are predominately capital-intensive manufactures.

Table 1: SACU countries' export volumes and main export products to the EU and the USA, 2001

	Export volume in million US$ and %	**EU**	**Export volume in million US$ and %**	**USA**
South Africa	8,776.5 (36.8%)	Minerals and metals (61.4%), Agriculture	2,043.6 (8.6%)	Minerals and metals (62.8%), Transport

		(9.6%), Machinery (8.4%), Transport equipment (5.4%), Miscellaneous manufactures (2.8%), Chemicals (2.6%), Textiles (1.9%).		equipment (9%), Chemicals (6.4%), Machinery (5.8%), Textiles and apparel (4.8%), Agriculture (3.9%).
Botswana	1,925.0 (84.7%)	Diamonds (82.7%), Beef and beef products (8.2%), Machinery (4.3%), Textiles (3.3%)	16.0 (0.7%)	Minerals and metals (73.8%), Textiles and apparels (14%)+, Miscellaneous manufactures (8.2%),
Lesotho ++	0.24 (0.08%)	-	140.3 (74.3%)	Textiles and apparels (99.8%)
Namibia	550.9 (55.1%)	Diamonds (52%), Beef and beef products (46.2%),	29.5 (3%)	Agriculture (33%) *, Minerals and metals (32%), Energy-related products (29.9%), Textile and apparel (0.3%) **
Swaziland	151.3 (18.5%)	Prepared foodstuff (72.5%), Textiles (7.8%), Wood articles (3.5%)	104.6 (12.8%)	Textiles and apparels (74%), Agriculture (10.6%), Miscellaneous manufactures (6%), Machinery (3.5%)

+ 21.4% in 2002.
++ Trade figures of 2000.
* 11.3% in 2002.
** 11.7% in 2002.

Source: European Commission (2001a) and AGOA.info (2003). Figures of export volumes are obtained from national trade statistics as cited in WTO 2003b.

Table 2: SACU countries' import volumes and main imports from the EU and the USA, 2001

	Import volume in 2001	EU	Import volume in 2001	USA
South Africa	8,910.0 (40.4%)	Machinery (39.5%), Transport equipment (16.6%), Chemicals (12.3%), Plastic articles (5%), Optical instruments (4.3%), Agriculture (2.1%)	2,633.0 (11.9%)	Transport equipment (38.9%), Chemicals (16.3%), Electronic products (14%), Machinery (10%), Agriculture (3.6%)
Botswana	174.0 (9.2%)	Machinery (39.1%), Transport equipment	35.0 (1.8%)	Special provisions (42.5%), Transport

		(38.1%), Jewellery (8.9%), Optic instruments (2.7%)		equipment (32%), Electronic products (16.1%), Agriculture (2.4%)
Lesotho *	1.1 (1.5%)	Transport equipment (62%), Machinery (34%)	5.8 (8%)	Electronic products (42.8%), Transport equipment (42.8%)
Namibia	90.6 (6.9%)	Transport equipment (36.9%), Machinery (24.9%), Agriculture (8.6%), Jewellery (4.9%), Chemicals (4.5%)	11.9 (0.9%)	Transport equipment (70.7%), Special provisions (19.9%), Electronic products (4.1%), Agriculture (2%), Chemicals (1.7%)
Swaziland	17.0 (1.9%)	Machinery (22.1%), Chemical products (16.3%), Base metals (15.3%), Agriculture (11.6%), Transport equipment (8.3%), Miscellaneous manufactures (8.1%),	N. A.	Electronic products (36.5%), Chemicals (28.4%), Transport equipment (13.8%), Agriculture (5.4%)

* Trade figures of 2000.

Source: European Commission (2001a) and AGOA.info (2003). Figures of import volumes are obtained from national trade statistics as cited in WTO 2003b.

4.3 Summary of Findings

So, what do the SACU-EU and SACU-USA trade relations mean from a theoretical point of view? According to the classical examination, this depends primarily on the volume and the structure of trade. Relating to the volume of trade it can be stated that the EU is South Africa's major trading partner and a relevant export destination for the BLNS countries (with exception of Lesotho). The USA, whereas, is a middle level trading partner for South Africa and of lesser relevance for Botswana, Namibia and Swaziland. Only for Lesotho, is the USA, next to South Africa, the major trading country. However, the export market of the USA gains importance for all SACU countries because of the AGOA initiative.

As regards the structure of trade it can be stated that intra-industrial trade occurs to a certain extent, namely in the fields of machinery, transport equipment and chemicals. However, these segments account for around 17% of South Africa's total exports to the EU and the USA but make up close to 70% of South Africa's imports from these countries. Furthermore, it remains questionable whether South Africa will be able to compete successfully in these capital-intensive, high-skilled technology sectors in a liberalised market. Although South Africa shows overall export shares of motor vehicles and chemicals of on average 14.3% from 1991-2001, the majority of its exports is still made in the category of labour-intensive and low-skilled technology products where the export share was more than 27% in the same period (DTI 2001). Besides this, South Africa's automotive industry is currently only able to compete internationally because of the export promotion programme MIDP (DTI 2002).[11]

Yet the trade relations between the BLNS countries and the EU and USA respectively, show a traditional trade pattern: while the BLNS countries export exclusively primary goods and labour-intensive manufactures to the EU and the USA, they import above all capital-intensive manufactures, like machinery and transport equipment.

In summary, SACU's trade relations with the EU and the USA are characterised by a complementary production structure with limited options for intra-industrial trade. Although this would imply the dominance of trade diversion vis-à-vis third countries from the classical theory point of view, this risk seems to be limited. Even before the TDCA entered into force, South Africa imported the majority of its goods from the EU. The USA is South Africa's second important import source. In total, more than 50% of South Africa's imports come either from the EU or the USA (DTI 2001:13). As SACU is, moreover, negotiating an FTA with the EFTA, and is currently exploiting further free trade negotiations with MERCOSUR, India, and China, the vast majority of its imports is supposed to come from its free trading partners in future.

However, the different factor endowment is likely to limit the options for trade creation so that the static effects of regional integration are going to be very low. Further to the static effects there are several dynamic effects of trade integration, such as attraction of FDI, technology effects and economies of scale, that that might be reaped by the SACU economies when entering into an FTA with the USA. Non-tariff barriers and special arrangements that might discriminate free trade, whereas, must also be analysed when determining the possible impact of a SACU-USA FTA. For this purpose the next section investigates the motivations, chances and risks of a SACU-USA FTA with respect to the dynamics of trade and analyses the constraints SACU countries are facing when negotiating an FTA with the strongest economy in the world.

[11] The "Motor Industry Development Plan" (MIDP) was launched in 1993 and follows-up the goal to reduce domestic prices, stabilise employment levels and encourage growth. The MIDP promotes the outward orientation of the automotive industry and has lowered tariffs. On the other hand, manufacturers benefit from cheaper inputs and a comprehensive export subsidy programme (DTI 2002:30).

5. Motivations, Chances and Risks of a SACU-USA FTA

Negotiations for a SACU-USA FTA started June, 2nd – 5th, 2003 and are supposed to be concluded by the end of 2004 (DTI 2003b:1).[12] Thitherto, the SACU economies benefit from the AGOA initiative. In Botswana 2,000 additional jobs in the textile and apparel industry have been created since 2001 (WTO 2003b:A1-94), in Namibia 7,000, in Swaziland 11,000 and in Lesotho 15,000 (USTR 2002:3).[13] South Africa's automotive exports benefit also from the AGOA initiative and have increased considerably. Under AGOA they are allowed to enter the US market duty free, so that automotive exporters save up to US$ 600 per car (NZZ, 13/01/03). Moreover, the USA is also an important export destination for industries that are of minor importance to South Africa's export earnings but important for employment, such as the textile and foodstuff industry, and the agricultural sector.[14] The DTI (2003b:6) summarises: "…*the United States has emerged as a key market for our manufacturing sector."* And further: *"…. an FTA would assure a stable basis for commercial relations to deepen."*

However, when discussing the impact of the AGOA initiative on the manufacturing sector of the SACU economies one has to highlight also the negative aspects. So far, the BLNS countries have only been able to attract (Asian) investment in the garment and textile industry. The jobs created offer bad working conditions and low salaries, and the (foreign-owned) firms do not show any linkages to local enterprises. The manufacturing of basic products leaves only a very limited amount of value-added in the country and brings no technology or learning effects. Moreover, the high dependency on US-trade preferences does even raise the vulnerability of African countries (UNCTAD 2003, Oxfam 2002). For Lesotho, Schuler (2002, as cited in WTO 2003b:A2-121) states: "*Benefits to Lesotho might … be fairly limited if the only effect of AGOA trade preferences is that Lesotho now exports larger quantities of the same products it has always been shipping to the U.S., without any expansion of exports into new product lines…"* It remains therefore doubtful whether AGOA helps the BLNS economies to diversify their export base sustainable.

Next to the objective of improved market access and greater export options, the SACU

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[12] The second round of negotiations took place on August 4th – 5th; the third round, where also the SACU and the US-business sector should be included, is planned to take place in Washington in October 2003 (AGOA News, 07/08/03).

[13] However, it is very difficult to quantify the job effects of the AGOA agreement. Although these jobs might have been created only due to AGOA, this agreement is also likely to divert capital and jobs into favoured industries and away from others (The Economist, 16/01//03).

[14] Thanks to AGOA, South Africa's clothing and textile exports to the USA rose by almost one third and accounted for US$ 356 million in 2001 (GoSA 2003:37).

economies hope to increasingly attract FDI when entering into a FTA with the USA.[15] However, the promising attraction of FDI proved to be also an illusion as for entering the TDCA: although European countries are responsible for around 90% of FDI to South Africa (compared to 6% from the USA), total FDI remained very low and averaged just below 1% of GDP in the period 1994-2001, comparing to 3.5% for countries with similar development status (WTO 2003b:A4-274).[16] This confirms the assumption that contractual agreements with industrial countries are only a positive but not sufficient condition for reaping FDI, and that domestic as well as regional factors are more relevant. The chances to benefit from the outsourcing of production seem to be questionable as well. The thesis that an FTA between developing and industrialised countries results in increased labour division, as argued by Piazolo (2001), Collier and Gunning, (2000), and Venables (1999), ignores the relevance of proximity in trade. Empirical evidence from the South African automotive industry supports the assumption that industrialised countries use their neighbouring countries for the outsourcing of production.[17] As neighbouring countries of the EU and the USA also show cheap labour costs but face lower transport costs than the SACU economies and are, moreover, able to deliver just-in-time as they close-by, SACU countries would not be able to compete successfully. Hence, the division of labour in regional trade is more likely to be beneficial for Eastern Europe and Mexico. Still, the SACU economies might benefit from cheaper industrial inputs and decreased consumer prices. This is most of all relevant for the BLNS countries that receive the vast majority of their imports from South Africa. Another concern for the SACU economies, most of all for South Africa, is that US-owned firms located in South Africa might close as they can now freely serve the southern African market from the USA. This risk is most of all evident for subsidiaries of large companies that produce homogenous goods. These firms might remove to more competitive markets and export their goods to the SACU.

Critics of the SACU-USA FTA argue that SACU countries already benefit from the AGOA initiative so that there is no need to negotiate an FTA with the USA (Makgetla 2003). However, this argument does not consider that the benefits of AGOA can be cancelled unilaterally at any time while an FTA is a contractual agreement that might also exceed pure trade relations. Moreover, the AGOA initiative requests the compliance of strict rules of origin, from which the

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[15] So far, SACU's textile and apparel industry increasingly attracted FDI thanks to AGOA. However, this investment came mainly from Taiwan and China and not from the USA (Tralac news, 11/07/03).

[16] Although European FDI inflows to South Africa increased from € -115 million in 1999 to € 1,526 million in 2001, outflows rose from € 2,933 million to 7,331 million in the same period (Eurostat 2002).

[17] Although South Africa was able to raise its automotive exports to the EU substantially since 1994, it could not keep pace with East European countries, such as the Czech Republic, Hungary and Poland (DTI 2002:29).

BLNS countries are only exempted until the end of September 2004. So, the SACU-US FTA also follows-up the goal to improve the market access of SACU countries to the USA and to bunch trade liberalisation issues with developmental elements, such as technical cooperation and trade capacity building (DTI 2003b:5). The USA has already signalled that they are ready to grant substantial assistance to help the SACU economies to meet technical standards and increase their trade capacities (Zunckel 2003:2). Besides this, it appears that the maintenance of AGOA is not a realistic option for South Africa. AGOA seems to be only a pre-stage for an extensive re-organisation of the US-trade relations with Africa that follows the re-organisation of the EU-African trade relations.[18] It is therefore likely that the USA is not only interested in a SACU-USA FTA, but in further FTAs that comprise its other important trading partners on the continents, namely Nigeria and Gabon.[19] As the US-trade representative Robert Zoellick states: "*If Europe does free trade agreements around the world, I welcome it. If we're too slow, it's our problem not anybody else's.*" (US Department of State 2003). Bilateral trade agreements are *en vogue* and do more and more substitute multilateral efforts. In 2002, 250 FTAs were negotiated worldwide; currently another 50 FTAs are under negotiation (FR, 28/07/03). For the EU and the USA bilateral trade negotiations become more and more attractive. Since the Doha Round they face increasingly the problem to preserve and accomplish their interests (agricultural protection, binding agreements for investment protection and competition control) at the WTO level.[20] While for developing countries the preference of bilateral to multilateral trade negotiations bears not only the risk of excessive demands of negotiation capacities but also that of decreasing power *vis-à-vis* the most powerful trading blocks. In case of the SACU the USA pointed out that it is ready to negotiate an asymmetric FTA that takes the different development levels of the countries into account. However, as the experience of the TDCA shows, a *general* asymmetry of an FTA might not be sufficient for the weaker party: although the TDCA is an asymmetric FTA in both, time frame and

[18] With the signature of the Cotonou Agreement in the year 2000 the EU and the group of African, Caribbean and Pacific countries (ACP countries) have changed their trade relations from unilateral preferences towards reciprocity. Until the end of 2007 the EU will enter into Economic Partnership Agreements (EPAs) with regional groupings of ACP countries that are in accordance to Art. XXIV, WTO Agreement.

[19] Nigeria, South Africa and Gabon account for 50%, 25% and 10% respectively of Africa's total exports to the USA in 2001. Nigeria's and Gabon's exports to the USA are mainly energy-related products (US Department of Commerce 2003).

[20] Though FTAs are originally not in conformity to WTO provisions because of discrimination against non-FTA members, the WTO allows the formation of FTAs and GATT according to Art. XXIV. However, this is only the case if trade barriers will be demolished for "...substantially all trade...in a reasonable length of time..." (GATT 1994, Art. XXIV). This formulation is generally interpreted as the liberalisation of 90% of trade within 10 years.

content,[21] South Africa will open its agricultural market to a larger extent than the EU (81% vs. 62%). Besides, it has to be taken into account that South Africa liberalises its market from a higher protection level (mainly in regards to industrial products)[22] and that its trade share with the EU is much larger than the EU's equivalent with South Africa (40% vs. 1.4%). Next to substantial revenue losses, most of all for the BLNS countries,[23] the TDCA implies an increased level of competition for the SACU economies. Although it is possible to argue that an increased competition can result in a more effective use of resources and can stimulate innovation effects, there is also the fear that it may lead to a growing number of bankruptcies and rising unemployment that could possibly result in de-industrialisation (Harvey 2000, Goodison 1999).

Even though it can be expected that the SACU-USA FTA will not increase the competition situation in the SACU in the same dimension as the TDCA, due to its lower trade volume, special attention should be given to the BLNS countries, as their low development level has to be taken into account (DTI 2003b). This implies the protection of sensitive sectors in the BLNS countries and the exemption of subsidised agricultural products from free trade. The negative experience with the TDCA, where South Africa agreed to open its agricultural market faster and to a higher extent than the EU, and was ready to include free trade of subsidised agricultural imports *"...is not a position that we [SACU] would like to see repeated in the current instance."* (Zunckel 2003). However, the USA, that increased the financial promotion of farmers under President George W. Bush, signalled already that they want to keep their export subsidies at a high level. Furthermore, the USA is planning to push genetically modified organisms under the agreements (Padayachee 2003). As those organisms would not only affect the SACU but the whole "Southern African Development Community" (SADC), where the majority of countries reject genetically modified food, this clause would not be acceptable for the SACU.[24] In addition, the import of gene-food would bring out a problem for SACU's agricultural exports to the EU, as genetically modified organism have to be declared for consumer protection reasons. Since European consumers are

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[21] The EU will open its market for 95% of all South African products until 2010, while South Africa will liberalise 86% of its market until 2012 (Council of European Union 1999).

[22] In 2010, the EU will have reduced its average tariffs for South African products from 2.7 to 1.5%, while South Africa will have shortened its average tariffs for European products from 10 to 4.3% in 2012 (Eurostep 2000:10).

[23] It is expected that the TDCA results in income losses of 5.3% for Botswana, 8.6% for Namibia and 13-14% for Swaziland and Lesotho (Goodison 2002:40-1). The compensation of these income losses by broadening and strengthening the tax base are judged as difficult (BoN 2002, Nowak and Ebrill 2003).

[24] All SACU countries are members of the SADC which is going to establish an FTA until 2008. While South Africa is ready to accept the import of genetically modified organism this is not the case for other SADC countries, such as Zimbabwe and Zambia. However, during famines, gene-food has already been imported from SADC members Angola, DRC, Malawi, Zambia, and Zimbabwe (taz, 10/09/2002).

very sceptical towards gene-food, SACU countries' agricultural exports to the EU would be likely to decline.

Furthermore, South Africa fears that the USA will exclude sectors where it has comparative advantages, like the steel industry, and that it may dump subsidised industrial products into the South African market.[25] Although, such trade practises could be launched under the WTO dispute settlement, this procedure is long and expensive. It would therefore be essential for the SACU countries that one agrees on an independent dispute settlement mechanism. However, it is assumable that the USA would reject the establishment of such an institution, as it wants to avoid the "institutionalisation" of its trade relations. The US-proposal on settling disputes on a company-to-state basis, instead favours a bias towards the stronger party (Makgetla 2003). Nevertheless, even if the USA agreed on the creation of an independent dispute mechanism this would not automatically imply that it is willing to cede control to this institution as evidence from the NAFTA dispute settlement mechanism shows.[26] So, even if the SACU countries would have the right on their side, the costs of adopting retaliatory measures might not outweigh the economic and political benefits.

Another concern for the SACU economies are the US non-tariff barriers in the areas of health, standards, licensing, patent rights and safety objections that could be used to stop imports from South Africa (Makgetla 2003). So, special emphasis must be given to the non-tariff barriers of trade to guarantee an improved market access. Moreover, SACU's management capacity is supposed to be overextended by the comprehensive agenda the USA wants to negotiate. This includes trade in services, investment, procurement, physiosanitary measures, and protection of intellectual rights (Makgetla 2003).[27]

Besides, SACU also faces internal constraints to achieve its interests. The SACU-USA FTA is the first trade agreement SACU negotiates as a trading block, following the restructuring and democratisation of the SACU by its new agreement in 2002.[28] However, the new SACU Agreement has not been implemented yet and own institutions and procedures for trade and dispute settlement have not been established. Besides this, different non-tariff policies, such as quantitative restrictions, customs procedure, standards and technical regulations, still exist.

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[25] In 2002, the USA introduced custom duties for their steel products (Netzzeitung.De, 13/05/2003).

[26] See Cánovas (2003) for an overview about the experience of the NAFTA dispute settlement mechanism.

[27] SACU's chief negotiator, Xavier Carim, has already confirmed that trade in services will be included to the SACU-USA FTA negotiations (Tralac news, 12/08/03).

[28] The new SACU Agreement is supposed to come into force in late summer 2003. So far, the SACU Agreement of 1969 is in force, which provides barely any institutions and is highly dominated by South Africa.

Moreover, the taxation system has not been harmonised (WTO 2003b:22).[29] Taking these internal challenges into account, the WTO (2003b: ix) warns that SACU's trade relationships with different countries and trading blocks are likely to overstrain its management capacities and bear the risk to further complicate its trade regime. Besides this, it should not be overlooked that the USA has FTAs with Canada and Mexico (NAFTA), Israel, Jordan, Chile and Singapore, and is currently negotiating further 34 FTAs with other developing and developed countries (DTI 2003b:5). For the SACU economies this implies an increased competition in the US market and the risk of raised competition in the domestic market if the rules of origin are not supervised perfectly.

Altogether it can be stated that there are several chances of a SACU-US FTA but also many risks as summarised in Table 3.

Table 3: Chances and Risks of a SACU-USA FTA

[29] Currently, when commodities are transported from one SACU country to another, the shipper has to apply for VAT/sales tax refunds from the exporting country and pays the relevant tax to the importing country (WTO 2003b:32).

Chances	Risks
Expansion of trade and market access opportunities received under AGOA	- Non-tariff barriers (e.g. technical and safety requirements) might frustrate enhanced market access options - Exclusion of sector's where South Africa has comparative advantages, e.g. steel industry
Effectiveness and innovation effects due to increased competition and cheap capital-intensive inputs → Product diversification process will be promoted and industrialisation strengthened.	- US-export subsidies, i.e. relating to agricultural products, result in adverse competition in the SACU - Import of genetically modified organism might constrain SACU's export options ↓ Increased and unfair competition could result in bankruptcies of firms and increased unemployment.
Increased attraction of FDI due to larger market and contractual binding to the USA	Closure of US-owned firms in South Africa due to direct supply from the USA.
Consumer effects: increased consumption due to price reductions	
Trade creation between the SACU and the USA due to increased division of labour.	Trade diversion vis-à-vis third countries due to dominance of complementarities in trade.
Negotiation of an asymmetrical FTA that takes the different development degrees into account and protects sensitive SACU industries for a certain period.	Comprehensive negotiation agenda, including services, investment, intellectual property, competition law and government procurement might overstrain the SACU
Receipt of financial and technical assistance, e.g. in the fields of customs administration, trade negotiations and investment promotion	Internal challenges constrain SACU's negotiation capacity
	Establishment of an independent dispute settlement mechanism and compliance with its decisions by the USA respectively is insecure
Contractual agreement negotiated in partnership results in increased political reputation.	Bilateral trade agreements do more and more substitute multilateral efforts. For SACU countries, this bears the risk of decreasing power vis-à-vis the USA.

6. Topics that need to be addressed in a SACU-USA FTA

As already discussed, the extension of AGOA is very unlikely to be an option for South Africa. However, as the USA is highly interested in negotiating an FTA with the SACU, the American ambitions should be used to push through fundamental issues that are in the interest of all SACU economies:

- *Improved market access for all products*. This requires less the reduction of (already low) tariffs but the guarantee that SACU countries do not face non-tariff barriers to trade, such as numerous technical standards and food safety requirements. Necessary quality and product standards should be clearly formulated in advance. This relates most of all to agricultural and processed agricultural goods that face numerous barriers to enter the US market. The USA should provide financial and technical assistance to meet any product and quality requirements. The comprehension of this assistance should be part of the agreement.
- *Support to address supply-side constraints.* This is particularly important for small- and medium-sized enterprises (SMEs), which represent the majority of enterprises within the SACU. SMEs need assistance to upgrade products and services in order to diversify their exports and to improve the added value. So, the provision of technical assistance by the USA should also be a part of FTA negotiations.
- *Asymmetry in the liberalisation schedule in both, time frame and content.* To address the extremely divergent development status of the USA and the SACU economies it is necessary that SACU opens its market to a lesser degree and has more time for market liberalisation than the USA. Asymmetry in liberalisation should include each single sub-sector.
- *Ban of genetically modified food*. One should keep in mind that the import of subsidised and genetically modified US-food is likely to harm SACU enterprises' domestic performance as well as their export success to the EU.
- *Exclusion of certain agricultural products.* Products that receive high US subsidies, such as beef and poultry, and are also produced by the SACU countries, should be excluded from the agreement. Besides, commodities that contain a high subsidy content and are also produced in SACU countries, such as processed meat and sugar products should be excluded.
- *Generous rules of origin that allows extensive cumulation.* The rules of origin valid for "Lesser Developed Countries" under AGOA should be maintained for the BLNS countries. Even though extensive rules of origin holds the risk that only little value is added in the BLNS countries as almost all inputs are imported and only cheap labour is added to the product, the BLNS countries are not able to build the necessary industries "out of nothing". Being able to produce inputs required for export products is a long-term project.
- *Technical assistance to broadening and strengthening the tax base in order to cope with*

fiscal losses. The BLNS countries, most of all Lesotho and Swaziland, are dependent on the income of customs duties. Due to the restructuring of the SACU Common Revenue Pool and South Africa's increased engagement in FTA negotiations, income from this source is shrinking although alternative income sources are not sufficiently built-up so far.[30]

- *Negotiate trade-related issues on a multilateral level.* The USA pushes to include issues to negotiations that go far beyond pure trade negotiations. As this amount of topics is overextending the SACU countries, it is recommended to focus on trade-related issues, such as intellectual property rights and investment procurement, within the WTO before negotiating specific details in a regional context.
- *Establishment of an independent dispute settlement mechanism.* To sanction unfair trade practices, such as safeguard measures and subsidies, it is necessary that a dispute settlement mechanism, consisting of all parties involved, will be established. However, even an independent dispute settlement mechanism does not guarantee that the legal practise will be observed.

In addition to the enforcement of these controversial subjects, there are also several points the SACU economies, most of all the BLNS countries, need to realise to make sure that they benefit also from the SACU-USA FTA. To formulate a SACU position and to realise a bottom-up approach consensus building within the SACU it is necessary that also the business community, trade unions, consumer groups, NGOs, academics etc. are involved. Although negotiations are on a Ministerial level they offer the chance to influence and to address needs and concerns. However, this requires and immediate pro-active approach:

- SACU countries' trade flows to the USA must be evaluated in detail. Which goods are currently delivered to the USA? Which sectors could benefit from a SACU-USA FTA? What are the current problems to export these goods to the USA (tariffs, non-tariff barriers, capacities)?
- How can SACU countries' trade potential with the USA be realised? What kind of support is needed to increase and expand SACU's export range to the USA? The technical assistance

[30] The revenue share of each country used to be determined by the size of its imports and unaffected by the amount actually collected in the Pool. However, according to the revised revenue sharing as agreed in the SACU Agreement 2002, the new formula bases on the actual funds available in the Pool. Thus, the new formula will initially translate any fall in the Pool into reduced revenues for any member state. By dint of the EU ("Economic Integration Programme to the BLNS – Phase I"), the BLNS countries are currently exploring options to broaden and strengthen their tax base and reform their public sectors.

required should be specified and be part of the negotiations.

- To realise the attraction of FDI from the USA, the motivations for FDI in all SACU countries and the hindrances must be addressed. In which sectors could SACU attract US-investment? Where does the country offer advantages for potential investors besides the traditional field of mining and agriculture?
- In which sectors could SACU build-up linkages with US-firms? How can SACU countries increase their profits under AGOA beyond the textile and apparel industry and build-up backward and forward linkages with local suppliers? When a SACU-USA FTA should help SACU to upgrade its products and processes the countries must try to ensure that a significant value-added process of production occurs their economies.

It is the business community that has to come-up urgently and be aware of the SACU-USA FTA. Only when the SACU countries know their strengths and weaknesses in detail they can address their interests and try to get the best out of it.

7. Conclusion and Policy Recommendations

This article analysed the chances and risks of SACU countries' approach to negotiate free trade areas (FTAs) with industrialised countries on the example of the USA and the EU. When analysing the structure of SACU-EU and SACU-USA trade, high similarities become apparent. SACU countries export predominantly primary and low-skilled, labour-intensive goods, while the import is dominated by high-skilled, capital-intensive commodities, like transport equipment and electronic products. Intra-industrial trade occurs only between South Africa and the EU and the USA respectively and comprises only a limited share of trade. Although the dominance of a complementary trade pattern is theoretically likely to result in increased trade diversion vis-à-vis third countries when entering into an FTA, this risk seems to be rather low due to SACU countries comprehensive trade shares with the EU and the USA and its approach towards "open regionalism" in the context of the WTO. However, although the trade-divertive effects against the rest of the world are supposed to be limited, the dominance of trade creation effects is also unlikely, as the trading partners show only very limited category groups of direct competition. Besides this, it seems doubtful whether the SACU countries will benefit from increased foreign direct investment (FDI) and outsourcing activities of US-firms when entering into an FTA with the USA. As the experience with the EU shows, a contractual agreement with an industrialised country might improve SACU countries' options to attract FDI but is not a sufficient condition. A prosperous selling market, a big pool of qualified labour, and political stability in the country and the region are judged as more important than an FTA with an industrialised country (WTO 2003b). Moreover, it should not be forgotten that the EU and the USA find SACU countries' advantages, such as cheap labour, good infrastructure and macroeconomic stability also in their peripheral areas, namely Eastern Europe and Mexico. As these countries have, moreover, a closer distance to the delivery area, SACU countries are not able to compete with them.

Although the detrimental effects due to increased competition are judged as rather low in a SACU-USA FTA (DTI 2003), as the USA delivers only around 12% of SACU's imports (compared to over 40% from the EU) remaining non-tariff barriers and US subsidies are likely to circumvent SACU countries' market access and result in an unjust competition in the SACU market. Besides, the import of genetically modified organism is likely to harm SACU's agricultural exports to the EU.

The AGOA initiative shows that SACU countries' trade potential with the USA has not been exhausted so far. The BLNS countries are thus highly interested in maintaining their generous rules of origin and all SACU countries want to keep their preferential access to the US-market. However, the SACU countries should undertake a detailed analysis about the net gains that occur from the AGOA initiative, taking the character of investment and employment as well as its long term prospects for the economy into account. When a SACU-USA FTA should help the SACU countries to upgrade their products and processes the SACU must ensure that a significant value-added process of production occurs in its economy.

"Trade, not aid" is the general motto (not only of the current US government) for the relations between developing and industrialised countries. However, "trade", namely an improved market access and generous rules of origin, is not enough to integrate the SACU countries into the world economy. Trade-related "aid", which means manifold assistance in the areas of customs procedures, capacities, finance, human capital, technical standards etc., is essential for the SACU countries to benefit from an FTA with the most powerful country in the world. Like the TDCA, the SACU-USA FTA should contain a strong development component that applies to a close, long-term cooperation. In contrary to the TDCA, the SACU-USA FTA should exclude subsidised agricultural products and open its market comprehensively for agricultural and labour-intensive products where the SACU countries have comparative advantages. However, such a strategy would imply less self-interest of the US government and more commitment to development policy. Based on the current US-policy towards developing countries, it is doubtful that the USA is ready to include contractual development provisions to trade negotiation or that it agrees on the establishment of an independent dispute settlement mechanism.

Whether South Africa's negotiation position is strong enough, to set through its interests, remains to be seen. However, the detailed formulation of their interests should be SACU countries prior concern. Only if chances and risks of a SACU-USA FTA are elaborated for all SACU members a common position for negotiations can be formulated.

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