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Likely revenue losses worry some Southern African states

South Africa and European Union conclude sweeping trade agreement

Busy commercial port in Saldanha Bay, South Africa: wide-ranging pact with EU will bring freer trade, but also reduce fiscal revenues of South Africa's neighbouring trade partners.

By ***Jacqueline Irving***

South Africa has signed a wide-ranging trade pact with the European Union (EU), which South African Minister of Trade and Industry Alec Erwin described as "the most comprehensive economic agreement" the country has ever concluded with "any other partner." But several of South Africa's smaller regional trading partners are likely to be hard hit by revenue losses and other repercussions of the new arrangement, concluded with the EU on 26 March.

Botswana, Namibia, Lesotho and Swaziland will stand to lose up to 15 per cent of fiscal revenue as tariffs are scrapped under the pact. Because of their strong economic ties to South Africa through the Southern African Customs Union (SACU), the deal means the four smaller economies will be obliged to accept a de facto free trade area with the EU. South Africa, however, must still win the unanimous support of its SACU partners before the deal can take effect.

And because of South Africa's membership in the 14-nation Southern African Development Community (SADC), the agreement has broader significance for other countries in Southern Africa, raising fears that many sectors across the region will become vulnerable to intense competition from European producers (see page 23).

The Trade, Development and Cooperation Agreement (TDCA) will open up South Africa's market to 86 per cent of EU goods over a 12-year period, while opening the 15 EU economies to 95 per cent of South African goods over a 10-year period. The EU — already South Africa's largest market, source of foreign investment and development aid — pledged to drop average duties on South African goods from 2.7 per cent to 1.5 per cent. For its part, South Africa agreed to cut average duties on EU goods from 10 per cent to 4.3 per cent. The deal is also notable for the EU because it constitutes the first time that the regional grouping has included agriculture in a bilateral free trade agreement. Following ratification by South Africa and the EU, the agreement is slated to be phased in beginning in January 2000.

Many exceptions and protocols

The result of nearly four years of hard-nosed bargaining during 22 rounds of talks, the final compromise includes many exceptions and protocols. Following two days of intense discussions in March, the final barriers to reaching agreement were swept away when Spain

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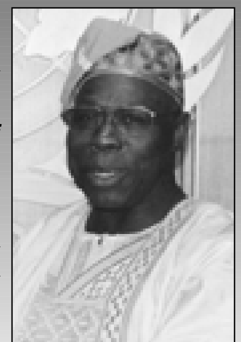
Country in focus: Nigeria



For the first time in 15 years, Nigeria has a democratically elected government. But President Olusegun Obasanjo (right), newly inaugurated on 29 May, faces a host of complex challenges confronting Africa's most populous nation. A legacy of mismanagement and decay, high indebtedness, uncertain international oil prices and persistent political turbulence will make the road to recovery a difficult one. Yet the continent's second largest economy also holds enormous potential.

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South Africa – EU

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and Portugal agreed to drop their long-standing objections to the use of the terms "sherry" and "port" by South African fortified wine producers in their domestic market for a further 12 years. The two EU states argued throughout the trade talks that the terms should be reserved exclusively for fortified wines produced in the regions of Jerez, Spain, and Oporto, Portugal.

Under the eleventh-hour compromise, this contentious issue is to be revisited at the end of the trade pact's phase-in period, when "new denominations" for those products will be jointly agreed by South Africa and the EU. Clearly displeased that the final deal basically grants the EU a right to veto the use of "port" and "sherry" on South African wine labels, the South African Port Producers' Association quickly announced its intention to challenge the decision by taking the case to the World Trade Organization.

South African Tourism Board

Vineyard workers in South Africa's Western Cape: EU compromised in dispute over labelling of South African wines.

Lingering concerns of Spain, Portugal, France, Italy and Greece that the EU's terms in the agricultural sector were too generous had also delayed conclusion of the deal. Fearing damage to their fruit, fruit processing and cut flowers sectors, in February the five EU states vetoed a draft agreement brokered by Mr. Erwin and Mr. João de Deus Pinheiro, European Commissioner for Development. But as the talks entered their final stages, all five states agreed to compromise. The final agreement grants South Africa sizeable zero-tariff quotas, which allow the country to export a predetermined volume of goods in these sectors on a duty-free basis.

Negotiations continue separately on a fisheries deal, as well as a wider agreement on trade in wines and spirits. The EU insists on maintaining trade restrictions on South African fishery products until South Africa opens its waters to EU fishing boats.

Controversial agricultural deal

South African fortified wine producers are not alone in harbouring concerns about the deal's impact on South Africa's economy. Some South African agriculturalists complain that only 61.4 per cent of the country's farm products will gain unrestricted access to EU markets, while trade barriers on another 13 per cent (including table wine) will be partially liberalized. In contrast, South Africa is obliged to scrap tariffs on 95 per cent of agricultural imports from the EU over a 10-year period.

A comprehensive study on the region-wide impact of the deal, carried out in April 1999 by the Johannesburg-based South Africa Foundation (SAF), refers to the agricultural side of the agreement as "perhaps the most controversial," while noting that South Africa nevertheless did manage to improve access for key products in the final negotiations. The study, *South Africa and the EU: the Free Trade Agreement and Related Developments,* refers to the EU's practice of generously subsidizing its agricultural exports (through the much-criticized Common Agricultural Policy) as a factor that will continue to impede the ability of South African agricultural producers to compete in international markets. Already hard hit by competition from heavily subsidized EU goods, local manufacturers of processed fruits and vegetables are expected to suffer further losses because the trade agreement obliges South Africa to cut customs duties on these products.

The SAF study describes the trade deal's initial impact on South Africa's economy as "limited" because significant sections of EU-South Africa trade are already "substantially duty-free." However, the study does conclude that over time, access to the European market will increase for South African producers, imported capital and consumer goods will be available more cheaply to producers and consumers, and the South African economy's competitiveness will generally increase.

BLNS adjustment costs

But it is the economies of South Africa's SACU neighbors — Botswana, Lesotho, Namibia and Swaziland (known as the BLNS countries) — that will feel the harshest effects of the trade deal. Having achieved the deepest form of regional integration on the African continent, SACU links the trade regimes of its five members and also interlinks the value of the currencies of SACU members, with the exception of Botswana's currency, the pula. Since trade between SACU economies is tariff free, a South African free trade agreement with the EU would therefore in effect be extended to the smaller BLNS economies.

And because the five Southern African countries share common external tariffs, the erosion of these tariffs over the next 12 years under the terms of the South Africa-EU trade pact is expected to impose considerable adjustment costs. BLNS governments rely heavily on revenue from customs duties, which provide around half of total government revenue for Lesotho and Namibia, about one-third of Swaziland's fiscal revenue and 14 per cent of Botswana's fiscal revenue, according to an April 1998 working paper issued by the European Centre for Development Policy

SADC pushing toward free-trade area

Trade ministers of 11 Southern African Development Community (SADC) member states are set to meet in Gaborone, Botswana, in early July to conclude talks on the schedule for liberalizing tariff and non-tariff barriers among their countries. "We've made substantial progress and I personally am looking forward to ratification of the free-trade protocol by October this year at the latest," Mr. Prega Ramsamy, SADC Deputy Executive Secretary, said recently. The trade protocol must be ratified by two-thirds of SADC members in order to begin phasing in the free-trade area over an eight-year period from 1 January 2000.

Significant progress already has been made since negotiations began last year. The 11 SADC members participating in the initiative have agreed not to raise tariff barriers beyond mid-1998 levels. The remaining three SADC members — Angola, the Democratic Republic of Congo and Seychelles — have not been participating in the talks, but may opt to join an agreed free-trade area at a later date. SADC members hope that a free-trade area will help the region attract more foreign capital and technology, create new jobs and boost the region's gross domestic product.

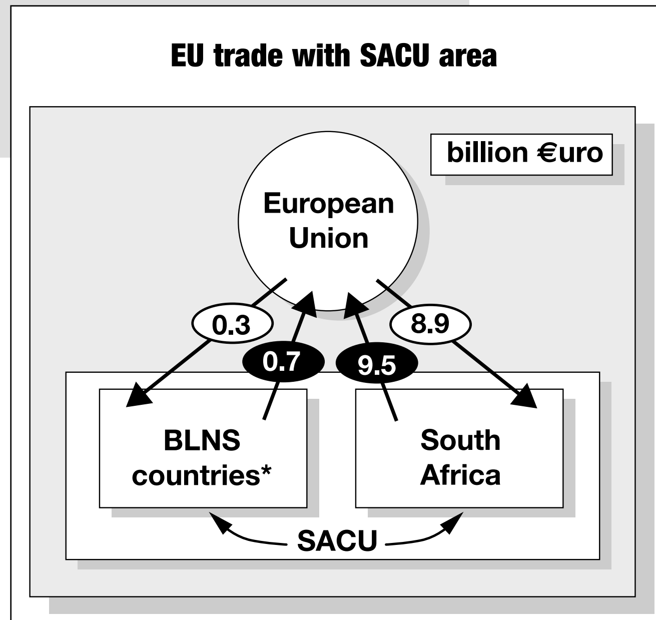
Management. With the EU as the source of 42 per cent of SACU imports in 1997, this means BLNS governments face a worrying loss in fiscal revenue. The BLNS countries could see revenue cutbacks of as much as 15 per cent (R1.9 bn to R3.5 bn per year), as tariffs on EU imports erode. Their customs revenue from non-EU imports may also fall as EU imports increase their SACU market share due to the lower tariffs, projects the SAF study.

Citing the results of studies commissioned by the BLNS states and financed by the EU, a January 1999 memorandum prepared jointly by the BLNS governments predicts that revenue losses associated with the South Africa-EU agreement will have "particularly severe" effects on the budget deficits of Lesotho and Namibia, which stand to lose some 13-21 per cent and 9-14 per cent of fiscal revenue, respectively. The revenue losses will also have "serious consequences" for Swaziland, says the memo, with only Botswana appearing to have any "real scope" for making the personal and corporate income tax increases that would be required to manage the fiscal adjustments.

Alternative revenue sources

"We certainly are looking at alternative [revenue sources] now, being aware of the fact that the revenue pool is not going to be there forever," Mr. Mpho Malie, Lesotho's Minister of Industry, Trade and Marketing, told *Africa Recovery.* He cited royalties from the country's massive Highlands Water Project and extra taxes on cigarettes and liquor as possible ways of compensating for some of the revenue shortfall. But if the reduction of fiscal revenue from the SACU external tariff barrier is "well planned and well phased, then we would be able to deal with it," Mr. Malie added.

EU trade with SACU area



*Botswana, Lesotho, Namibia, Swaziland

Source: EU Commission, April 1999

Noting that the phased nature of the trade agreement means that it will mainly affect fiscal revenues in the second half of the next decade, Ms. Musa Fakudze, Principal Secretary to Swaziland's Minister of Finance, says that her government has already begun considering measures to address the expected fiscal impact. Proposed measures include a review of the tax system as part of a revenue diversification package and improvements to public sector management.

"It is conceivable that the tax base will be broadened by being able to import more goods from the EU at comparatively cheap prices — including production inputs that have been barred from entering our markets because of the [SACU] tariff," Mr. Hidipo Hamutenya, Namibian Minister of Trade, recently told *Africa Recovery.* Taking an overall positive view of the trade agreement's medium- and long-term effects, Mr. Hamutenya sees the liberalization of the external SACU tariff as "an opportunity for us now to be able to develop our own capacity for revenue collection."

Similarly, Mr. Prega Ramsamy, Deputy Executive Secretary of SADC, explained to *Africa Recovery* how the scrapping of tariff walls could actually have beneficial effects on fiscal revenue and the overall economy in cases where producers buy inputs more cheaply from the EU and "plow back this money that they have not paid to the government in the form of customs duties into their own productive units, or to improve their businesses." And, of course, increased corporate profits could mean increased corporate tax revenues. But Mr. Ramsamy emphasized that creating a free trade area is a "win-win situation" so long as the economies involved take an "incremental approach."

EU support package

The EU must "fully recognize the seriousness of the adjustment effort" that the anticipated revenue cutbacks will impose on the BLNS countries, "if fiscal stability is to be promoted," urges the January BLNS memorandum. For its part, the European Commission stresses that the revenue cuts will occur only gradually and it has offered to provide a "support package" to ease possible difficulties in these countries as the external tariff is gradually dismantled.

In late May, the EU gave some $1.3 mn to Swaziland to help cushion the impact of the trade deal. "The idea is to help Swaziland cope with any fall-out or effects from the South Africa-EU free trade agreement," Mr. Pierre Bide, an EU economist in Swaziland, told the UN's Integrated Regional Information Network. "We want to help build economic capacity in that country." He said that similar compensatory packages were being considered for Botswana, Lesotho and Namibia, but that a meeting scheduled for June to take up the issue had been postponed for several months.

Other factors at play — such as SACU members' negotiations on reform of their own customs union — could lead to further erosion

of revenues from customs duties, Mr. Sam Geiseb, acting Chief Executive of the Namibia Chamber of Commerce and Industry, told *Africa Recovery.* At present, income from the region's customs and excise duties is pooled and then distributed to BLNS countries according to a complicated formula, with South Africa receiving remaining income after the BLNS countries are allocated their fixed share. This has been one of the thornier issues on SACU's agenda for some time: negotiations to reform the overall pact governing the regional organization have been under way since 1994. Only a few days after reaching agreement with the EU on the trade pact, South Africa and its four SACU partners met in Pretoria to discuss South African proposals for revamping the revenue-sharing mechanism.

At the same time, South Africa used the meeting to try to convince its SACU partners that its free trade agreement with the EU also would benefit their economies. This was particularly necessary as any bilateral trade deal with non-SACU countries requires the approval of the other SACU members.

Limited consultation

Because the agreement was "designed with a strong regional component," an April 1999 report on the TDCA published by the EU Commission specifically states the EU's conviction that "in the long-term the EU-South Africa free trade agreement will have net positive effects for Botswana, Lesotho, Namibia and Swaziland." According to the report, the BLNS countries were consulted regularly by both the South African government and the EU Commission to ensure that the trade agreement would "be of benefit for the Southern African region as a whole."

But Mr. Malie, Lesotho's Minister of Industry, Trade and Marketing, recently expressed concerns that BLNS trade ministers were largely "kept out of the picture" during the lengthy negotiating period. Pointing out that information on the emerging trade deal was relayed to BLNS ambassadors in Brussels rather than directly to the countries' trade ministers, Mr. Malie described both the South African and the EU negotiating teams as being "fairly cagey about what was being discussed." While making clear that the BLNS countries acknowledge there are more advantages than disadvantages associated with free trade in the long run, he felt that the SACU agreement meant "South Africa ought not to have moved into that kind of negotiation without taking members' concerns on board."

"We were anxious to take part, but unfortunately the EU actually told us that we should not participate in the whole thing," Ms. Fakudze said. "We all understood that these were supposed to be negotiations between South Africa and the EU. But despite that, they undertook to brief us now and again and they were also looking at our own positions as BLNS countries," Ms. Fakudze added.

SACU trade by region, 1997 (bn rands)

	SACU imports	SACU exports	%, total SACU trade
EU	54.6	41.1	35
Asia	40.9	28.2	25
North America	18.1	9.1	10
SADC	2.8	15.9	7

Source: South Africa Foundation

Flood of imports

Some sectors will be particularly vulnerable as SACU economies are opened to EU competitors. "The flood of imports of subsidized EU agricultural products will definitely impact negatively," said Mr. Hamutenya, noting that up to 70 per cent of the population in the SACU region is employed in agriculture. Many local observers argue that the export of cheaply priced agricultural goods by the EU to SACU countries constitutes a form of unfair trade known as "dumping" because of the generous subsidies under the EU's Common Agricultural Policy.

Agricultural products — such as dairy products in Namibia, canned fruit and jam in Swaziland, asparagus in Lesotho and flour-based products in Botswana — figured prominently on a list of sectors, cited in the BLNS memorandum, where "difficulties could emerge." Moreover, the document pointed out that the anticipated difficulties faced by SACU producers could range from a loss of domestic market share to EU producers in certain sectors, to a loss of region-wide (SACU) market share and, in some sectors, complete loss of the South African market. Furthermore, some SACU producers faced with large market-share losses likely would be forced to incur significant restructuring costs or close down. Some 12,000 full-time workers across the SACU region are potentially affected, according to the memorandum.

The April 1999 European Commission report concedes that some SACU sectors "might suffer adjustment costs" and admits that certain sectors may need continued protection. For example, throughout the trade pact negotiations, Namibia in particular was worried about its beef industry, with meat products accounting for some 70 per cent of the country's exports. Swaziland was worried about its sugar sector, which provides 17 per cent of its export revenue.

Speaking at a 1997 conference of the European Network for Information and Action on Southern Africa, Mr. Pinheiro specifically referred to the exclusion of sensitive sectors such as beef and sugar from any free trade agreement between the EU and South Africa as "the most effective defensive instrument."

Gains and losses to Southern Africa

Possible gains

- Some local businesses may be able to import inputs more cheaply, thereby boosting profits and corporate tax revenues.
- By being forced to acquire new technology and/or restructure operations, some local businesses may become more competitive.
- Some local businesses will gain greater access to European markets.
- Some imported consumer goods will be cheaper.

Possible losses

- Botswana, Lesotho, Namibia and Swaziland could suffer major fiscal revenue losses.
- Some local producers will lose domestic and/or regional market shares due to intensified competition from EU producers.
- Some local producers will be forced to shut down due to intensified competition from EU producers.
- EU producers could gain access to the South African market on better terms than those on offer to neighbouring Southern African firms.

During the conference, Mr. Pinheiro also made clear his conviction that "sensible plumbing and engineering" could keep painful short-term effects for South Africa and its SACU neighbors to "an absolute minimum and will be far outweighed by [the agreement's] positive effects."

Consequently, beef and sugar were both excluded from the final trade agreement. Moreover, the pact includes a safeguard clause that can be invoked to protect infant industries in the SACU region.

But the exclusion of beef from the free trade agreement will not protect Namibia's beef sector from cheaply priced EU beef products, predicts the SAF study, which notes that highly subsidized beef from the EU is already used in 70-80 per cent of all canned meat in South Africa.

Swaziland's sugar producers also find it difficult to compete with EU sugar sold in the region at artificially cheap prices. And the expected increase in EU exports of products containing sugar (such as beverages and biscuits) to SACU countries under the TDCA will further lower demand for Swazi sugar, according to Mr. Mike Matsebula, Chief Executive Officer of the Swaziland Sugar Association. Faced with lower demand within SACU, Swaziland will be forced to sell more sugar on the world market where the price is much lower than the price in SACU markets, says Mr. Matsebula.

Monitoring problems

"Of course, the problem is that although there might be some [safeguard] mechanisms in place, the fact that [SACU] is a common market really makes it difficult to monitor where these products land and how they actually flow in the market," added Mr. Geiseb.

The trade ministers for Lesotho and Namibia recently expressed similar concerns, stating that they really do not yet know whether the agreed infant industry safeguard clause and protection accorded to sensitive sectors will provide effective protection. Mr. Malie mentioned that he and the other BLNS trade ministers planned to meet in the near future to "flesh out some of the concerns that we have in order to take them up with the EU."

But Mr. Hamutenya stresses that there will be gains as well as losses associated with the trade agreement, with SACU "consumers certainly better off" in terms of the range of cheaper products available. He also believes that it is important for local beef and other agricultural producers to adopt a more aggressive attitude to marketing and to begin to diversify their export markets.

"No doubt the EU-South Africa trade agreement will force the pace of tariff reduction," says Mr. Hamutenya. Noting that South Africa built a high wall of protective trade barriers during the apartheid years, Mr. Hamutenya adds that "it's critical that sooner or later we're going to have to face up to this reduction because of World Trade Organization pressure that tariffs must come down." ■

Trade pact's wider Southern African impact

At the launch of the Southern African Development Coordination Conference (SADCC) in 1980, member states set as a key goal a reduction in their economic dependence on regional giant South Africa. But following the inauguration of a democratic government in 1994, South Africa was actually invited to join the grouping, renamed in 1992 as the Southern African Development Community (SADC). Some of the country's SADC partners now are increasingly concerned about the way in which South African suppliers are gaining increasing market share in the region.

Compounding these concerns are fears in some quarters that the South Africa-European Union trade pact will enable EU companies to use South Africa as an export base from which to make inroads into other Southern African markets, damaging local industries. SADC states also fear that EU exporters will gain access to the South African market on better terms than those available to neighbouring SADC firms.

Speaking at a 1997 conference of the European Network for Information and Action on Southern Africa, Mr. João de Deus Pinheiro, European Commissioner for Development, dismissed speculation that the EU-South Africa trade pact would hurt Southern African businesses, emphasizing that there are "good reasons to be optimistic." Mr. Pinheiro pointed out that the EU made clear in its trade negotiations that South Africa, as a minimum, should give the same trade concessions to its neighbours as it will give to the EU. "This very principle has also been laid down in the SADC trade protocol," he said. "Through this double-locked mechanism, the EU-South Africa trade talks serve as a crowbar for opening up South Africa to the region." Moreover, Mr. Pinheiro predicted that the entire region would benefit because growth in South Africa-EU trade would fuel growth in South Africa, in turn leading it to buy more from its neighbours.

Similarly convinced that the trade deal will have benefits for SADC as a whole, SADC Deputy Executive Secretary Prega Ramsamy explained that the asymmetry principle agreed between South Africa and its partners in the SADC trade protocol negotiations means that the South African "cuts in tariffs will be deeper for the SADC countries than for the EU." (The 14 SADC member states aim to gradually remove tariff and non-tariff barriers to create a free trade area; see box, page 21.)

Mr. Ramsamy also discounted fears that EU companies would be able to encroach on SADC markets by transiting goods through South Africa: SADC rules of origin specify that if more than 35 per cent of a product's inputs originate in SADC countries, the product gets preferential access to the SADC market. And certain bilateral agreements between South Africa and other SADC countries specify a threshold lower than 35 per cent. "It may be that those companies with a very high component of foreign imports won't meet the 35 per cent value-added [threshold] and might have problems penetrating the market," he surmised.

Describing SADC countries' concerns over the EU-South Africa trade deal as "legitimate," an April 1999 study by the South Africa Foundation nevertheless predicts that signature of the SADC trade protocol "will go a long way to providing equal access for products from SADC countries to the South African market." Moreover, the study says the EU-South Africa trade agreement may give an impetus to signing of the SADC trade protocol.

Mr. Hidipo Hamutenya, Namibia's Minister of Trade, shares this view: "There was really no sense of urgency [to trade liberalization in South Africa]. But now that South Africa is focused on the free trade agreement with the EU, they will have the opportunity to speed up the SADC protocol."

If South Africa responds to pressure induced by trade liberalization by acquiring technology to improve competitiveness, then this technology acquisition also will likely penetrate the rest of the SADC market, adds Mr. Ramsamy. "I think it's important in the context of globalization that we should use the region as a stepping stone to the global market, and this is where the South Africa-EU free trade pact comes in."