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COMPETITIVE LIBERALIZATION AND A US-SACU FTA

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Competitive Liberalization and a US-SACU FTA
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ABSTRACT

This paper evaluates a possible US-SACU (Southern African Customs Union) free trade agreement as part of a US approach to new preferential trade agreements characterized by the term "competitive liberalization." This is the idea that competition among large countries (US/EU) to negotiate preferential arrangements with smaller countries or regions will lower barriers, and eventually add fresh impulse to new multilateral WTO negotiations. In commercial policy terms, the US interest in such an arrangement lies in improved access to a smaller but more protected market where the EU already has preferential arrangements, and the SACU interest lies in improved access to a much larger but less protected market. There is also a SACU interest in weakening the trade restrictive effects of MFA quotas in the US for apparel imports. The risk of entrapment in extremely complex rules of origin arrangements which at times close markets (as in NAFTA and other US bilaterals) is a concern for SACU. Also, gains to SACU may be only temporary because of the US proposal to eliminate non agricultural tariffs entirely in the WTO by 2015. In key non commodity trade areas (services, investment, intellectual property, temporary entry of business persons), if other US bilaterals are any guide most liberalization requested will be heavily asymmetric if not unilateral on the SACU side. SACU does not currently cover any of these items since it is only a customs union, and prior negotiation will be needed among SACU countries. SACU also clearly has an interest in coordinating its negotiation with other US bilateral negotiating partners. These and other barriers to negotiation (including negotiating capacity constraints in several SACU members) will influence the outcome of negotiations.

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Introduction

This conference is devoted to the analysis of actual and potential regional trade initiatives proposed by the United States over the last year or so for various parts of the world. The broad rubric for this set of initiatives is "competitive liberalization," the idea that a sequence of barrier reducing preferential initiatives undertaken by the US and the EU in competition one with another for smaller regional markets can serve to spur global trade growth and also sow the seeds for a successful conclusion to the WTO Doha round in 2007 by partially reducing some barriers first (see Bergsten (2002) and Zoellick (2002)). These latest bilaterals stand in contrast to preferential trade arrangements in the 1980s and 90s such as the Canada-US Agreement and NAFTA, which were typically initiated by the smaller parties seeking security of access (or insurance, to paraphrase Perroni and Whalley (2000)). A counter argument to the claimed likely success of this new competitive thrust in moving multilateral liberalization forward is that by establishing margins of preference in large markets for middle sized entities, blocking coalitions of groups of countries who would otherwise lose margins of preference may be created who will oppose new multilateral liberalization. There is no theoretical reason why competitive liberalization will achieve its stated aim, but on the other hand it could. The proof of the pudding in our view will be in the eating.

Here we discuss a possible US bilateral arrangement with the Southern African Customs Union (SACU), consisting of South Africa, Botswana, Lesotho, Namibia, and Swaziland, assessing both its potential contribution to the overall US strategy and the impacts on SACU countries. Thus far, in addition to NAFTA, four US agreements have been concluded (with Israel (1985), Jordan (2001), Chile (agreed 2003), and Singapore (agreed 2003)). Several others

seem slated to follow, including Morocco, Australia, ASEAN and Central America. We assume there has been a conscious policy choice by the US to negotiate with the whole of SACU rather than only with South Africa, in contrast with the Europeans who have two separate agreements -- one with South Africa and the other with the African, Caribbean, and Pacific (ACP) countries under the Cotonou agreement, which includes the smaller SACU members, Botswana, Lesotho, Namibia, and Swaziland (BLNS). It is important to note that SACU is for now only a customs union; there is no coverage of key non commodity trade issues such as services, investment, intellectual property and other areas. If these are substantively included in a US agreement (they are effectively not, save competition policy, in the prior EU-South Africa agreement) there will need to be a prior internal SACU negotiation. Also, constraints on government capacity to participate are a major factor, both in terms of expertise and relative to other urgent policy issues in several SACU members. Whether the US should also seek wider humanitarian goals when negotiating (such as an offer of waiver of drug patent rights for treatment of AIDS) is another issue.

We assume, for now, that a US-SACU agreement would likely follow the broad contours of the recently signed Singapore and Chile agreements, although in practice there will of course be differences. These are NAFTAesque in incorporating duty free trade in goods (following transitional arrangements), with extremely complex NAFTA likes rules of origin in textiles/apparel and autos and many other areas, as well as related provisions covering intellectual property, investment protection, temporary entry of business persons, and bilateral dispute settlement. They go well beyond NAFTA in the coverage of services, as well as competition policy.

We suggest that SACU's interest, while that of 5 countries collectively, will likely be dominated by the interests of its predominant member, South Africa. These are multifaceted. South African trade policy was for many years highly protectionist, in part because of anti-apartheid sanctions, and focused on trade with local hinterland small market economies with transportation routes through South Africa. This policy focus has changed substantially in recent years with liberalization in South Africa, first under WTO negotiations (Uruguay Round), and later under the 1999 bilateral FTA between the EU and South Africa. South Africa is already liberalizing.

As Table 1 below indicates South African exports to the EU and to Asia are considerably larger than to NAFTA, and exports to the region are also large. Trade with NAFTA is not the dominant South African interest it might seem from the outside. Also, given the high unemployment rates in South Africa, any trade agreement perceived to exacerbate this problem may be hard to navigate through domestic opposition.

Table 1: South African Trade Shares With Selected Regions, 2000
(percentage shares)

Region	Exports	Imports
EU	34.2	39.8
SADC	10.0	1.4
NAFTA	12.5	12.9
Asia	18.7	24.6

Source: Cassim et al., 2002, Table 6.6

In this paper we make six points relating to the evaluation of the impacts such an arrangement and the possible benefits to the two sides. First, the gains in conventional trade policy terms lie in improved access for SACU to a large North American market, while for the

US the SACU market is much smaller. The asymmetry in size is partially offset by a substantial (if now diminished) asymmetry in initial barriers which are considerably higher in SACU. However, if multilateral elimination of non-agriculture tariffs in the WTO were to occur in 2015 as per the latest US Doha Round proposal, such benefits to SACU members would be temporary. A SACU-US FTA, coming on top of the South Africa-EU FTA might also speed the reduction of SACU's MFN trade barriers, better preparing the SACU producers for multilateral free trade in non-agricultural goods. But the reduction of trade barriers also means reduction of tariff revenue, an important consideration for some of the smaller SACU members, making the development of alternative revenue sources such as a value-added tax, all the more urgent. Potential complexities in rules of origin are another key issue.

Second, a potentially important benefit for SACU may be in access in the textiles/apparel sector that is free from quotas under the MFA (and trade regime that eventually replaces it). There has been rapid growth in recent years of apparel exports from SACU to the US, encouraged in part by the AGOA facility and some elements of the MFA phase-out, but some products still remain restrained by quotas. Potential benefits here for SACU may be significant, as well as for US fiber producers under the yarn forward rules of origin in textiles/apparel. Hence not only does possible multilateral tariff elimination enter, but also MFA elimination in 2004.

Third, the implementation of an extensive agreement covering services, intellectual property, and competition policy poses special problems for SACU. SACU does not cover these matters. The smaller countries are still in the process of developing updated competition policy statutes; intellectual property regimes are in process also, designed for compliance with WTO's

TRIPS; and financial institutions are regulated under national authorities in each SACU country. While these are all issues included in the Doha Round agenda, their potential inclusion in a likely more immediate bilateral with the US may encounter complexities and inconsistencies. Perhaps most importantly, if the US-Chile and US-Singapore arrangements are a guide, requested liberalization may well be highly asymmetric and in some areas (such as banking and insurance) involve larger (and even in some areas unilateral) concessions on the SACU side.

Fourth, the prior completion of a bilateral FTA between South Africa and the EU in 1999 and the EU-ACP Cotonou agreement covering the smaller members of SACU are further factors involved in a US-SACU negotiation. The US will want to restore their competitive position in SACU markets, giving SACU some negotiating room. The form and content of the two bilateral relationships – US-SACU and EU-SACU -- will raise issues with their joint operation. The EU arrangements sidestep the most significant non commodity trade issues likely to be raised by a US negotiation.

Fifth, the multi country nature of SACU, combined with the fact that it covers only goods trade may cause problems. SACU will have to both agree on how to treat issues such as services, intellectual property, investment, temporary entry of business persons, and competition policy and how to expand its coverage of these issues before it can negotiate bilaterally with the US. This raises the issues of negotiating capacity and institutional infrastructure. SACU's relationship with the wider SADC (14 Countries) grouping in the region (and individual SACU members' bilateral arrangements with Zimbabwe) will also likely need some refocusing as a result.

Finally, although the focus of a US-SACU arrangement will be on commercial policy

considerations, there are clearly wider implications in terms of humanitarian and developmental objectives for US foreign policy in the region. Even if the benefits of such an arrangement were to accrue more than proportionately to SACU (which given the services situation is by no means clear), such an arrangement still fits within wider US aid and development objectives towards Africa. These were the motives behind the recent US initiative for Africa Growth and Opportunity Act (AGOA). A bilateral US-SACU arrangement is complementary to this, and promises somewhat more permanence than the time-limited and unilateral AGOA. But key developmental issues may almost certainly be raised in a bilateral negotiation: How will poverty in Southern Africa be affected? What about patent rights of AIDS drugs? How will growth be affected?

Thus, overall, while we see a bilateral US-SACU FTA as highly negotiable, especially if it is limited in its services and related provisions, it may only offer SACU temporary and relatively small benefits if US MFN tariffs are already low. In contrast, liberalization in non commodity trade areas, and the associated regulatory reform within SACU members, may be more significant. The prior EU-South Africa arrangement provides added US incentives to pursue a bilateral, but also in its own way complicates things. Complexities arise with the overlapping regional arrangements already existing in the region. And foreign policy issues and domestic SACU macro policy concerns enter. But, both the reduction of barriers to goods trade, and liberalization of other areas, are likely to be growth-promoting and potentially poverty-reducing in SACU. Such a thrust is also clearly in the foreign policy interest of the US.

What is SACU?

SACU refers to the Southern Africa Customs Union, a grouping of five countries

(Botswana, Lesotho, Namibia, South Africa, and Swaziland) who maintain a common external tariff to third countries. Most trade goes through South Africa, and economically the grouping is dominated by South Africa which accounts for a large majority of the GDP of the region.

While the SACU arrangement dates from 1910, it has been renegotiated on various occasions, with the most substantial changes made in 1969 and 2002. The renegotiation completed in 2002 was initiated in November 1994, shortly after the launching of the Government of National Unity in South Africa. The five members of SACU are also all members of the 14 member Southern African Development Community (SADC), and several members of SACU have long-standing bilateral trade arrangements with other countries of the region. Furthermore, these arrangements are evolving independently of the proposed US-SACU free trade agreement. Also important to the background is the bilateral EU-South African trade and cooperation agreement of 1999, and the long-standing EU-ACP agreement which covers the smaller members of SACU, which we take up below.

The basic elements of SACU are a common external tariff, common excise duties, and a compensation (or revenue) distribution formula between members. The latest treaty changed the compensation formula, and introduced new governance and administration arrangements (Kirk and Stern, 2003). The SACU compensation formula had previously transferred revenues to the smaller members on the basis of shares of the value of their imports from all sources (including elsewhere in SACU) plus consumption of excisable goods. All the revenues from the common external tariff and the common excise duties on third country imports were paid into the South African Treasury, and after payments made to the smaller members, South Africa retained the

residual balance (Hudson, 1981)[1]. That arrangement under compensated the smaller members relative to direct application of the tariff to their third country trade before the implementation of the Uruguay Round tariff cuts (Leith, 1992), but in later years may have overcompensated them for the net costs of the common external tariff. The new formula simply divides up the revenue collected from the common external tariff, and does so on the basis of shares of intra-SACU trade.

In addition, the distribution of the common excise duties switched to a sharing on the basis of shares of GDP adjusted at the margin to favor the poorer members. The new arrangement means that any reduction in the customs pool due to lower average tariffs or duty-free access under the EU-SA bilateral and the proposed US-SACU bilateral arrangement will be of concern to those members that rely heavily on this revenue source -- Lesotho and Swaziland, and to a lesser extent Namibia.

New SACU institutional arrangements under the latest treaty also create a Secretariat to manage the affairs of SACU; a SACU tariff board to replace the South African Board of Tariffs and Trade which previously set and adjusted the common external tariff; and an independent ad hoc tribunal to arbitrate disputes. Establishing these institutions is still under way. At the time of writing the head of the secretariat has yet to be named, and the process for amending the common external tariff has yet to be established. A US-SACU agreement would thus be negotiated in a period when SACU itself is in institutional flux.

The new SACU agreement also raises for the first time the possibility of establishing common policies in a limited number of areas beyond tariffs and excise duties. There is a

[1] The old formula also contained an amplification of the share of imports plus exciseable consumption to compensate the smaller members for the disadvantages that they faced such as lack of fiscal discretion, plus

commitment to harmonize product and technical standards, and to apply product standards and technical regulations in accordance with the WTO. Members have agreed to develop common policies and strategies on industrial development. On agricultural policies, members have agreed to co-operate with each other, with the aim of ensuring coordinated development of agriculture. Each is committed to having a competition policy (but for most of the smaller members that remains to be achieved) and to cooperate on the enforcement of competition laws and regulations. Finally, members are committed to develop SACU-wide policies to address unfair trade practices between members. The new agreement does not set out the nature or detail of these common policies. Much remains to be done, and the capacity among the smaller members for policy development on intra-SACU issues is severely limited, given other very pressing policy questions that must be addressed. All of this evolution will also complicate a US-SACU negotiation.

The Content of a Possible US-SACU Arrangement

Predicting the outcome of a bilateral trade negotiation is always difficult, but to have a rough sense of what a US-SACU agreement could look like is clearly germane to any evaluation of both the impact of and interests of the parties to such an arrangement. Our assumption is that a US-SACU agreement would broadly follow the contours of the already negotiated US-Singapore and US-Chile deals, since such an agreement would be seen from the US side as fitting into its broad strategy of competitive liberalization.[2] As one of the more heavily protected significant markets around the world, from a US position such an agreement would have the

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minimum and maximum provisions.

[2] Our interpretation of these agreements in based primarily on the USTR (2002) summaries and the reports of the US Advisory Committee for Trade Policy and Negotiations. The lengthy texts of the US-Chile and US-Singapore agreements have only recently become publicly available.

explicit objective of restoring the US market position in the Southern African market given the 1999 EU-South African Free Trade Agreement and the Cotonou Agreement (see section 6 below).

The assumption from the US side is that the US would negotiate on its own and independently of its NAFTA partners. There is nothing in the structure NAFTA which precludes this. We see the following elements as a likely package which could emerge.

Trade in Goods

We would anticipate that all duties between the US and SACU would be removed on a bilateral basis. The majority of tariff line items (say 85% as in the Chile agreement) would become duty free upon signing. The remainder would be phased out over a five year implementation period.

Rules of origin, as in NAFTA, would most likely apply. These would likely be extremely complex and detailed. Not only would they involve a two way test of significant transformation (perhaps 50% of manufacturing content) and a change in tariff nomenclature on reexport but many detailed product and sectoral prisons would certainly apply. Brenton (2003) discusses how the Singapore-US Agreement in draft form contains 240 pages of text on rules or origin with mind bewildering detail.[3] A SACU arrangement would almost certainly encounter similar

[3] To quote Brenton (pp. 29-31) "The rules of origin for clothing products in the proposed Singapore-US FTA provide an example of how complex the rules can become and how difficult they must be for producers to satisfy and prove compliance. The following example is for men's or boy's overcoats made of wool:
620111 A change to subheading 620111 from any other chapter, except from heading 5106 through 5113, 5204 through 5212, 5307 through 5308 or 5310 through 5311, Chapter 54 or heading 5508 through 5516, 5801 through 5802 or 6001 through 6006, provided that:
(a) the good is both cut and sewn or otherwise assembled in the territory of one or more of the Parties, and
(b) the visible lining fabric listed in Note 1 to Chapter 62 satisfies the tariff change requirements provided therein.
The requirements of Note 1 are that
Chapter Rule 1: Except for fabrics classified in 54082210, 54082311, 54082321, and 54082410, the fabrics identified in the following sub-headings and headings, when used as visible lining material in certain men's and

problems as such rules are used as trade exclusion devices. In the two critical areas of textiles/apparel and autos/parts, NAFTA rules of origin would likely apply. These would involve duty free treatment only for apparel items made from US or SACU fibers, and US-SACU yarn and yarn processing (the so-called yarn forward rule). In autos/parts, where SACU exports have been growing rapidly in recent years, the 60% NAFTA local content rule for duty free treatment would most likely apply.

In agriculture, if the Chilean agreement sets a precedent, while there will eventually be duty free treatment, it will be phased in differentially across the two country groupings. In the US-Chile agreement Chilean agricultural duties disappear after 4 year period, while bilateral US

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women's suits, suit-type jackets, skirts, overcoats, carcoats, anoraks, windbreakers, and similar articles, must be formed from yarn and finished in the territory of a party: 5111 through 5112, 520831 through 520859, 520931 through 520959, 521031 through 521059, 521131 through 521159, 521213 through 521215, 521223 through 521225, 540742 through 540744, 540752 through 540754, 540761, 540772 through 540774, 540782 through 540784, 540792 through 540794, 540822 through 540824 (excluding tariff item 540822aa, 540823aa or 540824aa), 540832 through 540834, 551219, 551229, 551299, 551321 through 551349, 551421 through 551599, 551612 through 551614, 551622 through 551624, 551632 through 551634, 551642 through 551644, 551692 through 551694, 600110, 600192, 600531 through 600544 or 600610 through 600644,
There is also a second general rule for the chapter which is applicable
Chapter Rule 2: Apparel goods of this Chapter shall be considered to originate if they are both cut and sewn or otherwise assembled in the territory of one or more of the Parties and if the fabric of the outer shell, exclusive of collars or cuffs, is wholly of one or more of the following:
(a) Velveteen fabrics of subheading 580123, containing 85 percent or more by weight of cotton;
(b) Corduroy fabrics of subheading 580122, containing 85 percent or more by weight of cotton and containing more than 7.5 wales per centimeter;
(c) Fabrics of subheading 511111 or 511119, if hand-woven, with a loom width of less than 76 cm, woven in the United Kingdom in accordance with the rules and regulations of the Harris Tweed Association, Ltd., and so certified by the Association;
(d) Fabrics of subheading 511230, weighing not more than 340 grams per square meter, containing wool, not less than 20 percent by weight of fine animal hair and not less than 15 percent by weight of man-made staple fibers; or
(e) Batiste fabrics of subheading 551311 or 551321, of square construction, of single yarns esceeding 76 metric count, containing between 60 and 70 warp ends and filling picks per square centimeter, of a weight not exceeding 110 grams per square meter

Brenton then suggests that "the basic rule of origin stipulates of chapter but then provides a list of headings and chapters from which inputs cannot be used. Thus in effect the overcoat must be manufactured from the stage of wool fibres forward. In addition, Chapter Rule 1 stipulates that the visible lining used must be produced from yarn and finished in either party. This rule may well have been introduced to constrain the impact of the tolerance rule which would normally allow 7 per cent of the weight of the article to be of non-originating materials. In overcoats and suits the lining is probably less than 7 per cent of the total weight. The second chapter rule seems to provide very specific exemptions to the rules of origin for materials which are in short-supply or not produced in the US or

duties disappear in 12 years. Bilateral export subsidies will likely be banned, and a bilateral agricultural safeguards mechanism (snapbacks) installed. The treatment of sugar will be of particular interest to the South African province of Kwa-Zulu-Natal and Swaziland. If the Chile agreement is the precedent, the US will insist on SACU not replacing sweeteners exported to the US by lower-priced imports from elsewhere. Similarly, wine may be a contentious issue.

For the US, the opportunity is to gain improved market access to a much smaller but more heavily protected Southern African market. For Southern Africa, it is improved access to the large US market, with the added benefit of being quota free in textiles/apparel if content rules are met, should whatever trade regime which eventually follows on from the MFA (from 2004) continue to have some form of quotas in my newly negotiated post MFA arrangement.

Trade in Services

There has been a substantial amount of recent literature attention given to the impact of services liberalization in developing countries. Mattoo et al (2001) have claimed from econometric work large growth effects in developing countries (1½ percentage points a year) from certain forms of services trade liberalization. Dee and Hanslow (2000) have produced FTAP (a version of GTAP) model based calculations showing very large gains as a percentage of GDP for certain countries (11% for China). Some therefore argue that services liberalization is the key trade policy issue for developing countries in both regional and multilateral liberalization.

However, other studies produce much smaller gains, and there are issues with data and the representation of barriers in ad valorem form. Also these studies apply to genuinely

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in Singapore, see category (c) for example, and reflects firm specific lobbying to overcome the restrictiveness of these rules of origin when the original NAFTA rules of origin were defined."

multilateral liberalization, rather than the more asymmetric liberalization that may occur in SACU. Nonetheless, the potential is there for this to be the most significant part of a SACU agreement in terms of positive impacts on SACU members.

If the Chilean precedent is followed, SACU will be asked to take on significant liberalization in the areas of banking, insurance, securities, and other related services. Under the Chilean arrangement, US insurance firms have full rights (with only very limited exceptions) to establish subsidiaries or joint ventures in Chile for all insurance sectors (life, nonlife, reinsurance, brokerage). US banks and securities firms may establish branches and subsidiaries, and invest in local firms without restriction, and offer services to Chilean citizens participating in Chile's privatized voluntary savings plans. In telecoms, US phone companies can interconnect with Chilean networks at non-discriminatory rates. In E-Commerce and Digital products, duties are based on physical value (e.g. the disc, not the music). We anticipate these and other components being in a US-SACU agreement, but perhaps with little by way of new liberalization occurring on the US side.

The services area will pose special problems for SACU. First, with no coverage of services in SACU, if SACU is to negotiate as a single entity it will first have to agree on common positions among its members. Beyond trade and directly related issues, it is important to note that there are no SACU-wide arrangements on most of the non-goods trade issues likely to be on the agenda for a US-SACU bilateral.

Second, service sectors in each SACU country are heavily regulated, and if a US-SACU FTA includes services, major change both within SACU members and between members will be required in this area.

Third, and perhaps most importantly, the liberalization requested of SACU could well be asymmetric and heavily so in some key sectors such as banking and insurance. While four of the five SACU members are part of the Rand Monetary Area,[4] whose currencies are irrevocably fixed to the South African Rand, licensing of banks and banking supervision in each SACU member is handled by each country's central bank under its national legislation. The same applies to insurance and other financial services such as mutual funds. In most cases the national legislation requires incorporation and capitalization in the country. The emphasis has been on maintaining solvent financial institutions to protect depositors' and policy-holders' interests. Any proposal to establish free trade in banking and other financial services between SACU and the US would require significant modification of current practices in these critical areas and in different ways in each SACU country.

Investment

Major bilateral protection of investors along the lines of the NAFTA agreement will likely be proposed. These may include rights to establish, acquire, and operate investments in either region on an equal footing; rights to due process protection and fair market value compensation in the event of expropriation. Local content rules on inputs to be used by investors will likely be banned. None of these provisions currently apply under the SACU treaty. Some SACU members have investment promotion schemes that are biased in favor of citizen entrepreneurs.

Intellectual Property

Here existing (or get to be implemented) WTO levels of intellectual property protection

[4] The exception is Botswana which established its own independent currency in 1976, and has since accumulated over US$5 billion in foreign exchange reserves.

will likely be enhanced in several ways, as in the Chilean agreement. There will be protection for copyrighted works in digital form, expanded protection for patents and trade secrets, and firmer penalties for piracy and counterfeiting.

SACU currently does not deal with IPR issues, and in some of the countries there are effectively only limited (or no) intellectual property regimes given the lags in implementation of WTO disciplines. This will again pose tough challenges and require major change for some SACU members.

Competition Policy

SACU members will likely be requested (following the Chilean agreement) to install/maintain competition laws that prohibit anti-competitive business behavior, and regulate state owned enterprises. At present, laws governing competition in SACU members are focused not so much on ensuring open markets but on preserving certain activities from outside competition. The new SACU agreement requires members to have competition policies. Whether or not individual country laws can conform with the range of commitments contained in the US-Chile agreement is an open question.

Government Procurement

The Chilean agreement in effect extends WTO procurement agreements to all regional and municipal governments in both countries; and a US-SACU agreement could take similar form. This may require abandonment of domestic preference in government procurement in place in several SACU members, and could be particularly problematic for South Africa with its separate provincial jurisdictions.

Customs Procedures

Information sharing, and transparency provisions would likely apply here. There are no formal common customs procedures currently in SACU, but in practice there is considerable co-operation in dealing with fraud and similar matters. Plans are afoot to create a common customs declaration form to be used to document each transaction for each of the exporting and importing countries on intra-SACU trade.

Temporary Entry of Personnel

If the Chilean model is followed, NAFTA style temporary entry visas will also apply. They are without limit for entry to Chile, but on the US side limited to holders of 4 year degrees, and subject to a numerical cap. SACU, we presume, could be asked to enter into similar arrangements.

Labor and Environment

On both labor and the environment, given the flux on these issues in the WTO, the likely content of a US-SACU bilateral agreement is less clear. Worker rights as set out in the ILO will likely be reaffirmed, and there will likely be joint environmental projects, as in the Chile agreement. Special environmental dispute settlement procedures for environmental cases could enter. Some form of environment impact assessment might also be agreed.

Dispute Settlement

Bilateral dispute settlement as in the Chilean agreement may be adopted. An important new feature could be provision for fines to enforce rulings. With the thrust to establish new FTAs, pressures on US bilateral dispute resolution from the number of potential pairwise panels could become a factor. If NAFTA provides any lessons it is that bilateral dispute resolution arrangements will not fully restrain US contingent protection practices in anti-dumping and

countervailing duties.

In sum, a US-SACU agreement could involve bilateral free trade in goods (with rules of origin, especially in textiles/apparel and autos), asymmetric liberalization in services, bilateral investment protections, strengthened intellectual property arrangements, arrangements on competition policies and a series of related measures in other areas. Bilateral preferential access in goods would be temporary if eventually superceded by WTO non-agriculture tariff elimination in the Doha Round in 2015 as the US has proposed.

Issues in Non Commodity Trade Areas

In many ways, it is the non commodity trade areas of a US-SACU agreement which are simultaneously the most challenging and rewarding in terms of the potential benefits which could accrue to both parties, but also the most problematic. SACU members will face many difficulties, not the least of which is that SACU is only an agreement covering trade in goods. Present SACU negotiating capability in these areas is extremely limited. In the WTO it is accepted that there is a need to develop negotiating capacity in these areas in lower income countries. Similar issues now arise in preferential trade agreements. These and other issues are explored in the recent paper by Mattoo and Fink (2002).

Another central issue in this area will be the extent to which potential commitments by SACU are both in reality and perceived to be unbalanced. If the broad deal is understood effectively as bilaterally accelerated tariff removal in goods for what anyway (under current US WTO proposals) would largely disappear by 2010 and totally so by 2015, in return for large and mainly unreciprocated liberalization in non trade areas by SACU, such a deal may well be rejected by SACU as insufficiently balanced.

In services it is likely that commitments will be sought by the US across a wide range of sectors. Taking the Chilean agreement as a guide, this could include some degree of two way commitment in a list of peripheral services, including computer and related services, telecom services, audiovisual services, construction and engineering, tourism, advertising, express delivery, professional services (architects, engineers, accountants), distribution services, adult educational training, and environmental services. However, the core services of banking, insurance, and telecoms could well be areas where mainly only SACU commitments would apply. These would open cross border supply of insurance and banking services, brokerage, retirement income advice and management and other services.

In investment, the focus will likely be on investor guarantees, somewhat similar to Chapter 11 arrangements in NAFTA. Intellectual property would strengthen and extend arrangements into new areas including digital content. An especially significant set of issues will likely arise with drugs and patent protection related to social calamities, as discussed recently in the WTO. SACU will no doubt raise issues connected with AIDS related medications.

In competition policy, South Africa's post-apartheid policy thrust has been to open up markets to competition, and the smaller SACU members have also all been developing new competition policies harmonized with the South African approach. These approaches may not be compatible with the US approach. However, one major benefit to SACU of a SACU-US agreement to SACU consumers might be to allow freer entry of US firms to compete with local firms.

Negotiating new bilateral labor migration rules poses special difficulties, and any

liberalization on the US side will likely be numerically restricted, and limited in other ways as in the Chilean agreement. The parallel development of US-SACU dispute resolution mechanisms may also prove challenging. SACU's new agreement, for instance, contains an untried provision under which the council of ministers refers disputes to ad hoc tribunals.

We see these non commodity trade issues as perhaps the most significant quantitatively for both SACU and the US (even if few or no studies exist), and the hardest to negotiate. There is both limited capacity to negotiate on the SACU side, and a perceived (if not actual) one sidedness to this part of any negotiated arrangement.

Third Parties

Any new bilateral preferential trade agreement will potentially have effects on third parties with which there are existing preferential trading arrangements. In the case of SACU, members are involved in preferential trading arrangements with two important third parties: the European Union (EU) and the Southern African Development Community (SADC).

The EU-South Africa and the EU-ACP (Cotonou) Agreements

One motive for the US to establish trade and related agreements in many parts of the world is undoubtedly competition with either earlier or proposed EU initiatives made in the same direction.[5] The idea is to restore a level playing field for US exporters in foreign markets from EU preferential agreements. It is likely then that the EU-South African agreement of 1999 has been one factor in the US identifying SACU as a bilateral target for a US FTA negotiation.

Following its change in government, South Africa had hoped to be included in the EU's agreements with former colonies; the Africa, Caribbean, and Pacific (ACP) countries. The

asymmetrical nature of the then EU-ACP agreement, providing ACP countries with preferential access to the EU market while not requiring the reverse, was particularly attractive to South Africa. Arguing that certain aspects of the South African economy resemble a developed economy, the EU instead developed a two track arrangement with South Africa: (1) a free trade agreement between the EU and South Africa, signed in 1999; and (2) inclusion of South Africa in the renewed arrangement with the ACP, the Cotonou Agreement (2000), but (3) explicit exclusion of South Africa from the trade arrangements of the Cotonou Agreement and from access to the soft loan European Development Fund.[6]

The FTA portion of the EU-South African agreement covers 90% of bilateral trade, but has some significant exceptions. Separately negotiated agreements cover entry into the EU of wines and spirits, as well as fisheries (still in process). South Africa continues to restrict entry of various industrial items, including motor vehicles, and some textiles. In addition, there are safeguard provisions when imports cause injury to a national industry.

Several trade related issues, such as competition policy, intellectual property rights, free movement of capital, and technical barriers to trade are covered, but importantly core services (banking, insurance, telecom, and transportation) are not. Generally the language is couched in terms of objectives, with ‘consultations’ and ‘close cooperation’ as the mechanisms. In both the EU-SA and the Cotonou agreements the EU includes a reference to the importance of democratic principles, human rights, and the rule of law. Each party is free to employ ‘appropriate measures’ unilaterally if the other violates those principles.

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5 The Congressional Research Service paper on FTAs (Cooper 2003) notes that the EU has FTAs with a number of countries, and explicitly notes the existence of the Canada-Chile and Mexico-Chile FTAs, and the Japan-Singapore FTA.

[6] The Cotonou Agreement also includes provision for phasing in reciprocal trade concessions commencing 2008.

From a US point of view a US-SACU agreement would redress the trade advantage currently enjoyed by EU exporters over US exporters in the South African market, and give preferences to US exporters in the rest of SACU markets. As a driver of a US-SACU agreement, the role of the prior EU-South Africa agreement seems clear. But in the key areas of autos and textiles different trade rules will apply. It is very likely that the US would seek preferred access to the still highly protected SACU auto market. Yet if multilateral elimination of non agricultural tariffs were to be achieved by 2015, all such effects would be temporary.

Also, it is important to highlight the sharp differences in architecture between the US and EU approaches. The EU negotiates defacto separately with South Africa and other SACU countries, recognizing their differences. The EU agreement explicitly states the wider humanitarian goals that underlie wider foreign policy, and proceeds to link them to trade. The EU agreement does not deal centrally with service and key non trade issues. If the US objective were only to compete with the EU, maybe it would do the same. Maybe the strategy is to go beyond the EU in to new areas to establish new US advantage. Maybe the EU response will be to renegotiate, also extending into new areas. All these issues await resolution, but the need to consider the interplay between these agreements is inescapable.

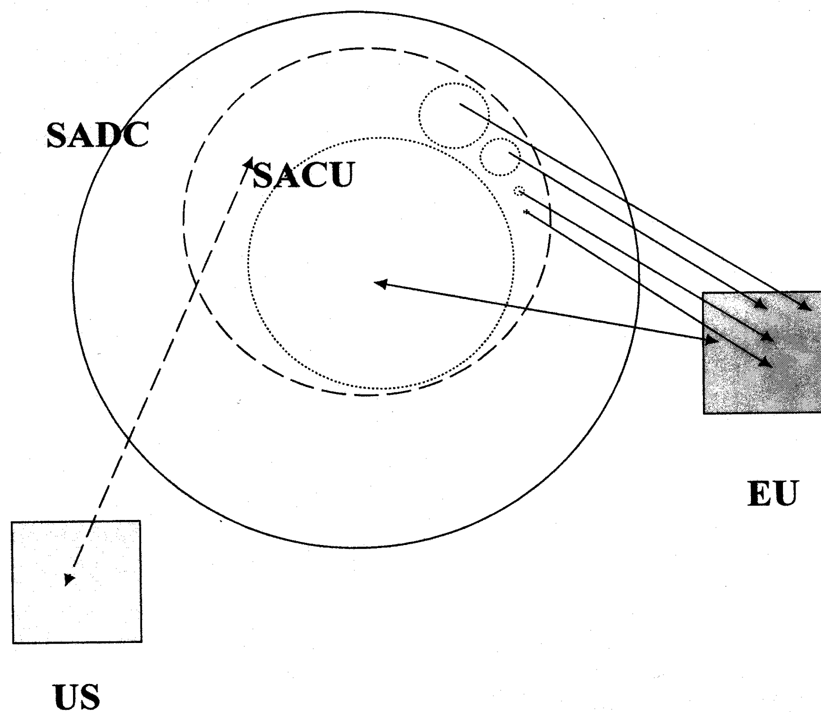
The Southern African Development Community

The five members of SACU all belong to the 14 member Southern African Development Community (SADC), and most SADC members have signed a FTA protocol[7] effective September 2000, which envisions almost complete intra-SADC free trade by the year 2012. Hanging over the SADC FTA are a complex set of rules of origin, which differ across different types of goods (Flatters 2002). Rules of origin are not an issue within SACU, given the common

external tariff.[8] Hence, the potential for inconsistencies between the protection of goods originating within SACU and goods originating elsewhere within SADC is substantial.[9] It is perhaps for this reason that in mid 2002, the SADC Executive Secretary proposed that SADC move to a customs union. This complex combination of actual and proposed preferential trading arrangements is illustrated in Figure 1.

Figure 1

Overlapping Trade Relationships Between SACU, the US, SADC, and the EU



7Angola, DR Congo, and Seychelles have not yet signed the SADC trade protocol.

[8] Rules of origin issues arising from the EU-SA FTA are avoided by EU treating all SACU origin inputs as South African for purposes of calculating origin, and the BLNS being content to purchase lower-priced goods that enter duty-free through South Africa.

9 A further wrinkle is that two members of SACU (Namibia and Swaziland) also belong to the Common Market for Eastern and Southern Africa (COMESA), although they cannot grant duty-free entry to COMESA origin goods.

Several SACU members also have bilateral free trade agreements with regional non-members, including Zimbabwe, Malawi, and Mozambique.

The overall picture that is one where both the US and the EU engage in a series of bilateral preferential arrangements, Ronald Wonnacott (1996) calls a 'hub and spoke' system (Wonnacott, 1996): The hubs in this case are either the US or the EU, and the spokes are the individual countries or regions that have or are considering preferential bilateral trading arrangements with each hub. While competition between the EU and the US may hasten multilateral free trade, in the meantime there may be other significant effects that need to be included in any evaluation of impact. For each spoke of an existing preferential arrangement, the addition of another spoke will reduce its margin of preference into the hub. This effect applies particularly to the non-SACU members of SADC in their relationship with SACU. Further, the individual spokes could gain by collectively dealing with the hub rather than individually. For this reason, SACU clearly has an interest in coordinating its negotiations in concert with other US bilateral partners.

Within this context of preexisting cross cutting preferential trading arrangements in Southern Africa, new institutions barely underway, and a substantial unfinished agenda of intra-SACU policy development, the proposed US-SACU FTA poses challenges to SACU to both determine and promote the interests of its members in any negotiations. It is in part because of all these complexities, limited intra-SACU coverage across non trade areas, complex bilaterals, limited negotiating capacity in some of the smaller SACU countries, and the need for a prior SACU negotiation that an obvious prior question arises. From the point of view of all the parties

to the proposed SACU-US FTA, might not a dual track arrangement, of the US-SA and US-BLNS, in a manner similar to the relationship between the EU and SA and the BLNS (under the Cotonou Agreement) be simpler, easier, and quicker to negotiate? The economic impacts for the US would be much the same, but the complexities much reduced. Alternatively, an asymmetric treatment of the smaller/poorer SACU members, allowing a longer period of adjustment, might be contemplated. We put such issues to one side, given the stated US aim of bilaterally negotiating with SACU, and turn now to assessing the impacts of a US-SACU arrangement.

Assessing the Impacts of US-SACU Arrangement

Evaluating the impact of a possible US-SACU arrangement involves an assessment of what the initial barriers to flows of goods and services and levels of intellectual property protection are used by the two parties; the relative sizes of the potential markets, and the sizes of current and potential flows; as well as the strength of possible negative trade and service diversion effects. Once these possible impacts are known, then an evaluation of the narrower commercial policy incentives to participate can be judged for the two parties. This discussion puts on one side, for one moment, whether there is also a humanitarian/development/implicit aid objective for the United States; so that contributing to a rebuilding of African society even if the balance of commercial advantage goes against the US, might nonetheless motivate participation. There are also other initiatives already underway, including the US AGOA of 2000, and so a bilateral agreement also needs to be evaluated relative to a changing trade policy environment.

The principal trade flows in the bilateral US-SACU relationship are set out in Table 2. The US now runs a substantial merchandise trade deficit with SACU, the outcome of rapid

growth of SACU exports to the US in recent years, against stagnant US exports to SACU.[10] US imports from SACU are dominated by platinum (for catalytic converters) and diamonds, which are already largely duty free, but SACU exports of autos/parts, and apparel are growing rapidly. US exports of manufactures to SACU face significant tariffs, which are still moderately high, although they have come down substantially in recent years (Table 3).[11] Service trade flows, for now, are probably small, but data are not readily available.

Table 2: US-SACU Trade Flows in Goods
(US$, millions)

HTS No.	**IMPORTS FROM SACU**	**1996**	**1997**	**1998**	**1999**	**2000**	**2001**	**2002**
7110	Platinum	744	754	1,006	1,002	1,529	1,534	1,173
7102	Diamonds	105	163	163	144	342	474	517
87	Motor vehicles & parts	46	57	76	120	150	359	573
61&62	Apparel	143	180	205	241	321	441	603
72	Iron & steel	338	306	467	393	462	289	302
26	Ores, slag & ash	274	282	330	340	269	243	248
84	Mechanical appliances	79	72	91	121	154	253	235
	Other	741	899	912	1,027	1,252	1,178	1,108
	Total	2,470	2,713	3,250	3,388	4,479	4,771	4,759
HTS No.	**EXPORTS TO SACU**							
84	Mechanical appliances	793	756	763	578	541	540	501
88	Aircraft	162	178	733	400	609	631	317
87	Motor vehicles and parts	260	264	286	147	238	457	287
85	Electrical mach. & equip.	239	238	284	199	198	200	160
90	Optical instruments	149	157	168	155	148	153	150
	Other	1,509	1,408	1,356	1,148	1,214	1,142	1,139
	Total	3,112	3,001	3,590	2,627	2,948	3,123	2,554
BILATERAL BALANCE		642	288	340	(761)	(1,531)	(1,648)	(2,205)

Source: USITC, Dataweb.

[10] A large part of the change is probably due to the dramatic real depreciation of the Rand against the US Dollar.

Our evaluation of the impact of a US-SACU agreement follows on from what we have set out in the earlier section. While labeled as a Free Trade Agreement, the reality of such an agreement is more complex than this. A Free Trade Agreement suggests the central element as trade in goods, but much more is involved in this case (services, investment, intellectual property, labor mobility, dispute settlement, and others). Also, post Uruguay Round formal tariff barriers are already low.[12] While they are significantly higher on the SACU than on the US side, save for remaining tariff peaks in textiles and apparel, average tariffs facing SACU exports are already low in US markets. These may anyway be phased out through multilateral negotiation in the WTO Doha Round. More significant access issues for SACU are contingent protection (antidumping and countervailing duties). These are governed by US quasi-judicial process which is unlikely to be affected by a bilateral US-SACU arrangement.

Table 3:
SACU Tariff Structure, 2000 and 1997

	No. lines 2000	Imports (%) 2000	Weighted Avg., 2000	Unweighted Avg., 2000	Unweighted Avg., 1997
Agriculture	295	0.8	1.4	4.2	5.6
Mining	107	14.5	0	1.2	1.4
Manufacturing	5479	84.7	8.6	6.7	15.6
Gas	2	0	0	0	0
Total	5883	100	7.3	6.5	15.1

Source: Cassim et al., 2002, Table 3.11
Note: The source indicates that the tariff data refer to South Africa. However, since there is a common external tariff, and many of the goods destined for the BLNS markets pass through South Africa, the data are a reasonable representation of SACU's tariffs.

[11] The IMF (2002) reports that the average unweighted tariff rate in 1990 was 30%.
[12] See also, however, the discussion of effects of regional trade agreements in Burfisher, Robinson and Thierfelder (2003) that stresses new trade theory considerations.

In contrast, major barriers remain in the services area where domestic regulation segments services markets in banking, insurance, telecoms, and transportation services. This segmentation is both across US-SACU, and within SACU. While bilateral service US-SACU flows are still small relative to goods flows (data is a major problem here), the barriers which apply through licensing and other restrictions are major. The key here, if the Chilean agreement is a guide, is that what the US will likely seek is in many ways one sided liberalization: i.e., freer entry for US service providers to SACU markets with little reciprocal access improvement offered to US service markets. It may be that SACU providers cannot anyway compete in US markets, but unless improved access is offered this will never be tested.

In addition, liberalization offered in other non manufactures trade areas is also highly asymmetric in the Chilean case. Short term entry permits for professionals are unconstrained for entry to Chile, but are to be numerically capped to the US. Agricultural liberalization occurs over four years on the Chilean side, but over 12 years on the US side. Investment protections are designed for US investors in Chile, rather than for Chilean investors in the US.

Thus, one could view the US-Chile agreement as primarily an asymmetric package for the liberalization of non manufactures trade barriers. If a US-SACU negotiation takes this same direction, its evaluation on the SACU side may be influenced by this perception. SACU exporters in textiles might gain by being quota-free in the US market, but depending on what follows the MFA, this may be worth less than might appear. Given the relative absence of services arrangements in SACU, to be plunged into effectively unilateral liberalization in services (which did not occur with the EU-SA agreement of 1999) may be hard for SACU to deal with institutionally and politically, even if there are substantial domestic consumer benefits.

The more direct impacts which may follow on trade and other bilateral flows are unfortunately conjectural at best at this point. Mattoo et al (2003) assess the impacts of AGOA as surprisingly small, and attribute this to the restrictions from rules of origin. Bhagwati (2002) suggests that the majority of benefits for smaller entities such as SACU from these types of arrangements could potentially be achieved by unilateral liberalization without the trade diversion costs of regional agreements, although this neglects the access benefits to US markets. Collier and Gunning (1999) discuss reasons for poor African growth and do not have access barriers high on their list. Brenton and Machin (2003) highlight the role of rules of origin in making EU agreements work, something that also may apply to a US-SACU arrangement.

Inter alia, most trade liberalization and removal or lowering of trade barriers is viewed by economists as good; and economic theory clearly suggests that as the smaller partner SACU should benefit more than proportionately from a US-SACU arrangement. Theory also suggests that there is likely to be trade diversion where existing barriers are high, such as in services. But the combination of an FTA with temporary and small barriers in the large market and all the add on diversions does not guarantee that such an arrangement will be welfare enhancing. Also, such an arrangement in being so broad, may prove too difficult to negotiate with the whole of SACU at this time of flux. Simpler alternatives may need to be explored.

Developmental Implications for Southern Africa and Concluding Remarks

In our view, the political reality is that debate in both SACU and the US on a US-SACU FTA will not be able to be delinked from wider foreign policy and developmental issues, nor perhaps should it. Some of the key questions raised may be; would a proposed US-SACU FTA contribute to the development of the Southern African region? Would it contribute to a

reduction of poverty in the region? If so, in what ways? Will unemployment rates in South Africa and in SACU grow with liberalization?

It is widely acknowledged that successful development depends on good policies (Burnside and Dollar 2000). Among the 'good policies' usually credited for successful development is the alignment of domestic prices with world market prices, usually achieved by movement towards freer trade. Such a policy stance also limits the power of domestic monopolies, and the power of specific interests to capture transfers from the rest of society, both of which force entrepreneurs to continuously pursue innovation, on which productivity growth depends. Empirical work which draws on both developing and mature economies offers evidence that trade has a significant and positive effect on growth (Frankel and Romer 1999), although Mattoo et al. (2003) argue the size of the effect is uncertain. This suggests that the US-SACU FTA, and *a fortiori* in combination with the EU-SA FTA, by hastening the process of trade and market liberalization, could bring substantial development benefits to the region.

Major caution is in order, however, even over this qualified claim of benefit. First, the poverty effects in SACU of an FTA with the US may be negative. While in general it is reasonable to presume, after Bhagwati and Srinivasan (2002), that trade promotes growth, and growth reduces absolute poverty, the opposite outcome is possible in the current circumstances of SACU. Given the distortions in both the goods markets and the factor markets of SACU, and the partial nature of any US-SACU trade liberalization, it would be too facile to presume a positive effect on the poor. Further, the region's comparative advantage is based on natural resources, while natural resources and capital appear to be complementary inputs.[13] In these circumstances, a movement towards freer trade will very likely reduce demand for labor in a

labor market that is already exhibiting significant evidence of unemployment.[14] Thus for poverty reduction to result from trade liberalization, the distortions giving rise to the unemployment must also be tackled. This link between liberalization and unemployment is likely to be a central issue in the debate on an agreement within SACU.

Second, as Collier and Gunning (1999) contend, non trade issues are the more critical in explaining Africa's slower growth performance. A particularly significant issue is the development of institutions. Easterly and Levine's recent work (2002) argues that once one controls for institutions, the effect of good policies on growth disappears. If that is the case, we need to be concerned about SACU's regional and national institutions' effectiveness. This applies not only to the question of negotiating and then administering new policies and programs, such as the proposed US-SACU FTA, but also the effectiveness of national economic institutions.

South Africa, over the twentieth century, developed effective institutions that reflected the wishes of the governing interests. As the governing interests changed in the 1990s, the institutions were largely maintained -- by both the Government of National Unity and by the ANC-led government. Unlike the change-over in Zimbabwe in 1980, the experience base of existing South African institutions was kept intact. Consequently, today's economic institutions are both effective and largely reflect the wishes of the new governing interests.

Botswana, which has maintained both institutional and political continuity since its Independence in 1966, is similarly reasonably well positioned to negotiate and administer a new arrangement, and to reap the growth benefits from the increased openness. Namibia, which has

[13] Alleyne and Subramanian (2001) show that South Africa's exports are capital intensive.
[14] The IMF (2002) cites the official unemployment rate for 2001 as 28.8%.

been independent for a far shorter period (since 1990), along with Lesotho and Swaziland which have ongoing constitutional debates, are less well equipped institutionally.

The new SACU is only now commencing the building of its institutions. While the new institutions will be able to draw on the experience base of its members, the SACU institutions themselves have yet to develop. SACU policies dealing with industrial development, competition, and 'unfair' trade practices face a significant gestation period. Yet such SACU policies may be a pre-requisite for agreement with the US on many of the non-trade issues that the US will likely seek to include in any agreement. The need for considerable patience on the part of all parties to the negotiation is clear. The US will need to be patient with the need for SACU to develop policy positions, and SACU will need to be patient with a potentially over-stretched USTR.

The promise of substantial American funding for technical assistance announced at the time of Robert Zoellick's January 2003 visit to South Africa may be of some help in the institution building process. However, unless that technical assistance is perceived by the SACU governments and the new SACU institutions as working to promote their interests, and not simply pushing the agenda of the donor, as has happened all too often with donor-funded advice, it will do little to promote an agreement that is seen to benefit all parties. Another non-trade issue that is likely to be on the table is the matter of capital controls. As Weintraub's paper in this volume makes clear, capital controls were prohibited in the Chile[15] and Singapore agreements at the insistence of the US Treasury. Chile, in particular, had been relatively successful for several years at avoiding the disruptive effect of 'hot money" on the real side of

[15] Chile is allowed to impose restrictions for 12 months on certain types of speculative capital, as long as those restrictions do not substantially impede transfers.

the economy. On more than one occasion in the past, South Africa has used the financial rand to separate the exchange rate for current account transactions from the exchange rate for capital account transactions, allowing real adjustment to a major capital flow to be made gradually over months, not days. The governments of the countries of Southern Africa may not be willing to give up this degree of freedom among the instruments available to it to deal with international financial disturbances.

On balance, however, we believe that since the principal impact of a US-SACU FTA will be to align SACU prices more closely with world prices the effect on the region is likely to be positive. Such an agreement may also prove the opportunity for SACU member governments to launch much needed regulatory reform which is particularly important in unleashing the forces of "creative distruction" (Aghion and Howitt). To be seen to be pressing a growth-promoting agenda is clearly in the foreign policy interests of the US. Further, this thrust is likely to coincide with the new governing interests in South Africa, which are less captive of the import-substitution sector that was built up under apartheid. The rest of SACU has a fundamental interest in freer trade with the rest of the world, as the bulk of consumer goods are protected by the common external tariff, and most exports sell on the world, not regional, markets. If this change in incentives can be accompanied by reduction of factor market distortions, especially in South Africa, and effective SACU institution building, then the development benefits for the region will begin to flow.

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