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## Barriers to Cross-Border Trade and Investment: Lessons from Southern Africa

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**Discussion Draft**

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# Barriers to Cross-Border Trade and Investment:

Lessons from Southern Africa

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# Barriers to Cross-Border Trade and Investment:

## Lessons from Southern Africa

### 1 Introduction and Overview

A major purpose of the Africa Emerging Markets Forum is to examine the economic and social challenges facing our continent in order to discover effective, growth-enhancing strategies for connecting our own economies with each other and with the rest of the world.

The underlying premise of meetings such as this is that we can learn from each other's experiences and that there are gains to be had from regional cooperation among African economies. We share these presumptions, but wish to stress that, while there is much to be said for regional cooperation and solidarity per se, its greatest value will arise if it can be used to increase the effectiveness of our integration with the global economy. This should be a principal goal and major benefit of regional cooperation.

The goal of this paper is to explore the links between global and regional economic cooperation from a southern African perspective, with particular emphasis on South Africa and the SADC region. I do this not only because it happens to be the case I know best, but also because of the great efforts we have made and achievements we have realized in integrating ourselves with the region and the world economies in the less than two decades that have passed since the end of the apartheid regime, and because of the key role our economy plays in Africa and especially in the SADC region.

### 2 The South African Economic Integration Experience

It would not require a drastic stretch of the truth to say that democratic South Africa was born out of autarky. The apartheid regime that preceded it was subject to sanctions on trade and investment with large parts of the world. Years of living under such conditions bred trade, investment and state enterprise policies based on self-sufficiency. "Strategic" industries were nurtured and protected; and the domestic economy was heavily regulated with wide use of price controls on basic commodities.

#### 2.1 Post Apartheid Global Trade Integration

The political liberation that began in the 1990s provided both the opportunity and the realization of the necessity to begin a major program of economic liberalization. South Africa embarked immediately on an ambitious program of tariff and trade policy reforms. This included major MFN-based liberalization through the WTO—the elimination of quotas and most import surcharges and the replacement of most formula, specific and mixed tariffs with *ad valorem* duties. The tariff structure was also simplified through a reduction in the number of tariff lines and some reduction in the number of rates levied. Table 1 shows the evolution of import tariffs from 1990 to 2004.

These reforms have reduced import tariff rates substantially. The unweighted average nominal tariff (scheduled rates, including surcharges) fell from 22.9 percent in 1994 to 8.2 percent in 2004 (Edwards 2005).<sup>1</sup> This represents a substantial liberalization of trade.

Table 1. Structure of SACU Tariffs, 1990-2004

	1990	1994	1998	2004 MFN	2004 EU	2004 SADC
No. of tariff lines	12475	11231	7773	6697	6697	6697
Ad valorem	8649	7707	5793	6492	6504	6658
Compound	66	51	6	1	0	0
Specific	499	398	214	135	135	37
Mixed	566	2071	1736	64	53	2

<sup>1</sup> Cassim and van Seventer 2005 estimate that the unweighted average nominal rate fell from 17.4 percent in 1996 to 8.3 percent in 2004 and the import value weighted average went from 11.0 to 7.5 percent over the same period.

Formula	2695	1004	24	5	5	0
No. of tariff bands						
Ad valorem	38	37	45	38	54	25
Other	695	686	230	62	47	18
Duty free (% tariff lines)	24	26	42	53	56	81
Domestic tariff spikes (% tariff lines) <sup>a</sup>	0.7	3.7	4.5	8.9	8.5	14.9
International tariff spikes (% tariff lines) <sup>b</sup>	43.7	43.5	39.4	21.2	20.1	5.8
Nuisance rates (% tariff lines) <sup>c</sup>	12	11	6	7	6	3

Notes: Calculations based on tariff schedules including *ad valorem* equivalents.

a. Domestic tariff spikes are defined as those exceeding three times the overall simple average applied rate.

b. International tariff spikes are defined as those exceeding 15%.

c. Nuisance rates are those greater than zero, but less than or equal to 5%.

Source: Edwards (2005)

As a result of these reforms, South Africa has been rapidly reintegrated into the global economy. Our shares of imports, exports and of inward and outbound investment have grown as a percentage of GDP. The economy has become more open, more productive and more outward oriented.

As desired and expected, this process has led to substantial restructuring of the economy. Table 2 shows one set of indicators—the change in export orientation and in import penetration of the economy between 1994 and 2002. ‘Export orientation’ shows the share of production in each sector that is exported and ‘import penetration’ shows the share of domestic consumption accounted for by imports.

At broad sector levels it can be seen that the entire economy has become more outward-oriented, with export orientation and import penetration increasing across both primary sectors and manufacturing. The greatest change, however, has been in manufacturing where import penetration has risen by 54 percent and export orientation has almost doubled. Even more remarkable is the uniformity of this experience across all manufacturing sectors; export orientation increased in all except two of the 28 sectors shown in the table, and the same is true of import penetration.

Table 1. Change in Trade Orientation by Sector, 1994-2002

Sector (SIC classification)	Export Orientation			Import Penetration		
	1994	2002	% change	1994	2002	% change
Agriculture, forestry & fishing [1]	16.0	18.6	16.3	5.7	9.1	59.6
Mining [2]	62.6	68.0	8.6	51.5	60.9	18.3
Manufacturing [3]	15.5	29.5	90.3	23.2	35.8	54.3
Food [301-304]	6.7	9.1	35.8	7.6	9.8	28.9
Beverages [305]	6.8	13.2	94.1	3.7	5.9	59.5
Tobacco [306]	3.5	7.3	108.6	1.9	1.0	-47.4
Textiles [311-312]	13.6	19.1	40.4	24.2	31.8	31.4
Wearing apparel [313-315]	9.7	25.1	158.8	8.4	19.7	134.5
Leather & leather products [316]	37.9	39.4	4.0	35.8	38.2	6.7
Footwear [317]	4.6	4.9	6.5	17.9	46.6	160.3
Wood & wood products [321-322]	14.0	22.8	62.9	10.9	15.0	37.6
Paper & paper products [323]	19.9	19.6	-1.5	14.2	9.5	-33.1
Printing & publishing [324-326]	2.3	2.8	21.7	17.9	23.5	31.3
Coke & refined petrol [331-333]	14.1	33.9	140.4	12.6	28.0	122.2
Basic chemicals [334]	40.4	51.7	28.0	45.2	52.1	15.3
Other chemicals [335-336]	5.3	15.3	188.7	22.1	32.3	46.2
Rubber products [337]	9.7	25.4	161.9	21.8	34.8	59.6
Plastic products [338]	4.6	12.2	165.2	9.9	18.8	89.9
Glass & glass products [341]	9.7	15.0	54.6	18.2	26.7	46.7
Non-metallic minerals [342]	7.8	11.6	48.7	10.3	20.7	101.0
Basic iron & steel [351]	45.3	63.6	40.4	11.2	17.6	57.1

Basic non-ferrous metals [352]	44.6	27.6	-38.1	17.5	20.1	14.9
Metal products [353-355]	10.9	17.7	62.4	10.6	18.6	75.5
Machinery & equipment [356-359]	16.8	54.6	225.0	56.3	77.7	38.0
Electrical machinery [361-366]	7.7	15.4	100.0	31.9	38.1	19.4
Communication equip [371-373]	9.6	44.2	360.4	59.4	88.1	48.3
Professional & scientific [374-376]	23.7	62.5	163.7	72.8	91.7	26.0

*Source:* Based on data in Dunne and Edwards (2006), Table 1.

*Note:* Export orientation is calculated as the share of exports in domestic production and import penetration as the share of imports in domestic consumption.

These are all signs of a radical and highly successful economic adjustment. Whatever the reasons, and there can be no doubt that economic reform and the dropping of sanctions have played a key role, the South African economy has become much better integrated with the global economy and has rationalized production in ways that respond at least in part to South Africa's relative cost competitiveness. This has happened not just between but also within sectors.

Despite substantial economic restructuring, however, South Africa's post-1994 economic performance has been less than might have been hoped for. In particular, export growth has been disappointing, and certainly less than might have been expected following such a deregulation of trade and other economic control measures. While world export growth increased to 6.2 percent a year over the decade since 1994, South Africa's average export growth rate fell marginally to 5.6 percent, and the country's share of world exports has fallen from 0.7 to 0.5 percent.

A sectoral breakdown of export performance does not provide any more grounds for self-congratulation (Edwards and Alves 2005). Our exports of non-resource-based manufactures have outperformed the world average over the past two decades (8.57 percent versus 6.59 percent), but have underperformed those of other developing countries and other resource-based economies. Within manufacturing, South Africa's strongest relative performance (*vis à vis* the rest of the world) has been in medium and high technology products and it has underperformed both the rest of the world and other developing countries in low technology products. The relatively strong performance of South Africa in 'medium technology' exports is almost fully explained by subsidized auto exports. All other sub-sectors have performed worse than the basket of resource-based economies (and well below the average performance of other developing countries).

Why has trade reform failed to produce the expected results? One of the main reasons is that trade liberalization has been far less complete than might be thought.<sup>2</sup>

- The process of trade reform slowed to a crawl following the first wave in the mid-1990s. Further MFN-based tariff reductions are strongly resisted in some quarters, in part as a 'weapon' to be used in WTO negotiations. The main focus of tariff reform in recent years has been preferential trade agreements (PTAs).<sup>3</sup>
- The tariff structure remains complex. Despite an early commitment to reduce the number of tariff rate bands to six, the number of MFN bands in 2004 was still 38, exactly the same as in 1990 (see Table 1 above). For imports from the EU the number of bands was 54. In addition, the complexity of the tariff structure has been increased by the use of special rebates and by detailed differentiation of tariffs within sectors.
- The proliferation of special sub-chapter rates and rebates reflects a product and sometimes even firm-specific approach to tariff policy. This made-to-measure approach involves deliberations on tariff policy based on the claimed or perceived needs of individual firms. Rather than setting relatively low and uniform tariffs across all products, tariff policy has continued to be negotiable.

<sup>2</sup>This discussion is based on Flatters and Stern 2006 and summarized in part in Flatters and Stern 2007.

<sup>3</sup> See Cassim and van Seventer 2005, especially the discussion of section 5.

This is an obvious incentive for rent seeking and a source of uncertainty for the majority of investors and producers.

- Despite considerable reductions in tariff rates, the made-to-measure structure of the tariff book has kept actual protection very high for many domestic producers. Detailed examinations at the product level confirm that many of goods actually produced in South Africa continue to have very high levels of effective protection and at least some of them have experienced increases in effective protection since 1994.
- With the possible exception of India, South Africa has been the developing world's most prolific user of WTO anti-dumping provisions. At the end of 2003 South Africa had 90 different anti-dumping duties in place, placing her fourth in the world, behind the US, India and the EU (Bekker 2005); in the first half of 2005, South Africa launched more anti-dumping investigations than any other country in the world. This creates great uncertainty for producers and investors dependent on the use of products subject to such actions.
- There is growing evidence that the list of important impediments to trade and investment extends far beyond "traditional" trade policy instruments such as tariffs and quotas. We return to this issue below.

For all of these reasons, it is apparent that, despite considerable progress in the past couple of decades, trade reform still has a long way to go in South Africa. This might help to explain why the dividends from trade reform to date have been less than might have been hoped, especially in most recent years.

## 2.2 Regional Trade Integration

In addition to these multilateral trade reform measures, we negotiated a bilateral trade agreement with the EU, made substantial progress in reconfiguring our relationship with our immediate neighbours in the Southern Africa Customs Union (SACU) and have worked with our Southern Africa Development Community (SADC) partners to develop and implement a new SADC Trade Protocol and other associated trade, investment and development cooperation measures. Meanwhile our trade negotiators have been exploring and in some cases negotiating a variety of other preferential trading arrangements.

The new SACU agreement that was finalized in 2002 fundamentally altered the terms of the world's oldest existing customs union by a) providing a framework for joint decision-making on tariff-setting and excise taxes, and b) reconfiguring the mechanism for sharing tariff revenues. The SADC Trade Protocol sets the terms for the elimination of import duties on almost all intra-SADC trade according to differential implementation schedules, with SACU reducing its rates at a faster pace than other members, but with full implementation by all members by 2008. Implementation of the Trade Protocol was to be supported and extended through cooperation in a wide range of other measures ranging from Customs cooperation, to common transit shipping rules and agreement on and implementation of rules for recognition of standards. According to the wide-ranging Regional Indicative Social and Development Program (RISDP) the free trade agreement eventually would be broadened into a full customs union by as soon as 2010, a common market by 2015 and a monetary union by 2016.

Intra-regional trade performance has seen some improvement over the past decade or so (DNA 2007). Intra-SADC trade has grown significantly from the early 1980s. The value of intra-SADC trade as a share of total imports of SADC members grew from 1.6 percent in 1980 to 10.6 percent in 2003. Similarly, the share of intra-SADC exports as a share of total exports grew from 0.9 percent to 10.6 percent over the same period.<sup>4</sup>

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<sup>4</sup> SACU is treated as a single region. If SACU members are treated separately, then the share of intra-SADC trade rises in response to the very high proportion of intra-SACU trade by BLNS economies.

However, trade patterns remain quite asymmetric. South Africa is by far the largest supplier of exports to and demander of imports from the region. SACU accounts for between 71 and 78 percent of total intra-SADC exports. The region is even more dependent on South Africa as a source of imports. 90 percent of SADC (excluding SACU countries) imports from the region are sourced from SACU. Although a relatively high proportion of SADC economies' trade is conducted within the region, most of this is bilateral trade flows with South Africa. Trade flows between non-SACU SADC members are very low (less than 10 percent of total trade).

The predominant role of South Africa in intra-regional trade is in large part a reflection of its entrepôt role—as a logistical hub for the region's trade with the rest of the world. This helps to explain why countries with the highest trade dependence with South Africa are those that are logistically connected to South Africa.

Current intra-regional trade patterns suggest that the remainder of trade is based largely on exploitation of local and regional markets. Unfortunately these markets are very small and cannot realistically be expected to form the basis for the kinds of scale economies and specialization needed to compete in global markets. The focus of regional integration of trade and investment in Africa needs to expand beyond increasing access to regional markets and shift instead to a strategy of using trade to boost global competitiveness. Freeing of trade in SADC has not yet been used as a basis to exploit production cost complementarities and economies of scale in order to increase the competitiveness of the region in global markets.

ASEAN, by contrast, which started with much larger markets than are found in SADC, has built a free trade area and improved regional integration on the basis of development of production networks focused on global markets. A substantial part of the trade that takes place among ASEAN economies, and with the greater East Asian region, is in intermediate products whose production is parcelled out among different countries, poorer and richer, according to differences in their cost structures. This has equipped the region to improve its competitiveness and export success in global markets, with resulting high growth rates for all members subscribing to this strategy. This has not yet begun to happen in our region.

A closer examination of the intra-SADC trade data reveals other concerns. Within SACU, of course, almost all trade is conducted under the rules of the customs union, not SADC. Outside of SACU, most trade also takes place outside of the SADC framework—under COMESA, under bilateral trade agreements or other special arrangements. A recent study for the SADC Secretariat on implementation of the SADC Trade Protocol (TSG 2007) found that very little additional intra-regional trade had actually been created by the SADC agreement. This was attributed in part to delays and ambiguities in implementation by various members and in part to administrative difficulties in complying with SADC rules, especially rules of origin.

The evidence from the South African and SADC experience is that regional and other PTAs suggests at best a mixed impact of these arrangements on trade and growth. They have added considerable complexity to and hence increased the costs of trade in South Africa. Although the number of lines in South Africa's tariff schedule has been reduced from 11,231 to 6,697 between 1994 and 2004, the existence of just the EU and SADC agreements means that the effective number of tariff lines in force now is actually 20,081 (three times 6,697). This is almost twice the number of tariff lines in 1994. Implementation of these agreements requires criteria and procedures for determining where goods actually originate—rules of origin. Rules of origin are complex and costly to comply with and to enforce. This is a serious impediment to trade, especially if they are deliberately designed to restrict preferential trade—to make it difficult if not impossible for importers and exporters to qualify. The EU rules are now widely recognized to be highly restrictive in this regard and to have a significant impact on the ability of South African exporters to take advantage of EU preferences. Even worse,



however, is the SADC agreement, in which rules of origin in many sectors could not be met even by South African exporters let alone those in much less developed partner countries.<sup>5</sup>

Even if they ‘work’ by promoting trade, PTAs suffer from two serious economic problems—trade diversion and policy diversion. The first of these is certainly well known. Tariff preferences divert imports from low cost non-member sources to higher cost sources in member countries. The risk and cost of trade diversion increases with the gap between preferential and non-preferential tariff rates. The obvious cure for the problem is to lower all MFN tariff rates or better still to make all tariff cuts on a non-discriminatory basis. This approach was followed in a number of heavily protected sectors in Mauritius in conjunction with implementation of preferential tariff reductions in COMESA (see Box 7 of Flatters 2002). Other countries, including South Africa, have been loath to do this.

The second problem is less well known but is critical in a policy-making environment with limited policy resources. Negotiating and implementing trade agreements is labour and time intensive. Devoting policy-making resources to this activity reduces resources available to deal with potentially much more useful MFN-based liberalization (unilateral or cooperative) and even more critical domestic constraints to growth.

### 3 Changing Focus: “Deep” Economic Integration

Cross-border trade and investment are critical elements in any economic growth and development strategy. Effective participation in global markets is essential for achieving acceptable rates of growth of incomes and more general economic welfare. This involves far more than bargaining with other countries about rates and timing of tariff reductions—the standard stuff of trade negotiations. It requires policies that promote competitiveness, and that reduce unnecessary costs of trade, investment and doing business. It is not just taxes, tariffs, import licensing and quotas that can restrict or encourage trade and investment. It is how these and associated measures are implemented; it is the costs and efficiency of international transport; it is the availability and cost of financial and insurance services to support international trade and investment; and it is the way in which domestic regulations and markets work to encourage or discourage legitimate and productive business activities.

Many of these policy areas are “sovereign”—countries are free to act as they wish; they are not bound by international agreements to act in any particular way. Even where international obligations exist, there is considerable scope for gains by moving beyond minimal requirements. However, there might still be significant gains from cooperation, and international and regional collaboration is evolving to take advantage of these opportunities. International customs cooperation through the WCO, for instance, is a prime example of the mutual gains to be realized by pursuit of common standards, rules and procedures.

The WTO now includes guidelines and obligations regarding the use of product standards and other regulations to protect public health, safety and the environment. Implementing these and further follow-up measures are the focus of a variety of OECD regulatory initiatives, voluntary cooperation among APEC member countries, and are included in one way or another in a variety of bilateral and other preferential trading arrangements. The SADC Trade Protocol includes provisions on standards that echo those of the WTO and encourage the development of compatible standards among SADC members. As currently written, however, the Protocol provides little more than a framework under which to develop a SADC-wide regime for the treatment of technical standards (TSG 2003).

The World Bank now conducts annual surveys of the cost of doing business in different countries, with a view to increasing awareness among policy makers of the scope for and benefits of regulatory reforms that will enhance competitiveness of and deepen integration among economies (see, for instance, *Doing Business 2008*). These surveys have helped to focus the attention of policy makers

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<sup>5</sup> See Flatters 2004 and Erasmus, Flatters and Kirk 2006.

around the world, and certainly in Africa, on the need for regulatory improvements to enhance their countries' competitiveness in world markets.

Whether done cooperatively or independently, there is growing recognition of the importance of finding measures to promote development through "deeper" economic integration, at the border and behind the border. This is especially so in Africa.

While there certainly is value in continuing to reduce tariffs, whether unilaterally, multilaterally or preferentially, there is no question that the gains from these and other development policies will be enhanced enormously by paying more attention to the investment, legal and regulatory changes that deepen our economic integration among our own economies and with the rest of the world. This is an area of enormous breadth and scope, and one short paper cannot do justice to all of the issues. Rather than even attempt to do so, the remainder of this paper will illustrate some of the most important issues by drawing on a few examples from or pertinent to our own experience.

## 4 Legal and Regulatory Impediments: Some Examples

### 4.1 The Big Picture on Business Costs: Where Do We Stand?

For several years now the World Bank has been doing annual surveys and reports on the costs of doing business around the world.<sup>6</sup> It collects data from 178 countries on a wide variety of regulatory costs and of regulatory (in)efficiency, summarized under a few headings: starting a business, dealing with licenses, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business. From these measures they construct a summary ranking of ease of doing business in all 178 countries. Given the variety of performances of different countries according to each of the different criteria and in different parts of the world, it is difficult to make any generalizations. However, African countries are not generally among the top performers. Only three Sub-Saharan African countries rank among the top 50 countries according to the overall ease of doing business ranking, and another four make it into the next fifty. So only seven rank among the top 100 out of the 178 countries that are ranked by this index.

Furthermore, even among the top Sub-Saharan performers there is considerable room for improvement. While Mauritius performs even better than its overall ranking of 27<sup>th</sup> in terms of starting a business, protecting investors, paying taxes and trading across borders, it does considerably worse than its overall ranking in several other categories, and especially so in registering property, getting credit and enforcing contracts. South Africa, which ranks 35<sup>th</sup> overall, does particularly well in terms of getting credit and protecting investors, but does especially poorly in employment of workers, trade across borders and enforcement of contracts.

The fact that these surveys have been under way for several years now makes it possible to track changes over time. Here there is also some good news for Africa. In particular, Egypt, Ghana and Kenya have been identified as among the top reformers in the world, with Egypt ranked first in the world in this regard and Ghana third. However, there clearly is a long way to go for all African countries, and there are some dangers. First, it is possible to backslide, as has happened in Zimbabwe and Venezuela. Second, too slavish attention to rankings according to one particular index can distort the focus of reform initiatives. Of necessity, these indices have been designed with a view to easily quantifiable data. While this contributes to measurable indicators of results, it is possible that the measures might not be fully reflective of the most important underlying problems and issues, and policy makers might be tempted to work towards "quick hits" rather than dealing with the biggest and sometimes most difficult issues. According to the World Bank data, the most popular reforms have been in assisting in the start up of small businesses and in reducing company taxes. While these are certainly important issues, policy makers in each country and region should think carefully to identify the most important problems to tackle.

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<sup>6</sup> The first report was done in 2004 . This discussion is based primarily on the most recent report, *Doing Business 2008*.

Nevertheless, the World Bank data is certainly a rich starting point for us in identifying regulatory and policy weaknesses, and in enabling us to learn from the experience of others.

## 4.2 Regulatory Impediments to Logistical Efficiency

The global integration of world markets that has taken place in recent decades has facilitated and has been driven by a fragmentation of production around the world. Improvements in information technology, transport and logistics have made it possible to break down product value chains and allocate production tasks for goods and services much more finely and in line with comparative costs of production in different locations. Countries do not have to rely on the growth of domestic markets; they do not have to be self-sufficient in any set or subset of production; they do not need to be tempted down the self-destructive path of import-substitution as a means of developing local industrial competencies. This presents enormous opportunities for poorer countries as is well illustrated by the experience of many Asian countries.

In this environment logistics, ease of communication and trade facilitation are critical determinants of success in achieving economic development.

Transport infrastructure is clearly an important element in logistical efficiency. But it is only part of the story. An incentive structure and training environment in which crane operators can move 50 containers per hour achieves much more, at much lower cost, than one in which operators move 25 or 30 containers per hour.<sup>7</sup> Customs procedures and transit arrangements can add or subtract many days to or from the shipping times, a critical factor in a world of just-in-time production and constant customer-driven style changes.

As mentioned earlier, one of the areas in which many South African countries lag significantly in the World Bank “Doing Business” surveys is the cost of trading across borders. The indicators used for this purpose include complexity of customs procedures, container freight costs, and time to move traded goods between factories or warehouses and ports. Our geographic isolation from major world markets and the landlocked nature of many of our countries are natural handicaps for Africa. The lack of sufficient scale of output and trade to attract regularly scheduled shipping faces us with a difficult “chicken and egg” problem in promoting industrial development. These handicaps increase the challenge we face, but also increase the potential gains from any kind of logistical improvements we can achieve.

A background study by the World Bank (Djankov et al 2006) illustrates the problem by looking at the cost of time delays. Data were collected from freight forwarders, customs and port officials in 126 countries on the time it takes to send a container from a factory in the largest industrial city to the nearest port, and fulfil all the Customs and administrative and port requirements to load it on a ship. Table 3 shows that Africa is by far the poorest performer on average, and also has the greatest variation in shipping times.

Slow and variable shipping times impede export competitiveness both by reducing access to and increasing the cost of intermediate inputs, and by reducing the demand for and the value of exports. The study quantified some of these costs by estimating the (negative) impact of shipping times the volume of countries’ exports. The impacts are significant.

According to these estimates “each additional day that a product is delayed prior to being shipped reduces trade by more than 1 percent. Put another way, each additional day is equivalent to a country distancing itself from its trading partners by one percent, or about 85 km. For example, if Uganda reduced its factory-to-ship time from 58 days to 27 (the median for the sample), exports would be expected to increase 31 percent and Uganda would bring itself 2,600 km closer to its main trading partners—nearly the distance from Kampala to Cairo. If the Central African Republic reduced its factory-to-ship time from 116 days to 27, exports would nearly double. The same effect could be

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<sup>7</sup> According to a Sri Lankan trainer working in South Africa, productivity differences between operators in Sri Lanka and at Durban in South Africa are of this order of magnitude.

achieved if the Central African Republic cut 7,565 km from its distance to the main markets—three-quarters the distance from Bangui to New York.” (Djanov et al 2006, pp. 4-5)

Table 3. Required Time for Exports (No. of days)

	Average	Minimum	Maximum
Africa	47.55	16	116
Developed Countries	12.59	5	29
E Asia & Pacific	23.92	6	66
Europe & Central Asia	32.09	6	93
Latin America & Caribbean	29.00	17	43
Middle E & N Africa	28.40	10	49
South Asia	32.83	24	44
All Countries	30.35	5	116

*Note:* Shipping time is the number of days necessary to move a container from factory to port and fulfil all necessary customs, administrative and port procedures to prepare for loading on board ship.

*Source:* Djankov et al 2006, Table 1.

What does this mean for policy? It suggests there could be enormous economic gains if we can find ways to increase logistical efficiency and reduce unnecessary shipping delays. Within each country we need to streamline customs and port procedures through improved risk assessment methods, reduced reliance on physical inspections of cargoes, greater use of electronic data filing, etc. Among bordering countries we need to find ways to harmonize customs documents, share standard customs forms and data, and harmonize transit procedures, including those for customs bonds where these are necessary.

In SACU and in SADC we have expended considerable effort in this regard. We have introduced a common customs document for use in SACU. The same document is now being used in the Dar es Salaam Corridor countries of Malawi, Tanzania and Zambia. We have worked with SADC and SACU neighbours to streamline several key regional transport corridors, to improve transit procedures and to simplify bonding requirements. But progress, although significant, is slow. As in all regulatory reform, bureaucratic resistance is strong, and vested interests exert pressure to preserve particular ways of doing things.

Throughout the Doha Round of trade negotiations we have expended great effort to seek reductions in tariff barriers to our exports to the rich markets of the US and the EU. If successful, this would certainly be useful for most African countries. But how would it compare with the effects of improving our own logistics? According to this study, “In Sub-Saharan Africa it takes 48 days on average to get a container from the factory gate loaded on to a ship. Reducing export times by 10 days is likely to have a bigger impact on exports (expanding them by about 10 percent) than any feasible liberalization in Europe or North America.” (Djankov et al 2006 pp. 21-22)

#### 4.3 Making Regional Free Trade Work: Rules of Origin and Other Issues

As mentioned earlier, regional economic integration can be a useful avenue to achieving more general integration into the global economy. However, if regional arrangements are undertaken with a view of insulating the participants from broader global forces, they could divert policy attention from the more important task of increasing global competitiveness and, even worse, reduce growth and efficiency by diverting trade from low cost to high cost sources.

As also mentioned, one of the weakest links in PTAs as a path to economic integration is the necessity of introducing rules of origin—criteria for ensuring that goods claiming trade preferences actually originate from a country eligible for such preferences. In today’s world of fragmented production, with production of the elements going into any final good taking place in many different places around the world, determining origin can be a tricky business. In fact, the whole idea of thinking of a

good as originating in any particular place is foolish. An iPod, for instance, is assembled in China. However, less than 10 percent of its total final value actually originates there; the rest can be attributed to manufacturing and other activities that take place in many different locations all around the globe.

For the purposes of administering a PTA, the real question is not whether a product claiming preferential treatment actually *originated* in a member of the PTA, but rather whether significant economic activity involved in its production occurred there. Was the supplying country in some meaningful sense a part of the global value chain for the production of the good claiming preferences?

Rules of origin regimes usually deal with this question in two ways. The first is to declare certain trivial activities such as packaging, labelling, and simple mixing of chemicals as insufficient to confer origin. The second, as a means of providing additional clarity, is to specify some minimal types of economic activity as being necessary to confer origin. This could be indicated by levels of local content, substantial transformation of products (often as determined by a change of tariff heading when moving from inputs to outputs), or specification of particular production activities that need to have taken place (such as cutting and stitching of cloth to make a garment).

Unfortunately, as happens in many trade-negotiating processes, something was lost in moving from these simple principles to actual implementation.

In preferential arrangements with and among developed countries, special interests in the richer countries often see rules of origin as a means of diminishing the value of preferences granted or of providing hidden protection for their own products. The classic example is the garment industry, where both the EU and the US textile and garment producers lobbied to insist that if preferences were to be granted to garments produced in poorer countries, they must be made from cloth and/or yarn produced in the preference-granting country or region. The only alternative was to use cloth and/or yarn produced in the preference-using country. Both of these criteria, of course, are an attempt to deny the whole process of global division of labour that characterizes the globalization of production over recent decades. In so doing these rules diminish if not entirely negate the value of the preferences being granted.

In south-south PTAs, rules of origin have come to be seen as development tools—a way to stimulate the development of upstream-downstream production networks by making local or regional content a necessary condition for enjoying trade preferences (see Erasmus, Flatters and Kirk 2006). It is well known from more general trade and development experience that this is a heavily flawed development model, and this is why local content and other performance requirements are outlawed in most MFN-based trade arrangements, and most importantly in the WTO.

In many cases, the real motivation behind the use of such restrictive rules of origin, as is the case in developed countries, is to provide hidden protection to reduce the impact of trade preferences on firms and industries that fear external competition. A justification that is often given for such protectionist use of rules of origin is to compensate for lax customs and/or standards enforcement in partner countries. In order to prevent use of the PTA for “smuggling” of non-eligible, dumped or sub-standard goods from third countries, rules of origin are made so restrictive that no company in the exporting country could possibly satisfy them. In other words, rules of origin can be and are used to exclude certain goods from trade preferences.

To the extent that these kinds of arguments are legitimate and are not simply back door ways to increase protection, the solution is not to prevent legitimate preferential trade from taking place, but rather to cooperate to improve customs enforcement among member countries. As we have already seen, poor customs administration can be a serious and costly impediment to development of international competitiveness.

Lack of trust and/or differences in trade policy goals can result in other troublesome customs enforcement difficulties in our own preferential trading arrangements, with harmful consequences for international competitiveness.

Consider a garment industry in a small, poor landlocked country that is utilizing developed country trade preferences to compete in global markets. Firms in this industry depend critically on timely and efficient transshipment of most major inputs and of all outputs through internationally linked ports in neighbouring countries. Suppose the country of transshipment were to insist on physical inspection of sealed containers, often including unstuffing and restuffing of the contents, when goods pass through in transit. This would be a serious impediment to the import and export trade of the affected companies, certainly would reduce their net factory prices and might well threaten their whole business. International buyers generally have a very low tolerance for such shipping uncertainties and associated costs.

Unfortunately this is not a hypothetical example. It actually happens in our region, even within a customs union in which there should be free movement of all goods (Mpatha et al 2005a and 2005b).

The garment transshipment example arises in part because of lack of trust among the relevant customs authorities and in part because of differences in trade policy. In this case, one member country chose to restrict imports of a wide variety of textile and garment products from China in order to protect its own industries. Under pressure from its own industries, customs authorities have become excessively vigilant about all textile and garment shipments, to the serious detriment of the competitiveness of legitimate regional firms competing exclusively in global, not regional markets.

Similar problems have arisen when one member of a PTA decides unilaterally to ban or seriously restrict imports of particular goods in order to develop local “infant industries.” In SACU this has happened for a number of basic products, including pasta and bread.

Regional integration works best if it is based on improving global competitiveness of regional products. It relies on reducing all impediments to trade within the region, while at the same time using this as platform for the similar removal of impediments to trade and investment with the entire world. This requires trust and cooperation in a wide range of issues in trade policy and implementation.

#### 4.4 Investment Incentives and the Business Environment

Investment incentives are generally regarded as a stimulus to investment rather than as an impediment. However, in an interdependent world one country’s investment incentives can impede another country’s ability to attract investors.

There is considerable evidence, from our own region and elsewhere, that tax relief and other forms of more “sophisticated” or direct investment incentives are very costly, not just in their fiscal effects, but also as a result of their unintended consequences for patterns of economic development. They are corrosive of the fiscal system. They encourage rent-seeking, thus diverting entrepreneurial resources from improving competitiveness to seeking favours from government. They can make economically wasteful investments privately profitable, thus diverting investment and entrepreneurial activity away from activities with much greater economic potential for the country. They often tend to favour capital-intensive investments, to the detriment of long-term employment growth. As experience in SACU shows, providing subsidized electricity to energy-intensive activities can be very costly at a when electricity becomes more scarce and its cost increase; and providing cheap water and subsidized water treatment facilities in a water-scarce environment can encourage unsustainable water-intensive and environmentally-threatening investments.

The greatest long-term danger of the investment incentive game is that it distracts our attention from the more fundamental issues that need to be tackled in order to improve our international competitiveness. In our own country, we have been under enormous pressure to provide investment incentives to business process outsourcing activities, an area identified as a potential source of investment and substantial employment growth. At the same time, exhaustive studies of this sector show that the largest impediment to its success in South Africa is our high telecommunications costs. Rather than designing incentives to compensate for this problem, should we not be thinking more carefully about the regulatory framework and investment environment in our telecommunications sector? What might be the role of greater domestic and international competition?

It is not just business process outsourcing that depends on efficient and low cost telecommunications services. Just like logistics, these services are a key part of the backbone of our industrial and service competitiveness in today's globalised world economy.

To achieve deeper and more successful integration among ourselves and with the global economy, should we not agree on limits to the use of investment incentives and shift our attention to the real impediments to our ability to compete in international trade and investment?

## 5 Conclusion

We have made a great deal of progress in improving our business environment so that we can participate and compete effectively in global markets. We still face many challenges; but we know what they are and we have some pretty good ideas of how to deal with them. Much of what needs to be done can be done by each of us individually. But there is also considerable scope for and potential benefit from cooperating to deepen and enrich our economic integration with each other and with the world economy.

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