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CHAPTER 3

SOUTH AFRICAN–EUROPEAN TRADE RELATIONS

3.1 Introduction

The start of a new political era in South Africa has had more benefits than just the creation of a new democracy. Although South Africa was not completely shut out of the global tradingsystem during the apartheid era, sanctions left their mark on the economy especially during the last years of apartheid.

South Africa can be classified as a middle-income developing country, which is attempting a major economic restructuring amidst political uncertainty and risk, whilst trying to find its feet in a new democratic regime. This gives the country a definite basis from which to appeal to foreign powers and trading partners for external encouragement and assistance. The popular slogan for developing countries has become "trade, not aid". In this context, trade policies need to be pursued which are most likely to establish feasible long-term development.

The new government has committed itself to promoting growth and creating new jobs. The enhancement of trade, especially on the export side, has been identified as one of the strategies to achieve these goals. Because the EU had always been South Africa's most important trading partner, attention is being paid to existing deals and a possible extension of agreements, with regards mainly to agriculture. In fact, the government pursued the creation of a new trade deal with the EU with commendable persistency, aiming at opening up lucrative European markets for South African products. This Chapter analyzes possible trade regimes South Africa can enter into with the EU, after briefly discussing trade deals of the past, beginning with a brief overview of South African trade in agricultural commodities thus far. Subsequently the actual Free Trade Agreement signed between South Africa and the EU in March 1999 is analyzed. Thisforms the basis of the analysis conducted in Chapter 5.

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3.2 South African Trade in Agricultural Products

3.2.1 Overview

In 1993, South Africa's GDP registered positive growth for the first time in four years with 1.1 percent growth (CSS, 1997). Two principal factors (a substantial increase (6%) in the volume of merchandise and net gold exports, and a significant recovery in agricultural production) made a major contribution to this revival in economic activity (OECD, 1995). Although the agricultural sector accounted for most of the growth during the early part of 1993, the increase in economic activity spread to other sectors in the second half of that year, resulting in growth in the mining, manufacturing, electricity, gas and water, and commerce and finance areas. In 1994, the economy got off to a sluggish start due to uncertainty surrounding the election and transitional period and a large number of public holidays. The GEAR (growth, equity and redistribution) macro-economic strategy was adopted at the end of 1996, which predicted growth of up to 4% for 1998, but the first quarter produced hardly any substantial growth, and final figures have since been revised to less than 1% for the whole of 1998 (F&T Weekly, 1998).

In contrast to many developing countries, particularly in Africa, in South Africa there are no major infrastructure constraints on trade (Cassim and Zarenda, 1995). In particular there is substantial surplus capacity in power, internal transport and the ports. These include two ports, which meet modern international standards. The banks and credit agencies also offer a developed (and at present liquid) capacity to finance trade, and probably the capacity to open more trade promotion offices to supplement the present representation.

Table 3.1. South African Imports of Agricultural Products ($thousand)

1998				1999			
Animal products	Vegetables and fruit	Cereal products	**Total of agricultural products**	Animal products	Vegetables and fruit	Cereal products	**Total of agricultural products**
92,884	97,896	327,143	**1,723,837**	85,895	88,033	299,584	**1,361,453**

Source: FAOSTAT Database, 2001.

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During 1998, South Africa imported food products to the value of $1,723 million (Table 3.1). Between 1998 and 1999, agricultural imports experienced a decrease of 21 percent. This negative growth can be partially attributed to the fact that, due to the weakening of the local currency, less was imported.

Table 3.2. South African Exports of Agricultural Products ($ thousand)

1998				1999			
Animal products	Vegetables and fruit	Cereal products	**Total of agricultural products**	Animal products	Vegetables and fruit	Cereal products	**Total of agricultural products**
120,623	906,274	206,997	**2,411,410**	96,233	974,880	148,756	**2,187,050**

Source: FAOSTAT Database, 2001

Table 3.2 shows that South Africa maintained a positive trade balance as far as agricultural products were concerned for 1998 and 1999. It is also interesting to note that, while most major export items were declining, vegetables and fruit showed an increase of 8% during those two years. However total exports declined, which suggests that trade reforms might really be needed to stimulate economic growth and to create jobs.

To summarize, South Africa is a net exporter of agricultural products, and these exports contribute approximately 15 percent to the country's total exports (CSS, 1997). However these facts give rise to some concern. World prices of primary products, including agriculture, are declining, thereby inhibiting earnings growth from these sectors, due to over supply (Goldin et al., 1993). The country needs to improve its export performance of value-added products if it wants to achieve long-term sustainable economic growth. The aim of the government therefore should be to introduce supply support measures, aimed mainly at value-adding enterprises. However, this does not exclude agriculture from being targeted as well. For export purposes the emphasis should however fall on growth areas with comparative advantages on a global basis. Agricultural is one such area, and therefore exports need to be supported by enabling trade agreements and need to be free of prohibitive measures to become successful.

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3.2.2 Trade Policies

Under the terms of the Import and Export Control Act of 1963, South Africa's Minister of Trade and Industry was entitled to act in the national interest to prohibit, ration, or otherwise regulate imports (Helm, 1994). More recent regulations required import permits for a wide variety of goods, including foodstuffs, clothing, fabrics, footwear, wood and paper products, refined petroleum products and chemicals. Surcharges on imported goods, which ranged as high as 40 percent on some items, were the most significant barriers to imports. Due to its position as signatory to the GATT agreement, and more recently the WTO, instructions have been given to the Department of Trade and Industry to simplify its system of tariffs and to align protective and supportive trade policies accordingly.

On the export side, South African Government incentives used to be divided into four categories:

- compensation for a portion of import duties;
- a proportion (10 percent) of value added during manufacture;
- financial assistance for activities such as market research and trade promotion; and
- income tax allowances.

Other direct and indirect export subsidies were available to local manufacturers, particularly for factories located in designated development areas. Subsidies included electricity and transport rebates, export finance and credit guarantees and marketing allowances. Most of these export policies are presently under review, and many, if not most, of them have been removed in accordance with the WTO agreement (Van der Merwe and Otto, 1998).

To shed more light on current developments, some points need to be highlighted to indicate the differences between the old and new trade policy, whereas old refers to the era before the new political dispensation came into being. The GEAR (growth, equity and redistribution) program, although highly criticized and with little to show in the way of results, is now the official macro-economic policy framework of the government. The focus falls mainly on growth and job creation, attempting to lift the South African masses out of poverty. This commendable goal is to be achieved through attracting foreign investment and stimulating international trade, and also by maintaining strict fiscal discipline and monetary stability. It is envisaged that the freeing up of

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the South African economy will increase competitiveness and enhance export opportunities by forging trade alliances.

To fall in line with GEAR, and to keep up with international developments, a more appropriate agricultural trade policy also had to be devised. First however, let us consider the past highlights of South Africa's agricultural trade regime, as presented by the OECD report (1995).

Past

- *Food self-sufficiency.* Import substituting investments were made, often not based on comparative advantage principles.
- *Import protection.* The Marketing Act before 1996 provided local producers with high tariff barriers and quotas to bar international competition.
- *Export promotion.* Apart from being controlled by the single desk marketing, the promotion of exports was done through GEIS (General Export Incentive Scheme).

Generally speaking, this was an inward orientated policy, with direct intervention in markets. Although still under revision by the NDA, the new agricultural trade policy will be outward oriented and geared towards increased trade (Trade Policy Committee, 1997).

Present

- *Food security.* To be able to move away from self-reliance towards security at household, national and regional level, the economy needs to be opened up substantially.
- *Minimum market intervention.* The deregulation of the domestic marketing environment as far as agriculture is concerned, has progressed substantially and all but a couple of Marketing Boards have been scrapped.
- *Comparative advantage* on a regional basis will play an essential role, takinginto account the sanitary and phyto-sanitary regulations laid down by the WTO. It is widely assumed that these will in future be of great importance in the regulation of trade amongst the countries of the world (F&T Weekly, 1998).

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However, it needs to be stressed that had the Uruguay Round agreement on agriculture been strictly implemented, it would have had little effect on agricultural marketing in South Africa (Van der Merwe and Otto, 1998). As far as market access commitments are concerned, the tariffication of non-tariff measures into tariff equivalents was the most important element. Had the South African authorities followed the guidelines in this regard, it would have resulted in the same protection that prevailed under the previous trade regime. The high cost of supportive and protective measures, was arguably one of the driving forces behind the extensive liberalization effort.

Although the GATT agreement forces members to decrease export subsidies, these have not been completely abolished (OECD, 1995). Most developed countries still subsidize exports, whereas South Africa has abandoned GEIS and, due to the closure of control boards, other forms of subsidies such as producer-financed export subsidies for surplus removal purposes had to be implemented (Van der Merwe and Otto, 1998). These developments place South African exporters of agricultural products at a distinct disadvantage in global markets. According to Helm (1994), in the early 1990s only New Zealand and Australia had lower percentage producer subsidy equivalents (PSEs) than South Africa. Swart (1997) estimates that South Africa's percentage PSE might have been the lowest of all developed countries during the latter part of the 1990s. This again underscores the argument that South Africa is one of the countries that has moved the furthest down the path of total compliance with WTO regulations. The PSE figures in Table 3.3 support these findings.

These facts have serious implications for planners in the industry: it is necessary to improve the industry's international competitiveness. South Africa has committed itself to the WTO rules and regulations and to the Marrakech agreement. This implies that existing tariff levels will be scaled down according to its notification to the WTO, while minimum market access requirements will be adhered to. The Green Paper on Tariff Policy for Agricultural Products will form the basis on which future agricultural trade policy is developed, and it is imperative that the agricultural industry becomes actively involved in the development of the final tariff policy document. The

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trade deal with the EU falls neatly in line with this strategy. The next section will take a closer look at trading relations of the past and the new agreements envisaged.

Table 3.3. Percentages of Domestic Agricultural Support — A Comparison between Countries

Country	1998	1991
New Zealand	0.8%	4%
Australia	6.8%	15%
South Africa	5.2%	16%
United States of America	23%	30%
Canada	16%	45%
EU	45%	49%
Japan	63%	66%

Source: OECD, 1998

3.3 South African–European Trade Relations

There are arguably three plausible reasons for South Africa to wish to enter the agricultural markets of the EU. First, the EU is South Africa's most important trading partner. This is sufficiently important, so much so that South Africa has deliberately changed its industries to comply with EU standards. Secondly, it is a useful base for selling primary goods and contracting services worldwide. In particular, it is seen as a base for building trade with East European countries. There is also an element of familiarity and tradition. South Africans see it as easier to enter. Finally, policy-makers believe that the world is breaking into regional trade pacts, and that it is absolutely necessary to get a foothold in the EU.

Until 1995, neither the EU nor policy-makers in South Africa had moved beyond a preliminary stage in identifying the most appropriate post-apartheid trade regime. Opinions expressed tended towards two extremes: one, that South Africa's future lies with the OECD and that, in order to avoid sending the wrong signals to private investors and commercial banks, it should retain

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developed country status, implying a Most Favored Nation (MFN) trade regime. The other was that the employment creation problems facing a new South Africa would be so severe that the country should seek the most preferential trade regime possible (Hirsch, 1991). At present, South Africa is classified as a developed country within the GATT, a status that dates from the foundation of GATT.

If South Africa were to be granted membership in an existing scheme, such as the GSP (Generalized System of Preferences) or Lomé, or alternatively granted some special form of association with the EU, this would need to be reported to GATT by the EU. In all cases, any member of GATT which thought that its trading interests would be damaged by such an offer, could either formally challenge it, and require that a vote be taken, or allow the necessary waiver, while entering a reservation. The same procedure would apply to any entry by South Africa into a regional trading organization of African countries.

The custom appears to have evolved, that arrangements to benefit developing countries, or regional pacts among them, are examined more cursorily, and are less likely to be challenged, than those between developed countries. Furthermore, the extension of existing arrangements between developing countries are less likely to be opposed than new or special arrangements. Two contrary factors might now work against these customs, and would be relevant for South Africa. The first is the growth in the last few years of both new preferential arrangements and new regional groups. Countries, which are not involved, have expressed growing concern that these could be increasing too much for the system to cope with. Regardless of these special factors, a final consideration, which would influence the likelihood of a challenge to any arrangement for South Africa, would be whether any country saw a risk of trade diversion for itself due to the arrangement.

Before continuing the discussion on possible arrangements between South Africa and Europe, a brief historical overview of trade will follow. As mentioned before, Europe is South Africa's most important export market.

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Table 3.4 SACU Trade Shares, 1995

Region	Imports	Exports
EU	44%	34%
RSA (rest of Southern Africa)	1.5%	9%
RSS (rest of sub-Saharan Africa)	1%	3%
ROW (rest of the world)	54%	55%

Source: GTAP, 1999

Table 3.4 indicates South Africa's most important trading partners on the basis of 1995 data. The EU was clearly the biggest source of imports and exports for South Africa, while the rest of Southern Africa (RSA, basically SADC without SACU) was more significant in terms of exports than imports. Table 3.5 is a disaggregation of trade between the EU and South Africa, based on 1996 trade flows and tariffs. Note that the tariffs are value weighted to reflect the average tariff on each commodity group. The disaggregation mainly focuses on the agricultural sector, which shows a positive trade balance with the EU. The balance for services and manufactured goods is however a large negative figure — hence the overall negative trade balance. Although a more in-depth analysis of trade flows will be conducted in Chapter 5, Table 3.5 indicates that vegetables and fruit, together with fish and other agricultural products are the biggest net exports. The biggest trade flows occur in the other processed food sector. The high EU import tariffs for livestock and meat, and dairy products are also quite significant.

Table 3.5. Agricultural Trade between the SACU and the EU

Commodity aggregation	Description	Imports (R mil)	Share (%)	SACU tariff (%)	Exports (R mil)	Share (%)	EU tariff (%)	Trade balance (R mil)
Grains and oilseeds	Cereals	86	0.81	15.16	9	0.11	2.06	
	Oilseeds and oleaginous fruits; miscellaneous grains, seeds and fruit; industrial or medical plants	21	0.19	7.58	76	0.89	2.06	
Total		**107**		**13.68**	**85**		**2.06**	**–22**
Vegetables and fruit	Edible fruit and nuts; peel of citrus fruit or melons	23	0.54	0.00	2,890	0.97	8.02	

Table 3.5. **Agricultural Trade between the SACU and the EU (cont.)**

Commodity aggregation	Description	Imports (R mil)	Share (%)	SACU tariff (%)	Exports (R mil)	Share (%)	EU tariff (%)	Trade balance (R mil)
	Edible vegetables, certain roots and tubers	20	0.46	0.00	86	0.03	2.01	
Total		**43**		**0.00**	**2,976**		**7.85**	**2,933**
Livestock and meat	Live animals	15	0.08	0.00	9	0.13	101.51	
	Meat and edible meat offal	179	0.92	33.21	56	0.87	67.67	
Total		**194**		**30.70**	**64**		**72.20**	**–129**
Fish	Fish and crustaceans, mollusks and other aquatic invertebrates	**25**	1.00	**0.00**	**570**	1.00	**0.00**	**546**
Dairy	Dairy produce; bird's eggs; natural honey; edible products of animal origin n.e.c.	**113**	1.00	**7.30**	**0.026**	1.00	**77.56**	**–113**
Other animal products	Products of animal origin n.e.c.	**131**	1.00	**0.00**	**9**	1.00	**0.00**	**–122**
Other Agricultural Products	Live trees and other plants; bulbs, roots and the like; cut flowers and ornamental foliage	22	0.39	0.00	129	0.57	16.41	
	Coffee, tea, malt and spices	24	0.45	0.00	95	0.42	0.00	
	Vegetable planting materials; vegetable products n.e.c	9	0.16	0.00	1	0.01	0.00	
Total		**55**		**0.00**	**225**		**9.42**	**170**
Other processed food	Products of the milling industry; malt; starches; inulin; wheat gluten	167	0.15	10.56	0.3	0.00	13.48	
	Lac; gums, resins and other vegetable saps and extracts	33	0.03	0.00	4	0.00	0.00	
	Animal or vegetable fats and oils and their cleavage products; animal or vegetable waxes	49	0.05	0.00	11	0.01	0.00	

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Table 3.5. Agricultural Trade between the SACU and the EU (cont.)

Commodity aggregation	Description	Imports (R mil)	Share (%)	SACU tariff (%)	Exports (R mil)	Share (%)	EU tariff (%)	Trade balance (R mil)
	Preparations of meat or fish or of crustaceans, mollusks or other aquatic invertebrates	14	0.01	5.28	16	0.01	13.48	
	Sugars and sugar confectionery	32	0.03	10.56	35	0.03	26.96	
	Cocoa and cocoa preparations	50	0.05	0.00	8	0.01	0.00	
	Preparations of cereals, flour, starch or milk; pastry cooks' products	70	0.06	5.28	0.4	0.00	13.48	
	Preparations of vegetables, fruit, nuts or other parts of plants	42	0.04	0.00	461	0.39	13.48	
	Miscellaneous edible preparations	114	0.10	0.00	7	0.01	0.00	
	Beverages, spirits and vinegar	453	0.42	0.00	531	0.46	13.48	
	Residues and wastes from the food industries; prepared animal fodder	45	0.04	0.00	29	0.02	0.00	
	Tobacco and manufactured tobacco substitutes	18	0.02	0.00	64	0.06	0.00	
Total		**1087**		**2.34**	**1167**		**12.47**	**80**
Total agriculture								**3,274**
Total industry								**–12,970**
Overall total								**–96,96**

Source: IDC, 1998

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Any trade agreement between South Africa and the EU, should aim at reducing the tariff barriers between these two regions, thereby increasing trade flows. The main purpose of this study is to indicate the changes in trade flows and the corresponding welfare effects due to tariff reductions according to the FTA agreement. In Chapter 5 the GTAP general equilibrium framework will be used to simulate the change in trade flows. This Chapter will, however, continue with the discussion of other possible trade agreements between South Africa and the EU from a historical perspective, and the implications thereof.

3.4 Possible Trade Schemes for Closer Cooperation between South Africa and the EU

3.4.1 GSPs and Most Favored Nation Status

South Africa has until now participated in non-reciprocal GSPs extended by both the EU and the US. These schemes provide a number of South African exports with better than MFN access to their markets. It could be argued that the GSP could be used as a mechanism by developed countries to entice developing countries into a closer relationship with them. Such a relationship could then be developed into a reciprocal trade agreement, or even an FTA (OECD, 1995). The EU and the US are not the only parties to have extended such preferences to SA, the others being Canada, Japan, Hungary, Switzerland and Norway. This raises the possibility of these countries also wanting to foster even closer relationships with South Africa.

The GSP is likely to be the least attractive option for South Africa, apart from MFN treatment. The relative unattractiveness of the GSP arises both from the limited nature of the trade preferences and from the less satisfactory rules on cumulation. The GSP is a bilateral, non-negotiated agreement. Before the EU would be willing to agree to extend its preferential agreements to entire regions (cumulation), it is required by the WTO that the areas seeking cumulation must have a secretariat, which will affirm that the members of the sub-regional group will apply between themselves the same rules of origin as those that apply to exports to the EU. Such cumulation had been offered to three groups of GSP beneficiaries: the Andean pact, ASEAN and Central America. Thus far, only ASEAN has availed itself of the opportunity because of problems in obtaining agreement in the other two cases (OECD, 1995).

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For South Africa and its neighbors, therefore, obtaining cumulation provisions under a GSP arrangement would require South Africa to join an organization that has a secretariat able to provide the necessary policy statement. SADC is the obvious candidate; it is possible that a specially-created "SACU Secretariat" would be sufficient for the task. It is not clear that a sub-set of the SADC, willing to offer complete reciprocity among themselves, could do so. In all these cases the requirements would be similar to those applying to an association agreement. The GSP rules of origin are less favorable in some respects than those of the Lomé Convention. Hence, there could still be problems for South Africa's neighbors of reduced access to the EU market for items including South African inputs.

MFN status on the other hand, would be the simplest option to adopt, and no special actionwould be required in or out of GATT. It would however fail to provide any extra support to South Africa's efforts to develop new exports, if a new government adopted an export strategy (OECD, 1995). It would not encourage growth of intra-regional production of exports to the EU. Given the possible new regional arrangements discussed in the previous Chapter, it is important thatany agreement between the EU and South Africa does not limit the scope for intra-regional trade and production.

Whilst it would be possible to negotiate cumulation provisions within an association agreement and, to a less satisfactory degree, within the GSP, this would not be possible with MFN status. South Africa and other African countries could export goods based on joint production or using each other's inputs, but these would be ineligible for Lomé preferences if they contained more than the prescribed proportion of South African inputs, including energy, power and transport services, and labor. Whilst this situation would be no different to that at present, it can be argued that its impact may become more serious in future. As the Southern African states, including South Africa, diversify into more processed exports the need to include each other's inputs may grow, especially for the smaller countries. The advantage of MFN status for other countries, especially those with Lomé status, is that it would preserve part of their preferential margin of access to the EU and other developed countries.

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3.4.2 The Lomé Convention

When Lomé I was concluded in February 1975, few would have anticipated that the Convention would continue for more than two decades, let alone become the finest and the most complete instrument of North--South cooperation ever. When Lomé IV was signed in December 1989, the number of ACP and EU signatories had grown to 68 and 12 respectively. Today there are 70 ACPs and 15 members of the European Union, the EC having meanwhile become a Union following the completion of the internal market and the signing of the Maastricht Treaty in 1992.

On the subject of access for ACP products to the EU market, the final agreement arrived at was based on a horizontal approach rather than a product-by-product one. The main points included:

- expansion of the preferential system to cover virtually all products originating in ACP countries;
- relaxation of quantitative restrictions applied to certain tariff concessions;
- extension of tariff concessions beyond current timetables.

During the negotiations with the EU and ACP countries, South Africa sought to be awarded full membership to the Lomé Convention in order to gain highly preferential, non-reciprocal access into the EU. South Africa was hoping to make the general trade arrangements, as specified in Article 24 and 25 in the "General Provisions of ACP/EU Cooperation" the foundation for trade co-operation with the EU. These arrangements are based on the principle of free access to the EU market for products originating in the signatory states, with special provisions for sensitive agricultural products and a safeguard clause (Faber and Roelfsema, 1997).

Full Lomé membership would have been a valuable option for South Africa in four respects. The degree of preference given to the ACP is the most substantial offered by the EU on a non-reciprocal basis to any group of states, although less than is offered in reciprocal agreements like that with the EFTA (European Free Trade Area). Second, it would allow regional processing. Third, it would quickly provide a definite relationship with South Africa's most important export market, nominally guaranteed for the remainder of the last century. This might have been especially valuable given the other uncertainties facing South Africa. Fourth, the Lomé

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convention provides preferences over a wide range of products, an important consideration if changes to South African economic policy result in the emergence of new and unpredictable exports. On the other hand, South Africa is not a "typical" ACP economy: it is large and relatively industrialized. The largest previous "new entrant" to Lomé was Zimbabwe (Winters, 1997). The difficulties associated with the negotiations surrounding its most sensitive exports, such as beef and sugar, provide an indication of the extent of European resistance to extending trade preferences. The interests affected by South African entry would be much greater, and the negotiations would not in practice be automatic or predictable.

Recognizing the high-middle income IMF classification of SA and its potential competitiveness in the production of certain products, together with protests from other ACP countries, the EU was prompted to award SA only a very limited or qualified Lomé membership, which it did in April 1997. This qualified membership of the Lomé Convention would however have entailed only a few direct economic benefits for SA:

- products produced in an ACP country with South African inputs would be able to enter the EU market on a Lomé basis;
- South African companies would have the right to tender for EU development fund projects;
- South Africa could participate in joint bodies of the ACP;
- South Africa could improve market access through the further granting of GSPs;
- further cooperation and integration with ACP states could be facilitated;
- participation in the institutions of the Convention would become possible for South Africa.

Although originally opposing South Africa's attempt to join the Lomé Convention, many ACP countries were in favor of South Africa's involvement, because it was felt that South Africa would strengthen their bargaining power during negotiations with the EU. South Africa's accession to the Convention would thus not result in improved market access for agricultural products in line with the characteristic non-reciprocal Lomé arrangement.

However in 1995 a proposal was made by the EU to South Africa to enter into a bilateral agreement and work towards the establishment of a Free Trade Area (FTA), partly because of the promise of economic support that was made to a politically correct South Africa. Negotiations

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therefore centered around the establishment of such an FTA, brushing aside other possibilities such as Lomé accession or GSPs. However the negotiations ended up focusing on the economic status of South Africa and the degree of concessions which could be handed to South Africa, without harming EU industries or the industries of other ACP countries, losing its initial supportive and developmental undertone rather quickly.

3.4.3. A Free Trade Agreement

An FTA allows for the duty-free movement of goods within a geographically defined area, but it does not imply that the area has a single external tariff; rather each country retains its external tariff in respect of non-FTA countries. Because South Africa and the EU are both signatories to the WTO agreement, they were compelled to construct the envisaged FTA within the boundaries set by the WTO. The cornerstone of the WTO is the Most Favored Nation (MFN) clause, which lays down the principle of non-discrimination. This infers that a member country cannot extend preferences to another member country without immediately and unconditionally extending such preferences to other members. There are, however, two exceptions to the MFN clause as contained in Article XXIV of the General Agreement on Tariffs and Trade (GATT), now included in the WTO rules, namely the Generalized System of Preferences (GSP) and FTAs. With respect to the latter, the WTO sets two conditions for such agreements: (i) the removal of tariffs and other barriers to trade should affect substantially all trade; and (ii) it should not result in the imposition of new barriers to trade for other countries.

Since WTO acceptance of a free trade area requires that "substantially all trade" be free, it follows that the list of excluded products should be small. Moreover, it is generally agreed that permanent exclusion should be avoided, and that it would be preferable to double the time allowed for the phasing-in of zero tariffs on sensitive products. But there should be some yardstick by which to define whether or not a product is sensitive and hence whether or not it should qualify for the exclusion list. A product could be regarded as sensitive on one or more of the following grounds:

- it might yield a substantial part of the government's revenue from customs or excise duties;
- it might be important for reasons of national security;

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- it might be of great political and social importance if it is labor intensive;
- it might be critical in the country's balance of trade;
- it might be in a sub-sector which is inefficient and which depends on tariffs for its survival.

It could be argued that countries, which conclude FTAs are effectively signaling their willingness to re-negotiate their MFN duties with other countries or territories. For instance the implication of an FTA between South African and the EU would be that EU exports would gain an advantage over those of countries, such as the US, whose products would still be subject to import duties. For this reason it can be expected that the US, as one of South Africa's major trading partners, will monitor the EU agreement closely. The next section will focus on the negotiating process from a South African perspective, and how the actual agreement came into being.

3.5 Negotiating a Free Trade Agreement between the EU and South Africa

3.5.1 Background

The year 1999 proved to be decisive in the South African government's efforts to open the country's markets both regionally and internationally. Not since becoming a member of the World Trade Organization (WTO) in January 1995, had the government shown such firm commitment to the removal of all trade barriers, both tariff and non-tariff. The government signaled the intent of partly achieving its goal of economic integration through the negotiation of a Free Trade Area with the EU. The reality of South Africa concluding an FTA agreement with the 15-member European Union (EU), was made possible through exhaustive negotiations and lobbying. The South African government added a final impetus to the process by publishing, for public comment, its proposed offer to the EU in the Government Gazette of 28 November 1997.

The FTA negotiations with the EU were, however, by no means the only discussions of this kind in which the government was involved. Other negotiations included those with the 14-member Southern African Development Community (SADC) and the five-member Southern African

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Customs Union (SACU). In line with the South African Government's commitment to the region, the conclusion of an FTA with the EU would well be followed by negotiations with the SADC towards a similar agreement. The SADC trade protocol, signed in August 1996, although needing ratification by the majority of members, envisaged the formalization of an FTA. In future, it might even be possible for the EU to commit itself to an FTA with the SADC.

3.5.2 The Negotiating Process

In June 1995, EU Commissioner Pinheiro extended an invitation to the South African Minister of Trade and Industries, Trevor Manuel, for South Africa to enter into bilateral negotiations in order to conclude a Free Trade Agreement with the EU. Minister Manuel accepted this invitation, on the condition that nothing is agreed upon, until everything is agreed. The first round of negotiations took place in September 1995 in Pretoria, followed by a second round in October 1995 in Brussels. Although the original aim was to acquire full Lomé membership, after being awarded only partial membership with no chance of receiving additional concessions in this regard, South Africa pursued the extension of trade agreements along the lines of a bilateral agreement with the EU. It has nevertheless been argued that, in contrast to the Lomé Convention, a reciprocal FTA with Europe could give South Africa the opportunity, not only of gaining greater access to the EU market and improving domestic welfare, but also of enhancing the credibility of its trade liberalization program. The agreement would also increase the incentives for investment in the tradable goods sectors (Jenkins and Naudé, 1996).

The draft mandate submitted by the Commission to the EU Council of Ministers ran into unexpected difficulties. This was largely due to EU member states becoming increasingly concerned about sensitive sectors of their economies, particularly agriculture, and more especially the broader implications which the FTA offer to South Africa could have for the EU economic relations with other countries. The major concerns in this regard were that, as the FTA offer would be the first which the EU has made to a country after the conclusion of the WTO agreement, and the first to a country not in a region geographically close to it, this would set a precedent for any future negotiations. Countries with existing similar arrangements might aspire to be granted the same concessions as were granted to South Africa. In addition, if the WTO were

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not to declare the agreement to be in accordance with its rules on free trade agreements, the EU could be forced, according to the MFN principle, to grant the same concessions to all member countries of the WTO, or to retract the agreement.

The EU initially proposed that there should be a fully reciprocal FTA covering 90% of each party's trade. According to Davies (1998), calculations made on the basis of figures in the draft mandate indicated that this would have required the EU to remove duties on only 7% of its imports from South Africa, mainly on agricultural products. However, it would have required South Africa to remove duties on 46% of imports from the EU. Intense pressure from groups within the EU had furthermore resulted in a sizeable list of mainly agricultural products, constituting nearly 39% of South Africa's current exports to the EU, that would be excluded from the FTA. It therefore appeared that South Africa would gain considerably less than 7% of duty-free market access into the EU.

The responsibility of dealing with the agricultural component of the negotiations was placed on the South African National Department of Agriculture (NDA) in September 1995. The NDA decided to follow a consultative and inclusive process, which led to the formation of a Steering Committee (SC) in conjunction with the South African Agricultural Union (SAAU), to assist in research and the drawing up of a draft negotiating mandate for agriculture. The NDA, the SAAU, the National Agricultural Farmer's Union (NAFU), the Department of Trade and Industry (DTI), the National Marketing Council (NMC), and two individuals, representing the horticultural and the agronomic industries, and the livestock industries respectively, were represented on the SC (Figure 3.1).

The industrial representatives who were responsible for liaison with all the parties with an interest in trade in the assigned products organized themselves into three task teams for this purpose. They formed the channels through which the agricultural industry as a whole was included in the negotiating process. The principal function of the task teams was to evaluate each assigned tariff item in detail with a view to verifying the trade data, to establish which productswere sensitive to each side and to devise options for the negotiations. A Eurostat database was updated by the NDA, assisted by SC task teams, with all the statistical information and qualitative assessments

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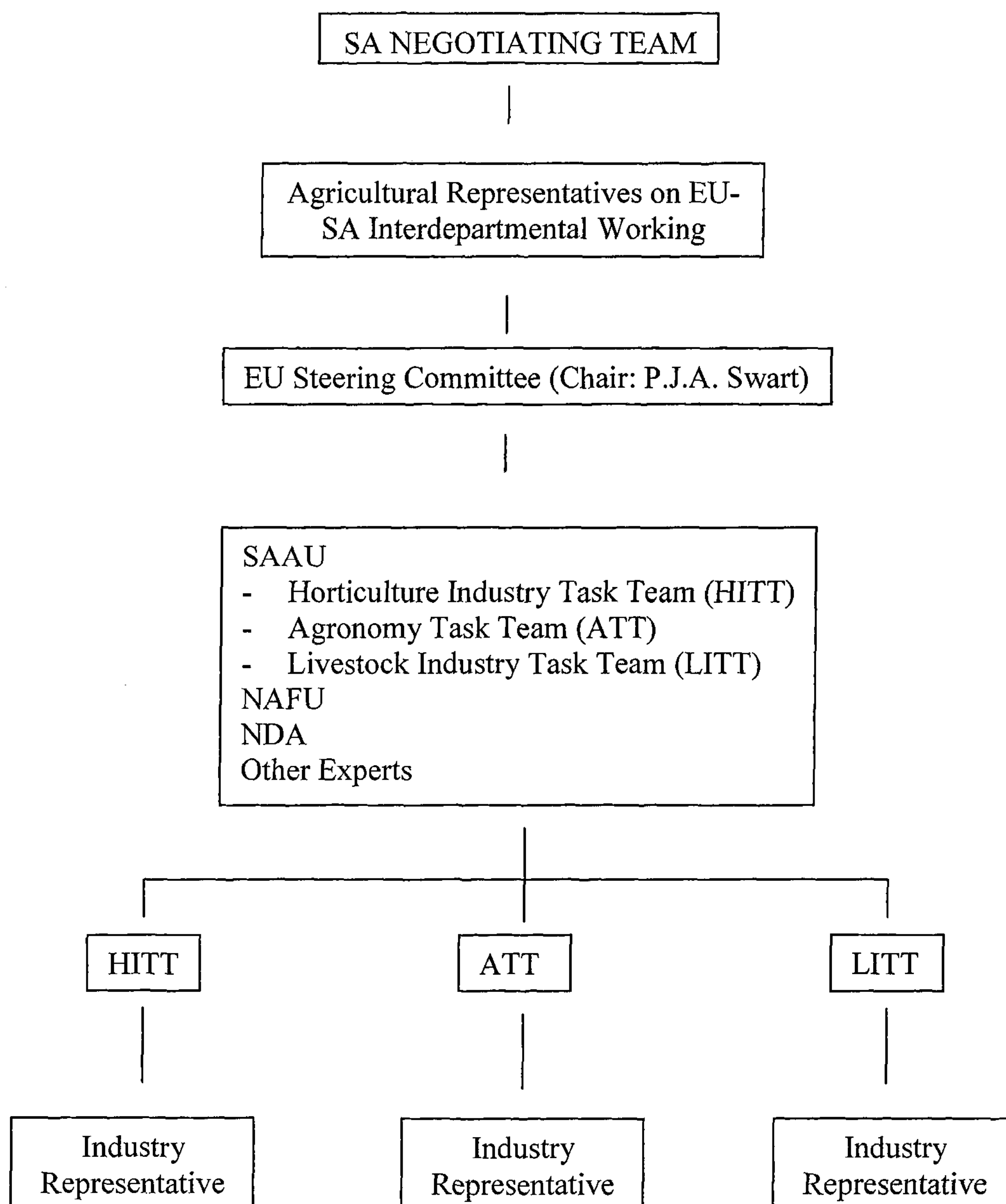
required to assess various negotiating positions. This process led to the formulation of the draft mandate relating to agriculture, as formulated by the SC, which was included in the general negotiations.

Figure 3.1. A Flowchart of the Agricultural Consultation Process



Source: NDA, 1998

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Before going on to the next logical step, which is to analyze the actual agreement between the EU and South Africa, the discussion will briefly focus on the envisaged effect of an FTA on South African agriculture and that of its neighbors.

3.5.3 Envisaged Effects of an FTA on South African Agriculture

From a South Africa perspective, the FTA is meant to open up the European market to South African products, earning foreign exchange, and stimulating the economy to provide jobs and create wealth. This section will focus on those products, which could possibly gain most from such liberalization.

The deciduous fruit industry supplies about 3% of South Africa's total exports and it is important as a major employer and because it is internationally competitive, without subsidies. It is based largely in the Western Cape and is well established in export markets. More potential, however, exists for increasing fresh exports by diverting produce from the domestic market by offering better prices. The industry claims that exports could also be increased through a modest extension in the area under cultivation. A more favorable trade regime could offer improved returns significant to the future of the industry.

The MFN duty rates applying to deciduous fruit are high but significant preferences exist for some suppliers. Of the products currently exported by South Africa, ten receive preferences under Lomé IV, albeit subject to a quota in some cases. The principal exception is grapes. Where quotas apply they are binding in the case of apples and pears, but for apricots, peaches and plums the greater part is still unutilized. Since the Common Agricultural Policy (CAP) regime for deciduous fruit involves a minimum import price in most cases, any duty rebate will be an absolute gain to the exporting state.

For citrus fruit the EU is one of the major export markets. South Africa is at present a major external supplier to the EU, but competition from Chile has recently become more important. South Africa produces oranges, lemons, grapefruit, tangerines etc., with some 60% of production

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being exported (GTAP, 1999). It is clear from its success in penetrating the European market that import controls have not been an insuperable constraint for South Africa.

It is understood that the capacity for expansion in the fishing industry is not large. During the late 1960s there was major over-fishing of South African waters so that by 1982 less than 580,000 tons of ocean fish were caught, compared with a peak catch of 1,917,000 tons in 1968. By 1988 the total had risen again to 1 million tons but it is not clear how much of this was caught in South African, as opposed to Namibian, territorial waters (CSS, 1997). If South Africa were awarded a trade regime permitting cumulation with its neighbors, it might compete with European fishing fleets for the rights to fish in the richer nearby waters.

Paper, with pulp and paper products, is rather more important in trade with the other African countries, particularly the paper. However, exports to the EU have been increasing, in spite of the tariff barriers, and therefore a preference could provide a useful stimulus. There are intentions at least of trying to increase exports, perhaps only of some specialist papers.

Other potential products are sugar, beef and wine in which South Africa is competitive in other export markets, but which are largely excluded from the EU market by the high level of CAP protection. Fresh vegetables and cut flowers are examples of products into which South Africa wants to diversify, and which could gain from preferential access into EU markets. South Africa could export beef to the EU were it not for CAP protection. In contrast to sugar, the country is trying to increase production of meat.

An FTA between South Africa and the EU could encourage the expansion of the meat trade; this would particularly affect the quantity of beef, chicken and pork meat available in the local market. Given that South African markets for beef, chicken, pork and mutton are interrelated, changes in particular meat imports would probably cause the prices of all meats to change simultaneously over time. To analyze this issue, the study by Badurally and Darroch (1997) estimated a meat demand system for South Africa by using the Rotterdam model as developed by Theil, (1978). The estimated cross-price elasticities of meat demand were then used to quantify the potential impact on demand for these meat types of the likely outcomes of the FTA

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negotiations. The results showed that the net short-term effect of the FTA on South African meat consumers would depend on the extent to which different meat prices would change.

Both sugar and beef could become important crops on new smallholdings under the proposed redistribution of land in South Africa. Although this is one factor behind the lack of competitiveness on costs, it is also potentially a strong political reason for South African pressure for trade concessions. South Africa has a well-organized and competitive wine industry, although in value terms it is of negligible importance to exports. Some of the EU–Mediterranean association agreements provide the beneficiaries with preferential access to the EU for wine. However, as with sugar and beef, it seems unlikely that in the present conditions of over-supply on the European market, a concession for South Africa would be politically feasible. It should be noted, however, that if the EU went for a non-reciprocal association agreement, many of which offer preferences on wine, it might face strong pressure from South Africa for improved access.

Given the competitiveness of South Africa's present major fruit exports, increased exports of higher value fruits and vegetables (such as pineapples, mangoes, avocados, litchis and melons) and potentially of asparagus, cherries and strawberries are considered to be commercially desirable. All receive preferences under Lomé IV. For some, there are quotas, but these are still underused. The climate is suitable for these products.

This product-by-product examination suggests that the South African products most likely to benefit from the type of preferential trade regime currently available to developing countries from the EU are deciduous fruits and other new fruit, vegetables, flower and paper products. Citrus fruits would probably benefit, but the EU is not the area to which exporters of citrus fruits are currently looking. Sugar and beef would benefit from improved access to the European market, but are unlikely to receive any preference under an FTA.

3.5.4 Effects of trade preferences on South Africa's trading partners

The biggest concern for South Africa's neighbors centers around the trade diversion effects that would be created by the Free Trade Agreement with the EU. This spurred the SADC countries to

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accelerate their long-standing trade negotiations and sign an historic trade protocol that would gradually turn SADC into a free trade area over the coming decade. This will be implemented through variable and evolving sets of tariff and trade terms between the countries of SADC, in conjunction with the coordination and upgrading of customs systems and infrastructures, and cross-border investment and industrial development programs.

The impact of South African preferences on the competitive position of other exporters is distorted by the application of minimum import prices. It is difficult to predict whether South Africa would displace other suppliers without knowledge of production costs and markets at a level of detail, which cannot be obtained within the context of the present study. However the high volume of its present exports shows that the impact could be large. If market prices in the EU exceed the level determined by the minimum import price, competition among suppliers could result in the market price falling to the minimum, with the possibility of some marginal producers among present preference holders being driven out. Alternatively, the result might simply be an increase in consumption of the fruit in question, perhaps at the expense of some other fruit.

Studies on the effects of the proposed South African–EU Free Trade Agreement on imports have shown that duty-free access of EU agricultural products to the South African market would have significant adverse effects on South Africa's neighbors. Products and countries specifically mentioned include livestock and meat products in Namibia, Botswana and Zimbabwe, sugar in Swaziland and grain milling in all other neighboring countries (Imani Development (International) Ltd, 1997a). This is so even given the existence of free trade within the SACU. The reason for the adverse impact is that the EU pays high producer subsidies (49 per cent) as well as export subsidies in the agricultural sector. According to Goodison (1996), this system of producer and export subsidies will remain in place so long as the EU retains its Common Agricultural Policy (CAP). Stevens and Kennan (1995) nonetheless argue that there will be no significant changes to this policy for the next few years.

The close proximity and apparent close dependency of South Africa's neighbors on both its policy and its trade, makes them vulnerable to changes in these areas. Interviews with African

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policy-makers have suggested more than once that the countries most willing to admit South Africa to normal African status were those furthest away. The nearest countries are, however, among those with the most practical possibilities of joint ventures, and other cooperation with South Africa. They also have infrastructure links in power schemes, communications, and transport systems. At least two, Lesotho and Swaziland, and possibly Botswana as well, are highly dependent on South Africa, not just for trade in goods, but also in terms of migrant labor, Customs Union income, South African production and export-marketing. Their own future is inextricably tied to the good performance of the South African economy, and goodwill from South Africa. Hence they have to compare the possible negative effects from trade diversion to the potential positive effects of preferences arising from the South African–EU Free Trade Agreement.

In terms of agricultural products, the OECD study (1995) identified the EU countries most likely to be affected by South Africa as Spain, Italy, France and Greece for fruits.On past EU form, the fact that there is no direct competition because of seasonal differences will not prevent opposition. This means that, even if only the most obvious products were included, some producers would be affected in almost all member countries. The minor products reinforce this spread: Portugal, the UK and France for paper; for both wood and leather products, mainly Germany, but also Italy, France, Denmark, the Netherlands and Belgium; and potentially all countries for textiles. In considering this list, it is important to remember that three of South Africa's three principal commodity exports to the EU enter without important barriers (gold, diamonds and platinum). The difficulty is that the next two (coal and fruits) happen to compete with the northern and the southern parts of the EU respectively. Those, which are minor, and therefore potentially more acceptable to the EU, are also minor for South Africa. A further adverse effect for the EU of trade preferences would be a loss of customs revenue. Hence there could be budgetary opposition to preferences, although this could be balanced by considerationof a possible trade-off between trade and aid.

Up to now, the whole discussion has been based on speculation about possible trade regimes and their effects on the parties involved. The next section will analyze the actual agreement signed between the EU and South Africa early in 2000. Specific attention will be placed on the changes

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envisaged in import tariff structures. The agreement will be analyzed in two parts, namely the EU offer and the South African offer, which indicate the tariff concessions made to each other. The trade effects of the actual agreement will then be discussed in Chapter 5.

3.5.5 The Final Agreement

After more than three years of negotiations a final agreement was reached in 1999. The two parties accepted their respective tariff reduction schedules. Although the agreement includes all the tradable commodities, this study will focus on agricultural products only.

Table 3.6 is a summary of the time structure of the tariff reductions from the EU side and the South African side. All products were placed within groups according their specific reduction schedule as agreed upon. Hundreds of pages were needed to cover all the relevant products and their negotiated tariffs. It was nevertheless against the specifications of these groups that most of the criticism arose, because it was felt that South Africa was opening up its borders much quicker and to more sensitive agricultural products than the EU.

Table 3.7 shows the percentages of total trade, which the most important commodities comprise, and is fairly self-explanatory. The key issue is what percentage of trade falls within which group and which products are left out of the agreement completely. This would indicate which party is opening up its market more quickly. The Table therefore gives an overview of the most important commodities according to trade value in each group, and also the percentages of total trade in value terms within each group.

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Table 3.6. Import Tariff Reduction Schedule of the FTA Agreement

EUROPEAN UNION		SOUTH AFRICA	
GROUP	**EXPLANATION [a]**	**GROUP**	**EXPLANATION [a]**
1	Tariff elimination at eifota	0	Tariff elimination at eifota
2	Tariff elimination within 3 years after eifota	1	Tariff elimination within 3 years after eifota
3	Tariff elimination between 4 and 10 years after eifota	2	Tariff elimination within 6 years after eifota, starting not later than 4 years after eifota
3A	Tariff liberalization in 10 years, starting in year 1, in equal steps	3	Tariff elimination within 12 years after eifota, starting not later than 7 years after eifota
4	Tariff elimination between 6 and 10/12 years after eifota	4 (PROT)	Protocols
5 PARTIAL 1	Partial liberalization: industrial component of the tariff eliminated at eifota; agricultural component treated the same as basic commodity concerned		
5 PARTIAL 2	Tariff quotas with a growth factor of 3%. in-quota duty of 50% of MFN applied duties		
5 RESERVE	Exclusion–reserve list (review/partial liberalization)		
O	List of omission (list O): list of products not produced in South Africa (products of the community and other regions)		

Note: eifota: entry into force of the agreement

Source: NDA, 1998

South Africa was disappointed that the concept of asymmetry had not been respected by the EU's offer. Under such a scheme, South Africa would have had more time to cut import tariffs, enabling producers to adjust to a more competitive market. The EU had suggested different levels of tariff cuts for industry and agriculture, with the latter being much more conservative, and appeared to be treating South Africa as an equal trading partner and not as a developing country — so much so that about 6% of total trade, or 46% of agricultural trade, would be excluded from tariff cuts. Tariffs on products where South Africa had the greatest export potential, such as vegetables, fruit, meat, and some wines, would only be cut between the 4th and 10th year after

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Table 3.7. Percentages of Total Trade and Most Important Commodities

South African offer		
Groups	**Total trade**	**Most Important Commodities**
0	35%	Barley, sausage casings, alcoholic preparations
1	5%	Vegetable oils, malt and malt products, cherries
2	5%	Preparations of foodstuffs, oils, wafers and rice products
3	39%	Whiskies, compound alcoholic preparations, ethyl alcohol
4	16%	Boneless beef, wheat, dairy products
EU offer		
Groups	**Total Trade**	**Most Important Commodities**
1	23%	Hides and skins, fruits, wool, venison, tea
2	7%	Cane molasses, dried fruits, fruits
3	5%	Fruits, cut flowers, fruit juices
3A	3%	Dried fruits, dairy products, vegetables
4	24%	Fruits, dairy products, wine
5 Partial 1	0%	Dairy products
5 Partial 2	16%	Fruits, fruit juices, wine
5 Partial 3	22%	Fruits, dairy products
Total 5	**38%**	

Source: GTAP and own calculations, 1999

entry into force of the agreement, and in some instances this could be stretched to the 12th year. This would be of great significance to various agricultural sectors in South Africa, one of them being the canned fruit industry. South African canned fruit, for example, is subject to duties of up to 21% in Europe. The EU proposal however failed to bring down tariffs and the suggestion thus was that South African canners would continue to face disadvantages in exporting to European countries. Only for about 6% of total trade did the EU propose that it and South Africa should move tariffs to zero at the same time. This suggestion covered goods such as textiles, some clothing, insecticides, lamps and light fittings, tires, steel and furniture but very few agricultural products.

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3.6 Early Efforts to Model the Effects of the Proposed Free TradeAgreement: A USAID Study

The last section of this Chapter discusses a study on the impact of various FTA agreements between South Africa and the EU, and a Southern African regional FTA, conducted by Davies (1998). The study makes use of the GTAP software and methodology, which provides a very convenient and efficient way for interpreting changes in trade flows due to tariff structure adjustments using a complex system of general equilibrium equations. Although the paper illustrates multiple scenarios for regional cooperation and FTAs between South Africa and the EU, the focus will be on the two most important simulations in the context ofthe present study. Simulation 1 (SEFTA4) implements part of the eventual FTA through the bilateral removal of tariffs and export subsidies between South Africa and the EU. It illustrates the effects of freer trade between these two partners, without any concessions towards South Africa's regional neighbors. The second simulation (SEFTA6) implements an FTA between South Africa and the rest of Southern Africa through the removal of import tariffs only, including those on intra-regional trade. No EU Free Trade Agreement is assumed.

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3.6.1 Reciprocal Removal of Import Duties on All Trade between South Africa and the European Union (SEFTA4)

This simulation entails a full South Africa–European Union FTA, in which all trade flows between the two trading partners are liberalized. This has a significant impact on sectoral outputs. The effects are however of an opposing nature for the two partners. Agricultural and food outputs are predicted to rise in South Africa, together with capital goods, while the output of these sectors is expected to fall within the EU (Table 3.8). As might be expected, free access to the European Union market gives a big boost to food and agricultural production in South Africa, whose outputs rise by 7% and 6% respectively. There is also a rise in capital goods (CGDS) output related to increased investment. Other sectors experience a relative decline, with light manufactured goods suffering the most.

Table 3.8. Percentage Change in Output for South Africa (SA), the Rest of Southern Africa (RESA), the Rest of Sub-Saharan Africa (RESS), the European Union (EU), and the Rest of the World (RESW)

	South Africa	Rest of Southern Africa	Rest of sub-Saharan Africa	EU	Rest of the world
Agriculture	6.07	0.27	–0.02	–0.17	–0.00
Mining	–0.99	0.15	0.02	–0.02	0.01
Food processing	7.11	–0.19	–0.03	–0.11	–0.01
Light manufactured goods	–4.60	–1.69	–0.00	0.17	–0.03
Technical manufactured goods	–4.29	–0.31	0.04	0.06	0.00
Heavy manufactured goods	–2.32	0.36	0.06	0.01	0.02
Services	0.36	–0.09	–0.00	–0.00	–0.00
Capital goods	7.52	–1.78	–0.08	–0.02	–0.04

Source: GTAP, 1999

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From Table 3.9 we see that in this scenario South Africa's agricultural and food exports to the European Union rise dramatically, while exports to other regions fall. South Africa is induced by the FTA to switch markets. This switching is not only away from other foreign markets but also away from the domestic market towards the European Union. This explains the simultaneous increase in imports of agricultural goods. There are thus clearly trade creation/diversion effects at work.

Table 3.9. Percentage Change in the Quantity of Exports from South Africa to Various Regions of the World

	South Africa	**Rest of Southern Africa**	**Rest of sub-Saharan Africa**	**EU**	**Rest of the world**
Agriculture	–7.64	–15.45	–16.85	58.82	–16.54
Mining	–4.76	–2.97	–3.92	1.07	–4.06
Food processing	–19.63	–6.50	–7.50	–345.84	–7.67
Light manufactured goods	–39.62	0.34	1.56	36.92	1.51
Technical manufactured goods	–20.29	–5.12	–5.43	17.57	–5.52
Heavy manufactured goods	–10.68	–3.79	–5.07	7.44	–5.24
Services	–3.00	–6.65	–6.18	–5.97	–6.18

Source: GTAP, 1999

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Table 3.10 shows that although both South Africa and the European Union gain from the FTA, in South Africa there is a large positive terms of trade (TOT) effect that is somewhat diminished by the negative resource allocation effects. These are still dominated by the trade diversion effect, although there is a small effect deriving from domestic distortions. As the FTA induces South Africa to produce more, it expands production of subsidized commodities, reducing its allocative efficiency. Although the trade creation induces large positive values within the EU and South Africa, the trade diversion effects are also large, resulting in a relatively small positive value as the overall welfare gain attributable to the FTA.

Table 3.10. Welfare effects on SA of an SA–EU FTA ($ millions)

	Allocative	TOT	Capital Goods	Total
South Africa	–63.73	402.10	–0.83	337.55
Rest of Southern Africa	–5.11	–41.74	–0.05	–46.90
Rest of sub-Saharan Africa	–2.26	–18.78	–0.70	–21.74
EU	221.14	271.29	209.41	701.84
Rest of the world	–131.05	–615.38	–207.92	–954.35
Total	18.99	–2.50	–0.08	16.40

Source: GTAP, 1999

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3.6.2 A Southern African Free Trade Area (SEFTA6)

This simulation depicts the effect of removing all tariffs on trade between South Africa and the rest of Southern Africa, including those on trade amongst the countries within Southern Africa. The biggest impact will be experienced in trade in light manufactured goods in the rest of Southern Africa, which rises by almost 29% (Table 3.11). There is little impact on other sectors. In South Africa the output effects are small. Both partners, however, are faced with a negative effect on agriculture. This reflects the regional comparative advantage of the rest of Southern Africa in light manufactured goods and the current high tariff barriers on trade in these commodities. Essentially, sub-regional producers replace domestic ones in the South African market. Resources flow into the sector from elsewhere in the economy.

Table 3.11. Percentage Changes in Output by Region

	South Africa	Rest of Southern Africa	Rest of sub-Saharan Africa	EU	Rest of the world
Agriculture	–0.21	–1.79	0.01	0.03	0.01
Mining	–0.62	–1.86	0.00	0.01	0.01
Food processing	0.27	–0.68	–0.00	–0.00	–0.00
Light manufactured goods	0.49	28.95	–0.04	–0.04	–0.03
Technical manufactured goods	0.46	0.40	–0.01	–0.00	–0.00
Heavy manufactured goods	–0.19	–3.50	0.00	0.00	0.00
Services	–0.01	–0.31	–0.00	–0.00	–0.00
Capital goods	1.11	15.15	–0.02	–0.01	–0.01

Source: GTAP, 1999

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Table 3.12 shows that under this scenario prices rise in the rest of Southern Africa, except for land and natural resources. This reflects the impact of declining output on a sector specific factor, for instance land is only used in the agricultural sector, which has a declining output. The rising prices choke off some of the expansion that might otherwise have occurred. The expectation that the FTA will significantly induce trade between the partners is confirmed. Flows within the rest of Southern Africa rise substantially, particularly in light manufactured goods. Imports of light manufactured goods from South Africa rise by some 254% (not shown), partly as a reflection of the low initial flows. At the same time exports of light manufactured goods to South Africa rise by 643%. Imports and exports to other parts of the world both decline, reflecting substantial switching of markets caused by the FTA. The exception is agricultural imports, which rise to plug the gap caused by reduced output. A similar pattern can be observed for South African imports and exports.

Table 3.12. Percentage Price Changes

	South Africa	Rest of Southern Africa	Rest of sub–Saharan Africa	EU	Rest of the world
Land	–0.28	–4.06	0.06	0.17	0.04
Unskilled labor	0.79	5.15	0.01	–0.00	–0.00
Skilled labor	0.79	5.39	0.00	–0.00	–0.00
Capital	0.78	5.05	0.01	–0.00	–0.00
Natural Resources	–0.91	–3.07	0.02	0.02	0.03
Agriculture	0.53	2.49	0.01	0.01	0.01
Mining	0.29	0.49	0.01	0.01	0.01
Food processing	0.48	1.51	0.01	0.01	0.00
Light manufactured goods	–0.38	0.37	0.01	0.00	–0.00
Technical manufactured goods	0.53	1.20	0.01	0.00	–0.00
Heavy manufactured goods	0.56	1.43	0.01	0.00	–0.00
Services	0.64	2.70	0.01	–0.00	–0.00
Capital goods	0.43	0.96	0.01	0.00	–0.00

Source: GTAP, 1999

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Table 3.13 illustrates the welfare decomposition under a SA–SADC FTA. Both partners to the agreement gain. As usual the effects are dominated by terms of trade effects, which occur because of rising exports. There are however relatively large trade diversion effects, as indicated by the large negative values for the countries excluded from the FTA. Comparing this simulation to the first, the global welfare gains from the SA–EU FTA exceed those of the SA–SADC FTA. In fact the second simulation has a negative global value because of trade diversion effects. The gains for the partners to the FTA are also larger for the first simulation. It is however interesting to note that there always will be trade diversion where countries excluded from the FTA will experience welfare losses. The compensation principle could therefore be advocated by the WTO where FTAs are considered.

Table 3.13. Welfare Effects of an SA–SACD FTA ($ millions)

	Allocative	**TOT**	**Capital goods**	**Total**
South Africa	18.12	117.89	28.27	164.26
Rest of Southern Africa	15.74	149.10	5.14	169.93
Rest of sub-Saharan Africa	–2.12	–0.85	0.65	–2.31
EU	–68.72	–88.67	0.91	–156.48
Rest of the world	–43.28	–178.61	–35.07	–256.96
Total	–80.26	–1.14	–0.10	–81.56

Source: GTAP, 1999

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3.7 Summary

This Chapter starts by discussing previous trade agreements with South Africa's most important trading partners. The focus is mainly on Europe and the possibility of South Africa entering into the Lomé constellation is explored, together with the effects that such an agreement would have on various agricultural commodities. The discussion culminates by analyzing a study, which models some free trade scenarios. There are many other scenarios which could be considered, one of them being a regional Southern African FTA in lieu of an agreement with the EU. The study could improve its usefulness to policymakers by displaying a greater disaggregation into individual products or product groups. This would enable policy makers to identify competitive products within a sector, which could then be enhanced to gain even bigger benefits from liberalization. A further very important issue, especially in the context of Southern Africa is employment, or rather unemployment. The transfer of labor between sectors, labor rigidities and increased use of unskilled labor would definitely make an expansion of these simulations worthwhile.

The next Chapter will be of a more technical nature, discussing the general equilibrium framework of the GTAP model, which will be used for an in-depth analysis of the FTA agreement between South Africa and the EU. In Chapters 5 and 6 the analysis of the results of the actual FTA between South Africa and the EU is conducted, making use of the GTAP model described in Chapter 4. This is a more accurate study than the USAID study, because it has more recent data at its disposal (which is essential given the altered import tariff structures for both the EU and South Africa). After all, both the welfare and trade flow effects stem from these tariff changes.

Furthermore, the focus is mainly on the agricultural sector, which is disaggregated as much as possible to indicate the various effects on the different sectors. There is also a section on unemployment. The results are tested through a sensitivity analysis. To the knowledge of the author, there has not been another study on the FTA up to now that uses a general equilibrium framework to calculate the quantitative effects of the agreement. This study could therefore be the catalyst for further studies and discussion.