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THE EU, SOUTH AFRICA AND SOUTHERN AFRICA AFTER THE COTONOU TRADE REGIME: IMPLICATIONS FOR SACU

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A thesis submitted to the Faculty of Arts, University of the Witwatersrand, Johannesburg, in partial fulfilment of the requirements for the degree of Master of Arts.

Johannesburg, 2009

DECLARATION

I declare that this thesis is my own unaided work. It is submitted for the degree of Master of Arts in the University of the Witwatersrand, Johannesburg. It has not been submitted before for any other degree or examination in any other university.

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Emilian Gueorguiev

11th day of February, 2009

ABSTRACT

This study examines the impact of the EU's trade policy on the integrity of SACU in the context of the EPA negotiations, which is expected to be signed in early-mid 2009. To this end, it analyses the policy leverage (i.e. conditionality, issue-linkage and sanctioning) exerted by the EU on SACU countries towards signing onto the EPA. It also examines the intra-SACU arrangements between on the one hand, Botswana, Lesotho, Namibia, Swaziland (BLNS), and on the other, South Africa which brings into perspective the highly unequal levels of economic size and level of development. The study posits that in a trade negotiation with a dominant trading partner, smaller countries will face much higher opportunity costs than medium-sized countries, in which case smaller states will accept the terms of a more dominant trading power much easier than medium-sized states. Overall, the study concludes that South Africa's unwillingness to sign onto the EPA alongside its SACU partners is a product of insufficient pressure on the part of the EU and differing domestic and regional interests to those of the BLNS.

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TABLE OF CONTENTS

LIST OF ACCRONYMS VII

INTRODUCTION 9

CHAPTER 1 UNDERSTANDING THE THEORY BEHIND TRADE NEGOTIATIONS..... 18
1.1 Introduction..... 18
1.2 Theoretical Framework..... 18
1.3 Analytical Framework..... 23

CHAPTER 2 THE POLITICAL ECONOMY OF THE SOUTHERN AFRICAN CUSTOMS UNION 30
2.1 Introduction..... 30
2.2 The Economics of Customs Unions..... 30
2.3 Characteristics of SACU..... 32
2.4 The persistent patterns of SACU cooperation..... 34
2.5 The 2002 SACU Agreement: Towards a single arrangement vis-à-vis third parties? 39
2.6 Summary..... 43

CHAPTER 3 THE EU AND SOUTHERN AFRICA: CONDITIONALITY, DIFFERENTIATION AND THE SHIFT TOWARD RECIPROCAL TRADE RELATIONS 45
3.1 Introduction..... 45
3.2 The shift toward reciprocal trade relations 45
3.3 The WTO dimension 52
3.4 Alternatives to EPAs..... 53
3.5 The introduction of conditionality for EU aid in the context of the EPAs..... 55
3.6 South Africa's shift toward trade liberalisation in the post-1994 era 58
3.7 WTO plus issues in the EPA negotiations..... 60
3.8 The Trade, Development and Cooperation Agreement..... 60
3.9 TDCA compensatory measures and BLNS acceptance of greater trade liberalisation 62
3.10 Summary..... 65

CHAPTER 4 EXAMINING THE EPA NEGOTIATION PROCESS 67
4.1 Introduction..... 67
4.2 Regional inconsistencies in Southern Africa..... 67
4.3 Regional inconsistencies in SACU..... 68
4.4 Examining the negotiation process 70
4.5 Game theory and the political economy of the negotiations 77

CONCLUSION 81

REFERENCES 84

TABLE OF FIGURES

Figure 1 Causal diagram 25

Figure 2 Game Theory Payoff Matrice 78

LIST OF ACCRONYMS

ACP	African, Caribbean and Pacific countries
ANC	African National Congress
BLNS	Botswana, Lesotho, Namibia and Swaziland
CAP	Common Agricultural Policy
CARIFORUM	Caribbean Forum of ACP States
CEMAC	Caribbean Forum of ACP States
CET	Common External Tariff
CRP	Common Revenue Pool
DFQF	Duty Free, Quota Free
DTI	Department of Trade and Industry
EBA	Everything But Arms
EC	European Commission
ECOWAS	Economic Community of West African States
EDF	European Development Fund
EEC	European Economic Community
EPA	Economic Partnership Agreement
ESA	East and Southern Africa
EU	European Union
FTA	Free Trade Agreement
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GEIS	General Export Incentive Scheme
GSP	Generalised System of Preferences
IEPA	Interim EPA
ISI	Import Substitution Industrialisation

LDC	Least Developed Countries
MFN	Most Favoured Nation
NEPAD	New Partnership for Africa's Development
NIEO	New International Economic Order
PACP	Pacific ACP states
RPTF	Regional Preparatory Task Forces
SA	South Africa
SACU	Southern African Customs Union
SADC	Southern African Development Community
SAIIA	South African Institute of International Affairs
SDT	Special and Differentiated Treatment
TDCA	Trade, Development and Cooperation Agreement
UNCTAD	United Nations Conference on Trade and Development
US	United States
WTO	World Trade Organisation
ZAR	South African Rand

INTRODUCTION

The European Union (EU) and the Africa, Caribbean and Pacific (ACP) countries have a long history of development cooperation. This has proceeded through various phases, beginning with the Yaoundé Conventions (1963-1974), followed by the four Lomé Conventions (1975-2000) and the current Cotonou Agreement. These frameworks for cooperation have contained unique features of the broader field of North-South cooperation such as trade and development. In terms of trade provisions, the EU has granted ACP countries with unilateral non-reciprocal trade preferences in order to encourage these countries to diversify and increase exports. However, the results of these trade preferences offered under the Lomé Convention to a large extent were disappointing as the ACP states' share of exports to the EU declined steadily from 6.7 percent in 1976 to 2.8 percent by 1994.[1] At the same time, there were substantial changes in the external environment relating to the global trading system, globalisation and trade liberalisation. The conjunction of these factors led to a reassessment of the EU's development approach which led to the signing of the Cotonou Agreement in 2000. The new Agreement represents a major break with the non-reciprocal preferences of the past meaning that trade preferences will be applied by both the EU and the ACP countries, thereby ending the one sided application by the EU of the Lomé Convention trade provisions. In terms of the Cotonou Agreement, non-reciprocal trade preferences should have been replaced by reciprocal Economic Partnership Agreements (EPAs), between different ACP groupings and the EU by 31 December 2007.

According to the Cotonou Agreement, poverty reduction and integration into the world economy are the main objectives of EPAs. As policy analysts have emphasised a positive correlation between trade and development, it comes as no surprise that the EU has seen trade as a prime instrument for development. The EU maintains that this objective is best served by EPAs which would *inter alia*, support regional integration. The EU has a clear preference for negotiating

[1] Hurt, S. "Co-operation and coercion? The Cotonou Agreement between the European Union and the ACP states and the end of the Lomé Convention" in Third World Quarterly, Vol. 24, No. 1, February 2003, p. 165.

EPAs on existing integration efforts, which have been characterised by weak capabilities and institutional weakness. The Southern African Customs Union[2] (SACU) is considered to be the most stable, coherent and prominent economic grouping in Africa and has undertaken significant liberalisation commitments vis-à-vis the EU. In the context of the EPA negotiations with the EU, four of the five members of SACU have pressed ahead to deepen integration with the EU, while South Africa has remained reluctant to follow. These developments have produced major divisions in SACU, thereby threatening to dissolve the world's oldest customs union (SACU). It is within this context that the research report will seek to assess the impact of the EU's trade policy on the integrity of SACU.

Even though the BLNS and South Africa form part of the same customs union (SACU), the former and latter hold very divergent views regarding economic policy vis-à-vis the EU. At the same time, given the wide developmental gaps between SACU members, the EU also differentiates between South Africa and the BLNS in terms of economic policy. For these reasons, the research report will separately assess the EU's trade policy toward, on the one hand, South Africa, on the other, the BLNS.

In order to understand the extent to which the EU's trade policy has threatened to undermine SACU, the research report will examine the strategic interaction (power) within which the EPA negotiations have taken place. As the behaviour of states can be considered a function of the distribution of power within a system, a structural approach will enable the research report to examine the function of constraints and choice in bringing the initial divergent positions of actors into convergence. For instance, the BLNS, were at first hesitant to initial the EPAs, however subsequently initialled out of fear of losing out on EU aid and market access as the end of 2007 was approaching. By contrast, South Africa has resisted pressure on the part of the EU to initial the EPAs and has argued that such a move would undermine its national interests. This raises important questions such as: to what extent is the choice of initialling EPAs with the EU informed by power and dependence? Has the EU manipulated the

[2] SACU is formed by Botswana, Lesotho, Namibia, Swaziland (BLNS), as well as South Africa

opportunity costs of the BLNS, thereby compelling them to initial EPAs? In addressing these questions, the research report will examine the link between underlying power capabilities and ability to influence policy outcome.

This research question is important as it examines costs and benefits associated with small countries' accession to discriminatory trade arrangements with much larger countries. In theory it is assumed that the benefits of openness are inversely related to size. In other words, small countries should receive disproportionately more trade flows than larger countries within the context of reciprocal liberalisation. However, economic openness is no longer limited to trade flows, but includes trade in services, trade related disciplines and new issues, which pose a serious policy challenge to weaker states. Therefore, the focus on power and inequality between the EU and SACU countries, will allow the research report to examine the extent to which relative power capabilities affect the distribution of gains.

The analytical foundations of this world view are provided by theories on international regimes and cooperation. Theories of international regimes have been selected as most appropriate for this research report as these provide a political framework within which international economic processes occur, thereby allowing a link to be forged between international economics and politics. As was indicated above, cooperation between the EU and ACP countries has been characterised by increasingly complex collaboration that has involved institutional collaboration on different topics and issues. This condition of "complex interdependence" involves the adjustment of policies on the part of actors through a process of policy coordination. This process of collaboration or policy coordination forms the core concept of *regime theory*. *Regimes* are defined as norms, rules, and procedures around which actor's expectations converge in a certain issue-area.

The literature on regime theory can be grouped in a number of categories, namely, structural, modified structural (game theoretic), functional, and cognitive. These approaches are not mutually exclusive, but overlap in certain instances in explaining aspects of collaboration. However there are fundamental

differences in the underlying assumptions of some of these approaches. The main cleavage that cuts across the above approaches emerges between the "structural" approach and the "cognitive approach". The former stresses the role of power and the distribution of power in the international system, whereby state behaviour is a function of international conditions (i.e. the distribution of power). The latter stresses the pervasive characteristic of the international system, thereby arguing that changes can occur regardless of the structure and hierarchy of power in the international system.

The structural approach accounts for the behaviour of states on the basis of differing distributions of power among states. For structuralists, the nature of international regimes is determined by the distribution of power among states which leads to the inference that *regimes* have little or no impact.[3] Such emphasis of power leads to the reasoning that as the power of states changes, there will be a concomitant change in the rules that comprise international regimes.[4] This is consistent with the theory of hegemonic stability which emphasises the importance of hegemony and leadership in the international political economy. One of its major proponents, Kindleberger has argued that a hegemonic power will undertake to provide leadership, thereby making interstate relations more stable.[5] Even though the concept of hegemony, defined in terms of attributing a decline in international economic regimes to eroding hegemony appears ambiguous, certain elements of this theory provides insight into the preferences and incentives of hegemonic powers. For instance Krasner argues that the structure of international trade (the degree of openness for movement of goods) will be contingent on potential economic power. For Krasner, a hegemonic distribution of economic power will lead to a more open

[3] Krasner, S., "Structural causes and regime consequences: regimes as intervening variables" in International Organization, Vol. 36, No. 2, Spring 1982, p. 190.
[4] Keohane, R., and Nye, J. Power and Interdependence: World Politics in Transition, Little, Brown and Company, Boston, 1977, p. 43.
[5] Kindleberger, C., "Dominance and Leadership in the International Economy: Exploitation, Public Goods, and Free Rides" in International Studies Quarterly, Vol. 25, No. 2, June 1981, p. 242-247.

trading system as relatively large states will find that their political power will be enhanced by a more open economic system.[6]

By contrast, in *Transforming International Regimes, What the Third World Wants and Why*, Krasner argues that as the international system is characterised by asymmetrical economic interdependence, whereby weaker states have been unable to influence international behaviour on the basis of national power capabilities, these states have perceived regime change to be the only source for potentially increasing their economic and political power.[7] In other words, by changing norms, rules and procedures which govern the movement of goods and factors of production in the international economy, the Third World can ameliorate the effects of inherent weak national power capabilities and domestic political structures.[8]

Although the main focus of this research report is not on regimes, theories of international regimes can provide useful insight into the constraints and opportunities faced by actors which is contingent on relative economic strength. These also demonstrate that asymmetries of power or dependency relations are inherent in the structure of the international system, which largely determines international behaviour and negotiation outcomes. The analytical foundations of this worldview provide a strong basis for analysing the relationship between unequal or asymmetric parties. This has broad relevance in the context of North-South relations, especially in economic relations and trade agreements. In this regard, the most publicised aspects of trade and development (i.e. trade liberalisation and integration into the global economy) have depicted the South to be a coherent entity pursuing similar objectives, such as the call for a New International Economic Order (NIEO). When looking closer however, it appears that developing countries and least developed countries (LDCs) have been severely constrained in acting jointly toward bringing about fundamental changes in the international economic system. The most important of these

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[6] Krasner, S., "State Power and the Structure of International Trade" in World Politics, Vol. 28, No. 3, April 1976, p. 317-320.
[7] Krasner, S., "Transforming International Regimes: What the Third World Wants and Why" in International Studies Quarterly, Vol. 25, No. 1, March 1981, p. 119-121.
[8] Ibid, p. 122.

changes relate to influencing the debate over the new consensus on development, elements of which are reflected in the Washington Consensus. The most notable debates within this literature arise in certain aspects of economic development which are relevant to the research report, such as the degree of openness vis-à-vis the international economy and the degree of state intervention in the market.

The research report aims to reinforce this view by indicating that developing countries and LDCs have found it extremely difficult to adopt common positions in trade negotiations vis-à-vis developed countries in the context of bilateral trade agreements. The corollary of this is that there emerges to be a growing separation within the South which casts a shadow over the vision of South-South co-operation and ultimately blurs the conceptualisation of a North-South divide. This is illustrated by the split over the signing of the Interim Economic Partnership Agreement (IEPA) between South Africa and the BLNS vis-à-vis the EU. On the one hand, South Africa has pursued institutionalised forms of regional co-operation through SACU and the broader Southern African Development Community (SADC), but on the other, has found it increasingly expensive in maintaining institutional frameworks of co-operation like SACU.

In assessing the impact of the EU's trade policy on the integrity of SACU, the research report will examine the two selected case studies[9] of *South Africa* and the *BLNS* and the treatment accorded to these actors on the part of the EU respectively. As the EU insists of treating South Africa differently to the BLNS in the context of the EPA negotiations, this would mean that internal border controls would have to be maintained in order to enforce the different rules of origin which ultimately undermines the integrity of SACU and its Common External Tariff (CET). A CET is one of the essential characteristics of a customs union, without which SACU may become unrecognisable as a customs union.[10] The EU has been willing to align both trade regimes which would ameliorate such an outcome, but has made this contingent on South Africa's accession to

[9] As Botswana, Lesotho, Namibia and Swaziland (BLNS) constitute a uniform group, these will be treated as a single case study

[10] Viner, J. The Customs Union Issue, New York, Lancaster Press, 1950, p. 5.

a full EPA. For South Africa this has been a contentious issue as such a move entails acquiescing to "behind-the-border" issues, which have become increasingly prominent in the new EU trade strategy. This relates to undertaking liberalisation in services, competition, investment, government procurement, etc. In considering the impact of the EPA on the future of SACU, it will also be important to review the relationship amongst SACU member states with respect to revenue distribution and institutional arrangements. In terms of revenue distribution, the National Budget Review 2008 of the South African Department of National Treasury indicates that SACU payments in the first nine months of 2007 amounted to 1.1 per cent of GDP.[11] Under the new Agreement, South Africa contributes about 92 per cent to the SACU GDP, but retains only about 52 per cent of the revenue pool.[12] As South Africa's net costs exceed its net benefits in participating in this arrangement, it comes as no surprise that the treasury has been increasingly uncomfortable with the revised revenue-sharing formula in the new SACU Agreement of 2002.

Therefore in assessing the impact of the EPA on the coherence of SACU, any analysis would be incomplete without considering South Africa's position within SACU and its approach toward the broader Southern Africa region. This can also be considered an important factor influencing the strategic choice faced by South Africa in the context of the EPA negotiations, which ultimately involves having to reconcile between on the one hand, national and domestic interests (i.e. a cost/benefit analysis of acquiescing to "behind-the-border" measures in the context of the EPA), and on the other, preserving the integrity of SACU (i.e. a cost/benefit analysis of aligning both tariff regimes and maintaining the current revenue sharing arrangement) and enhancing broader regional co-operation efforts. For instance as SACU is circumscribed within the broader SADC, it is seen as a potential building block for deeper integration within SADC.

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[11] South African Department of National Treasury, Medium Term Budget Policy Statement 2007, 30 October 2007, p. 21, available from: http://www.treasury.gov.za/documents/mtbps/2008/mtbps/Chapter%202.pdf, accessed 29 November 2008.

[12] McCarthy, C., (1) "The Southern African Customs Union in Transition" in African Affairs, Vol. 102, 2003, p. 627.

Such aspirations for deeper integration are confirmed by the launch of the SADC Free Trade Area (FTA) in August 2008 and an ambitious plan to evolve this arrangement to a customs union by 2010, which critics maintain will be impossible due to numerous issues, amongst which are decisions relating to the EPA negotiations.[13] A SADC customs union would in *de facto* mean a merger between SACU and SADC as a CET would need to be adopted, which seems most unlikely as SADC members are undertaking different commitments in the EPAs vis-à-vis the EU. By virtue of South Africa's position in SACU, the latter has undertaken significant tariff reductions toward SADC since the SADC Protocol on trade came into force in 2000; all imports now enter duty-free, excluding motor vehicles and respective parts, and used clothing.[14] This highlights not only SACU's important role as a potential precursor toward deeper regional integration, but also South Africa's dominant position within SACU and the respective implications for future regional co-operation in the region. As a corollary, the choices that South Africa is faced within the context of the EPA negotiations will directly influence not only the future of SACU, but any deeper integration efforts within the region and beyond. This brings into perspective the indirect impact of the EU's trade policy on SACU and the broader region, which is induced through South Africa.

In terms of the case studies selected, the *BLNS* can be considered "typical" of a class of cases; they all form part of the same customs union, all are economically reliant on South Africa, and all have initialled interim EPAs, as the non-reciprocal Lomé preferences have expired at the end of 2007. By contrast, *South Africa* also forms part of the same customs union, but can be considered a "deviant" or "outlier" case, as it is by far much more developed than the BLNS and has its own trade agreement with the EU since 1999.

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[13] Stevens, C., "A Tangled Web: Factionalism over EPAs reveals SADC fault lines" in Trade Winds, Vol. 2, No. 1, November 2008, p. 9.
[14] Kruger, P. The Impact of the SADC FTA on intra-regional trade, Tralac, 28 August 2008, available from: http://givengain.com/cgi-bin/giga.cgi?cmd=cause_dir_news_item&cause_id=1694&news_id=51493&cat_id=1030, accessed 1 December 2008

The following chapter provides a detailed analysis of key theoretical insight which has informed the formulation of this study. It also provides a clear analytical framework by contextualising the study within clearly defined variables. Chapter 2 provides a background to SACU by considering the intergovernmental co-operation amongst members and highlighting South Africa's dominant role in terms of decision making. This part provides insight into the essential characteristics of a customs union and essentially defines the variance in the dependent variable, which is an important precondition for understanding the subsequent chapters. Chapter 3 considers the shift in the EU's trade policy toward reciprocal trade relations and policy instruments through which it has been able to gain political acceptance of such policies on the part of Southern African countries. The final chapter considers the EPA negotiation process between on the one hand, the BLNS and South Africa, and on the other, the EU.

CHAPTER 1 UNDERSTANDING THE THEORY BEHIND TRADE NEGOTIATIONS

1.1 Introduction

The trade negotiations between the EU and countries in Southern Africa are essentially about the conclusion over the EPAs, which are seen to be developmental strategies to help integrate these countries better in the international economy. To this end, the debates surrounding the content over the EPAs embody core elements of the developmental literature such as economic openness to trade and degree of state intervention in the market. At the one end, larger and more developed countries, in this case the EU, have a clear preference for economic openness and trade liberalisation with minimal government intervention as a key to stimulating economic growth and creating the preconditions for economic prosperity. At the other end of the spectrum, weaker countries that are latecomers to industrialisation see trade liberalisation as an important precondition, yet not an exclusive precondition in fostering economic development. For instance, from the perspective of the ACP, in order for these countries to maximise the benefits of open markets, the role of the state is essential in developing the capacity to internalise the benefits of more open trade (i.e. strengthening of infrastructure and building institutions).[15] The rationale for constructing or reforming trade regimes along the lines of the neoliberal model is well captured by both theories of realism and liberalism.

1.2 Theoretical Framework

Realism on the one hand, accords a central role to state power and the distribution of power amongst states. From this perspective the behaviour of states is informed purely by egoistic self-interest in maximising utility without regard for the utility of another party. Therefore state behaviour is considered to

[15] Bilal, S., and Rampa, F. Alternative (to) EPAs: Possible scenarios for the future ACP trade relations with the EU, ECDPM, Maastricht, February 2006, p. 47.

be purely a function of the power distribution within the system.[16] To this end, decisions over economic policy (i.e. a more open or closed economy) are informed purely by egoistic self-interest calculations in serving particular state interests to enhance state power.[17] Realist theory would predict that the decisions of the EU to seek reciprocal trade relations and more open trade with ACP countries are purely informed by its self-interests which does not account for the utility function of the ACP countries.

On the other hand, the liberal response to the behaviour of states would downplay the diverging interests of states and would explain that state power is a response to "failures" in markets of responding to problems of collective action. In this context, state power is considered an optimal response to enhance global welfare and promote joint maximisation of gains.[18] This position is consistent with classical approaches to political economy, particularly the work of Adam Smith and the provision of public goods.[19] Although Smith recognises that that "the invisible hand" best organises the attainment of society's capital stock toward developing social wealth, the state has a minimalist role in providing certain public goods (i.e. protecting society from violence, injustice; and maintaining certain public goods and institutions).[20] In other words, state power is a function of attaining the common good by providing the preconditions for furthering society's general interests.[21] One particular liberalist theory which is consistent with employing state power for the attainment of the common good is the hegemonic stability thesis, which sees an enlightened hegemon providing the public good of a steady market and providing liquidity when the international monetary system is in distress.[22] According to liberal theory, open markets and free trade can be considered

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[16] Krasner, S., "Regimes and the Limits of Realism: Regimes as Autonomous Variables" in International Organization, Vol. 36, No. 2, Spring 1982, p. 498.
[17] Locit.
[18] Haggard, S., and Simmons, B. "Theories of international regimes", in International Organization, Vol. 41, No. 3, Summer 1987, p. 509.
[19] Caporaso, J., and Levine, D. Theories of Political Economy, Cambridge University Press, Cambridge, 2005, p. 44.
[20] Locit.
[21] Krasner, S., (1) op.Cit, p. 197.
[22] Kindleberger, C., op. Cit, p. 247.

public goods which further the interests of all parties. The rationale for more open markets has its foundation in the neoliberal model which supports the free market, ensures a more competitive environment and takes advantage of economies of scale. One of the most debated issues in international political economy has been over the idea that intervention in markets is inefficient. From a neoliberal perspective, governments are not able to intervene efficiently and the latter should have a minimalist role in the functioning of the market.[23] The neoliberal approach provides the foundations for a global economic system characterised by a shift towards free trade, open markets, unrestricted capital mobility and harmonised institutions. This is achieved by urging governments, especially in developing countries to adopt an elaborate agenda of privatisation and liberalisation, which has been the linchpin of the EPA provisions.[24]

The task of this research proposal is to examine the political process through which actors' preferences are brought into convergence in the context of a negotiation process. To do this end, theories of international regimes provide useful insight in explaining co-operation amongst actors in trade relations for the reason that the starting premise of conceptualising regimes can not only be undergirded by the core theories of international political economy such as realism and liberalism as highlighted above, but allow for the incorporation of systemic level analysis. In other words, instead of accounting for outcomes based solely on actors' self interests and power which is the basic realist premise, or a more liberal perspective that sees outcomes as a function beyond the calculations of self-interest, a systemic level analysis focuses on environmental factors in explaining outcomes, such as the competitiveness of markets for instance.[25] In analysing trade relations, in particular why states seek to co-operate, such approach can move beyond liberal and mercantilist assumptions of trade to a focus on choice within the negotiation process.

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[23] Nayyar, D., "Globalisation and Development Strategies" in Toye, J (ed.), Trade and Development Directions for the 21st Century, Edward Elgar Publishing, Inc., Massachusetts, 2003, p. 41.
[24] Loc cit.
[25] Keohane, R., "The demand for international regimes" in International Organization, Vol. 36, No. 2, Spring 1982, p. 328.

As the process by which divergent positions are reconciled involves decisions on the part of actors, theories on international regimes and negotiation such as rational-choice theory, attribute a strong degree of rationality to the decision makers by focusing on choices as a means of arriving at an end result. In this regard rational-choice theory assumes that actors and decision makers act rationally and make choices in the context of *constraints* and *decision making*.[26] This approach allows an examination of the *convergence process* by focusing on voluntary choices as a means of arriving at the end result, but at the same time underscoring that choices are *voluntary* in the context of *constraints* and *decision* making. When considering the extent to which decision or action is "voluntary", it is important to consider these two important aspects that set the parameters within the structural realist context, thereby remaining sensitive to the role of power and inequality.[27] Constraints can be imposed by powerful actors in the context of negotiations through a manipulation of opportunity costs for instance; this can ultimately force the weaker party to make decisions within constraints that gives greater preference to the more powerful actors.[28] As more powerful actors are able to manipulate incentives and alter the opportunity costs of weaker actors by compelling them to behave in a desired way, such manipulation of incentives can be considered a *de facto* imposed form of co-operation.[29] Therefore the process of policy convergence among actors or the reconciling of interests can be understood as a process of choice in the context of constrains and decision making, whereby weaker actors may be impaired to make autonomous choices.

To this end, game theoretic approaches, such as the well known game of Prisoners' Dilemma (PD) provides important insight into the strategic interaction between actors by showing that under certain restrictive conditions, the choice of actors may be constrained in such a way, in which greater preference is given to the more dominant actor. In this instance weaker actors will find it

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[26] Ibid, p. 330.
[27] Keohane, R. After Hegemony: cooperation and discord in the world political economy, Princeton University Press, New Jersey, 1984, p. 71.
[28] Keohane, R., (1) op. Cit, p. 330.
[29] Young, O., "Regimes Dynamics: The Rise and Fall of International Regimes" in International Organization, Vol. 36, No. 2, Spring 1982, p. 284-285.

within their interest to cooperate and enter into an agreement with a more dominant actor.

Although this exemplifies a *de facto* imposed form of cooperation, the literature contends that as long as actors are collaborating to realise joint gains, it is co-operation by definition.[30] Co-operation defined in this way not only underscores the asymmetrical power relations amongst actors in influencing outcomes, but more importantly the fact that outcomes are affected by the opportunity costs faced by actors. In other words the bargaining outcome will be affected by the relative opportunity cost to actors of forgoing an agreement. Nye and Keohane refer to this as "asymmetrical interdependence".[31] In such conditions, asymmetrical interdependence can be considered a source of power as any changes in the relationship between two actors (which change may be affected by the dominant actor), will be more costly to the weaker actor than to the more dominant actor. For instance Hirschman indicates that in international trade, in line with the neoclassical assumption of welfare benefits, despite that both actors gain from a trade relationship, these gains can make one actor dependent on the other.[32] In trade relations between a small (A) and large country (B), the small country will most likely carry a greater portion of its trade with B, as opposed to the other way around. Therefore A will be much more important to B, than the opposite.[33]

In determining the mutual dependence of actors in an agreement it is important to refer to the concepts of *sensitivity* and *vulnerability*. The former relates to the perceived effects of policy changes to societies or governments, whereas the latter relates to the ability of actors to adjust to policy changes; in other words the ability to make alternative agreements if the initial agreement breaks down.[34] An example of sensitivity dependence in the relations between the EU

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[30] Milner, H, "Review: International Theories of Cooperation among Nations: Strengths and Weaknesses" in World Politics, Vol. 44, No. 3, April 1992, p. 470.
[31] Keohane, R., and Nye, J., op.Cit, p. 11.
[32] Hirschman, A, "Beyond Asymmetry: Critical notes on myself as a young man and on some other old friends" in International Organization, Vol. 32, No. 1, Winter 1978, p. 45.
[33] Loc cit.
[34] Keohane, R., and Nye, J., op.Cit, p. 12-14.

and ACP would be how these actors perceive their sensitivities if agreement over the EPAs breaks down. For instance each actor would examine its terms of mutual dependence. Can ACP countries refuse to go along with the provisions of the EPAs? Can they negotiate preferential agreements with an alternative country (i.e. the United States)? Are there alternative countries that the EU can import commodities and agricultural exports from? Another relevant example of sensitivity interdependence that can be considered is the situation over the future of SACU. In this scenario, the sensitivity of interdependence would be determined by the relative extent to which the BLNS on the one hand, and South Africa on the other perceive the effects of potential breakdown of SACU. Vulnerability of interdependence by contrast would refer to the relative extent to which these actors would be able to follow alternative strategies if there is a change in policy, i.e. breakdown of SACU. Krasner for instance indicates that in trade relations between a small and large country, the relative opportunity costs if there is a breakdown in agreement will be much greater for the smaller state, which as a corollary places it in a much weaker political position.[35]

In establishing a link between politics and international economics, theories of international regimes provide valuable insight into the ways in which stronger actors can manipulate opportunity costs to force a weaker actor to behave in a desired way. Therefore it has been demonstrated that there is a link between international economics and politics, in the sense that the political power of actors is affected by their relative size and level of development, which as a consequence is an important determinant of policy outcomes.

1.3 Analytical Framework

This study aims to find out how the EU is exerting pressure on SACU members to conclude EPAs by making the alignment of both trade regimes contingent on all members' accession to a full EPA. The EU has ultimately presented the BLNS and South Africa with a choice which will ultimately determine the future

[35] Krasner, S., (3) op.Cit, p. 320.

of SACU and its integrity. To this end, the method of process tracing is used, which indentifies the intervening causal process or causal chain between the independent variable and the dependent variable (outcome).[36] As the method of process tracing allows an investigator to determine the cause-effect link which links the independent and dependent variable, this method can be used to explain more complex causality by showing how the convergence of several conditions can sometimes determine outcomes. This method can also be used as a strong test for theory testing and theory development.[37] For instance process tracing is a useful methodology for examining the extent to which rational-choice theory as defined above explains events. As rational-choice theory posits that actors can make decisions in the context of constraints and decision making, process tracing would be a useful methodology to examine to what extent this explains on the one hand, the decision of the BLNS to initial the interim EPA, and on the other, South Africa's reluctance to follow. Process tracing would require an examination of the cause-effect link that connects the independent and dependent variables to determine whether the theoretical causal explanations (rational-choice theory) are consistent with the causal mechanisms in the case of the BLNS and South Africa. Although the objective of this research report is not theory testing, the theoretical background can identify the causal processes that explain how the relative opportunity costs of breakdown in agreement for weaker countries will be much greater, thereby placing them in a significantly weaker political position within the negotiation process.

The diagram below illustrates the major causal process between the independent and dependent variable. The independent variable is situated on the far left, while the dependent variable (variable representing the caused phenomenon) is represented on the far right.[38] The variables in between form part of the intervening causal process as these are caused by the independent

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[36] Bennett, A., and George, A. Case Studies and Theory Development in the Social Sciences, MIT Press, Massachusetts, 2005, p. 206.
[37] Van Evera, S. Guide to Methods for Students of Political Science, Cornell University Press, Ithaca, 1997, p. 65.
[38] Ibid, p. 11.

variable and affect the dependent variable. The diagram below indicates that the convergence of two intervening variables is an important determinant of the dependent variable.

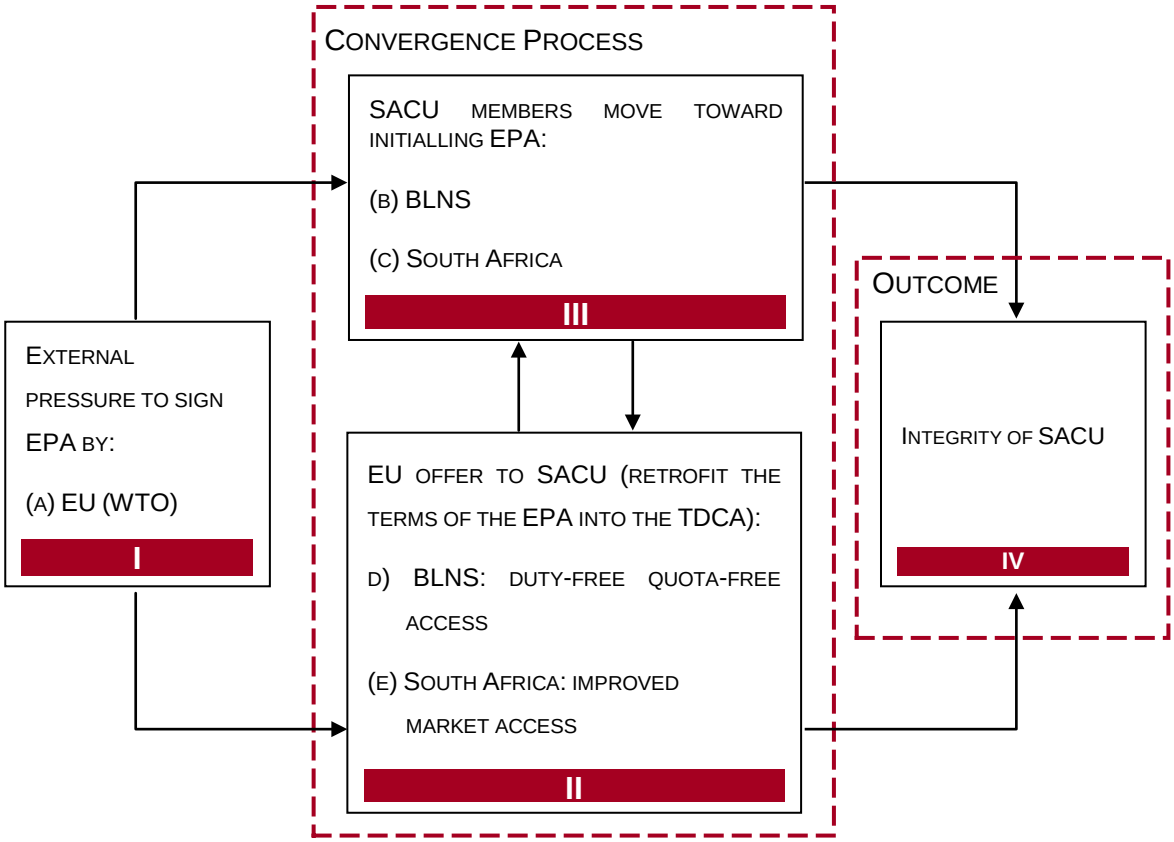


Figure 1 Causal diagram

The dependent variable or outcome to be explained in this study is the coherence of SACU (IV). This is discussed in the following chapter. The main causal process responsible for the variance in the IV is believed to be pressure exerted by the EU and more indirectly by the World Trade Organisation (WTO) over the conclusion of EPAs (I). This is discussed in Chapter 3. The diagram above illustrates two main intervening variables (II and III) standing between I and IV, the convergence of which affects IV. On the one hand, the EU is pressuring (a) the BLNS to initial the interim EPA (b), which these countries have already done and in return have been granted duty free quota free access to its markets (d). On the other hand, the EU has offered more favourable market access to South Africa (e) which would align the tariffs of the EPA and the bilateral EU-SA Agreement (TDCA) closer together and preserve the

integrity of SACU. However the EU has made this contingent on South Africa's accession to the provisions of the EPA (c). The link between II and III illustrates that these two intervening variables are mutually dependent on one another, the convergence of which will lead to greater coherence within SACU (IV). The relationship between II and III forms part of the negotiation process and is discussed in Chapter 4.

The above causal diagram essentially represents one aspect of a trade negotiation process between on the one hand, small and medium-sized states (by measure of size and relative level of development) and on the other, a more dominant trading power. Medium-sized countries in the context of a trade negotiation can be considered different for the reason that if there is a breakdown in agreement, the relative opportunity costs faced by medium-sized states will not be as high as those faced by smaller states. Recalling the concept of "asymmetrical interdependence" which specifies that any changes in relations as a result of disagreement will be much more costly to the weaker actor than to a more dominant actor; it is expected that weaker states will accept the terms of a more dominant trading power much easier than medium sized-states. This view is simply based on the fact that the relative opportunity costs will be much higher for the weaker state than a medium-sized state as indicated earlier.

It follows then that medium-sized countries or countries that face relatively lower opportunity costs like South Africa will be more resistant to pressure on the part of a more dominant actor. The BLNS by contrast are in a much more vulnerable position such as potentially losing out on EU aid and market access for instance, which explains their shift toward initialling the Interim EPA Agreement. These countries are also heavily dependent on SACU for revenue as a source of income. By contrast South Africa has a separate agreement with the EU, while SACU represents more of a net cost than a net benefit in terms of the current revenue sharing arrangement. The BLNS all form part of the ACP countries, which have a long history of co-operation in a number of areas,

including: political dialogue, development aid; and trade and economic co-operation.[39] The ACP countries all share a common objective of reducing poverty, achieving sustainable development and integrating themselves better into the international economy. These countries are discernable in terms of development status, as either developing or least developed countries (LDCs) – classified according to the United Nations Development Programme's (UNDP) Human Development Index (HDI).[40] Most of these countries have received development assistance through the European Development Fund (EDF) and have been in the process of negotiating Interim EPA Agreements which were supposed to be finalised before the end of 2007. These are essentially agreements that introduce trade reciprocity in the form of EPAs, which are due to replace the trade chapters in the Cotonou Agreement.[41]

The ACP countries are currently negotiating with the EU within several regional groupings. These are the East and Southern Africa (ESA) EPA; the East Africa Community (EAC) EPA; the Southern Africa Development Community (SADC) EPA; the Central Africa Monetary and Economic Community (CEMAC) EPA; the Economic Community of West Africa States (ECOWAS) EPA; the Pacific ACP states (PACP) EPA; and the Caribbean Forum of ACP States (CARIFORUM) EPA.[42]

As the BLNS form part of the ACP group, these countries have been circumscribed within the SADC EPA, together with Mozambique and Angola. In this respect the BLNS can be considered typical and representative of the broader ACP group. However in certain respects, such as being members of a customs union with South Africa makes the BLNS atypical to normal ACP

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[39] South Centre, (1) Aid for Trade and Financial Assistance to Implement the EPAs, Geneva, May 2007, p. 5, available from: http://www.southcentre.org/publications/AnalyticalNotes/Other/2007May_EPA_Fact_Sheet_No6.pdf, accessed 9 December 2008.
[40] The Courier, The ACP-EU Special Issue on the Cotonou Agreement, Directorate General for Development, September 2000, Brussels, p. 31.
[41] South Centre, (2) EPA Negotiations: State of Play and Strategic Considerations for the Way Forward, Geneva, February 2008, p. 3-6, available from: http://www.southcentre.org/index.php?option=com_content&task=view&id=608&Itemid=67, accessed 9 December 2008.
[42] Stevens, C., op. Cit, p. 10.

countries. What further sets the BLNS apart from typical ACP countries is their *de facto* incorporation into the Trade, Development and Co-operation Agreement (TDCA) concluded between South Africa and the EU in 1999.[43] By virtue of their membership in a customs union, the effectiveness of which as mentioned requires the enforcement of a CET, the BLNS were incorporated into the free trade agreement with South Africa, which under the WTO is considered a developed country.[44] By contrast, South Africa as a case study can on the one hand be considered typical to the BLNS and countries in Southern Africa as it forms part of the same customs union and has undertaken regional integration initiatives such as the launch of the SADC FTA in August 2008; with an ambitious plan to fast-track this to a customs union by 2010. On the other hand, the case of South Africa is rendered atypical when considering its relatively much more developed and diversified economy, representing over 90 per cent of SACU GDP and about 80 per cent of the combined GDP of Southern Africa.[45] The relative disparities between the BLNS and South Africa makes these strong test cases for determining the extent to which the choice of these countries in the context of the EPA negotiations is informed by the relative opportunity costs faced by these actors.

In order to understand to what extent the choice of the BLNS and South Africa in the context of the EPA negotiations is determined by the relative opportunity costs faced by these actors, the next section of this research report presents a background of SACU and focuses on the costs and benefits SACU offers to South Africa and the BLNS. It focuses on the intergovernmental co-operation between members, especially highlighting South Africa's dominant role in terms of decision making. An analysis of the costs and benefits offered by SACU to

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[43] Erasmus, G., (1) "Legal conundrum: SACU, the TDCA and the EPAs" in Bertelsmann-Scott, T and Draper, P (eds.), The TDCA: Impacts, Lessons and Perspectives for EU-South and Southern African Relations, the South African Institute of International Affairs (SAIIA), Johannesburg, 2005, p. 102.

[44] Bernard, H. and Lecomte, S., (1) "The Impact of the EU-SA Agreement on Lomé", in Bertelsmann-Scott, T et.al (eds.), The EU-SA Agreement. South Africa, Southern Africa and the European Union, the South African Institute of International Affairs (SAIIA), Johannesburg, 2000, p. 66.

[45] Alden, C., and Soko, M., "South Africa's economic relations with Africa: hegemony and its discontents" in Journal of Modern African Studies, Vol. 43, No. 3, 2005, p. 374.

the BLNS and South Africa also informs the way in which the former and latter perceive their opportunity costs of signing onto the interim EPA.

CHAPTER 2 THE POLITICAL ECONOMY OF THE SOUTHERN AFRICAN CUSTOMS UNION

2.1 Introduction

In assessing the relative opportunity costs faced by South Africa on the one hand, and the BLNS on the other in making alternative arrangements if there is a potential breakdown in agreement, this chapter provides a brief non-technical introduction to *customs union theory*, which considers the essential characteristics and rationale of a customs union. The following part of this chapter uses these characteristics in assessing the past and current institutional arrangements that have ensured the integrity of SACU, in particular highlighting the dominant decision-making role of South Africa. The final part considers the major institutional changes of intra-SACU relations in light of the 2002 SACU Agreement, in particular focusing on the ability of member states to harmonise trade policy with third parties.

2.2 The Economics of Customs Unions

Customs union theory focuses on the welfare implications of eliminating tariffs between two or more member states while maintaining uniform tariff barriers on imports from non-member states.[46] The equalisation of tariffs amongst member states on imports from non-member states follows that member states must share a common external tariff (CET). The CET is the essential defining characteristic of a customs union which engenders policy co-ordination among member states regarding the allocation of revenues by an agreed upon formula.[47] The welfare implications of participating in a customs union involve an assessment of net economic gains to member countries of participating in a customs union. It is expected that states will be willing to participate in a customs union arrangement if their perceived net economic benefits exceed

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[46] Viner, J., op.Cit, p. 4.
[47] McCarthy, C. (2) The Challenge of Reconciling Revenue Distribution and Industrial Development in the Southern African Customs Union, Tralac, 25 October 2006, p. 3, available from: https://www.givengain.com/unique/tralac/pdf/20070116_SACU_igd_workshop.pdf, accessed 14 December 2008.

their net economic costs. Such analysis draws from economic theories of clubs which posits that unless members perceive net gains from participating in a club, members would not join (or remains part of the club).[48] According to Viner, the net welfare gain of a customs union is a function of the trade created on the one hand, and the trade diverted, on the other.[49] Trade creation represents the benefits to members for participating in a customs union; for instance the elimination of sales by inefficient high cost domestic industries with cheaper priced sales from a member of the customs union. By contrast, trade diversion refers to the costs to members of participating in a customs union; for instance when more efficient lower-cost imports from countries outside of the customs union are displaced in favour of less efficient higher-cost goods produced by a member of the customs union.[50] Economists generally contend that the trade creation and trade diversion effect are not sufficient to explain the net welfare gain, but suggest another two motives for the rationale of customs unions. The first motive focuses on the effect of the CET on the terms of trade. It is expected that the customs union will improve its terms of trade vis-à-vis non-member countries that produce competitive products with high price-elasticises of demand, as these products will be sourced from within the customs union once the CET is imposed.[51] This is also likely to render producers within the customs union more efficient, leading to greater competition, thereby increasing the opportunities to realise economies of scale. The second motive refers to the ability of states that are at a comparative disadvantage to maintain domestic policies that favour domestic agricultural and industrial production *per se*, as opposed to following strategies that maximise national income.[52] For instance South Africa had a clear preference for protectionist industrial policies since the 1920s, which forced the other SACU members to purchase more expensive imports from South Africa as opposed to lower cost imports from countries

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[48] Sandler, T. and Tschirhart, J. "The Economic Theory of Clubs: An Evaluative Survey" in Journal of Economic Literature, Vol. 18, No. 4, December 1980, p. 1491.
[49] Viner, J., op.Cit, p. 44-46.
[50] McCarthy, C., (2) op.Cit, p. 4.
[51] Mattli, W. The Logic of Regional Integration: Europe and Beyond, Cambridge University Press, Cambridge, 1999, p. 33.
[52] Ibid, p. 34.

outside of the customs union.[53] Therefore in addition to the trade creation and trade diversion effect in determining the net economic benefits of membership in a customs union, these two factors are also important determinants to the net economic benefits, as these may offset the welfare loss accruing to trade diversion.

In determining the net welfare gains to members of participating in an integration arrangement such as a customs union, it appears that the additional two motives (especially the first) in determining the net welfare gains have limited relevance to regional integration schemes amongst developing countries or countries of unequal economic size and level of development.

The track-record of regional integration in Africa provides many examples of failed integration efforts, thereby putting into question the correlation between on the one hand, economic growth and on the other, competition and economies of scale. In theory, a customs union provides protection to a regional market through a CET, which can result in a terms of trade gain as mentioned. However the way the net benefits are distributed amongst member countries depends on their relative size and level of development, thereby making this highly relevant to SACU, which has been characterised by extreme inequalities in relative size and level of development amongst member states.[54]

2.3 Characteristics of SACU

The inequalities between member states are illustrated by the fact that currently South Africa represents about 94 per cent of SACU's GDP.[55] In terms of trade relations between member states, in 1998/99 South Africa ran a trade surplus with the BLNS exceeding ZAR 20 billion and during the same period exported goods and services worth more than ZAR 34 billion, which represented between

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[53] Alence, R., "SACU and the Political Economy of Regionalism: Towards Deeper and Broader Integration?" in The South African Institute of International Affairs (SAIIA): Trade Policy Briefing, No. 12, June 2006, p. 5.
[54] McCarthy, C., (1) op.Cit, p. 609.
[55] McCarthy, C. (3) SACU at the cross roads, Tralac, 12 November 2008, available from: http://givengain.com/cgi-bin/giga.cgi?cmd=cause_dir_news_item&cause_id=1694&news_id=55810&cat_id=1059, accessed 15 December 2008.

75 and 90 per cent of the BLNS import needs.[56] Apart from these quantitative descriptions, South Africa has a particularly well developed infrastructure, such as telecommunications and transportation; as well as a much more sophisticated financial sector.[57] As SACU is characterised by such large inequalities amongst member states, it follows inevitably that investment and economic development has had a polarisation effect toward South Africa.[58] This is consistent with traditional customs union theory which posits that trade between countries with unequal economic size and level of development will lead to polarised economic development, favouring the developed member at the expense of the less developed member.[59] Another notable feature of SACU has been the fact that South Africa has unilaterally determined the CET in line with its own industrial policies, which have legally obliged the BLNS states to apply the same CET, thereby constraining their ability to manipulate fiscal policy to meet their development needs.[60]

The co-operation that has sustained SACU throughout its history has involved a trade-off between on the one hand a political dividend to South Africa, whereby the latter has been able to maintain close trade relations and fiscal links with African states during the period of political isolation, and on the other, offering an increasingly disproportionate share of the revenue pool to the BLNS to pre-empt any potential withdrawal by its neighbours.[61] As a result, the compensatory revenue sharing payment on the part of South Africa to the Common Revenue Pool (CRP) has offered significant benefits to the BLNS, thereby making these countries fiscally dependent on SACU. The size of the CRP is determined by the revenues collected through the CET (as determined by South Africa). In 2001/02 revenue income from the SACU CRP as a share of total revenue was: 13 per cent for Botswana; 51.6 per cent for Lesotho; 51 per

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[56] Alden, C., and Soko, M., op.Cit, p. 371.
[57] McCarthy, C., (1) op.Cit, p. 609.
[58] Gibb, R., (1) "Regional Integration in the Post-Apartheid Southern Africa: The Case of Renegotiating the Southern African Customs Union" in Journal of Southern African Studies, Vol. 23, No. 1, March 1997, p. 79.
[59] Gibb, R., (2) "Southern Africa in Transition: Prospects and Problems Facing Regional Integration" in The Journal of Modern African Studies, Vol. 36, No. 2, June 1998, p. 293.
[60] Gibb, R., (1) op.Cit, p. 79.
[61] Alence, R., op.Cit, p. 4.

cent for Swaziland; and 28.4 per cent for Namibia.[62] Therefore it should come as no surprise that revenue-sharing has been the most important feature surrounding the debates around SACU.

2.4 The persistent patterns of SACU cooperation

SACU was established under the 1910 Agreement between South Africa and the British High Commission Territories of Bechuanaland (Botswana), Basutoland (Lesotho) and Swaziland (BLS). Although Namibia/South West Africa had been a *de facto* member since 1915, it chose to join the Union after gaining independence in 1990.[63] Since its establishment, the relationship between South Africa and the BLNS has been characterised by inherent tensions over tariffs and the allocation of revenue. Under the 1910 Agreement, South Africa assumed responsibility for determining the CET.[64] The CRP was also administered by South Africa on a fixed basis, which ensured South Africa with a 98.7 per cent share of the revenue.[65] South Africa determined the CET unilaterally in line with its own industrial development policies, with little consideration for the BLS, which were forced to purchase more expensive uncompetitive South African imports, as opposed to sourcing lower cost imports from countries outside of the Union. However, the independence of the BLS in the latter half of the 1960s necessitated a revision of the growing inequality that had been reflected in the 1910 Agreement in a new customs union agreement, which culminated in the 1969 SACU Agreement.[66]

The new 1969 Agreement reflected the changed political landscape as the BLS had attained independence, which on the one hand led South Africa to make significant concession in the way in which revenue was distributed, and on the other, allowed scope for South Africa to continue determining the CET

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[62] World Trade Organisation (WTO). Trade Policy Review: Southern African Customs Union, 24 March 2003, p. 7, available from: http://www.wto.int/english/tratop_e/tpr_e/s114-0_e.doc, accessed 15 December 2008.
[63] Gibb, R., (3) "The New Southern African Customs Union Agreement: Dependence with Democracy" in Journal of Southern African Studies, Vol. 32, No. 3, September 2006, p. 583.
[64] Ibid, p.
[65] Alence, R., op.Cit, p. 5.
[66] McCarthy, C., (1) op.Cit, p. 612.

unilaterally. The new 1969 Agreement recognised the need to promote economic development in the region on the basis of equality in order "to ensure the continued economic development of the customs union area as a whole, and to ensure in particular that these arrangements encourage the development of the less advanced members of the customs union and the diversification of their economies, and afford all parties equitable benefits arising from trade among themselves and with other countries".[67] To this end, South Africa made significant concessions in the way the CRP was distributed among members by incorporating a compensation factor, which according to Alence, had the effect of raising the BLS shares two to three fold to what would have accrued under the 1910 Agreement.[68] Furthermore a stabilisation factor was enacted in 1977 due to revenue volatility linked to political uprisings in South Africa, which ultimately ensured a guaranteed minimum rate of 17 per cent to the BLS.[69] The new 1969 Agreement in theory also made provision for infant industry protection to the BLNS, but was subject to approval by South Africa, which in *de facto* had a very limited effect in promoting industrialisation in the BLS. In terms of the CET, South Africa continued to retain the authority to unilaterally determine this in line with its own industrial policies, despite recognising the need to give "the other contracting parties adequate opportunity for consultations before imposing, amending or abrogating any customs duty with respect to goods imported into the common customs area from outside".[70]

Therefore this illustrates that despite significant concessions on the part of South Africa, the now politically independent BLS were unable to determine their industrial, fiscal or development policies as the CET was essentially a South African prerogative. From the perspective of the BLS, the new revenue allocation is seen as a compensatory measure for the detrimental trade-diverting impact resulting from the CET.[71] However in recent times, South Africa has been increasingly dissatisfied with this arrangement as its share of the CRP

[67] Gibb, R., (1) op.Cit, p. 77.
[68] Alence, R., op.Cit, p. 6.
[69] McCarthy, C., (1) op.Cit, p. 619.
[70] Gibb, R., (3) op.Cit, p. 593.
[71] Gibb, R., (1) op.Cit, p. 78-79.

has been declining steadily due to higher growth rates of member countries like Botswana and changes in South Africa's tax structure.[72] Furthermore, the increase of vehicle imports due to the consumer boom in South Africa has represented 32 percent of the CRP in 2005 as opposed to only 5 percent in 2003.[73] For instance the tariff on vehicles imported into SACU is 25 percent, of which part over half is transferred to the BLNS. By way of example, an imported vehicle worth ZAR 200 000, would be subject to ZAR 50 000 in duties, of which over 25 000 ZAR would accrue to the BLNS from the CRP.[74]

For these reasons between 1993/94 and 2006/7, payments to the BLNS from the CRP have increased steadily from approximately 30.2 per cent to 61 per cent.[75] The South African National Treasury Budget Review 2008 indicates that the revenue accruing from customs and excise duties for 2007/08 is estimated at ZAR 24.7 billion[76], which based on these percentages would result in net fiscal transfers from the CRP to the BLNS in the region of between ZAR 10.4 and 15 billion. As was indicated above, these net fiscal transfers from the CRP to the BLNS have reflected a substantial part of the GDP of these countries, which the BLNS have become increasingly dependent on.

The changing political landscape in the 1990s diminished the political imperative of sustaining co-operation with the BLS at any cost and led to the renegotiated 2002 agreement which recognised the need for more consensual relations amongst member states.[77] The transition to majority rule in 1994 inclined the incoming African National Congress (ANC) government to institutionalise and democratise SACU. To this end, negotiations towards a

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[72] Ibid, p. 81.
[73] Dawes, N., The wheels may come off, Mail and Guardian (M&G), 16 July 2007, available from: http://www.mg.co.za/article/2007-07-16-the-wheels-may-come-off, accessed 15 December 2008.
[74] Locit.
[75] McCarthy, C., (3) op.Cit.
[76] South African Department of National Treasury, Medium Term Budget Policy Statement 2007, 30 October 2007, p. 39, available from: http://www.treasury.gov.za/documents/mtbps/2007/mtbps/Chapter%204.pdf, accessed 18 December 2008.
[77] Alence, R., op.Cit, p. 6.

reconstituted SACU began in November 1994 in Windhoek.[78] After eight years of negotiations, the new SACU 2002 Agreement was signed in October 2002 in Gaborone, which *inter alia*, made fundamental changes to the revenue-sharing formula.[79] The changes reflected in the revenue-sharing formula recognised the concerns of the BLNS relating to the detrimental impact of trade diversion and the polarisation effects of participating in the same customs union with South Africa.[80] The new revenue-allocation system of the 2002 SACU Agreement, consisting of a customs component, an excise component, and a development component, makes provision for compensating the BLNS for these adverse effects by ensuring a measure of revenue protection to the BLNS.

The customs component and the development component are specifically designed for this purpose. For instance, the customs revenue is distributed according to intra-SACU imports, which are heavily skewed in favour of the BLNS, as the latter import considerably more from South Africa than the other way around. Under the new formula, the customs revenue share accruing to the BLNS would come to about 80 per cent, while South Africa would only receive 20 per cent of the total share.[81] The development component would benefit the BLNS even more, as it is specifically designed to benefit the BLNS for the decline in the revenue pool (on a basis of per capita income) as a result of multilateral and bilateral trade liberalisation on the part of South Africa.[82] The development component was initially set at 15 per cent of the excise pool, to which South Africa contributes about 90 per cent.[83] The remainder of the excise component under the new Agreement however is distributed in terms of members' GDP value as a percentage of SACU GDP, of which South Africa is allocated approximately 92 per cent.[84] As excise rates as opposed to customs duties are considered important to South Africa, it has been maintained that

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[78] Gibb, R., (1) op.Cit, p. 82.
[79] Van der Staak, S., Trade Liberalisation and Financial Compensation. The BLNS states in the wake of the EU-South African Trade and Development Agreement. MA research report for the University of the Witwatersrand, Johannesburg, 2003, p. 45.
[80] McCarthy, C., (1) op.Cit, p. 625.
[81] Locit.
[82] Alden, C., and Soko, M., op.Cit, p. 372.
[83] Gibb, R., (3) op.Cit, p. 602.
[84] McCarthy, C., (1) op.Cit, p. 626.

South Africa has sought to protect this source of income for its own economic purposes, which casts doubt over any "democratisation" or "joint decision-making" emerging over the distribution of this component.[85]

Since the conclusion of the GATT/WTO Uruguay Round, South Africa has undertaken a significant rationalisation of its tariff structure, reducing the number of tariff lines from 10000 to 6000 and maximum tariffs from 100 per cent to 30 per cent (excluding sensitive products).[86] There have been two notable implications for the BLNS as a result of this. On the one hand, the lowering of the CET has curtailed the ability of South Africa to promote domestic industrialisation as previously, thereby minimising the trade diverting impact experienced by the BLNS, and on the other, has resulted in a reduction of the amount received by the BLNS from the CRP as a result of a decline in the CET.[87] Therefore, although the new SACU 2002 Agreement makes provision for increased shares of the CRP to the BLNS, these developments should be seen in light of increasing trade liberalisation, both multilaterally and bilaterally.

The trade negotiations between the EU and South Africa, which culminated in the signing of the TDCA in 1999, have also had profound implications for the BLNS. The lowering of the CET towards the EU as a result of a reduction in duties has also contributed to a decline of the revenue collected in the CRP. In addition, it has not only presented the BLNS with increased competition from EU goods in their markets, but also competition in the South African market, as a result of a reduction of duties for EU imports.[88]

It has been estimated that the total revenue losses experienced by the BLNS as a result of the TDCA range between ZAR 1.9 billion and ZAR 3.5 billion per year, which translates into decreasing levels of spending on social services (i.e.

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[85] Ibid, p. 601.
[86] Gibb, R., (1) op.Cit, p. 81.
[87] Alence, R., op.Cit, p. 7.
[88] Davies, R., (1) "Forging a New Relationship with the EU" in Bertelsmann-Scott, T et.al (eds.), The EU-SA Agreement. South Africa, Southern Africa and the European Union, the South African Institute of International Affairs (SAIIA), Johannesburg, 2000, p. 11.

health, housing, education); infrastructural projects; and development.[89] The EU-South Africa TDCA in *de facto* transformed the non-reciprocal EU-BLNS trade relations into a reciprocal preferential agreement alongside South Africa.[90] As mentioned earlier, although the 1969 SACU Agreement makes provision for consultations to take place with regard to undertaking changes in the CET, the BLNS were excluded from the negotiation process which fundamentally transformed their trade relationship with the EU.[91]

2.5 The 2002 SACU Agreement: Towards a single arrangement vis-à-vis third parties?

The new 2002 SACU Agreement however contains provisions requiring consent of all members prior to any new agreements with third parties. Article 31, paragraph 2 of the Agreement states that "with respect to future trade negotiations with third parties a common negotiating mechanism in accordance with the terms of reference to be determined by the Council in accordance with paragraphs 2 and 7 of Article 8 for the purpose of undertaking negotiations with third parties".[92]

Similarly, Article 31, paragraph 3 underscores this by stating that "no member state shall negotiate and enter into new preferential trade agreements with third parties or amend existing agreements without the consent of other member states".[93] However, as the TDCA and other preferential external agreements

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[89] Kamidza, R., "Unequal Partners: Two Southern African groupings in trade talks with EU" in Trade Winds, Vol. 1, No. 1, December 2007, p. 12.
[90] Goodison, P. (1) Marginalisation or Integration? Implications for South Africa's Customs Union partners of the South Africa-European Union trade deal, Institute for Global Dialogue (IGD), Johannesburg, 1999, p. 53.
[91] Olympio, J. et al., (1) "The TDCA and SADC-EPA: Is the Risk of Giving South Africa Duty-Free Access Alongside that Offered to the Rest of Southern African Countries Perceived or Real" in Bertelsmann-Scott, T. and Draper, P. (eds.), Regional Integration and Economic Partnership Agreements: Southern Africa at the Crossroads, the South African Institute of International Affairs (SAIIA), Johannesburg, 2006, p. 103.
[92] Southern African Customs Union Agreement between the Governments of the Republic of Botswana, the Kingdom of Lesotho, the Republic of Namibia, the Republic of South Africa and the Kingdom of Swaziland, signed October 2002. Tralac, 4 June 2008, available from: http://givengain.com/cgi-bin/giga.cgi?cmd=cause_dir_news_item&cause_id=1694&news_id=46567&cat_id=1040, accessed 18 December 2008.
[93] Locit.

predate the 2002 SACU Agreement, these are exempted by Article 31, paragraph 1, which states that "member states may maintain preferential trade and other related arrangements existing at the time of entry into force of this Agreement".[94]

Therefore the exemption provided in Article 31, paragraph 1 presents a challenge to harmonising existing trade relations with the negotiation of any future agreements with third parties. This has important implications for the CET which is essentially the defining characteristic of SACU. The EPA negotiations between the BLNS and the EU (which exclude South Africa) present one such challenge in particular. For instance it would be inconsistent for South Africa to have one tariff on imports from the EU (via the TDCA), whilst the BLNS apply a different tariff on imports from the EU (under the EPA). In such a scenario internal border controls would have to be maintained in order to enforce the different rules of origin, which would ultimately undermine the integrity of SACU and its CET.

As there is no single arrangement that directs trade between SACU and a third party, Stevens contends that if the EPA agreement does not include all five members, it would be legally unenforceable.[95] This illustrates the lack of harmonisation in determining rules of origin between member states, which is linked to the adoption of common intra-regional policies in industrial policy, agricultural policy, competition policy and unfair trade practices, as set out in Part Eight of the new 2002 SACU Agreement.[96]

To this end, the new Agreement emphasises the importance of supra-national (intra-state) institutions in governing industrial and trade policy. It lists six new SACU institutions which are to govern these functions, namely, the Council of Ministers; the Customs Union Commission; the Secretariat; the Tariff Board;

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[94] Locit.
[95] Stevens, C., op. Cit, p. 11.
[96] Erasmus, G., (2) "New SACU Institutions: Prospects for Regional Integration" in Hansohm, D. et al. (eds.), Monitoring Regional Integration in Southern Africa Yearbook, Namibian Economic Policy Research Unit, Windhoek, 2004, p. 190, available from: http://www.kas.de/wf/doc/kas_6395-544-1-30.pdf, accessed 20 December 2008.

Technical Liaison Committees; and a Tribunal.[97] Reference to these institutions is made only insofar as these inform the attainment of adopting common policies as set out in the new Agreement.

The adoption of common policies in policy areas among member states as set out in the new Agreement appears to be a problematic issue, if not unrealistic when considering the disparate level of development and the lack of institutional capacity to implement the Agreement. With respect to the implementation of common intra-regional policies in industrial policy, agricultural policy and competition policy, members are to attain these objectives through their own national legislature, thereby not being subjected to enforceability by any of the supra-national institutions highlighted above.[98] Only in terms of unfair trade practices can the Council undertake the development of common policies in addressing unfair trade practices amongst member states.[99] Despite this, decisions made within the Council are reached through "consensus", meaning that these have to be reached collectively and unanimously by member states. Gibb maintains that in certain instances where a deadlock situation exists, the Council can potentially refer a matter to the Tribunal, which is supra-national in nature and has the authority to make final and binding decisions.[100]

However an important qualification is in order; as the new Agreement does not clarify the terms on which the Council can refer an item for settlement by the Tribunal, given that decisions within the Council are reached by consensus, a member state can veto a Council decision regarding referral to the Tribunal.[101] Similarly, under the new Agreement, decisions made by the Tariff Board regarding amendments in the level of customs, anti-dumping, countervailing and safeguard duties on the importation of goods into the customs are also to be reached by consensus between member states. However, once again, in a deadlock situation, a member may veto a decision to refer an item to the Tribunal.

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[97] Gibb, R., (3) op.Cit, p. 596.
[98] Erasmus, G., (2) op.Cit, p. 190.
[99] Ibid, p. 190-191.
[100] Gibb, R., (3) op.Cit, p. 600.
[101] Locit.

It has been indicated that the adoption of common policies is a clear requirement for harmonising trade-policy and developing the ability of concluding new trade agreements with third parties. However, the ability of adopting common policies is contingent on the effectiveness of the common institutions set out in the new Agreement, as highlighted above. As has been shown, in certain areas, member states still retain a considerable measure of sovereignty in implementing common policies. In other areas in which co-operation is mandated by the common institutions, the possibility of fragmentation still exists, given the fact that Agreement in the Council is reached by consensus. There are also new disciplines which have become increasingly important in trade negotiations that are not covered by the new Agreement; such as services, trade facilitation, intellectual property, investment and competition.[102] These so called "new generation" issues are very important to the EU and constitute binding provisions in the EPA negotiations. Similarly, in the negotiations of the US/SACU FTA, the US also had a clear preference for the inclusion of new generation issues, which presented a major challenge to SACU countries, although in the end SACU-US talks broke down and did not culminate into a FTA.[103] As mentioned, although Part Eight of the Agreement makes provision for the further development of common policies which would in theory allow for the negotiation of new disciplines; it appears that SACU is still a long way from pursuing such initiatives of "deepening" policy harmonisation within SACU and should rather first "pick the low-hanging fruit inherent in getting the basics of operating a customs union right".[104]

Whatever the case, it is clear from the above that the reconciling of domestic policies among member states in several policy areas is a prerequisite for the development of common negotiating strategies in negotiating with third parties, which ultimately determines the legal quality of SACU and its capacity to act as

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[102] Draper, P. et al., "SACU, Regional Integration and the Overlap Issue in Southern Africa: From Spaghetti to Cannelloni?" in The South African Institute of International Affairs (SAIIA): Trade Policy Briefing, No. 15, January 2007, p. 32.
[103] Stoneman, C. and Thompson, C., "Trading Partners or Trading Deals? The EU & US in Southern Africa" in Review of African Political Economy, Vol. 34, No. 112, June 2007, p. 242.
[104] Draper, P. et al., op.Cit, p. 33.

a customs union.[105] As was mentioned, the new Agreement does not clearly specify how member states are to develop these common policies and furthermore enforcement is in many policy areas subject to national laws; thereby exempting the supranational common institutions alluded to above. In cases where co-operation is enforced by a supranational institution, given that binding decisions by the Tribunal can be potentially vetoed within the Council, raises some concern over the rules-based nature of the customs union.[106] This also reflects the inter- as opposed to the intra-governmental nature of decision making within these common institutions, thereby giving preference to the national, as opposed to the common regional interests.[107]

In terms of international regime theory, this position is consistent with the structural realist view, which depicts regime outcomes as a function of the distribution of power among states, thereby reflecting the bargaining power and national interest of the more dominant actor. Although regime theory is far too simple to capture the complexity of the interaction between member states in SACU, it shows that the arrangement between member states, even under the new SACU 2002 Agreement still reflects the asymmetries inherent in the distribution of power amongst member states. It is therefore not surprising that in relation to decision making within the new SACU 2002 Agreement Gibb contends that "... given the history of SACU and the geo-economic realities... it is hard to envisage a situation where Lesotho has the same voting rights as South Africa".[108]

2.6 Summary

This chapter has provided an overview of the past and present institutional context which has characterised SACU as a customs union. A notable feature which has remained constant throughout its history is the inherent asymmetry in relative size and level of development among member states. These

[105] Erasmus, G., (1) op.Cit, p. 102.
[106] Erasmus, G., (2) op.Cit, p. 195.
[107] Gibb, R., (3) op.Cit, p. 599.
[108] Gibb, R., (1) op.Cit, p. 83.

asymmetries have made the task of regional integration and development very difficult, if not impossible. The historical overview of SACU indicates that regional integration or development has never been an end in itself, but under the 1969 Agreement served a political purpose by tying the BLNS with South Africa to maintain the geo-political status quo during the period of political isolation. The new SACU 2002 Agreement represents a fundamental break with the past by providing an institutional framework operating on a more consensual basis, which in theory seeks to distribute benefits more equitably among member states. However, as mentioned, there are inherent weaknesses relating to the operational nature of the common institutions, which has important implications for harmonising trade policy with regard to third parties. The next chapter seeks to examine how these weaknesses are compounded by the trade policies of the EU towards SACU in the context of the shift toward reciprocal trade relations on the part of the EU.

CHAPTER 3 THE EU AND SOUTHERN AFRICA: CONDITIONALITY, DIFFERENTIATION AND THE SHIFT TOWARD RECIPROCAL TRADE RELATIONS

3.1 Introduction

This first part of this chapter examines the shift in the EU's trade preferences from non-reciprocity toward the introduction of reciprocal trade relations under the form of EPAs. As part of the reason advanced by the EU for the shift toward greater liberalisation and reciprocity has been meeting WTO compatibility, this part examines the conflicting views between the EU and ACP over satisfying the minimum requirements of making the EPAs compliant with the WTO. Apart from EPAs, this part also considers alternative trade arrangements, but concludes that these offer limited options, thereby serving to constrain the choice of ACP countries to EPAs. The subsequent part considers the developmental dimension of EPAs, arguing that trade related assistance has been linked to the EPA negotiations. The final part considers South Africa's shift toward trade liberalisation in light of the TDCA and the compensatory measures offered to the BLNS to gain political acceptance for the TDCA.

3.2 The shift toward reciprocal trade relations

The policy frameworks governing trade and development co-operation between the EU and ACP countries have evolved through various phases; beginning with the Yaoundé Convention (1963-1974), followed by the four Lomé Conventions (1975-2000) and the current Cotonou Agreement, signed in 2000.[109] The Lomé Conventions did not deliver satisfactory results in achieving its stated objectives, which led the European Commission (EC) to propose major changes in the way trade preferences will be governed. To this end, economic and trade co-operation in the Cotonou Agreement is aimed at promoting the gradual integration of the ACP countries into the world

[109] Venter, D. et.al., (1) The European Union and South Africa, Intrepid Printers, Johannesburg, 2004, p. 134-137.

economy.[110] The most important change which represents a significant break with the past relates to the shift from non-reciprocal trading arrangement to the introduction of reciprocity within the framework of Economic Partnership Agreements (EPAs). There appears that in advancing EPAs as future modalities for trade co-operation, the EU has pursued two potentially conflicting objectives.[111] On the one hand, Article 35 of the Cotonou Agreement states that trade co-operation will seek to be compatible with existing regional integration efforts, but on the other, in determining which countries are in a position to enter into an EPA, the EU has divided the membership of the ACP countries according to developmental criteria.[112]

This has complicated matters for SACU; for instance, Lesotho is classified as an LDC, while Botswana, Swaziland and Namibia are classified as non-LDCs (developing countries); and to complicate things even further, South Africa is a non-ACP country and is classified "developed" under the WTO, thereby making use of its TDCA in trade vis-à-vis the EU.[113] Apart from trade in goods provisions, the Cotonou Agreement underscores the importance for the negotiation of "new generation issues", while the TDCA is limited to trade in goods only. These issues are further discussed in Chapter 4.

The first Lomé Convention was concluded between the EEC and forty-six ACP countries in 1975. Lomé succeeded the former Yaoundé Convention to expand membership to former ACP British colonies. The group of ACP members eventually incorporated seventy-eight members by the year 2000, which provided a strong rationale for North-South cooperation.[114] The Lomé Conventions were comprised of an aid and trade pillar.

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[110] The Courier, op.Cit, p. 25.
[111] Gibb, R., (4) "The State of Regional Integration: The Intra- and Inter-regional Dimensions" in Clapham, C, et.al. (eds.), Regional Integration in Southern Africa: Comparative International Perspectives, the South African Institute of International Affairs (SAIIA), Johannesburg, 2001, p. 77.
[112] Hurt, S., op.Cit, p. 166.
[113] Gibb, R., (5) "Post Lomé: the European Union and the South" in Third World Quarterly, Vol. 21, No. 3, June 2000, p. 474.
[114] Venter, D. et.al., (1) op. Cit, p. 136.

The aid pillar was divided into programmable assistance or project assistance, and non programmable assistance. Programmable assistance dealt with national and regional indicative programmes and Structural Adjustment Aid. Non-programmable assistance was conditional, relating to circumstantial needs. The latter consisted of export revenue stabilisation funds for agricultural products (Stabex) and a new system for mineral and mining exports, known as Sysmin which was introduced with the signing of Lomé II in 1979.[115] These mechanisms ensured compensation to ACP countries during periods of lower export earnings.

One of the main features of the Lomé Conventions was the trade pillar, which ensured ACP countries with non-reciprocal duty-free market access to the EU market, which discriminated positively in favour of ACP states at the expense of excluding other developing countries which are not party to the Lomé Convention, but at a similar level of development, such as Bangladesh, Guatemala or Honduras.[116] The main objectives of these preferences were to ensure the sustainable economic development of these countries and to promote their gradual integration into the world economy.[117] Despite the fact that the ACP countries wanted to preserve the status-quo under the Lomé Convention, the EU advanced two main reasons as to why this regime had to be renegotiated.

First, the results of Lomé were disappointing as it did not achieve its stated objectives. To this end, the European Commission (EC) published a document entitled *Green Paper on Relations between the European Union and the ACP Countries on the Eve of the 21st Century: Challenges and Options for a New Partnership*, in which it argued that the ACP exports to the EU on average constitute 40-60 percent, thereby suggesting that significant diversification had not taken place and that the share of ACP exports to the EU have declined from

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[115] Ibid, p. 135.
[116] Gibb, R.,(4) op.Cit, p. 76.
[117] Bernard, H. and Lecomte, S., (2) "Developing a Post-Lomé Trading Regime: ACP and EU Positions" in Le Pere, G and Ngobeni, S (eds.), Regionalism and a Post-Lomé Convention Trade Regime: Implications for Southern Africa, Institute for Global Dialogue (IGD), Johannesburg, 2000, p. 94.

6.7 per cent in 1976 to 2.8 per cent in 1994; in general the document states that the ACP "have not been able to take advantage of all the opportunities offered by the special preferences granted under the Lomé Convention".[118]

The second, perhaps most important reason requiring the revision of this regime is attributable to changes within the multilateral trading system on the one hand, and the need to comply with the rules of this system, on the other. Since the end of the Cold War, the prevailing views on industrialisation shifted away from import substitution toward export-growth led models, which was reflected within the multilateral trade regime by making the promotion of domestic industries and selective protection vis-à-vis foreign third parties increasingly difficult.[119] In this light, the special and differentiated treatment (SDT) preferences extended to developing countries have been eroded by progressive rounds of tariff reductions such as the Uruguay Round.[120] Gibb notes that there has been a significant reduction of the EU's CET from 10-12 percent in the 1970s to between 3-4 percent after the implementation of the Uruguay Round, which has reduced the Most Favoured Nation (MFN) tariff extended to all WTO members.[121]

Aside from multilateral liberalisation, preference erosion has also occurred and still occurs as a consequence of a number of phenomena. First, the conclusion of FTAs with regional groups such as South Africa, Mercosur, Turkey, Morocco and others extends these countries the same market access to the EU market.[122] Second, the reform of the European Common Agricultural Policy (CAP) aims to move away from price support toward granting direct aid to

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[118] European Commission, Green Paper on Relations between the European Union and the ACP Countries on the Eve of the 21st Century: Challenges and Options for a New Partnership, Office for Official Publications of the European Communities, Luxembourg, 1997, p. XII.
[119] Nayyar, D., op.Cit, p. 47.
[120] Amsden, A., "Industrialisation under new WTO Law" in Toye, J (ed.), Trade and Development Directions for the 21st Century, Edward Elgar Publishing, Inc., Massachusetts, 2003, p. 84.
[121] Gibb, R.,(5) op.Cit, p. 466.
[122] Meyn, M., (1) "Are Economic Partnership Agreements likely to Promote or Constrain Regional Integration in Southern Africa?" in Hansohm, D. et al. (eds.), Monitoring Regional Integration in Southern Africa Yearbook, Namibian Economic Policy Research Unit, Windhoek, 2004, p. 38, available from: http://www.kas.de/wf/doc/kas_6395-544-1-30.pdf, accessed 26 December 2008.

farmers.[123] This will reduce the artificially high agricultural prices to world market prices, thereby lowering the prices ACP producers receive on the EU market for agricultural products.[124] Third, the introduction of the EU's Everything But Arms (EBA) initiative introduced in March 2001 allows duty-free market access to the EU market for all LDCs alongside ACP countries.[125] This exempts arms and ammunition; and includes qualifications for sensitive products like rice and sugar, which are to be fully liberalised by the end of 2009.[126]

Despite that, significant erosion of preferences has taken place and still takes place, the most serious reason for the ending of the Lomé Convention relates to the rules and values of the multilateral trading system. The first Article of the GATT requires non-discrimination and compliance with the MFN principal by stating that "any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other members".[127] As Lomé allowed discriminatory treatment to the ACP, but excluded other countries at similar levels of development, it violated the MFN principal. In response, the Green Paper acknowledges that this has provided ACP countries with liberal rules of origin, but argues that the multilateral trade system has undermined the Lomé preferences with respect to the principles of non-discrimination and non-reciprocity.[128] Therefore, the Cotonou Agreement which replaced Lomé had to take into account the rules of the multilateral trading system, which had become incompatible with Lomé. Many authors including Gibb contend that the EU has placed the WTO in the centre of the negotiations, not only in informing the successor of Lomé, but the negotiations over the EPAs.[129] It appears that the EU has used WTO compliance as a *fait accompli* for justifying changes in

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[123] Stoneman, C. and Thompson, C., op.Cit, p. 234.
[124] Locit.
[125] Olympio, J. et al., (1) op. Cit, p. 99.
[126] Ibid, p. 100.
[127] Van den Bossche. The Law and Policy of the World Trade Organization: Texts, Cases and Materials, Cambridge, Cambridge University Press, 2005, p. 310.
[128] European Commission, op.Cit, p. 10-11.
[129] Gibb, R.,(5) op.Cit, p. 468.

regimes, especially in the context of the EPA negotiations, which Goodison depicts as a "common EC rhetorical ploy".[130]

The Cotonou Agreement, which replaced the 25 year old Lomé framework, was signed in 2000 and reflected the shift of the multilateral trading system toward a more liberal position, emphasising the economic integration of markets and greater economic openness, which not only takes into account trade in goods, but contains provision for the negotiation of new generation issues as mentioned earlier. It is set to last until 2020 with an important qualification for its trade chapter, which was to be replaced by the end of 2007.[131] The Cotonou Agreement consists of three interrelated pillars: political, development, and economic and trade cooperation.[132] The most fundamental change is represented within the first pillar which sets out to negotiate new EPAs, which are presently being negotiated to prevent any loss of market access to the EU market. These are to replace the non-reciprocal market access provisions previously enjoyed under the Lomé, which were extended under the Cotonou Agreement through a WTO waiver secured in 2001, which expired on 31 December 2007.[133] Within the framework of the Cotonou Agreement, the objective of the economic and trade cooperation is aimed at "fostering the smooth and gradual integration of the ACP States in the world economy".[134] It also aims at improving trading, supply and production capacity; as well as enhancing capacity to attract foreign investment.[135]

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[130] Goodison, P., (2) "EU Trade Policy & the Future of Africa's Trade Relationship with the EU" in Review of African Political Economy, Vol. 34, No. 112, p. 254.
[131] Stevens, C. and Kennan, J., "What Role for EPAs in Regional Economic Integration?" in Bertelsmann-Scott, T. and Draper, P. (eds.), Regional Integration and Economic Partnership Agreements: Southern Africa at the Crossroads, the South African Institute of International Affairs (SAIIA), Johannesburg, 2006, p. 75-76.
[132] Venter, D., et al. (2) Regional Integration – Economic Partnership Agreements for Eastern and Southern Africa, Intrepid Printers, Johannesburg, 2007, p. 90.
[133] Alavi, A. et.al. EU-ACP Economic Partnership Agreements (EPAs): Institutional and Substantive Issues, Danish Institute for International Studies, Copenhagen, 2007, p. 14, available from: http:// www.diis.dk/graphics/Publications/Andet2007/pgi_EPAs.pdf, accessed 27 December 2008.
[134] The Courier, op.Cit, p. 25.
[135] Locit.

As regional integration has informed the EU's domestic experience, this has influenced its belief that this model will also benefit other regions.[136] Therefore it comes as no surprise that when considering the modalities surrounding the implementation of EPAs, these contain strong elements of regional integration. For instance Article 35 of the Cotonou Agreement states that "economic and trade cooperation shall build on the regional integration initiatives of ACP States, bearing in mind that regional integration is a key instrument for the integration of ACP countries into the world economy".[137] For this reason the EU has had a clear preference for negotiating EPAs on a regional basis. In theory the trade reform envisaged by the EPAs can lead to lower prices, increased competition and higher economic growth, however it has been argued that this is more applicable to North-North relations, as opposed to North-South relations, in which case necessitates meeting certain preconditions prior to undertaking such reforms.[138] This has informed the central debate between the EU and the ACP countries in the context of the EPA negotiations. The latter have argued that in order to be able to benefit from the EPAs, supply-side constraints such as infrastructure should be addressed in sequence to progressive opening of markets, as well as strengthening of institutional capacity, aimed at improving the capacity of these countries to negotiate and implement EPAs.[139] By contrast, the EU has cited the benefits of increased economic growth emerging as a result of the reciprocal liberalisation required under Article XXIV (GATT/WTO) and the additional benefits of the EPAs, which contain provisions for the negotiation of new generation issues.

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[136] Woolcock, S., "The European Union's Trade Policy Trajectory" in Bertelsmann-Scott, T. and Draper, P. (eds.), Regional Integration and Economic Partnership Agreements: Southern Africa at the Crossroads, the South African Institute of International Affairs (SAIIA), Johannesburg, 2006, p. 5.
[137] The Courier, op.Cit, p. 25.
[138] Szepesi, S., "Coercion or Engagement? Economics and Institutions in EU-ACP Trade Negotiations" in Bertelsmann-Scott, T. and Draper, P. (eds.), Regional Integration and Economic Partnership Agreements: Southern Africa at the Crossroads, the South African Institute of International Affairs (SAIIA), Johannesburg, 2006, p. 13.
[139] Bilal, S., and Rampa, F., op.Cit, p. 47.

3.3 The WTO dimension

One of the key issues over the negotiation of the EPAs has been ensuring compliance with GATT's Article XXIV which requires FTAs to "eliminate duties and other restrictive regulations of commerce...on substantially all the trade between constituent territories in products originating in such territories".[140] However as there has been no clear definition as to how "substantially all trade" is measured, or what proportion of trade is to be liberalised amongst parties, it has generally been maintained that between 80 and 90 percent of total trade between member states is sufficient to meet WTO compatibility. Therefore in theory, if an ACP grouping were to liberalise 60 percent of its trade toward the EU, while the EU liberalised 100 percent of its imports from an ACP grouping, this would meet the "substantially all trade" requirement. In reality, however it has been argued that most ACP countries are heavily dependent on tariff revenues, which will significantly inform the level of reciprocity that these countries will accept in the context of tariff-elimination on the part of the EU.[141] Furthermore when considering FTA agreements concluded between the EU and third parties, these have liberalised over 90 percent of total trade, in which case the EU's partners have actually liberalised a greater share of imports than the EU.[142]

In addition to the requirement of liberalising "substantially all trade", according to Article XXIV (GATT/WTO), this is to be achieved within "a reasonable length of time", which is understood to be 10-12 years, except in "exceptional cases", without clarifying what constitutes such cases.[143] As these requirements are subject to interpretation, ACP countries in some regional groupings (i.e. ESA) have tended to propose longer transition periods of up to 35 years. However the EC has been adamant in accepting such extended transition periods of tariff elimination, citing the "spectre of WTO compatibility".[144] However Bilal and

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[140] Milner, C. et al., "Some Simple Analytics of the Trade and Welfare Effects of Economic Partnership Agreements" in Journal of African Economies, Vol. 14, No. 3, 2005, p. 331.
[141] Goodison, P., (2) op.Cit, p. 253.
[142] Bilal, S., and Rampa, F., op.Cit, p. 24.
[143] Alavi, A. et.al., op.Cit, p. 18.
[144] Goodison, P., (2) op.Cit, p. 252.

Rampa contend that longer time frames are adopted unilaterally by the participating parties to an FTA, which in practice is not subject to WTO interpretation or dispute settlement.[145]

This illustrates on the one hand, the limited flexibility that the multilateral trading system provides to developing countries by virtue of their level of development, and on the other, that the provisions of the EPAs will predetermine the future of ACP trade policy (i.e. liberalising domestic markets vis-à-vis the EU), over which ACP countries have limited influence. As an alternative to EPAs, the EU also offers other trade arrangements, based on developmental status - such as its Generalised System of Preferences (GSP), the GSP-plus and the EBA.

3.4 Alternatives to EPAs

The GSP ranks relatively low (just above MFN treatment) on the EU's pyramid of trade preferences which allows duty-free access for non-sensitive products and a reduced tariff at the MFN rate for sensitive products.[146] It was developed within the United Nations Conference on Trade and Development (UNCTAD) since 1968 and has been open to all developing countries (LDCs and non-LDCs). However, the preferences offered by this arrangement can be unilaterally withdrawn at any time by the EU and cover much fewer products with stricter rules of origin.[147] The non-LDCs that chose not to sign the interim agreements as the end of 2007 deadline was approaching have been downgraded to the less advantageous GSP. For instance it has been estimated that Namibian beef exports to the EU would face 142 percent higher tariffs under the GSP.[148] By contrast, the GSP-plus provides additional benefits of duty-free market access for countries that implement international conventions relating to human and labour rights, environmental standards and good governance, but still has restrictive rules of origin.[149] The LDCs on the other

[145] Bilal, S. and Rampa, F., op.Cit, p. 25.
[146] Markov, H., "Checking the System: A Review of Trade Preferences" in Trade Negotiations Insights, Vol. 7, No. 6, August 2008, p. 3.
[147] Hurt, S., op.Cit, p. 168.
[148] Kamidza, R. op.Cit, p. 47.
[149] Markov, H., op.Cit, p. 3.

hand qualify for duty-free and quota-free market access to the EU under the EBA initiative, which provides the most favourable treatment. Despite this, the EBA offers very stringent rules of origin, which in some instances are less favourable than those offered under the EPAs and preferences can be withdrawn at any time as it is a non-contractual arrangement.[150] Furthermore countries that take advantage of the EBA, but at the same time form part of a regional arrangement that is negotiating an EPA will have to maintain stringent border controls to enforce the different rules of origin. Given that these countries have limited capacity of enforcing these, LDCs using the EBA will in *de facto* become party to the EPAs.[151] Therefore LDCs like Mozambique and Lesotho that qualify for the EBA had initialled the interim EPA agreement with the EU a month before the expiry of the WTO waiver. Under the EPA for instance, a country like Lesotho can export apparel products to the EU market under the single transformation rule which allows cumulation of origin (i.e. apparel made from imported materials), which is not allowed under the EBA due to its restrictive rules of origin criteria.[152] Therefore its decision to initial the interim agreement has been driven by perceived economic opportunities of market opening.

Since January 2008, the EU has presented EPA countries with a new opportunity by offering duty-free, quota-free access (DFQF) to all imports with a qualification for sugar and rice, to be phased in by 2010 and 2015 respectively.[153] This has been part of the EU's broader commitment to Aid for Trade by seeking to compensate EPA countries for the adverse consequences of market opening, which will have several implications, *inter-alia*: undermining tariff revenues; reduced access to services resulting from privatisation of public goods; de-industrialisation in some regions; and the undermining of regional

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[150] South Centre, (2) op.Cit, p. 33.
[151] Alavi, A. et al., op.Cit, p. 22.
[152] European Commission. No link between the access to grants allocated to Malawi under the European Development Fund (EDF) - € 451 million – and the signature of the Economic Partnership Agreement, Lilongwe, 17 April 2008, p. 2, available from: http://delmwi.ec.europa.eu/en/eu_and_malawi/Delegation%20Press%20Releases/EDF%20-%20EPA%20Press%20Release%2017.04.08.doc, accessed 31 December 2008.
[153] Stevens, C., op. Cit, p. 16.

economic integration efforts.[154] In this regard the "development dimension" of the EPAs acknowledges that these are not mere FTAs, but are accompanied by development assistance provided under the current 10th European Development Fund (EDF), which entered into force 1 July 2008.[155] To this end, Trade Commissioner Peter Mandelson contends that EPAs are to be seen as "trade and development tools... not classical hardnosed free trade agreements of the sort that developing blocks negotiate between them[selves]".[156] However the manner in which trade related adjustment funding is distributed under the EDF suggests that the process is linked to that of the EPA negotiations.

3.5 The introduction of conditionality for EU aid in the context of the EPAs

Under the previous Lomé Conventions a significant part of aid had been allocated toward agriculture and rural sector development. Consequently under the 9th EDF, support for agriculture and rural sector development declined dramatically in favour of structural adjustment support.[157] This clearly indicates the EU's preference for allocating aid in support for improving supply capacity and economic adjustment. Under the 10th EDF, the EU has agreed to commit a figure of €22.6 billion, which is set to run up until 2013. From this amount, €17.9 billion has been allocated for development support, which is to be channelled though the Regional and National Indicative Programmes (RIPs and NIPs).[158] However, ACP negotiators have argued that the resources provided under the EDF will be insufficient to meet the adjustment costs of the EPAs highlighted above and have requested increased resources in addition to those provided under the EDF. The European Commission's response has been that the EPA negotiations are ultimately trade negotiations which are not part of the

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[154] Goodison, P., (2) op.Cit, p. 261.
[155] Julian, M. et al., "EPA Negotiations Update" in Trade Negotiations Insights, Vol. 7, No. 6, August 2008, p. 13.
[156] Mandelson, P. Economic Partnership Agreements: putting a rigorous priority on, Brussels, 20 January 2005, p. 3, available from: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/05/23&format=PDF&aged=1&language=EN&guiLanguage=en, accessed 2 January 2009.
[157] South Centre, (1) op.Cit, p. 12.
[158] Kotcho, J. and Abega, M., "EPAs: what is at stake for agriculture and development in Central Africa?" in Trade Negotiations Insights, Vol. 7, No. 6, August 2008, p. 8.

aid/development pillar under the Cotonou Agreement.[159] As the mandate of the European Commission excludes undertaking negotiations in the aid pillar, Regional Preparatory Task Forces (RPTFs) containing members of the negotiating parties were established in order to ensure coherence between the EPA negotiations and development cooperation.[160]

The linking of the RPTF discussions to the programming of the 10th EDF has proved to be a frustrating process given that in regions where ACP groupings have carried out costly assessments of adjustment costs; these have been rejected by the EC.[161] Another point of concern for the ACP countries has been that EPA-related adjustments will be provided under the EDF, which in addition, also provides funding for other development programmes (i.e. health, rural development, water, etc.). This means that in financing EPA-related adjustments, this may involve diverting money away from other EDF programmes.[162]

This illustrates the potential link between the aid for trade agenda and the EPA negotiations, which suggests that aid for trade in this case can serve a political purpose for "buying" progress in the trade negotiations. In this respect the EC's position has been that aid and trade are two separate processes and affirmed that aid for trade is not contingent on the conclusion of EPAs, but will be available regardless of whether these are concluded.[163] The ACP countries have however drawn linkages between commitments made in the context of EPA negotiations and aid assistance. To this end, ACP countries have favoured including binding commitments on aid for trade delivery in the EPA texts.[164]

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[159] South Centre, (1) op.Cit, p. 10.
[160] Lui, D. The aid for trade Agenda and accompanying measures for EPAs, European Centre for Development Policy Management (ECDPM), Discussion Paper 86, Maastricht, 10 December 2008, available from: http://www.ecdpm.org/Web_ECDPM/Web/Content/Navigation.nsf/index2?readform&http://www.ecdpm.org/Web_ECDPM/Web/Content/Content.nsf/7732def81dddfa7ac1256c240034fe65/bbe8fffcc5a8e8c0c125750f0055f7ae?OpenDocument, accessed 2 January 2009.
[161] Locit.
[162] South Centre, (1) op.Cit, p. 6.
[163] Overseas Development Institute (ODI) and European Centre for Development Policy Management (ECDPM), "Interim EPAs in Africa: What's in them? And what's next?" in Trade Negotiations Insights, Vol. 7, No. 3, April 2008, p. 3.
[164] Lui, D., op.Cit.

Despite the differentiation between aid for trade and the commitments in the EPAs on the part of the EC, the latter has viewed both processes "mutually reinforcing", in the sense that it has implied that the successful adoption of "the right policy framework" will lead to increased assistance. [165]

For Commissioner Mandelson, trade related adjustment is a means to an end, and while policy reform is not translated into practice there can be "no cheques".[166] In this respect, "the right policy framework" for the EU relates to undertaking liberalisation and "locking in" reforms in respect to the so called "new generation" issues prior to implementing additional EPA-related adjustments.

By contrast ACP countries have argued that trade-related assistance geared towards capacity building should come prior to undertaking liberalisation commitments. However Goodison contends that the EC has had considerable leverage in encouraging ACP trade ministers to conclude the EPAs through "the engineered convergence of the final stages of the EPA negotiations with the programming of 10th EDF aid resources".[167] This illustrates the link between trade related assistance in the context of the EPAs negotiations and the programming of the 10th EDF. From a broader perspective, this is also reflective of the shift away from "entitlement aid" towards more conditionality attached to aid preferences. For instance under the Cotonou Agreement "political conditionalities" have been included which emphasise *inter-alia*, respect for human rights, good governance, democratic principles and other objectives consistent with the EU's foreign policy objectives.[168] Therefore this is representative of the broader Western ideology of promoting development through trade rather than aid.

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[165] Mandelson, P. Address to the European Socialist Party Conference on Economic Partnership Agreements, Brussels, 19 October 2006, p. 3, available from: http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/612&format=HTML&aged=0&language=EN&guilanguage=en, accessed 4 January 2009.
[166] Locit.
[167] Goodison, P., (2) op.Cit, p. 260.
[168] Venter, D. et.al., (2) op. Cit, p. 92.

3.6 South Africa's shift toward trade liberalisation in the post-1994 era

It was against this backdrop that South Africa sought to develop new trade relations with the EU. The transition to majority rule in 1994 inclined the incoming ANC government to seek a new trade relationship with the EU, which would be complementary to its long-term economic and political objectives of economic growth and development. To this end, the Department of Trade and Industry (DTI) has been the main instrument through which policy measures have been implemented in regard to stimulating market-based incentives, in particular focusing on trade reform and competition policy.[169] This approach is consistent with the neoliberal model which posits that free trade and competition is the key to most efficient distribution of resources, thereby maximizing both national and international welfare.

Prior to the 1990s, the South African economy had been characterised by a persistent negative trade balance mainly due to the import substituting industrialisation (ISI) policies and capital subsidies. As economic growth has been dependent on ability to import, these policies, combined with its deepening political isolation inhibited economic growth and led to stagnation in the domestic economy.[170] However, Cassim et al. note that trade liberalisation had already been initiated as early as the 1980s, particularly to reduce the anti-export bias resulting from these ISI policies.[171] This resulted in providing incentive to export through the short lived General Export Incentive Scheme (GEIS) in 1990, which was dismantled in 1994 as part of South Africa's offer to the multilateral trading system under the GATT/WTO Uruguay Round.[172] This once again highlights the spectre of GATT/WTO compatibility which has made selective protection vis-à-vis foreign third parties increasingly more difficult under progressive rounds of tariff reductions. As was mentioned in this chapter,

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[169] Lewis, D., et.al, "South Africa: Economic Policy Making and Implementation in Africa: A study of Strategic Trade and Selective Industrial Policies" in Soludo, C et.al (eds.), The Politics of Trade and Industrial Policy in Africa. Forced Consensus?, Africa World Press, New Jersey, 2004, p. 151.
[170] The Industrial Development Corporation (IDC). Manufacturing Trading Conditions, April 1995, p. 32.
[171] Cassim, R, et.al, The State of Trade Policy in South Africa, Trade and Industrial Policy Strategies (TIPS), Johannesburg, 2004, p. 6.
[172] Gibb, R., (1) op.Cit, p. 81-82.

South Africa has undertaken a significant reduction in tariff levels and in certain instances has reduced these below the required level of the GATT/WTO.[173]

Another important market-based incentive which is seen increasingly complementary to trade reform has been competition policy. In addition to the net welfare gains (trade creation versus trade diversion) stemming from participation in a regional trade arrangement (i.e. customs union or FTA) as alluded to in chapter 2, in theory it is assumed that this will lead to increased competition. In turn, this is likely to contribute to a more efficient allocation of resources, thereby resulting in price reductions for goods and services. From a broader perspective, competition policy and other "new generation" issues are clearly consistent with the liberal approaches to political economy, which in this respect delegate a minimalist role of the state along the continuum of state versus market.

When considering the protectionist industrial policies of South Africa in the past and the strategic role played by the state in formulating these, it comes as no surprise that competition policy law and enforcement have been weak. For instance, although an anti-trust enforcement agency in the form of a Competition Board had been created in 1980, there had been no successful prosecutions in terms of anti-competitive practices over a period of 20 years, up until 2000.[174] Part of the reason for this has been that under the pre-1994 regime, the pursuance of highly protectionist industrialisation policies required close government co-operation with the business community which was comprised of a privileged group of companies and entrepreneurs.[175] With the advent of the new 1994 government, competition law reform was not given much precedence either, in the main for political imperatives, amongst which include the effect on public enterprises and public policies, such as employment creation and Black Empowerment Equity requirements.[176]

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[173] Lewis, D., et.al, op.Cit, p. 162.
[174] Ibid, p. 166.
[175] Locit.
[176] Ibid, p. 167.

3.7 WTO plus issues in the EPA negotiations

However the inclusion of competition policy issues, along with the other Singapore issues (government procurement, trade facilitation and investment) has increasingly appeared both on the agenda of the multilateral trading system and in bilateral FTA agreements, the most notable of which in respect to this research report are the EPAs and the EU-SA TDCA. These issues were first raised at the WTO Ministerial Conference in Singapore in 1996 by the EU and are often referred to as the "Singapore issues" or the so-called "behind the border" issues.[177] Since the Doha Round, the EU has been a firm advocate of including these issues on the WTO agenda, but the refusal of developing countries to negotiate these has made this task more difficult.[178] Therefore these outstanding issues are depicted as "WTO plus" and are not necessary for securing a WTO-compatible basis for negotiating bilateral agreements. As these provisions have been excluded from the WTO agenda, the EU has made these integral parts of future FTA Agreements. Although the EPAs have a strong developmental aspect, from the above assessment on aid for trade, it can be argued that these are essentially FTAs with a political "sweetener" to gain political acceptance of the inclusion of these issues on the part of ACP countries.

3.8 The Trade, Development and Cooperation Agreement

The situation for South Africa however is different as its trade is framed under the TDCA and covers mainly trade in goods, without any obligation to negotiate any "new generation issues". From the start, South Africa had a preference to pursue full participation of the Lomé Convention, but this was rejected by the EC on the grounds of its "developed" status under the WTO and its economic

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[177] South Centre, (2) op.Cit, p. 12.
[178] Meyn, M. (2) The TDCA and the Proposed SACU-USA FTA: Are Free Trade Agreements with Industrialised Countries Beneficial for the SACU?, Institute for World Economics and International Management (IWIM), Bremen, p. 18, available from: http://www.essa.org.za/download/2003Conference/MeynM_The%20TDCA%20And%20The%20Proposed%20SACU-USA%20FTA%20Are%20Free%20Trade%20Agreements%20With%20Industrialised%20Countries%20Beneficial%20For%20The%20SACU.pdf, accessed 6 January 2009.

sophistication relative to other ACP economies.[179] Hence, its exclusion from the Lomé trade chapter necessitated the negotiation of the TDCA.

The TDCA is a bilateral agreement between the EU and South Africa, signed in 1999, committing both sides to immediate liberalisation which commenced on 1 February 2000.[180] Under the TDCA, both sides are reducing tariffs to zero over a transitional period; by 2010, 95 percent of South African exports will be entering the EU market duty free; while by 2012, 86 percent of EU exports will be entering the South African market duty free. Both sides agree that this meets the WTO-compatible basis and essentially meets the requirements of Article XXIV (GATT/WTO). A review process is also included in the TDCA taking place every five years, which can be used by both parties to reopen talks on undertaking further negotiations in certain issues, such as sensitive products.

Although the TDCA will fully liberalise trade in goods on substantially all trade, both sides have placed certain sensitive products on a review list. The review list contains sensitive products which are partially liberalised and back-loaded, with tariffs being phased out towards the end of the implementation period. For the EU, agricultural products have been a sensitive area, which has proved difficult to negotiate. Despite this, Goodison contends that this was the first time the EU has included its agricultural sector in a FTA.[181]

In this regard, the EU had agreed to liberalise 62 percent of agricultural imports from South Africa. Out of the excluded portion of 38 percent, 12 percent are subject to partial liberalisation through tariff quotas, thereby in *de facto* reducing total agricultural exclusions from South Africa to 26 percent.[182] In contrast, South Africa has also subjected certain agricultural and industrial products from the EU to partial liberalisation or exclusion, most notably motorcar components and some steel products.[183] Although both sides can use the review process to

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[179] Bertelsmann-Scott, T. The European Union and South Africa: Reaching Agreement?, the South African Institute of International Affairs (SAIIA), Johannesburg, 1998, p. 25.
[180] Olivier, G., op.Cit, p. 67.
[181] Goodison, P. (1) op.Cit, p. 33.
[182] Locit.
[183] Ibid, p. 29.

further liberalise any of the products on the exclusion list, any liberalisation of products by one member, would require this to be offset by a concomitant liberalisation by the other member. In this regard South Africa has been reluctant to re-open the agreement with the EU as it has feared pressure of having to offset product liberalisation by the EU with its sensitive sectors, such as its automotive industry.[184] This has important implications for the BLNS and SACU.

It was indicated in the preceding chapter that the EU-South Africa TDCA in *de facto* transformed the non-reciprocal EU-BLNS trade relations into a reciprocal preferential agreement, alongside South Africa. As the TDCA was negotiated prior to the SACU 2002 Agreement, at a time in which South Africa unilaterally determined the CET and revenue issues in line with its own needs, the BLNS were excluded from the negotiation process.[185]

3.9 TDCA compensatory measures and BLNS acceptance of greater trade liberalisation

Despite this, in terms of the negotiation process, both South Africa and the EU have tried to not only accommodate the interests of the BLNS in the context of SACU, but also the interests of the broader SADC region. To that end, South Africa has excluded certain products which are considered sensitive to ACP countries on the South African market, such as beef, some sugar products and some cereals.[186]

The EU has emphasised its development rhetoric by stating that "In line with our general policy, which is to actively encourage economic integration at regional level, we wanted to ensure that we would not gain better access to the South

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[184] Meyn, M. (3) The Impact of EU Free Trade Agreements on Economic Development and Regional Integration in Southern Africa. The Example of EU-SACU Trade Relations, Peter Lang, Frankfurt, 2006, p. 148.
[185] Olympio, J. et.al. (2) A Study to Assess the Likely Impacts on Southern African and EU Producers of Further Liberalising the Trade, Development and Co-operation Agreement (TDCA) by Granting South Africa Duty Free Access to the EU, the Regional Trade Facilitation Programme (RTFP), Pretoria, 2006, p. 13.
[186] South African Department of Agriculture, SA-EU Trade Development and Cooperation Agreement (TDCA), p. 1, available from: http://www.nda.agric.za/docs/TDCA_May_2006.pdf, accessed 8 January 2009.

African market than the SADC countries. Concepts such as 'SADC first' or SADC preference have underpinned the negotiations, and we showed a lot of understanding, for example in the textile sector, when it was explained that South Africa would prefer to reserve certain trade concessions for its SADC partners".[187] However, it has been argued that "South Africa's offer to SADC is superior to its offer to the EU, though the preferential market offer can only be accessed by non-SACU countries for a limited number of products within three to five years. These concessions are small considering the development gap between non-SACU SADC countries and SA-SACU countries".[188] Furthermore under the TDCA, there are certain value-added products of potential interest to the BLNS which are not excluded.[189] These include products such as processed meat and apparel, in which South Africa has received better preferential access to the EU under the TDCA, than the BLNS under the Cotonou Agreement.[190] This is indicative of the fact that the EU has a preference for differentiated tariff offers to South Africa on the one hand, and the BLNS on the other.

In addition to excluding certain sensitive products, the TDCA also contains a safeguard clause which is designed as a remedial action to protect BLNS interests from negative effects stemming from the introduction of free trade. In this regard the TDCA Agreement contends that "Where any product is being imported in such quantities and under such conditions as to cause or threaten to cause serious deterioration in the economic situation of one or more of the member countries of the Southern African Customs Union, South Africa, at the request of the country or countries concerned, and after having examined alternative solutions, may exceptionally take surveillance or safeguard measures in accordance with the procedures laid down in Article 26".[191] Against

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[187] Lowe, P., "Main Parameters of the EU-SA Partnership", in Bertelsmann-Scott, T et.al (eds.), The EU-SA Agreement. South Africa, Southern Africa and the European Union, the South African Institute of International Affairs (SAIIA), Johannesburg, 2000, p. 44.
[188] Pallangyo, A., "The Impact of the EU-SA Agreement on SADC" in Bertelsmann-Scott, T et.al (eds.), The EU-SA Agreement. South Africa, Southern Africa and the European Union, the South African Institute of International Affairs (SAIIA), Johannesburg, 2000, p. 81.
[189] Meyn, M., (3) op.Cit, p. 141.
[190] Ibid, p. 142.
[191] European Commission and the Republic of South Africa, Agreement on Trade, Development and Cooperation between the European Community and its Member States, on the one part,

this background it can be observed that the BLNS are not able to apply for safeguards autonomously, but through South Africa, which seriously curtails their ability to safeguard their interests.

The EU also envisaged that the BLNS would benefit from the so-called "full cumulation of origin", which allows the latter to use inputs from any ACP country and export under the existing preferential market conditions to the EU. However, apart from using inputs from ACP countries, a related contentious issue within the negotiations of the TDCA has been that it was initially envisaged that the BLNS would be able to source inputs from South Africa and still export under preferential terms to the EU market.[192] However, full cumulation within SACU (between BLNS and South Africa) has not taken place as this has required customs arrangements to be put in place on the part of South Africa, which would guarantee that the rules of origin are supervised.[193] In this regard the EU has noted that "this was not a subject to be dealt with under the agreement with South Africa; it belongs to Lomé.[194]

In order to ensure a positive regional impact, the EU also launched an Economic Integration Support Programme (EISP) with a funding of €6 million, to help the BLNS deal with the introduction of free trade, in particular revising trade policies, undertaking impact studies and supporting the development of the private sectors in these countries.[195] However, this funding had only been released in 2005, after a long dispute regarding "concurrence" of the BLNS to the TDCA.[196] As South Africa and the BLNS are part of the same customs union, the need for the latter to "concur" to the TDCA is essential in order to preserve the legal quality of SACU and its CET.

Therefore "concurrence" in this respect would refer to "official recognition of not being in a position to access indirect EU imports, it implies BLNS countries'

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and the Republic of South Africa, on the other part, Tralac, 1999, p. 11, available from: https://www.givengain.com/unique/tralac/pdf/20061009_tdca.pdf, accessed 8 January 2009.

[192] Meyn, M., (3) op.Cit, p. 140.

[193] Ibid, p. 141.

[194] Lowe, P., op.Cit, p. 44.

[195] Van der Staak, S., op. Cit, p. 58.

[196] Meyn, M., (1) op.Cit, p. 42..

unilateral acceptance of the TDCA liberalisation schedule".[197] In this instance the EU has made the release of these funds contingent on BLNS concurrence of the TDCA liberalisation schedule. This once again illustrates a certain degree of conditionality attached to aid preferences. Eventually, the EU had released these funds under the 9th EDF, arguing that the ratification of the 2002 SACU Agreement would imply concurrence to the TDCA liberalisation schedule on the part of the BLNS. As was indicated in chapter 2, although the new SACU 2002 Agreement requires the consent of all members in regard to preferential trade arrangements, it contains a clause which exempts preferential trade agreements that predate this agreement, such as the TDCA.

After having briefly examined the regional measures that have been taken on the part of South Africa and the EU in respect to compensating the BLNS in the context of the TDCA, two important points can be made, which have been a recurrent theme and have important implications for the EPA negotiations and the future of SACU. First, it is clear that the EU is unwilling to extend the same level of concessions to the BLNS and South Africa. Second, the regional measures undertaken on the part of EU to compensate the BLNS with respect to the TDCA contain a strong element of conditionality, which once again exemplifies the link between trade and aid.

3.10 Summary

This first part of this chapter has considered the shift in the EU's trade policy from non-reciprocal trade relations, towards the introduction of reciprocity in the context of the EPA negotiations, in part necessitated by the multilateral trading system. It was highlighted that the EU has cited the spectre of WTO compatibility as a reason for moving towards reciprocal trade relations under EPAs, without offering much flexibility in respect to the time frame and proportion of trade to be liberalised. In terms of alternatives to EPAs, it has been shown that these cover fewer products with stricter rules of origin, thereby

[197] Meyn, M., (3) op.Cit, p. 146.

limiting the choice of ACP countries and making it unlikely that these would be chosen over the EPAs.

An analysis of the requirements of securing a WTO-compatible basis in regard to the provisions of the EPAs as modalities for future trade co-operation, suggests that these move beyond the minimum required, to embrace “new generation” issues which were referred to as “WTO plus”. To this end, it was argued that there is a potential link between trade related assistance and conclusion of an EPA, thereby exemplifying a measure of conditionality and issue-linkage. Hence, it was suggested that the developmental dimension of the EPAs in the form of trade related assistance can be depicted as a political “sweetener” to gain concurrence on the part of ACP countries to the inclusion of “new generation” issues.

The latter half of this chapter highlighted that South Africa has undertaken significant trade reform in line with its multilateral (WTO) and bilateral (TDCA) trade commitments, but has been unwilling to undertake further reform in other policy areas (i.e. competition policy), which have become increasingly important to the EU. This part also highlighted that the negotiation of the TDCA has had important implications for the BLNS, to which end, both the EU and South Africa had undertaken compensatory measures, which have served a purpose of gaining concurrence on the part of the BLNS to the TDCA liberalisation schedule, thereby once again exemplifying a potential link between trade related assistance and trade policy reform. This part also indicated that the EU has had a preference for differentiated tariff offers to South Africa on the one hand (under the TDCA), and the BLNS on the other (under Cotonou), which points to the fact that different rules of origin have to be maintained within SACU, thereby having important implications for its future.

CHAPTER 4 EXAMINING THE EPA NEGOTIATION PROCESS

4.1 Introduction

This chapter will examine the EPA negotiation process in light of the perceived costs and benefits associated with aligning both sets of rules of origin on the part of the EU and South Africa. It is assumed that the choices made by South Africa on the one hand, and the BLNS on the other, in terms of commitment to initial the interim EPA (IEPA) has been informed by a perceived cost/benefit analysis on the part of these actors. This part will also examine the extent to which the EU has been able to manipulate the opportunity costs of SACU members and the kind of leverage used to this end. In this regard, a game-theoretic analysis is used to illustrate the strategic interaction between the EU and South Africa by showing how the choice of these actors is informed by their individual preferences. However, under certain restrictive conditions, which have increasingly appeared on the agenda of the EU as was shown in the preceding chapter, *inter-alia*, conditionality, issue-linkage and sanctioning, a game-theoretic approach is used to show how these can alter the order of preferences of the weaker actor and as a corollary have an impact on its choice in the negotiation process. As was indicated in chapter 1, this can force the weaker actor to make decisions within constraints, which will ultimately give greater preference to the more dominant actor within the negotiation process.

4.2 Regional inconsistencies in Southern Africa

The replacement of the trade pillar of the Cotonou Agreement with new modalities for trade cooperation in the form of EPAs has necessitated ACP countries to enter negotiations with the EU on a regional basis. According to the EU, these are intended to enhance regional integration and help integrate these countries better in the world economy. However there is a growing consensus amongst ACP countries and NGOs that EPAs are divisive and are likely to have a major negative repercussion on regionalism within Southern Africa. The Southern Africa region which is negotiating EPAs with the EU has formed three groups. The first consists of 11 countries, namely, Malawi, Zambia, Zimbabwe,

Mauritius, Seychelles, Comoros, Djibouti, Eritrea, Ethiopia, Madagascar and Sudan, (the first five are all SADC countries) which are negotiating as part of the ESA EPA. The second is the TDCA with South Africa; the last group is the SADC EPA which is comprised of Botswana, Lesotho, Namibia, Swaziland, South Africa[198], Angola and Mozambique (the first five are all SACU members, while all are SADC members).[199] From the above it can be seen that SADC members are involved in multiple bilateral and regional trade arrangements which poses considerable challenges to regionalism in Southern Africa.

As the liberalisation schedule of the ESA EPA and that of the SADC EPA are different, it means that neighbouring Southern Africa countries belonging to different groupings will have to implement different tariffs for EU imports, the effectiveness of which would depend on the enforcement of rules of origin. Most of the SADC countries within both groupings are signatories to the SADC Trade Protocol that envisages the implementation of tariff liberalisation schemes, which process will be weakened considering that each grouping will have to retain robust border controls on EU originating goods, where liberalisation schedules differ vis-à-vis the latter. Despite the launching of the SADC FTA in August 2008 as set out by the SADC Trade Protocol, the idea of fast-tracking this arrangement to a customs union by 2010 will make that impossible in light of the differing commitments vis-à-vis the EU.[200]

4.3 Regional inconsistencies in SACU

The situation for SACU is equally complicated as the BLNS are covered *de facto*, but not *de jure* by the TDCA and at the same time are members of the SADC EPA group, to which South Africa is not an official member.[201] Therefore the most important question stemming from this has been over the alignment of the TDCA and the SADC EPA processes in order to ensure coherence within

[198] South Africa joined the SADC EPA group as an observer in February 2007.
[199] Stevens, C., op. Cit, p. 10.
[200] Ibid, p. 9.
[201] Stevens, C. and Kennan, J., op.Cit, p. 77.

SACU.[202] In this regard, one of the key issues has been the extent to which the BLNS have been willing to accommodate the TDCA in the context of the SADC EPA negotiations.[203] The reason for this is that as the EU requires reciprocity, the BLNS cannot offer further tariff concessions by virtue of SACU's CET, which would require concurrence on the part of South Africa.[204] It has been argued that if the BLNS were to negotiate the EPA on the basis of the TDCA, given that they would not be able to offer further market opening without the concurrence of South Africa, they would in *de facto* be incorporated in the market provisions of the TDCA, thereby loosing the preferential market access enjoyed under Cotonou.[205] Such incorporation into the market provisions of the TDCA would impose duties on beef and beef products; fisheries; and sugar and sugar related products.[206] It is estimated that this would affect Namibian and Swazi exports to the EU by over 50 percent and 82 percent respectively.[207] This situation illustrates the fact that South Africa, by virtue of its membership in SACU and as the only signatory to the TDCA, has a central role to play in sorting out the BLNS EPA question by harmonising SACU's position vis-à-vis the EU. The TDCA review and the EPA process have been seen as the only frameworks through which to address these inconsistencies.[208]

However, in terms of the TDCA review, it was mentioned that neither the EU nor South Africa are too keen on reopening talks on liberalisation as this would require both sides to liberalise products which are partially excluded or fully excluded. It had been suggested that the rules of origin could also be

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[202] Grant, C., Southern Africa and the European Union: the TDCA and SADC EPA, Tralac, May 2006, available from: http://www.tralac.org/pdf/20060518_TDCA_SADC_EPA_Grant.pdf, accessed 14 January, 2007.
[203] Tekere, M., "Challenges for the SADC EPA Group" in Bertelsmann-Scott, T. and Draper, P. (eds.), Regional Integration and Economic Partnership Agreements: Southern Africa at the Crossroads, the South African Institute of International Affairs (SAIIA), Johannesburg, 2006, p. 68.
[204] Draper, P. et al., op.Cit, p. 28.
[205] Ibid, p. 28.
[206] Goodison, P. and Stoneman, C., "Europe: Partner or Exploiter of Africa? The G-90 and ACP" in Review of African Political Economy, Vol. 31, No. 112, December 2004, p. 727.
[207] Locit.
[208] Smalberger, W., (1) "The Future for SA-EU trade relations" in Bertelsmann-Scott, T and Draper, P (eds.), The TDCA: Impacts, Lessons and Perspectives for EU-South and Southern African Relations, the South African Institute of International Affairs (SAIIA), Johannesburg, 2005, p. 41.

renegotiated within the TDCA review in order to implement a single SACU origin, but the European Commission has had a clear preference for differentiated tariff offers to the BLNS on the one part, and South Africa on the other part. It has made it clear that the SADC EPA negotiating members must receive better tariff concessions than South Africa.[209] As SACU and the TDCA is limited to trade in goods only, whilst the EPA includes new generation issues, the extent to which the TDCA review can sort out this BLNS EPA situation remains questionable.[210]

4.4 Examining the negotiation process

Although the EC is insisting on treating South Africa differently, it has maintained that the latter should be more involved in the SADC EPA negotiations to ensure regional coherence. To this end, at a visit to the South African Institute of International Affairs (SAIIA) on 10 February 2006, Commissioner Mandelson indicated the need to "lock together consistently" the TDCA review and the SADC EPA negotiation.[211] In this regard he proposed the need to expand the TDCA toward "a step change into services, investment and procurement – the hardwiring of dynamic, modern economies".[212]

In response, South Africa formulated a negotiating framework document together with the SADC EPA countries, through which it was formally included in the SADC EPA negotiations in February 2007.[213] The framework document made a number of important points with relevance to SACU.[214] First, it argued

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[209] Olympio, J. et al., (2) op. Cit, p. 6.
[210] Bertelsmann, S. and Draper, P., "The TDCA: perspectives for EU-South and Southern African relations" in Trade Negotiations Insights, Vol. 4, No. 1, January-February 2005, p. 2.
[211] Mandelson, P., EU-Africa: Trade and Development, Johannesburg, 10 February 2006, p. 1, available from: http://www.europarl.europa.eu/meetdocs/2004_2009/documents/fd/dza2006022202/dza2006022202en.pdf, accessed 15 January 2009.
[212] Locit.
[213] South Centre, (3) EPA Negotiations in Southern Africa: Some Issues of concern, Geneva, October 2007, p. 6, available from: http://www.southcentre.org/index.php?option=com_content&task=view&id=296&Itemid=67, accessed 15 January 2009.
[214] South African Department of Trade and Industry (DTI), SADC EPA Group – EC Negotiations: Assessing the Emerging Outcome, p. 1-2, Pretoria, 30 January 2008, available from: http://www.thedti.gov.za/parlimentary/EPAoutcomes.pdf, accessed 15 January 2009.

that if the BLNS were to negotiate the EPA on the basis of the TDCA, their sensitivities should be taken into account. Second, it was highlighted that South Africa should receive DFQF market access alongside the other SADC EPA countries to ensure regional coherence. This option would have allowed South Africa to gain improved access for certain products which were not treated favourably under the TDCA.[215] In return, South Africa would have reduced the TDCA tariff for EU goods on around 380 product lines; this is discussed further below. In this regard, South Africa has always argued that as it does not make differentiated tariff offers to separate EU states, the latter should also treat SACU in the same coherent manner. Third, in regards to new generation issues, the view of the EPA members has been that trade related assistance and capacity building should precede the negotiation of these issues, which in addition should be non-binding.

The EC has responded that while it might consider addressing BLNS sensitivities under the TDCA review; these would not apply to South Africa.[216] As was mentioned, since January 2008, the EU has granted DFQF market access to all ACP countries with a qualification for rice and sugar, but this once again has excluded South Africa, "where a number of globally competitive products will continue to pay import duties".[217] With regards to differentiating amongst SACU members, in a meeting with the six SADC member ministers on 4 March 2008, Commissioner Mandelson responded that South Africa should not try and use the EPA process as a means of pursuing its own interests at the expense of its SACU partners, but spoke of the need to "re-engage South Africa in the negotiations for a wider and deeper EPA", through which it would be possible to find ways of increasing South Africa's access into European markets.[218] In other words, from the above it can be seen that the EU has

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[215] Davies, R., (2) op.Cit, p. 2.
[216] Ibid, p. 2.
[217] European Commission, EU offers full market access to Africa, Caribbean and Pacific regions in Economic Partnership Agreement negotiations, 4 April 2007, available from: http://www.eu-un.europa.eu/articles/en/article_6927_en.htm, accessed 15 January 2008.
[218] Le Roux, M., SA lacks recognition of EPA benefits, Mandelson [Interview], Tralac, 10 April 2008, available from: http://givengain.com/cgi-bin/giga.cgi?cmd=cause_dir_news_item&cause_id=1694&news_id=44296&cat_id=1076, accessed 15 January 2008.

foreclosed the possibility of aligning market access provisions (between South Africa and the BLNS) under the TDCA review, but is willing to consider alternatives only in the context of the negotiation of a full EPA (on the part of South Africa).

In addition to the obligation of having to negotiate the so called "new generation issues" under the EPA, the EC has also inserted a number of additional legal provisions in the interim text at the last moment, such as; the prohibition on the use of export taxes; a provision requiring free circulation of goods within the SADC EPA; removal of infant industry protection; and the inclusion of an MFN clause.[219]

The elimination of export taxes has been a particular concern to Namibia and South Africa. The former has used these to prevent predatory trade practices in its market by South African companies, while the latter has argued that these go beyond what has been agreed under the TDCA and will serve to limit regional integration efforts.[220] The provision relating to the promotion of the free movement of goods within the SADC EPA has been framed by the EC as a means of ensuring that EU goods entering the SADC EPA countries will pay customs duties only once. However it has been argued that this will serve to promote EU exports, by virtue of the fact that goods will be able to flow freely between trade entities with different tariff schedules or tariff phase-downs.[221] For instance, goods exported from the EU to Botswana can be re-exported duty-free to Mozambique (which is not part of SACU and has a different tariff phase down to the BLNS). Mozambique has also excluded a higher proportion of imports from the EU, while the exclusions of the BLNS are much smaller, as less than three years remain until the TDCA will be fully implemented (in 2012). Therefore the inclusion of such a clause could serve to limit the preferences

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[219] Rumpf, H., "Accommodating regional realities: practical issues and challenges for the SADC EPA negotiations" in Trade Negotiations Insights, Vol. 7, No. 3, April 2008, p. 6.
[220] Locit.
[221] Draper, P., et al., (2) why South Africa should take lead in ending EPA standoff, Business Day, 19 December 2007, Johannesburg, available from: http://www.businessday.co.za/articles/article.aspx?ID=BD4A665080, accessed 15 January 2008.

granted to countries that have excluded a higher proportion of imports or that are liberalising slower. The clause requiring removal of infant industry protection is also a contentious issue, which may limit the prospects for domestic industrialisation as local industries will be rendered less competitive relative to EU companies.

Perhaps the most contentious of these additional provisions has been the MFN clause, which requires that the SADC EPA countries extend the EU the same treatment that may be offered to other major trading countries, which represent 1 percent or more of world trade (such as the US, Japan, China and Brazil).[222] For the SADC EPA members and South Africa, the MFN clause is seen as placing significant limits on policy space by limiting the development of preferential South-South trade co-operation and effectively locking in the EU as the primary trading partner of the region.[223] South Africa has been unable to agree, arguing that "this goes to the heart of our trade policy sovereignty, limiting our negotiating leverage and options".[224]

Despite the insertion of these provisions in the last moment, which have represented a red line for the EU, the SADC EPA members initialled the IEPA as the deadline of 31 December 2007 was approaching. Namibia initialled the IEPA on 12 December 2007, with a qualification of revisiting certain issues ahead of signing.[225] South Africa however was unable to agree on these issues and has not initialled the agreement as of January 2009. Although several objections were raised by the SADC EPA countries at the same meeting with Commissioner Mandelson in March 2008, over the possibility of revisiting the MFN clause and the use of export taxes, Mandelson, foreclosed any such possibility by stating that "I am prepared to be flexible, on the basis that we

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[222] Alberto, F. and Camilo, C., "MFN in the Cariforum EPA is no threat to South-South trade" in Trade Negotiations Insights, Vol. 7, No. 4, May 2008, p. 10.
[223] Third World Network (TWN), Trade: African Ministers and CSOs in scathing attack on EPAs, 13 May 2008, available from: http://www.twnside.org.sg/title2/wto.info/twninfo20080507.htm, accessed 15 January 2009.
[224] South African Department of Trade and Industry (DTI), op.Cit, p. 5.
[225] Rumpf, H., op.Cit, p. 8.

move forwards and not backwards". He further added that "there is no way of re-opening the process that has already been negotiated".[226]

For countries like Namibia and Botswana which are major beef producers, it appears that under the EPA, these will continue to benefit from the beef commodity protocol, which permits guaranteed export quantities, with up to 92 percent reduced duties.[227]

As was pointed out earlier, if Namibia refuses to sign the EPA and as a consequence is downgraded to the less advantageous GSP, it would face up to 142 percent higher tariffs. It is also worth noting that even though the EU absorbs almost the entire beef export capacity of these countries, these have been unable to fill their export quotas to the EU market.[228] Therefore arguably perhaps, the demands of the ACP countries in seeking to build trading, supply and production capacity prior to negotiating EPA provisions, is not unreasonable. Notwithstanding, some SADC EPA countries like Botswana have perceived the provisions of EPAs positively, especially in regards to liberalisation of services, which is expected to result in increased investments in the diamond industry and more competition to South African companies operating in its economy.[229] Arguably, the increase in competition resulting from market opening to EU companies will limit the ability of South African companies to exploit business opportunities through oligopolistic or predatory trade practices in the BLNS, thereby resulting in greater efficiency and price reductions for goods and services in these countries.

From the above analysis, given that only four of the five SACU member states have initialled the IEPA which is expected to be signed and notified to the WTO in early-mid 2009; unwillingness on the part of South Africa to join the EPA will necessitate rigorous border checks and enforcement of the different rules of

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[226] Hanson, V. and Julian, M., "EPA Negotiations Update" in Trade Negotiations Insights, Vol. 7, No. 3, April 2008, p. 15.
[227] South Centre, (3) op.Cit, p. 16.
[228] Ibid, p. 18.
[229] Botswana Sunday Standard, Mandelson urges SADC to conclude EPA, 10 March 2008, available from: http://www.sundaystandard.info/search/search_item.php?NewsID=2798, accessed 16 January 2009.

origin within SACU, owing to different liberalisation schedules and market access provisions to the EU market. Given the unenforceability of the EPA in SACU, due to South Africa's reluctance to sign, the BLNS can in *de facto* enact the EPA tariff rate as opposed to applying the TDCA tariff to EU imports entering SACU directly through their territories.[230] According to Stevens, such a situation may persist indefinitely or may be ameliorated when the final tranche of liberalisation occurs under the TDCA (in 2012), which will align both tariff regimes closer together.[231]

In an interview conducted as part of this research report at a SAIIA Conference on regional economic integration in Southern Africa on 25 November 2008, Xavier Carim (Deputy Director-General of the DTI), indicated that there are currently discrepancies on about 436 product lines between the TDCA and EPA tariffs, which could be reconciled either through unilateral opening on the part of South Africa to 380 of these product lines (South Africa to adjust the level of the TDCA tariff to that of the EPA), or for South Africa to implement border controls for these products.[232] The remaining 54 product lines are treated more favourably under the TDCA than the EPA in line with addressing BLNS sensitivities and would therefore be a concern to the latter.[233] As far as unilateral opening is concerned, this option would require South Africa to liberalise most product lines faster than required under the TDCA and opening up the remaining product lines which have not been negotiated under the latter agreement.[234] This option would certainly preserve the regional coherence through the enforcement of the CET across SACU by not requiring South Africa to negotiate new generation issues under the EPA. However, this is considered unrealistic as it is self-evident that it may not be in South Africa's interest, given that it will not gain anything in return. Therefore, the second option seems most probable, whereby South Africa will implement border controls due to the unenforceability of the CET across SACU, ultimately leading to its demise.

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[230] Stevens, C., op. Cit, p. 11.
[231] Locit.
[232] Gueorguiev, E., Interview with Xavier Carim, Deputy Director-General of the Department of Trade and Industry (DTI). Johannesburg, November 2008.
[233] Locit.
[234] Locit.

When considering the costs and benefits which South Africa faces in making a choice of joining the EPA with the BLNS, it has had to reconcile between various conflicting interests, such as its national economic interests, its wider regional role, meeting its stated commitment to South-South relations and the relationship with its most important trading partner, the EU.[235] As was indicated in chapter 2, the size of the SACU CRP has steadily increased to ZAR 24.7 billion in 2007/08, which has also resulted in a sustained increase in net fiscal transfers to the BLNS, costing South Africa about 1.1 percent of its GDP. In this context there have been speculations that if the BLNS sign the EPA with the EU in early-mid 2009, South Africa could use this opportunity to dismantle the customs union on the grounds of the unenforceability of a CET across SACU. Therefore, by not signing onto the EPA, South Africa can potentially dissolve the customs union and redirect these transfer payments away from the BLNS toward much needed domestic social expenditure for instance.

By not signing, South Africa will also avoid opening up to competitive EU companies in the services sector, which would limit its ability to pursue its political imperatives, the most notable amongst which as noted were its employment creation and Black economic empowerment drive. Such choice will also allow South Africa to pursue South-South cooperation by avoiding the MFN clause under the EPA. This would be consistent with the proverbial "butterfly" strategy of the DTI, which seeks to prioritise South-South relations by extending its wings to East Asia and Latin America; and forming closer relations with African countries.[236] On the flipside however, given that South Africa has assumed a position of leadership in lifting the continent from its position of exclusion in the world economy through various frameworks, amongst which is the New Partnership for Africa's Development (NEPAD), dissolution of SACU will send a negative political message to Africa that it is not committed to

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[235] Marrs, D., Tradeoff, Business Day – the South African Explorer, p. 2, May 2008, available from: http://www.businessday.co.za/downloads/mayexplorer2008.pdf, accessed 18 January 2009.

[236] Mills, G., The Wired Model: South Africa, Foreign Policy and Globalisation, South African Institute of International Affairs (SAIIA), Johannesburg, 2000, p. 331.

regional economic integration.[237] Although South Africa does not perceive much benefit from its firms potentially entering the EU market under the EPA, it has been suggested that EU firms in the South African market will bring much needed competition to high-cost services in the fields of telecommunications, energy and transport sectors; thereby leading to greater efficiency and price reductions for goods and services.[238]

The position of South Africa with regard to it having to reconcile between domestic politics and the trade negotiations with the EU at the international level is consistent with the model of Robert Putnam, which depicts the politics of trade negotiations to be operating at both the national level and at international level, which can be conceived as a "two-level game".[239] At a national level, domestic constituents seek to pressure government toward adopting favourable policies. On the international level, government will seek in meeting the demands of domestic constituents, while concurrently seeking to avoid imposing costs on foreign developments.[240] The greater the consistency between the processes at both levels, the more likely agreement will be reached. In the case of South Africa, it appears that there have been grave inconsistencies between both levels. At the domestic level, narrow interest group goals coupled with the political power of trade unions have to a large extent informed the decisions made by government at the international level, in the context of the trade negotiations with the EU. As a result, at the international level, meeting domestic considerations has threatened to impose costs on the BLNS and the integrity of SACU, by virtue of South Africa's unwillingness to join the EPA.

4.5 Game theory and the political economy of the negotiations

Figure 2 below, has reduced the choices faced by the EU and South Africa to a 2X2 Prisoner's Dilemma (PD) game theory matrice, whereby each actor is

[237] Draper, P., et al., (2) op.Cit.
[238] Locit.
[239] Putnam, R., "Diplomacy and Domestic Politics: The Logic of Two-Level Games" in International Organization, Vol. 42, No. 3, Summer 1988, p. 432.
[240] Locit.

faced with a dichotomous choice. It has been illustrated that South Africa would seek to gain more favourable market access to the EU (by seeking alignment of the TDCA with the EPA), which would preserve the integrity of SACU without having to sign onto the EPA *(Block B)*. Such improved market access to the EU market depicts the request of South Africa to be given DFQF market access to the EU market alongside the other SADC EPA countries. In turn, South Africa would have granted improved market access to the EU under the TDCA for 380 product lines. Conversely, the EU would seek to make South Africa sign onto an EPA, without extending improved market access to the latter *(Block C)*. As this model assumes that actors are self-seeking egoists, the rational pursuit of self-interest will in theory lead to Pareto sub-optimal outcomes *(Block D)*, whereby both actors end up being worse-off than if they had co-operated (through mutual policy co-ordination). This model assumes that both actors will gain more if they avoid the rational pursuit of self-interest by co-operating (arriving at *Block A*), but only under certain restrictive conditions, *inter-alia, conditionality*, *issue-linkage* and *sanctioning*.

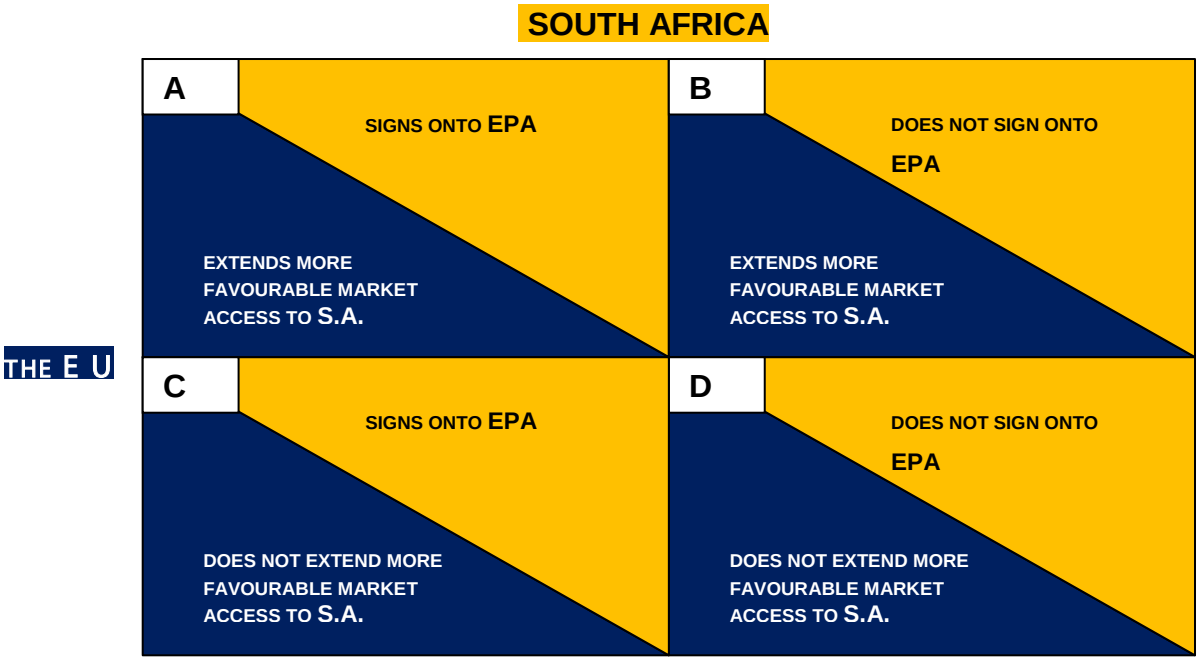


Figure 2 Game Theory Payoff Matrice

As was shown in the preceding chapter, the EU has had a clear preference of moving away from "entitlement aid" toward increased *conditionality* on aid

preferences as part of its broader approach of promoting development through trade rather than aid. To that end, given that EPAs are representative of this broader shift, it was shown how the EU has linked trade related assistance to the programming of the 10th EDF for instance, which exemplifies a measure of both *conditionality* and *issue-linkage*. The possibility of reneging on the part of ACP countries (i.e. the BLNS) in not signing onto the EPA would result in a loss of market access and aid preferences, which in this case serves as a form of *sanctioning*. In theory, these functions are performed by international regimes which increase the prospects for long-term cooperation by holding potential defectors in line and preventing defection for short-run gains, making it more likely that the choices of actors will converge in *Block A*.

It is important to recall that theories of international regimes allow for a systemic level analysis by focusing on choice in explaining how actors' preferences were brought into convergence within the negotiation process. As actors make choices in the context of *constraints*, these can be imposed by the more dominant actor through a manipulation of opportunity costs; which will ultimately force the weaker actor to make choices voluntarily within constraints that are mandated by the more dominant actor. In this context, reference was made to the concept of "asymmetrical interdependence", which posits that any changes (which may be enacted by the more dominant actor) within the relationship between actors will be more costly to the weaker actor than to the more powerful actor.

In this context it may be argued that the opportunity costs faced by the BLNS have been manipulated in such a way by the EU (through *conditionality*, *issue-linkage* and *sanctioning*), that the perceived costs of not signing onto the EPA have appeared greater than the perceived benefits. This has in turn altered their preferences, leading to a point where the BLNS have accepted to sign the EPA "voluntarily". As for South Africa, it can be argued that there has been insufficient threat on the part of the EU to trigger any systemic level changes, where South Africa would find it in its interest to "voluntarily" sign onto the EPA. As a result, the choices of the EU and South Africa have converged in *Block D*. This confirms the view that medium-sized countries like South Africa face

relatively lower opportunity costs than weaker countries that are in a much more vulnerable position, such as the BLNS. Although such game-theoretic approaches like Prisoner's Dilemma are far too simple to capture all the important aspects of the trade negotiations between the EU and South/Southern Africa, these allow for a more restrictive and parsimonious analysis, by capturing the most important parameters of the negotiations, thereby exemplifying how problems of international cooperation can be resolved through *conditionality*, *issue-linkage* and *sanctioning*.

CONCLUSION

This research report aimed to examine the potential impact of the EU's trade policy on the integrity of SACU. To this end, the differentiation on the part of the EU between the BLNS (under Cotonou) and South Africa (under the TDCA) has had considerable implications for SACU. An argument was made that the EU's trade policy agenda has exhibited a significant degree of conditionality and issue-linkage between trade and aid, as a means for gaining political acceptance for trade policy reform. It was shown that the extent to which such policy has been successful has depended on its adversary's relative size and level of economic development. As the relative opportunity costs faced by medium-sized states like South Africa have been much lower than those faced by smaller states such as the BLNS, respectively, the EU's ability to gain concessions for trade policy reform on the part of South Africa has been relatively lower than in the case of the BLNS. Apart from relative size and level of economic development, it was also shown that opportunity costs can also be affected by the relative consistency between domestic and international affairs (the two-level game).

In examining the impact of the EU's trade policy on the integrity of SACU, this research report has consisted of four sections to substantiate this analysis. To this end, a method of process tracing was used to trace the cause-effect link which connects the independent, intervening and dependent variables.

In formulating and specifying the variance in the dependent variable, Chapter 2 provided insight into the essential characteristics and rationale of a customs union, which in the case of SACU has been characterised by extreme inequalities in relative size and level of economic development between member states. In this regard, throughout its history, it was shown that co-operation between its members has been characterised more by the inter- as opposed to the intra-governmental nature of decision making, in part sustained by a trade off between on the one hand, South African policy dominance in determining the CET unilaterally and prior to the 1990s, a political dividend to maintain the geo-political status quo, and on the other hand, a generous share

of the revenue pool to the BLNS. These characteristics have had a profound impact on the ability of developing common negotiating strategies with third parties, which has threatened to undermine the legal quality of SACU and its CET, which has been its defining feature.

Since the 1990s, these characteristics have been compounded by the shifts in the multilateral trading system toward greater liberalisation and trade openness, both directly and indirectly. The direct effect has been felt more by South Africa, while the indirect effect by the BLNS on a regional and international level, through; South Africa's reduction of the CET and as a corollary, the reduction of the common revenue pool, which has been the main source of national income for these countries; and the shift toward greater openness in trade, services and other "new generation" issues on the part of the EU.

As has been shown, the EU has been able to gain political acceptance on the part of Southern African countries in accepting greater openness in trade and "new generation" issues through increased *conditionality*, *issue-linkage* and *sanctioning*. However the extent to which these countries have been resilient to the demands of the EU has been dependent on their relative opportunity costs, which have been determined by their economic size and level of development. The argument was made that these can also be affected by the relative consistency between politics at the domestic and international level.

In the case of South Africa, it was shown that developments at the national level have served to decrease its opportunity costs of undertaking changes at the international level, in the direction of joining the EPA alongside the BLNS by negotiating services and "new generation" issues, which have been so important to the EU. Therefore the relative inconsistency between both processes has informed South Africa's order of preferences, which prioritises its own national policies and South-South relations, while arguably, according a more secondary role to regional economic integration. By contrast, the opportunity costs for the BLNS have increased as a direct consequence of the shift in the EU's trade policy, thereby making it within their interest to accept greater trade openness and "new generation" issues. Testimony to this is the

fact that these countries have initialled the IEPA and have indicated their willingness to shortly sign this agreement, which is expected to take place in early-mid 2009.

From the analysis it is clear that there has been insufficient political will on the part of both the EU and South Africa to resolve the impasse over the potential dissolution of SACU. Neither the EU is willing to make concessions in granting South Africa improved market access, nor is South Africa keen in joining the EPA. As was indicated, the perpetuation of this situation may engender the introduction of border controls, for both inbound goods destined to SACU from the EU, due to the unenforceability of the CET across SACU, and for outbound SACU goods destined for the EU, as the BLNS will export under more favourable terms under the EPA.

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