RULES OF ORIGIN: THE MAJOR STUMBLING BLOCK FOR THE INTEGRATION OF SADC, COMESA, AND EAC

By

Chimvano Humphreys KAPELETA

THESIS

Submitted to
KDI School of Public Policy and Management
in partial fulfillment of requirements
for the degree of

MASTER OF PUBLIC POLICY AND MANAGEMENT

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Approval as of July, 2011

Abstract

The Common Market for Eastern and Southern Africa (COMESA), Southern African Development Community (SADC), and the East African Community (EAC), are just three of so many Regional Economic Communities (RECs) on the African continent. Together, the three RECs have a combined membership of twenty-six countries, stretching from South Africa in Southern Africa to Egypt in North Africa. One of the main challenges facing COMESA, EAC and SADC in the implementation of their integration programs is the overlapping membership of their respective Member States. For instance, EAC is already a Common Market but it shares four Member States with COMESA which is a Customs Union, and one Member State with SADC which is a Free Trade Area. On the other hand, SADC and COMESA have seven member states in common; while five of the SADC Member States are also members of Southern African Customs Union (SACU).

Partly to rectify this anomaly, and partly to contribute towards the goal of achieving the African Economic Community as stipulated in the Abuja Treaty of 1991, the three RECs have recognized the need to initiate a process of coordination and harmonization of their regional integration programs. In that regard, the three have agreed to form one grand Free Trade Area, possibly by 2012, a decision that was endorsed by the Heads of State and Government of the twenty-six countries that comprise the three regional institutions in October 2008. Already, COMESA, EAC and SADC have made significant progress in simplification of customs procedures and documentation; rationalization of the COMESA and SADC customs bond guarantee schemes; development of customs training and capacity building schemes; preparation of an inventory of harmonized product standards; co-ordination of competition policies and institutional frameworks; identification, removal and monitoring of non-tariff barriers; as well as establishment of One-Stop Border Posts.

This thesis holds that the differences in the Rules of Origin that govern trade regimes in the three RECs will be the biggest huddle towards realization of the grand Free Trade Area. More to the point, the forces that necessitated the complicated and restrictive SADC Rules of Origin are still at work even now when the official negotiations for the grand FTA have been launched. Unless some countries in the two regions, notably South Africa, and to some extent, Egypt, show some flexibility in the way they protect their vested interests, especially by using Rules of Origin, the idea of a Free Trade Area extending from Cape to Cairo will remain just a dream.

Table of Contents

LIST OF TABLES

LIST OF FIGURES

1.0 Introduction

1.1 Integration Efforts in Africa

Africa has long recognized the importance of cooperation and integration among African countries in order to accelerate transformation and achieve sustained development of the continent. Although efforts towards integration of Africa started much earlier with Pan-Africanism—various movements in Africa that aim at unity of Africans and the elimination of colonialism and white supremacy from the continent—one of the first concrete moves was the formation of the Organization of African Unity (OAU) in 1963. Not only the Charter of the OAU, but also the Constitutive Act that transformed OAU into African Union in 2000, define regional integration as one of the anchoring ideals of the African unity. In 1980, the OAU Extraordinary Summit adopted the Lagos Plan of Action (LPA) in which African leaders committed themselves to the promotion of economic integration of Africa. In addition, the African leaders also undertook to establish national, regional, and sub-regional institutions leading to a dynamic and interdependent African economy. These efforts ultimately led to the signing of the Abuja Treaty, establishing the African Economic Community (AEC) in 1991.

The principle characteristic of the AEC is that it spelt out a number of stages which should be followed to achieve the dream of the African Economic Community by 2025, mainly through integration efforts of the various regions of Africa. In that regard, the AEC recognized eight Regional Economic Communities (RECs) as the building blocks of the continent-wide economic community. The eight are: the Arab Maghreb Union (UMA) in North Africa; the Common Market for Eastern and Southern Africa (COMESA); the East African Community (EAC); the Community of Sahel-Saharan States (CEN-SAD) in West, Central, Southern and North Africa; the Economic Community for Central African States (ECCAS) in Central Africa; the Economic Community for West African States (ECOWAS); the Inter-

Governmental Authority of Development (IGAD) in the Horn of Africa; and the Southern African Development Community (SADC) in Southern Africa. Each of these organizations intends to eventually become either a full economic union or a common market. The expectation of the Abuja Treaty is that each of these RECs should take steps towards integrating or working together with other RECs for the African Economic Community to become a reality. "The expectation is that the Regional Communities should evolve into free trade areas and customs unions, eventually consolidating and culminating in a common market covering the continent" (Economic Commission for Africa, p. 39). It is in view of this background that COMESA, EAC and SADC have embarked on efforts to form one grand Free Trade Area.

1.2 Background of COMESA and SADC

1.2.1 Common Market for Eastern and Southern Africa

COMESA started as a Preferential Trade Area (PTA) in 1981 to allow greater social and economic cooperation, with the ultimate objective of creating an economic community for the countries involved. It was transformed into COMESA in 1994 along the lines of the PTA Treaty which envisaged ultimate transformation into a Common Market. The nineteen countries that comprise COMESA[1] cooperate in various social and economic sectors including harmonization of trade policies and development of regional infrastructure projects. COMESA launched a Free Trade Area in the year 2000 and since then, intra-COMESA trade has been growing at an average rate of 20% annually. Since mid-2009, COMESA has been a Customs Union with a common external tariff.

[1] The 19 members of COMESA are Burundi, Comoros, Democratic Republic of Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

COMESA has made various strides in some areas while, in yet other areas, the institution has not made much advancement. Among the areas in which progress is evident include establishment of macroeconomic convergence criteria aimed at helping member states to focus on economic stability as an outcome of integration and development; improvement in transport and communication interconnectivity; and the advanced level of integration itself, having launched a Customs Union in 2009. On the other hand, COMESA is yet to achieve some tangible results in utilizing economies of scale in energy generation and supply through regional power pools; as well as free movement of people within the region. In implementing its programs and activities, especially in specialized sectoral work, COMESA works through its independent and semi-autonomous institutions. These institutions include Trade and Development Bank; Africa Trade Insurance Agency; the COMESA Regional Investment Agency; COMESA Competition Commission; and the COMESA Court of Justice. The region is still proceeding with processes towards deeper integration with the ultimate aim of forming a Monetary Union by 2025.

1.2.2 Southern African Development Community

The Southern African Development Community (SADC) has its origins in the 1970s when Angola, Botswana, Mozambique, Tanzania, and Zambia decided to work together for the promotion of regional cooperation and integration. In 1980, the five countries, along with Malawi and Lesotho, formed the Southern African Development Coordination Conference (SADCC) with an additional objective of attaining economic autonomy from the then white minority-ruled South Africa. However, the struggle against colonialism in the region lost its relevance when Namibia, the last country to be freed from colonialism, finally got independence in 1990. The focus of SADC then changed to promotion of economic and social development through cooperation and integration as the next logical step after political independence. Consequently, with the signing of the SADC Treaty in 1992, SADCC, a loose association of states, was changed to SADC, a legally binding arrangement, aimed at promoting deeper cooperation and integration.

The fifteen member states of SADC[2] cooperate in regional security, and several other economic and social sectors, as well as implementation of regional infrastructure projects. In addition, SADC has developed protocols in a number of areas, which provide the legal framework for cooperation among member states. These areas include: trade; transport, communications and meteorology; combating illicit drugs; education and training; mining; politics, defence, and security; energy; and tourism, to mention but a few. The region became a Free Trade Area (FTA) in 2008, and there are plans to launch a Customs Union soon, a Common Market in 2015, as well as an Economic Community in 2018.

SADC has made visible progress in establishing macroeconomic convergence criteria; transport and communication interconnectivity; knowledge sharing; utilization of regional energy power pool resources; as well as maintaining peace and security. In this regard, SADC has, under its wings, a number of specialized institutions that carry on specialized SADC functions. These include the SADC Tribunal, Regional Tourism Organization, Peacekeeping Training Centre, Southern African Power Pool, and Southern African Cooperation in Agricultural Research and Training. But like COMESA, SADC has also not made much progress on involvement of the private sector on its integration programs, as well as free movement of people within the region, with the issue being handled more bilaterally than regionally.

[2] The 15 members of SADC are Angola, Botswana, Democratic Republic of Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

1.3 Steps Towards Cooperation

Taken together, COMESA, EAC, and SADC comprise 26 countries with a combined population of 527 million people, a collective Gross Domestic Product (GDP) of US$624 billion, and a GDP per capita averaging US$1,184. One of the main challenges facing COMESA, EAC and SADC in the implementation of their integration programs is the overlapping membership of their respective Member States. For instance, EAC is already a Common Market but it shares four Member States with COMESA which is a Customs Union, and one Member State with SADC which is a Free Trade Area. On the other hand, SADC and COMESA have seven member states in common; while five of the SADC Member States are members of the Southern African Customs Union (SACU).

This has led to the recognition by the three RECs of the need to initiate a process of coordination and harmonization of their regional integration programs as a way of mitigating the challenge of multiple memberships. In that regard, the three have agreed to form one grand Free Trade Area, possibly by 2012, a decision that was endorsed by the Heads of State and Government of the twenty-six countries in October 2008. Already, COMESA, EAC and SADC have made significant progress in simplification of customs procedures and documentation; rationalization of the COMESA and SADC customs bond guarantee schemes; development of customs training and capacity building schemes; preparation of an inventory of harmonized product standards; co-ordination of competition policies and institutional frameworks; identification, removal and monitoring of non-tariff barriers; as well as establishment of One-Stop Border Posts.

1.4 Challenges

This thesis will, however, argue that COMESA and SADC[3] will encounter serious huddles in their endeavor to form one grand Free Trade Area. Some of these challenges include: differences in levels of integration between the two RECs; overlapping membership to both COMESA and SADC; persistent political instability challenges in some member states; and harmonization of rules of origin. Specifically, this thesis contends that harmonization of rules of origin of the two RECs will be the biggest huddle against the efforts to combine them into one FTA. The main difficulty in harmonizing the rules of origin is not necessarily the magnitude of their differences but the specific interests of the Southern African Customs Union (SACU)[4], especially South Africa, to protect their industries from competition from within the region. The complicated rules of origin of SADC are attributed to the influence of the particular interests of South Africa. It has been noted, for instance, that "because of South Africa's diversified economy the rules of origin for the SADC FTA are very complicated, with different rules for each subcategory" (van den Bosch, 2010). Furthermore, it has even been observed that South Africa is showing growing aversion towards trade integration in SADC.

South Africa is by far the largest and most diversified economy in the SADC region. Even when all the 26 countries comprising COMESA and SADC are taken into consideration, South Africa still stands as the biggest economy, making up almost fifty percent of the combined GDP (Table 1). As explained in detail later in this thesis, negotiations for the

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[3] Although the proposed grand FTA involves COMESA, EAC and SADC, the thesis will only talk about COMESA and SADC for two main reasons: First, all members of EAC are also members of COMESA and SADC. Second, COMESA and EAC are already beyond FTA stage, and they use similar common external tariffs in their respective Customs Unions. Including EAC in the analysis, therefore, will not yield any additional meaningful information to the result.

[4] Southern African Customs Union (SACU) is composed of South Africa, Botswana, Lesotho, Namibia and Swaziland

SADC Trade Protocol resulted in asymmetric approach to phasing down of tariffs: While the low income countries were to have a longer duration to lower their tariffs, the more developed countries led by South Africa, were to bring down their tariffs much faster. But the more developed countries, notably, South Africa, used the opportunity to compensate themselves by bringing complicated rules of origin which can be satisfied mostly by South African producers. Some observers have noted that SADC rules of origin are not compatible with the type associated with low income countries. Instead, they resemble those “being employed by the EU in its preferential regimes such as the Cotonou Agreement, Everything-But-Arms (EBA) initiative and in PTAs with rich, highly industrialized countries” (Kalenga 2005, p. 29). And indeed, South Africa signed a Free Trade Agreement with the European Union in 2000, a clear pointer to the fact that SADC rules of origin were heavily influenced by those applicable in the EU-South Africa trade agreement (Brenton et al. 2005, p. 1).

The interests of South Africa to shield her industries from regional competition have not changed even in view of the forthcoming grand Free Trade Area. Analysts single out South Africa, with her complicated rules of origin, as one of the major stumbling blocks towards achievement of the grand Free Trade Area (van den Bosch, 2010). And again, in a thinly-veiled reference to South Africa, a senior COMESA official, while commenting on the possibility of the grand Free Trade Area, is quoted as saying, “The most contentious issue has been the rules of origin…. There are people who have not kept pace with the changing world but we are moving and we are not going to allow those who want to hold us back” (Njini, 2010). And South Africa is not alone in this game: Egypt, the semi-hegemonic power in the COMESA sub-region, is also expected to adopt a similar approach. Servaas van den Bosch captures it very well when he stated that, "Both Egypt and South Africa see rules of origin as a means of protecting their domestic markets. The tension South Africa and Egypt bring into this process is perhaps the most important complicating factor in the negotiations" (van den

Bosch, 2010).

In other words, this thesis will explain the origins of the major differences in the rules of origin used by SADC and COMESA; and the difficulties which these differences will pose to the efforts by the two regional economic groupings to become a single regional grouping. Particular attention will be paid to the underlying developments that led to the stringent nature of SADC rules of origin, and, based on that, a conclusion will be arrived at, that, unless the parties that pulled SADC rules of origin towards their restrictive nature show some flexibility in the process of harmonizing them with those of COMESA, the grand FTA will remain just a dream.

1.5 Contribution

There is abundance of literature on rules of origin of COMESA and SADC in general, and specifically, the stringent nature of SADC rules of origin. (For example, (Khandelwal 2004), (Flatters and Kirk (2003), (Kalenga 2004), and (Kalenga 2005), provide a comprehensive treatment of the issue). However, all this was written well before the idea of combining the two economic communities into one Free Trade Area was even hatched. In that sense, this thesis breaks new ground because it provides an analysis of the rules of origin of the two regional groupings with a specific focus on the possibility of harmonizing them, especially now that the two RECs are discussing that likelihood. Secondly, although the already available literature touches on the importance of rules of origin in a preferential trading arrangement, this thesis goes further by specifically looking at the significance of the rules of origin of COMESA and SADC, particularly their differences, and the extent to which they will be a hindrance in the negotiations for a Free Trade Area between the two institutions. This thesis will fill these gaps by providing a general overview of the rules of origin of the two regional organizations, with special emphasis on the evolution of the rules of origin of

SADC, which most writers on the subject have singled out as the more restrictive of the two (See for example Estevadeordal and Souminen, 2005, (Khandelwal 2004), (Flatters and Kirk 2003), (Kalenga 2004), and (Kalenga 2005)).

2.0 Literature Review

2.1 Prospects for Cooperation between COMESA and SADC

COMESA and SADC share some of their member states, pursue the same goals, and are geographically located within the proximity of each other. It would only be logical, therefore, for them to come together and synchronize their programs especially their rules of origin (Brenton et al. 2005). As Khandelwal (2004) has noted, growth of trade in Africa has been negatively affected by a number of factors, together with inadequate infrastructure, which result in high transaction cost, and distorted trade regimes. Yet more factors include insufficient political commitment and frequent policy reversals, multiple and conflicting objectives of overlapping regional arrangements, as well as limited administrative resources. A possible solution to these challenges might be regional trade arrangements (RTAs) which play a very important role by, among other things, dealing with infrastructure challenges, harmonization of customs procedures and standards, as well as strengthening the region's bargaining power in multilateral negotiations.

Specifically, implementation problems at the level of member states have restricted progress of integration in COMESA while restrictive rules of origin have hampered progress in SADC. Furthermore, advancement in both organizations has been slowed down by overlapping memberships which also demonstrates lack of political commitment on the part of leaderships of the respective member states, and commitment to open regionalism and deep integration would help address some of these challenges.

While noting that regional integration in COMESA and SADC can bring in vital benefits to the region, (Khandelwal 2004) outlines some challenges towards tariff liberalization and harmonization. First, the majority of the countries in the region depend on trade tax for their government revenue. As such, trade liberalization is likely to have a negative impact on fiscal revenue in most countries through the lowering of import duties. The majority of low-income countries face a great deal of fiscal challenges in the face of trade liberalization. Chauvin and Gaulier (2002) note that “regional integration may lead to changes in the structure of individual economies that could result in contraction of previously import-substituting industries that were important sources of revenue” (quoted in (Khandelwal 2004), p. 20-21). In that study, Chauvin and Gaulier put the rough estimate of loss of revenue through the SADC Free Trade Area at 6 percent of total revenue. In yet another study by Baunsgard and Keen (2004), it was found that most low-income countries have not been able to replace lost trade tax revenue from other revenue sources, signifying the seriousness of concerns over loss of tax revenue (Khandelwal 2004).

In addition, there are some large differences in openness to world trade between countries of the regions. While countries like Malawi, Djibouti, Rwanda, Uganda, are among the most open in the world, yet others including Burundi, Comoros, and Seychelles are among the most restrictive trade regimes. To make matters worse, the relatively developed countries in the region (Egypt, Kenya, and South Africa) are not among the most open trade regimes, signifying that they have not played a leadership role in trade liberalization in the region. As such, harmonization will require a considerable adjustment for a majority of the countries since they will be starting from very different starting positions (Khandelwal 2004).

2.2 Why Rules of Origin Matter

Rules of origin are needed to determine the products which should be accorded trade preferences in any bilateral or regional trade arrangement. In other words, rules of origin verify the ‘citizenship’ of a product for purposes of trading or statistics. If, for instance, there’s a trade agreement between countries A and B, a product that is produced in country C cannot be accorded duty-free status in country A just because it has entered through country

B. Rules of origin specify what should be done in country B for the product to be regarded as a product of that country and be accorded duty-free status in country A (Palmeter 1993).

Rules of origin are used for other purposes as well, including ascertaining the originality of the product for purposes of trade statistics, quota eligibility, as well as assisting consumers to obtain or shun products from some specific countries. Strictly speaking, rules of origin are of no consequence for goods that have no import content, as is usually the case with most basic agricultural products. But in today's world of specialization and globalization, some production processes are unavoidably undertaken in other countries, hence the relevance of rules of origin (Brenton et al. 2005).

Rules of origin, therefore, play a pivotal role in any type of preferential trading arrangement, whether bilateral, regional, or multilateral. In fact, it is not possible to have a preferential trading arrangement between any two or more counties without specifying the rules of origin that will regulate the operations of the agreement. In other words, rules of origin are an essential part of trade rules especially since a number of policies like quotas, preferential tariffs, anti-dumping actions, countervailing duties, and many more, discriminate between exporting countries (World Trade Organization 2010). The importance of rules of origin is manifested in the efforts that have been taken to harmonize them, though little progress has been made in that regard. For instance, the Organization for Economic Cooperation and Development (OECD) came up with a template of rules of origin to be used by its member countries in 1976. The model rules became the basis on which the compendium of rules of origin prepared by the United Nations Conference on Trade and Development (UNCTAD) in 1982 for use by developing countries under different preferential arrangements.

Serious attempts to harmonize the rules of origin internationally, however, only came to the fore in the late 1980s during the Uruguay Round trade negotiations. These efforts were mainly prompted by three important developments: a notable increase in the use of preferential trading arrangements with their associated different rules of origin; an evident multiplication in the number of trade disputes involving origin, especially from the quota arrangements; and a remarkable expansion in use of anti-dumping laws, notably by the European Community and the United States of America (Palmeter 1993, p. 335). Partly as a result of these developments, the United States of America submitted comprehensive proposals regarding rules of origin which have been extensively negotiated in the Uruguay Round and now by the World Trade Organization (WTO) negotiations. Consequently, rules of origin are now part of the WTO agreements.

Among other things, the WTO agreement on rules of origin expect the member states to construct rules of origin that are transparent, non-restrictive, and not having any distortive or disruptive effects on international trade. In addition, the WTO agreement require rules of origin by member countries to be based on a positive standard, specifying what confers origin as opposed to what does not. Most importantly, the agreement hopes to harmonize rules of origin among all WTO members, with exception of some kinds of preferential trade arrangements like FTA. In that regard, the agreement incorporates a harmonization work program based upon a set of principles including making rules of origin objective, understandable and predictable. The expected outcome of the harmonization program will be a single set of rules of origin to be applied under non-preferential trading conditions by all WTO member states in all circumstances (World Trade Organization 2010, p. 50).

It is in view of this background that COMESA and SADC cannot avoid reaching an agreement on rules of origin if they are to merge and form one grand Free Trade Area. Each of the two institutions already has rules of origin which are used by the respective member countries when trading within their respective trade arrangement. It is only normal, therefore, to expect the two institutions to consider harmonizing their rules of origin instead of starting afresh to negotiate new rules for the grand FTA. And this is where the battle lines are drawn between the two institutions because their rules of origin are so different it would take a lot of give-and-take for the two to be harmonized. Specifically, the metamorphosis of SADC rules of origin has divorced them so far away from their counterparts in COMESA that the two institutions have developed into competing blocs.

2.3 Restrictive Rules of Origin

Possibility of trade deflection, and the need to prevent it, is perhaps the only justifiable *raison d'être* behind rules of origin. There are instances, however, when rules of origin have gone beyond this basic rationale and perform as shields for domestic producers of inputs and intermediate goods against foreign competition. Such type of rules of origin are usually negotiated industry by industry, or even product by product, providing enough room for industries that are well-organized to protect themselves from the effects of the Free Trade Arrangement by formulating appropriate rules of origin (Krishna 2004). In the European Community, for example, the semiconductor industry is shielded against competition from outside by specifying that origin is conferred when substantial working or processing includes ‘diffusion.’ But diffusion takes place at such an early stage in the manufacturing of semiconductors that it is not technically practicable to start manufacturing semiconductors in any other place other than where diffusion is performed (Krueger (1993).

Other ways of making rules of origin more complex and restrictive is by tampering with any of the four methods of establishing origin, either by adding some exceptions to the basic rule or making the necessary changes in the product more extensive. Under the change in tariff rule, for instance, a product may be required to satisfy origin requirements by changing its tariff heading in a specified manner. By changing the specific way in which tariff heading should change, it is possible to make the rule more or less restrictive. Yet another example is the provision in NAFTA where "transformation from any other chapter (2 digit classification level) of the harmonized system, to tomato catsup, chapter 21, confers origin, *except* transformation from tomato paste which falls in chapter 20!" (Krishna 2004, p. 9). This is clearly an attempt by the U.S. to retain the production of catsup in the U.S in view of the fact that the U.S. is a larger market for catsup than Mexico, while Mexico has a natural advantage in growing tomatoes, and hence making paste.

However, restrictive rules of origin have some well-documented shortcomings. To begin with, complex and restrictive rules of origin, especially using detailed product by product rules, hamper economic integration. Moreover, those rules restrict international specialization and hurt smaller economies most since they have little chance of sourcing raw materials and intermediate goods within their economies in order to satisfy the rules. Yet another disadvantage of restrictive and complex rules of origin is that they add complexity and costs of participating in and administering trade agreements. Sometimes, the unnecessary costs that are imposed on exporters by cumbersome rules of origin are large enough to lead eligible exporters to prefer paying the normal duty and forgo the preferences (Palmeter (1993)). This point is also emphasized by Krishna (2004), as well as Estevadeordal and Souminen (2005). Furthermore, restrictive rules of origin limit the possible benefits of preferential market access, citing low levels of utilization by low income countries of preferential access to European Union under the Generalized System of Preferences (GSP), as well as American market under AGOA (Kalenga (2004). Finally, restrictive rules of origin place unnecessary burdens on Customs management and, as such compromise progress on trade facilitation (Brenton et al. 2005).

3.0 Analysis and Findings

3.1 Evolution of SADC Rules of Origin

As already pointed out above, rules of origin are crucial to determine the eligibility of products for preferential treatment when being imported into a trade arrangement member country. However, the way in which they are structured and implemented has got important implications on the resulting trade flows and the extent of regional integration. SADC rules of origin are relatively complex and restrictive, and not only meant to prevent SADC non-members from benefitting from the preferential treatment reserved for members, but are also being used to shield some industries from competition from beyond the region. This will have the opposite effect of facilitating trade in the region, as well as increase transactions costs and have a negative effect on the region's efforts to attract foreign direct investment (Brenton et al. 2005).

Khandelwal (2004), Flatters and Kirk (2003), Kalenga (2004), and Kalenga (2005) all agree that SADC rules of origin have, over the years, developed into "more complex, restrictive, cumbersome, costly, product-specific rules of origin, especially in manufacturing products such as electronics and electrical goods, textiles and garments, and motor vehicles" (Kalenga 2004). Flatters and Kirk (2003) specifically express the same sentiments when he labels SADC rules of origin as "defensive rules of origin", likening them to "local content regulations, a more familiar tool that is a common feature of failed import substitution regimes" (p. 2).

The initial rules of origin that were agreed among SADC member states, and which are stipulated in the original SADC Trade Protocol, were not as complicated. Rather, they were simple, general, and in line with those expected in preferential trading arrangements of developing countries. Most importantly, they were comparable with those applicable in the neighborly and overlapping COMESA. Under those initial SADC rules, origin was conferred to goods if they underwent a single change of tariff heading, contained a minimum of 35 percent value added within the region, or included non-SADC imported materials worth no more than 60 percent of the value of total inputs used. Needless to add, agricultural and primary products would need to be wholly produced or obtained in the region (Flatters and Kirk (2003), p. 7; Kalenga 2004, p. 22). If those initial SADC rules of origin were not changed to their present form, the issue of harmonization of the rules of SADC and COMESA would have been a foregone conclusion.

However, in the process of intra-regional tariff phase-down negotiations, different national interests started dictating the outcome of the process. On the one hand, the lesser developed economies in SADC began to voice out their concerns regarding potential loss of revenue from customs duties especially on imports from South Africa, by far the largest economy in the region and one of the biggest trading partners for each SADC member country. As a result of these fears of revenue loss, and also worries of de-industrialization in their countries due to competition from the well-developed industries of South Africa, the lesser developed countries opted to back-load their tariff phase down schedules.

On the other hand, South Africa and her SACU partners, Botswana, Lesotho, Namibia, and Swaziland, had to fast-track their tariff reduction schedules. Furthermore, producers in some sectors of the more developed countries, notably South Africa, started to push for more strict rules of origin for a number of reasons. First, they argued that the Customs authorities in other countries are not capable of preventing trans-shipment of cheaper products from non-member states through their countries and onto other member states using the preferential tariff rates of the region. Second, they contended that the rules of origin should encourage industrial growth within the region by encouraging industries in the region to source their raw materials and intermediate goods from within the region. It needs to be added, however, that, within the region, only South Africa is so developed that it has a capacity to supply most of the intermediate inputs required in downstream production processes.

So, while the lesser developed countries were pre-occupied with delaying the lowering of their tariffs towards the end of the phase-down period, the more developed countries compensated themselves by complicating the rules of origin in favor of mostly producers in their countries, and notably, South Africa. Consequently, SADC ended up with complex, restrictive and product-specific rules of origin. Kalenga 2005 put it this way, "a temporary 'problem' related to the asymmetry of tariff phase-downs had to be resolved through 'permanent' restrictive rules of origin" (p. 29). It might not be an exaggeration, therefore, to conclude that the final rules of origin adopted the shape of South African industries' interests.

3.2 Comparison of SADC and COMESA Rules of Origin in Selected Sectors

3.2.1 Textiles and Garments

SADC

Textiles and garments industry in SADC is one of the few sectors in which a number of member states have significant manufacturing capacity. In addition, there are potential complementarities because member states have capacities in different production processes in the textiles and garments value chain. Some member states, particularly Mauritius, have already demonstrated the region's potential in this sector, and the region can greatly improve its competitiveness in world markets through outward-looking trade initiatives. The rules of origin for textiles and garments require double transformation for the products to qualify for SADC tariff preferences. Garments, for instance, should be made from regionally produced textiles; fabric should be manufactured from yarn produced in the region; and yarn should be made from uncarded, uncombed fiber or from chemical products. These rules of origin, modeled on the EU-South Africa free trade agreement, are very difficult for most producers in the region to satisfy, since they were mainly influenced by producers in South Africa, that are focused on domestic markets (Brenton et al. 2005).

The textile and garment industry in South Africa operate behind a wall of high tariff structures, ranging from 10% for raw materials up to 40% for finished garments. Furthermore, the escalation structure of the tariffs is such that garment making for domestic sales receive between 60% to 70% of effective protection from outside competition, and not the 40% appearing in the tariff books. Cotton fiber can be imported duty-free but can only be imported after the local market has run out of the product. This protection regime has produced a domestic industry which is focused mostly on the domestic market in South Africa, and it is this domestic industry which shaped the rules of origin of SADC.

Contrast this with the situation in Mauritius where the textile and garment industry is, for the most part, oriented towards exports. Mauritius adopted a policy of duty-free imports, as well as other export processing zones privileges that have contributed to the growth of the industry in the country. It is now generally accepted in Mauritius that low import tariffs and unrestrictive rules of origin are in the best interest of not only Mauritius but the SADC region as a whole, that the country is now advocating for the region to adopt these. It was hoped that that the double transformation rule would encourage producers in SADC to source from within the region, thereby, promote deeper integration of the regional textile and garment industries. But this is not happening. Instead, the rules have just managed to hamper intra-SADC trade in the sector (Brenton et al. 2005).

COMESA

In COMESA, textiles and garments qualify for preferential treatment if they are wholly-produced in a member country, or if the c.i.f. value of imported materials used in the production does not exceed 60 percent of the total cost of the materials used in the production of the goods. On the other hand, either the value added resulting from the process of production accounts for at least 35 per cent of the ex-factory cost of the goods, or the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported. There is not even a requirement on specific manufacturing processes that should be undertaken for the products in this sector to be conferred origin in the COMESA region, unlike the case in SADC.

3.2.2 Machinery and Electrical Products

SADC

Light manufacturing industries – HS chapters 84, 85, and 90 - is one area in which the most contentious issues in rules of origin arose in SADC. HS Chapters 84, 85, and 90 include mechanical and electrical machinery and components, as well as several kinds of technical and medical equipment. Originally, the rules of origin for products under these HS chapters were that imported content should not go beyond 65% of their ex-factory or net cost. During the negotiations, it was proposed that the basis for calculating value should be changed from ex-factory to ex-works price, which is the system used by the rules of origin in the European Union. It is important to note that, for any given content requirement, ex-works price is more restrictive than ex-factory price (Brenton et al. 2005). Eventually, it was resolved that for HS Chapters 84, 85, and 90, SADC preferences would apply if the import content does not exceed 60% of the ex-works price.

Even in that case, some exceptions to the chapter rule were also introduced, making the rules even more complicated. Some member countries, notably South Africa, singled out certain chapter sub-headings of particular interest to them and suggested that for those products, the rules should even be made tighter. After an elongated period of negotiations, it was agreed that some of these products should benefit from SADC preferential tariffs if the import content does not go beyond 45%, while the rest should have a maximum import content of 55% of the ex-works price (Brenton et al. 2005).

COMESA

Just like the COMESA situation with textiles and garments above, machinery and electrical products – HS Chapters 84, 85, and 90 - qualify for preferential treatment if they are wholly-produced in a member country, or if the c.i.f. value of imported materials used in the production does not exceed 60 percent of the total cost of the materials used in the production of the goods. Alternatively, either the value added resulting from the process of production accounts for at least 35 per cent of the ex-factory cost of the goods, or the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported.

3.2.3 Coffee, Tea and Spices

SADC

In SADC, the original requirement was that the final product would qualify for SADC tariff preferences if it contained at least 80 percent by *weight* of regionally-produced materials. In the case of mixtures of spices, however, the local/regional content requirement was 80 percent of the *value* of the final product. During the negotiations, however, the member states that do not produce these products argued for relaxation of the rules, resulting in the following final agreement:

- At least 40 percent by weight of the raw materials must be wholly originating in the region in the case of tea, coffee and spices;
- For curry and mixtures of spices, a change in tariff heading, and all cloves used in the mixtures must be wholly originating in the region, (Brenton et al. 2005).

COMESA

The requirement in COMESA is that the c.i.f. value of imported materials used in the production does not exceed 60 per cent of the total cost of the materials used in the production of the goods. Alternatively, either the value added resulting from the process of production accounts for at least 35 percent of the ex-factory cost of the goods, or the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported. It is important to note that these requirements apply to the whole Chapter without any exceptions, unlike the SADC scenario.

3.2.4 Wheat Flour

SADC

Despite discussing for a long time, the SADC region has not managed to agree on the rules of origin for wheat flour (Chapter 1101) and the products that are made from it (Chapters 1901, 1904, and 1905). The main bone of contention is the amount of local/regional wheat that is required. While one camp is arguing that 70 percent of the wheat used (by weight) be sourced in the region, others are suggesting that the rules should make no reference to the source of the wheat, apart from stating that the flour be milled in the region. The best way to understand the basis for these extreme views is to appreciate the large variations in production capacities and even regulatory environments for wheat and wheat flour in the region.

While some member states produce substantial amounts of wheat, others produce none at all; and though other member states offer significant protection to their wheat growers, others do not provide any. When looked at from the region's point of view, however, no member country, including South Africa, the largest producer, is self-sufficient in wheat. This means that the region as a whole is not self-reliant in wheat and has to rely on some imports to cover the deficit (Brenton et al. 2005). Despite the fact that member states offer different levels of protection to the wheat producers in their respective countries, Tanzania and South Africa/SACU have the highest import duties. For instance, Tanzania's lowest duty for the industry is 25 percent; South Africa on the other hand, imposes a specific duty which is prompted by a world price less than its long term average (Brenton et al. 2005).

It is this import duty, intended to protect South African local wheat producers, which formed the basis for South Africa's major excuse for restrictive rules of origin for wheat flour. But since individual members of SADC are net importers of wheat, non-SACU millers cannot satisfy rules of origin that require significant amount of regionally produced wheat. As (Brenton et al. 2005) put it, "a rule of origin allegedly designed to protect South African millers and grain growers would also prevent all preferential SADC trade outside of SACU" (p. 19).

COMESA

Contrary to the situation in SADC, there is an agreement on rules of origin in COMESA and the requirement is that wheat and wheat flour qualify for preferential treatment if the c.i.f. value of imported materials used in the production of wheat flour does not exceed 60 per cent of the total cost of the materials used. Alternatively, either the value added resulting from the process of production accounts for at least 35 percent of the ex-factory cost of the goods, or the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported. This simple rule recognizes that wheat milling is an economic activity substantive enough to warrant qualification as a change in tariff heading. In other words, if SADC had the same view, a simple change of tariff heading would have been adequate to confer origin to wheat flour.

3.2.5 The Motor Industry

SADC

The motor industry in SADC is dominated by South Africa in every facet of the industry. The SADC rules of origin regarding the industry specify a general chapter rule of import content not exceeding 60% of the ex-works price. However, this clear chapter rule is supplemented by many other exceptions to the rule, including maximum import content of 55%-60% for vehicles, and 50% for most vehicle components. Furthermore, there are accompanying requirements for vehicles, laying down some specific operations that should be undertaken for the vehicle to satisfy the SADC rules of origin. The intention was to avoid simple 'screwdriver' operations from benefitting from the SADC preferential tariffs. Ironically, even most of the advanced producers in South Africa cannot satisfy the rules as they are (Brenton et al. 2005).

COMESA

In COMESA, motor industry products like vehicles and their component parts qualify for preferential treatment if they are wholly-produced in a member country, or if the c.i.f. value of imported materials used in the production does not exceed 60 percent of the total cost of the materials used in the production. Then again, either the value added resulting from the process of production accounts for at least 35 per cent of the ex-factory cost of the goods, or the goods are classified or become classifiable under a tariff heading other than the tariff heading under which they were imported. And again, just like most HS Chapters, attempts to come up with product-specific rules in this sector are avoided.

4.0 Findings

These four examples have confirmed that, compared to the rules of origin that are used in COMESA, rules of origin of SADC are restrictive and complicated, mostly detailing the requirements down to a single product level. In most cases, the rationale behind this complexity is the desire by South Africa/SACU to protect the industries in their respective countries. As has been pointed out, however, the rules are doing more than that: they are hampering intra-SADC trade. Furthermore, it has been demonstrated earlier on that the vested interests that brought about the complexity of rules of origin in SADC are still prevalent within the region. It is on this basis that harmonization of rules of origin of COMESA and SADC will prove to be the biggest stumbling block for the formation of a grand free trade area.

It might be suggested that the way out is for COMESA to follow the direction shown by the SADC rules of origin. That would, however, go against common sense since most of the countries in the two regions are low income countries that could gain more from simple rules of origin and not contrary. In any case, even the WTO advocates and expect its member countries to come up with simple and straight-forward rules of origin within their respective regional trading arrangements.

5.0 Conclusion

In this thesis, it has been demonstrated that the rules of origin for the Common Market for Eastern and Southern Africa (COMESA) are very different from the ones used by the Southern African Development Community (SADC); the ones used by SADC are more complicated and restrictive than the rules that apply in the COMESA region. The thesis has also tried to shed some light on how those differences came about. The important question which this thesis is trying to answer is: bearing in mind that the political underpinnings that complicated the rules of origin of SADC are still at work now, how difficult will it be to harmonize the rules of origin of the two regional groupings?

The major finding and conclusion has been that it will be a challenge to harmonize the rules of origin of COMESA and SADC, and realize the dream of forming a grand free trade area between the two groups, unless some countries in the two regions, notably South Africa, and to some extent, Egypt, show some flexibility in the way they protect their vested interests. It has been demonstrated, for instance, that South Africa is just using the rules of origin as an '*excuse*,' while the main idea is to shield some industries in that country from regional competition. As the example of the SADC rules of origin for wheat and wheat flour above shows, policies intended to protect South Africa/SACU industries, have ended up holding the whole SADC region at ransom through complicated and restrictive rules of origin. The country is conducting itself just like any more developed country behaves when it is dealing with less developed counterparts: allowing fair competition only in those areas in which the more developed country can win, but not in the fields in which the less developed have comparative advantage.

In view of the level of economic development in the Member States of SADC, a review of SADC Rules of Origin towards simpler and more general rules has been necessary for a long time. With the impending grand Free Trade Area, however, the review is now particularly pertinent in order to align SADC Rules with those of COMESA and EAC. Without an agreement on rules of origin, the idea of forming a free trade area will remain just a dream.

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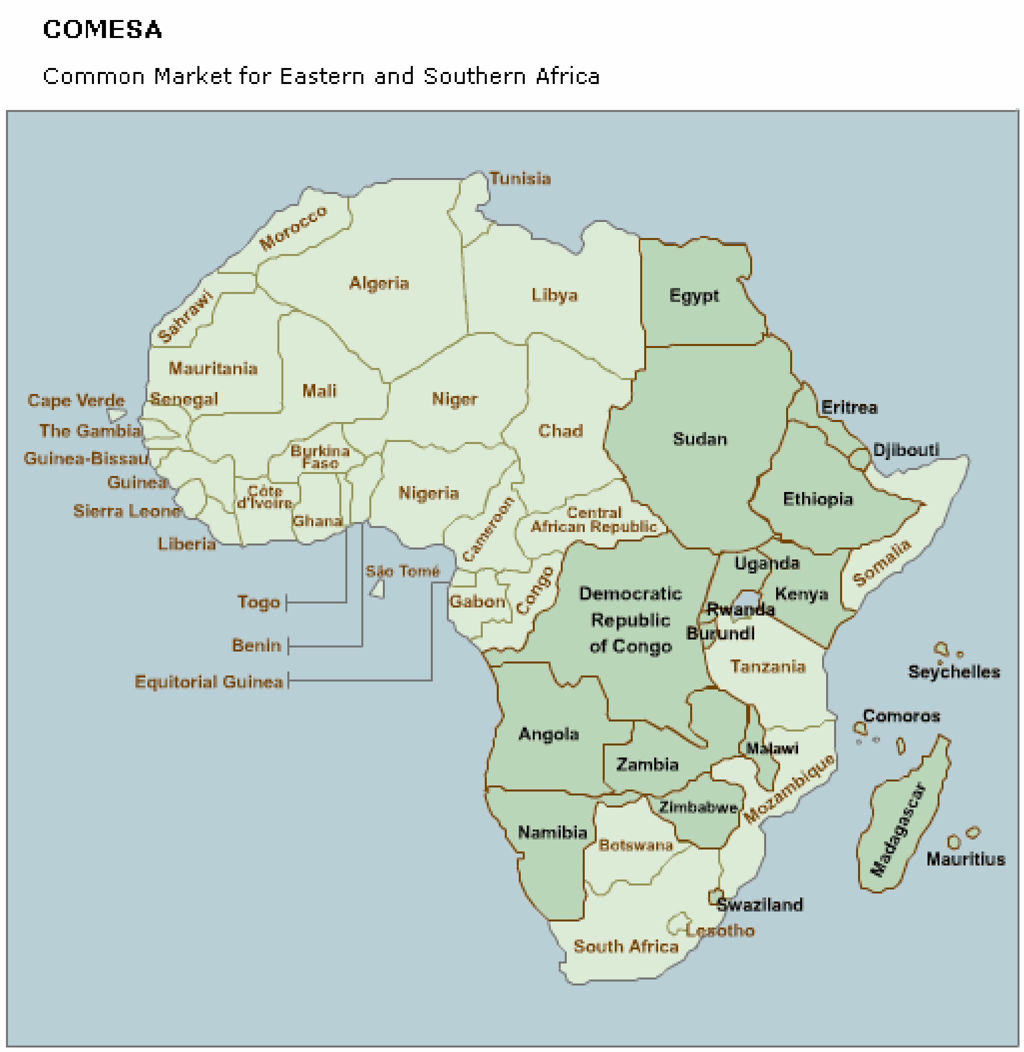
Table 1 Selected Statistics on Member States of COMESA, EAC, and SADC

Country	GDP, US$' m	Population	GDP/capita, US$	GDP Country Share, %
South Africa	254,992	47,391,000	5,380.60	40.84002
Egypt	107,484	75,397,000	1,425.57	17.21485
Angola	44,033	16,391,000	2,686.41	7.052411
Libya	50,320	5,965,000	8,435.88	8.05935
Sudan	37,565	37,003,000	1,015.19	6.016484
Kenya	21,186	35,143,000	602.85	3.393191
Ethiopia	13,315	72,712,000	183.12	2.132556
Tanzania	12,784	39,477,000	323.83	2.04751
Zambia	10,907	11,862,000	919.49	1.746886
Botswana	10,328	1,758,000	5,874.86	1.654153
Uganda	9,322	29,874,000	312.04	1.49303
DRC	8,543	59,338,000	143.97	1.368264
Mozambique	7,608	20,144,000	377.68	1.218512
Mauritius	6,448	1,253,000	5,146.05	1.032724
Namibia	6,372	2,051,000	3,106.78	1.020552
Madagascar	5,499	19,087,000	288.10	0.880731
Zimbabwe	5,010	13,086,000	382.85	0.802411
Swaziland	2,648	1,126,000	2,351.69	0.424109
Rwanda	2,494	9,244,000	269.80	0.399444
Malawi	2,232	13,163,000	169.57	0.357481
Lesotho	1,476	1,789,000	825.04	0.236399
Eritrea	1,085	4,538,000	239.09	0.173776
Burundi	807	7,833,000	103.03	0.129251
Djibouti	757	806,000	939.21	0.121243
Seychelles	750	86,000	8,720.93	0.120121
Comoros	403	614,000	656.35	0.064545
Totals	624,368	527,131,000	50,879.98	**100**

***Source*: World Bank, 2006 data**

Figure 1: Member States of COMESA[5]



5 Namibia is no longer a member of COMESA while Libya is a member.

Figure 2: Member States of SADC