



## **CRS Report for Congress**

# **United States-Southern African Customs Union (SACU) Free Trade Agreement Negotiations: Background and Potential Issues**

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### **Summary**

Negotiations to launch a free trade agreement (FTA) between the United States and the five members of the Southern African Customs Union (SACU) (Botswana, Lesotho, Namibia, South Africa, and Swaziland) began on June 3, 2003. In April 2006, negotiators suspended FTA negotiations, launching a new work program on intensifying the trade and investment relationship with an FTA as a long term goal. A potential FTA would eliminate tariffs over time, reduce or eliminate non-tariff barriers, liberalize service trade, protect intellectual property rights, and provide technical assistance to help SACU nations achieve the goals of the agreement. This potential agreement would be subject to congressional approval. This report will be updated as negotiations progress.

On November 4, 2002, United States Trade Representative (USTR) Robert B. Zoellick notified Congress of the Administration's intention to launch negotiations for a free trade agreement (FTA) with the Southern African Customs Union (SACU), comprised of Botswana, Namibia, Lesotho, South Africa, and Swaziland. This agreement would be the first U.S. FTA with a Sub-Saharan African country.

The first round of negotiations for the SACU FTA began on June 3, 2003, in Johannesburg, South Africa. The negotiations were initially scheduled to conclude by December 2004, but the deadline was pushed to the end of 2006 after negotiations stalled in late 2004 and resumed in late 2005. The talks continued to move at a slow pace until April 2006, when U.S. and SACU officials decided to suspend negotiations and instead begin a longer term joint work program. On July 16, 2008, USTR Susan Schwab signed a Trade, Investment and Development Cooperation Agreement (TIDCA) with trade ministers from SACU.

Several possible rationales exist for the negotiation of an FTA with SACU. One impetus derives from Sec. 116 of the African Growth and Opportunity Act (AGOA) (Title I, P.L. 106-200), in which Congress declared its sense that FTAs should be negotiated

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with sub-Saharan African countries to serve as a catalyst for trade and for U.S. private sector investment in the region. Such trade and investment could fuel economic growth in Southern Africa, by creating new jobs and wealth. SACU member countries have achieved the most robust export growth under AGOA, and an FTA may expand their access to the U.S. market. An FTA may also encourage the continued economic liberalization of the SACU members, and it could move SACU beyond one-way preferential access to full trade partnership with the United States. Finally, although SACU is a customs union, its members' investment and regulatory regimes are not fully harmonized. A comprehensive FTA with the United States could force SACU to achieve greater harmonization.

A potential U.S.-SACU FTA is of interest to Congress because: (1) Congress will need to consider ratifying any agreement signed by the parties; (2) provisions of an FTA may adversely affect U.S. business in import-competing industries, and may affect employment in those industries; and (3) an FTA may increase the effectiveness of AGOA and bolster its implementation. On January 9, 2003, a bipartisan group of 41 Representatives wrote to Ambassador Zoellick to support the beginning of FTA negotiations with SACU.

The U.S. business community has also shown interest in a U.S.-SACU FTA. The U.S.-South African Business Council, an affiliate of the National Foreign Trade Council, announced the creation of an FTA advocacy coalition in December 2002. The Corporate Council on Africa, a U.S. organization dedicated to enhancing trade and investment ties with Africa, also supports the negotiations. For these business groups, a primary benefit of an FTA with SACU would be to counteract the free trade agreement between the European Union and South Africa, which has given a price advantage to European firms. The FTA could also provide an opportunity to address the constraints on U.S. exports to SACU countries, such as relatively high tariffs, import restrictions, insufficient copyright protection, and service sector barriers.<sup>1</sup> Some U.S. businesses have reportedly expressed skepticism about an FTA with SACU, citing concerns over corruption and inadequate transparency in government procurement, particularly in South Africa.<sup>2</sup>

On December 16, 2002, the interagency Trade Policy Staff Committee, which is chaired by the USTR, held a hearing to receive public comment on negotiating positions for the proposed agreement. Several groups representing retailers, food distributors, and metal importers supported the reduction of U.S. tariffs on SACU goods that an FTA would bring. Others representing service industries and recycled clothing favored negotiations to remove tariff and non-tariff barriers in the SACU market. Yet other groups opposed the additional opening of U.S. markets to SACU goods or sought exemptions for their products. They included the growers and processors of California peaches and apricots, the American Sugar Alliance, rubber footwear manufacturers, and producers of silicon metal and manganese aluminum bricks.

Some U.S. civil society organizations are concerned that a SACU FTA could have negative consequences for poor Southern Africans, citing potential adjustment costs for

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<sup>1</sup> The United States Trade Representative, *2005 National Trade Estimate Report on Foreign Trade Barriers*, p. 551.

<sup>2</sup> "South Africa Trade Pact Meets Business Skepticism," *Inside U.S. Trade*, January 17, 2003.

import-competing farmers, poor enforcement of labor rights, privatization of utilities, and increased restrictions on importing generic drugs to treat HIV/AIDS.

## Background

The South African Customs Union consists of Botswana, Lesotho, Namibia, South Africa, and Swaziland: five contiguous states with a population of 51.9 million people encompassing 1.7 million square miles on the southern tip of the African continent. Although this figure represents less than 1% of the population of sub-Saharan Africa, SACU accounts for one-half of the subcontinent's gross domestic product (GDP). Wide differences exist among the economies of SACU. While South Africa has developed a significant manufacturing and industrial capacity, the other countries remain dependent on agriculture and mineral extraction. The grouping is dominated by South Africa, which accounts for 87% of the population, and 93% of the GDP of the customs area. SACU member states had combined real GDP of about \$158 billion in 2005.<sup>3</sup>

SACU is the United States' second largest trading partner in Africa behind Nigeria—whose exports are almost exclusively petroleum products. Overall, SACU is the 33<sup>rd</sup> largest trading partner of the United States. Merchandise imports from SACU totaled \$10.0 billion in 2007, a 33% increase from 2005 and a 169% increase from 1997.<sup>4</sup> They were composed of minerals such as platinum and diamonds, apparel, vehicles, and automotive parts. Major U.S. exports to the region include aircraft, automobiles, computers, medical instruments and construction and agricultural equipment. The 2007 merchandise trade deficit with SACU was \$4.4 billion.

The United States ran a services trade surplus with South Africa (the only member of SACU for which service data are available) with exports of \$1.6 billion and imports of \$1.1 billion in 2006.<sup>5</sup> Services trade between the United States and South Africa has increased steadily over the last decade, with both imports and exports doubling since 1996. The stock of U.S. foreign direct investment in South Africa totaled \$3.8 billion in 2006 and was centered around manufacturing, chemicals and services. The stock of South African investment in the U.S. stood at \$652 million in 2006.<sup>6</sup>

FTA negotiations with SACU may result in the first U.S. trade agreement with an existing customs union. SACU is the world's oldest customs union; it originated as a customs agreement between the territories of South Africa in 1889. The arrangement was formalized through the Customs Agreement of 1910 and was renegotiated in 1969. In 1994, the member states agreed to renegotiate the treaty in light of the political and economic changes implicit from the end of the apartheid regime. The renegotiated

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<sup>3</sup> The World Bank, *World Development Indicators*. In constant 2000 U.S. dollars.

<sup>4</sup> Goods data compiled by World Trade Atlas. U.S. imports for consumption calculated as customs value; U.S. domestic exports as FAS (free alongside ship) value.

<sup>5</sup> Bureau of Economic Analysis, [<http://www.bea.gov/international/xls/tab2b.xls>]. Services figures are calculated from current account data and thus are not directly comparable to goods data above.

<sup>6</sup> Bureau of Economic Analysis, [<http://www.bea.gov/bea/international/datatables/fdipos/fdipos-06.htm>]. Figures are historical-cost basis.

agreement was signed on October 21, 2002 in Gaborone, Botswana, and it is now being implemented. Some observers are concerned that further integration of the customs union may be threatened by individual member countries signing economic partnership agreements (EPAs) with the European Union (EU), because these agreements would include policies that SACU has yet to harmonize, such as rules of origin and customs procedures. Some observers believe that SACU should only negotiate these policies as a group to avoid roadblocks to harmonization.<sup>7</sup>

**The 2002 Agreement.** The 2002 Agreement provides for greater institutional equality of the member states and effectively redistributes tariff revenue within the member states. Its three key policy provisions are: the free movement of goods within SACU; a common external tariff; and a common revenue pool. It also provides more institutional clout to Botswana, Lesotho, Namibia, and Swaziland (BLNS) in decision-making by creating a policymaking Council of Ministers. The agreement enhances the existing Customs Union Commission, and it creates a permanent Secretariat based in Windhoek, Namibia. The Agreement renegotiated the formula for disbursement of the common revenue pool, which accounts for a large portion of government revenue in the BLNS countries. BLNS disbursements were specified under the old formula, but under the new formula they are variable and based on shares of intra-SACU trade. Both formulas result in a redistribution of SACU tariff revenues from South Africa to BLNS, but the new formula has its basis in some measure of economic activity. Recent estimates indicate SACU payments accounted for 49% of government revenue in Lesotho, 69% in Swaziland, 25% in Namibia, 12% in Botswana, and 3% in South Africa in 2005.<sup>8</sup>

**SACU Tariff Structure.** A 2003 WTO Trade Policy Review<sup>9</sup> of SACU member states examined the tariff structure and trade posture of the customs union. It noted that the South African tariff structure, which was still the basis for the SACU tariff, was relatively complex, consisting of specific, *ad valorem*, mixed compound and formula duties. However, the South African government has embarked on a tariff rationalization process to simplify the tariff schedule, to convert tariff lines to *ad valorem* rates, and to remove tariffs on items not produced in the SACU. According to the USTR, the complexity of the tariff regime has made it necessary for some U.S. firms to employ facilitators to export to South Africa.<sup>10</sup> The WTO found applied MFN tariffs averaged 11.8% in manufacturing, 5.5% in agriculture, and 0.7% in mining and quarrying. These average tariffs represent a reduction from the previous WTO review in 1998, when MFN tariffs averaged 16%, 5.6%, and 1.4%, respectively. However, tariffs are often bound<sup>11</sup> much higher, with some bindings as high as 400%.

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<sup>7</sup> "EPA Threatens to Tear Apart Oldest Customs Union," *Africa News*, Inter Press Service, May 17, 2008.

<sup>8</sup> Frank Flatters and Matthew Stern, *Implementing the SACU Revenue-Sharing Formula: Customs Revenues*, USAID South Africa, March 31, 2005.

<sup>9</sup> World Trade Organization, "Trade Policy Review: Southern African Customs Union, Report by the Secretariat," (WT/TPR/S/114), March 24, 2003, pp. ix-xi.

<sup>10</sup> U.S. Trade Representative, *2002 Foreign Trade Barriers*, p. 381.

<sup>11</sup> A bound tariff rate is a rate which a country agrees not to exceed because of trade commitments, such as those made in the WTO. An applied tariff rate is a rate that is actually imposed on goods.

## Progress of the Negotiations

After nearly three years of slow-moving and stalled negotiations, U.S. and SACU trade officials called off the FTA negotiations in April 2006 in favor of a longer term trade and investment work plan. On July 16, 2008, they signed a Trade, Investment and Development Cooperation Agreement (TIDCA), which is the first of its kind. The TIDCA is reportedly a formal mechanism for the United States and SACU to negotiate interim trade-related agreements which may serve as the building blocks for a future FTA. The agreement will also allow the two parties to work on key issues in their trade, such as trade facilitation, technical barriers, investment promotion, and sanitary and phytosanitary standards.<sup>12</sup>

Observers have cited several possible reasons for the halt in FTA negotiations. First, the United States and SACU did not agree on the scope of the negotiations. Per their mandate from Congress to pursue comprehensive FTAs, U.S. negotiators attempted to proceed with negotiations including intellectual property rights, government procurement, investment, and services provisions. However, SACU officials reportedly argued for these provisions to be excluded from the negotiations. They called for making market access commitments first, and then negotiating the other areas. Now that Congress has extended the AGOA benefits to 2015 through the AGOA Acceleration Act of 2004 (P.L. 108-274), there may be less incentive for SACU countries to complete an FTA with the United States. Also, the United States and SACU reportedly held different views on how to include certain industrial sectors in the negotiations. The United States preferred what is called a negative list, where all industries are negotiable unless specifically excluded. Meanwhile, SACU preferred a positive list, where the industries to be included in the negotiations are specified in advance, and additional industries may be included in the agreement over time. Finally, the United States and SACU differed on issues concerning labor rights and environmental regulations. Some observers have speculated that South Africa may be leery of negotiating issues that are included in the current WTO negotiations, so as not to influence their positions in the WTO.<sup>13</sup>

Former USTR Robert Zoellick has stated that the United States recognizes that SACU is still an emerging entity. It has not developed harmonized policies on many of the issues that would be included in an FTA, which may add to the challenges of negotiating an FTA.<sup>14</sup>

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<sup>12</sup> “U.S. Signs Commercial Pact with SACU, Says Free Trade Agreement Still Possible,” *BNA*, July 17, 2008.

<sup>13</sup> “Business Must Not Miss This Boat,” *Business Day (Johannesburg)*, December 15, 2005.

<sup>14</sup> “U.S.-SACU Free Trade Negotiations Put on Hold; New Mechanism Being Created,” *International Trade Reporter*, December 16, 2004.

**Table 1. U.S. Merchandise Trade with SACU Countries, 2007**

U.S. Imports		U.S. Exports	
2 digit HTS Category	Imports	2-digit HTS Category	Exports
Precious Metals, of which, -Platinum -Diamonds	\$5,179 million -\$3,788 million -\$1,308 million	Machinery and Mechanical Appliances	\$1,260 million
Iron and Steel	\$753 million	Vehicles and Parts	\$1,066 million
Vehicles and parts	\$551 million	Electrical Machinery, Equipment, and Parts (includes telecommunications equipment.)	\$421 million
Ores Slag and Ash	\$511 million	Optical, photographic, cinematographic, measuring, precision, medical, and surgical instruments and parts	\$303 million
Machinery and Mechanical Appliances (primarily catalytic converters)	\$435 million	Special Classification/ Low value	\$302 million
Knitted Apparel and Clothing	\$391 million	Aircraft and Parts	\$291 million
Aluminum Products	\$350 million	Organic Chemicals	\$205 million
Mineral Fuels and Oils	\$278 million	Mineral Fuels and Oils	\$192 million
Organic Chemicals	\$251 million	Precious Stones, Metals	\$189 million
Apparel and Clothing, not knitted	\$212 million	Plastics	\$173 million
Inorganic Chemicals	\$154 million	Cereals (primarily wheat and meslin)	\$164 million
Special Classification/ low value exports	\$98 million	Miscellaneous Chemicals	\$121 million
Beverages, Spirits, and Vinegar	\$71 million	Rubber	\$78 million
Edible Fruits and Nuts	\$68 million	Pharmaceutical Products	\$73 million
Electrical Machinery	\$61 million	Toys, Games, and Sports Equipment	\$69 million
All Other	\$737 million	All Other	\$793 million
Total	\$10.1 billion	Total	\$5.7 billion

Source: World Trade Atlas