

PART II

REMOVING NON-TARIFF BARRIERS TO TRADE

8. Deepening Regional Integration to Eliminate the Fragmented Goods Market in Southern Africa

Ian Gillson³⁷

Introduction

This note summarizes new studies that identify the most restrictive barriers to regional goods trade in Southern Africa. It also illustrates the costs associated with these barriers using information gathered from some of the largest firms engaged in cross-border trade. The note concludes by providing practical policy recommendations to deepen regional integration in the goods market and increase competitiveness.

A recent and important trend in global trade has been the proliferation of regional trade agreements (RTAs), and Southern Africa is no exception. Regional integration efforts in Southern Africa, such as COMESA, SADC and SACU, have all sought to liberalize trade between countries so as to increase bilateral trade flows, diversify exports by overcoming the limits of small markets, and deepen specialization through achieving economies of scale. Harnessing regional integration more effectively, for both goods and services, would help all countries lower their cost base thereby enhancing global competitiveness. For the smaller Southern African countries, regional integration also offers the prospect of improved access to neighboring markets as well as the potential to attract greater SADC-orientated FDI. In some of these countries (e.g. Lesotho) greater exploitation of the regional market is critical to reduce reliance on exports of a single product to a single market (e.g. clothing to the United States under AGOA). For the larger countries, especially South Africa, regional integration offers opportunities to enhance the sustainability of existing exports (e.g. light manufacturing) on world markets by lowering costs through specialization within the context of integrated regional value chains.

However, while Southern African countries have largely succeeded in increasing their trade with the rest of the world (more than tripling in value between 2000 and 2008 from US\$50 billion to US\$153 billion), increased regional trade has only played a relatively small role. Opportunities for export growth and diversification therefore remain unexploited at the regional level. While efforts to reduce tariffs have largely

³⁷ Ian Gillson is a Senior Economist in the International Trade Department of the World Bank

been met with success, other forms of trade restriction remain widespread. These barriers affect *considerably more* than one-fifth of regional goods trade, and are hindering the competitiveness of domestic firms and their ability to export to regional and global markets, and so must now be urgently addressed.

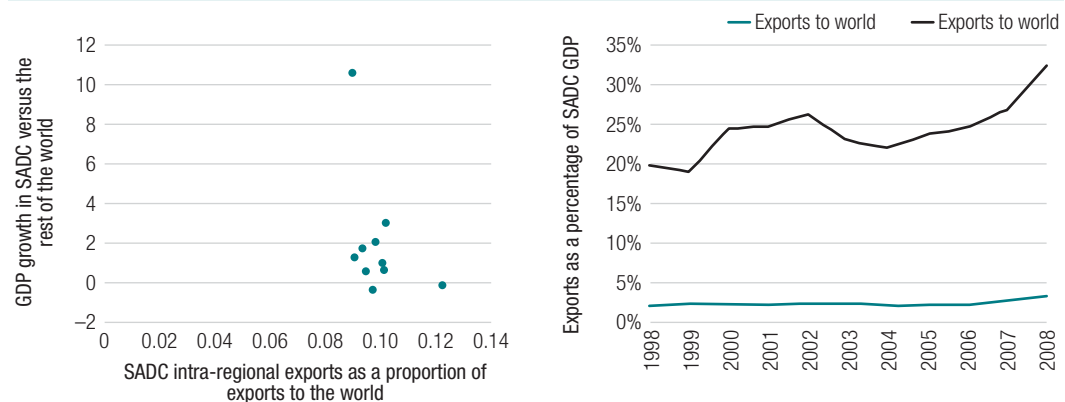
Despite Southern African Economies often Growing Faster than the World Average, Regional Trade has Remained Relatively Constant

The share of intra-regional exports in SADC has remained relatively steady at around 10 percent of total exports over the last decade despite Southern African countries often achieving higher annual GDP growth rates than the world average over this period (particularly 2003–2007). In contrast, the most successful RTAs in Asia and Latin America (e.g. ASEAN; MERCOSUR) have reached and maintained relatively higher degrees of regional trade (typically over 20 percent of their total trade), often through intensified intra-industry linkages. While SADC's merchandise exports to the world as a proportion of its GDP have increased dramatically, the share of exports to the region have grown more slowly and account for just three percent of GDP (see Figure 8.1). Furthermore, traditional exports of agricultural raw materials and minerals continue to dominate regional trade in Southern Africa. Cases of diversification into higher value-added manufacturing exports to the region remain limited (e.g. Mauritian clothing to South Africa) and strong trade imbalances persist between South Africa and the smaller countries. Regional production chains for exports to the world market remain virtually non-existent.

The key policy issue for regional integration in the Southern African goods market is why these trade outcomes have been so limited and what can be done to consolidate the various RTAs to increase regional trade?

Figure 8.1 >

Regional Trade has Lagged behind SADC Income Growth while Exports to the Rest of the World have Boomed (1998–2008, annual values)



Sources: IMF Direction of Trade Statistics and IMF.

While Efforts to Reduce Tariffs Have Largely Been Met with Success, other Barriers Are Critically Hindering Regional Trade

Regional integration efforts in Southern Africa have made significant progress in lowering tariff barriers to regional trade. For example, SADC has been trading on preferential terms since 2000 and, based on the implementation of tariff phase down commitments under the SADC Trade Protocol, formally launched a free trade area⁵⁸ (FTA) in August 2008. Under this, 85 percent of intra-SADC merchandise trade flows are now duty-free with most of the remaining 15 percent comprising sensitive products⁵⁹ scheduled to be liberalized by 2012 (2015 for Mozambique). A sub-set of five SADC members have already established a customs union under SACU. COMESA has also had an FTA since 2000. Trade between FTA⁴⁰ and non-FTA⁴¹ COMESA countries is conducted on reciprocal terms under the Preferential Trade Agreement.

The next step in COMESA's regional integration agenda is the formation of a customs union, which was formally launched in June 2009.⁴² There are also a number of bilateral trade agreements between Southern African countries, most of which were signed and implemented long before the SADC and COMESA FTAs came into effect.

The lesson from successful regional integration experiences elsewhere in the world is that tackling tariff barriers is not enough to enhance trade. Countries must also aim to facilitate regional trade by addressing non-tariff barriers (NTBs), such as restrictive product standards or complex rules of origin. In the Southern African context, borders remain thick as major obstacles to regional trade remain. A mapping of the various NTBs reported by firms in SADC countries to trade flows in the affected sectors shows that these barriers impacted US\$3.3 billion of regional trade in 2008, or one-fifth of regional exports (see Table 1). In other words, even those barriers which have been reported (and many others may yet be identified) are affecting products in which there is already significant regional trade. This is also a least cost estimate of the impact of NTBs on trade in the region since some barriers are so restrictive that preferential trade is effectively prohibited (e.g. wheat flour) and, of course, others which affect all trade and not just individual products (e.g. customs delays, transport costs) which are not captured here. So NTBs are widespread in their effect on regional trade, even more so than these figures suggest.

The remaining barriers are also costly. On average the tariff equivalent of NTBs is 40 percent, which for most products is much higher than the MFN tariff applied by most countries (Carrere and De Melo 2009a, b). Assuming 40 percent ad valorem equivalence on those NTBs cited above, which affect US\$5.3 billion of Southern African regional trade,

⁵⁸ The FTA is being implemented by Botswana, Lesotho, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

⁵⁹ The remaining sensitive products mostly comprise textiles and clothing, cotton, cereals, dairy, and motor vehicles.

⁴⁰ Burundi (since 2005), Comoros, Djibouti, Egypt, Kenya, Libya (since 2006), Madagascar, Malawi, Mauritius, Rwanda (since 2005), Sudan, Zambia, Zimbabwe.

⁴¹ DR Congo, Eritrea, Ethiopia, Seychelles, Swaziland, Uganda.

⁴² After five years of negotiation, COMESA member states agreed to a common external tariff in May 2007 with four bands for raw materials (0 percent), capital goods (0 percent), intermediate goods (10 percent) and final goods (25 percent) although, for some products, discussions continue on which category they will be classified under. All tariff lines carrying a rate above or below its common external tariff have been placed on sensitive product lists, which should be adjusted to the CET in a period of no more than five years.

Table 8.1> NTBs that have been Notified to SADC Affect at Least one-fifth of Regional Trade

Barrier	Examples of products affected	Volume of intra-SADC trade potentially affected (percentage of total)
Import bans, quotas & levies	Wheat, beer, poultry, flour, meat, maize, UHT milk, cement, sugar, eggs, pasta, sorghum, pork, fruit & vegetables	6.1
Preferences denied	Salt, fishmeal, pasta	0.4
Import permits & levies	UHT milk, bread, eggs, sugar, fruit & vegetables, livestock, liquor, cooking oils, maize, oysters	5.4
Single marketing channels	Wheat, meat, dairy, maize, tea & tobacco, sugar	5.3
Rules of origin	Textiles & clothing, semi-trailers; palm oil; soap; cake decorations; rice; curry powder; wheat flour	3.0
Export taxes	Dried beans, live animals, hides, skins, sugar, tobacco, maize, meat, wood, coffee	4.8
Standards/SPS/TBT	Milk, meat, canned tuna, beer, honey, maize bran, cotton cake, poultry, batteries, sugar, coffee, ostriches	2.5
Customs-related	Wine, electronic equipment, copper concentrate, salt, cosmetics, medicines	5.2

Source: Authors calculations based on NTBs reported to the SADC-EAC-COMESA Non-Tariff Barrier Monitoring Mechanism

would imply a crude cost estimate of US\$1.3 billion per year. Consequently, NTBs significantly increase costs both for firms that source intermediate inputs from the region as well as for consumers. For example, in SADC, Woolworths reports that prices in its franchise outlets in non-SACU SADC countries are 1.8 times higher than those within SACU because of higher expenditures associated with sending goods to these markets as well as the higher costs of doing business in them.

What Are the Main Types of Barrier that Remain and How Much Do They Cost?

There are, therefore, opportunities for Southern African firms to trade across regional borders which currently remain unexploited due to policy constraints that serve to raise trade costs. Five main types of barrier can be broadly identified as follows:

Inefficiencies in transport, customs, and logistics raise trade costs: In order for RTAs to be effective, it is critical that intra-regional trade be able to move without hindrance. Many Southern African countries are landlocked, making road and rail networks very important in linking these countries to both regional and global markets. However, high transactions costs are being incurred from inadequate transport infrastructure, inefficiencies in customs procedures (including delays at road checks, borders, and ports) as well as poor quality and costly logistics due to weak competition among service providers. For example, Shoprite reports that each day one of its trucks is delayed at a border costs US\$500 (Charalambides 2010). And at Durban, the Citrus Growers' Association in South Africa estimates

that delays there cost its growers US\$10.5 million per season (on approximately US\$400 million of exports). A related source of delay within the region concerns work permit regimes for foreign truck drivers. In South Africa, visitor visas used to be accepted for this purpose but foreign drivers will soon be required to obtain work permits. This necessitates companies proving that the skills being sought outside of South Africa are not available domestically and involves each post being advertised locally. There are between 1,600 and 2,000 foreign drivers in South Africa who will require these permits, affecting 6,000–8,000 deliveries per month. While ostensibly designed to protect employment opportunities, the new approach does not take into account prospects for South African drivers operating in regional markets and may hamper regional integration. In particular, it risks South Africa's neighbors reciprocating with similar measures that will force South African drivers working in these countries to also apply for work permits. For example, Angola has already signaled its intention to put in place a similar requirement for South African drivers crossing its border. Such restrictions could significantly impede the movement of trucks in and out of countries and make trade even more difficult for regional exporters than it is now.

Cumbersome fiscal arrangements necessitate borders: Fiscal borders between Southern African countries are unnecessarily complicated and inefficient and contribute to higher trade costs. The three main reasons SACU retains internal border posts, even though it is a customs union, are to capture data on intra-SACU trade for revenue sharing purposes; administer NTBs e.g. infant industry protection; and, because domestic sales taxes have not yet been harmonized, requiring refunds and payments. The costs and delays associated with these procedures reduce trade flows between Southern African countries. Those costs attributable to the differences in VAT alone have been estimated to be up to two percent of the value of each transaction on intra-SACU trade (Jitsing and Stern 2008).

Restrictive rules of origin limit preferential trade: Onerous local content requirements in rules of origin (ROOs), particularly in labor intensive sectors (e.g. clothing) that use capital intensive inputs not produced competitively in the region (e.g. fabrics), and high compliance costs with administering certificates of origin reduce the utilization of tariff preferences offered by RTAs and therefore the incentive for Southern African firms to trade regionally. A recent example of the costs associated with meeting ROOs involves SACU moving to more restrictive rules (double transformation) on selected clothing imports from Malawi, Mozambique, Tanzania, and Zambia following the expiration of the MMTZ-SACU Market Access Arrangement at the beginning of 2010. This has resulted in some clothing producers in these countries (e.g. Bidserv in Malawi) being no longer able to compete in the regional market. It has also further distorted investment decisions as some of these firms have relocated to the BLNS countries as a result of the change to avoid the loss of preferences in supplying the South African clothing market. For other products where ROOs have been so contentious (e.g. wheat flour) or simply not agreed upon (e.g. certain electrical products for which rules were only finalized in April 2010), preferential trade within the region has been effectively prohibited (Naumann 2008).

Further costs arise from the administrative requirements for certificates of origin, which can account for nearly half the value of the duty preference. For example, Shoprite spends US\$5.8 million per year in dealing with red tape (e.g. filing certificates; obtaining import permits) to secure US\$13.6 million in duty savings under SADC. Woolworths does not use SADC preferences at all in sending regionally produced consignments of food and clothing

to its franchise stores in non-SACU SADC markets. Instead it simply pays full tariffs because it currently deems the process of administering ROO documentation to be too costly.

Poorly designed technical regulations and standards limit consumer choice and hamper trade: Standards regimes in Southern Africa are often characterized by an over-reliance on mandatory inspections and certifications; unique national (rather than regional or international) standards and testing; overlapping responsibilities for regulation; and, occasional heavy government involvement in all dimensions of the standards system. These factors create unnecessary barriers to trade, especially when technical regulations and standards are applied in a discriminatory fashion against imports. International best practice is to use technical regulations only to ensure core public policy objectives such as maintaining safety. Voluntary standards should be used in all other cases, including indicating quality attributes. But in several Southern African countries, scarce public resources are being wasted on developing and enforcing technical regulations that go well beyond issues of purely public interest. One example is shoes in Mauritius where the Chamber of Commerce has proposed the development of a regulation to govern their quality to prevent the entry of low-cost Chinese sandals that are perceived to have a tendency to wear more quickly than domestically produced ones. However, these are often the only shoes that the poorest people in Mauritius can afford to buy.

In most Southern African countries there are also no procedures by which technical regulations are assessed in terms of their consistency with public policy objectives; whether countries and the private sector have the capacity to implement them; or, their impact on trade and competitiveness. The main objective, therefore, should be to make regulations more efficient at achieving public policy objectives while minimizing their impact on trade. In particular, no ‘Office of Regulatory Reform’ exists in any Southern African country to review the justification for both new and existing technical regulations. This absence of regulatory impact assessment causes problems and raises costs. For instance, the environmental levy on plastic bags in South Africa was introduced to reduce problems associated with litter, but the technical regulation governing it also affects unrelated issues such as the minimum thickness of the plastic to be used as well as the size of the text that could be printed on the bags. While regional efforts to harmonize standards in SADC are under way (i.e. SADCSTAN), application remains lacking. Only Namibia and Swaziland have adopted all 78 (to date) of the SADC-defined harmonized standards for the region, of which some have been developed without any real sense of prioritization and so are unlikely to bring significant increases in regional trade (e.g. frozen peas and dried apricots).

Other non-tariff barriers restrict opportunities for regional sourcing: Other barriers such as trade permits, export taxes, import licenses and bans also persist. Shoprite, for example, spends US\$20,000 per week on securing import permits to distribute meat, milk, and plant-based goods to its stores in Zambia alone. For all countries it operates in, approximately 100 (single entry) import permits are applied for every week; this can rise up to 300 per week in peak periods. As a result of these and other documentary requirements (e.g. ROOs) there can be up to 1,600 documents accompanying each truck Shoprite sends with a load that crosses a SADC border. Lack of coordination across government ministries and regulatory authorities also causes significant delays, particularly in authorizing trade for new products. Another South African retailer took three years to get permission to export processed beef and pork from South Africa to Zambia.

In SACU, national protection for infant industries has often been used to justify import bans. Namibia has used the provision to protect a pasta manufacturer and broilers and maintains protection on UHT milk even though its eight-year limit to do this recently expired. Botswana has recently limited imports of specific varieties of tomatoes and UHT milk. Seasonal import restrictions on maize, wheat, and flour also ensure that domestic production is consumed first. For example, Swaziland's imports of wheat flour were effectively prohibited for half of 2009 since no import permits were issued since June of that year. Export taxes also impose costs and inhibit the development of regional supply chains. A case in point is small stock exports from Namibia. Since 2004 the Namibian Government has limited exports to encourage local slaughtering. Quantity restrictions were originally used but have recently been replaced by a flexible levy of between 15–30 percent, effectively closing the border for the export of live sheep to South Africa. The impact of this restriction is affecting the small stock industry in *both* Namibia and South Africa. In the former, exports of live sheep declined by 84 percent between 2004 and 2008 as farmers have switched to alternative activities like cattle and game farming. For those sheep farmers that remain, they have become almost entirely dependent on the four Namibian export abattoirs while they were previously able to sell more sheep to the South African market where they received higher prices (PWC 2007). There have also been cases of livestock smuggling to avoid the tax. In South Africa, 975 full-time jobs are at risk because of the scheme, especially in the bigger abattoirs in the Northern and Western Cape that focus on slaughtering Namibian sheep during the low season to better utilize their capacity (Talijaard et al. 2009).

The implication of the current system and the barriers remaining to regional trade in Southern Africa is that it imposes unnecessary costs for producers that limit trade and raise prices for consumers. Many of these barriers are simply wasteful and do not serve any real purpose. Import bans and delays create uncertainty over market access and limit investment. Thick and fragmented borders limit possibilities for regional production chains in which countries can exploit their comparative advantage in specific tasks and intra-industry trade. Finally, the heavy bureaucratic burden imposed on all regional trade flows ties up regulatory and customs resources, limiting their attention on achieving the most pressing public policy objectives such as effective border management to ensure security. Instead of scrutinizing all consignments, border checks should be focused on those for which the risks are greatest for circumventing national trade policy measures.

Priorities for Regional Merchandise Trade Reform and Implementing Them

There are, therefore, a wide range of barriers that persist on regional merchandise trade in Southern Africa. Which among these are the most pressing in terms of their restrictive effect, or perhaps easiest to deal with, that should be prioritized and tackled early on by policymakers?

First, one of the biggest issues for regional trade integration in Southern Africa, especially for manufactures and agro-processed products, is undoubtedly ROOs. The issue has gained particular prominence in light of the planned Africa-wide Tripartite FTA where one set of rules for all countries will have to be agreed upon. This is generally accepted by all member states in SADC, COMESA and EAC. Harmonization of the different rules among the regional groups will not be possible for all products because

process requirements, employed for example under SADC, cannot be easily harmonized with the value addition criteria under, for example, COMESA. So a new set of ROOs will need to be agreed, either based on one of the existing arrangements or completely re-designed. Characteristics of ROOs that would encourage the development of new export industries would include:

- Providing exporters with a *choice* as to which rule (defined simply and transparently) they apply—e.g., either a change in tariff heading test (ideally at a disaggregated product level) *or* a reasonable value-added rule (20 percent);
- Eliminating process-specific ROOs which set out how a product is to be made for originating status to be conferred;
- Removing the requirement for certificates of origin for products with nuisance tariffs, i.e., those with preference margins below three percentage points;
- Enforcing these simplified rules more consistently and effectively at customs to mitigate any concerns over leakage or trade deflection; and,
- Greater use of risk assessment, especially for large, trusted regional traders who should not be required to provide a certificate of origin for each consignment but, instead, should be able to submit these electronically per batch.

Secondly, resolving other types of existing NTBs and curtailing the development of new ones is also vital, since these critically restrict trade in the region, particularly for primary agricultural commodities. Among these, the most serious barriers are import bans, quotas, permits, and licensing, often implemented by countries with little or no consultation with their trading partners. In dealing with these types of restrictions, the existing framework to remove NTBs in the region (the non-tariff barrier monitoring mechanism) is not used as much as it should be. The use of regulatory impact assessment should also be extended.

Thirdly, while tariffs have been reduced across the region barriers arise in those sectors where tariff peaks persist. One advantage to addressing remaining tariffs is that tariff reform can often be dealt with by “a stroke of the pen” approach, as opposed to some of the other barriers where reform will be complex, perhaps more costly, and certainly more involved. High tariffs are especially restrictive because concerns of leakage from third countries can create the need for additional barriers at the regional level (e.g. ROOs) as well as affecting regional trade in all sectors, as border checks are intensified to check for transshipments of these products. Lower, more uniform external tariffs would significantly reduce the need for many of the barriers which persist on regional trade in Southern Africa as would the development of policies that directly address the difficulties that protected sectors may be facing such as assisting labor in these industries to retrain in tasks where employment opportunities are much better.

Fourthly, reducing bureaucratic requirements, streamlining border management procedures and implementing trade facilitation measures, including one-stop border posts (OSBPs), have significant potential to lower border crossing times and reduce transport costs, at least along the main corridors in Southern Africa. There is also increasing political willingness among the member states for this type of reform to go ahead sooner rather than later. For example, the South African Government has recently identified OSBPs as one focus area it wishes to develop for regional integration in the next twelve months.

However revenue concerns among the smaller SACU countries risk impeding reform. Overcoming this challenge will require the development of better ways to capture trade flows across SACU borders than those currently employed as well as an open discussion about alternatives to the current revenue sharing arrangement that might be more effective and sustainable in the long-term.

In which areas of trade reform would regional approaches be most appropriate? One reason RTAs have become so prolific has been due to their convenience in dealing with more complex and modern trade barriers (e.g. NTBs) in a simpler setting involving fewer countries than in global trade negotiations. Another argument is that adjustment costs of trade reforms may be easier to deal with by opening up to a subset of countries initially before to all later on. In other words, regional trade reform can be used strategically to support unilateral trade reform that might otherwise be too difficult on the grounds of adjustment.

Nevertheless, not all reforms need wait for regional agreement either and much can be done both unilaterally and bilaterally to increase regional trade. For example, regional harmonization is just one way to deal with restrictive product standards. Countries retain significant scope to unilaterally improve both the quality of their technical regulations and the way these are applied. Another example is trade facilitation which can be, and is being, promoted at the regional level in SADC but countries can still push ahead with reforms bilaterally to increase cooperation and share customs facilities at their borders. Some reforms may even be best tackled outside the regional process. Cooperation on indirect taxes might be more feasible bilaterally instead of regionally. And the issue of tariff peaks must be dealt with unilaterally, particularly by South Africa, which under the current SACU arrangement is able to export a diverse range of goods to SADC but behind high and complex external barriers to trade which are costly to consumers and producers in neighboring countries alike.

References

- Carrere, C. and J. De Melo. 2009a. “Notes on detecting the effects of Non Tariff Measures.” CERDI working document E 2009.32.
- Carrere, C. and J. De Melo. 2009b. “Non Tariff Measures: What do we know? What should be done?” CERDI working document E 2009.33.
- Charalambides, N. 2010. “Addressing NTBs in regional goods trade in Southern African countries.” Sustainable Commerce Consulting, Gaborone.
- Jitsing, A. and M. Stern. 2008. “VAT practices within SACU and possibilities for harmonisation” Southern African Regional Integration Project, World Bank.
- Naumann, E. 2008. “Intra-SADC and SADC-EU rules of origin—reflections on recent developments and prospects for change.” TRALAC.
- PWC 2007. “Evaluation of the implementation of the Small Stock Marketing Scheme in relation to the Namibian Government’s value addition goals and objectives” Windhoek.
- Talijaard, P., Z Alemu, A. Joote, H. Jordaan and L. Botha. 2009. “The impact of Namibian Small Stock Marketing Scheme on South Africa” National Agricultural Marketing Council, South Africa.

9. Addressing Trade Restrictive Non-tariff Measures on Goods Trade in the East African Community

Robert Kirk⁴³

Introduction

The East African Community (EAC) launched a regional common market in July 2010. This followed closely on the full implementation of the customs union, which was realized in January 2010 after a five-year transition period. While all the partners have been able to eliminate a significant proportion of tariffs on intra-EAC trade and agree on a common external tariff, there has been more limited progress in addressing trade restrictive non-tariff measures (NTMs), which are referred to as non tariff barriers (NTBs). The EAC Customs Union Protocol makes specific reference to the need to eliminate NTBs and to refrain from imposing new ones. Recognition of the importance of reducing NTBs has resulted in Partner States and the EAC Secretariat devoting considerable time and attention to identifying specific measures based on a series of surveys. Moving from identifying NTBs to their reduction and removal has proven to be more challenging.

NTMs are generally understood to refer to any measure other than a tariff that causes a trade distortion. A trade distortion exists where the price at the border diverges from the domestic price and can result from regulations or administrative procedures which are imposed to serve a specific objective such as ensuring food safety, or addressing product safety or environmental issues. The pursuit of such domestic policy objectives is quite legitimate; however, in many cases the regulatory policies, procedures, and administrative requirements are implemented in a manner that effectively discriminates against imports relative to domestically produced products. Thus a NTM has the potential to become a NTB when it serves to constrain imports. Any NTM that is not implemented in the “least trade-restrictive” manner may be classified as a NTB. This chapter focuses on NTBs.

The rise in prominence of NTBs mirrors the reduction of tariffs in progressive rounds of trade liberalization at the multilateral and regional levels. The multilateral agreements of the WTO have focused on developing core principles for addressing NTBs, including transparency, non-discrimination, and proportionality. Using these three principles, the WTO members developed taxonomies for classifying NTBs with the objective of defining

⁴³ Robert Kirk is Senior Vice-President at AECOM International Development.

appropriate design criteria. All countries have made progress on significantly reducing “old style” NTBs, such as quotas and restrictive import licensing requirement. However, implementing regulatory reforms to minimize the trade restrictiveness of specific NTBs has largely taken place in the major developed and developing countries.

The new multilateral rules that established the WTO in 1995 included explicit agreements relating to the management of NTBs with a specific focus on customs and transit, technical regulations, and health and safety issues. Including these regulatory issues in the trade agenda requires extensive inter-government coordination as portfolio responsibility often rests with a non-trade ministry such as Agriculture, Health, Science and Technology, or Environment.

The policy recommendations in this note draw on the experience of both the WTO and other regional organizations to identify the characteristics of a successful approach for reducing and eliminating NTBs. Over the past 15 years members of the WTO have implemented the SPS and TBT Agreements through notifications and active participation and engagement in the Committees. In addition, the binding dispute settlement process of the WTO has resulted in a number of NTBs being resolved through enforceable legal process and the consequent development of precedent and case law. At the same time regional economic agreements have also turned their focus to addressing NTBs. While the European Union has pursued a legally binding approach with sanctions to enforce compliance the majority of regional economic communities have chosen moral suasion through establishing committees and other institutional structures (such as technical expert groups) requiring dialogue and the exchange of information.

The remainder of the note discusses the approach to NTBs within the EAC before outlining the key policy recommendations for reducing and removing NTBs. The policy recommendations draw on the relevance of the WTO rules and the experience of both the EU and ASEAN in addressing NTBs.

Non-tariff Barriers in the EAC

Partner States within the EAC have made progress on addressing NTBs, and the EAC Secretariat with support from Ministers and Heads of State has entered into commitments to eliminate and reduce NTBs. All the Partners recognize that realizing the vision of the EAC to create an integrated market requires the reduction and removal of NTBs. To date, the approach has focused on developing national-level focal points and publicizing specific NTBs. Establishing formal notification requirements is an important element in monitoring NTBs and represents a necessary condition. However, it is not sufficient for moving to the next step—the reduction and removal of NTBs.

The legal framework governing the EAC provides a basis for addressing NTBs. Article 13 (1) of the EAC Protocol states that Partner States must agree to eliminate remaining NTBs and refrain from imposing new ones. The following paragraph provides that Partner States shall formulate a mechanism to identify and eliminate such NTBs. The Protocol defines NTBs as “administrative and technical requirements imposed by a Partner State in the movement of goods.” Implementing this Article remains a major challenge for all five Partner States. The working definition of NTBs within the EAC is “quantitative restrictions and specific limitations that act as obstacles to trade,” other than tariffs that may be embedded in government laws, regulations, and practices at the national and local level.

Identifying and classifying NTBs is often not straightforward as specific administrative practices and legislation has evolved over time in response to political economy developments at the national and local level. These practices inevitably pre-date the initiative to move towards a Common Market in East Africa and also pre-date the establishment of the WTO. Over the past several years Partner States and the EAC Secretariat have devoted considerable attention to addressing NTBs. A series of detailed studies has identified specific measures based on surveys undertaken by private sector advocacy organizations in the region. Further studies have made recommendations for establishing an implementation mechanism to facilitate their reduction and removal. As part of this process, Partner States have established National Monitoring Committees (NMCs).

The EAC Partner States have adopted a Time-bound Program for the Elimination of Identified Non-Tariff Barriers (2009). This classifies the listed NTBs into one of four categories (see Box 9.1) based on the level of political and economic complexity and the magnitude of the impact on EAC trade. The action agenda is prioritized according to the degree of difficulty in achieving a consensus and the quantitative impact on intra-regional trade flows. Essentially this approach seeks to identify ‘easy’ NTBs to remove in order to harness a growing consensus behind further reform.

Classifying NTBs in accordance with the dual criteria of political complexity and intra-regional trade impact is justified by arguing that it will deliver a few ‘quick wins’ that will increase trade. This in turn will result in an increased awareness of the trade benefits, which will build the support necessary for addressing the more challenging NTBs. In practice there have been very few ‘quick wins’ over the past two years since it proven very difficult to remove the Category A NTBs. Some of the specific NTBs classified as Category A are shown in Table 9.1. While a number of NTBs may be explicitly protectionist, the majority of NTBs seek to meet an agreed regulatory objective—such as food safety or product safety. While there may be a consensus that an existing NTB should be abolished this does not mean that there is agreement on how to meet legitimate regulatory objectives in a less trade restrictive manner.

The publication of *Non Tariff Barriers in EAC* (now available on the EAC Web site for download) along with the existence of a high-profile forum within the EAC for discussing NTBs represents a major step forward. EAC Partner States and the Secretariat face the challenge of moving from identifying and discussing NTBs to implementing regulatory reforms and reducing trade restrictive measures. Presently there is no mechanism for ensuring that Partner States follow a process of either justifying the NTB or agreeing to remove it once a NTB is identified and publicized. The absence of a clearly defined monitoring mechanism with time limits for action means each Partner State is responsible for voluntarily removing or reforming listed NTBs without being subject to possible sanctions for non-compliance. The “moral suasion” approach to removing

Box 9.1. EAC Categories for Non-tariff Barriers

- **Category A:** NTBs with a low political and economic complexity and a low impact on EAC trade. Immediate Action required, consensus reached at EAC Council
- **Category B:** NTBs with a low political and economic complexity and a high impact on EAC trade. Short term (1–6 months) EAC Council consensus but no agreement on implementation
- **Category C:** NTBs with a high political and economic complexity and a high impact on EAC trade. Medium term (6–12 months) No political consensus as EAC Council
- **Category D:** NTBs with a high political and economic complexity and a low impact on EAC trade. Long Term (>12 months) No political consensus at EAC Council

NTBs within the EAC has, to date, failed to yield significant progress. This may be contrasted with the more formal legally binding mechanisms with sanctions that are practiced by the European Union.

At the national level the NMC is generally coordinated by either the Ministry of East African Affairs (Kenya) or the Ministry of Commerce (Rwanda and Uganda). The Ministry of East African Affairs does not have the capacity to analyze and review the identified NTB, and while the Ministry of Commerce may have more capacity to assess specific NTBs it does not have the mandate to make decisions on their modification or removal. In the absence of a transparent process for removing and reforming specific NTBs the National Monitoring Committees risk becoming ineffective “talk shops” as the same issues are repeatedly referred back to the EAC Council of Ministers for resolution.

The five members of the EAC all belong to the World Trade Organization (WTO). As such they have already committed to organizing their multilateral trade relations in a transparent and non-discriminatory manner with least trade restrictive regulations, within a legally binding and enforceable system. Linking specific reforms, such as removing NTBs, to high-level regional and multilateral commitments that already have buy-in, can assist in building support for the reduction and removal of NTBs and provides a basis for tackling difficult regulatory and procedural issues.

In Southern Africa, the SADC Ministry of Trade has established a transparent system for monitoring and ensuring compliance with the SADC Trade Protocol, which includes procedures for addressing reported barriers to trade including NTBs. The SADC Trade Monitoring and Compliance Mechanism (TMCM) requires all members to report all trade laws and regulations, and will function as a system for notification, consultations, and negotiation among Member States as well as for implementing judgments and sanctions determined by the dispute settlement system.

Policy Recommendations

The commitment of Partner States and the EAC Secretariat to reduce and remove NTBs has, to date, focused on identifying specific NTBs and establishing NMCs. Raising awareness and improving transparency over NTBs represent necessary first steps however, it is apparent from the lack of progress in removing NTBs in East Africa and elsewhere that they are not sufficient. At the Partner State level, a commitment to implement in full their commitments under the GATT 1994 Articles V, VIII, and X and the Agreements on Technical Barriers to Trade and Sanitary and PhytoSanitary measures would go a long way in advancing the EAC moves to promote a single market. Developing an effective program for reducing NTB requires governments, the private sector, and civil society to consider the following policy issues.

Firstly, all existing identified NTBs should be subjected to a WTO Compliance review to ensure that the measure is transparent, non-discriminatory, and minimizes trade restrictiveness. EAC Ministers could consider establishing a transparent rule that when a NTB is found to be non-compliant with the WTO the Partner State is required to abolish or modify the measure to ensure compliance within 12 months. This is consistent with each of the Partner States committing to implement their commitments under GATT 1994 Articles V, VIII, and X.

Table 9.1 > Examples of EAC Non-tariff Barriers Identified for Immediate Action

NTB Category	Summary Description	Objective	Potential for Non-Transparent & discriminatory application	Evidence/Scientific Basis	Alternative Measure
B	Non-recognition of EAC Rules and Certificates of Origin	Prevent trade diversion under the EAC FTA	High	Verification Missions	Apply risk assessment
A	Import Bans (Milk, day old chicks, beef, poultry)	Public Health	High	Inconsistent between imports and domestic production	Mutual recognition within EAC
B	Multiple Road Blocks	Prevent tax evasion on transit goods	High evidence of bribes	None	Document based controls at borders
D	Kenya levies charges on Plant Import Permit for Ugandan tea	Protection	Yes	None	Abolish levy
D	Kenya requires Ugandan tea to have a SPS certificate but does not recognize it	Public Health	Yes	Lack of confidence in UNBS certificates	Recognition of SPS certificates within EAC
B	Multiple weighbridges along Northern Corridor	Road Safety	High	None	Use risk assessment
B	Requirement for import license from the Ministry of Trade and Industry and a bond prior to Tanzania issuing excise duty stamps	Protection	Yes	None	Remove requirement
B	Discriminatory excise duty on cigarettes that do not have 75 per cent of Tanzanian tobacco	Domestic Content protection	Yes	None	Remove requirement
B	Landing certificates for exports from Kenya through Namanga issued by TRA in Arusha rather than at the border	Administrative	Yes	None	Abolish Landing Certificate requirement
B	Extra charges levied on Kenya pharmaceutical exports by Tanzania	Protection	Yes	None	Abolish requirement
B	Cotecna inspection required for imports to Tanzania	Undervaluation	Yes	None	Abolish requirement
B	Road Consignment note required from transporters prior to packing of goods	?	Yes	None	Abolish requirement
B	Corruption along Northern and Central Corridors at roadblocks, weighbridges, and borders		Yes	None	Increase transparency

Secondly, and with immediately effect, all proposed new regulatory measures/procedures should be required to be reported to the other Partners and the EAC Secretariat in advance to allow time (a minimum of 90 days) for consultation and review. When Partner States report new regulatory requirements or procedures to the EAC Secretariat and each other they should also notify the WTO. For simplification, the reporting requirements should be identical. The experience of the WTO, and the SPS and TBT Committees represent a relevant model for notification, reporting and discussion.

Thirdly, prior to any modifications or new technical regulations being announced, the Partner Country should undertake a regulatory impact analysis (RIA). While the RIA is widely used in developed economies it is rarely undertaken in developing countries. The RIA assesses the likely economic and social impact of a proposed regulation. Donors could potentially provide technical assistance to develop capacity for the EAC to undertake RIAs.

Fourthly, the EAC and Partner States should commit to ensuring all existing policies, regulations, administrative procedures, and any related fees and charges relating to the importation and export of goods are readily available through a publicized web site. Provision should also be made for all proposed changes to technical regulations to be posted on the web site with a facility for interested parties to submit comments.

Fifthly, EAC Partner States and the Secretariat should ensure that the dispute settlement system is in place and ready to address NTBs. It is recommended that the EAC consider adopting the SADC approach of linking the management of NTBs with a formal monitoring and compliance mechanism that allows for fast-track decision making and is linked to the formal dispute settlement mechanism with a legally binding outcome. The experience of the EU in establishing a legally binding mechanism with sanctions for non-compliance provides a relevant model.

References

- ASEAN. 2005. *Program for Regional Integration Support, Issues and Options for the Work Program to Eliminate Non-Tariff Barriers in AFTA*.
- EAC (East African Community), 2007. *NTB Elimination Plans for Kenya, Tanzania and Uganda*, Arusha, Tanzania.
- EAC. 2009. *An Evaluation of the Implementation and Impact of the East African Community Customs Union*. Final Report.
- East African Community Secretariat-East African Business Council (EAC-EABC). 2006. *Proposed Mechanism of the Elimination of Non-tariff Barriers in the EAC*. Arusha, Tanzania.
- Van Den Bossche, Peter. 2008. *The Law and Policy of the World Trade Organization: Text, Cases and Materials*, Second Edition.
- World Bank. 2008. *A Survey of Non-Tariff Measures in The East Asia and Pacific Region*. January.
- World Bank. 2008. *Non-Tariff Measures on Goods Trade in the East African Community: Synthesis Report*. October 10. Report No. 45708-AFR.

10. Non-tariff Barriers and Regional Standards in the EAC Dairy Sector

Michael Jensen and John Keyser⁴⁴

Introduction

The dairy industry of the East African Community (EAC) is one of the largest in Africa, and is an important part of the region's agricultural economy. Thousands of small farmers take part in the production of dairy products, and millions of consumers benefit from the health benefits brought by dairy products. In recent years, East African countries have been working to design and implement a set of regional health and production standards in order to help the dairy industry reach its full potential. Most stakeholders agree that standards should be developed by East African countries, because standards are important for health reasons and are necessary for maintaining a healthy population in the long-term. However, since almost all consumers in East Africa boil the milk before drinking it, the health risks from bacterial infection are actually quite low. Therefore, while standards are important, they need to be developed for the long run such that, in the short run, they allow small-scale producers to prosper.

Since imposing standards that small-scale producers are incapable of implementing is not useful from either a health or economic development perspective, dairy standards must be designed carefully, taking into account the technological and economic constraints in the region. This chapter examines the role that standards can play in promoting the healthy consumption of dairy products while at the same time helping the vibrant dairy industry to modernize and develop. The note begins by discussing the East African dairy industry and the current attempts to design standards, and concludes by outlining ways in which the World Bank and other stakeholders can work together in order to design and implement useful and long-lasting dairy standards that would take into account both health and economic considerations.

⁴⁴ Michael Jensen is Project Senior Researcher at the Danish Institute for International Studies. John Keyser is a Consultant at the Danish Institute for International Studies.

The Dairy Industry in East Africa

Although the East African dairy industry is quite large, dairying is a domestically focused activity, with only 10 percent to 20 percent of milk sold and distributed through formal channels and less than one percent of the region's milk products being exported. This domestic focus is mostly due to the unique production and transportation challenges facing the sector. Raw milk is a difficult product to trade, especially given the tropical temperatures in Africa and the lack of refrigeration infrastructure. Dairy products that are more easily tradable include milk powder, UHT milk, and luxury products such as cheese and yoghurt. Although intra-regional trade is in its infancy and the highly perishable nature of dairy products makes the development of a functioning regional market difficult, dairy trade has been growing strongly over the past several years, and the potential for expanding trade in dairy products exists.

In this context, agreements on production, transportation, and health standards relating to dairy products are essential, since low-quality dairy products can have negative health consequences and can reduce demand across the emerging regional dairy market. From a production and health perspective, standards specify the quality of dairy products in terms of fat content, purified water content, and bacterial count. From a transportation perspective, cross-border trade in dairy products is limited to a large degree by the technological capacity of the industry in each country, and growth in the dairy market can even be a catalyzing factor for bringing more advanced technology to the region. For example, producers with access to refrigeration systems are more likely to be able to transport and trade dairy products across relatively long distances. In markets where producers and consumer groups can agree on appropriate health and production standards, the consumer is more likely to receive a healthy product and producers can maintain access to a growing market. The rationale for designing and implementing a regional standards regime, therefore, is strong.

At the same time, implementing poorly designed standards can come at a high cost to market efficiency and product quality, and implementing standards that will not be upheld in practice is counterproductive. For example, laboratories might test milk to try to ensure the quality of dairy products, yet the vast majority of milk is consumed locally beyond the reach of formal conformity assessment procedures—80 percent of milk producers are part of the “informal market,” which is comprised of milk vendors, milk shop owners, and mini-processors. Conforming to standards is oftentimes costly for producers, and the average East African consumer would not be able to pay higher prices for milk if these costs were passed on. The fact that implementing standards will come with a price tag is an important first step in designing standards that will be mutually beneficial across the region, and increases the importance of designing standards that will strengthen the dairy market instead of constrain it.

A further issue is that standards may be misused. Vested interests sometimes try to manipulate standards and conformity assessment procedures in order to advance the sales of their own products and block market access for their competitors. Although international trade is only a small portion of overall dairy distribution, the influence of vested interests is particularly visible in this area. Dairy quality is assessed during border crossing procedures and the imposition of standards may be used as non-tariff barriers to trade. Harmonizing standards assessment procedures across the region could therefore help to facilitate the cross-border trade of healthier dairy products given that

the standards to be harmonized are carefully calibrated to the realities of the regional dairy industry.

Despite the need to overcome the challenges facing the dairy industry, implementing standards will not, on their own, develop the dairy industry to a world-class level or expand intra-regional trade. Like many issues in development, the utility of regulatory and oversight measures for economic growth is determined by their specific details. Standards that are designed taking into account the specific situations of producers and consumers can promote efficiency and safeguard public health, but poorly designed standards can lead to inefficient markets and can be sources of rent seeking for vested interests. The effective design and implementation of standards depends on the careful calibration of the standards with the needs of the countries setting them.

Current Efforts to Harmonize Standards in East Africa

The current effort for setting and harmonize standards in the EAC has been supported by a USAID-funded regional trade integration project. The rationale given for imposing standards on dairy products is that the consumption of raw milk poses health hazards, and regulating the production and transport of dairy products can lead to positive health outcomes across the region. Specifically, milk and other dairy products may cause harm if the microbial quality is poor and if zoonoses—diseases transferred from animals to humans—are present. A study by Omore et al. (2005) illustrates the potential health risk of consuming Kenyan dairy products, in which the microbial quality is generally poor and exceeds the international health standards by a large margin. This is due almost exclusively to the hot climate, the long distance some milk is transported, and the lack of refrigeration technology. Illustrating these trends, the authors found that, in general, the bacterial count of milk in Africa increased as distance from the milking site increased.

The new EAC dairy standards are largely based on the Codex Alimentarius, which are held as the best international standards. Although the health dimension of dairy standards is important, however, basing standards on the Codex Alimentarius is problematic since the Codex assumes that consumer incomes and production infrastructure are equivalent to Western levels. In practice, this means that dairy products have to be produced, stored, transported, and labeled in specific ways that adhere to the standards. For example, in developed countries people mainly consume fresh pasteurized milk, whereas in East Africa, most milk is consumed raw. Nevertheless, eight common EAC standards now exist for raw milk, pasteurized milk, UHT milk, powdered milk, sweetened and condensed milk, butter, yoghurt, and dairy ices and ice cream. None of these standards have been implemented and, apart from a few large-scale export-oriented producers, most traders, producers, and processors will not be able to comply with the standards.

There is also the question of whether the health hazard posed by high bacteria levels in East African milk is as dangerous as some critics claim. The argument for strong health standards is based on how milk is prepared for consumption in Africa. In developed countries, milk is almost always pasteurized, a process which removes much of the bacteria content. In Africa, most milk is consumed raw. While there is no doubt that contaminated milk is dangerous to the health of people consuming it, however, this observation does not take into account differences in Western and African consumption habits and practices. Indeed, the consumption habits of EAC consumers have so far prevented the low quality

of milk to become a health risk. In Africa, nearly all milk is boiled before it is consumed, which reduces the health risk of drinking bacterial pathogens to very low levels. According to a survey conducted by Omore et al. (2005), 100 percent of urban households and 96 percent of rural households sampled boil their milk before consumption.

In addition, most dairy sector policies and project interventions in the EAC region have been guided by a view that equates dairy sector competitiveness with modern value chain development. Until recently, small-scale milk traders who account for over 80 percent of total milk trade were largely overlooked in planning project strategies and were effectively regarded as something that needed to be stamped out to make room for improved linkages with modern dairy processors. While this negative view of small-scale traders has since moderated as result of policy dialogue with donor projects and other changes that came with market liberalization, small-scale milk traders continue to be regarded by many in the EAC region as a transitional part of the dairy landscape only. Consistent with this view, dairy projects have traditionally focused their efforts on improving linkages between small farmers and formal dairy processors. Due to these efforts, there has been a significant change of policy in Kenya (and to a lesser extent in Uganda), to endorse small-scale milk traders.

Because of the preference of most consumers in East Africa for low cost raw milk, a major challenge for value chain projects has been to make formal sector dairying more attractive. Indeed, one primary reason why small-scale informal milk traders are most popular among the rural and urban poor is because of more favorable pricing compared with formal sector channels. Dairy processors throughout the EAC region have so far been unable (or unwilling) to pay price premiums that would reward a farmer's investment in quality and various kinds of project support have been needed to promote the upgrades needed for formal sector marketing instead. Among other things this has meant showing farmers the financial benefits of improved silage making and better livestock care, training of farmers in animal husbandry and milk hygiene, establishment of artificial insemination service points, and work with dairy producer groups to identify market outlets and negotiate reliable supply contracts with dairy processors.

Fieldwork conducted in East Africa during December 2009 identified several problems with the standard-setting procedure. First, the standards setting process was driven mainly by international donors and the technical agencies, and did not consider the economic environment in which the small producers that make up the vast majority of the dairy industry operate; small producers account for 80 percent of the region's dairy production. Although some of the larger dairy producers in East Africa participated in the meetings, small producers and vendors were rarely consulted—the standards setting process involved mainly dairy technologists.

Second, some East African countries participated in the standards setting process without knowing about the quality of their milk, the needs of their small producers, or the technological and capacity challenges they would face in implementing and adhering to the new standards. Similarly, no assessment of economic and wider social impacts on small-scale producers or consumers was made. Therefore, while the emphasis on health and safety has been well intentioned, the actual process has not taken into account the wider context of long term and sustainable development in the region.

Despite these problems, there have also been some positive developments which indicate that there is the potential to implement real policy changes that can better address long term development issues. For example, there has been a significant change of policy in

Kenya (and to a lesser extent in Uganda) to endorse small-scale “informal” milk traders. These informal markets are important to the rural and urban poor because of more favorable pricing compared with formal sector channels. Therefore, evidence exists showing that enabling small producers to more effectively join the formal dairy sector could affect both health and economic considerations in the short and long run.

Policy Recommendations

These issues taken together demonstrate clearly that the current effort to implement dairy standards has not been successful. To the end of formulating standards that will promote health, welfare, and economic development into the future, stakeholders should consider the following policy issues.

In the context of the problems with the current set of dairy standards, a review of the standards designed so far should be undertaken to focus their usefulness and viability. A useful first step would be a review that ensures the standards meet both public health and market demands, especially with regard to maintaining the economic viability of small-scale producers. Standards which are not viable for economic or technological reasons, and that cannot be addressed by government or donor group assistance, should be jettisoned. Future efforts to set standards should take an incremental approach, recognizing the limitations that small producers have in terms of their ability to meet such standards as well as the importance of small producers to the East African dairy industry.

Regardless of the outcome of the review, the policy process that led to the adoption of the harmonized EAC standards should be improved. East African countries and the donors that support them should avoid importing policy measures designed for OECD countries without adjusting them to the realities in East Africa. In OECD countries Regulatory Impact Analysis (RIA) is increasingly being used to improve the knowledge base of policy makers. RIA considers economic and social factors that need to be explicitly considered when designing policy initiatives. RIA is a relatively new concept in developing countries. The use of RIA to document the economic and social impact should be considered in the EAC to comprehend the full consequences of measures affecting trade. Donors and international organizations with analytical expertise, like the World Bank, would need to support the development of a type of RIA suitable for East Africa.

After this review is carried out, in the short run the EAC could first focus on implementing the already agreed principle of mutual recognition of quality marks. The licensing system should also be reviewed and discussed, with an eventual transition to a system based on annual licenses. This system could also have increased efficiency by making it electronic or internet-based. In the medium term, if public health and/or market demand is established for another set of standards, these could be developed with the assistance of donors and international organizations. The FAO and the WHO could be consulted on the development of a standard for the unique product of the region: raw milk destined to be boiled before consumption. The implementation and conformity assessment procedures should be in accordance with the realities in the EAC region. However, it should be recognized that national agencies in East Africa must want reform; once requested, the assistance of donors and technical organizations will become more important.

In the longer term, East African countries should continue to expand their fundamental capacity-building effort. This will form the basis of increased regional trade. Work on

standards quality should be a cornerstone in capacity building but the approach should be incremental rather than an attempt to radically upgrade the industry. By creating the building blocks for quality in the supply chain little by little, East African dairy industries will in the long run be able to implement standards consistent with the international best practices in the Codex Alimentarius. An incremental approach is necessary especially given the questionable utility of a “top-down” approach to standards design. East African policy makers have generally attempted to learn from the most advanced dairy industries in the world, such as the United States and the EU. Due to technological and capacity constraints, however, the value of this is doubtful. Many developing countries have dairy industries that operate more efficiently than in the EAC and under more similar conditions regarding production, trade, processing, and consumption. India, for instance, has achieved phenomenal growth in dairy while relying on smallholders. An incremental approach to quality could be based along the following principles, taken from studies of the development of the Indian dairy industry:⁴⁵

- **Recognition of the crucial role of the informal market:** An estimated 70 percent of the marketed milk in India is sold in the informal market even after decades of rapid development. Demand for higher quality and diversified products is rapidly increasing as the Indian middle class expands. Yet the informal market and small-scale producers will constitute the backbone of the dairy industry for decades to come.
- **Listen to demand:** Most demand for milk, including from middle and upper income segments, is for traditional products such as dahi, paneer, butter, ghee, and Indian sweets. Demand for Western style products and quality has remained low. The laissez-faire approach of the Indian government towards the informal sector has allowed the dairy industry to respond constructively to demand and to expand. Today, India is no longer a net importer of dairy product, but a net exporter. Indeed, in 1998, India surpassed the United States to become the world’s largest milk producer.
- **Improve quality from the bottom up:** India has chosen to work on quality improvement by investing in production and trading practices in the long and often uncoordinated supply chains rather than attempting to upgrade the industry to Western standards. The focus on quality has been on basic hygiene issues, adulteration and similar simple quality issues for which basic capacity building is more important than the implementation of advanced food safety standards.

By expanding the East African dairy industry while solving basic quality problems first and at a speed that allows consumer demand to pay for the upgrading process, the process to design and implement standards that can address health and development issues for the long run can begin.

⁴⁵ Babcock Institute for International Dairy Research and Development 2006; Candler and Kumar 1998.

References

- Babcock Institute for International Dairy Research and Development. 2006. "The Dairy Sector of India: A Country Study." Babcock Institute Discussion Paper No. 2006-2;
- Candler, W. and N. Kumar. 1998. "India: The Dairy Revolution—The Impact of Dairy Development in India and the World Bank's Contribution." World Bank Operations Evaluation Department.
- Jensen, M. F. and J. C. Keyser. 2010. "Non-Tariff Measures on Goods Trade in the East African Community – Assessment of Regional Dairy Trade." World Bank.
- Leksmono, C., J. Young, N. Hooton, H. Muriuki, and D Romney. 2006. "Informal Traders Lock Horns with the Formal Industry: The role of research in pro-poor dairy policy shift in Kenya." Working Paper 266. Overseas Development Institute (ODI) and the International Livestock Research Institute (ILRI).
- Omoro, A., T. Lore, S. Staal, J. Kutwa, R Ouma, S. Arimi, and E. Kang'ethe, 2005. "Addressing the public health and quality concerns towards marketed milk in Kenya." SDP Research and Development Report No. 5. Smallholder Dairy (R&D) Project.

11. The Business Environment in Southern Africa: Issues in Trade and Market Integration

*Taye Mengistae*⁴⁶

Introduction

The Southern Africa Development Community (SADC) is an association of states promoting economic integration among the following countries: Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. The SADC has been a free trade area since 2008 and has an ambitious regional integration agenda that includes the establishment of a customs union by 2012. The free trade area provides for the elimination of import tariffs and nontariff barriers to trade among members and aims for, among other things, the harmonization of customs procedures and technical standards, and the liberalization of trade in services within the free trade area. Since 2006, the SADC has also had a Finance and Investment Protocol (FIP) that seeks to harmonize the policies of member countries in the areas of investment promotion, labor codes, and immigration laws, with the ultimate goal of developing the region into a “SADC Investment Zone.”

This chapter⁴⁷ examines the role of differences in business environments in impeding cross-border trade flows between Southern African countries. It also considers the cross-border integration of credit and labor markets based on microeconomic data on firms and households. The aim of the assessment is to help inform the policy and business environment harmonization agenda of the Community.

Trends in Trade Integration

SADC economies are far more integrated today within the region and with the global economy than they were in the mid-1990s. Most Favored Nation (MFN) tariffs have been reduced, intraregional trade flows have increased, and trade has risen as a share of GDP. On average,

⁴⁶ Taye Mengistae is a Senior Economist in the Africa Financial and Private Sector Development unit of the World Bank.

⁴⁷ This chapter is based on a larger report by a task team led by Taye Mengistae, “The Business Environment in Southern Africa: Issues in Trade and Market Integration,” The World Bank, 2010.

SADC countries export and import as much as would be expected relative to their income and distance from international and regional markets. Further, intra-SADC trade is relatively high in relation to what intraregional incomes and distance would predict. However, much of the increase in intraregional and extra regional trade occurred in the 1990s, and all indications are that progress has halted in recent years. In addition, substantial imbalances in trade flows persist. The South African Customs Union (SACU) continues to dominate intraregional trade flows, as both a destination for other SADC member exports and a source of their imports. Trade flows among non-SACU countries in the SADC area remain low.

Another feature of the nature of integration to date, posing a major policy challenge, is that, excluding South Africa, SADC exports to the rest of the world and within the SADC are comprised mainly of primary products, although Mauritius, Malawi, Swaziland, and Lesotho also export clothing and textile products. The high concentration in commodity-based exports has limited intra-industry trade flows and the productivity gains associated with the economies of scale and the diffusion of innovation that such flows facilitate. To realize productivity gains from intra-regional trade, many member countries need to diversify into nontraditional exports, including manufactured and service exports. Trade in manufactured goods and services is more sensitive to trade barriers and other cross-border transaction costs than the current trade in resource-based products. Its development in the region would therefore require greater openness to trade of member countries and significant reforms of the business environment within the region.

Adding to the urgency of diversifying members' exports is that most SADC countries are labor-surplus economies, and many face problems of high unemployment and widespread poverty. To successfully grow out of these problems many need to diversify production and exports into labor-intensive industries in manufacturing and services. Future progress in further trade integration within the region will indeed largely depend on how far member countries succeed in this type of diversification.

Business Environment and Trade Integration

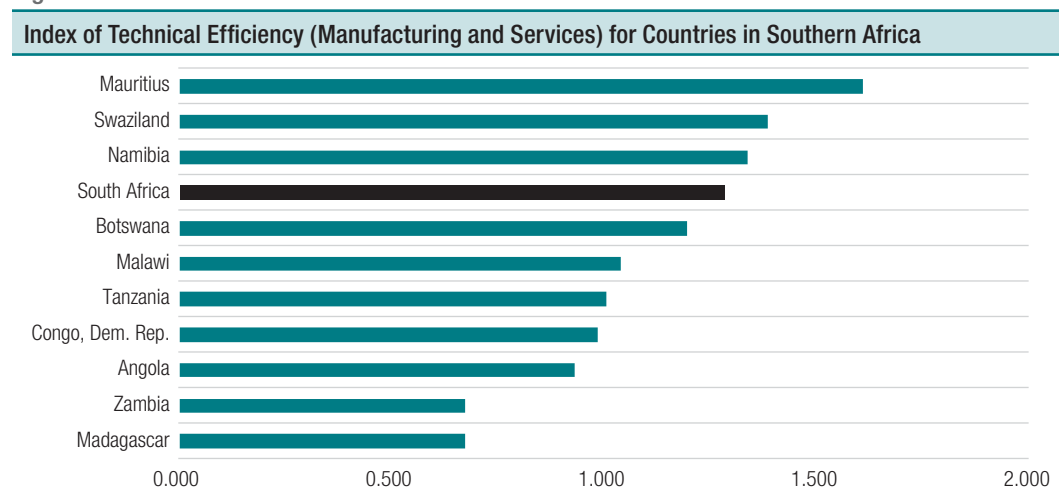
The cross-country differences in manufacturing productivity and exports that we observe today among SADC members have a great deal to do with differences in business environment. Specifically, more successful exporters of manufactures and services are, on average, more open to trade; have lower trade costs on account of more conducive geography and lower transport and regulatory costs; have lower regulatory barriers to business formation; provide better access to long-term finance; and have more reliable public utilities and better governance in the sense of having less corruption in government agencies. Above all, more successful exporters of manufactures and services suffer far less from allocative inefficiency resulting from disparities in access to long-term finance, public utilities, and to government services among sectors, business size groups, and entry cohorts, as they provide a more level playing field to everyone on those key dimensions of the business environment.

The top exporters of manufactures and services in the region currently are South Africa, Mauritius, Lesotho, Namibia, Swaziland, and Malawi. These are also among the most open to trade. All except Lesotho owe their exporting status to the higher productivity of their manufacturing sectors. On the other hand, Angola, the DRC, and Zambia have manufacturing and service sectors that are the least productive and least export-oriented in the region. One major source of the productivity gap between the two extremes of successful exporters of manufactures and services (South Africa, Mauritius, Namibia,

Swaziland, and Malawi), and non-exporters of the same (DRC, Angola, and Zambia), is differences in technical efficiency (Figure 11.1). Technical efficiency measures how efficiently an economy uses a given set of inputs; a higher score in Figure 11.1 shows higher efficiency.

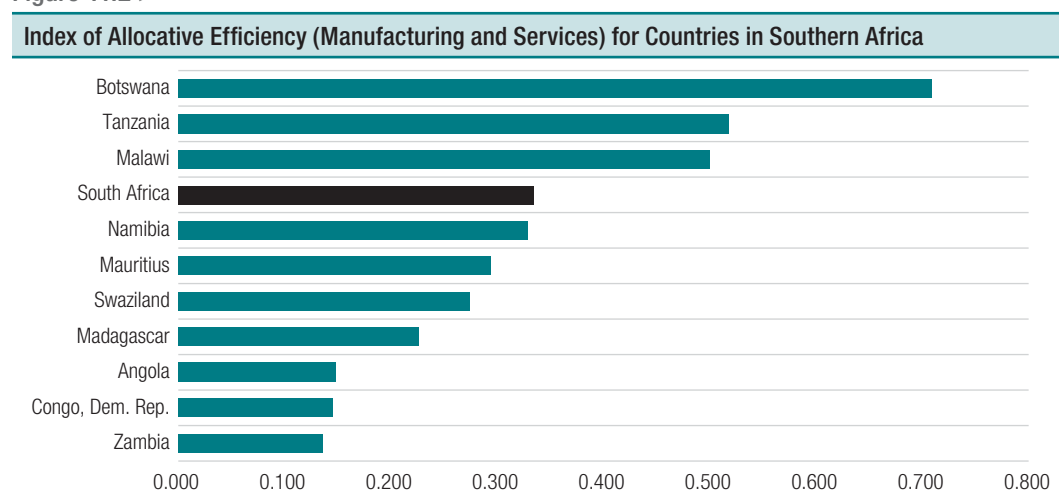
A second source of the manufacturing and services productivity gap between the two groups of countries is that, within the typical domestic industry, low productivity firms tend to have higher market shares in the non-exporting group than they would have in the group of successful exporters—a reflection of the lower allocative efficiency that characterizes industry in the non-exporting group (Figure 11.2). Allocative efficiency measures how efficiently an economy allocates available resources for production; a higher score in Figure 11.2 shows higher efficiency.

Figure 11.1 >



Source: World Bank Enterprise Surveys

Figure 11.2 >



Source: World Bank Enterprise Surveys

The relatively lower allocative efficiency of industries in the non-exporting group in turn is partly caused by the fact that there is greater in-country disparity of business environment in those countries than there is within the more successful exporters, where the playing field is more level for all firms regardless of how large they are, how long they have been in business, and where in the country and in which sector they are operating.

Business Environment Reforms and FDI

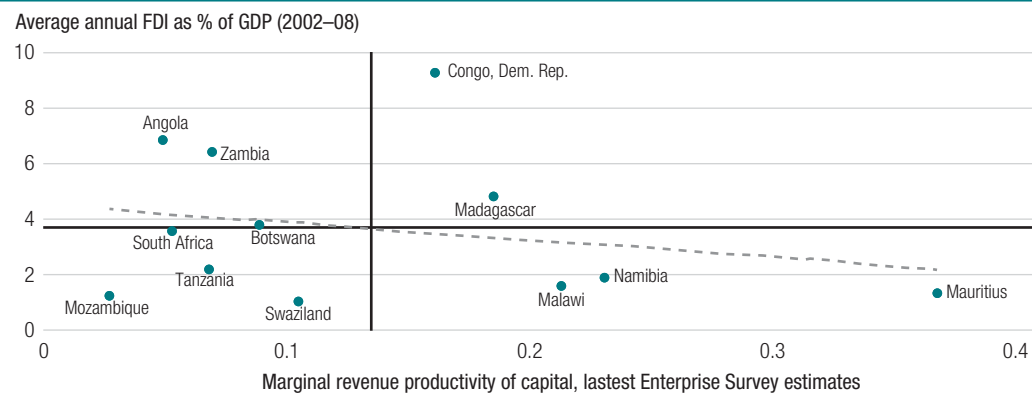
Cross-country differences in the business environment have also been a major factor in recent trends in inward foreign direct investment (FDI) in the region and in its allocation among member countries. In recent years SADC has attracted higher FDI on a per capita basis than most other developing regions (Figure 11.3). Though most of the inflow has been to mining, resource-poor countries have also attracted more than their share of FDI. In almost every case, FDI inflows have financed large shares of domestic savings and helped improve productivity, without which growth rates would have been significantly lower than they turned out to be.

However, given cross-country patterns in expected rates of return, Tanzania, Malawi, Mozambique, Swaziland, and Namibia should have attracted far more FDI than they actually did, while Angola, DRC, and Zambia are unlikely to sustain current levels of FDI as these far exceed those warranted by expected rates of return shown on the dashed line in Figure 5. Sustaining high levels of FDI in the second group and raising levels in the first group will require significant improvements in the countries' business environments. The type of improvements needed differ among countries, however. In at least one country (DRC), what is needed is reduction of investment risk through greater political stability. In almost all the others, there is an urgent need for reducing corruption and business start-up costs.

In the recent past, reforms that lowered start-up costs in Madagascar, Mauritius, and Mozambique have had drastically positive and visible impacts on FDI flows, while greater political stability in Zambia and Mauritius has had a similar effect in those countries. On the other hand, major declines in the control of corruption seem to have led to a sharp

Figure 11.3 >

FDI Inflows and the Marginal Productivity of Capital



Source: World Bank Enterprise Surveys.

fall in FDI in Namibia and Swaziland in the early 2000s. One indication of the scope for positive changes in these business environment factors is that start-up costs have steadily declined in nearly all resource-poor countries to converge with or to a lower point than the South African norm, while start-up costs are very high and have generally remained unchanged in most resource-rich countries.

DRC and Zimbabwe aside, the trend in the SADC as a whole has been one of members' convergence towards greater political stability, with steady improvements in every country's score on the stability index. Botswana, Mauritius, and Namibia are the most politically stable members; the larger countries—South Africa, Mozambique, Malawi, and Zambia—converge around something of a normal (or mean) score for the region.

On the other hand, there is not much evidence of convergence over time among SADC members in terms of control of corruption. Indeed, countries in the region fall into three distinct groups: relatively “corruption free” members, namely, Botswana, Mauritius, Namibia, Madagascar, and Lesotho; those with moderate corruption, namely, Zambia, Malawi, Mozambique, and Swaziland; and those where corruption is a serious problem—Angola, DRC, and Zimbabwe.

Issues in Financial Market Integration

Greater financial integration in the SADC should help improve the allocation of FDI and capital more generally within the region. It should also help promote trade integration. Some of the influence of business environment on investment and trade integration therefore occurs as an effect on financial integration and financial development.

At this point the level of financial integration is quite low, an indicator of which is the large variance in real interest rates among member countries: some have excessively high rates (Mozambique, Tanzania, and Zambia), while others report negative rates (DRC, Botswana, Madagascar, and Angola). Countries also vary hugely in terms availability of financial products and their accessibility to different sectors of the economy.

One major impediment to greater financial integration is that institutions of contract enforcement are weak in many member countries. The SADC scores lowest among all regions on time to enforce contracts, with Angola, Mozambique, Botswana, and Swaziland recording the longest times. Another barrier is that credit information is lacking in several countries, including DRC, Lesotho, Madagascar, Malawi, Tanzania, and Zambia. Capital controls constitute the third impediment. The SADC region has the most restrictions on capital flows, both in *de jure* measures of capital account restrictions and in *de facto* measures of actual capital flows during the past few years.

Employment Regulation and Labor Market Integration

Compared to other regions, employment contracts are not heavily regulated in the SADC. Seven countries have an overall Doing Business employment rigidity index that is well below the OECD average. The same index is below sub-Saharan Africa's average for three other members. However, there is enormous variation in the degree of employment regulation within the region itself. Angola, DRC, Zimbabwe, Botswana, and Madagascar regulate the labor market the most heavily. In Lesotho, Malawi, Mauritius, Swaziland, Namibia, and Zambia, employment contracts are the least regulated.

These differences in the intensity of labor regulation have significant implications for cross-country differences in employment and earnings, and for cross-country differences in trade integration. It is not by coincidence that the countries where employment is least regulated have attracted more FDI per capita and have more export-oriented manufacturing and service sectors than other member countries. Intraregional differences in employment regulation also generate differences in the price of labor and in labor market integration.

The reason for this linkage is that a country cannot sustain wage rates that exceed a global or regional norm unless it somehow restricts the flow of goods, services, capital, and people across its borders. Even where trade is restricted, labor market integration can be driven by the flow of capital among countries. When FDI is driven by a positive wage shock in the sending country labor market, it creates a link with the recipient country's labor markets. For example, FDI from South Africa to Zambia, motivated by a sudden rise in wages in South Africa, increases the demand for labor and, ultimately, wages in Zambia. International migration is another mechanism linking wages and labor markets across countries.

An evaluation of the extent of labor market integration involves measuring the speed with which wages in one country respond to shocks to the labor market in the rest of the region. The general rule for interpreting this measurement is that a faster adjustment indicates a more regionally integrated market. Such an evaluation shows that although South Africa has broadly integrated its labor market with others in the region, the depth of integration is still rather low. This reflects the fact that both trade and capital flows are far more restricted in the region than in places where there is greater cross-border labor market integration.

One such place is the U.S.–Mexican border, where a study showed that wages in Mexican border towns fully adjusted to wage shocks in the U.S. in around one month. This is 3.6 times shorter than the time it takes for wages in the Botswana, Namibia and Swaziland to fully adjust to wage shocks to the South African labor market. As would be expected, adjustments to the shock would take even longer as we move further away from South Africa's border. For example, it takes 5.5 months for Tanzanian wages and 11 months for wages in Mauritius to adjust to the same shock to South African wages.

Policy Recommendations

The key harmonization issues emerging from the diagnostics of the report concern import tariffs and nontariff barriers, competition policy, transport and other significant components of trade costs, provision of infrastructure, control of corruption, and access to finance.

Harmonizing Import Tariffs and Reducing Nontariff Barriers to Trade

Although average tariff rates are now quite modest in the region, the structure of MFN tariff rates vary significantly within the region, effective protection rates are quite high with a built-in anti export bias, many nontariff barriers remain in place within the FTA, and customs procedures have yet to be harmonized. As a result, the growth in regional and extra-regional trade has slowed down in recent years. There is thus an unfinished agenda for tariff reforms that should include the harmonization of MFN tariffs among SADC members and reduction of effective protection rates.

Developing and Harmonizing Competition Policies

As member countries liberalize intraregional trade and capital flows, care needs to be taken that first arrivals on the domestic scene from other parts of the region do not erect barriers to entry to domestic markets and domestic industries by design or otherwise. Combined with regionally harmonized trade policies, well crafted, effectively enforced, and regionally harmonized competition policies will help safeguard against such an outcome. At the moment South Africa is the only member country that has an internationally well-regarded competition policy regime. However, even it needs further competition policy reforms.

Reducing Trade Costs

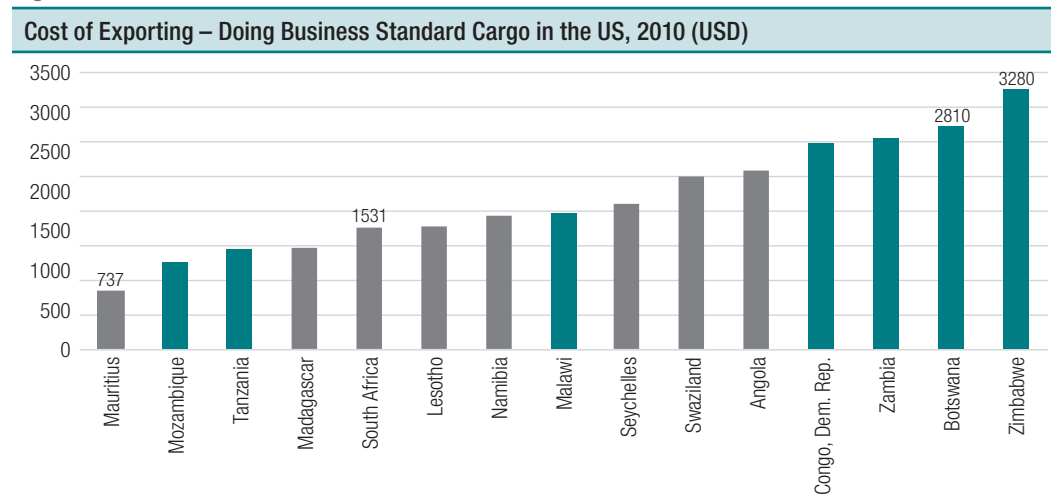
Perhaps the most prominent reason that intraregional and extra-regional trade in the SADC are not growing is that trade costs also remain high for reasons that are not necessarily related to trade policy. Trade costs are high, particularly in Angola, DRC, Zambia, Botswana, and Zimbabwe (Figure 11.4). High transport costs are often the main part of the problem, but problems with customs administration and regulatory costs of cross border transactions, and activities in general, are often major contributors.

In many countries, burdensome customs and trade regulations have added significantly to trade costs. In such countries there is a need to streamline clearance procedures as an important means of facilitating trade. Nearly everywhere there is a need to reduce transport costs by improving roads, railways and port services, although the specific means of achieving these differ from country to country.

Improving Power Supply

After freight transport and port facilities, power supply is the most important infrastructural obstacle to export diversification in many countries within the SADC. Power shortages are holding back manufacturing productivity and exports, particularly in Madagascar, Malawi, Angola, and Zambia. In each of these countries, start-ups can wait for months to

Figure 11.4 >



Source: Doing Business 2010

be connected to the public grid while established businesses report significant losses of revenue due to frequent outages. The proximate cause of the shortages in all of these cases is years of underinvestment in the power sector. As a result, governments have sought to promote large investments in maintenance and additional generating and transmission capacity.

The root causes of the shortages also include the deliberate under pricing of electricity, the failure of poorly managed state-owned operators to collect payments, and the absence of a workable legal and regulatory framework for private sector investment. Instituting cost recovery tariffs, establishing efficient billing and collection, and limiting transmission and distribution losses are also among the measures that some governments in the region are being advised to take.

Reducing Start-up Costs, Particularly in Resource-rich Countries

Although nearly all resource-poor countries have tried to lower business start-up costs, these costs as well as the time it takes to set up a company remain excessively high in all resource-rich countries. Governments should therefore carry out the administrative reforms needed to bring business start-up costs and set-up times down to international and regional norms.

Promoting Financial Development and Financial Integration

At the moment financial integration in the SADC is impeded by capital controls that are more stringent than in many other parts of the world, the lack of credit information in several member countries, and huge disparities in the quality of contract enforcement institutions among member countries. Improving availability of credit information, opening capital accounts, opening the banking industry to greater competition, and improving the quality of contract enforcement institutions are thus potentially important instruments for promoting financial development and financial integration in the region.

Monitoring Market Integration

In most SADC countries, government statistical agencies collect price data and household and labor force survey data with variable degrees of regularity and quality standards. Unfortunately, in many cases, the quality of data is so poor that they cannot be used to monitor the integration of regional goods markets or labor markets. And yet, well designed and disaggregated product price data are usually a more effective means of monitoring trade integration than are trade flows, and measures of labor market integration provide an indirect but quite powerful and indispensable indicators of barriers to trade and investment flows. Much effort has been expended by policy makers of member countries in negotiating mechanisms for achieving integration. To monitor these, sufficient investment needs to be made on collecting the price and labor market data needed to monitor integration in all member countries