Assessment of the Economic Partnership Agreement between South Africa and the European Union

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ABSTRACT

Trade agreements play a big part in international trade and have existed for as long as countries have been trading internationally. Countries often agree to sign a trade agreement with their trading partners because trade agreements can stimulate international trade by removing barriers. Trade agreements can also have a negative impact on a country, such as social injustice and economic inequality. South Africa has numerous trade agreements with various countries, one important agreement that South Africa is part of is the regional trade agreement between the European Union (EU) and the African, Caribbean and Pacific (ACP) countries which originated in 1976.

The Economic Partnership Agreement (EPA) is a preferential trade agreement which evolved from the Cotonou Agreement which came into force in 2000 and envisioned the creation of mutual trade agreements. When this agreement expired in 2007, the (EPA) was created. The main objective of the EPA's is to integrate the ACP countries into the world economy. The EU aims to combine trade, politics and development and enhance the political dimension of ACP countries by addressing issues such as corruption, poverty and inadequate development policies. The EU is in favour of the EPA because it will reduce the number of negotiations with various countries, which it currently holds simultaneously.

South Africa had some reservations regarding the EPA. South Africa is currently governed by the Trade, Development and Co-operation Agreement (TDCA), which was created with specific goals and also acts as a strategic partnership between the EU and South Africa. If the EPA is implemented in South Africa, it will replace certain elements of the TDCA agreement. South Africa has characteristics of both a developed and developing economy and will be excluded from several of the general trade arrangements of the EPA. The EU is offering duty-free and quota-free access for all the countries except for South Africa. This will result in two different SACU tariffs for imports from the EU. South Africa also argues that various discrepancies will arise between the EPA and TDCA which will cause various challenges regarding political, legal and technical aspects between Southern African countries and this will hinder regional integration amongst these countries.

There are various opinions as to which agreement will be more beneficial for South Africa. Where the EPA aims to create a single agreement for all ACP countries, the TDCA is an exclusive agreement between South Africa and the EU, and addresses issues specific to South Africa. The underlying problem is that South Africa has qualities of both a developed and a developing nation and is being excluded from some of the benefits that the EU is offering the other members. This rings some alarm bells, as South Africa and its neighbouring countries are working towards better regional integration. The EPA might have a negative influence on this regional integration because various African countries will benefit differently under the EPA.

This Study analyses the possible effects the EPA could have on South Africa's trade with the EU and South Africa's neighbouring countries by means of a literature study and an empirical analysis. The first part of literature study gives an overview on trade theories and trade agreements, advantages of free trade, trade barriers and the likeliness of countries to trade with each other. The second part provides an in depth overview of regional and preferential trade agreements and economic integration. The Third section of the literature study gives a complete overview of South Africa and the EU's economic and trade situation. The Fourth and final section of the literature study provides an overview of the TDCA and the EPA and compares the two agreements.

The literature study is followed by an empirical analysis and an overview of the gravity model. The empirical analysis studied the impact of trade barriers on the historic trade between South Africa and the EU using a gravity model as a basis. The gravity model was used as a base for the regression models, because it has proven to give accurate estimations in previous studies done with similar trade data. This study used data for each variable for the time period 2000 to 2010 and was sourced from the World Bank and the International Trade Centre but there are data limitations. Separate models were estimated for exports from South Africa to the EU and imports to SA from the EU. From the import regression results, it was clear that the coefficients were very small and should all tariffs be eliminated, there will not be a significant increase in imports to South Africa from the EU.

The export regression results were similar to the results of imports and indicated that if all tariffs should be eliminated with the implementation of the EPA, there will not be a significant increase in exports from South Africa to the EU. However the EPA stretches beyond only trade benefits and because the EU remains one of South Africa's biggest trade and development partners, it is vital to

consider the effects of the EPA. It does appear that the EPA's main motivator is not international trade, but that it is rather political and development orientated.

Key Words: Regional Integration, Economic Partnership Agreement, Trade Liberalisation, ACP-SA EPA

OPSOMMING

Handelsooreenkomste speel ‘n groot rol in internasionalehandel en bestaan sedert lande internasionaal met mekaar handeldryf. Lande sal dikwels ‘n handelsooreenkoms met hul handelsvennote onderteken aangesien handelsooreenkomste internasionalehandel kan bevorder deur hindernisse te verwyder. Handelsooreenkomste kan ook ‘n negatiewe impak op ‘n land hê, deur byvoorbeeld te aanleiding te gee tot sosiale onreg en ekonomiese ongelykheid. Suid-Afrika het vele handelsooreenkomste met verskeie lande. ‘n Belangrike ooreenkoms waarvan Suid-Afrika deel van uitmaak is die plaaslike handelooreenkoms tussen die Europese Unie (EU) en die Afrika, Karibiese Eilande en die Stille-Oseaan lande (*ACP*) wat in 1976 ontstaan het. Die Ekonomiese venootskaps ooreenmkoms (*EPA*) is ‘n voorkeur-handelsooreenkoms wat ontwikkel het vanuit die Cotonou-ooreenkoms (wat in 2000 in werking getree het). Die Cotonou-ooreenkoms het beoog om die skepping van wedersydse handelsooreenkomste tot stand te bring. Nadat hierdie ooreenkoms in 2007 tot ‘n einde gekom het, is die *EPA* gevestig. Die hoofdoel van die *EPA* is om die *ACP*-lande in die wêreldekonomie te integreer. Die EU beoog om handel, politiek en ontwikkeling te kombineer en die politiese sfeer van die ACP-lande te verbeter deur aanspraak te maak op kwessies soos korrupsie, armoede en onvoldoende ontwikkelingsbeleide. Die EU is ten gunste van die EPA, want dit sal die aantal onderhandelings met verskeie lande, wat tans plaasvind, verminder.

Suid-Afrika het voorbehoud teenoor die EPA. Suid-Afrika se Handel met die EU word tans deur die *Trade, Development and Co-operation Agreement* (TDCA) gereguleer, wat gevestig is met spesifieke doelwitte sowel as om ‘n strategiese vennootskap tussen die EU en Suid-Afrika te vestig. As die *EPA* in Suid-Afrika geïmplementeer word, sal dit sekere elemente van die *TDCA* vervang. Suid-Afrika het eienskappe van beide ‘n ontwikkelde en ontwikkelende land en sal nie kan baat vind by ‘n paar van die algemene handelvoordele van die *EPA* nie. Die EU bied belastingsvrye- en kwotavrye-toegang vir al die *ACP* lande, behalwe vir Suid-Afrika. Dit sal lei tot twee verskillende *SACU* tariewe vir invoere vanuit die EU. Suid-Afrika beweer ook dat verskeie teenstrydighede sal ontstaan tussen die *EPA* en die *TDCA*, wat verskeie uitdagings ten opsigte van politieke, regs en tegniese aspekte tussen die Suider-Afrikaanse lande sal veroorsaak.

Daar is verskeie opinies rakende watter ooreenkoms meer voordelig vir Suid-Afrika sal wees. Waar die EPA beoog om ‘n enkel ooreenkoms vir alle *ACP*-lande te skep, is die *TDCA* ‘n eksklusiewe

ooreenkoms tussen Suid-Afrika en die EU, en spreek kwessies aan wat spesifiek met Suid-Afrika te doen het. Die onderliggende probleem is dat Suid-Afrika eienskappe van beide ontwikkelde en ontwikkelende lande het en dus uitgesluit word vanuit die voordele wat die EU die ander lede bied. Hierdie is rede vir kommer, aangesien Suid-Afrika en sy buurlande in die rigting van beter streeksintegrasie werk. Die *EPA* kan ‘n negatiewe invloed op hierdie streeksintegrasie veroorsaak, omdat verskeie Afrikalande verskillende voordele onder die *EPA* sal hê.

Hierdie studie analiseer die moontlike gevolge wat die *EPA* op Suid-Afrika se handel met die EU en Suid-Afrika se buurlande kan hê deurmiddel van ‘n literatuurstudie sowel as ‘n empiriese analise. Die eerste deel van die literatuurstudie gee ‘n oorsig oor die handelsteorieë en handelsooreenkomste, voordele van vryehandel, handelhindernisse en die waarskynlikhede dat lande met mekaar handel dryf. Die tweede deel bied ‘n oorsig van streeksen begunstigende handelsooreenkomste asook ekonomiese integrasie. Die derde deel van die literatuurstudie gee ‘n volledige oorsig van Suid-Afrika en die EU se ekonomiese- en handelsituasie. Die vierde en finale deel van die literatuurstudie bied ‘n vergelykende oorsig van die *TDCA* en die *EPA* en ‘n se ooreenkomstes.

Die literatuurstudie word opgevolg deur ‘n empiriese analisering en oorsig van die gravitasie model. Die empiriese ontleding bestudeer die impak van handelshindernisse tussen Suid-Afrika en die EU in die verlede deur gebruik te maak van gravitasie model as basis. Die gravitasie model is gebruik as basis vir die regressie modelle, aangesien dit in vorige studies akkurate beramings gelewer het op soortgelyke handelsdata. Hierdie studie gebruik data vir elke veranderlike tussen die tydperk 2000-2010. Hoewel hierdie data verkry is vanaf die Wêreldbank en die Internasionale Handelssentrum is daar steeds data-beperkinge. Aparte modelle is beraam vir die uitvoer vanaf Suid-Afrika na die EU sowelo as die invoer vanuit die EU na Suid-Afrika. Uit die resultate van die invoer regressie, was dit duidelik dat die koëffisiënte baie klein was en indien alle tariewe uitgeskakel word daar nie ‘n beduidende toename in die invoer na Suid-Afrika vanuit die EU sal wees nie. Die uitvoerregressie-resultate was soortgelyk en dui aan dat indien alle tariewe uitgeskakel word met die implementering van die *EPA* daar nie ‘n beduidende toename in uitvoere vanaf Suid-Afrika na die EU sal wees nie. Die *EPA* strek verder as blote handelsvoordele en aangesien die EU een van Suid-Afrika se grootste handels- en ontwikkelingvennote bly, is dit noodsaaklik om die gevolge van die *EPA* in ag te neem. Dit blyk dat die *EPA* se belangrikste

motivering nie dié internasionale handel is nie, maar dat die *EPA* in teenstelling egter polities- en ontwikkelingsgeoriënteerd is.

Sleutel Woorde: Streeks integrasie, Ekonomiese venootskaps ooreenmkoms, Vrye Handel, ACP-SA EPA

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LIST OF ABBREVIATIONS

ACP – African Caribbean and Pacific countries

AR – Auto Regressive

ASEAN – Association of Southeast Asian Nations

AU – African Union

AVT – Average Applied Tariff

BLNS – Botswana, Lesotho, Namibia and Swaziland

BRICS – Countries of Brazil, Russia, India and China

CET – Common External Tariff

CFT – Container Port Traffic

CIA – Central Intelligence Agency

CMU – Common Monetary Union

CU – Customs Union

IMPV – Imports from the EU into SA

DAF – Department of Foreign Affaires

DIRCO - Department of International Relations and Cooperation

DPD – Dynamic Panel Data

DTI – Department of Trade and Industry

ECC – European Economic Community

ECB – European Central Bank

EDB – Ease of Doing Business

EFSF – European Financial Stability Facility

EPA – Economic Partnership Agreement

ESM – European Stabilization Mechanism

EU – European Union

EU 5 – European Union including France, Germany, Italy, Spain, United Kingdom

EU 5 + 3 – European Union including France, Germany, Italy, Spain, United Kingdom and Belgium, Luxembourg and the Netherlands

EU 15 – European Union including Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom

EXPV – Exports from to the EU from SA

FDI – Foreign Direct Investment

FTA – Free Trade Agreement

GDP – Gross National Product

GDP PC – Gross National Product Per Capita

GDP PPP – Gross National Product Purchasing Power Parity

GATT – General Agreement on Tariffs and Trade

GATS – General Agreement on Trade in Services

IEPA – Interim Economic Partnership Agreement

ICC – International Chamber of Commerce

IMF – International Monetary Fund

ITC – International Trade Centre

ITRISA – International Trade Institute of South Africa

LDC – Least Developed Countries

LPI – Logistics Performance Index

ML – Maximum Likelihood

MERCOSUR - Mercado Comúndel Sur (Common Market of the South)

MFN – Most Favourite Nation

NAFTA – North American Free Trade Agreement

NEPAD – New Partnership for Africa's Development

NICs – Newly Industrialised Countries

ODI – Overseas Development Institute

PTA – Preferential Trade Agreement

RTA – Regional Trade Agreement

SA – South Africa

SACU – South African Customs Union

SADC - Southern African Development Community

SADC EPA – Southern African Development Community Economic Partnership Agreement

SA Gov – South African Government

SARPN – Southern African Regional Poverty Network

SE – Standard Errors

TDCA – Trade Development and Cooperation Agreement

TRQ – Tariff Rate Quotas

UK – United Kingdom

UN – United Nations

USA – United States of America

VERs – Voluntary Export Restraints

WTO – World Trade Organisation

CHAPTER 1

OVERVIEW AND PROBLEM STATEMENT

1.1 INTRODUCTION

For as long as countries have been engaging in international trade, various trade agreements have existed between them, with regional trade agreements occurring most frequently. Trade agreements have the ability to stimulate international trade by removing trade barriers and making it more feasible for countries to trade with one another. However, trade agreements must be structured strategically to ensure that they remain beneficial for all members. Trade agreements can have negative impacts such as social injustice, cultural dispossession, environmental harm and economic inequality which should be avoided. For countries like South Africa, who are members of the World Trade Organization (WTO), trade agreements should also adhere to the rules specified by the WTO (Du Plessis, 2000; Easterly, 2002; Van den Bossche, 2005; Krugman & Obstfelt, 2009).

South Africa has several trade agreements with various countries. One important agreement that South Africa is part of is the regional trade agreement between the European Union (EU) and the African, Caribbean and Pacific (ACP) countries, which was created in 1976. This agreement came into the spotlight a few years ago because it did not comply with some of the rules set out by the WTO, as it gave one-way unilateral preferences for the ACP into the EU but was not reciprocal (Hinkle & Schiff, 2004; Perez, 2006).

According to the WTO, when engaging in regional trade agreements, developed countries like the EU may give unilateral preference to least developed countries (LDC) and developing countries, but this preference must be the same for all developing or LDC countries. In this case several developing countries that were not part of this EU-ACP agreement, protested. This agreement expired at the end of 2007 and a new trade agreement was established which was to comply with WTO rules. The new agreement, also referred to as an economic partnership agreement (EPA), has been accepted and signed by all the ACP countries except for South Africa and Namibia. This study aims to conduct in-depth study regarding the effects of this agreement on South Africa's trade, the economy as well as political implications of this agreement (Hinkle & Schiff, 2004; Van den Bossche, 2005; Perez, 2006).

1.2 BACKGROUND

1.2.1 Benefits of free trade

When a country engages in international trade, it benefits by means of economic growth, development and poverty reduction. This kind of integration into the world economy has been raising living standards and income levels (IMF, 2001). Trade liberalisation is associated with a rise in the current account of the balance of payments. It is also accompanied by a higher degree of exports, thus the volume of trade increases, which leads to growth in the GDP. There hence seems to be a positive effect between trade liberalisation and growth (Easterly, 2002; Krugman & Obstfelt, 2009; ITRISA, 2009).

Developing countries appear to gain more from trade liberalisation than more advanced economies. When developing countries start to engage in international trade, they gain access to investment and intermediate goods, which enable them to expand their scope of production. Trading internationally also includes the transfer of ideas and technology between countries. Having an open economy also means that developing countries have access to foreign savings which often help them overcome impediments and achieve better growth (Rodriguez & Rodrik, 2000: Bergoeing & Kehoe, 1999; Krugman, 1995).

Since trade liberalisation began in 1985, developing countries experienced a doubling in their trade shares (Greenaway, Morgan & Wright, 1997; Krugman & Obstfelt, 2009). It is thus beneficial for countries, especially developing countries, to try and increase their exports by means of creating of a free trade environment. Many barriers still exist that prevent trade from taking place. These barriers are usually trade instruments that include; tariffs, export subsidies, and non-tariff barriers such as health and safety standards, infrastructure limitations and administrative procedures like certification (Mimouni & Von Kirchbach, 2003). By using trade restrictions countries go against the basic principle of international trade namely: comparative advantage (Wall & Wall 1995). Although most countries strive towards free trade, there are still policies and agreements between countries to protect certain industries. These policies and agreements make use of trade instruments to control trade to some degree. The following section gives an overview of instruments of trade policy.

1.2.2 Instruments of trade policy

Various trade policy instruments can be used as trade barriers to control the openness of a country's economy (Feenstra, 2004). Tariffs are the most basic form of trade barriers and consist of a tax which is levied when a product is imported. Tariffs can either be specific (fixed charge per unit), ad valorem (charged as a fraction of the value) or a compound (combination of the two). A tariff increases the price of a product for the importing country and decreases the price for the exporting country. Small countries are affected more negatively than larger countries. Trade in a small country is reduced drastically by a tariff, as both imports and exports decrease after a tariff is imposed. When a foreign country imposes a tariff on a specific product, the consumers in the foreign country have to pay a higher price for that product and this decreases their welfare. The domestic producers also sell less and make less profit even if they have a comparative advantage in that product (Du Plessis, 2000; Feenstra, 2006; Suranovic, 2007; Krugman & Obstfelt, 2009).

An export subsidy is a grant from the government to a company or individual that exports specific goods or services. Export subsidies can either be specific or ad valorem, just like tariffs; however the effects of export subsidies on prices are the opposite of tariffs. In the exporting country the prices rise and in the importing country the prices fall. This enables producers in the exporting country to produce at lower costs and they can thus become more price-competitive in the international market (Feenstra, 2004; Suranovic, 2007; Krugman & Obstfelt, 2009). Table 1.1 provides a summary of the effects of trade barriers.

Table 1.1: Summary of the effects of trade barriers on the economy

EFFECTS OF TRADE POLICIES				
	Tariff	**Export Subsidy**	**Import Quota**	**VERS**
Producer surplus	Increases	Increases	Increases	Increases
Consumer surplus	Falls	Falls	Falls	Falls
Gov revenue	Increases	Falls	No change	No change
Overall welfare	Ambiguous	Falls	Ambiguous	Falls

Source: Krugman & Obstfelt (2009:200).

1.2.3 South Africa and trade barriers

In the past decade South Africa has undergone great liberalisation with regards to trade. Historically, South Africa had high tariffs and extensive import controls with several formal import quotas (SA Gov., 2010; DTI, 2011). When the idea that trade stimulates growth was first introduced, import tariffs, import licensing procedures as well as quantitative restrictions have been eliminated or reduced. Countries have been implementing various export promotion strategies to encourage international trade. One of these strategies which enable a country to stimulate international trade and create a more liberated market is to undertake free trade agreements with countries (Jonsson & Subramanian, 2001; Manger, 2009).

1.3 REGIONAL TRADE AGREEMENTS (RTA)

A regional trade agreement (RTA), also known as regionalism is an agreement where several countries agree to eliminate most trade barriers among themselves to liberalize and facilitate trade. These countries agree on eliminating trade barriers between themselves, but still maintain tariffs against other counties, which are not part of this regional trade agreement. Regional trade agreements can be bilateral but most have at least three members who usually (but not always) form a segment which is bound together by geographical, social, cultural, political or economic ties (Venter & Neuland, 2007).

RTAs have become more popular amongst trading nations and the majority of WTO members belong to some RTAs (Venter & Neuland, 2007). According to Perdikis (2006), the WTO encourages trade liberalisation and thus specifies that countries, who do not have geographical proximity, may conduct RTAs. RTAs stretch beyond countries reducing tariffs and quotas. Countries partaking in RTAs may adopt harmonized health and safety standards, environmental policy and even common customs rules and administration. These trade agreements are permitted under Article XIV of the GATT. In this Article, it is specified that countries may enter into regional trade agreements, however they may not jointly increase their tariffs against outside countries (Feenstra & Taylor, 2008).

There are four main types of integration, namely a free trade area (FTA), a customs union, a common market and an economic union (Du Plessis, 2000; ITRISA, 2009). A free trade area is where all members agree to eliminate trade barriers with each other for one or several products.

Although all members must agree to eliminate trade barriers, each member is still able to pursue individual trade policy with non-member countries. A customs union is an FTA, except members are obligated to utilize one common trade policy for non-member countries. This trade policy is usually in the form of a common external tariff (CET). A common market is in essence the same as a customs union. However, it encourages a higher level of trade liberalisation by allowing the free movement of capital and labour as well as of goods and services (ITRISA, 2009).

The most advanced regional integration is an economic union like the European Union, where all the members harmonize their monetary and fiscal policies and broaden their economic and social legislation. This is the most advanced form of a regional trade agreement (RTA) as it enables firms and workers who engage in economic activities in the union, to have the same economic conditions (Du Plessis, 2000; Venter & Neuland, 2007; ITRISA, 2009). Trade agreements can have various effects on a country and its economy. There are two main effects of trade agreements. They are trade creation and trade diversion. The following section of this chapter discusses trade creation and trade diversion.

1.3.2 Trade creation versus trade diversion

Regional trade agreements often increase trade between members. There are two types of trade increases, namely trade creation and trade diversion. Trade creation takes place when a member country starts to import a product, from another member country, which it previously used to produce for itself. Trade creation brings welfare gains to both the importing and exporting country by creating a gain in consumer surplus for the importing country and a gain in producer surplus for the exporting country. This is because more goods are available at a lower price and sales increase. Trade creation does not affect countries which are not part of the agreement. Trade diversion on the other hand occurs when a member country starts to import a product from another member country, which it previously imported from a country outside the agreement. Although this might benefit the exporting member country, the country outside the agreement is worse off than previously (Di Mauro, 2000; Kyambalesa & Houngnikpo, 2006; Krugman & Obstfelt, 2009).

It is evident that integration can benefit a country's economy. Benefits of integration often stretch far beyond only economic benefits. Social, security, technological and political factors also play an

important role. What influence will the EPA have on South Africa and the EU? The subsequent part of this chapter gives an overview of South Africa and the European Union (EU).

1.3.3 South Africa and the European Union

South Africa's international economic relations include a wide variety of arrangements including various bilateral agreements and multilateral agreements. South Africa was one of the original contracting parties to the first General Agreement on Tariffs and Trade (GATT) in 1947 and became a founding member of the World Trade Organization (WTO) in 1995 (Van den Bossche, 2005). Soon after the Uruguay round of multi-lateral negotiations, South Africa signed the General Agreement on Trade in Services (GATS). South Africa is also a member of SACU, the South African Customs Union and SADC, the Southern African Development Community and CMA, the Common Monetary Area (Bethlehem, 2008).

The European Union (EU) is different from South Africa, It is a lot more advanced and developed. The EU has the most advanced economic integration and often serves as a model union for other countries which aspire towards economic integration. The EU has in the last decade achieved many economic goals including a full customs union (CU), a good economic sphere where decision making was voluntarily surrendered to various collective agencies. The CU in the EU abolished many customs duties and other restrictions, while creating common and reduced external tariffs on imports (EC, 2011). In 2008 the global economic crises hit the EU. The European debt crisis is a big problem for the global economy. The crisis was mainly caused due to the EU not being able to pay the debts acquired in recent years. Europe now faces four main correlated economic challenges, high debt levels and public deficits in some countries, weaknesses in their banking systems, high unemployment in some countries and economic recessions as well as persistent trade imbalances. This might cause potential problems for the EPA agreement between the EU and SA (Bethlehem, 2008; EC, 2011).

South Africa is the EU's largest and most significant trading partners in Africa and over the past decade South Africa's exports to the EU have been increasing and are becoming more diverse. South Africa is progressively moving towards more manufactured products. This could be due to South Africa implementing the TDCA agreement with the EU, which has facilitated trade liberalisation and allowed South Africa to gradually open up their markets for trade with the EU.

The trade relationship that South Africa shares with the EU is very significant mainly because the EU is such an important trading partner for South Africa. Since SA signed the TDCA there has been a significant growth in SA's trade, however the TDCA agreement was implemented around the same time that the sanctions against SA were lifted, so it is hard to determine if the TDCA was responsible for this growth. If the EPA agreement is implemented in SA, it will replace the TDCA agreement (Andriamananjara & Hillberry, 2001; Grant, 2008). The following section gives an overview of the EPA.

1.4 ECONOMIC PARTNERSHIP AGREEMENTS (EPA'S)

Economic partnership agreements (EPA's) are regional free trade agreements between the European Union and the African, Caribbean and Pacific (ACP) countries. EPA's were signed in Cotonou in 2000 and were to succeed the ACP-EEC agreement signed at Lomé. The ACP's consist of nearly 77 developing countries, of which many are least developed countries (LDC). These ACP countries were able to enjoy a unique relationship with the EU, which granted them tariff preference and enabled them to export to the EU free from any permits or duties. The EU went a step further and the ACP countries have received billions dollars in technical and financial aid which was meant to compensate for the possibility of any export losses which may have occurred (Hurt, 2003; Meyn, 2004; Borrmann & Busse, 2007).

These new agreements are being implemented to replace the previous Lomé agreement which did not fully comply with the World Trade Organization's rules. One of the main reasons was that this agreement gave unilateral preferences for the ACP countries into the EU. Another problem which arose was that, according to the WTO rules, regional trade rules state that developed countries like the EU may only give preference to two groups, least developed counties and developing countries. While some agreements under the Lomé convention were not restricted to LDC nor were they granted to all developing countries (Meyn, 2004; Borrmann & Busse, 2007; Venter & Neuland, 2007).

The main objective of the EPA's is to promote sustainable development and thus contribute to eradicate poverty in the ACP by enabling developing countries to integrate into the world economy. This agreement is also different in the sense that it enables the EU to provide development assistance and thus support these developing countries even further. The EU aims to combine trade, politics and development and enhance the political dimension of ACP countries by addressing issues

such as corruption, poverty and inadequate development policies (Hurt, 2003; Borrmann & Busse, 2007).

Although the new agreements seem to have added benefits, there are still many challenges and risks faced by the ACP countries. The ACP countries will have to be well prepared and implement policies to ensure that they achieve a pro-development outcome. To comply with the WTO rules, ACP countries will have to open their markets for EU exports in the next 12 years, which can result in losses of tariff revenue, trade diversion and increased competition. ACP countries will face challenges with regards to limited negotiation capacity and the need to improve market access for agricultural products which are still a great difficulty in trade negotiations (Hinkle & Schiff, 2004).

1.4.1 EPA's and Africa

The EU is in favour of the EPA because it hopes to promote regional integration in Africa, but also hopes to reduce the number of negotiations with various countries, which it currently holds simultaneously. The fact that many African countries belong to various other regional trade agreements causes a huge overlapping of these regional groupings. Only 6 out of 53 African countries belong to only one regional community, 26 belong to two communities, while 20 are members of 3 communities, while the Democratic Republic of Congo belongs to four groups (Karingi *et al.*, 2009).

This makes it very difficult when establishing different trade benefits for different groups. A specific country may be eligible for duty free exports to the EU for certain products under a specific regional agreements, while at the same time, that country may be part of another regional group that does not enjoy the same benefits. One option that could lessen this problem is that intra-African trade should first be deepened and expanded before they establish trade agreements with the rest of the world. The overlapping trade agreements could prove to be a big challenge for the EPA. This is especially difficult because LCD countries will have additional benefits compared to non-LCD countries. The EPA should consider this and ensure that the LCD countries are not disadvantages and take advantage of by non-LCD countries. Rules of origin will have to be carefully specified to ensure that trade between ACP countries is not negatively influenced (Lee, 2003; SADC, 2010). Since South Africa is often seen as the centre of trade in Africa, the EPA being implemented in

South Africa will have an influence on trade of its neighbouring countries. The following part of this chapter gives an overview of the EPA and South Africa.

1.4.2 EPA and South Africa

Economic relations between the EU and South Africa commenced more than a decade ago, when South Africa was a contracting party to the fourth Lomé convention. This convention only came into force on 1 June 1998 and expired in February 2000. This convention was succeeded by the Cotonou agreement, between the EU and ACP, which was signed on 23 June 2000, entered into force in 2003 and was to continue until February 2020 (Bethlehem, 2008).

South Africa is governed by protocol 3 (Bethlehem, 2008) which states that because South Africa had characteristics of both a developed and developing economy it is excluded from the general trade arrangements and may not receive any financial assistance from the EU. Trade between South Africa and the EU is currently governed by the TDCA and is benefiting to a great extent with the TDCA and thus already enjoys most of the advantages that the EPA promises. The TDCA was created with specific goals and because the TDCA is between EU and SA only, it does not have much influence on the trade between SA and its neighbouring countries, which should eliminated the issues of overlapping trade agreements. Due to the fact that these countries already have trade agreements amongst each other, it is important to take this into consideration when analysing how the EPA will influence SA, and its trade (Grant, 2008).

The EU is offering duty-free and quota-free access for all the countries except for South Africa. This will result in two different SACU tariffs for imports from the EU; one for the EPA counties and the other for South Africa. South Africa also argues that various discrepancies will arise between the EPA and TDCA which will cause various challenges regarding political, legal and technical aspects between Southern African countries. This will hinder regional integration amongst these countries. Southern Africa will have to extend any concessions to the EU and this might intimidate and limit the scope of various agreements (EC, 2000; Grant, 2008).

1.5 PROBLEM STATEMENT AND MOTIVATION

There are many benefits for countries who engage in international trade. One way of stimulating trade is to promote a freer and open economy. South Africa and the EU have had various trade agreements over the last decades and the EU is one of South Africa's leading trade and development

partners. Currently the trade relationship between the EU and South Africa is governed by the TDCA agreement, which has shown some positive effects on SA's trade and development. However, the TDCA was implemented at a time where the sanctions imposed against SA were lifted, so the true effects of the TDCA are difficult to calculate. If South Africa implements the EPA, the majority of the TDCA agreement will be replaced by the EPA (Grant, 2008; Bethlehem, 2008).

There are different assumptions as to which agreement will be more beneficial for South Africa. Where the EPA aims to create a single agreement for all ACP countries, the TDCA is an exclusive agreement between SA and the EU and addresses issues specific to South Africa. The underlying problem is that South Africa has qualities of both developed and developing nations and is being excluded from some of the benefits that the EU is offering the other members. This rings some alarm bells, as SA and its neighbouring countries are working towards better regional integration. The EPA might have a negative influence on this regional integration because various African countries will enjoy different benefits under the EPA.

South Africa is thus insisting on a common external tariff (CET) for the South African region and was not as keen on signing the agreement as the other SADC and SACU members were. This has caused tensions between South Africa and the other members of SACU and SADC who have already sign the agreement. There are speculations that unless this problem is solved, SACU could experience severe problems and this can hinder development and cause political upheavals between members (Grant, 2008; Kyambalesa and Houngnikpo; 2006; Bethlehem, 2008). The problem statement of this study is what impact will the EPA have on South Africa's trade with the EU? And what impact will the EPA have on trade between South Africa and its neighbouring countries?

1.6 RESEARCH OBJECTIVES

This study has primary and secondary objectives:

PRIMARY OBJECTIVE:

- To provide an in depth overview of the possible effects the EPA can have on South Africa's trade with the EU and its neighbouring countries.

SECONDARY OBJECTIVES:

- To provide a complete literature overview of trade theories and trade agreements
- To provide an overview of the Economic Partnership Agreement
- To provide an overview of the European Union and South Africa and their trade with each other.
- To provide an overview of the TDCA and the effects of replacing the TDCA with the EPA
- To aim to empirically analyse the impact of trade barriers on the historic trade between SA and the EU

1.7 RESEARCH METHOD

1.7.1 Method for literature overviews

This study consists of an in-depth literature study focusing on trade barriers, trade agreements and integration. The study focuses on regional trade agreements and the effects of these agreements on the member countries. The purpose of this in depth literature study is to gain a better understanding of trade agreements, to be able to understand the EPA. Previous publications were consulted with specific emphasis on regional integration on previous publications on regional integration. This study specifically focuses on comparing previous effects of regional trade agreements between South Africa and the EU with each other, in order to try and establish the possible effects that the EPA could have on South Africa.

1.7.2 Method for empirical analysis

This study also includes a regression model based on the gravity model which shows the effects of trade barriers (tariff and non-tariff) on the trade between South Africa and the EU. The models will be estimated using the statistical program oxmetrics. Separate models are estimated for South Africa's imports from the EU as well as for South Africa's exports to the EU. The main reason for this is to understand what the influence of the EPA would be on imports as well as exports and not on the total trade balance. Data was collected from the World Bank and the International Trade Centre's Trade Map database.

1.8 DIVISION OF CHAPTERS

Chapter one gives an overview and problem statement. The introduction provides information on the background of the study, the problem statement and its motivation. Chapter two provides a literature overview on trade theories and trade agreements. This section provides the theoretical overview of the literature and policy on trade policies, regional trade agreement and preferential trade agreements. Chapter three gives a complete overview of the EPA. This chapter provides an overview of the theory and dynamics of trade agreements, especially preferential and regional trade agreements. The aim of this chapter is to provide a clear understanding about the Economic Partnership Agreement and how it will affect the South Africa and the ACP countries. Chapter four provides a complete overview of South Africa and the EU. This chapter provides a country profile for South Africa and the EU and an overview of the value and volume of South Africa's trade, focusing on the trade in goods, services and FDI between South Africa and the EU. Chapter five focuses on the effects of replacing the TDCA with the EPA. This chapter gives an overview on the TDCA and compares the TDCA to the EPA to establish what the effect of replacing the TDCA with the EPA will be. Chapter six consists of an empirical analysis of the EPA's effects of South Africa's trade. A regression model based on the gravity equation is used to determine the effects of barriers on trade. Chapter seven consists of the summary of the study, the conclusion as well as recommendation.

CHAPTER 2

LITERATURE OVERVIEW: TRADE THEORIES AND TRADE AGREEMENTS

2.1 INTRODUCTION

Trade theories have been around for nearly as long as international trade has been around for, since economists and policy makers try to pin point the best possible theoretical solution which will enable countries to gain the maximum benefits from the resources available to them. As global trade increased, certain countries with common interests started engaging in trade agreements with one another to better benefit from trade. Currently trade agreements are very common and stretch a lot deeper than purely economic gains. This chapter provides the underlying theoretical overview of trade theories and trade agreements, which give a better understanding of how the Economic Partnership Agreement (EPA) will affect South Africa (SA), the international trade and the economy (Du Plessis, 2000; Krugman & Obstfelt, 2009).

In section 2.2 the definitions of the terms used in subsequent chapters are provided and thereafter the development of trade theories is discussed. Section 2.3 provides a background on trade theories ranging from Mercantilism up to new trade theories. Section 2.4 discusses the benefits of trading internationally. Section 2.5 analyses the likeliness of countries that will trade with each other and section 2.6 gives an overview of trade instruments. Section 2.7 gives an overview of trade agreements and finally section 2.8 provides a conclusion.

2.2 DEFINITIONS

To provide an understanding regarding the terms used in this study, a brief definition is given.

- "*Economic* can be defined as anything relating to an economy, concerning or affecting material resources or wealth; concerned with or related to necessities of life" (Online Etymology Dictionary, 2010).
- "*Integration* is explained as the act of combining or adding parts to make a unified whole; organization into a unified pattern" (Collins English Dictionary, 2003).
- "*Trade* is the act or an instance of buying and selling goods and services either on the domestic (wholesale and retail) markets or on the international (import, export and entrepôt) markets or the exchange of one thing for another" (Collins English Dictionary, 2003).

- "*Free* is defined as the ability to act at will; not under compulsion or restraint; autonomous or independent (of a country); not subject to or restricted by some regulation or constraint exempt: *a free market*" (Collins English Dictionary, 1994).
- *Regionalism* is described by Bach (1999), as "the adoption of a regional project by a formal regional economic organization designed to improve the political, economic, cultural, social and security of member states".
- *Regionalization* is "the process by which state and non-state members seek to improve their economic, political, cultural, social and security interactions within the regional area via formal or informal structures" Bach (1999).
- *Economies of scale:* "increase in production (mass production) diminishes the cost per unit produced" (Collins English Dictionary, 2003).
- *Entrepôt: "*Intermediary storage facility (warehouse) where goods are temporarily stored for distribution within a country for re-export" (Bach, 1999).

The subsequent part of this chapter discusses trade theories.

2.3 TRADE THEORIES

International trade evolved when countries realised that it was more efficient and beneficial for both countries to produce a limited amount of goods and exchange the rest. These theories were first discussed by Adam Smith with his publication the *Wealth of Nations* (1776) and by David Ricardo in his book, *Principles of Economics* (1951). Today the theories of Smith and Ricardo are known as the standard theory of international trade. After Smith and Ricardo various theories evolved, which provided countries with ways to allocate their resources in order to achieve optimal levels of output and thus maximise their opportunities for trade (Hettne & Soderbaum, 2002; Sen, 2010).

It is necessary to understand how trade theories evolved as this forms a basis for many arguments for and against free trade and regionalism. Free trade and regionalism form an integral part of the question this study is addressing, namely how will the EPA affect the trade between the EU and SA? This part of the chapter provides a theoretical background on various traditional trade theories which evolved over the past decades and provide an understanding as to why certain theories developed and how they influence countries' trade.

2.3.1 Mercantilism, absolute and comparative advantage theories

It is proven that when a country engages in international trade, it enjoys benefits like enhanced economic growth. The first traditional trade theory is Mercantilism, where countries aimed to create a favourable trade balance (Du Plessis, Smit & McCarthy, 2000). Historically, the best way for a country to become rich was to export more than it imported and generate global payment inflows. This payment was used to buy various supplies to equip armies and acquire colonies. Mercantilism was encouraged by the government, who stimulated exports and restricted imports and held the belief that not all nations should have an export surplus at the same time. Therefore, a nation could only gain at the expense of another country (Bergoeing & Kehoe, 1999; Sen, 2010).

Adam Smith was the first to challenge Mercantilism, when his book, *Wealth of Nations* was published in 1776. He stated that: "*It is the maxim of every prudent master of a family never to make at home what will cost him more to make than to buy*" (Smith, 1776: 264). This created a new approach to international trade theories and the absolute and comparative advantage theories developed. Smith's theory was based on the fact that countries have different abilities and weaknesses when it comes to their ability to produce goods. When a country is able to produce something more efficiently and cheaply, this country has an absolute advantage in that particular product and should produce and export it, while importing everything else. David Ricardo had a similar theory in his book, *The Principles of Political Economy* (1951).

Together, Smith and Ricardo argued that countries should partake in free and unrestricted trade and nations should produce those products in which they had an absolute advantage or comparative advantage. Their theories of absolute and comparative advantage based on the concept of "*laissez-faire*", meaning non–interference (from government), were born. Their main argument was that countries should produce those goods that they could produce most cheaply and import the rest. Their main focus was on the consumer, who they felt should be able to buy goods in the market which is offering them at the lowest price (Kreinin, 2006). In 1990, Michael Porter added another dimension to Ricardo's theories.

2.3.2 Porter's competitive advantage theory

A renowned American marketing expert, Porter stated that when a country is able to produce exactly the same benefits as its competitors, but do so at a lower cost or deliver much more desirable

benefits, it has a cost advantage or a differentiation advantage respectively. This enables countries to create superior value for consumers and more profit for itself (Porter, 1990).

However, for countries to have the ability to compete internationally and be successful, it is required that they have the following factors of production: adequate links to supporting industries like government aid and transport; reliable suppliers; an effective business operation; meaningful and implementable strategies for international expansion.

If any of these factors are missing, the country will be more likely to rely on imports and not have a cost or differentiated advantage (ITRISA, 2009; Du Plessis *et al*., 2000). Linder, a Swedish economist had another idea about countries and their international trade. He suggested that a country must already have a large domestic market and expand the product to other countries, thus causing a spill-over effect (Linder, 1961).

2.3.3 Linder's spill-over theory

Linder put forward that for a country to be able to start exporting a certain product, they must already have a large domestic market for that product, thus creating what he called the "*spill-over*" theory. When a product is well established in the domestic market and has a large demand in that country, it "*spills-over*" into its neighbouring countries' markets. His theory also stated that trade mostly takes place between countries that have similar market structures. This theory was challenged by the experience of newly industrialized countries (NICs) that grew as rapidly by belligerently marketing their products in foreign markets. This was in contrast to what Linder's theory suggested (Krugman & Obstfelt, 2009; ITRISA, 2009).

The main explanation for this is that many countries have very small domestic markets and the only way for them to achieve economies of scale was to export their products to foreign markets and thus gain enough returns (Du Plessis, 2000; Krugman & Obstfelt, 2009). His theory was soon to be challenged by two other Swedish economists, Heckscher and Ohlin.

2.3.4 Heckscher-Ohlin theory

In 1930, Eli Hekscher and Bertil Ohlin developed a theory, the Heckscher-Ohlin theory which was built on the theory of comparative advantage and stated that most international trade patterns are determined by factors of production available to countries. Countries could either be labour

intensive or capital intensive, and will thus lean towards specialising in the production of those goods that it is better endowed in. A country that has an abundance of capital will thus rather produce capital intensive (Germany) goods like computers or cell-phones, while a country that has more labour, will likely specialise in labour intensive (China) goods like clothing or natural resources like corn. Their theory also stated that the bigger the difference between the labour-capital ratio, the bigger economic gain they would experience (Markusen *et al.*, 1995).

However, there were limitations to their theory, which was only true if the following factors were present:

- There could only be two countries, two products and two factors (capital and labour)
- Labour and capital could not be available in the same proportion in both countries.
- Of two goods produced, one should be capital intensive and the other labour intensive
- The labour and capital could not be moved between countries.
- There were no costs associated with transport of the goods.
- The needs and demands of both the countries were the same.
- There could be no government intervention in either country (Markusen *et al.*, 1995).

The Heckscher-Ohlin theory was applied in America by Wassily Leontief, and he found that although America was a capital intensive country, it was exporting labour intensive goods and importing labour intensive goods. His finding became known as the Leontief paradox which explained some of the reasons why the Heckscher-Ohlin theory did not give predicted results. He found that because labourers in America were highly educated and were skilled, they were much more productive than labourers in other countries. Therefore if skills and knowledge were to be grouped with capital as human capital, the Heckscher-Ohlin theory was not as incorrect as it appeared (Krugman & Obstfelt, 2009).

Leontief also found that America's consumption patterns were biased towards capital intensive goods and therefore America was importing more capital intensive goods. Therefore if natural resources were to be included in the Heckscher-Ohlin theory, then it would be more credible and true. Products should thus be ranked according to their factor-intensity in the country, because some goods might be capital intensive in one country yet be labour intensive in another country (Du

Plessis *et al.*, 2000). The next part of this chapter provides an overview of Krugman's and other new economists theories.

2.3.5 New trade theories (NTT)

At first, the Heckscher-Ohlin theory was capable of explaining most patterns in international trade; however after a while researchers became aware of large deviations which kept reoccurring in international trade patterns. The major occurrence was the increase in intra-industry trade between rich countries which strongly contradicted the Heckscher-Ohlin theory because it was evident that countries were exporting and importing the same type of goods. Around 1979 an American economist, Paul Krugman found an explanation for the observed patterns in international trade and proposed a new model. Krugman and other economists created an alternative approach to policies, known as new policies (Krugman, 1979; Krugman, 1980).

The theory that Krugman introduced was completely different from previous theories and intended to explain the increase of intra-industry trade. Krugman's theory was largely based on the assumption of economies of scale and the assumption that consumers prefer a variety and thus prefer diversity in their consumption (Jomo & Von Arnim, 2008). This theory was backed by Dixit and Stiglitz (1977) who had created a model to analyse the preference of consumers for product diversity two years before Krugman had published his findings. Dixit and Stiglitz (1977) found that each producer, although subject to fierce competition, becomes a sort of monopolist of his own brand if the producer produces under an increasing returns scale.

Krugman used these models to provide an indication that trade will occur not only between countries that specialize in different goods, but also between countries that are alike in factor endowments and have the similar access to technology. This also explained why intra-industry trade was increasing. Due to the fact that consumers prefer diversity in products, it was profitable for a country to specialize in a particular type of car and to produce it in large scales for the world market, while another country would make a different type of car. This allowed both countries to benefit from the advantages of economies of scale and consumers worldwide to benefit from lower prices and better product diversity (Jomo & Von Arnim, 2008).

Krugman later realised that his model could also be used to clarify various issues in economic geography. With this theory, he was able to explain what goods are produced in which part of the world and why labour and capital are located in some places and not in other places. Krugman's main finding was that countries with more people will make better use of economies of scale and thus have higher real wages. Higher economies of scale imply lower prices and better diversity for consumers, improving their welfare. For this reason, many consumers will migrate to the country with more people, increasing the population even further and thus continuing to increase the supply in goods, which will then give a further rise to migration. This cycle will then keep on continuing (Krugman, 1995; Jomo & Von Arnim, 2008).

Another one of Krugman's ideas is the so-called core-periphery model. This model indicates the connection between economies of scale and transport costs. This connection can either result in decentralization or concentration of communities. This is subject to certain conditions, where either the forces contributing to concentration will dominate or the forces contributing to decentralization. Conditions such as technology, which is usually concentrated in a central area will cause regional imbalances as the majority of the population will be concentrated in the high-tech zone, while the minority will still be caught in agriculture and live in rural areas. Under different conditions where forces increasing decentralization are dominant, there will be more decentralization which will promote a more balanced development (Krugman, 1995).

2.3.6 Summary of trade theories

It is evident that international trade between countries has been present for many years. Smith and Ricardo were the first to advocate free trade and counties quickly discovered that they gain more when their economy is more open. Many other theories were born, most of them based on Smith's theory of absolute advantage and Ricardo's theory of comparative advantage.

The Heckscher-Ohlin theory was capable of explaining most patterns in international trade, but after a while researchers became aware of large deviations which kept reoccurring in international trade patterns. The biggest being the increase in intra-industry trade between rich countries that strongly contradicted the Heckscher-Ohlin theory.

In 1979, Paul Krugman found an explanation and proposed a new model. Krugman and other economists created a new approach to policies that were based on various factors like sizes of economies and their geographical proximity. Countries that had economies of similar size were more likely to trade with each other and so were countries that were located closer to each other.

Trade theories play an important role regarding how countries trade with each other and which countries are more likely to have preferential, regional and other trade agreements. The EPA is between the EU, a developed country and various developing countries, many of which are LCD's. Due to the fact that the EU is a well-developed and much larger economy than most of the ACP countries, it is necessary to consider trade theories to give us an indication of what can be expected from the EPA. It is thus important to consider the various trade theories in this study, because they often give a prediction of which countries are more likely to succeed at trading with one another. The following part of this chapter will look at which benefits arise when countries engage in international trade.

2.4 BENEFITS OF TRADE

Countries obtain many benefits when trading internationally. This is especially true for poor countries. Trading internationally also includes the importation of investment and intermediate goods, which are not available domestically; it also includes the transfer of ideas and technology between countries. Having an open economy also means that poor countries have access to foreign savings which can aid countries to circumvent some obstacles and achieve rapid growth (Rodriguez & Rodrik, 2000: Bergoeing & Kehoe, 1999; Krugman, 1995).

Feenstra (2006) outlines three main gains when partaking in international trade. They are the gain from reduced prices, the gain from expansion in product varieties and the gain due to self-selection of firms, where only the most efficient ones survive. The gains Feenstra outlined will be explained in more detail in the next paragraphs:

The first gain Feenstra (2006) outlines is the gain from reduced prices. Firms begin to benefit from economies of scale once they start to export so they can increase production and save. Firms trading internationally have to face competition from other firms and therefore have to adjust their prices according to the markets. Feenstra (2006) found little empirical evidence to support the theory that

firms always expand their output and achieve lower priced due to economies of scale after liberalizing their trade. However, there was oblique evidence that firms cannot price-discriminate in unified markets like the EU internal market, because in environments where trade barriers are reduced prices become more similar across countries and this increases trade, which usually leads to sizeable gains.

The second gain is the gain from increased product variety. Feenstra (2006) found substantial evidence from his study by using disaggregate data to analyse 26 countries and their product varieties. New statistical methods were used to estimate the degree of substitution between product varieties across these 26 countries and the elasticity's of substitution, which measured the gains for consumers when a country imports more product varieties (Feenstra, 2004). Feenstra (2006) found that each country provides different product varieties compared to another country and the gains obtained from importing and having more variety of products is sizeable for the United States, and should be even larger for other countries with a high ration of trade to GDP.

The third gain that Feenstra (2006) outlined is the gain from self-selection or "*natural selection*" of firms, where only the most efficient ones survive due to increased standards and competition. Feenstra (2006) found that in recent studies, this gain from trade proved to be very accurate. These studies included the Canada-US free trade agreement and other firm-level datasets from the US, France and other countries. This might be considered as a negative gain for those firms who will be filtered out, however for the country, other firms and the consumers it is beneficial. The county as a whole gains, because the resources used by the less efficient firm can now be allocated to the more efficient firm, which can achieve economies of scale, create more jobs and produce more at a better price. Consumers will thus have more variety in products at better prices than before trade (Feenstra, 2004). The following parts of this chapter discuss the benefits of international trade on national and consumer level.

2.4.1 Benefits of international trade on national level

Exporting stimulates a country's economic growth, encourages development and reduces poverty. This kind of integration into the world economy has been raising living standards and income levels of many countries worldwide (IMF, 2001). International trade enables countries to specialise in certain products and achieve economies of scale and use resources more efficiently. According to

Van Aarde (2007), exports benefit a country more when it exports products in areas that it has a competitive advantage in, because this enables the country to use its scarce resources to gain maximum returns on its investments. Exporting creates employment opportunities, which in many countries can decrease unemployment and increase living standards (DTI, 2008).

Trading internationally also enables countries to exchange information and technological advances. This is especially true for developing countries, who often gain valuable information and technology advances from developed countries. The exchange of information often comes in the form of human capital. Liberalized trade often includes labour migration and therefore an exchange of human capital (Easterly, 2002; Krugman & Obstfelt, 2009).

2.4.2 Benefits of international trade on company level

When a country's trade policy enables companies to trade internationally with less difficulty, they experience many benefits. Firstly, market opportunities are expanded which enables companies to maximise production and increase profits. When local markets are already saturated, companies can introduce their products to the international markets and with this they can extend their products life cycle (Mattoo, Rathindran & Subramanian, 2001; Spanu, 2003; Topalova, 2004; Krugman & Obstfelt, 2009).

Companies that export often are able to save costs in the production process. In most cases, companies can save as much as 20 to 30% by doubling their output as this decreases the fixed costs per unit produced. The same companies now are also able to import some of their input products at lower prices and can thus cut costs and benefit from economies of scale. This is more evident for companies who make use of mass production techniques and capital equipment, like the automobile industries. Another advantage that arises for companies from international trade is the spread of risk. When companies spread their sales across the world, there is less fluctuation in demand, which can boost sales and allow demand to stay high (Spanu, 2003; Topalova, 2004; Krugman & Obstfelt, 2009).

Importing input goods from various sources also decreases the risks of shortages in supply of these goods (Du Plessis, 2000). The biggest advantage for companies that partake in international trade, is that due to the fierce competition in the global market, companies are forced to improve their

quality and thus also their operational efficiency. This creates more value for consumers and a better reputation and often better profits for the company (Du Plessis, 2000; Van Aarde, 2007; Krugman & Obstfelt, 2009).

2.4.3 Benefits of international trade for consumers

International trade holds many benefits for governments and companies, but the biggest advantage of international trade is that it is always beneficial to the consumer. The same basic principles of comparative advantage increase competition and economies of scale can be applied to the consumer. After international trade takes place, a consumer has access to a bigger, much more diverse and usually cheaper variety of goods and services. So an average consumer with an average income will be able to purchase more products after trade than before, therefore raising their standard of living without them having to increase their material standard of living (Deardorff & Stern, 2001). The next part of this chapter discusses the determinants of trade.

2.5 MEASURES OF TRADE LIKELINESS

It is beneficial for countries to trade with one another and to have more open economies as this decreases barriers and promotes trade. Globalization has also made it possible and more convenient for countries to trade internationally. Although it has become a lot easier for countries to trade with one another, not all countries want to or are able to trade with one another, or to trade in the same goods and services (Yanikkaya, 2002; Button, 2008). This part of the chapter examines the various theories of trade likeliness between countries and discusses why certain countries are more likely to trade with certain products and with one another. The gravity model (discussed below) i.e. the size of a country's economy divided by the distance between two countries to explain which countries will trade with one another.

2.5.1 Gravity model

The gravity model has become very popular in the last decade to analyse trade flows. The gravity model is based on Newton's law of gravitation and predicts the movement of people, commodities, information and capital between cities and countries. In its most basic form, the gravity model predicts trade flows as a function of the size of trade partners and the distance between them. It can be used to examine the impact on trade flows for any factor that can be controlled. Tinbergen (1962) created the original gravity equation, but it did not have a strong theoretical foundation. Many authors have since compensated for this shortcoming by providing the necessary theoretical

foundation to the model. Anderson (2011), Bergstrand (1985) and Deardorff (1994) have provided the best theoretical explanations regarding the gravity model (Verdeja, 2006).

The gravity model is also referred to as the modified law of gravitation. Just as the law of gravitation states that the gravitational attraction between two objects is in proportion to the product of their weight and decreases with distance, the trade between two countries follows the same basic principle (Deardorff, 1995). If all other factors are equal, the trade between two countries should be proportional to the product of their GDPs divided by the distance. Larger countries are more likely to attract more people, ideas and commodities than smaller countries and countries which are closer together, have a greater attraction because trade between then is automatically cheaper due to less travelling costs (Verdeja, 2006; Krugman & Obstfelt, 2009). The figure below illustrates the gravity model equation.

Figure 2.1: Gravity Model equation

$$Trade_{xy} = \frac{GDP_x\ GDP_y}{distance_{xy}}$$

Source: Krugman & Obstfelt (2009). Compiled by the author

The relative strength of trade between two countries is calculated by multiplying the population of both countries, then dividing the answer by the squared distance between the two (Krugman & Obstfelt, 2009). In other words, the closer countries are to each other and the more similar they are in size, the bigger their probability to trade with each other. However, for regional integration to be possible, all of the above conditions should be met, and unfortunately, currently many countries in Southern Africa are still faced with plenty of challenges. The subsequent part of this chapter gives an overview of resources and specialization as a measure of trade likeliness.

2.5.2 Resources and specialisation

As Ricardo's theory predicts, countries tend to trade in goods which they have a comparative advantage in. Resources like natural resources, technological advances or human capital play a vital role in determining which products a country can trade with (Krugman & Obstfelt, 2009). If a country is lucky, they have an abundance of natural recourses. South Africa, for example is rich in natural minerals like gold and platinum. In 2009 South Africa's top two export products to the rest

of the world consisted of precious stones and metals with an estimated trade value of $8 448 494 000 and mineral fuels, oils and distillation products with an estimated trade value of $6 048 226 000 (ITC, 2010).

Resources play an important role in determining areas in which a country will specialise in and who it will most likely to trade with. Countries which are more developed will be able to have more capital goods, and are more likely to specialise in capital intensive goods, compared to a country which has more people and labour is more likely to specialize in labour intensive goods. However, this is not always the case, as the Leontief paradox discovered. An important factor to consider is that consumers are diverse and therefore prefer to have diverse goods and services, where the best price is not necessarily as important as the best quality. China might be able to produce a car more cheaply than Germany. However, many consumers will be willing to pay more for good quality and more safety benefits (Lederman & Xu, 2001; Schott, 2001; Krugman & Obstfelt, 2009).

Specialisation theories like comparative advantage can therefore to some extent give an indication which countries will be able to specialise. However, during the last decade, technology and globalization dramatically changed the trade environment. In the modern world, it has become a lot easier for countries to specialise, not even in certain products, but in a certain stage of production of a product partly due to globalization. Multinational companies have factories all over the world and various countries play a part in the production of a certain product. This enables countries to really become experts in one area of production and export the intermediate goods to the next country (Lindert & Williamson, 2003; Button, 2008).

Having an open economy allows countries to benefit from specialization by dividing their labour and resources and due to this they are able to consume a lot more that they can produce. Specialization enables countries and all the citizens to enjoy higher living standards by giving the access to more diverse variety of products and services, which without trade would not be possible (Douglas, 2005). However, having an open economy also holds some negative effects like drowning domestic markets with cheap imported goods which are often subsidized and with which domestic producers cannot compete. In cases like these, governments use various trade instruments to restrict the imports of certain goods (Johansson, 2009). The various trade instruments applied by governments are discussed in the next section.

2.6 TRADE INSTRUMENTS

There are many benefits for countries when they engage in international trade by opening their economies, but despite many benefits of trade liberalisation, there is also scepticism (Rodriguez & Rodrik, 2000; Tussie & Aggio, 2004). The distributional impacts caused by more open economies may have adverse effects such as increased poverty for the poorer part of the economy (Winters, McCulloch & McKay, 2004).

Rodriguez and Rodrik (2000) concluded in their study that opening an economy could have a negative influence on the economy. On the other hand evidence found by the International Monetary Fund (2001) indicated that opening a country's economy can alleviate poverty. Especially for those who work in labour-intensive manufactures as well as agriculture as these sectors are often still protected by trade barriers (IMF, 2001).

The effect is especially evident in small countries, which are heavily reliant on trade in the agriculture and labour intensive manufacturing sectors. Countries therefore implement various instruments to enable them to protect their own economy. These instruments that are seen as barriers include: tariffs; anti-dumping measures; non-tariff barriers such as health and safety standards; certification; etc. In the global context some countries have a much higher advantage in certain products (due to more cost effective inputs). For example, China with its ultra-low-wage workers can produce almost any manufactured labour intensive goods cheaper. These cheap goods then end up harming markets all over the world, and thus often result in anti-dumping barriers being implemented (IMF, 2001; Winters *et al*., 2004).

Trade barriers are often formed where there are some possible coalitions of interest groups and often for reasons other than the economy. For example, trade barriers can be implemented for reasons concerning national security or if the country has a desire to preserve or isolate their culture and traditions from foreign influences. Trade barriers sometimes do protect local industries, especially infant industries from exploitations. Inefficient customs operations and regulations can also be seen as a barrier that reduces many benefits of international trade such as economic growth which can lead development and lift some countries out of poverty (Mimouni & Von Kirchbach, 2003).

When a country restricts imports, foreign producers are disadvantaged relative to their domestic competitors, and the volume of trade is reduced. This prevents both importing and exporting countries from realizing all of the gains from international trade, as resources will be diverted from industries where there are comparative advantages. By using trade restrictions countries go against the basic principle of international trade namely comparative advantage (Wall & Wall, 1995). The majority of trade restrictions are implemented to protect the income of a specific interest group, like for example farmers. Although politicians argue that trade barriers protect the nation as a whole, economist argue that free trade benefits the nation more. This can go both ways depending on the situation and the specific policies, theoretical grounds exist that state that the trade restricting policies can benefit the welfare of the nation (Krugman & Obstfelt, 2009: 217).

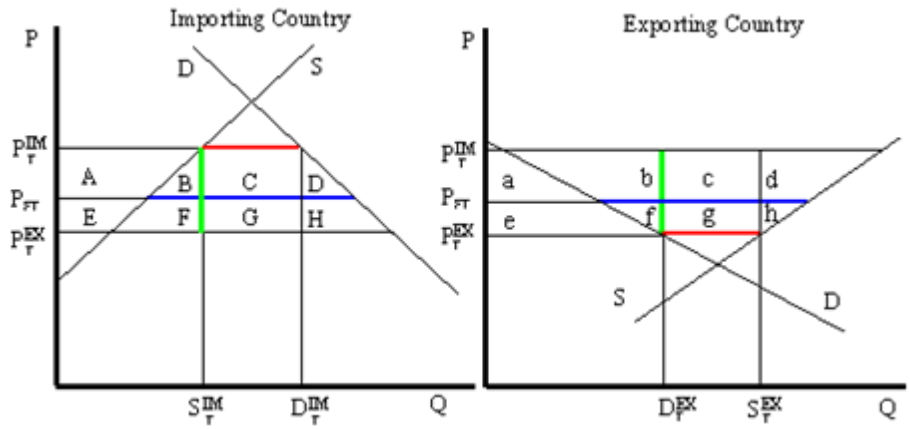
The next section is split into two sections, tariffs and non-tariff barriers. These sections discuss each relevant trade barrier and show the effect that the barrier has on the welfare of the country.

2.6.1 Tariff barriers

Tariffs are schedules of duties (very similar to taxes) which government imposes on imported goods. Tariffs are the most common type of barrier, because they are relatively easy to implement. A tariff increases the price of a good for the importing country and decreases the price for the exporting country. Small countries are affected more negatively than larger countries, because when trade in small countries is reduced by a tariff, both imports and exports decrease after a tariff is imposed. There are three types of tariffs, ad valorem (percentage of imported goods value), specific (a fixed charge per unit) and compound (a combination between ad valorem and compound) (Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009).

When a country imposes a tariff on a specific product, the welfare of the consumers decreases because they have to pay a higher price for that good. The producers' welfare also decreases because they usually sell less and make less profit even if they have a comparative advantage in that product. The effects of a tariff are slightly different for large countries than for small countries, because tariffs imposed in large countries might have a positive effect on the countries' welfare, but only if the tariff is small enough (Du Plessis, 2000; Suranovic, 2007; Krugman & Obstfelt, 2009). Figure 2.1 illustrates the effects of a tariff imposed on both a large importing and exporting country.

Figure 2.2: Welfare effects of a tariff imposed on a large country



Source: Suranovic (2007:313).

In figure 2.2, P_{FT} (Price at free trade) is equal to the equilibrium price at free trade. At the price P_{FT}, the excess demand by the importing country equals excess supply by the exporter in the standard trade model. The blue line indicates the quantity of imports (demand curve) and exports (supply curve) at the free trade price. As soon as a large country implements a tariff, in effect the price of the goods in the domestic market increases and the prices decrease in the rest of the world. After the tariff is imposed, the price in the importing country rises to P_T^{IM} (Total price of importing country) and the price in the exporting country falls to P_T^{EX} (Total price of exporting country). The table 2.1 summarises the effect of the tariff on the welfare of consumers, producers, governments, the nation and the world.

Table 2.1: Summary of the welfare effects of a tariff

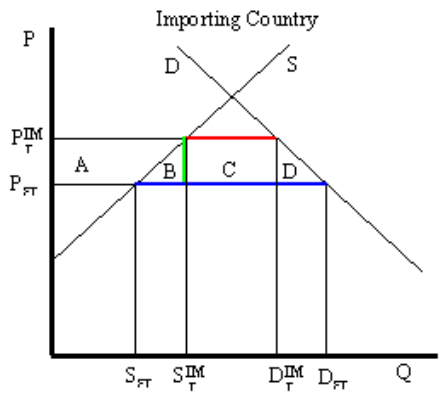
	IMPORTING COUNTRY	EXPORTING COUNTRY
Consumer Surplus	- (A + B + C + D)	+ e
Producer Surplus	+ A	- (e + f + g +h)
Govt. Revenue	+ (C + G)	0
National Welfare	+ G - (B + D)	- (f + g + h)
World Welfare	- (B + D) - (f + h)	

Source: Suranovic (2007:278).

From table 2.1 it is evident that consumers in the importing and producers in the exporting country will experience a decrease in welfare. Producers and government in the importing country will experience an increase in welfare and the national welfare in the importing country will thus also experience an increase in welfare. The exporting country on the other hand, will experience a

decrease in national welfare resulting in a decrease in world welfare (Suranovic, 2007; Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009). For a small country, there is a different effect and the following figure and table illustrate the effect of a tariff on the welfare of a small country.

Figure 2.3: Welfare effects of a tariff imposed on a small country



Source: Suranovic (2007:285).

In figure 2.3, P_{FT} is equal to the equilibrium world price at free trade. At the price P_{FT}, domestic demand is indicated by D_{FT}, domestic supply by S_{FT} and imports by the difference D_{FT} - S_{FT} (Demand at free trade and supply at free trade respectively) between the supply and demand.

Table 2.2: Summary of the welfare effects of a tariff

	IMPORTING COUNTRY
Consumer Surplus	- (A + B + C + D)
Producer Surplus	+ A
Govt. Revenue	+ C
National Welfare	- B - D

Source: Suranovic (2007:285).

From table 2.2 it is evident that consumers in the importing country will experience a decrease in welfare, as the products will now be more expensive than before. Producers will experience an increase in welfare as their products are now competitive again. Government in the importing country will experience an increase in welfare from the income of tariffs. However, the loss in welfare for consumers exceeds the gain in welfare. It is evident that producers and the national welfare in the importing country will experience a decrease in welfare. Tariffs are thus more harmful for small, poorer countries as they always lead to deadweight losses. A deadweight

loss (also known as excess burden) is a loss of economic efficiency that can arise when equilibrium for a good or service is not pareto optimal (Suranovic, 2007).

The average OEDC tariffs on imports from LDCs are low, because tariffs above 15% have big disproportional effects on the exports of LDCs. It has been found that if the tariff is reduced to 5% on a non-discriminatory basis, trade diversion can be avoided entirely. LDCs are therefore often encouraged to eliminate tariffs, as this can result in more trade opportunities and therefore can be seen as direct assistance to the poor countries (Hoekman, Ng & Olarreaga, 2002). This can also be a reason why the WTO is insisting on lower tariff rates for LCDs (Suranovic, 2009).

Why then do these countries impose tariffs on so many of their products if they have so many negative effects? Feenstra and Taylor (2008) have found that these countries impose these tariffs because it is their only certain form of government revenue, because collecting taxes from individuals and firms is ineffective as they often don't report the correct earnings and it is very difficult for government to check each report due to lack of proper organisation and lack of staff. Another possibility might be that many people in LCD countries cannot afford to pay taxes as they live under $1 a day. Tariff revenue is thus easy to collect because most countries have customs agents at every entry point. Unfortunately, the deadweight loss from imposing these tariffs still outweighs the benefits.

Political reasons can also influence governments to impose tariffs. Tariffs can benefit the local producers by eliminating the price benefits of imported goods and they provide government revenue. Therefore, if government cares more about producer surplus rather than consumer surplus, they will implement tariffs. Usually governments attempt to protect specific firms or groups and therefore often focus more on producers than on consumers (Krugman & Obstfelt, 2007; Feenstra & Taylor, 2008). After a total of eight rounds of the General Agreement on Tariffs and Trade (GATT), it has been agreed that tariffs worldwide are to be decreased drastically. Global trends seem to correlate with this idea as tariffs started to decrease over the next several years. South Africa for example had high tariffs and extensive import controls with formal import quotas, which slowly begun to decrease as the idea that trade stimulates growth was introduced; various attempts were made to decrease tariffs and import quotas. An increase of anti-dumping duties and import licensing thus occurred due to this reduction in tariffs and non-tariff barriers have increased

progressively (Du Plessis, 2000; Jonsson & Subramanian, 2001). The next section discusses non-tariff barriers.

2.6.2 Non-tariff barriers

Non-tariff barriers are barriers which restrict trade but are not in the form of a tariff. Non-tariff barriers include but are not limited to anti-dumping barriers, export subsidies, import quotas and voluntary export restraints (Krugman & Obstfelt, 2009). Non-tariff barriers include all other factors which have the potential to influence trade, for example, infrastructure can have a big influence on trade and can be seen as a non-tariff barrier. During the last two decades it has become clear that the number of countries that impose non-tariff barriers like anti-dumping have almost doubled when tariffs were discouraged by the WTO rules. Anti-dumping has become one of the most important non-tariff barriers and is now recognized as a successful form of protection (Zanardi, 2004).

2.6.2.1 Anti-dumping barriers

Dumping is regarded as an unfair competitive practise where foreign firms dump their low priced products in the domestic market (for example, China with its textile exports) and this result is harmful to local producers' businesses (Krugman & Obstfelt, 2009). An anti-dumping duty is thus imposed, and thus increases the price of those specific products of the exporting country in the importing country. This is done to correct the imbalance and allow local producers to stay in the market (Du Plessis, 2000; Krugman & Obstfelt, 2009). Mastel (1998) argued that anti-dumping duties are necessary to combat unfair trade due to foreign firms selling their goods below the equilibrium price, thus causing harm to domestic firms (Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009).

Denstler (1996) stated that anti-dumping duties can contribute to trade liberalisation because they act as a "*safety valve*". This "*safety valve*" enables governments to protect local industries without discouraging international trade by imposing a duty which enables local producers to compete with cheaper imports. It is evident that anti-dumping duties being imposed have a correlation with reductions in tariff barriers. As countries reduced tariffs to create more open markets, they often implemented anti-dumping duties on specific products to protect their local industries to some degree. Anti-dumping has become a more acceptable trade tool than tariffs and many countries prefer to use anti-dumping duties to regulate trade and protect local industries. This was particularly

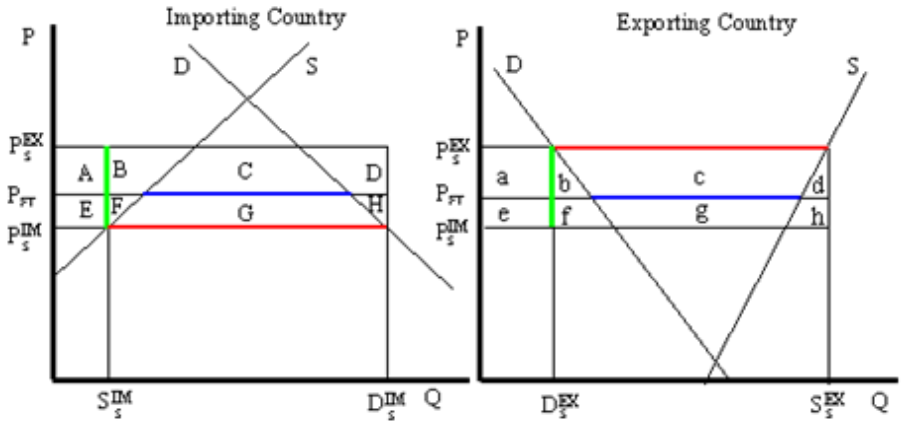
true for developed counties, where the effects of more anti-dumping duties resulted in reduced tariffs (Zanardi & Moore, 2006).

2.6.2.2 Export subsidies

Export subsidies are payments to firms that produce a certain product for exporting. These payments are funded by the government and occur when a specific local industry is being protected. The firms that receive these subsidies are able to produce at much lower costs, because the subsidies cover many of their input costs. The firms thus become more competitive and can increase their exports (Krugman & Obstfelt, 2009). The EU is a very good example as it is often characterised by having high agricultural subsidies. This makes it almost impossible for international farmers to export agricultural products to the EU, even when they have a competitive advantage in agricultural products. The effect of a subsidy decreases welfare of consumers and the government in the country giving the subsidy, while only the producers have an increase in welfare. In general export subsidies worsen terms of trade, because they tend to decrease world prices (Krugman & Obstfelt, 2009).

One particular event which drew a lot of attention was the US subsidies on cotton, which lowered the world prices to such an extent that the majority of the cotton producers in Africa faced severe problems. Many of the communities in Africa were dependent on cotton exports and when the world price dropped due to the US subsidies, these communities were pushed into poverty as they no longer made enough profit to sustain their farming (WTO Panel, 2004; Andersen & Taylor, 2005). Figure 2.4 summarises the effects of export subsidies.

Figure 2.4: Welfare effects of an export subsidy



Source: Suranovic (2007:313).

In figure 2.4 P_{FT} indicates the equilibrium at free trade prices in other words, the quantity of the import country's demand and the export country's supply. When the exporting country implements an export subsidy, it causes an increase in the price of the goods in the domestic market and a decrease in the price for the rest of the world. After the subsidy is given, the price in the importing country falls to P_T^{IM} and the price in the exporting country rises to P_T^{EX}. Table 2.3 summarises the effects on welfare for consumers, producers, government and national and world welfare for both the importing and exporting country.

Table 2.3: Summary of the welfare effect of an export subsidy

	IMPORTING COUNTRY	EXPORTING COUNTRY
Consumer Surplus	+ (E + F + G)	- (a + b)
Producer Surplus	- (E + F)	+ (a + b + c)
Govt. Revenue	0	- (b + c + d + f + g + h)
National Welfare	+ G	- (b + d + f + g + h)
World Welfare	- (F + H) - (b + d)	

Source: Suranovic (2007:314).

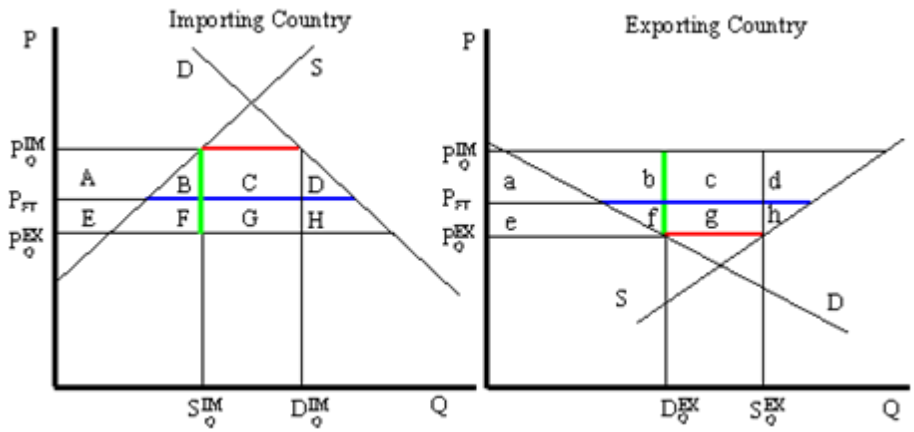
From table 2.3 it is evident that consumers in the importing country will experience an increase in welfare. Producers in the importing country will experience an increase in welfare and the welfare of the government will stay unchanged. National welfare will thus also increase. In the exporting country, both the consumer and government will experience a decrease in welfare but producers will experience an increase in welfare. National welfare in the exporting country will experience a decrease because the total decrease in welfare exceeds the total increase in welfare. World welfare will thus experience a decrease in welfare as well. It is thus evident that export subsidies harm almost everyone except producers who receive the subsidies in the exporting country (Du Plessis, 2000; Krugman & Obstfelt, 2009).

2.6.2.3 Import quotas

An import quota is a direct restriction on the quantity of goods being imported by a specific country. This form of barrier is enforced by issuing licenses to various groups of individuals or firms. An import quota always increases the domestic selling price of the imported goods. This occurs because a quota places a restriction on the amount of goods that can be imported, and generally the demand for a specific good remains the same. Due to the restriction of imports, a situation arises where the demand will always exceed supply (domestic plus imported) causing the price to increase

(Suranovic, 2007; Krugman & Obstfelt, 2009). Figure 2.5 shows the effect of an import quota on the supply and demand curves of both an importing and exporting country.

Figure 2.5: Welfare effects of an import quota



Source: Suranovic (2007:313).

In figure 2.5, P_{FT} is the equilibrium price at free trade. At that price, the excess demand by the importing country is equal to the excess supply by the exporter. If the importing country implements an import quota equal to P_o^{IM} the equilibrium will shift, and the price in the importing country will rise to where the import demand is equal to the quota.

Table 2.4: Summary of the effects of import quotas on welfare

	IMPORTING COUNTRY	EXPORTING COUNTRY
Consumer Surplus	- (A + B + C + D)	+ e
Producer Surplus	+ A	- (e + f + g +h)
Quota Rents	+ (C + G)	0
National Welfare	+ G - (B + D)	- (f + g + h)
World Welfare	- (B + D) - (f + h)	

Source: Suranovic (2007:291).

From table 2.4 it is evident that consumers in the importing and producers in the exporting country will experience a decrease in welfare. Producers and government in the importing country will experience an increase in welfare and the national welfare in the importing country will thus also experience an increase in welfare. In the exporting country, only the consumer will experience an increase in welfare, while the government's welfare will remain unchanged. At the equilibrium

price, at free trade, the excess demand by the importing country is equal to the excess supply by the exporting country. If the importing country implements an import quota equal to the equilibrium, the equilibrium will shift, and the price in the importing country will rise to where the import demand is equal to the quota. The price in the exporting country will then fall until the export supply is at the quota level. Consumers in the importing country and producers in the exporting country will experience a decrease in welfare. Producers and government (quota rents) in the importing country will experience an increase in welfare and the national welfare in the importing country will thus also experience an increase in welfare (Suranovic, 2007; Krugman & Obstfelt, 2009).

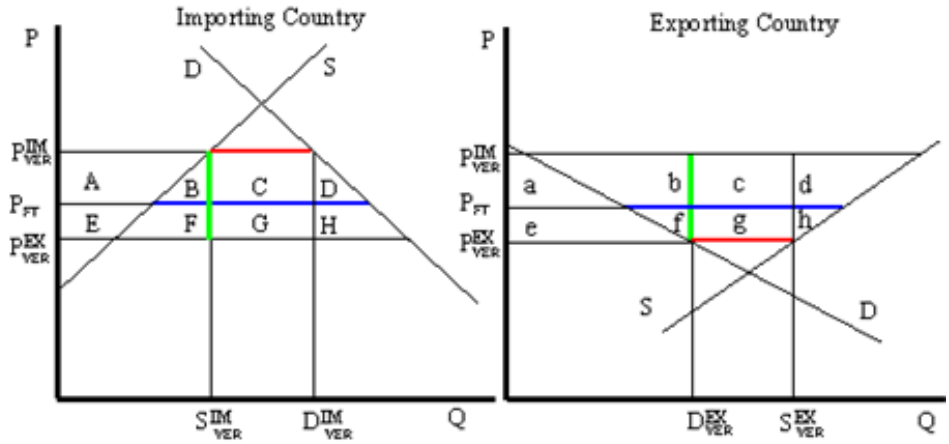
In the exporting country only the consumer will experience an increase in welfare, while the government's welfare will remain unchanged. The national welfare in the exporting country will also experience a decrease in welfare causing the world welfare to also decrease. It is thus evident that import quotas cause a decrease in world welfare. Only a small part of the world gains, while the majority's welfare decreases. An import quota thus only benefits the producers and government in the importing country and the consumers in the exporting country (Du Plessis, 2000; Krugman & Obstfelt, 2009).

2.6.2.4 Voluntary export restrains

A voluntary export restrain (VER) is a restriction set by governments of the exporting country on the quantity of goods exported during a specific time period. This usually occurs because industries in the importing country feel under threat and seek protection from imports of a particular exporting country (Krugman & Obstfelt, 2009). A voluntary export restraint is thus the same as an import quota but instead of the importing country being the one to impose it, the exporting country agrees to impose the quota. VER's are however generally enforced at the request of the importing country to the exporting country. The exporting country usually agrees to the VER because then all the other trade restrictions are prevented. VERs is thus usually implemented on a bilateral basis so that the relationship between the countries is kept strong (Suranovic, 2007; Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009). A VER was a very popular form of protection during the 1980's, especially since they did not violate any of the agreements under the GATT. Unfortunately due to this, during the next round of GATT in Uruguay, the VERs were to be phased out over a four year

period, with exceptions granted for one primary sector of an importing country and therefore no longer are as popular (Suranovic, 2007). Figure 2.6 illustrates the effects of VERs.

Figure 2.6: Welfare effects of a VERs



Source: Suranovic (2007:313).

In figure 2.6 the supply and demand of both the importing and exporting countries are illustrated. At the world free trade price P_{FT}, the quantity of imports and exports is indicated (the horizontal distance between the supply and demand curves). If the exporting country implements a voluntary export restraint equal to P^{IM}_{VER} the equilibrium will shift and the price in the importing country will increase, to where demand is equal to the quota level. The price in the exporting country will decrease until the export supply is equal to the quota level. Table 2.5 provides a summary of the effects of a VER on consumers, producers, national welfare and world welfare for both the importing and exporting country.

Table 2.5: Welfare Effects of a Voluntary Export Restraint

	IMPORTING COUNTRY	EXPORTING COUNTRY
Consumer Surplus	- (A + B + C + D)	+ e
Producer Surplus	+ A	- (e + f + g + h)
National Welfare	- (B + C + D)	c - (f + h)
World Welfare	- (B + D) - (f + h)	

Source: Suranovic (2007:302).

From table 2.5 it is evident that consumers in the importing country will experience a decrease in welfare and producers in the importing country will experience an increase in welfare. However, the loss in welfare for consumers exceeds the gain in welfare for producers and the national welfare

in the importing country will experience a decrease in welfare. For the exporting country, the consumers in the importing country will experience an increase in welfare. Producers in the importing country will experience an increase in welfare. However, the loss in welfare for consumers exceeds the gain in welfare for producers and the national welfare in the importing country will experience a decrease in welfare.

For the exporting country, the consumers will experience an increase in welfare but producers will experience a decrease in welfare. In general the national welfare should experience a slight increase. World welfare on the other hand will experience a large decrease. Therefore, only large countries that implement VERs can experience a slight increase in welfare, but only if the quota is small enough (Du Plessis, 2000; Krugman & Obstfelt, 2009).

2.6.2.5 Licensing

A license requirement forces an importer to apply for the license in order to import the goods to the country where there is a demand. Licensing is more or less the same as an import quota. It prevents the importation of too many goods to protect the foreign domestic producer, thus acting as a barrier to exports. The administration and implementation of licensing has been a great impediment to trade and has been a discussion area to facilitate trade (Grosso, Kleitz & Fliess, 2003; Krugman & Obstfelt, 2009). Licensing can thus be viewed as a subset of regulations to which a country that wishes to export must adhere to. There are various types of licensing, namely economic regulations, social regulations and administrative regulations (Grosso et al., 2003).

Economic regulations are licenses which are required for economic reasons for example to measure the effects of quantity, pricing or competition. Social regulations on the other hand are licenses which are required for non-economic reasons. For example various measures that protect the public interests such as health, safety and the environment. Administrative regulations are procedural aspects of licensing implementation. Administrative regulations include various paperwork and other types of administrative formalities (Grosso *et al*., 2003; Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009).

2.6.2.6 Embargoes and sanctions

A sanction is the most extreme form of quota, where the import and exports of a particular product are completely prohibited. Sanctions usually occur when the rest of the world does not agree to a specific political or social situation which arises in a specific country and thus apply a sanction to all exports of the country. In other words, they cut that country off from international trade, often forcing the country to change the political or social situation. South Africa, for example had sanctions imposed against the country during the apartheid era (Krugman & Obstfelt, 2009; ITRISA, 2009). An embargo on the other hand is also an extreme form of quota. Embargos are, however, usually not as severe as a sanction and are mostly implemented due to health and safety reasons. For example, if a sudden eruption of mad cow disease would occur in America, most countries would impose an embargo on beef imports from America (ITRISA, 2009).

2.6.2.7 The effect of custom regulations (ease of doing business) on exports

The customs department of a country administers and collects the duties levied by the government on imported goods. They are also the frontier where officials check incoming goods, travellers or luggage. The customs regulations differ from country to country and some countries have stricter rules with regards to health and safety regulations than others. A survey was done by Clarke (2009) on enterprises in eight African countries. A five-point scale used by the World Bank Enterprise Survey which measures trade and customs regulations was used. It revealed that improvement of trade regulations and customs by 0.2 points would increase the percentage of firms exporting by 2% and lead to a 1.5% increase in export output. Firms in most countries would be less willing to export when there is restrictive trade, customs regulations and poor customs administration. Other regulations like phytosanitary and sanitary measures can distort opportunities that arise from trade liberalisation as well as impede trade (Roberts, 1998). Chen, Wilson & Otsuki (2008) found that regulations on certification procedures caused the number of exporters and their products to decline. A study done by Wilson, *et al.* (2005) on Peru revealed that trade improved greatly once the customs procedures had undergone reform. It is therefore evident that if most custom restrictions were lifted and custom regulations were less strict, more firms in countries would be willing to export. If countries had a free trade agreement, most of the regulations would be eliminated, thus promoting trade. In most African countries it is essential for them to trade with each other to deepen intra-regional trade (Wilson, *et al*., 2005; Clarke, 2009).

2.6.3 Summary of trade barriers

Countries implement various trade barriers for various reasons such as the protection of their local producers or the generation of government revenue. In general, all trade barriers have a negative effect on customers and only a few actually have revenue generating abilities. Embargo's and sanctions seem to hold no benefits for anyone, but it is important to take into consideration that their implementation is usually motivated by political reasons or for health and safety reasons. In most cases countries that open their economy have more opportunities to raise their standards of living and become more competitive internationally. Table 2.6 below summarises the effects that various trade restrictions have on the welfare of producers, consumers, the government and it also provides the overall effect.

Table 2.6: Effects of the most common trade policies

	TARIFF	EXPORT SUBSIDY	IMPORT QUOTA	VERs	LICENSING	EMBAR-GOES	SANC-TIONS
Producer surplus	Increases	Increases	Increases	Increases	increases	Falls	Falls
Consumer surplus	Falls	Falls	Falls	Falls	Falls	Falls	Falls
Governme nt revenue	Increases	Falls	No change	No change	No change	No change	No change
Overall national welfare	falls for small countries	Falls	falls for small countries	Falls	Ambiguous	Falls	Falls

Krugman & Obstfelt (2009:200).

From table 2.6 it is clear that for all trade barriers, producer surplus will increase and consumer surplus will decrease. Only tariffs provide some sort of government revenue and these can help finance various government projects. For small countries looking at the big picture, any trade barriers seem to decrease national welfare, while larger countries can still manage to gain from tariffs and import quotas if said quotas are small enough. The advantage of more free trade is that it forces world markets to constantly become more competitive. For producers this mean they have to become more innovative in order to stay in the market and for consumers this means they have more choices and lower prices to choose from (ITC, 2010).

Open economies also enjoy more benefits such as economic growth and a reduction in poverty due to increase in exports. Although trade barriers sometimes can protect local industries, it is important for governments not to create industries which cannot exist on their own without government support. Governments and policy makers should carefully establish how much support and protection is needed for infant industries to ensure that those industries do not become dependent. It might be difficult for developing countries to open their markets to the rest of the world. They should rather try to find other ways to enter the world market successfully (Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009).

One way for developing countries to increase their trade and enter the global trading system is for them to sign trade agreements. Currently, many trade agreements exist between developed and developing countries which are successful in increasing international trade for both countries (Krugman, 1995; Bergoeing & Kehoe, 1999; Rodriguez & Rodrik, 2000). The next part of this chapter examines the various trade agreements which contribute to increasing trade and trade liberalisation between countries.

2.7 TRADE AGREEMENTS

Countries often prefer to sign a trade agreement with other countries or groups of countries to enhance trade between them as most trade agreements reduce trade barriers and thus promote exports, investment and the sharing of knowledge and technological advances (Rodriguez & Rodrik, 2000). Trade agreements are often very beneficial for developing countries, as this enables them to trade internationally and gain valuable knowledge from more developed countries, which they had no access to prior to trading (Feenstra & Taylor, 2008; Krugman & Obstfelt, 2009).

2.7.1 What is a trade agreement?

A trade agreement is defined by the Britannica encyclopaedia (2010) as: "*any contractual arrangement between states concerning their trade relationship*". Trade agreements can be formed between two countries (bilateral trade agreements) or between many countries (multilateral agreements). Trade agreements are used to reduce barriers such as tariffs, non-tariff barriers and prohibitions by opening borders and enabling all participating countries to gain the benefits of increased trade. Although trade agreements have many benefits for all countries participating, it is very complicated to establish a successful trade agreement as there are often many barriers to trade.

To ensure that all humankind benefits from international trade, there has to be rules to which every country has to adhere to. These rules govern all international activities. It is often very difficult to create an agreement which will benefit both parties, especially if the agreement is between developed and developing countries that often have very different needs and expectations. Trade law plays a major role in any international trade agreement, because it creates a set of laws which ensure that all parties benefit. Each trade agreement has various legal aspects and certain laws have to be abided by when creating a trade agreement (Van den Bossche, 2005). The following section gives an overview of the trade laws and legal aspects of a trade agreement.

2.7.2 Trade laws and legal aspects of a trade agreement

There are various laws and legal rules that play a big role in international trade and can influence international trade agreements. Are these rules really needed? And what is the benefit of these trade rules and laws? There are four aspects which have to be considered when looking at trade laws. Firstly, international trade rules control countries when taking trade-restrictive measures in their own and in world economy interests. Such measures often only benefit a specific interest group and only for a short period of time. These measures also give little benefit to the general economy of the country taking these measures. If countries were left to take these measures it would lead to an enormous escalation of trade-restrictive measures, which would have terrible consequences for the global economic welfare. Having trade laws in place prevents such escalations (Van den Bossche, 2005; Schram, 2007; Dynefors-Hallberg, 2008).

A second reason for trade laws is to give various investors and traders a sense of stability and security. Investors and traders who wish to work in a certain country, will have more security and be able to better predict how the country will react if that country adheres to and is bound by certain international trade laws and rules. Thirdly, with all the new challenges presented by globalisation and increased levels of trade in goods and services, most governments cannot cope on their own and often do not have the knowledge or skills to handle these problems. Trade laws incorporate the protection of social values such as public health, a clean green environment, safety for all consumers plus cultural identity. The final reason for needing trade laws is that there is a need to achieve a better measure of equity in all international economic relations. Father Lacordaire stated the following at a Paris Conference in 1835: '*Between the weak and the powerful, between the rich and the poor . . . it is freedom that oppresses and the law that sets free'* (Van den Bossche, 2005:77). It

is clear that without trade laws, which bind and enforce both the rich and poor, and rules that recognise the special needs of developing countries, most developing countries would not be competent to integrate fully into the world trading system and derive a fair share of the gains from international trade (Van den Bossche, 2005; Schram, 2007; Dynefors-Hallberg, 2008).

2.7.3 How does trade law affect South Africa and the EU?

Every trade agreement has to adhere to certain rules and regulations as specified by trade law, to ensure that it is fair and just. The EPA is no different and therefore it is important to understand the trade law which will govern the EPA. South Africa and the EU are both members of the World Trade Organisation (WTO) and are therefore - along with the other 146 members of the WTO - subject to a trading system which is based on rules set by the WTO. The original GATT agreement, namely the GATT 1947 provided a foundation for these rules which have been tested over time. These rules then became the very technical and complex WTO agreements. WTO law deals with a broad scale of issues, starting with tariffs, import quotas to intellectual property rights, food safety and various security measures. There are six categories of rules and principles under the WTO law, which make up the multilateral trading system. They are as follows: the principles of non-discrimination; the rules on market access, including rules on transparency, the rules on unfair trade, the rules on conflicts between trade liberalisation and other societal values and interests, the rules on special and differential treatment for developing countries; and a number of key institutional and procedural rules relating to decision making and dispute settlement (Van den Bossche, 2005).

Within these agreements, there are some sections which are especially important for South Africa and the EU. Special and differential treatment for developing-country members, although South Africa is considered being both a developed and developing country as it has aspects of both. WTO law provides a stipulation granting some form of special and differential treatment to developing-country members. This enables developing countries to address their special needs and to have them being taken into account when signing various trade agreements. In most cases, these rules are adjusted so they provide fewer obligations and have different objectives for developing countries (Van den Bossche, 2005; Schram, 2007).

Another important aspect to consider for the EPA is that most successful trade agreements share common features like reciprocity, the most-favoured-nation (MFN) clause and national treatment of

non-tariff barriers. Reciprocity is considered to be important in all agreements and it states that if both or all parties do not benefit with the agreement, there is no incentive to agree to it. If all parties have signed the agreements, it indicates that they agree to the agreements and expect to gain as much as they lose. The MFN clause prevents countries from further reducing barriers for just one country and thus ensures equal treatment for all countries. If a country X does not agree with using chemical pesticide on crops and decides to negotiate with country Z (who uses chemical pesticides) and agrees to further lower its tariff barriers if country Z stops using chemical pesticides on its crops, then country X should also give the same condition to country Y (who also uses pesticides). The National treatment of non-tariff restrictions ensures that properties of tariffs are not duplicated with nontariff restrictions like discriminatory regulations, sales tax or selective excise. The national treatment of non-tariff restrictions demands the same treatment from the country as it gives its domestic producers of the same goods. All these factors are important to consider when signing the EPA because they will influence the total influence that the EPA will have on South Africa and its economy (Van den Bossche, 2005; United nations, 2010).

2.7.4 Summary of trade agreements and their effects

It is clear that there are benefits for a country when it signs a trade agreement. It is usually a lot easier and less expensive to trade internationally with countries if there is a trade agreement in place. However, there are also aspects to consider ensuring that neither country gets fewer benefits or is affected negatively by these agreements. To help countries create legal and fair agreements, there are certain international trade rules to which they have to adhere to when trading internationally. The WTO is an organisation which helps govern international trade by providing a basic set of laws and rules to which all its members adhere to. This makes it a lot easier to member countries to trade, because it provides them with a common set of rules. The EPA is no different and therefore it is important to understand the trade law which will govern the EPA. Due to the fact that both South Africa and the EU are members of the World Trade Organisation (WTO), they are subject to a trading system which is based on rules set by the WTO. The original GATT agreement, namely the GATT 1947 provided a foundation for these rules which have become the very technical and complex WTO agreements.

Within these agreements, there are some sections which are especially important for South Africa and the EU. Special and differential treatment for developing-country members, because South

Africa is considered being both a developed and developing country, special attention should be given to these sections. For the EPA the common features of the most successful trade agreements like reciprocity, the most-favoured-nation (MFN) clause and national treatment of non-tariff barriers should also receive attention, to ensure that both countries gain the same amount of benefits from the EPA.

2.8 CONCLUSION

This chapter provided the theoretical background of trade theories, the benefits of international trade, trade instruments and trade agreements. By providing background information on these subjects it provides a better understanding in how the EPA will affect SA. This chapter gave a summary of various trade theories, from traditional to new trade theories. Trade theories indicate how countries trade with each other and which countries are more likely to have preferential, regional and other trade agreements. The EPA is between the EU, a developed country and various developing countries, including SA. Due to the fact that the EU is a well-developed and much larger economy than SA, it is necessary to consider trade theories to give us an indication of what can be expected from the EPA.

It is important to consider the various trade theories in this study, to gain a better understanding of the evolution of theories on international trade patterns. Understanding the evolution of trade theories, will enable the better analysis of the EPA and its effect on South Africa. This chapter also looked at likeliness of trade, like the gravity model and natural resources, which play a role in determining which countries will trade with one another. Because the EU is located relatively far from South Africa they must consider these factors and how they will affect trade between these countries. It is important for countries to sometimes protect their local markets, but to do this in such a way that the benefits outweigh the losses.

Various barriers to trade were discussed and the implications of these barriers to trade were given. South Africa should remember that they have a much smaller economy than the EU and that they are also not as developed and do not have the infrastructure and capital that the EU has. One way for South Africa to increase their trade is for them to sign trade agreements. Currently many trade agreements exist between developed and developing countries which are successful in increasing international trade for both countries. There are plenty of benefits for a country when signing a

trade agreement. There are certain laws and rules involved in international trade, which aim to protect all countries involved. Both South Africa and the EU are members of the WTO, and thus have to adhere to the rules and regulations set out by the WTO. The WTO tries to ensure that all countries participating in international trade should benefit. However, there are still many aspects which need to be addressed to provide a better idea on how the EPA will affect South Africa's trade and economy. The next chapter provides an in-depth analysis of the EPA and focuses specifically on how the EPA will influence the flow of trade between SA and the EU.

CHAPTER 3

UNDERSTANDING THE ECONOMIC PARTNERSHIP AGREEMENT

3.1 INTRODUCTION

The previous chapter discussed the theory behind trade theories, trade benefits and trade agreements. In order to address the question of how the Economic Partnership Agreement (EPA) will affect South Africa, what influence it will have on their international trade and how it will impact on their economy, it is important to analyse the EPA and understand where it originates from. It is therefore necessary to understand the theory and dynamics of trade agreements, especially preferential and regional trade agreements. Preferential and regional trade agreements are complex agreements and no two agreements are the same. The aim of this chapter is to provide a clear understanding of the economic partnership agreement and how it will affect South Africa and the ACP countries.

Section 3.2 defines regional integration and gives an overview of the effects of integration as well as degrees and dimensions of integration. Section 3.3 provides a background on preferential trade agreements and discusses preferential agreements between the North and the South. Section 3.4 gives a complete overview of the Economic Partnership Agreement (EPA), including the definition, the history, and the aim of the EPA and effects of the EPA on the ACP countries. Section 3.5 gives an overview of the Organizations, agreements and unions that influence the EPA between South Africa and the EU. Section 3.6 provides a conclusion.

3.2 REGIONAL INTEGRATION THEORY

To gain a better understanding with regards to the motivation behind the EPA, it is essential to understand the theory supporting it. The main idea behind the EPA is to establish a free trade agreement between the ACP countries and the EU. This agreement is to support development of the ACP countries by helping them improve their competitiveness in world markets, thus increasing their exports, creating trade facilitation, stimulating job creation and attracting more FDI inflows (Venter & Neuland, 2007). However, there are many doubts with regards to the possibilities of the EPA to achieve this. The following section of the chapter aims to provide a theoretical background on the theory behind the EPA and the possible benefits as well as possible downfalls and problems that might arise due to the EPA. The base of the EPA is economic integration which is discussed in the next section.

3.2.1 Economic integration

Balassa (cited *in* Lee, 2003) defines economic integration as a development and a condition. A development, because it includes resources that aim to eliminate any discrimination between economic units. A condition, because it represents the nonexistence of different discriminatory ways between different economies.

The main argument for the concept of economic integration can be traced back to Smith's and Ricardo's theories of absolute and competitive advantage. If countries are able to trade freely with other countries, they can concentrate on the production of goods and services in which they have a competitive advantage. Therefore they can supply these goods and services most efficiently. Global economic integration thus enables countries to specialize and achieve comparative advantage in certain products, and if no trade barriers exist, greater world production becomes possible (Venter & Neuland, 2007; Robinson, 2008).

Global integrations enable countries' outputs to increase due to the possibility of economies of scale. Also, countries' terms of trade with the rest of the world are improved as well. Increased competition within the group encourages better efficiency and due to integration-induced change, the quality and quantity of factor inputs is enhanced, which results in more capital inflows or increased technological advances (Robson, 2000 (cited *in* Lee, 2003); Venter & Neuland, 2007). The subsequent section gives an overview of the effects of integration.

3.2.2 The effects of integration

Apart from output increases and specialisation, there are another three potential effects from integration, namely static effects, dynamic effects and trade deflection (Kyambalesa & Houngnikpo, 2006). The static effect can come in two forms, namely, trade diversion and trade creation. Trade creation is the result of a member country that starts to import products from another member country, which it previously produced for itself, but at a higher price. Trade creation can improve welfare for both members because it created a gain in consumer surplus for the importing country and a gain in producer surplus for the exporting country.

Trade diversion, the second static effect, usually decreases welfare and occurs then a member country now starts to import products from another member country, which it previously imported

from a different country. The original country which might not be part of the new integration and will thus be worse off because it will lose the potential trade (Di Mauro, 2000; Kyambalesa & Houngnikpo, 2006; Krugman & Obstfelt, 2009). In addition to all the benefits that arise from trade creation, the static effect also provides countries with administrative savings, which occur when countries no longer need some of the functions of the customs department. Countries also gain bargaining power and are able to improve their collective terms of trade (Kyambalesa & Houngnikpo, 2006).

The dynamic effect can be described as a change in the economic performance and structures of member countries as a result of members forming an inter-governmental organisation. Dynamic effects include economies of scale, increase in competition, which results in more efficient and productive industries. More foreign investments can be attracted when countries integrate, because it allows for larger consumer and industrial markets which often also increase employment due to the boost in business activity. Economic integration can eliminate the exchange rate variability which creates larger and more stable financial markets. A stable exchange rate can result in more stable and soundly based economic growth for the whole integrated region (Di Mauro, 2000; Kyambalesa & Houngnikpo, 2006).

Trade deflection can be described as a deliberate attempt by importers or exporters to avoid high tariffs by exporting/importing to/from a low-tariff member-country in a free trade area, thus avoiding the country with higher-tariffs. The countries that have high-tariffs can be worse off because they now lose the potential revenue from import duties. To tackle this problem, countries can use the rule of origin or create customs unions that are able to provide some level of control over imports and exports (Gracia & Zuleta, 2005; Kyambalesa & Houngnikpo, 2006).

It is thus evident that integration can benefit a country's economy. However the benefits of economic integration stretch far beyond economic benefits. Social, security, technological and political factors contribute just as much. Political factors which can encourage integration are based on the assumption that the process of socio-economic development requires various degrees of international cooperation or inter-dependence. Countries can thus benefit from each other by exchanging policies and ideas; this also contributes at the technological level, where a country decides to engage in economic integration with other countries to gain access to a larger market of

advanced technology. Countries also often form joint scientific and technological development programs, which usually provide double the funding and often double the skills when two companies merge (Caniëls & Verspagen, 1999; Kyambalesa & Houngnikpo, 2006). The various degrees and dimensions of integration are discussed in the following section.

3.2.3 Degrees and dimensions of economic integration

These integrations can take various forms, but can be placed into four main categories representing different degrees of integration. There are four main types of integration, namely a free trade area (FTA), a customs union, a common market and an economic union (Du Plessis, 2000; ITRISA, 2009).

A free trade area is where all members agree to eliminate trade barriers with each other for one or several products and trade freely without trade barriers of special requirements. Although all members must agree to eliminate trade barriers, each member is still able to pursue individual trade policy with non-members. An FTA is considered to have very complicated rules (rules of origin) which aspire to prevent various trade policies being undermined. The main reason for these rules is that non-members are able to "*cheat*" their way to lower trade costs by directing their products via one of the member countries which has fewer trade barriers (Venter & Neuland, 2007).

A customs union consists of the same basics as FTA, except members are obligated to utilize one common trade policy for non-member countries. This trade policy is usually in the form of a common external tariff (CET). Custom unions have a much deeper form of integration than the average FTA because counties are required to give up some of their economic and political control. However, this often means that the members gain collective sovereignty and this often increases the economic and political power of all the members (Du Plessis, 2000; Venter & Neuland, 2007).

A common market is in essence the same as a customs union. However, it encourages a higher level of trade liberalisation by allowing the free movement of capital and labour as well as of goods and services. This can be very beneficial to the members because it enables migration of production factors, which in turn can seek the highest possible returns. This enables all the members to use their resources more efficiently, raise their factor productivity and in the end create a higher growth rate (Du Plessis, 2000; ITRISA, 2009).

The most advanced regional integration is an economic union like the European Union, where all the members harmonize their monetary and fiscal policies and broaden their economic and social legislation. This is the ultimate form of a regional trade agreement (RTA) as it enables companies and workers who engage in economic activities in the union, to have the same economic conditions. An economic union does not necessarily have a single currency but in most cases it is a lot more cost effective to adopt a single currency (Venter & Neuland, 2007; ITRISA, 2009).

Other types of integration apart from those discussed above consist of preferential trade agreements, which basically allow countries to form loose economic integration, where participating countries decide to reduce tariffs and other barriers for each other. Monetary and political unions also form part of integration, where with the monetary union, countries that already have an economic union decide to use one common currency and thus have one central bank. With a political union, countries that already operate under a monetary union decide to create a regional bloc and have one common centralized political institution and a regional parliament (Kyambalesa & Houngnikpo, 2006).

Economic integration thus comes in various degrees of participation, which usually evolve with time. The longer countries integrate with each other, the more evolved their integration will be. There are many factors which influence a country's level of participation and involvement (Venter & Neuland, 2007; ITRISA, 2010). Kritzinger-Van Niekerk (2005) and the World Bank (2011) define or explain economic integration along three dimensions, which is discussed in the following paragraphs.

The first dimension is the geographical scope or the number of countries involved. Membership to particular regional integration agreements is a choice a specific country makes by motivation of political, social or economic considerations. In the past, countries that partook in regional trade agreements had to be in close proximity to each other. Globalisation and improvements in technology are quickly making it possible for all countries to participate irrelevant of the distance between them. However, the functional coverage has to be taken into consideration, as there are various costs associated with the increase in distance between trading partners.

The second dimension of regional integration therefore incorporates the functional coverage or width of segment activity like trade, labour mobility, sector policies and macro-policies. This dimension focuses on how regions seek to enhance the supply of sub regional public goods which usually requires that benefits and costs spill over national borders and forces countries to work together. These are divided into three broad categories, and depend on the scope and externality involved. The three categories are:

1. **Spill-over goods and activities:** Spill-over goods and activities that consist of a combined and non-competitive consumption which is based in a specific country and due to adequate volumes, spills over to its neighbouring countries.

2. **Economies of scale driven competitive goods and services:** These goods and services consist of national goods, but because of market fragmentation, the decreased market size often reduces the possibility for healthy competition and reduces the benefits of economies of scale. To combat this effect, and enable supply to become more cost-effective, it is distributed into larger sub-regional markets. These types of products often were natural monopolies with no trade prospects in the past. However market liberalisation enables more sub-regional trade as it is often enhanced by sub-regional market integration.

3. **Consistency and credibility driven activities:** These activities include activities which a single country can take on individually, however for such actions the commitment and consistency of this country's neighbouring countries is vital for credibility and efficiency. Examples of such activities can include legal improvements, trade and investment policies and various governing activities.

The third dimension looks at the depth of the integration, which measures the degree of authority that a county is ready to surrender. To be able to distinguish the depth of regional cooperation, the nature of activities has to be taken into consideration, as differences in activities imply that different multi-country partnership programs may be needed. Procedures of cooperation can be characterized permitting to the scope of activities ranging from separate projects, policies and organizations as well as the loss of authority ranging from full country control to full delegation to a multi-national entity (Kritzinger-Van Niekerk, 2005; World Bank, 2011).

The global integration trends have shown conflicting patterns. Over the last decade, the global political economy and environment has changed dramatically. Many countries, including several African countries are in the process of economic merging and integration. However, there is still a big difference between Africa's regional integration which is not very advanced compared to the EU. Internationally, globalization and regionalization have a leading impact on various transformations occurring, where Africa and several other developing countries have often been left out from these trends. For this study, more emphasis is placed on Southern Africa and specifically South Africa, which is most definitely an exception with regards to its progress in development when compared to other African countries (Venter & Neuland, 2007). The global trends in regional integration amongst countries show similar characteristics. The subsequent section gives an overview of these characteristics.

3.2.4 General characteristics of successful regional integration groups

Viner (1950), Leistner (1997), Lipsey (1970), Van Rooyen (1998) and Salvatore (2003) cited in Kyambalesa & Houngnikpo (2006) have identified that for any integration to be successful and practical, certain conditions should be met in participating countries: Firstly, each of the participating countries should have sustained peace, stability, transparency and be willing to participate in integrated related decisions, protocols and treaties. Secondly, the leaders of all the participating countries should be willing and have a genuine desire to establish a successful economic bloc. Thirdly, to enable countries to create a competitive business environment in the integrated economy, each participating country should have a competitive economy originally. Fourthly, all costs and gains should be distributed evenly amongst member countries. Finally the countries participating in the integrations should establish a measure and assess the quantitative and qualitative costs and benefits (Viner *et al.*, 2003).

Countries must be willing to give preferential treatment to fellow member countries by importing more goods and services from each other. Pre-integration trade ties between countries are favoured because they create a more certain environment due to the fact that there are expanded harmonious political relations and a similarity in the economic systems between member countries. It is vital that participating countries should have some geographical proximity; as this will enable them to establish a well-developed transportation system and incorporate the flow of industrial inputs and finished products between all the members (Viner *et al*., 2003; Kyambalesa & Houngnikpo, 2006).

Regional integration comes in various types of agreements like Preferential Trade Agreements, which are discussed in the following section.

3.3 PREFERENTIAL TRADE AGREEMENTS

A preferential trade agreement is an agreement between two or more countries, where the members of this agreement have agreed to lower their trade barriers for each other. PTA's are most common amongst small groups of countries that have some geographical proximity (Manger, 2008). The most prominent PTAs include the North American Free Trade Agreement (NAFTA) and the European Economic Community (EEC), MERCOSUR between the Argentine Republic, Brazil, Paraguay and Uruguay and the ASEAN agreement which is an association of South East Asian countries. The subsequent part of this section discusses the theoretical basis of PTA and the PTA between the north and south.

3.3.1 Theoretical basis for PTAs

Manger (2008) describes a PTA as being a discriminatory arrangement that liberalises trade, but only between member states. According to the General Agreement on Tariffs and Trade (GATT) administered by the World Trade organisation (WTO), member countries may not discriminate against goods entering their borders based upon the country of origin. However, the WTO has through Article XXIV of GATT enabled members to enter into preferential trade agreements with each other (Krishna, 2006). Nevertheless customs unions, free-trade areas, and interim agreements leading to the formation of a customs unions or free-trade area, need to be consistent with Article XXIV and therefore must satisfy, *inter alia*, the requirements of that Article (Krishna, 2006).

PTAs increase trade flows between member countries, but PTAs are also usually negotiated without any tariff concessions of transfers to non-member countries. PTAs can therefore often result in a decrease in welfare of the neighbouring countries (Markusen *et al.*, 1995; Enhod, Hamada & Shimomura, 2009). On the contrary, Kemp and Wan (1976) created the Kemp-Wan theorem which shows that a PTA can sometimes benefit neighbour countries if tariff concessions or transfers are provided for these countries. In their theory, they also show that it is possible for neighbouring countries to benefit without being compensated, as long as one of the member countries is an

"*entrepôt*[1]". When one of the countries is an *entrepôt*, it is possible for countries to have PTA that improves the welfare of the rest of the world (Enhod *et al.*, 2009).

Enhod *et al.* (2009) found that the rest of the world's welfare usually decreases when countries form PTAs without any concessions made to neighbour countries. They found that Article XXIV of the GATT should be implemented more strictly because at present, it is a highly unfair process to non-member countries and unless compensation is given, a PTA worsens the welfare of the rest of the world.

Although there is evidence that PTAs can worsen the world's welfare, PTAs have been on the increase since the early 1990's. In 2008 there were more than 250 PTAs between various countries, and the majority of these agreements were formed over the last 10 years (Enhod *et al.*, 2009). Manger (2008) finds it prominent that PTAs are increasing at a time where most-favoured-nation (MFN) tariffs have decreased dramatically and are at low levels. Manger (2008) also found that there is an increase in agreements between developed (North) and developing (South) (especially emerging) countries, where their economies differ in size and levels of development. This increase between North and South preferential trade agreements is one of the most important developments in the global trade regime. The next part of this section examines preferential trade agreements between the north and south.

3.3.2 PTAs between North and South

In recent years there has been an evident increase in preferential trade agreements between North and South (Manger, 2009). However, even with the surge in North-South PTAs, information regarding their political economy is still limited. This is especially true for the least developed countries (Krishna, 2006).

North-South PTAs are also said to offer very limited export prospects if they are between developed and developing countries. This has however not had a negative effect on the US, the EU and Japan, who have all aspired towards having more agreements with emerging markets. One of the main motivations is that these agreements incorporate various other negotiations and are not focused primarily on the liberalisation of exports. These other negotiations often include foreign direct

[1]A port where merchandise can be imported and then exported, without paying import duties. Or a city whose commercial activity includes the transhipment or distribution of trade goods (Export Bureau, 2011).

investment (FDI) and projects that aid development and incorporate these emerging markets into the world economy (Krishna, 2006; Manger, 2009).

The majority of North-South PTAs were as a result of multi-national firms which invested in emerging countries due to lower labour costs. PTAs seem like an attractive option to multinational firms to reduce the barriers to trade and investment. For the multinational firms PTAs can also decrease the cost associated with establishing production plants in these emerging economies, and are therefore considered a feasible option. There are, however, always risks associated with this type of preferential trade agreement. For example, the risk associated with sharing technological knowledge and intellectual property can open a possibility for counterfeit goods being produced. Another risk multi-national firms should be aware of is opening a backdoor to their country's markets as many of these developing country's firms will use the developing country as a platform for exports as the majority of export barriers will have been removed. To counteract this and in order for this type of agreement to be politically attractive, it must contain non-tariff barriers which will exclude non-members from the benefits of the free trade (Manger, 2009). The Economic Partnership Agreement is a good example of an agreement between the North and the South, the following section of this chapter gives an overview of the EPA between the EU and ACP countries.

3.4 ECONOMIC PARTNERSHIP AGREEMENT BETWEEN THE EU AND THE ACP COUNTRIES

The EPA is a preferential trade agreement between the EU and regional blocks of ACP countries and was set to be implemented by 2008. However, due to some obstacles several of the ACP countries (including South Africa) are still in the negotiation process. The EPA stretches beyond the specs of free trade as it includes issues such as competition, intellectual property and trade facilitation (Meyn, 2004). According to the European Commission (2000), the EPA should improve the ACP countries' trade and business environment, promote growth and increase their overall competitiveness, which will aid their integration into the global economy (EC, 2000). The next section defines the EPA and provides the historical background of the EPA.

3.4.1 Definition

An Economic Partnership Agreement (EPA) is described by the Hakima (2008) as a preferential trade agreement that consists of regional integration, market access, trade facilitation, technical barriers to trade, rules of origin as well as various sanitary measures. With the last Lomé Agreement (IVbis) on the brink of expiry, the EC proposed a new trade and development system. The Cotonou

Agreement came into force in 2000 and envisioned the creation of mutual trade agreements between the EU and the ACP countries. This mutual trade agreement created the foundation for the EPAs and was due to be finalised in 2007. The ACP consists of nearly 77 developing countries and many of these are LCD countries, which will have a separate agreement with the EU in order to comply with WTO rules. The biggest goal of the EPA is to promote sustainable development, contributing by enabling developing countries to integrate into the world economy and thus fight against poverty. The EPA will also enable the EU to provide assistance to the ACP countries, combining trade, politics and development to enhance the political dimension of the ACP countries. The EU will attempt to control and eliminate corruption, poverty and inadequate development policies (EC, 2000; Borrmann & Busse, 2007).

Before the EPA, with the Lomé and Cotonou agreement, the ACP countries enjoyed a unique relationship with the EU. They were granted tariff preferences and were able to export to the EU free from any permits or duties. The EU grated billion dollars in technical and financial aid to the ACP countries, which was meant to compensate for the possibility of any export losses which may have occurred because of the implementation of the EPA. Currently there are two main views regarding the EPA. The supporters, argue that the EPA will help the ACP countries with regional integration and remove constrains which will encourage their development. Critics, on the other hand, argue that the EPA is anti-development and will only cause losses to ACP countries (ODI, 2007).

Although the EPA promises to have added benefits, many challenges and risks are faced by the ACP countries. They will have to be well prepared and implement policies to ensure that a pro-development outcome is achievable. In order for the EPA to comply with the WTO rules, ACP countries will have to open their markets for EU exports in the next 12 years. This can have many negative consequences, for example: losses of tariff revenue, trade diversion and increased competition. ACP countries will have limited negotiation capacity and they will need to drastically improve their market access for agricultural products, which currently pose great difficulty in trade negotiations (Hinkle & Schiff, 2004). The subsequent part provides an overview of the historic development of the EPA.

3.4.2 Historical development of the EPA

The EU's preferential relationship with Sub-Saharan Africa, Caribbean countries and Pacific countries dates back to 1963 when the EEC (European Economic Community) created a trade and development relationship with its past colonies (Treaty of Yaoundé). The EPA is therefore a result of many years of trade history between the EU and the ACP countries. It originated with the Lomé conventions in 1975. Lomé I (1975), the first Lomé convention, was a very unique agreement because it was negotiated during a special time, where ACP countries were slowly approaching a position of equality. The Southern countries started to feature more in the world economy and their needs and ideas were being considered. The New International Economic Order (NIEO) was formed and although it did not have the desired effects, it still enabled the South to be involved in, for example, the creation of the System for Stabilisation of Export Earnings (STABEX). This guaranteed financial aid from the European Development fund, should the revenue fluctuate for exports of agricultural products, not covered by the Common Agricultural Policy (CAP) (Hurt, 2003; Venter & Neuland, 2007).

Unfortunately, the first Lomé agreement was not as successful as hoped, but it served as a starting point towards decades of negotiations between the EU and ACP countries. South Africa only had partial accession to the Lomé convention because it was more developed than the majority of the ACP countries. At a later stage, South Africa signed a separate agreement with the EU, the Trade, Development and Cooperation Agreement (TDCA) which governed the majority of the trade between them and the EU (Venter & Neuland, 2007; Meyn, 2008).

Lomé I was followed by Lomé II and Lomé III, which aspired to include aspects of human rights. However the ACP countries were strongly opposed to this. By the time Lomé IV (1989**)** was signed, all the enthusiasm had died down (Hurt, 2003). According to Ravenhill (1993) (*in* Zartman, 1993), the relationship between the EU and the ACP countries had reached a plateau and was becoming progressively less important. Many of the ACP countries were classified by the United Nations (UN) as being least-developed and most of the ACP countries had very weak economies, mainly due to the large drop in commodity prices during the 1980's. Almost half of the ACP countries were forced into debt and had to obtain structural adjustment programs (SAPs) from the World Bank and the International Monetary Fund. The main occurrence during this period was that the relations had started changing from being purely economic and non-political to including some

politics. This became more evident with the signing of the Cotonou agreement in the year 2000 (Meyn, 2008).

The Cotonou agreement, successor of the Lomé Conventions, was signed in June 2000 in Cotonou, the capital city of Benin. The Cotonou agreement had to be compatible with the multi-lateral trade rule of the WTO. In order to make this possible, the ACP countries were divided into two groups. The one group consisted of the less-developed countries (LDCs) while the remaining developing countries would fell into the second group (Hurt, 2003). The Cotonou agreement thus focused more on important economic and social development initiatives such as poverty reduction and was viewed as one of the key components of the EU's policy on aid and cooperation in developing countries (Lee, 2003; Venter & Neuland, 2007).

This agreement represented the shift towards more neo-liberal values, which were evident with the addition of new innovations that were to drastically change the nature of the EU-ACP relationship. This was to be realized by using political dialogue, giving development aid and closer cooperation with regards to trade and the economy (Hurt, 2003). The main difference between the Lomé conventions and the Cotonou agreement was the big emphasis on rule of law, especially towards human rights (Lee, 2003). Special provisions were made to include the ability of sanctions to be imposed on countries that were violating human rights and had corrupt regimes. Aid would thus not be given to countries that did not have transparent and stable governments. The Cotonou agreement also attempted to incorporate the ACP countries into the global economy and thus encouraged participation and a more strategic approach towards cooperation (Venter & Neuland, 2007). South Africa played a big role in the pre-negotiations of the Cotonou agreement and managed to qualify for the same benefits which it did in the Lomé IV convention. At this stage South Africa was still excluded from the provisions for economic and trade cooperation because their trade with the EU was already regulated under the TDCA agreement (Lee, 2003; Venter & Neuland, 2007).

3.4.3 Aim of the EPA

The EPA will focus on restructuring the trade arrangements so that trade between the EU and the ACP countries is promoted. This agreement aims to focus on improving development goals and being more compatible with the WTO's rules and regulations. The EPA also will play a role with regards to the enhancement of political dimensions, where issues like corruption will not be

tolerated and participatory approaches will be used to refocus policies on poverty reduction (Hinkle & Schiff, 2004; Borrmann & Busse, 2007).

With the EPA in place, the EU will provide free access to its markets for all exports from ACP countries, but the ACP countries will also have to provide free access to their markets. There will be a slight difference in the agreement for LCD-ACP countries, as these countries will be getting more benefits and might not have to open their markets (Hinkle & Schiff, 2004). This might cause some problems with intra-regional integration within Africa. Many of the African countries had objections with regards to the agreement and the negotiations were postponed until solutions could be found. South Africa for example is part of the ACP countries, but will not enjoy the same preferential trade arrangements as the rest of the ACP (Hinkle & Schiff, 2004; Borrmann & Busse, 2007). South Africa is described as having characteristic of both developed and developing countries and therefore had its own agreement with the EU, governed under the TDCA. South Africa therefore does not want to sign the agreement. The majority of SACU and 5 of the 7 countries of SADC opted to sign an interim EPA, which is like a stepping stone towards the actual EPA (ITRISA, 2009; DTI, 2011; EC, 2011). The table below gives an indication of the planned negotiations and the time period provided for the various agreements to be implemented.

Table 3.1 Timetable of Cotonou trade negotiations

DATE	STATE OF NEGOTIATIONS
23 June 2000	Cotonou Agreement Signed
September 2002	Begin formal negotiations of EPAs
2004	EU to assess the position of non-LCDs that decide not to negotiate EPA
2005	Deadline for multilateral approval of non-reciprocal trade benefits for EPAs
2006	Review of progress made in the negotiation of EPAs
1 January 2008	Last date at which EPAs should enter into force

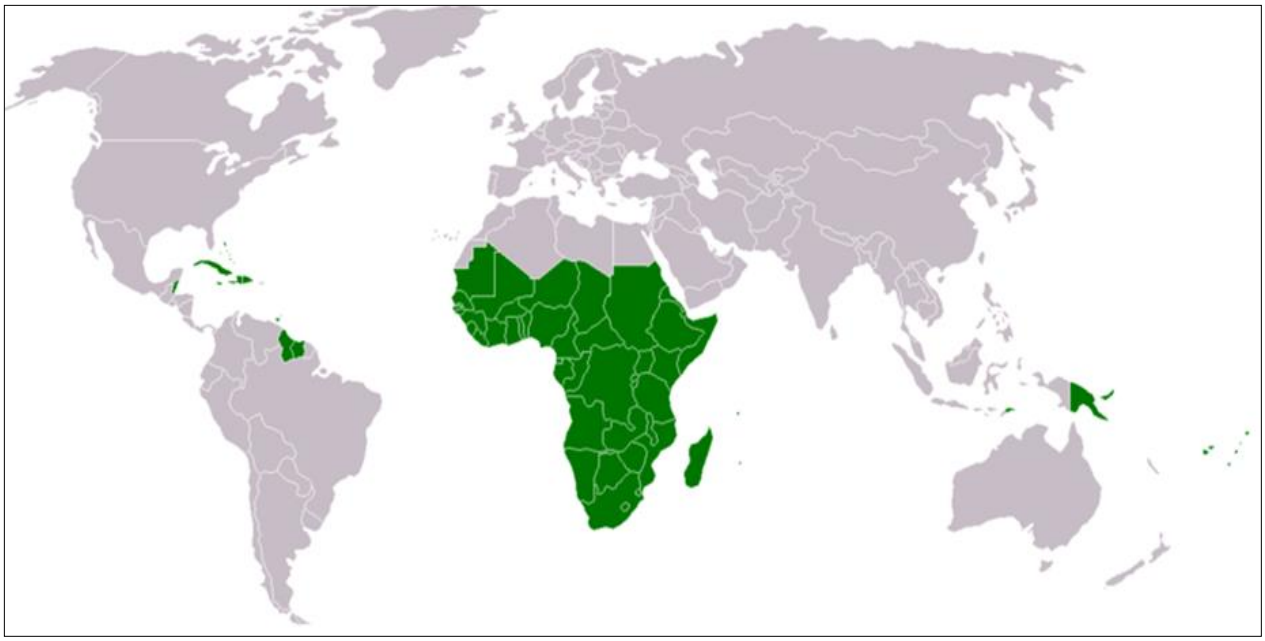
Source: Adapted from Hurt (2003).

It is evident from the table 3.1 that the EPA should already have entered into force January 2008. However, due to various problems that arose, there are still some countries which have not signed the agreement. It is important to remember that the EU is one of Southern Africa's largest trading partners and problems in terms of the EPA could have a great impact on Africa's economy (Hinkle & Schiff, 2004). The following section provides a description of the ACP countries.

3.4.4 The African, Caribbean and Pacific countries

The African, Caribbean and Pacific countries (ACP) consist of 79 developing countries that together form an organisation that was created by the Georgetown Agreement in 1975. The ACP countries meet frequently in order to discuss global development. All of the ACP countries signed the Cotonou agreement, which binds them to the European Union. There are 48 countries from Sub-Saharan Africa, 16 from the Caribbean and 15 from the Pacific (ACP secretariat, 2011). The ACP country grouping was created with specific objectives for the member counties, like achieving sustainable development, assisting with the gradual integration into the global economy and putting more emphasis on poverty reduction. Other objectives include establishing a more equitable world order, consolidating of unity and solidarity among ACP countries and consolidating peace and stability in a free democratic society (ACP secretariat, 2011).

Figure 3.1: Visual map of the ACP countries



Source: Department of International relations and cooperation (2012).

As can be seen from figure 3.1, the ACP group is principally made up of African states and a number of small Caribbean and Pacific Islands. All the ACP states are considered as equals, allowing for a broad based developmental plan which aims to improve the levels of development of all member states (ACP secretariat, 2011). The ACP countries can be grouped into seven groups namely the Southern Africa Development Community, Eastern and Southern Africa, West Africa,

Central Africa, the Pacific Islands and the Caribbean groups. Table 3.2 below summarises these seven groups, the member countries, main exports and main imports from the EU.

Table 3.2: Summary of the ACP groups

ACP COUNTRY GROUP	COUNTRIES	MAIN EXPORTS TO THE EU	MAIN IMPORTS FROM EU
Southern Africa Development community (SADC)	Angola, Botswana, Lesotho, Namibia, Mozambique, Swaziland and South Africa	diamonds, oil, fish, beef, sugar, tobacco	machinery, vehicles, chemicals
Eastern and Southern Africa (ESA)	Comoros, Djibouti, Eritrea, Ethiopia, Madagascar, Malawi, Mauritius, Seychelles, Sudan, Zambia and Zimbabwe	copper, raw cane sugar, textiles, tobacco, processed tuna, coffee	machinery, vehicles, chemicals
West Africa	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea-Bissau, Liberia, Mali, Niger, Nigeria, Senegal, Sierra Leone, Togo and Mauritania	oil, cocoa, bananas, pineapples, wood	machinery, vehicles
Central Africa	Cameroon, Central African Republic, Chad, Equatorial Guinea, Republic of Congo, Gabon, São Tomé and Príncipe	oil, wood products, diamonds, cocoa, bananas	machinery, vehicles, chemicals, iron and steel, pharmaceuticals
Pacific Islands Forum	Australia, Cook Islands, Micronesia, Niue, Kiribati, Nauru, New Zealand, Samoa, Palau, Papua New Guinea, Marshall Islands, Vanuatu, Solomon Islands, Tonga, Tuvalu	palm oil, sugar	machinery, transport equipment
Caribbean Forum	Antigua and Barbuda, Bahamas, Barbados, Belize, Cuba, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname, Trinidad and Tobago	fuel, chemicals, agricultural products (e.g. mangoes, bananas, rice, rum, sugar)	machinery

Source: Compiled by author using data from ITC and ACP secretariat (2011).

Table 3.2 gives a good overview of the ACP country groups and what they trade in, the next question arises, how will the EPA influence the ACP countries? The following section gives an analysis of the impact of the EPA on ACP countries.

3.4.4 Impact of the EPA on ACP countries

The export performance of ACP countries and Africa in particular, has not been very good over the last few decades. Their share in the EU market has declined from 6.7% in 1976 to 3% in 2005 (EU Commission, 2006). Although many non-reciprocal trade preferences for products originating in ACP countries exist, this appears not to be sufficient (Hinkle & Schiff, 2004). The EPA will boost the economies of ACP countries by proving more aid but also by making it easier for exporters to gain access to most EU markets. Other benefits according to Perez (2006) include the possibility of encouraging the liberalisation process in the ACP sub-regions, which can boost economic reforms and reinforce the credibility of governments in ACP countries.

On the downside, the EPA could prove to be costly for most of the ACP countries, because they will have to open their markets to the EU and will lose plenty of revenue from tariffs and customs duties (Perez, 2006). Domestic prices are likely to decrease, which will benefit consumers and increase their welfare, but this will harm local producers, who will now face a decrease in market share and thus decrease in welfare. Regional integration between the ACP countries could also experience negative effects due to trade diversion, because products previously imported from ACP countries will now be substituted by EU imports (Perez, 2006; Krugman & Obstfelt, 2009).

Due to the many difference between the ACP countries, they have been grouped into six sub-groups (see table 3.2) that all might have different arrangements under the EPA. LCD countries will also have a slightly different arrangement in order for the EPA to be compatible with WTO rules (ODI, 2007). This might drastically affect regional trade between the ACP countries. Table 3.3 summarises the members of the sub-groups of the EPA.

Table 3.3: Members of EPA sub groups

EPA SUB-REGION	MEMBERS [A]
Caribbean (15)	Antigua and Barbuda, Bahamas, Barbados, Belize, Dominica, Dominican Republic, Grenada, Guyana, Haiti, Jamaica, St Kitts and Nevis, St Lucia, St Vincent and the Grenadines, Surinam, Trinidad and Tobago
Central Africa (7)	Cameroon, Central African Republic, Chad, Congo Republic, Equatorial Guinea, Gabon, *São Tomé and Príncipe*
East and Southern Africa (16)	Burundi, Comoros, Democratic Republic of Congo, Djibouti, Eritrea, Ethiopia, Kenya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Uganda, Zambia, Zimbabwe
Pacific (14)	Cook Islands, Fed. Micronesia, Fiji, Kiribati, Marshall Islands, Nauru, Niue, Palau, Papua New Guinea, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu
SADC –minus (7)	Angola, Botswana, Lesotho, Mozambique, Namibia, Swaziland, Tanzania
West Africa (16)	Benin, Burkina Faso, Cape Verde, Côte d'Ivoire, Gambia, Ghana, Guinea, Guinea Bissau, Liberia, Mali, Mauritania, Niger, Nigeria, Senegal, Sierra Leone, Togo
[a]Countries in italics are least developed.	

Source: Compiled by the Author from the ODI (2007).

From Table 3.3, it is evident that many of the countries, especially countries in Africa are categorised in different groups. This might have negative implications for intra-regional trade for African countries, who might now face problems like trade diversion which is likely to decrease trade between these countries. Borrmann and Busse (2007) have identified other problems which African countries could face with implementation of the EPAs. For an EPA to be successful, certain conditions must be met. Institutional quality for example plays a vital role in trade liberalisation strategies and countries which do not have high-quality institutions and good government regulations rarely benefit from trade liberalisation. Most African countries lack these conditions and could face serious problems. Therefore it is necessary to consider these problems and find solutions when deciding to implement the EPA.

According to the ODI (2007), supporters of EPAs argue that the EPA can increase regional integration between ACP countries if the European Commission (EC) is able to achieve its objective of implementing a single agreement for all the ACP states. In other words, when it is possible for all ACP countries to have a single and unified arrangement with the EU, then regional integration amongst the ACP countries will also increase. Currently, this is almost impossible, the main reason being LCD countries, who will not survive opening their markets to the fierce competitive and often subsidised products from the EU.

The possibility of a single agreement for all ACP countries lies far in the future. In order for this to be possible, time and effort is needed for countries to adjust and implement various policies. Regional partners who currently have different tariffs towards the EU should implement stronger border controls to ensure that goods from the EU do not enter a low tariff country only to be transhipped to one with a high tariff. Unfortunately, this could cause deterioration in intra-regional trade between the ACP countries (ODI, 2007). If so many problems could arise from implementing the EPA, why would countries agree to participate in this agreement? The subsequent part of this chapter gives an overview of the EPA specifically between SA and the EU.

3.5 ORGANIZATIONS, AGREEMENTS AND UNIONS THAT INFLUENCE THE EPA BETWEEN SOUTH AFRICA AND THE EU

3.5.1 Organizations, agreements and unions that influence the EPA

When countries partake in an international trade agreement, there are various parties, unions and organisations which play a role in creating and governing this agreement. In the following section the various organisations and unions which have an influence on the EPA between the EU and South Africa are discussed. A brief definition and overview is given with regards to each of the organisations, agreements and unions.

As a result of Apartheid, South Africa experienced a decrease in trade due to various sanctions. Since the economy's liberalisation, the country has overcome many obstacles and South Africa's international economic relations currently include various bilateral agreements and multilateral agreements. South Africa played a big role in the establishment of the first General Agreement on Tariffs and Trade (GATT) in 1947 and became a founding member of the World Trade Organization (WTO) in 1995. South Africa is a member of SACU (the Southern African Customs Union) and SADC (the Southern African Development Community) and CMA (the Common Monetary Area) (Bethlehem, 2008).

With regards to the EPA, South Africa is currently a member of SACU and SADC and also has a separate trade agreement with the EU, the Trade, Development and Co-operation agreement (TDCA). This might cause potential problems with regards to the EPA, as there might be conflicting rules and regulations between the TDCA and the EPA. This might also cause some discrepancies between SA and other members of SADC, like Lesotho which is seen as an LDC country and will have different rules and regulations under the EPA than SA will have. This in turn could hamper regional integration between the SADC countries (EC, 2000; Grant, 2008).

The EPA will have to clearly specify its rules or origin to ensure that all trade between the SADC countries and the EU remains fair and beneficial to all countries. The World Trade Organisation (WTO) has specific laws to which the EPA should adhere to, to prevent harm to any country. The next part gives a brief overview of the WTO.

3.5.2 The WTO

The World Trade Organisation (WTO) with 153 member countries is a fairly young organisation that has made a significant impact on world trade. The WTO originated as a set of general agreements on tariffs and trade (GATT) that was negotiated between several countries in 1947. In 1994, nearly 50 years later, the WTO agreement was signed in Morocco and came into effect on January 1995. Since then, the number of countries involved in the WTO has grown significantly. The fundamentals of the WTO have been governing the trade between countries for more than 50 years (Fundira, 2009). The WTO provides rules and regulations for multilateral trade to ensure that it is both fair and free. The basic principles of the WTO focus on trade being non-discriminatory, fair and with equal market access for all. The WTO also plays a role in decision making and dispute settlements with regards to special and different treatment for developing countries, especially LCD countries and tends to conflict between trade, and other societal values and interests (ITRISA, 2009; WTO, 2010).

One of the main goals of the EPA was to create an agreement which would be compatible with WTO rules and regulations and also comply to the requirements of article XXIV of the GATT and article V of the GATS (ODI, 2007). The biggest change that had to occur was that the ACP countries needed to liberalise and open their markets to the EU. However, they only had to open their markets for several imports from the EU and this did not have to occur immediately but within a reasonable period of time. The WTO also required the EPA to have different arrangements with LCD countries, which due to their lack of development would enjoy more benefits from the EU. Also, they (unlike non-LCD countries) would not be required to open their markets to EU imports (IDO, 2006).

3.5.3 The EU

The European Union (EU) has a very advanced economic integration, and therefore often serves as a model union for other countries which aspire towards economic integration. The EU was very unique amongst other regional organizations because of these amazing advances towards super nationalism, which has improved the prosperity of all its members. EU members were able to enjoy various benefits of free trade and better opportunities. The formation of a customs

union in the EU abolished many customs duties and other restrictions. Further integration through the formation of a common market reduced external tariffs on imports and allowed the free movement of capital, labour, goods and services. The EU is one of the key role players in the EPA agreement, and could potentially be of great help to South Africa and the SADC countries, because if could encourage integration amongst them (EC, 2000; ITRISA, 2009).

Unfortunately in the last months Europe has been battling with a sovereign debt crisis. The crisis that began in Greece spread to Ireland and Portugal, and more recently to Spain and Italy. In order to keep all the EU countries together, major financial recourses and significant resourcefulness will be required. Breaking up of the EU countries would be a much bigger disaster and could trigger a Great Depression. Recent advances revealed that although the EU has a unified monetary policy, it does not have a unified fiscal regime. At the time the euro was generated, the credit risk did not disappear with currency risk (King & Henry, 2011).

There are various theories on how the EPA will be affected by the crisis. The optimists predict that the EPA can have a positive effect on the crisis. EPA can, by addressing some of the general impairments to economic development of the ACP countries, serve as an antidote to the global crisis. If the EPA can find a way to merge with the ACP countries' commitments on social, labour and environmental rules as well as development cooperation from the EU, the EPA could help the ACP countries recover from the crisis. The EPA could also become a dependable security against any further policy setbacks that would decrease the prospects for economic growth (Bilal, 2009).

Luckily South Africa was not as badly affected by the global financial crisis as any of the other ACP and EU countries. However, with the credit crunch exports to the EU countries decreased (Donohoe, 2008). South Africa currently has its own trade agreement with the EU, the TDCA and apart from this; they are also members of the WTO, SADC and SACU, which can cause some minor issues due to overlapping trade agreements.

3.5.4 South Africa and overlapping agreements

South Africa, Namibia, Lesotho, Botswana and Swaziland form the South African Customs Union (SACU). The SACU secretariat is currently located in Namibia's capital city Windhoek. SACU was established in 1910 and is the world's oldest customs union. The main role of SACU was to collect duties on the local production and customs duties on the imports from countries not part of SACU. The revenue that is collected is distributed amongst member countries in

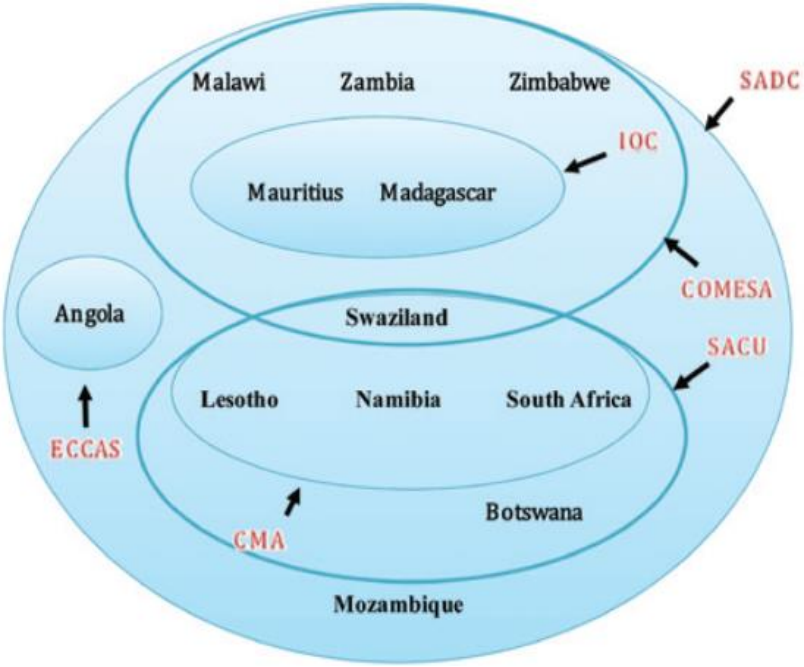
quarterly instalments. Today, the economic structure of SACU links members with a single tariff and forms a single customs territory where all tariffs and other barriers are completely eliminated on all trade between members. All the SACU members also apply a common external tariff to all non-members (Jakobeit, Hartzenberg & Charalambides, 2005; SACU, 2011). Several members of SACU are also members of SADC, which can cause issues with the EPA.

SADC consists of Angola, Botswana, the Democratic republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Swaziland, Tanzania, Zambia, Zimbabwe and South Africa. SADC has existed since 1980 when it was merely a loose alliance of nine of the states in Southern Africa, which were also known as the South African Development Coordination Conference (SADCC). When SADC originated, its main aim was to coordinate development projects that would decrease economic dependence on South Africa, which was still strongly in the apartheid era. In 1992 in Windhoek the SADC of today was formed and the organisation was given a legal character. Its main goal was to lead economic integration of Southern Africa (Jakobeit *et al*., 2005; SADC, 2010).

Trade relations that occur in SADC are very complicated, mainly because most of the members of SADC also belong to other regional groups like SACU, COMESA and the EAC (Lee, 2003). The issue of overlapping of members caused a rivalry between SADC and COMESA, which started in 1992. At that point SADC became a development community with most of its objectives being the same as those of COMESA. At the time, the overlapping membership did not pose a great threat, however in the future, with the EPA being implemented; it will cause many problems (Lee, 2003).

The majority of African countries belong to more than one regional trade agreements and currently there is no standard timetable for signing the EPA, there is a huge overlapping of these regional groupings (Odhaimbo, 2008). Only 6 out of 53 African countries belong to only one regional community, 26 belong to two communities, 20 are members of 3 communities, while the Democratic Republic of Congo belongs to four groups (Jakobeit *et al*., 2005; Karingi *et al*., 2009). The figure3.2 illustrates which countries belong to which regional groups and how they overlap each other.

Figure 3.2 East and Southern Africa Regional Economic Integration arrangements



Source: De Coubertin & Nouira (2011: 4).

It is not difficult to see the various overlapping memberships present in Africa's integration currently, something that can make it very difficult to establish different trade benefits for different groups. For example a specific country may be eligible for duty free exports to the EU for certain products, but at the same time that same country may be part of another regional group that does not enjoy those benefits. One option that could lessen this problem is that intra-African trade should first be deepened and expanded before they establish trade agreements with the rest of the world. It has been suggested by Kyambalesa and Houngnikpo (2006) that the smaller SADC should merge with COMESA. Chiluba (1992) from Zambia also urged the two to merge stating that having a single institution would benefit everyone. By combining resources and expertise and provide for wider markets would better enable these countries to achieve economies of scale and many of the other benefits of integration.

3.5.6 SA and the TDCA

The Trade Development and Co-operation Agreement (TDCA) is an agreement between the EU and South Africa, which governs trade relations and various development schemes. This agreement was signed in 1999 and its main goal was to establish a free trade area between the EU and South Africa within 12 years. The TDCA has encouraged trade between the EU and South Africa and trade volume has increased by around 30% from 2004 to 2008. South Africa's exports to the EU rose from €15.8 billion in 2004 to almost €22.2 billion in 2008. Exports from South Africa to the EU decreased in 2009 mainly due to the financial crisis, but started to

recover in 2011 where South African exports recovered to €20.5 billion. The EU is also by far South Africa's most important development partner, providing 70% of all external assistance funds (ITC, 2010).

South Africa is benefiting to a great extent with the TDCA and thus already enjoys most of the advantages that the EPA promises. The TDCA is however of more value for South Africa because it creates a strategic partnership with the EU. The TDCA was created with specific goals and because the TDCA is between EU and South Africa only, it does not have much influence on the trade between South Africa and its neighbouring countries. Due to the fact that South Africa and its neighbouring countries belong to more than one trade group, there might be some discrepancies when trying to implement the EPA in all of these countries (Grant, 2008). Because these countries already have trade agreements amongst each other, it is important to take this into consideration when analysing how the EPA will influence South Africa, and its trade.

3.6 SUMMARY AND CONCLUSION

To understand how the Economic Partnership Agreement (EPA) will affect South Africa and how it will affect their international trade and economy, it is important to analyse the EPA and understand where it originates from. This chapter mainly focused on the theory and dynamics of trade agreements, especially preferential and regional trade agreements. The EPA's main goal is to establish a free trade agreement between the ACP countries and the EU. This agreement aims to support development by improving competitiveness for the ACP countries in world markets, increasing their exports, and attracting more FDI inflows.

Global economic integration enables countries to specialize and achieve comparative advantages, and if no trade barriers exist, greater world production becomes possible. Economic integration can eliminate the exchange rate variability which creates larger and more stable financial markets. There are also three other potential effects from integration, namely static effects, dynamic effects and trade deflection. Countries thus become more competitive, can enjoy benefits from economies of scale and attract more foreign investments as integration allows for larger consumer and industrial markets. The benefits of economic integration stretch to include social, security, technological and political benefits. Countries benefit from each other by exchanging policies and advanced technology information. Countries often form joint scientific and technological development programs, which usually provide double the funding and double the skills.

There are various degrees and dimensions of integration. There are four main types of integration: free trade area (FTA), Customs union, Common market and an Economic union. The most advanced regional integration is an economic union like the European Union, where all the members harmonize their monetary and fiscal policies and broaden their economic and social legislation. For integration to be successful and practical, certain conditions have been identified. They are as follows: each participating country ought to have sustained peace, stability, transparency and be willing to participate in integrated related decisions, protocols and treaties. Leaders of participating countries should be willing and have a genuine desire to establish a successful economic bloc. A measure to assess the quantitative and qualitative costs and benefits should be established. Each participating country's economy should be competitive and all costs and gains should be distributed evenly amongst member countries.

A PTA or a RTA between several countries with similar economies can help boost their exports without them having to face the entire global market. In some cases developing economies have preferential trade agreements with one developed country, which will aim to help them incorporate into the global economy and boost their economic development. There has been an increase in PTAs between North and South. North-South PTAs can offer very limited export prospects when between developed and developing countries. Most of the North-South PTAs were as a result of multi-national firms investing in emerging countries due to lower labour costs. There are also risks associated with these preferential trade agreements, like the risk associated with sharing technological knowledge and intellectual property. This often opens a possibility for counterfeit goods. Another risk multi-national firms should be aware of is opening a backdoor to their country's markets.

The Economic Partnership Agreement is a preferential trade agreement between the EU and regional bloc of ACP countries and was set to be implemented by 2008. The ACP consists of nearly 77 developing countries and many of these are LCD countries, which will have a separate agreement with the EU in order to comply with WTO rules. The biggest goal of the EPA is to promote sustainable development, by enabling developing countries to integrate into the world economy and thus fight against poverty.

There are many organisations, agreements and unions that influence the EPA. The WTO has thus been an international institute for trade for more than 50 years and played a big role in the creation of the EPA. SA and the EU have had a trade relationship for many years and currently

the Trade Development and Co-operation Agreement (TDCA) governs trade relations and also includes various development schemes. Other parties that also play a role, specific regarding South Africa are SADC and SACU which generates another problem of overlapping regional trade agreements in Africa that hold many challenges for the EPA. Many economists urge that for the EPA to be successful the EU should attempt to have one single agreement with all the participating members.

Although the EPA promises to have added benefits, many challenges and risks are faced by the ACP countries. They will have to be well prepared and implement policies to ensure that a pro-development outcome is realisable. In order for the EPA to comply with the WTO rules, ACP countries will have to open their markets for EU exports in the next 12 years. This can have many negative consequences, for example: losses of tariff revenue, trade diversion and increased competition. ACP countries will have limited negotiation capacity and they will need to drastically improve their market access for agricultural products, which currently pose great difficulty in trade negotiations.

Looking at South Africa specifically, the country is already benefiting to a great extent with the TDCA and thus already enjoys most of the advantages that the EPA promises. The TDCA is however of more value for South Africa because it creates a strategic partnership with the EU. The TDCA was created with specific goals and because the TDCA is between the EU and South Africa only, it does not have much influence on the trade between South Africa and its neighbouring countries. This should eliminate the issues of overlapping trade agreements. Due to the fact that these countries already have trade agreements amongst each other, it is important to take this into consideration when analysing how the EPA will influence South Africa and its trade.

To be able to better understand how this agreement will influence South Africa and its trade, it is necessary to gain a better understanding with regards to the trade relationship between South Africa and the EU as it is currently. The next chapter provides an overview of South Africa and the E U and the trade relationship between them.

CHAPTER 4

SOUTH AFRICA AND THE EUROPEAN UNION – A COMPLETE OVERVIEW

4.1 INTRODUCTION

In order to address the issue of how the Economic Partnership Agreement (EPA) will affect South Africa's international trade and the economy, it is necessary to provide an overview of the current economic and trade situation in South Africa as well as in the EU. In order to understand how the EPA will influence this relationship, it is also vital to understand the dynamics of the current trade relationship between the EU and South Africa. This chapter provides a country profile for South Africa and the EU and an overview of the value and volume of South Africa's trade, focusing on the trade in goods, services and FDI between South Africa and the EU. This chapter also gives an overview on the TDCA and compares the TDCA to the EPA to establish where the biggest differences will lie.

The outline of the chapter is structured as follows. Section 4.2 provides the country profiles for South Africa and the EU, section 4.3 contains an overview of the trade value and volumes between South Africa and the EU. The trade volumes and values are compared across various time periods to indicate whether they have increased or decreased. This section of the chapter also provides an overview of the products which are mostly traded between the EU and SA. Section 4.4 analyses the effects of trade agreements on trade and aims to determine whether the trade volumes and values increased or decreased when trade agreements were formed between these countries.

4.2 COUNTRY PROFILES

This section provides profiles for South Africa and the EU. This includes an economic, political and trade overview that enables a comparison between the two countries and illustrates the degrees of difference between the EU and South Africa. It is important to understand the degrees of difference between these countries because it enables a better understanding of the possible problems and obstacles as well as benefits which may arise from the EPA. Studying the profiles of these countries also provides background knowledge on the products and partners the countries are most likely to trade with as well as indicate possible trends. The main focus of this study is on how the EPA will affect South Africa. Therefore the country profile for South Africa is discussed in detail in the following part of this chapter.

4.2.1 South Africa

4.2.1.1 Introduction

South Africa is classified as having characteristics of both developing and developed countries, and therefore often has its own set of regulations regarding international trade agreements. South Africa can be classified as being mostly a middle-income, emerging market with plenty of natural resources. However, the high unemployment rate, large population growth and unequal distribution of income resemble a developing country despite the abundance of natural resources. South Africa's key economic sectors include mining services, transport, energy, manufacturing, tourism and agriculture. South Africa is also seen as a distribution point for many of the land locked neighbouring countries, giving it an advantage in attracting trade. South Africa has excellent roads, rail and air facilities for both domestic and international purposes. Regarding telecommunications, South Africa is world class with four cellular networks and widely available internet access (CIA, 2011; World Bank, 2011). The more important factors such as the economy and trade environment which will be influenced most by the EPA are discussed in the following section of this chapter.

South Africa is mostly known for its rich mineral resources, which also form a big part of its exports. South Africa is one of the world's largest producers and exporters of platinum and a big producer of gold, chrome, vanadium, manganese and titanium. South Africa used to be very competitive in its gold exports but since 2000, platinum overtook gold as South Africa's biggest earner of foreign exchange. Historically South Africa mainly exported agriculture and raw materials. Over the last few decades, South Africa has increased its ability to process minerals. South Africa is now able to produce products such as ferroalloys, stainless steels and other similar products. South Africa has also increased the production of diverse manufactured goods such as motor vehicles and parts, synthetic fuels and mining equipment. Primary agriculture still accounts for 3% of GDP. The biggest most significant crops include citrus and deciduous fruits, corn, wheat, dairy products, sugarcane, tobacco, wine, and wool. South Africa is a net exporter of food to many countries, with the Middle East becoming an important importing country (Bureau of African Affairs, 2012).

4.2.1.2 Economy and demographics

South Africa has a population of 48 810 427 (2012) and a GDP per capita of US$11 100 (2011). South Africa has a relatively strong economy with good international trade and is the most advanced economy on the African continent. Since 1994 the economy has grown at a fast rate,

with the biggest contributing sectors being the mining sector, the manufacturing sector and the agriculture sector. South Africa's GDP was US$408.1 billion in 2011 and GDP PPP in 2011 was estimated at US$562.22 billion. The real GDP growth rate ranged between 4.9% and 5.3% from 2004 and 2007 but decreased to -1.5% in 2009 due to the financial crisis. In 2011, the estimated GPD increased to 3.1% (CIA, 2011). This was mainly due to a tighter domestic policy environment and the global economic crisis which had an effect on all countries. South Africa has recovered from this crisis relatively well. The 2010 FIFA World Cup also contributed to the country's economy and enabled South Africa to create jobs and generate income and thus combat the effects of the crisis. South Africa has a labour force of 17.66 million (2011) where agriculture accounts for 7% of the labour force, industry for 26% and services for 65% (2007). South Africa has a high unemployment rate of 24.9% (2011) and a Gini index of 65 (2005) which increased from 59.3 in 1994. South Africa also has a relatively high inflation rate at 5% (2011) which along with the high rate of unemployment had a negative effect on SA's economy (SA Gov., 2010; CIA, 2011).

Geographically, South Africa has a prime location and its good infrastructure allows access to other Southern African countries which are landlocked. The country also has very good financial and industrial infrastructure which still has excellent potential for growth. The infrastructure has been greatly improved as an upgrade was necessary due to the country hosting the 2010 FIFA World Cup. The country now boasts the Gautrain, as well as improved public transport with the Gautrain bus system and better roads and railways. South Africa with its combined characteristics of a developed and developing country offers a very unique and undeniable opportunity for international trade. The reason for this is that it offers the stability of a developed country but also plenty of opportunities of an emerging market and plenty of opportunities for growth (SA Gov, 2010; CIA 2011).

4.2.1.3 South Africa's current account deficit

A deficit on the current account is considered dangerous when it is more than 3% of the GDP, because it indicates that a country will experience problems when it has to cover the deficit. South Africa has had a current account deficit since 2002. In 2011 the current account deficit was 3.30% of GDP. Between 1980 until 2011 South Africa's current account averaged at -1.28% reaching the highest percentage yet of 6.00% in December 1987 and a record low of -7.50% in December 1971 (Draper & Freytag, 2008; South African Reserve Bank, 2012).

A current account deficit can be harmful for South Africa because it increases the pressure on the Rand to depreciate in order to increase exports. Imports thus become more expensive which can have hazardous effects. South Africa is very dependent on oil imports. When oil prices increase, inflation and interest rates rise causing the economy to become less price-competitive and is thus worse off (ITRISA, 2009).

However, it is crucial to analyse the cause of the deficit to be able to indicate whether or not it is a concern. If the deficit is mainly caused by increased expenditure on imported goods, it can be a cause for concern, while an increased expenditure on capital equipment for investment purposes is not a cause for concern, because it improves a countries economy over the long-term (ITRISA, 2009). South Africa's biggest deficit of the current account is the growing deficit on the trade account (Draper & Freytag, 2008). The deficit has increased due to increased imports of construction equipment and materials regarding the various upgrades of our infrastructure (Gautrain, various national roads etc.), with government importing around 40% of the road, rail and power equipment needed (South African Reserve Bank, 2012).

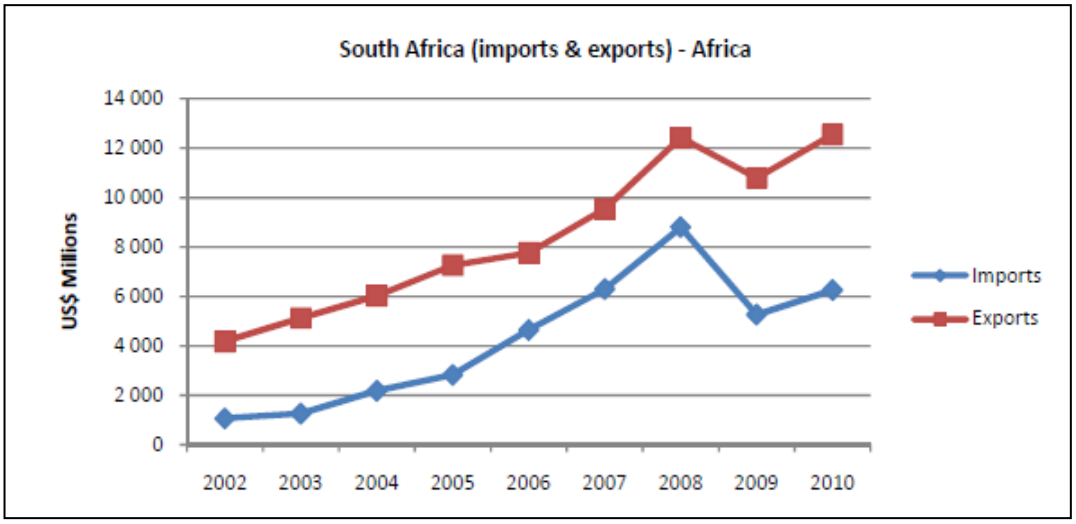
According to Draper and Freytag (2008), South Africa's current account deficit is not a cause for concern at the moment because South Africa is using the net capital inflows for further investments in the country such as upgrading the infrastructure like the Gautrain and various national roads. With the correct policies, South Africa can invest these capital inflows further by creating jobs and thus elevating the poorest out of poverty and providing incentives for the higher income groups to save with better interest rates. This would decrease the need for net capital inflows in the long run without having to implement policies regarding the exchange rate and various trade barriers (Draper & Freytag, 2008).

4.2.1.4 SA trade characteristics

South Africa has characteristics of both developing and developed countries. South Africa is often seen as the gate-way to the rest of Africa because it has adequate infrastructure. South Africa's infrastructure is suitable for international trade and includes rail, road, air and sea possibilities. When comparing the infrastructure of South Africa's neighbouring countries, their infrastructure is less developed in. Land locked countries like Lesotho, Swaziland and Botswana often completely rely on South Africa's infrastructure for all international trade from non-SADC countries. South Africa and the rest of SADC are working towards improved regional integration and South African businesses have invested substantially in African countries

(Fundira, 2011). Trade between South Africa and the rest of Africa has also increased significantly in the last decade. Figure 4.1 gives an overview of the trade growth.

Figure 4.1: South Africa's imports and exports from the rest of Africa



Source: Fundira (2011).

From figure 4.1 is it evident that trade between SA and its neighbouring countries has been increasing steadily between 2002 and 2008. Between 2008 and 2009 there was a dramatic decrease in trade, due to the global financial crisis. Imports from Africa to South Africa were most affected by the financial crisis but managed to start increasing again middle of 2009. South Africa's biggest import partner was Nigeria with a share of 35% and Angola with a share of 32% of SA imports. Mozambique with a share of 8% was in third place. For exports Nigeria had the biggest share of 18% closely followed by Zimbabwe's 17% and Mozambique with a share of 16% (Fundira, 2011).

4.2.2 The European Union

4.2.2.1 Introduction

The European Union (EU) is characterised by its advanced economic integration and has often served as a model union for other countries aspiring towards economic integration. It has brought five decades of peace and stability and it helped raise living standards for all its members. The EU also successfully launched a single European currency, and is gradually building a single European market in which people, goods, services and capital move among the member states as freely as if it were one country (Bilal, 2005). The EU is based on a FTA where 12 members have the Euro as a common currency. Three members of the previous 15 have decided to remain outside the Euro zone, while 12 "new" members are expected to join the Euro

zone in the near future once they manage to meet the terms of the thorough macroeconomic requirements for participation (Venter & Neuland, 2007).

The EU is very unique amongst other regional organizations because of these advances towards super nationalism which undoubtedly improved prosperity for all its members. However, this degree of integration was achieved over many years, starting in the late 1940's where funds from the Marshall Plan funds provided countries in Europe with a tool to recover after World War Two and stimulated West European integration (Mooslechner & Trumpel-Gugerell, 2003). New structures were created, based on common interests and treaties were created, which guaranteed the rule of law and equality between al countries. Statesmen like Schuman, Adenauer, de Gasperi and Churchill supported these new structures and persuaded their people to follow (EC, 2010).

4.2.2.3 Economy and demographics

The EU has an estimated population of 503 824 373 (2010) and has an average GDP per capita of US$34.5000 (2011). The EU has a combined labour force of 228.4 million (CIA, 2011; World Bank, 2011). Due to the fact that the EU is operating as a single market, it has become a major world trading power. It is one of the biggest benefits from regional integration and the EU was sure to optimise this to the maximum. The EU had planned to sustain its economic growth by investing in infrastructure like transport and energy (EC, 2012).

The EU faces some challenges in devising and enforcing common policies because there is a big difference in the per capita income amongst the member states. There are also some discrepancies in national attitudes towards matters like inflation, debt and foreign trade (CIA, 2012). These discrepancies became more apparent after 2007, when an additional 12 countries joined the EU between 2004 and 2007. These counties were generally less advanced economically that the other 15 members and only five (Slovenia, Cyprus, Malta, Slovakia and Estonia) of the 12 new members adopted the Euro as their currency, where 11 of the 15 members had adopted the Euro (CIA, 2012; EC, 2012).

The 2008 - 2009 global economic crises hit the EU harder than anyone expected causing the EU to have very moderate GDP growth in 2010 and 2011. The European debt crisis is a big problem for the global economy. The European debt crisis is mainly caused by Europe's inability to pay the debts it has acquired in recent years. The crisis started in Greece in the late 2009 but has evolved into an expansive economic and political crisis in. Europe now faces four main

correlated economic challenges, high debt levels and public deficits in some countries, weaknesses in their banking systems, high unemployment in some countries and economic recessions as well as persistent trade imbalances (Nelson, 2010).

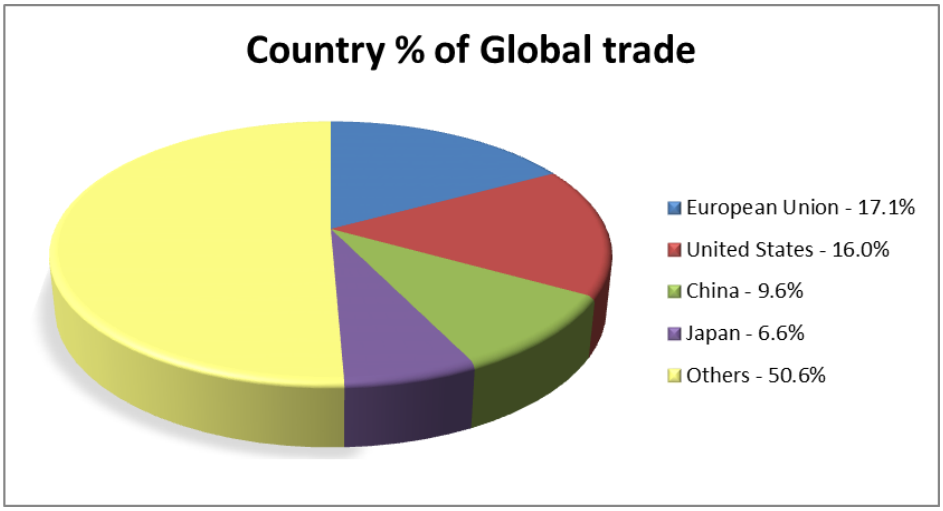
Greece, Portugal, Ireland, Italy, and Spain are the main offenders who failed to produce enough economic growth to be able to pay back bondholders. To make matters worse, a sovereign debt crisis erupted in the EU after 2011 and initiated the EU to shift its economic and political focus to prioritise combating the crisis. The EU/IMF implemented adjustment programs in Greece, Ireland and Portugal and various other consolidating measures in the other EU member states. Despite all their efforts countless risks to growth remain. The EU also faces high public debt, an aging population, challenging regulations and an underlying fear that the debt crisis will spread to other members (Nelson, 2010).

Furthermore, the EU is facing a political crisis. Discrepancies between Germany, France, and the European Central Bank (ECB) over the correct crisis response and complex European Union (EU) policy making processes, are seen as having aggravated concern in the markets (EC, 2012). In response to the debt crisis, the EU leaders shifted focus in 2011 to boost funding levels for the temporary European Financial Stability Facility (EFSF) to almost $600 billion. They also attempted to make loan terms a more favourable option for countries affected by the crisis and aimed to bring the permanent European Stabilization Mechanism (ESM) online a year earlier than they originally planned to (EU, 2012; CIA, 2012).

4.2.2.4 EU trade characteristics

When observing the trade behaviour of EU members, it is evident that there are some characteristics which all the members display. Firstly, the 27 member countries are all situated in the same geographical area, which is not a necessity in itself. However, the closer countries are to each other, the less the logistic costs will be. Not only are the countries situated close to each other, they also have easy access to one another. The transport network between member countries includes air, land (road and rail) and sea links providing for excellent geographical mobility. Most of the 27 countries have considerable natural resources and have developed substantial labour capacity and manufacturing skills. All 27 countries have an entrepreneurial culture and trading relations which are governed by treaties (European Commission, 2011).

Figure 4.2: Global trade in goods (2006)



Source: Eurostat (2006) Compiled by Author.

From figure 4.2 it is clear that the EU was the biggest contributor towards global trade in 2006. The EU contributed 17.1% towards global trade followed by the United States which contributed 16.0% towards global trade. According to Eurostat (2011), the EU is the biggest role player in trade globally, contributing a total of 17.1% of all trade. The US is closely second, with 16% of all trade. The following section gives an overview of the trade relationship between South Africa and the EU.

4.3 TRADE AND RELATIONS BETWEEN SOUTH AFRICA AND THE EU

To be able to determine how the EPA will affect South Africa and its trade with the EU, it is necessary to gain a better understanding of the trade and trade relationship between South Africa and the EU. This section provides an overview of South Africa's trade history with the EU, as well as how the TDCA has affected trade between South Africa and the EU.

4.3.1 Introduction

South Africa is the EU's largest and most significant trading partner in Africa. In 2011 South Africa was the EU's 15th largest trading partner globally and the second biggest trading partner in Africa (EC, 2012). Over the past decade South Africa's exports to the EU have been increasing and are becoming more diverse. South Africa is progressively moving towards more manufactured products. This is largely due to South Africa implementing the TDCA agreement with the EU, which has facilitated trade liberalisation and allowed South Africa to gradually open up their markets for trade with the EU. Apart from being South Africa's biggest trading partner, the EU is also by far South Africa's most important development partner, providing 70% of all external assistance funds (DFA, 2011; EC, 2012).

The trade relationship that South Africa shares with the EU is very significant mainly because the EU is such an important trading partner for South Africa. The subsequent part of this section gives a brief overview of South Africa's trade relationship with the EU over the last decade.

4.3.2 Trade relationship between South Africa and the EU

The EU and South Africa have had a trade relationship for numerous years. The TDCA, which was signed in Pretoria on 11 October 1999, aimed to set up a free trade area over a 12 year period. This free trade area would cover 90% of all bilateral trade. As a result of the interim application of the TDCA in January 2000, South African exports to the EU grew by 46%. Since then South Africa's exports to the EU have increased from around €15.8 billion in 2004 to almost €22.2 billion in 2008 (DFA, 2011; EC, 2012).

Total trade volumes improved by a third since 2004, increasing from approximately €31.8 billion in 2004 to approximately €42.4 billion in 2008 (DFA, 2011). In 2009 however, trade between the EU and SA decreased after steadily growing for the past 8 years. This was mostly due to the EU being hit by the credit crisis. Exports fell by nearly a fifth in 2009 and imports fell by nearly a third between 2008 and 2009. In 2011, trade between the EU and SA increased again significantly (DFA, 2011; EC, 2012). Tables 4.1 and 4.2 give a brief overview of the trade between South Africa and the EU for 2007 to 2011.

Table 4.1: South Africa's imports from the EU for the period 2007-2011

NAME	SOUTH AFRICA'S IMPORTS FROM THE EU						
	2007	2008	2009	2010	2011	Growth (% p.a.)	Share in South Africa Imports
EU-27	189 202 864	222 071 518	170 213 429	187 448 363	219 681 757	18.3%	
Germany	65 444 978	80 422 349	61 692 135	65 963 991	76 644 328	2.0%	10.7%
UK	27 138 537	28 847 599	20 951 144	22 008 410	28 812 081	-1.0%	4.0%
Netherlands	15 584 814	17 311 043	13 344 422	14 642 096	19 380 527	3.0%	2.7%
Belgium	18 827 174	20 300 782	16 531 197	17 010 423	19 193 961	-1.0%	2.7%
Italy	8 093 889	13 098 300	9 158 710	10 230 290	11 501 180	5.0%	1.6%
Spain	8 965 373	9 841 401	9 603 518	10 306 988	10 358 037	4.0%	1.4%
France	7 815 857	8 628 593	6 277 382	9 167 504	9 896 007	6.0%	1.4%
Poland	6 940 201	9 151 598	7 689 818	8 360 337	9 066 942	5.0%	1.3%
Sweden	4 078 364	3 324 033	2 218 980	4 061 713	5 205 764	8.0%	7.0%
Finland	5 392 818	5 898 601	4 357 544	4 401 246	4 856 079	-4.0%	7.0%
Denmark	2 053 782	3 167 123	3 009 725	3 608 327	4 800 654	21.0%	7.0%

Source: ITC (2012), Compiled by the author.

Table 4.2: South Africa's imports from the EU for the period 2007-2011 continued

NAME	SOUTH AFRICA'S IMPORTS FROM THE EU						
	2007	2008	2009	2010	2011	Growth (% p.a.)	Share in South Africa Imports
Czech Republic	5 683 353	6 955 917	4 320 653	5 246 798	4 502 842	-7.0%	6.0%
Ireland	2 444 849	3 146 965	2 686 381	3 610 047	4 410 803	15.0%	6.0%
Slovenia	5 224 725	5 712 512	3 135 319	3 263 241	3 525 342	-12.0%	5.0%
Austria	1 910 920	2 051 327	1 878 036	1 781 432	1 963 586	0.0%	3.0%
Portugal	186 503	772 521	707 333	967 334	1 915 869.	64.0%	3.0%
Hungary	1 003 324	1 029 841	847 715	886 919	1 005 212	-1.0%	1.0%
Greece	802 814	905 695	675 360	709 682	779 587	-2.0%	1.0%
Romania	180 013	293 856	214 910	270 573	418 088	18.0%	1.0%
Estonia	22 007	32 886	38 624	59 528	346 556	85.0%	0.0%
Bulgaria	465 244	291 236	256 396	219 091	292 116	-11.0%	0.0%
Luxem-bourg	214 552	316 732	245 929	266 463	291 124	5.0%	0.0%
Lithuania	81 145	115 620	142 505	145 570	162 082	18.0%	0.0%
Cyprus	101 052	157 810	113 003	125 010	161 600	8.0%	0.0%
Latvia	73 833	196 845	55 701	70 868	131 479	2.0%	0.0%
Malta	456 246	80 949	31 475	53 952	45 458	-39.0%	0.0%
Slovakia	16 486	19 371	29 501	10 516	14 438	-8.0%	0.0%

Source: ITC (2012), Compiled by the author.

Table 4.3: South Africa's exports to the EU for the period 2007-2011

NAME	SOUTH AFRICA'S EXPORTS TO THE EU						
	2007	2008	2009	2010	2011	Growth (% p.a.)	Share in South Africa Exports
EU-27	148 528 905	191 175 244	118 458 042	136 079 425	148 878 702	53.6%	
Germany	35 866 592	46 634 938	29 134 140	40 298 321	39 462 128	1.0%	5.9%
United Kingdom	34 470 466	39 796 287	24 898 698	26 990 976	28 694 753	-7.0%	4.3%
Netherlands	20 234 828	28 096 867	16 891 565	16 650 163	21 163 824	-4.0%	3.2%
Belgium	12 284 292	16 602 258	10 634 387	13 127 295	15 449 953	3.0%	2.3%
Italy	10 043 359	12 941 682	8 962 104	10 388 548	12 751 282	3.0%	1.9%
Spain	12 346 836	15 224 566	9 027 609	8 037 873	8 273 369	-13.0%	1.2%
France	9 714 149	11 739 744	6 978 014	7 132 639	7 168 178	-10.0%	1.1%
Poland	1 731 272	2 732 483	2 860 527	1 841 186	2 394 143	3.0%	4.0%

Source: ITC (2012), Compiled by the author.

Table 4.4: South Africa's exports to the EU for the period 2007-2011 continued

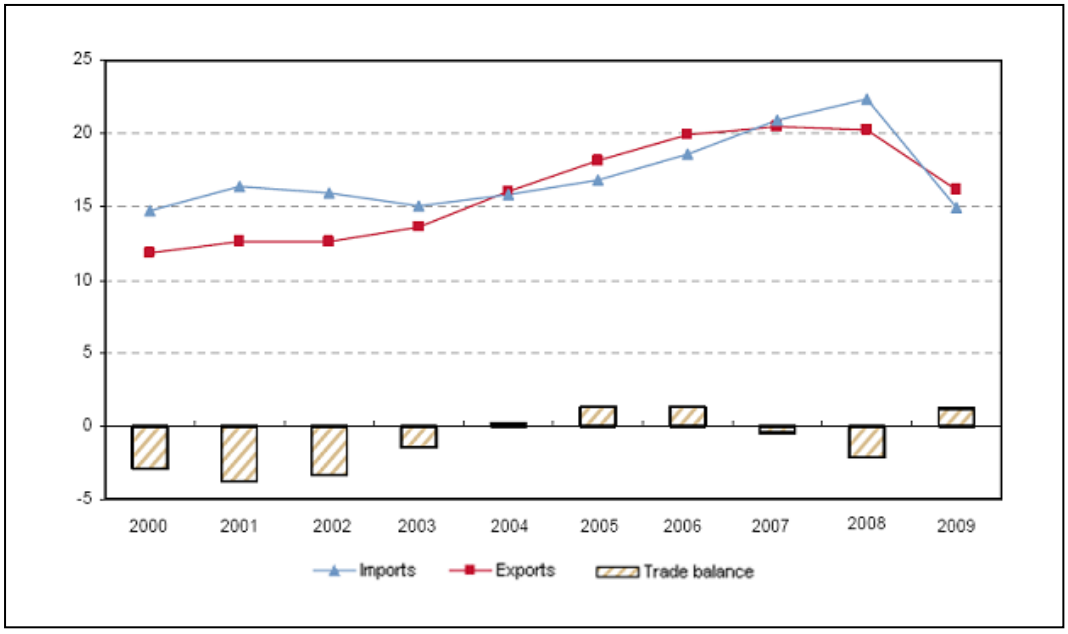
NAME	SOUTH AFRICA'S EXPORTS TO THE EU						
	2007	2008	2009	2010	2011	Growth (% p.a.)	Share in South Africa Exports
Sweden	3 013 808	3 385 912	2 080 813	2 897 376	2 219 484	-7.0%	3.0%
Finland	708 659	1 011 22	662 472	1 503 709	2 185 156	31.0%	3.0%
Denmark	1 300 511	1 535 210	997 925	915 196	1 476 065	-2.0%	2.0%
Czech Republic	773 986	878 285	596 511	1 053 478	1 449 338	16.0%	2.0%
Ireland	1 380 609	1 779 300	1 051 843	1 123 341	1 159 580	-7.0%	2.0%
Slovenia	230 286	363 246	221 172	659 533	987 926	43.0%	1.0%
Austria	828 094	1 335 533	643 363	650 227	879 823	-5.0%	1.0%
Portugal	1 573 224	2 951 028	1 493 616	1 110 937	862 623	-19.0%	1.0%
Hungary	235 505	491 229	160 345	316 313	630 965	17.0%	1.0%
Greece	628 111.	1 317 573	368 380	544 128	594 149	-9.0%	1.0%
Romania	466 719	926 648	224 274	279 516	346 750	-16.0%	1.0%
Estonia	38 324	47 674	46 860	187 417	196 345	60.0%	0.0%
Bulgaria	370 858	249 662	43 061	74 293	186 465	-22.0%	0.0%
Luxembourg	90 417	885 861	141 684	65 176	142 775	-15.0%	0.0%
Lithuania	56 391	85 557.	56 381	50 338	77 370	2.0%	0.0%
Cyprus	64 792	80 438	68 872	61 619	67 023	-1.0%	0.0%
Latvia	20 195	29 186.	84 696	24 130	23 477	2.0%	0.0%
Malta	34 349	31 531	107 720	84 555	22 743	2.0%	0.0%
Slovakia	22 260	21 310	21 000	11 128	13 000	-15.0%	0.0%

Source: ITC (2012), Compiled by the author.

From tables 4.1 and 4.2 it is evident that South Africa's biggest trading partner in the EU was Germany, with a 35% share of South Africa's exports. The UK was South Africa's second most important trading partner with a 14.8% share of South Africa's exports. The UK was South Africa's most significant trading partner with regards to imports, with a 27.2% share of all imports. Germany was the second biggest trading partner with a 20.7% share of all imports.

From tables 4.1 and 4.2, it is also evident that trade fell drastically between 2008 and 2009, especially for South Africa's most significant trading partners, Germany and the UK. During 2008 and 2009 imports from South Africa fell from 26% between 2008 and 2009 and exports fell 20% in the same period, resulting in a total loss of 2.6 billion Euros for South Africa. During that period the most significant exports for South Africa to the EU were coal, coke and briquettes as well as non-metallic mineral products. Imports included road vehicles and general industrial machinery (Euro stat, 2011). Figure 4.3 below gives a timeline of the trade between South Africa and the EU for the period 2000-2009.

Figure 4.3: Trade between South Africa and the EU for the period 2000 – 2009



Source: Eurostat (2011).

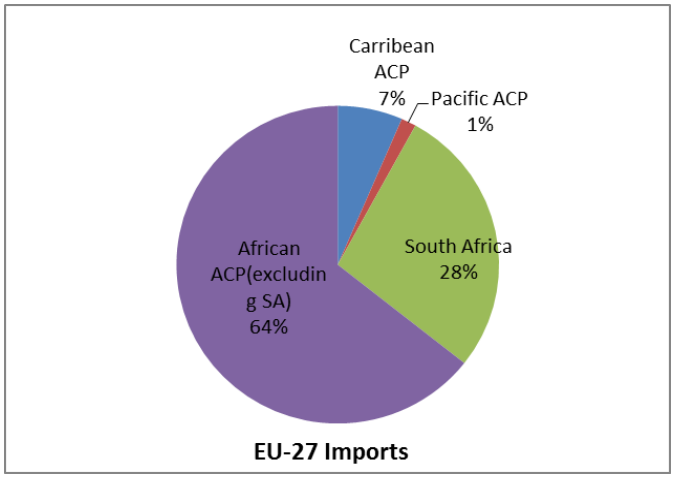
From figure 4.3 above it is clear that after 2000, trade between the EU and South Africa was steadily increasing. This is even more apparent after 2004, when exports to the EU increased at a faster rate than imports from the EU. It is also clear that exports stopped increasing after 2007 and decreased drastically between 2008 and 2009, which is partly due to the global financial crisis (European Commission, 2011).

To further understand the relationship between South Africa and the EU it is divided into three sections, namely trade in goods, trade in services and foreign direct investments.

4.3.2.1 Trade in goods between SA and the EU

As indicated above, the EU is a very significant trading partner for South Africa. Likewise, South Africa is also a significant trading partner for the EU. Figure 4.4 provides a clear indication of SA's share in EU imports.

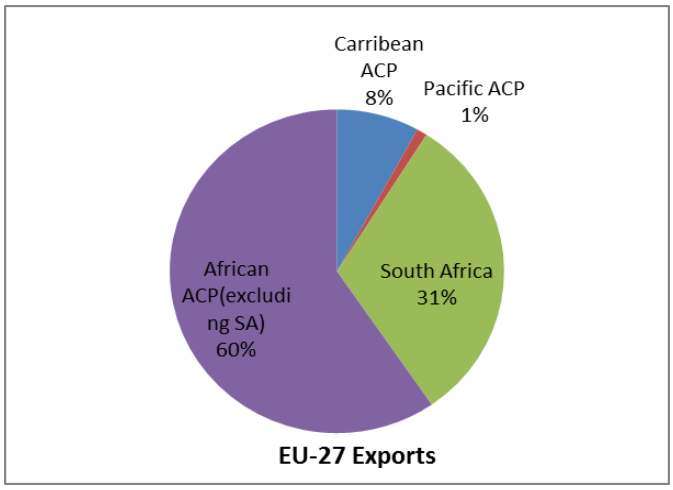
Figure 4.4: The EU's Imports from ACP countries for 2010



Source: Eurostat (2011).

From Figure 4.4 it is clear that South Africa with a 28% share of all EU imports is the largest trading partner of all the ACP countries. The other African ACP countries combined have a share of 64% where the Caribbean ACP and Pacific ACP have a share of 7% and 1% respectively. Imports are only a part of the total trade and Figure 4.4 give an overview of EU's exports to the ACP countries.

Figure 4.5: The EU's Exports to ACP countries for 2010



Source: Eurostat (2011).

From Figure 4.5 it is clear that South Africa with a 31% share of all EU exports is the largest trading partner of all the ACP countries. The other African ACP countries combined have a share of 60% where the Caribbean ACP and Pacific ACP have a share of 8% and 1% respectively. It is evident that South Africa is EU's leading trading partner of all the ACP countries. The following table gives a summary of the top ten products exported from SA to the EU.

Table 4.5: Summary of the top 10 products exported by SA to the EU

PRODUCT CODE	PRODUCT LABEL	SOUTH AFRICA'S EXPORTS TO EUROPEAN UNION				
		Value in 2007	Value in 2008	Value in 2009	Value in 2010	Value in 2011
TOTAL	All products	148 528 905	191 175 243	118 458 042	136 079 425	148 878 702
'71	Pearls, precious stones, metals, coins, etc.	26 226 958	28 149 895	16 752 809	21 771 018	25 126 339
'84	Machinery, nuclear reactors, boilers, etc.	22 488 200	28 840 939	14 398 613	16 256 590	19 533 629
'26	Ores, slag and ash	11 009 750	17 325 920	9 540 476	14 360 627	18 580 799
'87	Vehicles other than railway, tramway	8 887 423	13 641 527	9 530 773	15 424 251	16 057 671
'72	Iron and steel	15 731 890	23 906 115	10 668 508	16 031 741	13 890 383
'27	Mineral fuels, oils, distillation products, etc.	16 011 572	22 901 899	15 858 764	9 694 389	11 967 064
'08	Edible fruit, nuts, peel of citrus fruit, melons	6 366 753	7 685 291	7 633 096	7 883 710	7 901 602
'22	Beverages, spirits and vinegar	3 733 475	4 695 820	4 653 859	4 267 664	3 926 540
'76	Aluminium and articles thereof	3 939 036	2 746 914	1 818 520	1 702 263	2 490 986
'85	Electrical, electronic equipment	3 101 844	3 609 608	2 603 782	2 357 883	2 360 347

Source: ITC (2012).

From table 4.3 above it is evident that trade between South Africa and the EU consists of a diversified range of goods. South Africa's total exports to the EU were equal to R148 528 905.08 in 2007, but dropped significantly to R118 458 042.42 in 2009, largely due to the world credit and financial crisis. In 2010, South African exports increased to R136 079 425.25 and again to R148 878 702.54 in 2011 (ITC, 2012).

South Africa's primary exports to the EU are dominated by pearls, precious stones, metals, coins equal to R25 126 339.52 of which platinum accounts for R15 014 715.50 and diamonds account for R8 326 766.35. Machinery, nuclear reactors, boilers are equal to R19 533 629.22, of which centrifuges account for R16 220 955.19, motor engine part account for R849 084.08 and diesel engines account for R303 772.82. Iron and steel equal R8 562 897.48 where copper ores account for R3 354 774.81 and niobium, tantalum, vanadium or zirconium ores and concentrates contribute R2 273 018.27 (ITC, 2011).

4.3.2.2 Trade in services

Trade in services is the trade of intangible products, also called services. When trade in services takes place between a producer and consumer that is, in legal terms, based in different countries, or across borders, it is referred to as international trade in services (EC, 2011). With South Africa being one of the EU's leading trading partners in Africa, it is not unexpected that South Africa is also the EU's biggest trading partner in services. Table 4.4 summarises the EU's top 15 service trading partners.

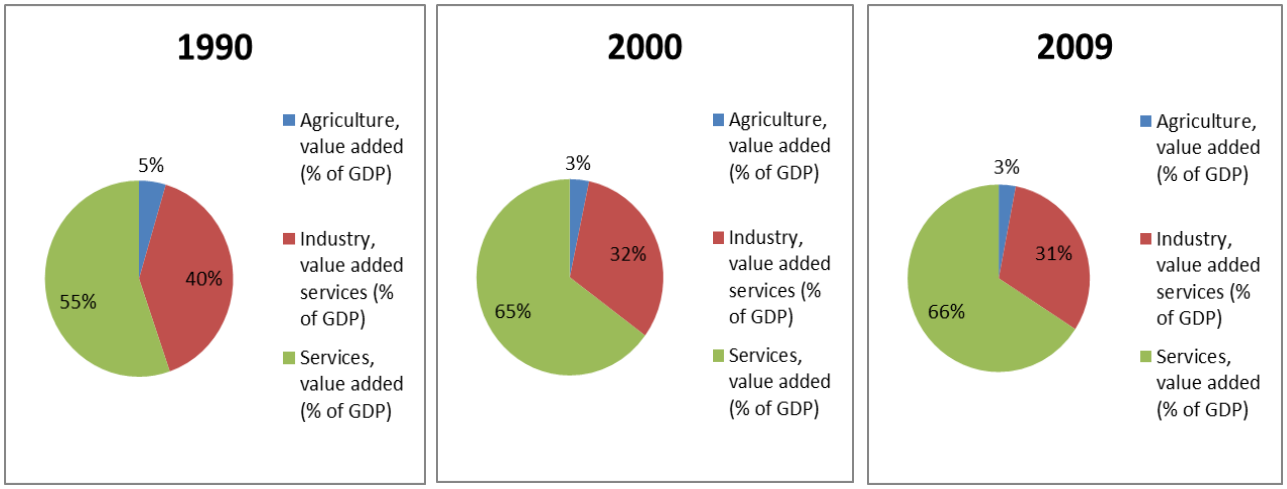
Table 4.6: Top 15 African partners in trade in services

RANK	COUNTRY	TRADE IN VOLUME (million Euro)
1	South Africa	10 522
2	Egypt	10 027
3	Morocco	7 592
4	Nigeria	6 631
5	Tunisia	5 297
6	Algeria	4 412
7	Angola	3 747
8	Libya	2 473
9	Mauritius	1 506
10	Kenya	1 408
11	Senegal	1 291
12	Liberia	1 187
13	Cote d'Ivoire	1 129
14	Gabon	1 032
15	Ghana	990

Source: Eurostat (2011).

From table 4.4 above, it is evident that in trade of services, South Africa along with Egypt, are the EU's leading partners in trade in services as both countries have a share of 15% of the EU's trade in services. SA's service imports from the EU were estimated at around €5 704 000 while exports were estimated for around €4 321 000 (Eurostat, 2011). South Africa's share of trade in services has significantly increased over the last decade, as illustrated in figure 4.6.

Figure 4.6: Growth of percentage services traded between EU and SA



Source: World Bank (2011).

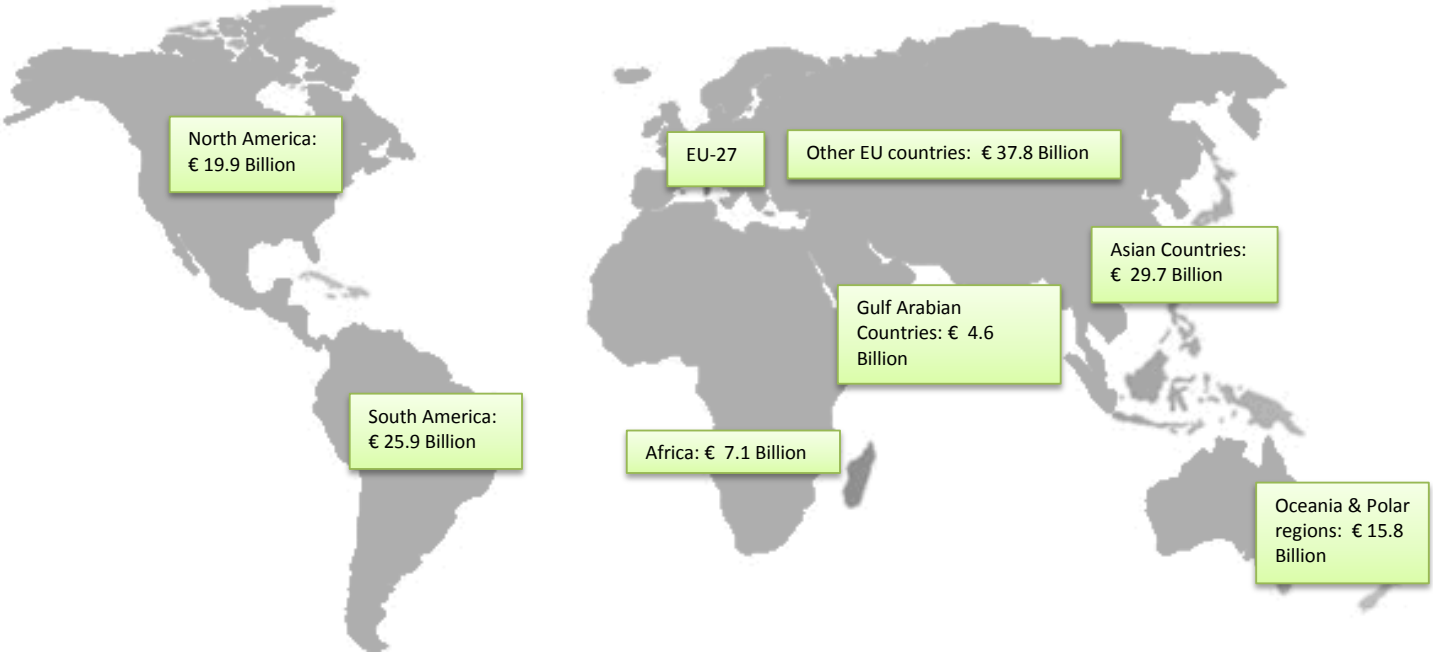
From figure 4.6 above, it is clear that in the last decade the trade in services had significantly increased from 55% in 1990 to 65% in 2009. The share of industrial goods decreased from 40% in 1990 to 31% in 2009. The share of trade in agriculture decreased from 5% in 1990 to 3% in 2009. This is significant because it indicates that SA is developing because they are starting to export more services and less agricultural products (ICC, 2011). Apart from trade in goods and services the EPA also will focus on foreign direct investments between SA and the EU. The following section of this chapter gives an overview of the foreign direct investment.

4.3.2.3 Foreign direct investment

Investopia defines foreign direct investment (FDI) as: 'An *investment abroad, usually where the company being invested in is controlled by the foreign corporation'*. FDI can therefore be described as investments which involved the insertion of foreign funds into a company or organisation which operates in a different country than the origin of the investor. FDI excludes foreign investments in stock markets, as the investment in the foreign countries assets are specifically for domestic goods and services. FDI is more beneficial for a country than equity investments, because equity investments tend to withdraw from the country as soon as any sign of problems occur in the country. This is unfavourable because it leaves the county more susceptible to money market shocks should any problems occur (EC, 2011). It is thus beneficial for any country to attract FDIs from foreign investors, because it enables a country to have access to external funds. It is also therefore important for South Africa to attract FDIs from the EU and a trade agreement like the EPA can make South Africa look more attractive to investors in the EU. The EU has a relatively strong economy and has FDI stock in various countries

worldwide (figure 4.5 below illustrates in which countries the EU currently has FDI stock) (EC, 2011).

Figure 4.7: EU-27 total outward FDI stock in 2010



Source: Eurostat (2011).

From figure 4.7 above, it is evident that in 2010, Africa combined received €7.1 billion in FDI, compared to some of the other continents. This is not a very large percentage of all EU FDI outflows. Apart from other non EU-27 European countries who received a total of €37.8 billion, the Asian countries are in the lead with €29.7 billion. South America received €25.9 billion and North America received €19.9 billion. To better understand which countries play a bigger role in investing it is necessary to have a deeper look at the outward flow of FDI. Table 4.5 below gives a summary of the EU's outward and inward FDI flows between 2008 and 2011.

Table 4.7: Global outward and inward flows of the EU's FDI stock (in Euro billion)

COUNTRY	FDI OUTFLOWS			
	2008	2009	2010	2011
Extra EU27	**383.5**	**316.5**	**145.6**	**369.9**
Europe (non EU)	100.3	91	37.8	No data
Switzerland	32.5	43.1	0.9	31.8
Russia	28	8.4	7.9	-2.3
Croatia	2.4	2.5	-1.3	No data
Turkey	6.2	4.3	5.8	No data
Ukraine	5	2.7	4.5	No data

Source: Eurostat (2011).

Table 4.8: Global outward and inward flows of the EU's FDI stock continued

COUNTRY	FDI OUTFLOWS			
	2008	2009	2010	2011
Africa	23.3	16.7	21.3	No data
Egypt	10.8	-3.4	3.2	No data
South Africa	3.2	8.6	7.1	No data
North America	132.9	85.9	19.9	No data
Canada	6.4	3.7	-1	12.4
United States	126.4	82.2	20.9	No data
South America	20.2	9.2	25.9	No data
Argentina	4.4	0.9	0	No data
Brazil	8.9	10.6	21.5	27.9
Asia	78.5	41.5	29.7	No data
Gulf Arabian counties	19.7	6.6	4.6	No data
China	6.5	6.5	7.1	17.5
Hong Kong	4.9	4.1	6.1	8
Japan	2.9	1	-2.2	3.6
India	3.4	3.3	4.7	12
Singapore	25.9	4.7	10.6	No data
Oceania and Polar regions	19.4	-0.8	15.8	No data
Australia	18.6	-2.2	14.9	58.9

Source: Eurostat (2011).

The EU had many foreign direct investment stocks in Africa and South Africa. In 2008, the total stock amounted to 23.3 billion Euros in Africa, of which 3.2 billion was in South Africa. In 2009 this amount grew to 8.6 billion Euros and slightly declined in 2010 to 7.1 billion (Eurostat, 2012). Taking all of the above into consideration it is evident how important the trade relationship between the EU and South Africa is. At the moment the EU is South Africa's biggest trading partner in goods and services, as well as being a very significant provider of FDI inflows to South African markets. With the EU facing a big crisis it is a bit uncertain how the future will unfold. It is therefore important for South Africa to consider how the relationship will be affected by the EPA. It is important that South Africa ensures that her relationship with the EU remains beneficial and strong. The following part of the chapter discusses how trade agreements like the EPA could possibly affect South Africa.

4.4 HOW TRADE AGREEMENTS INFLUENCE TRADE BETWEEN SOUTH AFRICA AND THE EU

It is evident from the previous part of this chapter that the trade relationship between the EU and South Africa is a valuable one that holds many benefits for both countries. It is thus important to keep this trade relationship stable and to ensure that both parties continue to benefit from the relationship.

4.4.1 Introduction

A trade agreement is a manner in which the parties involved can ensure that they keep on benefiting from the arrangement. A trade agreement also includes procedures and rules to which all parties should adhere to. This provides all parties with a clear understanding of what is in the agreement and how it will commence. It also ensures that if disputes should arise they will be handled according to the procedures that the parties had agreed on (Meyn, 2004; Bilal, 2010).

In general, trade agreements that stimulate regional integrations can hold many benefits for a country. Trade agreements can enable a country to become more competitive, encourage exports and make a country more attractive to investors. However, trade agreements can only have a limited effect if the benefiting country is unable to seize all the opportunities. These opportunities also only have a limited time span as multilateral trade agreements are increasing due to trade liberalisation. Trade agreements between developed and developing countries are often created in such a manner that they aim to help the developing country in several ways, such as offering financial aid and intellectual assistance (Di Mauro, 2000; Meyn, 2004; Bilal & Stevens, 2009).

The EPA was created to address the issues (mainly the WTO-compatibility issues) of the previous agreements between the EU, South Africa and the other ACP countries. The EPA's objectives are to create an agreement which would have a more comprehensive approach. The agreement also hopes to decrease barriers to trade through re-enforcing regional integration and attending to supply chain constraints (EC, 2002). One objective of the EPA is to encourage regional integration between the countries and to promote South-South integration (integration amongst countries in the Southern Hemisphere), because it will in turn provide these countries with more benefits (Meyn, 2004; Grant, 2008). The importance of South-South integration is discussed below.

4.4.2 Importance of South-South integration

At present many of the small markets in Africa are segmented, too expensive and not competitive enough to participate in global markets. Larger, more attractive markets with more diverse products often are more attractive to potential investors. EPA's can contribute to higher growth and more opportunities because they stimulate regional integration between the countries. Once countries integrate, their markets merge together and result in larger markets, with more potential customers, more opportunities and thus more attractive for investors.

Integration also allows for more free movement of labour and skills, which results in a larger, more diverse work force as well as a transfer of skills and knowledge (EC, 2002).

For the EPA to successfully enable African countries to integrate and promote trade simultaneously, both parties need to adopt a bottom-up approach. This can be done by identifying individual economic priorities of African counties and locking them into the EPA. The EPA should thus be tailored to individual countries' needs. The EPA will also aim to expand the integration to from South-South to North-South and a big part is focused on development of the South ACP countries. This will increase the benefits of integration as well as enhance their credibility and give confidence to potential investors (EC, 2002; UNCTAD/DITC, 2008). In theory these goals seem very plausible and the benefits appear to be big, however in practise things often are a lot different. One of the biggest issues surrounding the EPA is that it has been tailored to each country's individual needs, which results in slightly different agreements for each country. This could, instead of improving integration between the countries, have the opposite effect (Meyn, 2004; Venter & Neuland, 2007; Bilal, 2010). South Africa is a good example of a country that has a very different agreement with the EU compared to other African countries. The section below discusses the implications of this.

4.4.3 South Africa, the EPA and the ACP

South Africa, as part of the ACP group of countries, does not enjoy the same preferential trade arrangements granted to the other ACP countries under the Cotonou Agreement. The main reason for this is that South Africa is more developed than the other ACP countries and therefore does not require all the benefits that the other ACP countries require. This could cause a lot of potential problems with regards to trade between South Africa and the neighbouring countries also partaking in the EPA. As there will now be overlapping agreements (see chapter 3 section 3.5.1.3 for a more detailed discussion) and in the cases where the countries previously had to import goods via SA, they will now be able to import directly from the EU. This could result in revenue losses for South Africa. In the latest EPA, South Africa joined the negotiations with the Southern African Development Community also known as the SADC EPA (See chapter 3 for more detail on the historical development of the EPA).

This could potentially improve the previous problems with regards to trade between South Africa and its neighbours. However, South Africa has not yet decided to join the EPA fully at present as its trade relations with the EU is governed by the TDCA which is currently more beneficial

(Hinkle & Schiff, 2004; ODI, 2007; Venter & Neuland, 2007). The following part of this chapter analyses the TDCA agreement and the effects it had on South Africa's trade with the EU.

4.5 SUMMARY

In order to address the question of how the Economic Partnership Agreement (EPA) will affect South Africa's international trade and the economy, this chapter provides an overview of the current economic and trade situation between South Africa and the EU.

South Africa is both a developing and a developed country. South Africa has good infrastructure for both domestic and international purposes and is often seen as the distribution hub for land locked neighbour countries. The European Union (EU) is characterised by its advanced economic integration. The EU is based on a FTA where 12 members have a common currency, the Euro. Originating in the late 1940's with funds from the Marshall Plan funds, countries were provided with a tool to recover after World War Two which in turn stimulated West European integration. The 2008 - 2009 global economic crises hit the EU hard causing a very moderate GDP growth in 2010 and 2011. South Africa is an important trading partner of the EU.

The EU and South Africa have had a trade relationship for numerous years and a solid trading history. In 1999 they signed the TDCA which was to set up a free trade area over a 12 year period. Subsequently South African exports to the EU grew by 46%. After 2000 trade increased steadily. Between 2004 and 2008 trade increased by an estimated 27%. Exports decreased drastically between 2008 and 2009, due to the global financial crisis, but picked up again at a steady pace in 2010 and 2011. South Africa's share of trade in services has also increased over the last decade. With FDI, the amount South Africa received was less than what other countries received, but the EU was by far South Africa's most important development partner, providing 70% of all external assistance funds in 2010. The next chapter gives a complete overview of the TDCA agreement and analyses the effects of replacing the TDCA agreement with the EPA.

CHAPTER 5

REPLACING THE TRADE DEVELOPMENT AND COOPERATION AGREEMENT WITH THE EPA

5.1 INTRODUCTION

The previous chapter gave an overview of South Africa and the EU, as well as an overview of their trade history over the previous decade. The trade between South Africa and the EU is governed by the TDCA agreement since 1999. This chapter provides an overview of the TDCA agreement and also provides an overview of the effects of replacing the TDCA agreement with the EPA. Section 5.2 gives an overview of the TDCA. Section 5.3 provides an overview of the effects of the TDCA on trade between South Africa and the EU. Section 5.4 provides the amendments of the TDCA. Section 5.5 gives an overview of the effects of South Africa's trade agreements on itself as well as on its neighbouring countries. Section 5.6 compares SADC, the TDCA and the EPA agreement and discusses the various similarities and differences. Section 5.7 discusses the benefits and consequences of South Africa replacing the TDCA with the EPA. Section 5.8 ends this chapter with a summary and conclusion.

5.2 THE TRADE DEVELOPMENT AND COOPERATION AGREEMENT (TDCA)

Currently, the trade relationship between the EU and South Africa is governed by the TDCA. Once South Africa accepts the EPA several elements of the TDCA will be replaced with elements of the EPA (DTI, 2010; EC, 2011). In order to understand how the EPA will influence South Africa, it is important to examine the TDCA and understand how it influenced the relationship and trade between South Africa and the EU. This part of the chapter aims to analyse the TDCA and examine the effect if had on the trade between South Africa and the EU. This section also provides a brief comparison between the EPA, TDCA and the SADC agreement.

5.2.1 Introduction

The TDCA is an agreement between the EU and South Africa which governs trade relations and various development schemes. This agreement was signed in 1999, implemented in 2000 and its main goal was to establish a free trade area between the EU and South Africa within 12 years. The main objective of the TDCA was, as stated in Article 1(d)) "*to promote the expansion and reciprocal liberalisation of mutual trade in goods, services, and capital*" (Chetty, 2006: 10). The TDCA also aims to reinforce the channel of communication between the parties and to help South Africa with its economic and social transitions (Andriamananjara & Hillberry, 2001).

The TDCA is more than just a trade agreement, it also provides for economic development and various other co-operating proposals regarding health, safety as well as increasing economic integration within Southern Africa as well as in the world economy. The TDCA incorporated certain elements to ensure that the agreement will benefit both South Africa and the EU (Helsinki, 2008).

One such element is the exclusion of South African products such as red meats, dairy products, sugar and grains, as well as exclusions from the industrial sector, all of which South Africa is a big producer. EU exclusions are also mostly in agriculture, including beef, dairy, maize, oil seeds, sugars, cut flowers, apples, oranges, processed fruit and wine. All the exclusions account for nearly 40% of all imports (Andriamananjara & Hillberry, 2001; Chetty, 2006; Helsinki, 2008).

The main elements of the TDCA include:

- Asymmetry and differentiation: Due to the different level of development and South Africa's economic restructuring attempts, the EU aimed to eliminate the barriers to its market at a faster pace than South Africa. This resulted in 95% of South African products that were exported to the EU and 86% of EU products imported by South Africa to be barrier free. The excluded products would be imported under the MFN (most-favoured-nation) tariff (Chetty, 2006; Grant, 2008; Helsinki, 2008).

- Additional support for regional integration: The TDCA aims to support regional integration within Southern Africa by providing advice and making the necessary provisions within the agreement (Chetty, 2006; Grant, 2008; Helsinki, 2008).

- Protection of vulnerable sectors: Vulnerable or sensitive products were excluded from the agreement, either entirely or partially by means of tariff rate quotas (TRQ) (Chetty, 2006; Grant, 2008; Helsinki, 2008).

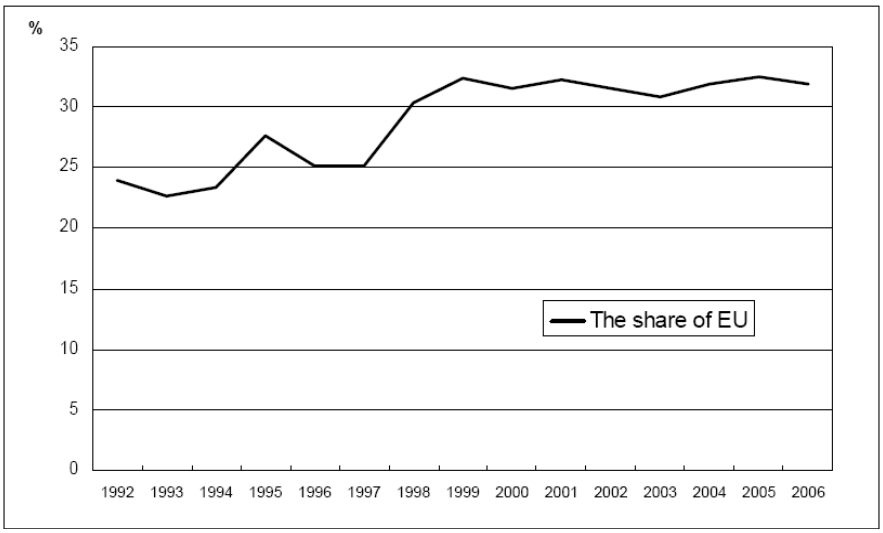
- Integration of South Africa into the world economy: Due to the sanctions being implemented during the apartheid period, South Africa's trade was negatively affected. The TDCA would attempt to aid South Africa with its integration into the world economy by helping to increase growth, competitiveness and encouraging FDI (Chetty, 2006; Grant, 2008; Helsinki, 2008).

The TDCA policies might seem good in theory, but what are the actual effects on the trade and economy of South Africa? The following sections analyse the effects of the TDCA on the trade between the EU and South Africa.

5.3 EFFECTS OF THE TDCA

The TDCA has encouraged trade between the EU and South Africa and trade volume has increased by around 30% from 2004 to 2008. South Africa's exports to the EU rose from €15.8 billion in 2004 to almost €22.2 billion in 2008. South Africa's exports fell to €14.282 billion in 2009, mainly due to the global credit crisis, but rose again in 2010 to €18.671 and to €20.704 billion in 2011. The EU is also by far South Africa's most important development partner, providing 70% of all external assistance funds (ITC, 2010). Helsinki (2008) evaluated the effects of the TDCA on trade between South Africa and the EU for the period 1995 to 2005, as summarized in figure 5.1 below.

Figure 5.1: Trade flows between EU and South Africa

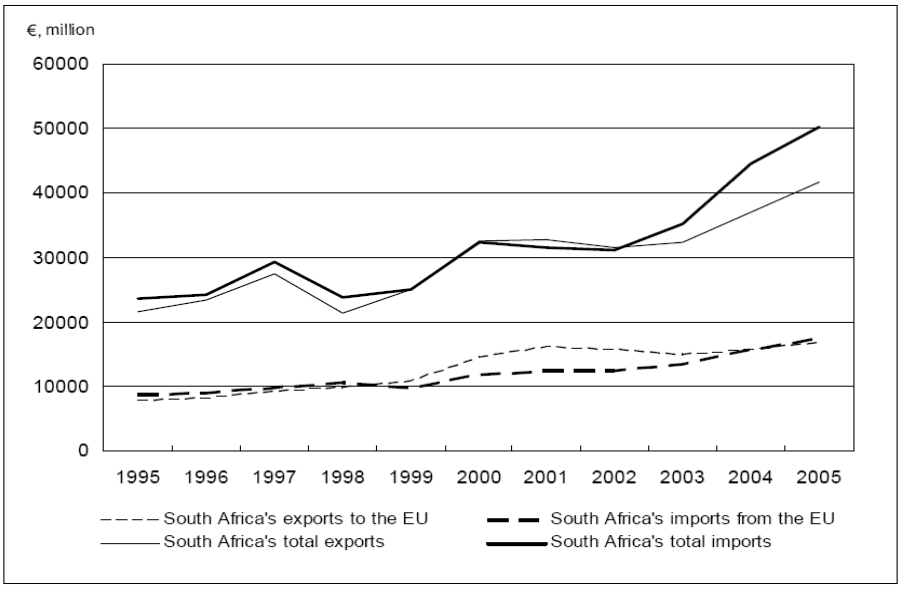


Source: Helsinki(2008: 43).

According to Helsinki (2008) regarding the trade between South Africa and the EU for the period 1995 to 2005, there were no strong signs of trade diversion on the trade or on the cost of trade with the rest of the world (see figure 5.1). It is evident that there was a significant rise in export to the EU and these exports grew faster than South Africa's total export for the same period. South African exports to other countries, especially Asian countries for the period 2000 to 2005 grew even faster than South African exports to the EU. The rise in exports to the EU could therefore not be correlated with the TDCA, but could be as a result of the price increases in metal and other raw materials which form most of South Africa's export volumes.

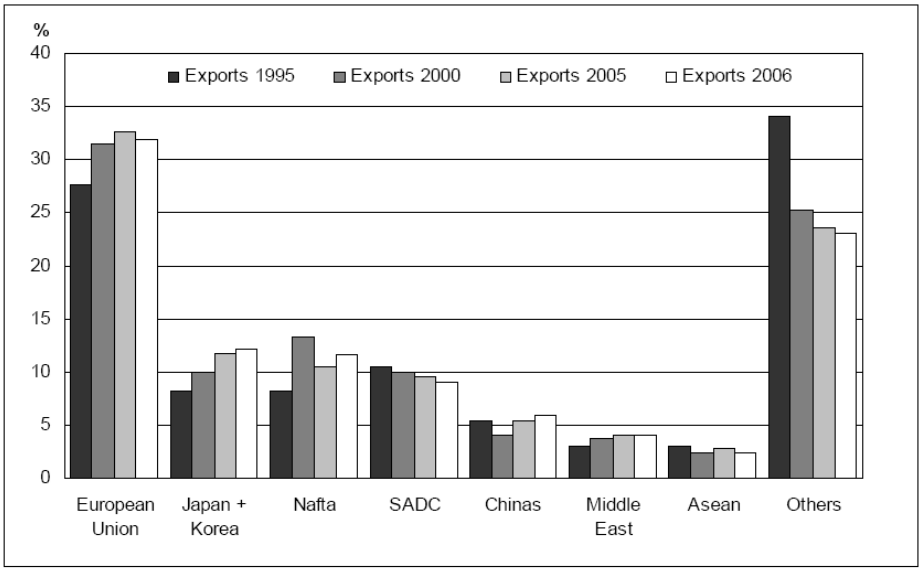
For EU exports to South Africa, the growth was much lower than the growth of South African exports to the EU for the period 2000 to 2005. One of the reasons could be the rice in oil prices which increased the Middle East's share in South African imports. Asian exports to South Africa also significantly grew for that period, especially exports from China (EC, 2012). Figures 5.2 and 5.3 give an illustration of South Africa's trade with the EU and other trading partners as well as exports from South Africa to the EU and other trading partners.

Figure 5.2: South Africa's trade with the EU and other trading partners



Source: EC (2011)

Figure 5.3: South Africa's exports to the EU and other trading partners

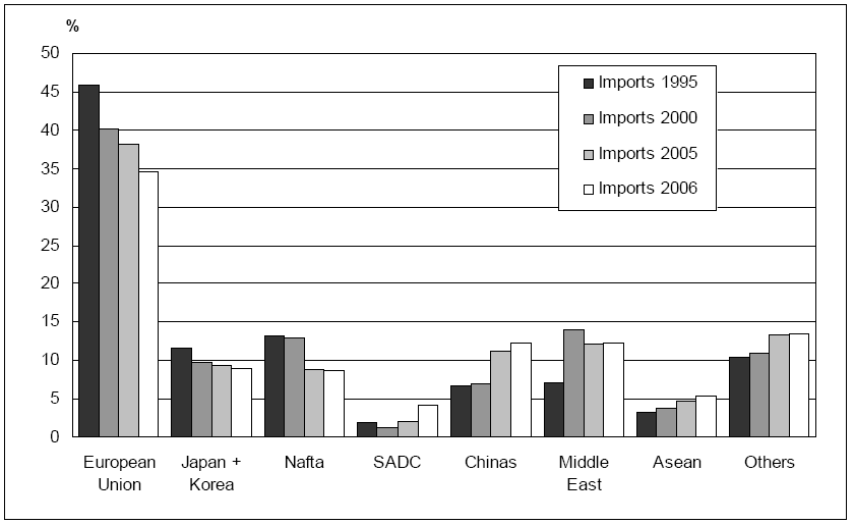


Source: EC (2011).

As clearly shown in figures 5.2 and 5.3, the EU's share of South Africa's exports did increase significantly over the period 1995 to 2000, but then dropped slightly again after 2005. Asian economies, especially Japan and South Korea have experienced the largest proportional growth for the period 1995 to 2005, while South Africa's exports to other counties fell drastically in the new millennium and South Africa's exports to SADC countries have also been declining progressively in the time period (EC, 2011).

When taking other factors into consideration, South Africa's development was much weaker than the growth in export markets indicated. South Africa's export market growth was a lot faster in Asia than in other industrial economies like the EU. In the industrial economies, the growth was relatively sluggish in comparison to that of the ASEAN counties. This also explains why economic growth in the EU remained slow compared to South Africa's growth after markets were opened in accordance with the TDCA (EC, 2011, ITC, 2011).

Figure 5.4: South Africa's imports from the EU and other trading partners



Source: EC (2011).

When taking a look at South Africa's imports from other countries, it is evident that over the period 1995 to 2005, imports from the EU have decreased quite drastically and also at a much higher rate than from other countries. The EU's share of South African imports has fallen from 45% to less than 35%. Other countries, for example NAFTAs share of South African imports has also fallen but not as drastically as that of the EU. These lost share percentages have been taken up by countries like China, the ASEAN countries as well as SADC countries, who all increased their import share percentage for the period 1995 to 2005 (EC, 2011; ITC, 2011).

Andriamananjara and Hillberry (2001) made use of the Global Trade Analysis Project (GTAP) model to predict the effects of the TDCA on South Africa's trade, focusing especially on dynamic gains. They made use of an 18 year time period to allow for the full implementation and adjustment of the agreement. The authors found that even with the assumption of dynamic gains included in the model, it is predicted that the TDCA should only account for around 2% of South Africa's total trade growth for that period. They argue that most of the growth South Africa would experience will come from other sources, such as the accumulation of factors of production.

When taking all these factors into consideration, the possible gains for South Africa from the TDCA become less significant. One must also consider the fact that the TDCA came into the picture in the same decade that South Africa underwent one of its most significant transformations and thereby regained its ability to trade internationally once the sanctions implemented during apartheid were lifted. So the growth in trade might not have been as a result of the TDCA, but merely the result of the lifting of the majority of sanctions against South Africa (Andriamananjara & Hillberry, 2001; Grant, 2008).

Andriamananjara and Hillberry (2001) further argued that the TDCA was complex because firstly, it had such an extensive transition period, benefits could possibly only be realised far into the future. Secondly, because South Africa has a limited degree of openness (due to safe products being excluded etc.), they also limit the benefits which they could possibly gain from liberalising trade completely.

Finally, Andriamananjara and Hillberry (2001) argue that the agreement has a regional nature (only focusing on South Africa and the EU) and that multilateral integration and openness would be a lot more beneficial and would include a bigger increase in trade. They also mention that the agreement would be more beneficial if it was implemented immediately without the 12 year transition period. The TDCA agreement has been amended a few times due to various reasons, and to accommodate the changing climate, the following section of this chapter takes a look at the amendments of the TDCA.

5.4 AMENDMENTS OF THE TDCA

The TDCA agreement incorporated Articles 18 and 103, which after 5 years of the agreement being implemented, call for a review with the possibility of amendments (Tralac, 2010). This review took place in 2004 where both parties decided to revise the provisions of the TDCA and

make certain changes. The provisions and amendments made in 2004 were subject to the negotiations on the EPA between EU, South Africa and other Southern African countries. These amendments implemented a strategic partnership between South Africa and the EU and provided an addition of their cooperation in order to deepen the agreement (Tralac, 2011; EC, 2012).

In 2007 formal negotiations on the EPA began. These negotiations were led by the Department of International Relations and Cooperation (DIRCO) and were divided into three themed negotiation groups. These groups consisted of political dialogue, economic and other areas of cooperation plus development cooperation. After the negotiations took place, there were 35 new and revised articles with various changes and additions. The South Africa-EU strategic partnership joint action plan was adopted in 2007 (Tralac, 2009).

The biggest changes occurred in terms of various levels of cooperation, e.g. economic, developmental and political cooperation. Specific elements were included such as the creation of dialogue forums for green energy, tourism, customs cooperation as well as mining and minerals. Some revisions were excluded, like the provisions on trade and trade-related matters. These were left pending the outcome of the EPA negotiations (DFA, 2011; Tralac, 2009).

The new amendment agreement was finalised and signed in 2009, but confirmations still have to take place to allow signatories to apply the changes, According to the South African constitution, section 231, 232 and 233, an international agreement is only binding after consent is given of the agreement by the National Assembly and the National Council of Provinces, or if it is a technical, administrative or executive agreement or one which does not require either ratification or attainment. However, due to the importance of the relationship between the EU and South Africa, any delays in ratification or failure to ratify will have certain implications for South Africa (Tralac, 2009). Table 5.1 provides a summary of the development and amendments of the TDCA agreement.

Table 5.1: EU's Summary of the Amendments of the TDCA

TOPIC	RELEVANT CONTENTS	SADC IEPA INITIALLED 23 NOV. 2007	SADC IEPA JOINTLY REVISED 19 MAY 2008	SADC IEPA ON COUNCIL WEBSITE DATED 18 SEPT. 2008
Statement of chief negotiators	Continued negotiations to be concluded no later than 31/12/08. Provisional applications from 1 July 2008.	yes	Yes	Statement has been removed
Preamble	South Africa is part of the SADC EPA	yes	Yes	Removed
Article 2: Principles	TDCA shall be implemented complementary	yes	Yes	Removed
Article 4: Regional integration	Reference to the TDCA	yes	Yes	Removed
Article21.3: Rules of origin (RoO)	Products originated in South Africa shall be subject to specific cumulation provisions to which particular attention shall be given	yes	Yes	Removed
Article 26: Customs duties on EU products	SADC EPA treatment of products originating in the European Community party	Joint SACU treatment Annex III (specification f treatment) is empty	Joint SACU treatment Annex III (specification of treatment) is empty	Separate SACU treatment (South Africa is excluded)
Article 28: MFN clause	South Africa was *de facto* excluded from the MFN treatment	yes	Yes	Reference to South Africa has been removed
Article 103	Relations with the Cotonou Agreement and the TDCA	yes	Yes	Reference to TDCA has been removed
Annex 3	SACU/BLNS liberalisation schedule	Customs duties applicable on imports into the SACU member states of products originating in the EC	Customs duties applicable on imports into the SACU member states of products originating in the EC	Customs duties applicable on imports into BLNS of products originating in the EC

Source: Europe legislation (2010).

Table 5.1: EU's Summary of the Amendments of the TDCA continued

TOPIC	RELEVANT CONTENTS	SADC IEPA INITIALLED 23 NOV. 2007	SADC IEPA JOINTLY REVISED 19 MAY 2008	SADC IEPA ON COUNCIL WEBSITE DATED 18 SEPT. 2008
Statement by Namibia	Namibia initialled the EPA on the Understanding that its concerns would be addressed in the on-going negotiations	No statement included	Yes	yes

Source: Europe legislation (2010).

From table 5.1, it is evident that the most significant change is the elimination of the solitary SADC IEPA (Interim Economic Partnership Agreement) states in several Articles like in the "*administrative cooperation and technical barriers to trade"* article. In the initialled text (the Original Interim EPA) it is referred to as "*the parties and the SADC EPA States, as the case may be"*, after the 19 May 2008 the text refers mainly to "*the parties"* (although this is not constantly throughout the document). Another worrying factor is that South Africa was originally excluded from several parts including Article 28, MFN clause but after September 2008 reference to South Africa was removed. All these amendments were made to improve the TDCA agreement so that all parties will continue to benefit from it. One of the biggest concerns South Africa has with the EPA agreement is how it will affect its trade with its neighbouring countries. The subsequent part of this chapter analyses the effects of South Africa's trade agreements on the trade with its neighbouring counties.

5.5 EFFECTS OF SOUTH AFRICA'S TRADE AGREEMENTS

5.5.1 What is at stake for South Africa?

Firstly, the EU is one of South Africa biggest trading and development partners, as the EU accounts for more than 50% of South Africa's foreign trade and provides 70% of all South Africa's external assistance funds. Secondly, because South Africa is also currently one of only nine strategic partners for the EU, the TDCA is highly beneficial for South Africa, especially in terms of cooperation (ITC, 2010). Thirdly, in 2007 South Africa and the EU entered into a strategic partnership which also acts like the political part which accompanies the TDCA.

With the TDCA in place very successful cooperation on senior level have already been implemented in sectors such as science and technology. The aim is to implement additional

forums in other sectors like education. All of the progress already achieved could be jeopardised if South Africa does not make good decisions regarding its trade agreements with the EU. Also if South Africa chooses to not ratify the revised TDCA, it faces diverse opportunity costs as well as sending a negative message to one of its most important trading and strategic partners. Postponing the ratification can agitate the current cooperation between South Africa and the EU and failure to ratify can lead to a total loss of potentially more beneficial cooperation (Viljoen, 2010).

Another important aspect to take into consideration when deciding which trade agreement to pursue is the role that South Africa plays in international trade with the rest of Southern Africa. South Africa plays a very important and crucial role in the SADC countries with regards to regional integration and the Regional Indicative Strategic Development Plan. Due to the fact that South Africa is a founder of the AU and the NEPAD initiative, South Africa is the primary investor and therefore also an active player in regional security within Africa. With South Africa having an agreement with the EU that stretches beyond only economic and trade related cooperation, it will ensure that the strategic partnership between the EU and South Africa also entails political and diplomatic cooperation with regards to issues within Africa. The agreement will thus play a role in the security as well as peacekeeping (EU, 2010).

5.5.2 Effects of South Africa's trade agreements on trade with neighboring countries

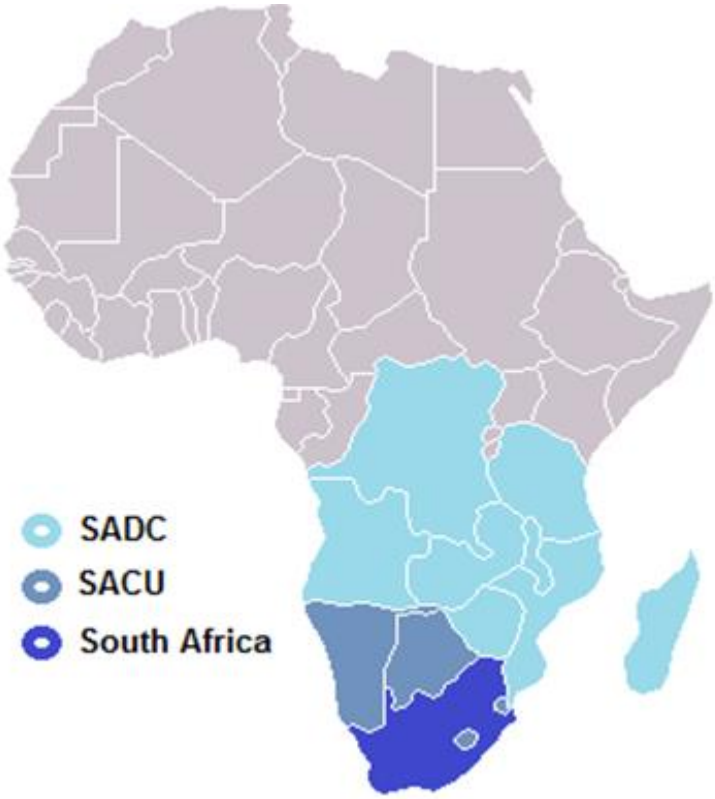
South Africa is often seen as being the hub for trade between African countries and the rest of the world. South Africa is also the stronger role player in the African economy and therefore any trade agreements South Africa undertakes, may also influence most of the other African countries and their economies. The trade agreements South Africa signs will not only affect that country, but also its neighbouring countries, particularly when it comes to trade between South Africa and other countries in Africa. This is especially true for South Africa's neighbouring countries Botswana, Lesotho, Namibia and Swaziland (BLNS). The BLNS countries are developing countries and therefore the revenue they generate with tariffs currently plays a major role in providing the much needed income (Grant, 2008; Hlatshwayo, 2010).

With trade agreements like the TDCA in place, EU goods can enter the BLNS countries at the same terms that South Africa has agreed on with the EU. Implementing the EPA can cause major revenue losses for these countries, especially South Africa, who will presumably not regain the amount of revenue lost, even with the additional benefits from a more free trade

environment. The effect of the TDCA therefore stretches far beyond South Africa's borders (Braude, 2008; Pant, 2009; TIPS, 2011).

Figure 5.5 illustrates how the effects of the TDCA agreements stretch beyond SA's borders and also influence SACU and SADC countries

Figure 5.5: Area's affected by the TDCA



Source: SADC (2011) and SACU (2011), Compiled by Author.

With the implementation of the EPA there have been many theories about how it will influence the SADC and SACU countries. The biggest concern is that the EPA allows each country to have its own set of particulars and specifications with the EU. The possible revenue losses these countries faced with the TDCA agreement in place should be less, as LDC countries have a different structure. This structure allows a longer transitional period to implement the necessary changes. The lost revenue can also be counter acted with the additional benefits that the EPA will provide (Grant, 2008; Pant, 2009; Vollmer,*et al.*, 2009).

Another concern with the EPA is the influence it might have on the trade and regional integration between these African countries. There are many speculations amongst the SADC

and SACU members that there is very little consistency between the EPA agenda and the regional integration process and plans in Africa. One of the biggest issues is that not all the African countries in the same economic region will liberalise the same basket of products, which will create new barriers to intra-regional trade to try and avoid trade deflection (Stevens & Bilal, 2009). The EPA was planned in such a manner that it should encourage and reinforce regional integration between the African countries. The EPA is said to provide more opportunities for these countries to strengthen regional integration by creating active regional markets, contributing to investment and development in those regions (EC, 2011).

According to the European Commission (2009), it would be easier for these countries to integrate regionally if they embrace a wider scale that stretches beyond trade liberalisation. The EPA provides an officially enforceable text which can help to encourage the much needed economic reforms in these countries (Mandelson, 2005; EU, 2011).

Whether this will actually be the case once the EPA is implemented is not yet certain. There are several issues which have become apparent in recent times. Some issues have already appeared with the TDCA and the complications surrounding the impact it has on the BLNS members. Another issue which will again pose various difficulties is the overlapping memberships. SADC is divided in the EPA negotiations where some members (Zimbabwe, Malawi and Mauritius) have chosen to become part of ESA (East Africa group). COMESA also has some overlapping members with SADC and was planning to become a customs union, which would make it impossible for several countries to remain members as it is not legal for a country to belong to more than one customs union (Pant, 2009; Bilal, 2010).

Apart from the already complex overlapping complications, the EPA also includes the Everything But Arms (EBA) initiative which grants duty-free and quota-free access to LDC countries. This further divides SADC, as it isolates LDC countries like Angola, Lesotho and Mozambique. This is especially true for Lesotho as it already has an existing common external tariff under SACU and the TDCA. This EPA initiative has the intention of further helping these countries to trade, however they should evaluate what measures are needed to give them better access to the EU market. These might include rules of origin, technical barriers to trade as well as other sanitary and phytosanitary measures. The EPA also aims to become reciprocal, these countries should remember that their markets will also need to open to the EU in time (Grant, 2008).

All the above-mentioned issues may hamper SADC's Trade Protocol, which intended to liberalise all trade by 2012 (Grant, 2008). According to the SADC Secretariat (2005), the most important challenge for these countries with regards to the EPA is to ensure consistency of positions and avoid conflicts in trade policy and other commitments. If the right attitude and structures are implemented, the EPA could be beneficial to these countries and encourage more regional trade between them. African countries should communicate openly and work together in a transparent manner to ensure that they gain the benefits from the EPA without compromising on the regional integration plans.

The next part of this chapter provides a tabulated comparison between the EPA, SADC and TDCA. In order to understand how the EPA will influence South Africa and its neighbouring countries it is important to understand the differences and similarities between the EPA and the TDCA. SADC is included in the table because it provides an overview of the agreement South Africa has with the other SADC countries.

5.6 COMPARING THE TDCA, SADC AND EPA

Table 5.6 on the next page provides a summary of the major differences between the SADC, TDCA and EPA agreements. The table is an extract from Pant (2009:40) "*The Costs and Benefits to South Africa of joining the SADC EPA.*"

Figure 5.6: The comparison of SADC EPA, TDCA AND SADC

INCLUSIONS	DE-MINIMIS RULES	CUMULATION RULES	CERTIFICATION
SADC			
All goods that meet the requirements of the SADC Rules of Origin qualify for preferential tariff treatment when they are traded within SADC.	Products wholly obtained from the exporting country. Materials undergone a substantial transformation of those materials such that: i) c.i.f. value of those materials does not exceed 60 per cent of the total cost of the materials used in the production of the goods; or (ii) the value added resulting from the process of production accounts for at least 35 per cent of the ex-factory cost of the goods; or iii) Goods are undergone a change in the tariff heading of a product arising from a processing carried out on the non-originating materials.	Raw materials or semi-finished goods originating in any of the Member States and undergoing working or processing either in one or more States shall for the purpose of determining the origin of a finished product be deemed to have originated in the member State where the final processing or manufacturing takes place.	The following documentary evidence to support the fulfilment of the above conditions should be produced to the Customs authorities: (a) Certificate of Origin duly signed by the exporter and authenticated with a seal and signature by the designated authorities of the country of export: (i) giving an exact description of the products; (ii) Origin criteria (iii) Consignee and consignor. (b) a single transport document covering the passage from the exporting member State through the country of transit; or (c) a certificate issued by the Customs authorities of the country of transit: (i) giving an exact description of the products; (ii) stating the dates of unloading and reloading of the products, and where applicable, the names of the ships or other means of transport used; and (iii) Certifying the conditions under which the products remained in the transit country.

Source: Pant (2009:40).

Figure 5.6: The comparison of SADC EPA, TDCA AND SADC continued

INCLUSIONS	DE-MINIMIS RULES	CUMULATION RULES	CERTIFICATION
TDCA			
Beef, sugar, dairy, corn, maize and products, starches excluded. In addition rice and products, some fruits, some cut flowers, processed tomatoes, some processed fruits and juices, vermouth, some fish, ethyl alcohol excluded for EU. For South Africa, barley and products, wheat and products chocolate and ice cream are excluded.	Products wholly obtained from the exporting country. Total non-originating value does not exceed 15 per cent of the ex-works price of the product except for few products.	**Bilateral Cumulation:** Materials originating either in the EC or South Africa provided that such materials have undergone sufficient working or processing. **Cumulation with ACP States:** Materials originating in an ACP State and SACU shall be considered as originating in the Community or South Africa when corporate into a product obtained there.	Products originating in the Community shall, on importation into South Africa and products originating in South Africa shall, on importation into the Community need Movement certificate, a declaration, the text of which is given by the exporter on an invoice, a delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified.

Source: Pant (2009:40).

Figure 5.6: The comparison of SADC EPA, TDCA AND SADC continued

INCLUSIONS	DE-MINIMIS RULES	CUMULATION RULES	CERTIFICATION
EPA			
1. Falling within Chapters 01 to 97, with the exception of Chapter 93, set out in each Party's respective tariff nomenclature in conformity with the rules of classification applicable to the Harmonised Commodity Description and Coding System (HS); and 2. Originating in the European Community or in the SADC EPA States.	Products wholly obtained from the exporting country. b) Total non-originating value does not exceed 15 per cent of the ex-works price of the product.	a) Products shall be considered as originating in the Community if they are obtained there, incorporating materials originating in the SADC EPA States, in the other ACP States or in the Overseas Countries and Territories (OCTs), provided the products are transformed more than insufficient working of processing operation. b) The product obtained shall be considered as originating in that SADC EPA State only where the value added there is greater than the value of the materials used originating in any one of the other countries or territories.	Products originating in the SADC EPA States shall, on importation into the Community and products originating in the Community shall, on importation into the SADC EPA states, benefit from the provisions of the SADC-EC EPA upon submission of either: (a) a movement certificate; or (b) a declaration, subsequently referred to as the 'invoice declaration', given by the exporter on an invoice, a delivery note or any other commercial document which describes the products concerned in sufficient detail to enable them to be identified.

Source: Pant (2009:40).

From the table above, it can be concluded that when comparing by agreement alone (excluding the effects on trade etc.) there is not a big difference between the TDCA and EPA. The biggest differences are in product inclusions and cumulation. The TDCA agreement allows for the product inclusions for 97.5% of imports for the EU and 89.5% of imports for South Africa, which satisfies the requirement of Article XXIV of GATT. The EPA also allows for some exclusion for the SADC countries, which also extends to South Africa.

The TDCA and the EPA both enable diagonal cumulation across ACP states, the EPA almost has full cumulation as it extends the cumulation to other countries as long as the products have some processing within the borders of the SADC countries, which extends beyond "*insufficient working*" and requires that the value added be equal to at least 50%. SADC has the strictest de minimis rules out of the three agreements and extends the definition of substantial transformation to change the tariff heading. South Africa will continue to be a member of SADC but when it

signs the EPA, some of the elements of the TDCA agreement will be overwritten by the EPA (Weller, 2008; Pant, 2009). How will these replacements affect South Africa? The next part of this chapter addresses this question.

5.7 EFFECTS OF SOUTH AFRICA REPLACING THE TDCA WITH THE EPA

Pant (2009) found in his analysis of trade creation and trade diversion effects of FTAs, that if South Africa joins the EPA, the economic costs are likely to be limited. Pant (2009) found that South Africa's trade with the SADC countries is mostly vertical as South Africa mostly exports industrial goods and imports goods like energy and precious stones. Therefore if South Africa signs the EPA with the EU, there should be no negative effects with regards to its trade with other SADC members, in contrast, it could actually increase trade between South Africa and other SADC countries.

Pant (2009) also found that there is little competition in products between South Africa and other SADC members as the exported products differ. The SADC countries mostly export raw materials like minerals and precious stones as well as agricultural products like sugar and fruit. The only country which could pose a competitive threat is Mozambique that also exports aluminium to the EU. This should not play a major role, as the EU market is large enough to accommodate imports from both countries. The better tariff rate with the EPA could actually prove to benefit South Africa's trade with the EU.

There are a few possible trade diversions that could result with the implementation of the EPA because the EU will give the SADC countries better access to its markets. Where previously South Africa could import goods from the EU at lower cost and SADC countries could export it via SA. This is particularly true for vehicles and parts of vehicles. In order to combat this effect, exclusion permissible under PTAs could be included in the EPA. Another benefit which arises from South Africa signing the EPA is that it can now extend the transition period from 2012 in the TDCA agreement to 2020-2023 with the EPA. This means that South Africa could postpone its tariff reductions commitments by almost 10 years. This will enable South African producers and infant industries to become more competitive and in 2020, the market disruption effects could be a lot smaller than they would be in 2012 (SARPN, 2004).

Pant (2009) found that, in general, the economic costs of switching to the EPA are small if South Africa plans ahead. Pant (2009) also found that this change should not affect trade between SACD countries and South Africa in a negative way, due to the trade in goods being vertical.

One issue which might arise is that the EU does not offer South Africa the same benefits that the other SADC countries get to enjoy. In terms of rules of origin the EPA allows for cumulation for non-originating products and is therefore closer to full cumulation. This is mostly to accommodate smaller counties like Lesotho, which would most likely not be able to satisfy the rule of origin criteria.

In general, the TDCA has not been of much benefit in increasing South Africa's exports to the EU, so when only considering trade, South Africa could possibly benefit more from the EPA. However, when taking the whole picture into consideration, there are various political costs which South Africa is concerned about. One of the major issues lies in Article 28(7) of the EPA, which restricts South Africa's ability to partake and sign other FTA's with non-EU countries. This could pose major challenges to South Africa in the future, as it completely constrains the country's ability to sign agreements with other major trading partners like Russia, China and other BRICS countries. This could hinder South Africa's plans for possible agreements with these countries and thus decrease the country's potential for growth and development, especially because the BRICS countries are starting to play a bigger role in global economic and political environment and could be of great benefit to South Africa. Partnership with the BRICS countries is of great importance and plays a vital part in the political aspects of various multilateral agreements at the WTO (SARPN, 2004; Pant, 2009).

When looking at benefits of switching from the TDCA to the EPA, the main advantage for South Africa is that it could assist the country with regional trade and integration, an important goal for South Africa with an imperative political dimension. Pant (2009) recommends that the TDCA would have to be harmonized with the EPA, or that clauses regarding rules of origin should be defined in such a way that they would not hinder regional FTA between African countries. In the broad prospective, the EPA if implemented correctly should not have plenty of negative effects for South Africa or the trade with its neighbouring countries. Article 28(7) of the EPA, which limits South Africa's ability to partake and sign other FTAs with non-EU countries, can influence South Africa's future trade with other non-EU countries. This is not in the scope of this study and needs more research to understand the possible effects of this restriction.

5.8 SUMMARY AND CONCLUSION

Currently, the TDCA governs trade between the EU and South Africa. When South Africa accepts the EPA, several elements of the TDCA will be replaced with elements of the EPA. The main objective of the TDCA was to liberalize trade. The TDCA incorporated certain elements to

ensure that the agreement will benefit both South Africa and the EU. All the exclusions account for nearly 40% of all imports. Andriamananjara and Hillberry (2001) found that the TDCA only accounted for around 2% of South Africa's total trade growth for that period. It is possible that most of the country's growth came from other sources, such as the accumulation of factors of production and the lifting of sanctions against South Africa. Firstly the TDCA had an extensive transition period, so the benefits could possibly only be realised far into the future. Secondly, South Africa has a limited degree of openness, due to safe products being excluded etc. This also limits the benefits that South Africa could gain from liberalising trade completely. Thirdly the agreement has a regional nature which is exclusively only between South Africa and the EU, so the benefits automatically are minimized when compared to the benefits multilateral integration would hold.

Although, the TDCA might not have been the sole cause of the increase in trade, the EU remains one of South Africa's biggest trading and development partners. South Africa is also currently one of only nine strategic partners for the EU, so from a political aspect the TDCA is highly beneficial for South Africa, especially in terms of cooperation. In 2007, South Africa and the EU entered into a strategic partnership which also acts like the political part which accompanies the TDCA. With the TDCA in place very successful cooperation's on senior level have already been implemented in sectors such as science and technology. All of the progress already achieved could be jeopardised if South Africa does not make good decisions regarding the EPA with the EU.

South Africa is often seen as being the hub for trade between African countries and the rest of the world. South Africa is also the stronger role player in the African economy and any trade agreements South Africa undertakes, may influence other African countries. This is especially true for South Africa's neighbouring countries, like Botswana, Lesotho, Namibia and Swaziland (BLNS). Revenue losses are one of the biggest concerns for countries, however the revenue losses should be minimised because the LDC will have a longer transition period. The EU claims that any lost revenue will be counter acted with the additional benefits that the EPA will provide.

One way to understand how the EPA will influence South Africa is to compare it to the TDCA. When comparing by agreement alone (excluding the effects on trade etc.) there is not a big difference between the TDCA and EPA. The biggest differences are in product inclusions and cumulation. The TDCA agreement allows for the product inclusions for 97.5% of imports for

the EU and 89.5% of imports for South Africa, which satisfies the requirement of Article XXIV of GATT. The EPA also allows for some exclusion for the SADC countries, which also extends to South Africa. The TDCA and the EPA both enable diagonal cumulation across ACP states, the EPA almost has full cumulation as it extends the cumulation to other countries as long the products have some processing within the borders of the SADC countries. This processing must extend beyond "*insufficient working*" and requires that the value added be equal to at least 50%. SADC has the strictest de minimis rules out of the three agreements and extends the definition of substantial transformation to change the tariff heading.

Pant (2009) found that if South Africa joins the EPA, the economic costs are likely to be limited, because South Africa's trade with the SADC countries is mostly vertical. If South Africa signs the EPA with the EU, there should be no negative effects with regards to its trade with other SADC members in contrast, it could actually increase trade between these countries. There is also very little competition in products between South Africa and other SADC members. The only country which could pose a competitive threat is Mozambique, also an aluminium exporter to the EU, but the EU market is large enough to accommodate imports from both countries. One benefit that South Africa will gain from signing the EPA is that it can now extend the transition period from 2012 in the TDCA agreement to 2020-2023. This means that South Africa can postpone tariff reductions by almost 10 years. This will enable South African producers and infant industries to become more competitive and in 2020.

However, there are also some risks like political costs, which should be taken into consideration. One of the major issues lies in Article 28(7) of the EPA, which restricts South Africa's ability to engage in FTA's with non-EU countries. This poses major challenges to the country in the future, as it constrains South Africa to sign agreements with other major trading partners like Russia, China and other BRICS countries. This article could hinder South Africa's plans for potential FTAs with other countries and decrease the country's potential for growth and development, especially because the BRICS countries are starting to play a bigger role in global economic and political environment.

When looking at benefits of switching from the TDCA to the EPA, the main advantage for South Africa is that it could assist itself and its neighbouring countries with regional trade and integration. For South Africa to gain the full benefits from the EPA the TDCA has to be harmonized with the EPA or else that clauses of rules of origin are defined in a way that would not hinder regional FTA between African countries. If the EPA is implemented correctly there

should be little negative effects for South Africa and its trade with neighbouring countries. The following chapter empirically analyses the impact of trade agreements on trade between the EU and South Africa by making use of a gravity model regression.

CHAPTER 6

AN EMPIRICAL ANALYSIS OF THE POSSIBLE EFFECTS OF THE EPA'S ON SOUTH AFRICA'S TRADE

6.1 INTRODUCTION

The previous four chapters provided a complete theoretical back ground on how the Economic Partnership Agreement (EPA) will affect South Africa's international trade and the economy. Due to varying opinions provided by the theories in the previous chapters, an empirical investigation is done in support of the argumentation. Trade between South Africa and the EU over the previous ten years are analysed to establish the impact of the various factors on trade. This chapter provides an empirical analysis of the possible effects the EPA could have on the trade between South Africa and the EU by using a gravity model. This chapter also includes a theoretical justification for using the gravity model in applied research of international trade.

The outline of the chapter is structured as follows. Section 6.2 provides an overview of the Gravity model used as a base for regression models and discusses previous applications of the Gravity model as well as the distance variable. Section 6.3 provides an overview of the descriptive statistics. Section 6.4 contains the method used on the regression models. Section 6.5 and section 6.6 provides the results of the regression models while section 6.7 gives a summary of the results of the models. Section 6.8 ends this chapter with a summary and conclusion.

6.2 THE GRAVITY MODEL AS A BASE FOR DETERMINING TRADE BETWEEN COUNTRIES

6.2.1 Introduction

The gravity model provides a platform by which a stable relationship in economics can be explained. It had been in use since 1962 and has the reputation of a robust and versatile tool to analyse various trade policy related questions. The gravity model portrays the various trade interactions between economies of similar size (Feenstra, 1998; Kandogan, 2007; Van Bergeijk & Brakman, 2010).

It has been used in recent times to measure implications for trade policy, specifically free trade agreements on international trade flows. Due to its diverse nature, the gravity model can easily be applied to studies which stretch beyond international trade flows and has, with great success, been used to describe the flow of customers between different shopping malls and patients

between hospitals and so forth (Evenett & Keller, 2002; Kepaptsoglou, Karlaftis & Tsamboulas, 2010).

The gravity model can be estimated using econometric techniques in order to calculate patterns of trade flows between countries. It is estimated over a specific time period against various explanatory variables which also symbolise the "*gravity*" or "*gravitational mass*". Recent gravity models have integrated indicators for bilateral, regional and other free trade agreements, which enable these models to assess the specific contribution of the free trade agreement to international trade (Evenett & Keller, 2002; DeRosa, 2007). The gravity model is thus a good empirical tool which can be used for this study. The gravity model should provide us with a better idea of how the economic Partnership agreement will influence the trade flows between South Africa and the EU. The following section discusses applications of the gravity model in regressions models.

6.2.2 The Gravity Model in regressions

Previous empirical studies have shown that the gravity model, although very simple is very successful from an empirical perspective because it is able to show very relevant trends and empirically describe these trends between different locations. It is sometimes perceived as unclear because of its simplified nature. Nevertheless, it can easily be adapted to include other more variables for the distance variable like tariffs, costs of transport and non-tariff barriers such as cultural differences, religious differences or even language differences. The latter however are very difficult to quantify and are therefore are not often used in statistical models (Bergstrand, 1985; Van Bergeijk & Brakman, 2010).

The adaptability factor of the gravity model explains the reason why the distance variable has become more significant in studies instead of less significant, as expected, due to the onset of globalisation. If globalisation is causing the global environment to become "*smaller*", what explains the reason why international trade between countries become more and more complex? To understand why distance plays a major role in the gravity equation, it is vital to grasp the idea that distance in the gravity equation refers to more than just the physical distance between trading countries/parties. Globalisation simplifies international trade in various ways and should in retrospect increase free trade between countries, but there are still many issues and problems which hinder free trade flows between countries (Christie, 2002; Novy, 2009). The following section discusses the distance variable in more detail.

6.2.3 The Distance variable

The concept of the distance variable in the gravity model stretches beyond the physical distance between the participating countries. The distance variable is the main decisive characteristic in the gravity model and it is vital to fully comprehend that there are numerous ways to interpret "*distance*". Distance in the field of natural science is well defined and easy to measure in an exact and unambiguous manner. Economic distance on the other hand is a complicated concept where the measurement and interpretation is difficult and under continued debate. The distance variable was originally included in the gravity model because it was an effective way to measure transportation cost and time. It was also used to measure the distance in the mind set and attitude between the importer and exporter (Kandogan, 2007; Van Bergeijk & Brakman, 2010).

With all the changes in the international trade environment, new challenging measures of intangible distances have emerged. It is thus very important when looking at distance variables, to consider these new intangible distances which might hinder free trade, as they often play a more substantial role as the physical distance. With globalization, many changes have occurred in the international trade environment. For example, transport costs have decreased as there are now companies that specialize in improved and more effective ways to transport goods. The ease of communication via the internet has also simplified international trade. In the past goods like machines and automobiles would need to be assembled and transported in their final form because it was hard to share the knowledge across borders without it being expensive and very time consuming (Kandogan, 2007; Van Bergeijk & Brakman, 2010; Marimoutou, Peguin & Peguin-feissolle, 2010).

In today's world products can be transported in parts and assembled in the country with the help of technological advances. With advances in engineering skills, the size of ships is also constantly increasing, enabling the transportation of bigger items. This decreases transport costs and subsequently also lessen barriers to trade. These changing factors provide a more accurate picture of which issues policy makers should consider and find solutions for, when trying to implement a free trade agreements (UN, 2008; World Bank, 2009).

Tariffs and non-tariff barriers are the biggest factors that hinder free trade. The majority of free trade agreements including the EPA, focus on decreasing or completely eliminating tariffs on most goods, with the exception of goods like weapons and in some cases agricultural products. Non-tariff barriers are harder to classify and measure, and therefore are often overlooked

(Kandogan, 2007). The biggest "*distances*" applicable to the EPA are tariffs, therefore the EPA focuses more on the reduction of tariffs, so for this study, the tariffs will be considered the most important factor. However because the distance does play a role and the distance between South Africa and the EU is quite large and could potentially be seen as an important factor, this study also includes the logistic performance index in the regression as a proxy for transport costs. The following section gives an overview of the gravity model equation and its application (Marimoutou et al., 2010).

6.2.4 Application and the gravity equation

The gravity model has developed into a significant and versatile tool in trade studies. The gravity model has been applied to a wide range of studies and is based on Newton's mechanics concept (Christie, 2002). Newton's gravity law states that the gravitational pull between two bodies will be equal to product of each body's mass, and divided by the square of the distance between their respective centres of gravity (Christie, 2002; Rahman, 2003: 2). At a later stage an astronomer, Stewart, and a sociologist Zipf conveyed this law to the social sciences and tried to apply it to spatial interactions.

They used the following specification (Rahman, 2003):

(1) $$F_{xy} = G\,\frac{M_x M_y}{D^2}$$

In the above equation, F_{xy} is number of trips between city x and city y, M_x and M_y account for the population of the two cities. D_{xy} is distance between city x and city y and G is a coefficient. The above equation can also be used to explain the likeness for trade between countries as follows: the trade flow between two countries (F_{xy}) is relative to the product of each country's *'economic mass'*, generally measured by GDP (but exponents are not pre-determined and thus flexible), and divided by the '*distance*' between the countries (D^2) (again exponents are flexible).

This basic model serves as a baseline gravity model, because it offers a lot of flexibility for estimation, as the exponents for the two masses and for distance are not set (Christie, 2002; Rahman, 2003; Novy, 2009). This formulation can be generalized to:

(2) $$X = kM_x^{\beta} M_y^{\gamma} D^{\delta}$$

In the above equation X is the flow of imports into country X from country Y, M_x and M_y are country X's and country Y's GDPs, and D is the geographical distance between the two countries capital cities. The linear form of the model is as follows (Christie, 2002; Rahman, 2003; Novy, 2009).

(3) $$Log(X) = \alpha + \beta Log(M_x) + \gamma Log(M_y) + \delta Log(D)$$

The above equation serves as a baseline model, because estimations using this baseline give relatively good results. However there are many other factors that affect trade levels. For example, trade between certain countries might be higher due to mutual benefits gained from trading. Trade can also be lower due to sanctions imposed or political disagreements between countries (Christie, 2002). To compensate for these occurrences, a number of dummy variables, which test for specific effects, are added to the base equation (3). For example, if two countries speak a common language, trade might be higher because there are no communication barriers.

If countries are part of the same union or trade agreements, trade might also be higher. Considering a situation where two countries speak a common language (indicated by the l), the equation is adjusted as follows (Christie, 2002; Rahman, 2003; Novy, 2009).

(4) $$Log(X) = \alpha + \beta Log(M_x) + \gamma Log(M_y) + \delta Log(D) + \sum_{s=1}^{l} \tau_s \, G_s$$

In the above equation just as in (3) the X is the flow of imports into country X from country Y, M_x and M_y are country X's and country Y's GDPs, and D is the geographical distance between the two countries capital cities, however (4) also takes language the common language of countries into consideration (indicated by l). The next part of this chapter gives an overview of the application of the gravity model in analysing the impact of the EPA on the trade between the EU and South Africa.

6.2.5 Using the Gravity model to analyse the impact of the EPA

This study focuses on the trade between the EU and South Africa, using dummy variables to section off various groups of countries. First an estimation is done for all 27 EU countries (Austria, Belgium, Bulgaria, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom), for the EU15 countries (Austria, Belgium, Denmark, Finland, France, Germany,

Greece, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Spain, Sweden and the United Kingdom), the EU5 + 3 (France, Germany, Italy, Spain, the United Kingdom and Belgium, Luxembourg and the Netherlands) and the EU 5 (France, Germany, Italy, Spain, the United Kingdom). The reason for this is to try and determine if countries that have been part of the EU for longer will have an increased trade with South Africa compared to countries that only recently joined the EU. However in the regression models the dummy variables were statistically insignificant and it is therefore evident that the time when a specific country joined the EU has no effect on its trade with South Africa.

In this study the following variables are used: South Africa's exports to the EU, South Africa's imports from the EU, GDP, GDP PC and the average tariff rate. This study also tests the logistic performance index, ease of doing business and container traffic. This study uses the data for each variable for the time period 2000 to 2010. This time period provides a good general idea if the previous trade agreement (the TDCA) had a big impact on the trade and also gives an adequate idea about the general trade patterns which occurred. The following section of this chapter gives an overview of the descriptive statistics.

6.3. DESCRIPTION OF VARIABLES

The aim of this study is to gain an understanding of the influence the economic partnership agreement will have on the trade between South Africa and the EU. The empirical part of this study consists of a statistical calculation based on the gravity model. The trade between South Africa and the EU is the dependent variable with GDP, GDP PC, LPI (Logistic performance index) and AVT (average applied tariff) as the explanatory variables. The following section gives a description of the various variables used in this study.

6.3.1 The Dependent –South African trade with the EU

Trade between South Africa and the EU can be split into the country's exports to the EU and imports from the EU. The trade between South Africa and the EU is the constant in this study, as in this study the influence of the EPA on the trade between South Africa and the EU is being determined. This study aims to find the effects of trade barriers for trade between the EU and South Africa. For this reason separate models are estimated for South Africa's imports from EU countries and South Africa's exports to the EU. For this study the total value (measured in dollars) for exports for the period 2000 to 2010 as well as for imports for the period 2000 to 2010 is used. This data was obtained from the International Trade centre (ITC) database, using the Trade Map tool (available at http://www.trademap.org/).

6.3.2 The explanatory variables

The explanatory variables are GDP, GDP PC, the applied average tariff and non-tariff barriers and Logistics Performance index. The explanatory variables are in a panel data format for the period 2000 to 2010 for South Africa and all the EU-27 countries.

6.3.2.1 Gross domestic product (GDP)

The Gross domestic product or GDP is one of the most basic indicators which provide information regarding a country's economic health. It gives a good indication of the size of a country's economy by representing the total dollar value of all goods and services products in the country over a specific period of time. GDP is thus the total market value of all final goods and services produced in a country in a given year, equalled to the sum of total consumer, investment and government spending, plus the value of exports and minus the value of import (Investopia, 2011). The data sample was collected for the time period 2000 to 2010, for all the EU countries and South Africa. In this study GDP represents EU's GPD and GDP_SA represents South Africa's GDP (available at World Bank, http://data.worldbank.org/).

6.3.2.2 GDP PC

The Gross domestic product per capita or GDP PC is the GDP per person in that country. GDP PC is an estimated average of how much each person has produced in a given year. It is an approximation of the value of all the goods produced in the country divided by the total number of people in it (Investopia, 2011). The data sample was collected for the time period 2000 to 2010, for all the EU countries and South Africa from the World Bank (http://data.worldbank.org/).

6.3.2.3 Applied average tariff

Tariffs are schedules of duties (very similar to taxes) which government imposes on goods imported. Tariffs are the most common type of barrier, because they are relatively easy to implement (see section 2.6.1). A tariff increases the price of a good for the importing country and decreases the price for the exporting country. Small countries are affected more negatively than larger countries. Because trade in small countries is reduced by a tariff, both imports and exports decrease after a tariff is imposed. There are three types of tariffs, ad valorem - percentage of imported goods value, specific - a fixed charge per unit and compound -a combination between ad valorem and compound. Applied average tariff is the average of all tariffs applied by the country (ITRISA, 2010). Applied average tariffs are included in this study as one of the main variables because one of the objectives of this study is to determine how the

EPA will influence trade between South Africa and the EU. One of the effects of the EPA will be a reduction in tariffs, so this study aims to determine what the effects of tariffs are on the trade between the EU and South Africa. The Applied average tariff data was obtained from the International Trade Centre (ITC) Market Access map (http://www.macmap.org/).

6.3.2.4 Non-Tariff barriers

Free Trade agreements aim for barrier free market access and this requires the reduction of all types of barriers to trade. Non-tariff barriers such as anti-dumping, licensing, quotas and voluntary export restraints sometimes hinder free trade more than tariffs (see section 2.6.2). Non-Tariff barriers form an integral part of hindering free trade between countries and are often overlooked. Although they are very hard to quantify and to measure, it is important to consider non-tariff barriers when looking at any type of free trade agreement like EPA, because including these variables provides a more accurate measure of market openness (Van Bergeijk & Brakman, 2010).

This study uses an overall approach and attempts to include non-tariff barriers, however there are currently no anti-dumping barriers, licensing or voluntary export restraint between the EU and South Africa. Other non-tariff barriers are exceptionally hard to quantify and very few have adequate data available. This study therefore aims to include non-tariff barriers and identify three non-traditional non-tariff barriers namely the ease of doing business index (customs procedures), container port traffic and the logistic performance index. However in the empirical analysis only the logistic performance index had a big enough influence and the other two were not included in the empirical models.

The Logistic performance Index (LPI) gives information regarding the friendliness and ease of use of a specific country's logistics system. The LPI is determined by worldwide surveys of global freight forwarders and express carriers, who have in-depth knowledge of the countries in which they operate. This is combined with quantitative data on the performance of key components of the logistics chain in nearly 130 countries. This provides both qualitative and quantitative measures and helps build profiles of logistics friendliness. With the help of the LPI one can get a general idea of how the global logistic environment looks and how each individual country compares (World Bank, 2011; Mustra, 2011). The LPI data was obtained from the World Bank database (http://data.worldbank.org) for the period 2000 -2010.

The LPI gives each country a score from one to five, where five is the best and one is the worst performance for the given dimension. The LPI results have been averaged by regions and this was done to facilitate meaningful comparisons for each key dimensions. These dimensions include: the efficiency of the clearance process; Quality of trade transport infrastructure; ease of arranging competitively priced shipments; competence and quality of logistic services; ability to track and trace consignments; timeliness of shipments reaching its destination (World Bank, 2012). The LPI results are also averaged by income per capita groups: high income, middle income and low income countries, making the LIP a diverse index which can be used for various studies. Regions and income per capita groups are defined by the World Bank country classification (World Bank, 2012). The LPI is included in this study because the logistic system of a country can drastically influence the trade of a country. It can be seen as a barrier to trade if the LPI score for a specific country is very low, because even if a specific country is part of a Free Trade Agreement, it's trade volume might be low because the LPI is very low, making it hard for countries to trade with this country, despite there being no tariffs.

6.3.3 Sample size and data limitations

This section considers the sample size of the data as well as the data limitations. This section examines the descriptive statistics of the data. Table 6.1 gives a summary of the total observations and missing observations of all the variables used in this study.

Table 6.1: Total observations of variables

YEAR	OBSERVATIONS EXPECTED	TOTAL OBSERVATIONS	OBSERVATIONS MISSING
2000	303	253	50
2001	303	256	47
2002	303	254	49
2003	303	255	48
2004	303	265	38
2005	303	264	39
2006	303	264	39
2007	303	263	40
2008	303	264	39
2009	303	289	14
2010	303	269	34

Source: Compiled from data used for this study (2012).

From table 6.1 it is evident that some of the data was missing. In some cases not all countries had data available until 2010, so with several of the variables the data for 2010 is missing. Several of the variables used in this study were also relatively new, like the Ease of doing

business index, which was only commenced in 2009 and therefore only has data available for 2009 and 2010. Due to this, the Ease of doing business variable was not included in the empirical study.

Container traffic index data was missing for several countries like Austria, Bulgaria, Cyprus, Czech Republic, Hungary, Latvia, Lithuania, Luxembourg, Romania, Slovakia and Slovenia. These countries had no data available for this variable. Unfortunately in any type of study there will always be data limitations and missing data, which is one of the biggest problems faced by researchers worldwide.

For this study, Container traffic index data was also excluded from the empirical study, as too many countries had missing data. To even further combat the effects of missing data, several empirical models were estimated using different groups of countries and the results were compared to each other. For the variables where the data was not available for a certain year, that year was excluded from the empirical model. The following section gives a statistical summary of the variables.

Table 6.2: Statistical summary of variables

VAR	SUM	MINIMUM	MAXIMUM	AVERAGE	STD. DEVIATION	SOURCE
GDP	$370 854 499 mil	$4 470 mil	$17 057 740 mil	$1 211 942 mil	$2 927 665 mil	World Bank
GDP PC	$5 mil	$1 601	$56 389	$16 490	$11 781	World Bank
AVT	810	0%	9%	3%	1	ICC-Market access Map
LPI	1 063	2.82	4.11	3	0	World Bank
EXPV	$206 197 mil	$ 317 764	$6 249 mil	$652 mil	$1 259 mil	ICC - Trademap
IMPV	$182 668 mil	$175 175	$7 638 mil	$632 mil	$1 256 mil	ICC - Trademap

Source: Compiled from data used for this study (2012).

From table 6.2 it is evident that there are significant differences between the minimum and the maximum of each variable. The GDP for example has a maximum of $17 057 740 million and the minimum of $4 470 million, which indicates that there is a very big difference in the GDP of participating countries. This is even more evident when looking at GDP PC where the highest is equal to $56 389 and the lowest $1 601, which indicates that where the GDP PC in one country is 3522% higher than that of the lowest country. South Africa had an average GDP PC of

$3406.70 for the time period 2000 to 2010 and all the EU countries combined had an average of $8292.84 for the same period.

The Applied Average tariff peaked at 9% (implemented by South Africa) and reached a minimum of 1.94%. The logistic performance index gives a score of between one and five, where five is the best possible score a country can reach. In this data sample, the Logistic performance index reached a maximum of 4.11 (Germany) and a minimum of 2.82 (Malta), which indicates that the country that scored the lowest is still relatively good compared to the world minimum of 1.34. The following section of this chapter describes the method used to estimate the models.

6.4 METHOD

The gravity model is used as a base for the regression models, because it has proven to give accurate estimations in previous studies done with similar trade data. However, due to the data being multi-dimensional and containing multiple occurrences and observations over multiple periods, this study makes use of panel data models. The models were estimated using the statistical program oxmetrics.

Separate models are estimated for South Africa's imports from the EU and for South Africa's exports to the EU. The main reason for this to understand what the influence of the EPA would be on imports as well as exports and not on the total trade balance. This was especially important because South Africa is less developed than the majority of the EU countries and the effects might be very different. Due to the fact that the EPA agreement has a different legislation for South Africa and a different one for the EU, it is important to test the effects of the EPA for both export and imports individually. Testing this way will give a more accurate overview of what the impact of signing the EPA would be.

For imports, an attempt was made use of the maximum likelihood (ML) with static panel methods; however the results reflected a strong convergence and significant missing data, indicating that the panels were unbalanced. Due to the data being unbalanced and the dependant variables appeared to be lagged (causing autocorrelation), the static model was rejected and the rest of the models were estimated using the one step using robust standard errors. To further analyse the effects of trade agreements on the imports and exports, dummies to form specific country groups are created and added to the models one at a time.

Due to various development stages of the EU countries and the different time periods where members joined, dummies were used to group the countries into various groups. Firstly, all EU countries are tested, then the EU 15, EU 5 + 3 and EU 5. The dummy variables for the EU15 group of countries have a value of 1 for the 15 EU countries and a 0 for countries not included in the EU 15. For the EU 5 + 3, all the EU 5 countries (original EU) and the Netherlands, Belgium and Luxembourg have a value of 1 and the rest have a value of 0. Various estimations are done with various groups of countries, testing different options, to get the best result (statistics) by avoiding different problem occurrences in modelling.

Robust SE's are used to avoid heteroskedasticity and/or intra-group correlations to ensure valid statistical inference (robust standard errors can sometimes be consistent). Both the Wald (joint) and the Wald (dummy) tests are used to determine if the dummy variables are significant. The sargan test is also used with some models which tests the validity of instrumental variables. This test sets the hypothesis that the instrumental variables are uncorrelated to the residuals and therefore are acceptable instruments. Furthermore the models are also tested for serial correlation using the AR (1) and AR (2) tests.

6.5 RESULTS OF REGRESSION IMPORTS

6.5.1 South Africa's imports from the EU- Model 1

The models are estimated using oxmetrics with data obtained from the World Bank and International Trade Centre. The first model is estimated using 1-step dynamic panel data, with South Africa's imports from the EU as the dependant variable with EU's GDP per capita, SA's GDP per capita, Logistics performance index and applied average tariffs as explanatory variables.

The explanatory variables are transformed using orthogonal deviations, an alternative transformation to the first differencing which is very useful for models with predetermined variables. This transformation entails subtracting the mean of the remaining future observations available in the data, from the current observation. This equalises the variances of the transformed errors. Orthogonal deviations preserve a lack of correlation among the transformed errors when the original errors are not auto correlated and do have a constant variance (Arellano, 2003; Heckman & Leamer, 2001).

The result of Model 1 are summarised in the table below.

Table 6.3: Model 1 - South Africa's import from the EU for all EU counties

IMPORTS	ALL EU COUNTRIES					
IMPV = + 4.38*OGDP_PC - 0.8575*OGDP_PC_SA + 2.217e-015*OLPI - 0.02527*OAVT- 0.1376						longest time series: 9 [2002 - 2010]
no. of observations: 233					no. of parameters 5	shortest time series: 5 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**			
1-step estimation using DPD	**OGDP_PC**	4.37955	0.9484	4.62	0.000	**44.40** **63.43**	**Transformation used:** orthogonal deviations **Transformed instruments:** IMPV(-1) **Level instruments:** Dummies Gmm("IMPV",2,8)	Wald (joint): Chi^2(4) = 38.85 [0.000] Wald (dum): Chi^2(1) = 4.189 [0.041] Sargan test: Chi^2(39) = 86.94 [0.000] AR(1) test: N(0,1) = -1.287 [0.198] AR(2) test: N(0,1) = -1.062 [0.288]
	OGDP_PC_SA	-0.857455	1.026	-0.836	0.404			
	OLPI	2.21721e-015	7.546e-016	2.94	0.004			
	OAVT	-0.0252748	0.1356	-0.186	0.852			
	Constant	-0.137634	0.06724	-2.05	0.042			

Source: results from this study (2012).

From Table 6.3 it is evident that only OGDP_PC (EU's GDP per capita) and OLPI (Logistics performance index) are significant on the 95% confidence level and both these variables have the predicted effect on the dependant variable. The coefficient of OLPI is very small and will therefore not have a very large effect on imports. OGDP_PC_SA (SA's GDP per capita) and OAVT (applied average tariffs) are statistically insignificant on the 95% confidence level or on the 90% confidence level and although OAVT has a negative effect on the constant which is in accordance with the theory, it is not statistically significant.

The Residual sum of squares has a value of 44.40 and the Total Sum of squares is equal to 63.43 which indicate that the regression function explains a large variance of the data. Various tests were included in the model like the Wald test for both the joint significance and the dummies, and two AR tests which test the null hypothesis of no serial correlation of the first order and the second order. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. With this model, the sargan test indicates that the instruments pass the test and are valid by this criterion. The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term. This indicates that there is no serial correlation present in this model.

6.5.2 South Africa's imports from the EU – Model 2

The second model was estimated using the same method as Model 1, except that the dependant variable IMPV was transformed and seen as exogenous. This was included in this model because often with economic models in time series analysis the dependant variable is exogenous

in the sense that the history has an influence on the future. Therefore time series models often depend directly or indirectly on the underlying historical data. That is why the IMPV variable is lagged and also included in this model. The explanatory variables were again transformed using orthogonal deviations. The results of Model 2 are summarised in the table below.

Table 6.4: Model 2 (IMPV as exogenous) - South Africa's import from the EU

IMPORTS	ALL EU COUNTRIES						
IMPV = + 0.6028*OIMPV(-1) + 0.07464*OGDP_PC + 0.04398*OGDP_PC_SA- 1.042e-016*OLPI - 0.007593*OAVT - 0.1039							longest time series: 8 [2003 - 2010]
no. of observations: 206					no. of parameters 6		shortest time series: 4 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
1-step estimation using DPD, import (-1) as exogenous		**Coefficient**	**Std.Error**	**t-value**	**t-prob**	**Transformation used:** orthogonal deviations **Transformed instruments:** IMPV(-2) **Level instruments:** Dummies	Wald (joint): Chi^2(5) = 64.51 [0.000] Wald (dum): Chi^2(1) = 5.655 [0.017] AR(1) test: N(0,1) = -1.696 [0.090] AR(2) test: N(0,1) = -0.4635 [0.643]
	OIMPV(-1)	0.602781	0.1714	3.52	0.001		
	OGDP_PC	0.0746371	0.02092	3.57	0.000		
	OGDP_PC_SA	0.0439805	0.01001	4.39	0.000		
	OLPI	-1.04249e-016	3.219e-017	-3.24	0.001		
	OAVT	-0.00759300	0.002980	-2.55	0.012		
	Constant	-0.103902	0.04369	-2.38	0.018		
					38.43 54.88		

Source: results from this study (2012).

From the results of Model 2 it is evident that all the variables are significant on the 95% confidence level and the majority of these variables also have the predicted effect on the dependant variable. With the exception of OLPI, which had a negative value and contradicts the theory that the better a countries' infrastructure, the more it will trade internationally. The value of the OLPI coefficient is very small and even if the variable was in line with the theory the effect it would have on South Africa's imports from the EU is minimal. The Residual sum of squares has a value of 38.43 and the Total Sum of squares is equal to 54.88 which are both an improvement from Model 1, and indicate that the regression function explains a large variance of the data and is a better fit than Model 1. Model 2 also includes tests the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term. When looking at the coefficients, the effect of the explanatory variables on the dependant variable range from a small to a very small effect.

6.5.3 South Africa's imports from the EU – Model 3

The third model was estimated using the same method as Model 2, with the addition of a dummy variable consisting of the EU 15 group of countries. The explanatory variables were again

transformed using orthogonal deviations. The result of Model 3 are summarised in the table below.

Table 6.5: Model 3 (15 EU countries) - South Africa's import from the EU

IMPORTS	EU 15							
IMPV = + 0.5517*OIMPV(-1) + 0.0686*OGDP_PC + 0.04391*OGDP_PC_SA- 9.263e-017*OLPI - 0.01289*OAVT - 0.1799 +0.1191*EU15								longest time series: 8 [2003 - 2010]
no. of observations 206						no. of parameters 7		shortest time series: 4 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**					**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**			
1-step estimation using DPD, orthogonal deviations	**OIMPV(-1)**	0.551790	0.1605	3.44	0.001	**37.52** **54.88**	**Transformation used:** orthogonal deviations **Transformed instruments:** IMPV(-2) (exogenous impv (-1) to struggle with AR process) **Level instruments:** Dummies	Wald (joint): Chi^2(5) = 78.82 [0.000] Wald (dum): Chi^2(2) = 7.139 [0.028] AR(1) test: N(0,1) = -1.680 [0.093] AR(2) test: N(0,1) = -0.4885 [0.625]
	OGDP_PC	0.0686798	0.01805	3.80	0.000			
	OGDP_PC_SA	0.0439164	0.01118	3.93	0.000			
	OLPI	-9.26387e-017	5.016e-017	-1.85	0.066			
	OAVT	-0.0128932	0.004514	-2.86	0.005			
	Constant	-0.179940	0.07466	-2.41	0.017			
	EU15	0.119138	0.06854	1.74	0.084			

Source: results from this study (2012).

From the results of Model 3 it is evident that all the variables except OLPI and the EU15 dummy variable are significant on the 95% confidence level. The coefficient of OLPI is also very small like in model 2 and even if it was statistically significant, the effect would be minimal. All the significant variables have the predicted effect on the dependant variable. The Residual sum of squares has a value of 37.52 and the Total Sum of squares is equal to 54.88 which is a slight improvement from Model 2, and indicates that the regression function explains a large variance of the data and is a better fit than Model 2. Model 3 also includes tests the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term. When looking at the coefficients, the effects of the explanatory variables on the dependant variable are small, but have bigger effects compared to Model 2.

6.5.4 South Africa's imports from the EU – Model 4

The fourth model was estimated using the same method as Model 3, except the dummy variable consisting of the EU 5 + 3 group of countries. The explanatory variables were again transformed using orthogonal deviations. The result of Model 4 are summarised in the Table 6.6 on the next page.

Table 6.6: Model 4 (5 + 3 EU countries) - South Africa's import from the EU

IMPORTS	EU5+3						
IMPV = + 0.5767*OIMPV(-1) + 0.07152*OGDP_PC + 0.04394*OGDP_PC_SA- 1.007e-016*OLPI - 0.01008*OAVT - 0.1392 + 0.09507*EU5+3							longest time series: 8 [2003 - 2010]
no. of observations: 206					no. of parameters 7		shortest time series: 4 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**		
1-step estimation using DPD, Using robust standard errors	**OIMPV(-1)**	0.576651	0.1677	3.44	0.001	**37.90** **54.88**	**Transformation used:** orthogonal deviations (exogenous impv (-1) to struggle with AR process) **Transformed instruments:** IMPV(-2) **Level instruments:** Dummies	Wald (joint): Chi^2(5) = 173.5 [0.000] Wald (dum): Chi^2(2) = 6.680 [0.035] AR(1) test: N(0,1) = -1.687 [0.092] AR(2) test: N(0,1) = -0.4770 [0.633
	OGDP_PC	0.0715182	0.01997	3.58	0.000		
	OGDP_PC_SA	0.0439433	0.01065	4.13	0.000		
	OLPI	-1.00679e-016	4.866e-017	-2.07	0.040		
	OAVT	-0.0100814	0.003681	-2.74	0.007		
	Constant	-0.139230	0.05741	-2.43	0.016		
	EU5+3	0.0950736	0.04855	1.96	0.052		

Source: results from this study (2012).

From the results of Model 4 it is evident that all the variables are significant on the 95% confidence level. All the variables have the predicted effect on the dependant variable except the OLPI, which has the opposite effect than theory predicts. Again the coefficient values of the OLPI and the AVT variables are very small and will not influence South Africa's imports from the EU significantly.

The Residual sum of squares has a value of 37.90 and the Total Sum of squares is equal to 54.88 which is a minimal increase from Model 3. Model 4 also includes tests the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression.

The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term. When looking at the coefficients, the effects of the explanatory variables on the dependant variable are small but all of them are significant.

6.5.5 South Africa's imports from the EU – Model 5

The fourth model was estimated using the same method as Model 4, except the dummy variable consisting of the EU 5 group of countries. The explanatory variables were again transformed using orthogonal deviations. The result of Model 5 are summarised in Table 6.7 on the following page.

Table 6.7: Model 5 (5 EU countries) - South Africa's import from the EU

IMPORTS	EU5						
IMPV = + 0.5904*OIMPV(-1) + 0.07322*OGDP_PC + 0.04408*OGDP_PC_SA- 1.067e-016*OLPI - 0.008709*OAVT - 0.1193 + 0.0654*G1							longest time series: 8 [2003 - 2010]
no. of observations 206					no. of parameters 7		shortest time series: 4 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**		
1-step estimation using DPD, Using robust standard errors	**OIMPV(-1)**	0.590375	0.1710	3.45	0.001	**38.22** **54.88**	**Transformation used:** orthogonal deviations **Transformed instruments:** IMPV(-2) **Level instruments:** Dummies	Wald (joint): Chi^2(5) = 132.5 [0.000] Wald (dum): Chi^2(2) = 7.881 [0.019] AR(1) test: N(0,1) = -1.690 [0.091] AR(2) test: N(0,1) = -0.4655 [0.642]
	OGDP_PC	0.0732165	0.02094	3.50	0.001		
	OGDP_PC_SA	0.0440760	0.01059	4.16	0.000		
	OLPI	-1.06713e-016	5.095e-017	-2.09	0.037		
	OAVT	-0.00870928	0.003391	-2.57	0.011		
	Constant	-0.119347	0.05202	-2.29	0.023		
	EU5	0.0654030	0.04434	1.47	0.142		

Source: results from this study (2012).

From the results of Model 5 we can see that all the variables except for the EU5 dummy variable are significant on the 95% confidence level. All the variables have the predicted effect on the dependant variable except the OLPI, which again has the opposite effect than theory predicts. The coefficient value of both the OLPI and the OAVT are again very small and will not have a big influence on South Africa's imports from the EU.

The Residual sum of squares has a value of 38.22 and the Total Sum of squares is equal to 54.88 which is a minimal increase from Model 4. Model 5 also includes tests the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term. Imports are however only one part of total trade, the next part of this chapter analyses the results of models estimated with exports of South African goods to the EU.

6.6 RESULTS OF REGRESSION EXPORTS

6.6.1 South Africa's exports to the EU – Model 1

The models were estimated using oxmetrics with data obtained from the World Bank and International Trade centre. The models were estimated using 1-step dynamic panel data, with South Africa's exports to the EU as the dependant variable. GDP_PC and GDP_PC_SA were transformed as the original export models estimated did not give satisfactory results. GPD_PC and GDP_PC_SA were transformed using first difference, which did not show much improvement in the model. The variables were then transformed using orthogonal deviations,

for both T-1 and T-2, which had significantly better results. The results are summarised in table 6.8 below.

Table 6.8: Model 1 (all EU countries) - South Africa's exports to the EU

EXPORTS	ALL EU COUNTRIES						
EXPV = - 1.652e-013*OLPI - 0.4571*OAVT + 5.848*OGDP_PC - 6.993*OGDP_PC(-1)+ 2.442*OGDP_PC(-2) - 1.007*OGDP_PC_SA - 1.607*OGDP_PC_SA(-1)							longest time series: 8 [2003 - 2010]
no. of observations 206					no. of parameters 7		shortest time series: 4 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
1-step estimation using DPD, Using robust standard errors		**Coefficient**	**Std.Error**	**t-value**	**t-prob**	**34.18** **37.35**	**Transformation used:** orthogonal deviations **Transformed instruments:** EXPV(-1) EXPV(-2) **Level instruments:** Dummies Gmm("EXPV",2,8)	Wald (joint): Chi^2(8) = 39.22 [0.000] Wald (dum): Chi^2(1) = 9.224 [0.002] Sargan test: Chi^2(35) = 78.07 [0.000] AR(1) test: N(0,1) = -2.185 [0.029] AR(2) test: N(0,1) = -0.9457 [0.344]
	OLPI	-1.65185e-013	2.032e-013	-0.813	0.417		
	OAVT	-0.457097	1.006	-0.454	0.650		
	OGDP_PC	5.84765	3.293	1.78	0.077		
	OGDP_PC(-1)	-6.99315	3.545	-1.97	0.050		
	OGDP_PC(-2)	2.44159	1.198	2.04	0.043		
	OGDP_PC_SA	-1.00745	3.999	-0.252	0.801		
	OGDP_PC_SA(-1)	-1.60690	5.172	-0.311	0.756		
	OGDP_PC_SA(-2)	8.99975	3.846	2.34	0.020		
	Constant	0.585473	0.1928	3.04	0.003		

Source: results from this study (2012).

From the above results it is evident that only OGDP_PC (-2) and OGDP_PC_SA (-2) are significant on the 95% confidence level and both these variables have the predicted effect on the dependant variable. The significant variables are relatively high and will therefore have a big effect on the constant. Although OAVT has a negative effect on the constant which is in accordance with the theory, it is not statistically significant and the coefficient value is also very small. The Residual sum of squares has a value of 34.18 and the Total Sum of squares is equal to 37.35 which indicate that the regression function explains a large variance of the data.

Various tests were included in the model like the Wald test for both the joint significance and the dummies, and two AR tests which test the null hypothesis of no serial correlation of the first order and the second order. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. With this model, the sargan test indicates that the instruments pass the test and are valid by this criterion.

The AR (1) test is significant, which indicates that there is some AR (1) behaviour in this model. The AR (2) is statistically insignificant and therefore there is no evidence of AR (2) behaviour in the error term. This indicates that there is some serial correlation present in this model in the AR (1) but no serial correlation on the AR (2). Serial correlation can often be a problem in panel data because it often occurs in repeated patterns like panel data, where the value of a variable

affects the future value of the same variable. Serial correlation in panel-data models biases the standard errors and causes the results to be less efficient. This causes the parameter estimates to appear more precise than they really are. However, because the models transformed using T-1 were statistically insignificant in any case, the serial correlation evident in AR (1) does not cause much of a problem for this specific model.

6.6.2 South Africa's exports to the EU – Model 2

Due to the fact that the EU was created over a period of time, and that various countries joined at different time periods, and that some countries are more established and more developed than others, this study aims to test if the results will differ a lot amongst different group of countries. This part of this section shows the results of models for EU 15.

Table 6.9: Model 2 (EU 15) - South Africa's exports to the EU

EXPORTS	EU 15						
EXPV = + 4.223*OGDP_PC - 1.474*OGDP_PC_SA + 1.262e-014*OLPI + 0.4864*OAVT + 0.1545 - 0.2953*EU15							longest time series: 9 [2002 - 2010]
no. of observations 233					no. of parameters 6		shortest time series: 5 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**		
1-step estimation, Using robust standard errors	**OGDP_PC**	4.22297	1.408	3.00	0.003	**46.56** **46.37**	**Transformation used:** orthogonal deviations **Transformed instruments:** EXPV(-1) **Level instruments:** Dummies Gmm("EXPV",1,8)	Wald (joint): Chi^2(4) = 25.95 [0.000 Wald (dum): Chi^2(2) = 8.112 [0.017] Sargan test: Chi^2(48) = 172.5 [0.000] AR(1) test: N(0,1) = -1.178 [0.239] AR(2) test: N(0,1) = -1.608 [0.108]
	OGDP_PC_SA	-1.47425	1.587	-0.929	0.354		
	OLPI	1.26234e-014	6.433e-015	1.96	0.051		
	OAVT	0.486411	0.1677	2.90	0.004		
	Constant	0.154496	0.07437	2.08	0.039		
	EU15	-0.295270	0.1144	-2.58	0.010		

Source: results from this study (2012).

From the results of Model 2 we can see that all the variables except for the OGDP_PC_SA variable are significant on the 95% confidence level. All the variables have the predicted effect on the dependant variable except the OGDP_PC_SA, which again has the opposite effect than theory predicts. The coefficient value of OLPI and OAVT are very small and will therefore not have a significant effect on South Africa's exports to the EU. The Residual sum of squares has a value of 46.56 and the Total Sum of squares is equal to 46.37 which is an increase from Model 1. Model 2 also includes tests the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. The AR tests are both statistically insignificant, and therefore there is no evidence of either AR (1) or AR (2) behaviour in the error term.

6.6.3 South Africa's exports to the EU – Model 3

This part of this section shows the results of models for EU 5 + 3. This group of countries includes the original EU 5 and the Benelux countries, Belgium, The Netherlands and Luxembourg. GPD_PC and GDP_PC_SA were transformed like in Model 1 for the same reasons as in Model 1. Table 6.10 summarises the results of the model.

Table 6.10: Model 3 (EU 5 + 3) - South Africa's exports to the EU

EXPORTS	EU 5 + 3						
EXPV = - 2.229e-013*OLPI - 0.3278*OAVT + 8.205*OGDP_PC - 3.548*OGDP_PC_SA- 9.98*OGDP_PC(-1) - 0.6298*OGDP_PC_SA(-1) + 4.314*OGDP_PC(-2)+ 11.17*OGDP_PC_SA(-2) + 0.7611 - 0.08648*EU5+3							longest time series: 8 [2003 - 2010]
no. of observations 208					no. of parameters 10		shortest time series: 5 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
1-step estimation using DPD, Using robust standard errors		**Coefficient**	**Std.Error**	**t-value**	**t-prob**	**38.06** **40.39**	**Transformation used:** orthogonal deviations **Transformed instruments:** EXPV(-1) **Level instruments:** Dummies Gmm("EXPV",2,8)	Wald (joint): Chi^2(8) = 32.50 [0.000] Wald (dum): Chi^2(2) = 10.68 [0.005] Sargan test: Chi^2(34) = 64.68 [0.001] AR(1) test: N(0,1) = -2.135 [0.033] AR(2) test: N(0,1) = -1.204 [0.229]
	OLPI	-2.22937e-013	1.632e-013	-1.37	0.173		
	OAVT	-0.327751	1.251	-0.262	0.794		
	OGDP_PC	8.20514	3.467	2.37	0.019		
	OGDP_PC_SA	-3.54796	4.057	-0.874	0.383		
	OGDP_PC(-1)	-9.97987	3.809	-2.62	0.009		
	OGDP_PC_SA(-1)	-0.629800	5.374	-0.117	0.907		
	OGDP_PC(-2)	4.31395	1.690	2.55	0.011		
	OGDP_PC_SA(-2)	11.1701	4.112	2.72	0.007		
	Constant	0.761090	0.2352	3.24	0.001		
	EU5+3	-0.0864802	0.06724	-1.29	0.200		

Source: results from this study (2012).

From the results of Model 3 it is evident that only OGDP_PC, OGDP_PC_SA, OGDP_PC (-1), OGDP_PC (-2) and OGDP_PC_SA (-2) are significant on the 95% confidence level, but only some of these variables have the predicted effect on the dependant variable. The significant variables are relatively high and will therefore have a big effect on the constant, however the standard errors of the significant variables are also quite large. OAVT has a negative effect on the constant which is in accordance with the theory, it is not statistically significant. The dummy variable EU 5 + 3 is statistically insignificant. The Residual sum of squares has a value of 38.06 and the Total Sum of squares is equal to 40.39 which indicate that the regression function explains a large variance of the data. Various tests were included in the model like the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. With this model, the sargan test indicates that the instruments pass the test and are valid by this criterion.

The AR (1) test is significant, which indicates that there is some AR (1) behaviour in this model. The AR (2) is statistically insignificant and therefore there is no evidence of AR (2) behaviour in the error term. This indicates that there is some serial correlation present in this model in the AR

(1) but no serial correlation on the AR (2). However, due to the fact that the variables transformed with the first lag were statistically insignificant, and so many other variables were statistically insignificant, the AR (1) being significant is not a big problem, since the rest of this model is generally not too good or does not give good results.

6.6.4 South Africa's exports to the EU – Model 4

This model was estimated for the original EU 5 countries, GPD_PC and GDP_PC_SA were transformed like in Model 1 for the same reasons as in Model 1. Table 6.11 on the next page summarises the results of the model.

Table 6.11: Model 4 (EU 5) - South Africa's exports to the EU

EXPORTS	EU 5						
EXPV = + 2.722e-013*OLPI - 0.2882*OAVT + 7.815*OGDP_PC - 3.007*OGDP_PC_SA - 9.522*OGDP_PC(-1) - 1.179*OGDP_PC_SA(-1) + 3.899*OGDP_PC(-2) + 11.44*OGDP_PC_SA(-2) + 0.7334 - 0.04628*EU5							longest time series: 8 [2003 - 2010]
no. of observations: 208					no. of parameters: 10		shortest time series: 5 (unbalanced panel)
METHOD	**COEFFICIENT RESULTS**				**RSS & TSS**	**TRANSFORMATIONS**	**TESTS**
		Coefficient	**Std.Error**	**t-value**	**t-prob**		
1-step estimation using DPD, Using robust standard errors	**OLPI**	2.72150e-013	3.118e-013	0.873	0.384	**37.75** **40.39**	**Transformation used:** orthogonal deviations **Transformed instruments:** EXPV(-1) **Level instruments:** Dummies Gmm("EXPV",2,8)	Wald (joint): Chi^2(8) = 33.75 [0.000] Wald (dum): Chi^2(2) = 10.28 [0.006] Sargan test: Chi^2(34) = 66.01 [0.001] AR(1) test: N(0,1) = -2.157 [0.031] AR(2) test: N(0,1) = -1.217 [0.223
	OAVT	-0.288233	1.246	-0.231	0.817		
	OGDP_PC	7.81507	3.448	2.27	0.025		
	OGDP_PC_SA	-3.00720	4.038	-0.745	0.457		
	OGDP_PC(-1)	-9.52246	3.725	-2.56	0.011		
	OGDP_PC_SA(-1)	-1.17886	5.347	-0.220	0.826		
	OGDP_PC(-2)	3.89877	1.491	2.61	0.010		
	OGDP_PC_SA(-2)	11.4415	4.157	2.75	0.006		
	Constant	0.733387	0.2287	3.21	0.002		
	EU5	-0.0462849	0.06176	-0.749	0.455		

Source: results from this study (2012).

From the results of Model 4 it is evident that the results are very similar to that of Model 3. Only OGDP_PC, OGDP_PC_SA, OGDP_PC (-1), OGDP_PC (-2) and OGDP_PC_SA (-2) are significant on the 95% confidence level, but only some of these variables have the predicted effect on the dependant variable. The significant variables are relatively high and will therefore have a big effect on the constant; however the standard errors of the significant variables are also quite large. OAVT has a negative effect on the constant which is in accordance with the theory, although it is not statistically significant. The dummy variable EU 5 is statistically insignificant. The Residual sum of squares has a value of 38.06 and the Total Sum of squares is equal to 40.39 which indicate that the regression function explains a large variance of the data.

Various tests were included in the model like the Wald test for both the joint significance and the dummies, and two AR tests. For this model the Wald test for both the joint and the dummies are significant on the 95 % level, which indicates that the dummies included do have an effect on the regression. With this model, the sargan test indicates that the instruments pass the test and are

valid by this criterion. The AR (1) test is significant, exactly like in Model 3, and the AR (2) is statistically insignificant and therefore there is no evidence of AR (2) behaviour in the error term. However, again due to the fact that the majority of the variables transformed with the first lag were statistically insignificant it is not a big problem. The subsequent part provides a summary of all the import regression models as well as a summary of all the export regression models in order to provide an understanding of the results of all the models combined.

6.7 SUMMARY OF THE MODELS

From the previous section it is evident that there are similar patterns between all of the regression models, it is also evident that there is a significant difference between the import regression models and the export regression models. This section gives an overview of the all the import models to provide an indication of the effects of barriers to trade on the trade between South Africa and the EU. Comparing all the import regression models with each other should provide trends which are evident across all models. Table 6.12 summarises the various import regression models.

Table 6.12: Summary of all import regression models

MODEL	EQUATION	SIGNIFCANT VARIABLES	STATISTICALLY INSIGNIFICANT VARIABLES	RSS & TSS	TESTS
IMPORTS					
MODEL 1 - Imports: All EU	IMPV = + 4.38*OGDP_PC - 0.8575*OGDP_PC_SA + 2.217e-015*OLPI - **0.02527*OAVT**- 0.1376	OGDP_PC OGDP_PC_SA OLPI Constant	OAVT	44.40 63.43	Wald (joint & dummy) Sargan test) AR(1) & AR(2) test
MODEL 2 - Imports: All EU-IMPV as exogenous	IMPV = + 0.6028*OIMPV(-1) + 0.07464*OGDP_PC + 0.04398*OGDP_PC_SA- 1.042e-016*OLPI - **0.007593*OAVT** - 0.1039	OIMPV(-1) OGDP_PC OGDP_PC_SA OLPI OAVT Constant	-	38.43 54.88	Wald (joint & dummy) AR(1) & AR(2) test

Source: results from this study (2012).

Table 6.13: Summary of all import regression models continued

MODEL	EQUATION	SIGNIFCANT VARIABLES	STATISTICALLY INSIGNIFICANT VARIABLES	RSS & TSS	TESTS
IMPORTS					
MODEL 3 - Imports: EU 15	IMPV = + 0.5517*OIMPV(-1) + 0.0686*OGDP_PC + 0.04391*OGDP_PC_SA- 9.263e-017*OLPI - 0.01289*OAVT - 0.1799 +0.1191*EU15	OIMPV(-1) OGDP_PC OGDP_PC_SA OAVT Constant	OLPI	37.52 54.88	Wald (joint & dummy) AR(1) & AR(2) test
MODEL 4 - Imports: EU 5 + 3	IMPV = + 0.5767*OIMPV(-1) + 0.07152*OGDP_PC + 0.04394*OGDP_PC_SA- 1.007e-016*OLPI - **0.01008*OAVT** - 0.1392 + 0.09507*EU5+3	OIMPV(-1) OGDP_PC OGDP_PC_SA OLPI OAVT Constant	EU5+3	37.90 54.88	Wald (joint & dummy) AR(1) & AR(2) test
MODEL 5 - Imports: EU 5	IMPV = + 0.5904*OIMPV(-1) + 0.07322*OGDP_PC + 0.04408*OGDP_PC_SA- 1.067e-016*OLPI - **0.008709*OAVT** - 0.1193 + 0.0654*G1	OIMPV(-1) OGDP_PC OGDP_PC_SA OLPI OAVT Constant	EU5	38.22 54.88	Wald (joint & dummy) AR(1) & AR(2) test

Source: results from this study (2012).

From table 6.12 it is evident that the majority of the variables are significant with one non-significant variable per model, with the exception of Model 2, where all the variables are significant. It is also clear that for all the models except Model 1, the AVT (average applied tariff) variable is significant.

It must also be noted that the coefficients for the AVT variables are very small ranging from 0.0075 – 0.1008 for the significant AVT variables. This indicates that although average applied tariffs do have an effect of South Africa's imports from the EU, the effect is very small. The results suggested that if all tariffs should be eliminated there might not be a significant increase in imports to South Africa from the EU.

The LPI (logistic performance index) variables are also significant for all models except Model 3. However the coefficients are very small and therefore the effect the LPI will have on South Africa's imports from the EU is too small to have any significant effect.

Table 6.14: Summary of all export regression models

MODEL	EQUATION	SIGNIFCANT VARIABLES	STATISTICALLY INSIGNIFICANT VARIABLES	RSS & TSS	TESTS
EXPORTS					
MODEL 1 - Exports: All EU	EXPV = - 1.652e-013*OLPI - **0.4571*OAVT** + 5.848*OGDP_PC - 6.993*OGDP_PC(-1)+ 2.442*OGDP_PC(-2) - 1.007*OGDP_PC_SA - 1.607*OGDP_PC_SA(-1)	OGDP_PC(-1) OGDP_PC(-2) OGDP_PC_SA(-2) Constant	OLPI OAVT OGDP_PC OGDP_PC_SA OGDP_PC_SA(-1)	34.18 37.35	Wald (joint & dummy) Sargan test) **AR(1)**& AR(2) test
MODEL 2 - Exports: EU 15	EXPV = + 4.223*OGDP_PC - 1.474*OGDP_PC_SA + 1.262e-014*OLPI **+ 0.4864*OAVT** + 0.1545 - 0.2953*EU15	OGDP_PC 03 OAVT Constant EU15	OGDP_PC_SA OLPI 1	46.56 46.37	Wald (joint & dummy) Sargan test) AR(1) & AR(2) test
MODEL 3 - Exports: EU 5 + 3	EXPV = - 2.229e-013*OLPI - **0.3278*OAVT** + 8.205*OGDP_PC - 3.548*OGDP_PC_SA- 9.98*OGDP_PC(-1) - 0.6298*OGDP_PC_SA(-1) + 4.314*OGDP_PC(-2)+ 11.17*OGDP_PC_SA(-2) + 0.7611 - 0.08648*EU5+3	OGDP_PC OGDP_PC(-1) OGDP_PC(-2)	OLPI OAVT OGDP_PC_SA OGDP_PC_SA(-1)	38.06 40.39	Wald (joint & dummy) Sargan test) **AR(1)**& AR(2) test
MODEL 4 - Exports: EU 5	EXPV = + 2.722e-013*OLPI - **0.2882*OAVT** + 7.815*OGDP_PC - 3.007*OGDP_PC_SA - 9.522*OGDP_PC(-1) - 1.179*OGDP_PC_SA(-1) + 3.899*OGDP_PC(-2) + 11.44*OGDP_PC_SA(-2) + 0.7334 - 0.04628*EU5	OGDP_PC OGDP_PC(-1) OGDP_PC(-2) OGDP_PC_SA(-2) Constant	OLPI OAVT OGDP_PC_SA OGDP_PC_SA(-1) EU5	37.75 40.39	Wald (joint & dummy) Sargan test) AR(1) & AR(2) test

Source: results from this study (2012).

From table 6.13 it is evident that the many of the variables are statistically insignificant. It is also clear that for all the models except Model 2, the AVT (average applied tariff) variable is statistically insignificant. In the export regression models the AVT variables coefficient have a higher value and thus would have a bigger effect of exports from South Africa to the EU, it AVT was significant.

In Model 2 where AVT is significant, it has a positive value indicating that if AVT increases exports will also increase, which contradicts the theory. This indicates that the effect of AVT does not have a significant effect on exports from South Africa to the EU. The results showed that if all tariffs should be eliminated there might not be a significant increase in exports from South Africa to the EU.

The LPI (logistic performance index) variables are statistically insignificant for all models. The coefficients are very small and therefore even if the LPI variables were significant, the effect they will have on South Africa's exports to the EU is too small to have any significant effect. Model 1 and Model 3 had a significant AR (1) test, which indicates that there is some serial correlation present in this models. The serial correlation could also contribute to the weak statistical results of these models. Although reputable sources were used (World Bank and International Trade Centre), there is also a possibility that the data obtained was not 100% accurately captured and some of the data was missing.

From the tables 5.12 and 5.13 is it evident that trade barriers like tariffs and infrastructure do not have a very significant effect on the trade between South Africa and the EU. This is slightly contradicting to the theory of free trade, but it is vital to take into consideration that the TDCA agreement currently governs trade between South Africa and the EU, and that trade between the two parties is already well established. This also indicates that from a purely economic and trade perspective, the EPA might not have a big effect on the trade between South Africa and the EU if trade barriers are reduced or eliminated.

6.8 SUMMARY AND CONCLUSION

This chapter provides an overview of the gravity model and provides an empirical analysis of the possible effects the EPA could have on the trade between South Africa and the EU by using a gravity model based regression model. The Gravity model has been used in studies for the previous 40 years and provides a platform by which a stable relationship in economics can be explained. The gravity model has the ability to portray the various trade interactions between economies of similar size (Feenstra, 1998; Kandogan, 2007; Van Bergeijk & Brakman, 2010).

Previous empirical studies have shown that the gravity model, although very simple, is very successful from an empirical perspective because it is able to show very relevant trends and empirically describe trends between different locations. The gravity model can easily be adapted to include other more defining variables for distance variable, e.g. tariffs, costs of transport and non-tariff barriers such as infrastructure. The distance variable was originally included in the gravity model because it was an effective way to measure transportation cost and time. It was also used to measure the distance in mind set and attitude between the importer and exporter. The gravity model is thus a good empirical tool for use in this study and should provide a better idea of how the Economic Partnership Agreement will influence the trade flows between South Africa and the EU (Evenett & Keller, 2002; Kepaptsoglou, Karlaftis & Tsamboulas, 2010).

For this study dummy variables were used to group the EU countries into groups of progression of the EU. The various dummies consist of all EU countries, EU 15, EU 5 + 3 and the original EU5. The reason for the dummies is to try and determine if countries that have been part of the EU for longer will have a different effect on trade with South Africa compared to countries that only recently joined the EU. In this study the following variables are used: South African exports to the EU: South African imports from the EU, GDP, GDP PC and average tariff rate. This study also tests for non-tariff barriers like the logistic performance index. This study uses the data for each variable for the time period 2000 to 2010 and was sourced from the World Bank and the International Trade Centre.

Analysing the descriptive statistics it is evident that there is some data missing. For some variables not all countries had data available until 2010, so with several of the variables the data for 2010 is missing. Unfortunately in any type of study there will always be data limitations and missing data, which is one of the biggest problems researchers, face worldwide. To combat the missing data in this study, the models were estimated for different groups of countries and in the case where the variables were missing for a certain year, that year was excluded from the model.

When summarising the results of all the South Africa's imports from the EU models combined, the majority of the variables are significant with an average of one non-significant variable per model, with the exception of Model 2, where all the variables are significant. It must also be noted that the coefficients for the AVT variables are very small ranging from 0.0075 – 0.1008 for the significant AVT variables. This indicates that although average applied tariffs do have an effect of South Africa's imports from the EU, the effect is very small. This was true for all the models estimated, whether using all EU countries or only the EU 5. If all tariffs should be eliminated, there might not be a significant increase in imports to South Africa from the EU.

The LPI (logistic performance index) variables are also significant for all models except Model 3. However the coefficients are very small. When looking at the Logistics performance index, it appears that these variables, although statistically insignificant in all the models and often having the opposite effect than theory predicts, have an even smaller effect on import than tariffs have. This indicates that a country's infrastructure and the efficiency of the clearance process, ease of arranging well priced shipments, quality of logistic services, and the ability to track and trace consignments as well as the timeliness of shipments play a very small role on the imports and exports between the EU and South Africa.

When looking at exports, the results were slightly different than the imports. Firstly, it is evident that the many of the variables are statistically insignificant. It is also clear that for all the models except Model 2, the AVT (average applied tariff) variable is statistically insignificant. In the export regression models the AVT variables coefficient have a higher value and thus would have a bigger effect of exports from South Africa to the EU, it AVT was significant. In Model 2 where AVT is significant, it has a positive value indicating that if AVT increases exports will also increase, which contradicts the theory. This indicates that the effect of AVT does not have a significant effect on exports from South Africa to the EU.

If all tariffs should be eliminated, there might not be a significant increase in exports from SA to the EU. The LPI (logistic performance index) variables are statistically insignificant for all models. The coefficients are very small and therefore even if the LPI variables were significant, the effect they will have on South Africa's exports to the EU is too small to have any significant effect. Model 1 and Model 3 had a significant AR (1) test, which indicates that there is some serial correlation present in this models. From the previous analysis it is evident that trade barriers like tariffs and infrastructure do not have a very significant effect on the trade between South Africa and the EU. This is slightly contradicting to the theory of free trade, but it is vital to take into consideration that the TDCA agreement currently governs trade between South Africa and the EU, and that trade between the two parties is already well established. This also indicates that from a purely economic and trade perspective, the EPA should not have a big effect on the trade between South Africa and the EU if trade barriers are reduced or eliminated. This indicates that if South Africa decides to join the EPA and the majority of the tariffs will decrease of fall away completely, the effect on imports from the EU will not be significantly larger. This arises from the fact that the EPA's main motivator is not increase in trade, but rather political and development orientated. The following chapter gives a complete summary and conclusion.

CHAPTER 7

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

7.1 INTRODUCTION

South Africa is the EU's largest trading partner in Africa and in the previous ten years, South Africa's exports to the EU have increased as well as become more diverse, to include more manufactured products (see section 1.3.3). South Africa is also a big role player in the regional trade agreement which originated in 1976 between the European Union (EU) and the African, Caribbean and Pacific (ACP) countries (see section 3.4). This agreement came into focus a few years ago, because it did not comply with rules set out by the WTO as it gave one-way unilateral preferences to the ACP into the EU, but was not reciprocal (Hinkle & Schiff, 2004; Perez, 2006). This agreement expired in 2007 and a new agreement namely the Economic Partnership Agreement (EPA) that fully complied with WTO rules was created (see section 1.1). South Africa did not want to sign this agreement because in 1999 it already signed a trade agreement with the EU namely the Trade Development and Cooperation Agreement (TDCA) and had some reservations regarding how the EPA would affect its trade with neighbouring countries. If the EPA agreement is implemented in South Africa, it will replace the TDCA agreement and have an effect on South Africa's trade with the EU and its neighbouring countries. The problem statement in section 1.5 aimed to analyse the impact the Economic Partnership Agreement (EPA) would have on South Africa (RSA) and its trade with the EU and furthermore the impact it would have on South Africa's trade with its neighbouring countries.

The motivation for this study was to attempt to analyse the effects the EPA could have on South Africa's trade with the EU because the EU is currently one of South Africa's biggest trading and development partners (see section 1.5). According to theory, more liberal trade promotes exports and have many benefits (see section 2.4). Therefore from a trade perspective, the EPA has several benefits for South Africa because fewer products are excluded when compared to the TDCA (see sections 3.5.6 and section 4.6). The big difference is that the TDCA was only between the EU and South Africa but the EPA also includes other African countries like the SADC countries. South Africa has qualities of both developed and developing countries and is being excluded from several benefits. This rings some alarm bells, as South Africa and its neighbouring countries are working towards better regional integration. There are speculations that the EPA might have a negative influence on the regional integration. For these reasons a complete literature overview is provided to gain an understanding of free trade agreements,

barriers to trade as well as of regional integration. To understand how the Economic Partnership Agreement (EPA) will affect South Africa and how it will affect their international trade and their economy, it is important to analyse the EPA and understand where it originates from.

The underlying question is what impact will the EPA have on South Africa's trade with the EU? And what impact will the EPA have on trade between South Africa and its neighbouring countries? These questions will be addressed in the subsequent part of this chapter, the summary.

7.2 SUMMARY AND CONCLUSION

The primary objective of this study was to provide an in depth overview of the possible effects the EPA could have on South Africa's trade with the EU and South Africa's neighbouring countries. This objective was achieved by the following secondary objectives.

The first secondary objective was to provide a complete literature overview of trade theories and trade agreements. This first part of this objective was reached in sections 2.3 to 2.6. Section 2.3 provided an overview of trade theories ranging from Mercantilism to New Trade theories. It is important to understanding the background of various trade theories to be able to understand how the EPA will affect South Africa and its trade. One of the advantages of a free trade agreement like the EPA is the benefits associated with a more liberal approach to trade. Section 2.4 discussed the benefits of international trade on national level, on a company level as well as on consumer level. Section 2.5 gave an overview on the measures of likelihood for countries to trade with each other, as this plays a role in determining which countries will indeed trade with one another. Section two was split into two sections namely the gravity model (2.5.1) and the role of resources and specialisation on the likelihood of trade (2.5.2). The Gravity model was used as a base in the empirical analysis (see section 5.2 for more information). Section 2.6 gave a complete overview of Trade instruments including Tariff barriers (section 2.6.1) and non-tariff barriers (2.6.2) like anti-dumping, export subsidies, import quotas, voluntary export restraints, licensing, embargoes, sanctions and other non-tariff barriers like ease of doing business and customs procedures.

The second part of the objective was reached in section 2.7 which discussed trade agreements in detail, starting by defining a trade agreement (section 2.7.1) as well as explaining the trade laws and legal aspects of trade agreements (section 2.7.2). It was important to understand the legal aspects of trade agreements for the EPA because South Africa has a much smaller economy and

still has qualities of a developing country. There are certain laws and rules involved in international trade, which aim to protect the countries involved. Both South Africa and the EU are members of the WTO, and thus have to adhere to the rules and regulations set out by the WTO (See section 2.7.3).

The second secondary objective of this study was to provide an overview of the Economic Partnership agreement. This objective was reached in section 3.4, however to fully comprehend the EPA, it is necessary to understand how it originated and the theory behind it. The EPA's main goal is to establish a free trade agreement and aid economic integration. The EPA aims to support development by improving competitiveness for the ACP countries in world markets, increasing their exports, and attracting more FDI inflows. The EPA can be seen as both a regional trade agreement and a preferential trade agreement, both of which are complex agreements and no two are the same. Sections 3.2 and section 3.3 provided a complete overview of regional trade agreements and preferential trade agreements respectively. Regional integration discussed economic integration (section 3.2.1), the effects of integration (section 3.2.2), degrees and dimensions of integration (section 3.2.3) as well as general characteristics of successful integrations groups. Section 3.3 gives the theoretical base of preferential trade agreements and an overview of preferential trade agreements between the South and the North.

Section 3.4 provided a complete overview of the EPA starting with a definition of the EPA. The EPA is a preferential trade agreement which promotes regional integration and market access, facilitates trade and removes technical barriers to trade as well as incorporating rules of origin and various sanitary measures (see section 3.4.1). The EU preferential relationship with the ACP countries started 1963 when the European Economic Community implemented a trade and development relationship with its past colonies (Treaty of Yaoundé). The first EPA originated during the first Lomé convention in 1975. At the time the ACP countries started to feature more in the World economy, voicing their needs and ideas and were approaching a position of equality. South Africa only had partial accession to the Lomé convention because it was more developed than the majority of the ACP countries. Lomé I was followed by Lomé II, Lomé III and Lomé IV (1989). The Cotonou agreement, signed in 2000, was the successor of the Lomé Conventions and had to be compatible with the multilateral trade rule of the WTO. At this stage South Africa was excluded from the provisions for economic and trade cooperation because the TDCA with the EU was already in place (see section 3.4.2). When the Cotonou expired in 2007, the EPA came into place. The aim of the EPA is to restructure trade to promote trade between the EU and the ACP countries. This agreement aims to focus on improving development goals

and being more compatible with the WTO's rules and regulations. The EPA also aims to enhance political dimensions, and eliminate corruption and refocus policies to reduce poverty (see section 3.4.3).

The third secondary objective was to provide an overview of the EU and South Africa and their trade with each other. This objective was reached in sections 4.1 to 4.3 by providing an overview of the current economic and trade situation between South Africa and the EU. South Africa is both a developing and a developed country. South Africa has good infrastructure for both domestic and international purposes and is often seen as the distribution hub for land locked neighbour countries (see section 4.2.1). The European Union (EU) is characterised by its advanced economic integration.

The EU is based on a FTA where 12 members have a common currency, the euro. The 2008 - 2009 global economic crises hit the EU causing a very moderate GDP growth in 2010 and 2011 (see section 4.2.2). South Africa is an important trading partner of the EU. The EU and South Africa have had a trade relationship and a solid trading history for numerous years. In 1999 they signed the TDCA, which was to set up a free trade area over a 12 year period after which South African exports to the EU grew by 46%. Trade after 2000 was steadily increasing and between 2004 and 2008 alone trade increased by an estimated 27%. Exports decreased drastically between 2008 and 2009 due to the global financial crisis, but in 2010 and 2011 it picked up again at a steady pace. South Africa's share of trade in services has also increased over the last decade.

With FDI, the amount South Africa received was less than what other countries received, but the EU was by far South Africa's most important development partner, providing 70% of all external assistance funds in 2010 (see section 4.3). Section 4.4 discussed how trade agreements influence trade between South Africa and the EU. A trade agreement ensures that the parties keep benefiting from the arrangement, stipulates procedures and rules and provides dispute settlement procedures (see section 4.4.1). The EPA can contribute to higher growth and more opportunities if it stimulates regional integration and this can be done if both parties need to adopt a bottom-up approach and identify individual economic priorities of counties and incorporating them into the EPA (see section 4.4.2). This is already being done to some degree with South Africa who has a very different agreement with the EU compared to other African countries (see section 4.4.3).

The fourth secondary objective was to provide an overview of the TDCA and the effects of replacing the TDCA with the EPA. The first part of this objective was achieved in section 5.1. Section 5.2 provided an overview of the TDCA. The EU and South Africa have had a solid trading history and in 1999 they signed the TDCA. The main objective of the TDCA was to liberalize trade. The TDCA incorporated certain elements to ensure that the agreement will benefit both South Africa and the EU. After the implementation of the TDCA South African exports to the EU grew by 46% (section 5.3). Andriamananjara and Hillberry (2001) found that the TDCA only accounted for around 2% of South Africa's total trade growth for that period. Firstly because there was a transition period, so the benefits could possibly only be realised far into the future. Secondly, several products were excluded which also limited the benefits. Thirdly this agreement was exclusively between South Africa and the EU, so the benefits are minimized when compared to the benefits multilateral integration could hold (see section 5.3).

However, because South Africa and the EU have had a trading relationship for over a decade there is a lot at stake if the country does not make good decisions regarding the EPA. Firstly, the EU is one of South Africa's most important partners as the EU accounts for more than 50% of the country's foreign trade and provides 70% of all South Africa's external assistance funds. Secondly, South Africa and the EU entered into a strategic partnership in 2007 which accompanies the TDCA. With the TDCA in place very successful cooperation on senior level have already been implemented in sectors such as science and technology and the aim is to implement additional forums in other sectors like education (See section 5.5.1). So for South Africa, it should be beneficial to accept the EPA. However, when considering South Africa's trade with its neighbouring countries, there is very little consistency between the EPA agenda and the regional integration process plans. A big issue is that not all the African countries will liberalise the same basket of products and there are numerous overlapping memberships (see section 5.5.2). The biggest difference between the TDCA and the EPA are in product inclusions and cumulation. Pant (2009) found that if South Africa joins the EPA, the economic costs are limited, as there are no drastic changes. South Africa's trade with its neighbours is mostly vertical and there should be no negative effects. To the contrary, it could increase trade between these countries. One advantage South Africa will gain from the EPA is that it can now extend the transition period from 2012 in the TDCA agreement to 2020-2023. Economically there are benefits from the EPA but politically, a major issues lie in Article 28(7) of the EPA, which constrains South Africa to sign agreements with any other non EU country. Since the EU is in some financial trouble following the credit- and debt crisis, it is imperial to further analyse this

clause (it is not in the scope of this study) and attempt to exclude it from the EPA agreement (see section 5.7).

The fifth secondary objective was to empirically analyse the impact of trade barriers on the historic trade between South Africa and the EU. This objective was reached in chapter 6, specifically section 6.5 and 6.6 which provided the result from the import and export regression models respectively. An overview of the gravity model was provided (see section 6.2) which was used as a base in the empirical analysis of the possible effects of the EPA. The gravity model can be estimated using econometric techniques in order to calculate patterns of trade flows between countries. The gravity model was used as a base for the regression models, because it has proven to give accurate estimations in previous studies done with similar trade data. The data multi-dimensional and contained multiple occurrences and observations over multiple periods, therefore this study made use of panel data to estimate the models. The models were estimated using the statistical program oxmetrics (see section 6.4). This study used data for each variable for the time period 2000 to 2010 and was sourced from the World Bank and the International Trade Centre but there is some data missing. This study used dummy variables to group the EU countries into groups depending on when they joined the EU (all EU, EU 15, EU 5 + 3 and EU5 (see section 6.3). The reason for the dummies is to try and determine if countries that have been part of the EU for longer will have a different effect on trade with South Africa compared to countries that only recently joined the EU. The majority of the dummy variables were statistically insignificant in the regression models and therefore indicates that the time the country joined the EU does not affect the trade with South Africa.

When summarising the results of all the South Africa's imports from the EU models combined, the majority of the variables are significant with an average of one non-significant variable per model. It must also be noted that the coefficients for the AVT variables are very small for the significant AVT variables. This indicates that although average applied tariffs do have an effect on South Africa's imports from the EU, the effect is very small. If all tariffs should be eliminated, there will not be a significant increase in imports to South Africa from the EU. When looking at exports, it is evident that the many of the variables are statistically insignificant. It is also clear that for all the AVT (average applied tariff) variable is statistically insignificant. In the export regression models the AVT variables coefficient have a higher value and thus would have a bigger effect on exports from South Africa to the EU. If AVT was significant, although it is not, it is evident that the effect of AVT does not have a significant effect on

exports. Therefore if all tariffs should be eliminated with the implementation of the EPA, there will not be a significant increase in exports from South Africa to the EU (see section 6.6.5).

In summary the primary objective of this study was to provide an in depth overview of the possible effects the EPA can have on South Africa's trade with the EU and its neighbouring counties. In theory the EPA agreements promises many benefits for South Africa and the other ACP countries. The biggest goal of the EPA is to promote sustainable development, by enabling developing countries to integrate into the world economy and one way of enabling this is to incorporate free trade agreements. To better understand the effects of the EPA on South Africa, this study analysed the effects of the TDCA on South Africa's trade and economy. After South Africa signed the TDCA with the EU in 1999, trade increased significantly for the following several years (2000 – 2008), only decreasing between 2008 and 2009, mostly due to the global crisis. However there were speculations that this increase in trade was caused by other factors like the lifting of sanctions against South Africa. In a study done by Andriamananjara and Hillberry (2001), they found that the TDCA only accounted for around 2% of South Africa's total trade growth for that period.

From the empirical analysis in this study, it is also evident that trade barriers like tariffs and infrastructure do not have a very significant effect on the trade between South Africa and the EU. This also indicates that the TDCA did not have a big effect on the trade between South Africa and the EU. In the study done by Andriamananjara and Hillberry (2001) reasons why the TDCA was not solemnly responsible for the trade increase were highlighted. Firstly the TDCA had an extensive transition period indicating that the benefits could possibly only be realised in the future. Secondly, South Africa has a limited degree of openness, due to safe products being excluded which limited the benefits that South Africa could gain. Thirdly the TDCA is a regional agreement between South Africa and the EU, so the benefits automatically are minimized when compared to the benefits multilateral integration would have held. The empirical analysis done in this study and the evidence found by Andriamananjara and Hillberry (2001) in their study, indicates that if the EPA is implemented and trade barriers are reduced or eliminated, the effect on trade will be limited. If South Africa decides to join the EPA and the majority of the tariffs will decrease or fall away completely, the effect on imports from the EU will not be significant. However, although it appears that the TDCA was not responsible for South Africa's growth in trade, the EU remains one of the country's biggest trade and development partners, so it is vital to consider the effects of the EPA which stretch beyond trade benefits.

When looking at benefits of switching from the TDCA to the EPA, the main advantage for South Africa is that it could assist the country and its neighbours with regional trade and integration. For South Africa to gain the full benefits from the EPA the TDCA has to be harmonized with the EPA and clauses of rules of origin should be defined to not hinder regional FTA between African countries. If the EPA is implemented correctly, there should be little negative effects for South Africa and its trade with neighbouring countries.

A big concern is that because the EPA allows each country its own set of particulars and specifications, this might have a bad influence on the trade and regional integration between these African countries. One of the biggest issues is that not all the African countries in the same economic region will liberalise the same basket of products, which will create new barriers to intra-regional trade to try and avoid trade deflection. Another issue is the overlapping memberships because SADC is divided in the EPA negotiations where some members have chosen to become part of ESA (East Africa group). Pant (2009) found that if South Africa joins the EPA, the economic costs are limited, as there will not be many drastic changes. South Africa's trade with the SADC countries is mostly vertical and if signing the EPA with the EU, there should be no negative affects with regards to its trade with other SADC members. According to Pant (2009), the EPA could actually increase trade between South Africa and other SADC countries because there is very little competition in products between South Africa and other SADC members.

The most important challenge for these countries with regards to the EPA is to ensure consistency of positions and avoid conflicts in trade policy and other commitments. African countries should communicate openly and work together in a transparent manner to ensure that they gain the benefits from the EPA without compromising on the regional integration plans. One positive benefit that South Africa will gain from signing the EPA is that it can now extend the transition period from 2012 in the TDCA agreement to 2020-2023. This means that South Africa can postpone tariff reductions by almost 10 years. However, although the EPA appears to have benefits for South Africa and its neighbouring countries, there are also some risks which should be taken into consideration. It is evident that the EPA's main motivator is not increase in trade, but is more politically and development orientated. Although this study touched on some political and development factors, it is beyond the scope of the study and more research should be on the political and development aspects of the EPA. One of the major issues lies in Article

28(7) of the EPA, which restricts South Africa's ability to engage in FTA's with non-EU countries.

From a political perspective South Africa is currently one of only nine strategic partners for the EU, so from that aspect, the TDCA was highly beneficial for South Africa, especially in terms of cooperation. With the TDCA in place, very successful cooperation on senior level has already been implemented in sectors such as science and technology. All of the progress already achieved could be jeopardised if South Africa does not make good decisions regarding the EPA with the EU.

7.3 RECOMMENDATIONS

The primary objective of this study was to determine the effects that the EPA would have for South African trade with the EU and its neighbouring countries. From the literature as well as the empirical analysis, it is evident that the EPA agreement will not have a big effect on the Trade between South Africa and the EU, or have any negative effects for trade between South Africa and its neighbouring countries if it is structured and implemented correctly. From the above statement it can be concluded that trade was not a main motivator for the EPA and that other factors like politics and development were main motivators. The EPA is a complex agreement and stretches beyond economic and trade related benefits, as it ensures political and diplomatic cooperation from the EU with regards to issues within Africa. The agreement will thus play a role in the security as well as peacekeeping. However, the political and development factors were not part of the scope of this study and should be analysed before South Africa takes a decision regarding the EPA.

Factors that Government and Policy makers should take into consideration regarding the EPA:

- A benefit from switching from the TDCA to the EPA is that South Africa can extend the transition period from 2012 in the TDCA to 2020-2023. South Africa can thus postpone tariff reductions by almost 10 years, but it is essential that strategies are developed which actively focus on improving their major industries to ensure that they will more competitive once the transition period is over.
- To ensure that the EPA does not influence South Africa's trade with the SADC countries in a negative way, South Africa and the SADC countries should communicate openly and work together in a transparent manner to ensure that they gain the benefits from the EPA without compromising on the regional integration plans.

- For South Africa to gain the full benefits from the EPA the TDCA has to be harmonized with the EPA and clauses of rules of origin should be defined to not hinder regional FTA between African countries. If the EPA is implemented correctly there should be little negative effects for South Africa and its trade with neighbouring countries.
- Due to the fact that the EPA's main motivator is not trade but politics, an in depth study should be done to analyse the political effects of the EPA. One of the major issues is Article 28(7) of the EPA, which restricts South Africa's ability to engage in FTA's with non-EU countries. It is crucial that this Article be completely excluded from the EPA as it will have a significant effect on South Africa's trade with other countries.

The first recommendation for future research is to further analyse the above mentioned clause. This article could hinder South Africa's plans for potential FTAs with other countries and decrease South Africa's potential for growth and development, especially because the BRICS countries are starting to play a bigger role in global economic and political environment. An additional recommendation for future research is to do a similar study to analyse the effects of the EPA on South Africa's political environment and development. Due to the complexity of the EPA agreement more research is needed to determine what the overall effects from a political and development aspect.

A limitation of this study is that in terms of the data, there was no adequate data available for all the EU countries for all the variables included in the regression models; therefore not all the non-tariff barriers could be included in the regression. Another limitation was the unavailability for adequate data for the trade between South Africa and its neighbouring countries. It was thus not possible to do an empirical analysis of the trade between South Africa and its neighbouring countries in the same manner that it was done for South Africa and the EU. Therefore in this study South Africa's trade with its neighbouring countries was based on theory and previous studies only.

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