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**SADC Trade Protocol and Its Potential Impact On The
South African Clothing And Textiles Industry**

A Case Study Of Pepkor

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Without the support of all these people, this work would not have been a success. However, I am responsible for any errors and omissions that may arise in this paper.

RESEARCH METHODOLOGY

I have adopted a combination of extensive desktop research as well as the case-study approach in this study. The desktop research involved reviewing literature and research work that has already been done on this and related topics, through use of books; published and unpublished papers, government publications, as well the internet.

I have also conducted a case study of one of the subsidiaries of Pepkor – Pep Clothing. This involved conducting face-to-face interviews with the management. I have attached a copy of a questionnaire that was used for this purpose in Appendix A. The decision to choose Pep Clothing for the case-study was motivated by the company's relocation of its manufacturing operations to Malawi in mid-1990s and their subsequent reversal of that decision after a few years, therefore closing down that.

The conclusions have been drawn and recommendations made, based on the experience of Pep Clothing, concerning the potential impact of the SADC Protocol on Trade on the manufacturing industry in general.

RESEARCH ABSTRACT

Generally, it is accepted that regional co-operation and integration is effective means to facilitate economic growth and sustainable development, particularly among the developing countries. Even the developed countries have adopted the regional approach since it is believed that its benefits outweigh the costs associated with it. Africa also acknowledged this, and formed various regional trading arrangements. However, this research focuses more on regional co-operation and integration in the SADC region. The SADC Trade Protocol was signed by all member states in 1996, with the aim to eventually form a free trade area by 2008 by gradually removing all tariffs and non-tariff barriers to intra-regional trade.

SADC member states are mainly concerned about the implications of the protocol on their economies, particularly the performance of their industries, as well as on trade patterns in the region. Hence, the process of ratification and implementation of the protocol has taken much longer than expected, due to ongoing negotiations between member states in an endeavour to address their concerns. Some of their major concerns are being addressed through revisions and additions to the provisions of the trade protocol. The implementation started on 01 September 2000.

This research aims to establish the potential impact of the trade protocol and the proposed free trade area on the South African manufacturing industry, particularly on the clothing and textiles industry. The most crucial part of this paper is a case study, which has been conducted on one of South Africa's largest clothing companies using telephonic and face-to-face interviews, in an attempt to gain insight on the impact of the trade protocol, especially the clause on rules of origin,

on the clothing and textiles industry and how the industry will continue to respond to the implementation of the protocol. How will the trade protocol impact on the trade and investment flows in the region? Will there be any specific implications on pattern of capital flows within the region? What about choice of location for future investment in the region?

While there are benefits of the trade protocol for the region, through its promotion of investment and intra-regional trade and opening a larger market for the member states, it remains a concern that some member states will not benefit as much as their counterparts. The impact of the rapidly changing trade and investment environment on various sectors may differ, and the sensitive sectors remain a major concern. What are the major concerns about the clothing and textiles industry, in view of its sensitive nature?

This research seeks to provide answers to various questions pertaining to the SADC trade protocol and its impact on manufacturing industry in South Africa and in the SADC region. It draws conclusions about the clothing and textiles industry as well as the manufacturing industry at large, based on the experience of one large clothing company.

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ABBREVIATIONS

AGOA	-	African Growth Opportunities Act
BLNS	-	Botswana, Lesotho, Namibia and Swaziland
BTI	-	Board of Trade and Industry
BTT	-	Board on Tariffs and Trade
CPI	-	Consumer Price Index
DCC	-	Duty Credit Certificate
DCCS	-	Duty Credit Certificates Scheme
CLOFED	-	Clothing Federation of South Africa
CMT	-	Committee of Ministers responsible for Trade
COMESA	-	Common Market for Eastern and Southern Africa
CPPP	-	Community Public Private Partnership
CSA	-	Customs Secured Area
FTA	-	Free Trade Area
GATT	-	General Agreement on Tariffs and Trade
GEIS	-	General Export Incentives Scheme
GSP	-	General System of Preferences
HLC	-	Higher Level Committee
HS	-	Harmonised System
IDC	-	Industrial Development Corporation
IPA	-	Investment Promotion Agency
LDMS	-	Least Developed Member States
MFA	-	Multi-Fibre Arrangement
MFN	-	Most Favoured Nation
MMTZ	-	Malawi, Mozambique, Tanzania and Zambia
NCF	-	National Clothing Federation of South Africa
NEAC	-	National Exports Advisory Council
PPMS	-	Productivity Performance Monitoring Scheme
PTA	-	Preferential Trading Arrangement
SACU	-	South African Customs Union
SADC	-	Southern African Development Community
SADCC	-	Southern African Development Co-ordination Conference

SANS	-	South African Nylon Spinners
SAP	-	Structural Adjustment Programme
SDIs	-	Spatial Development Initiatives
SMEDIP	-	Small Medium Enterprise Development Programme
SMMDP	-	Small/Medium Manufacturing Development Programme
TEXFED	-	Textile Federation of South Africa
TIPS	-	Trade and Industry Policy Secretariat
USA	-	United States of America
WTO	-	World Trade Organisation
WWI	-	First World War
WWII	-	Second World War

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CHAPTER ONE: INTRODUCTION

The experience of other countries in the world has shown the importance of international trade in economic development. In fact, literature and practice has confirmed that trade increases welfare through its contribution to economic growth and poverty alleviation. However, the trade regime and policies prevailing in the country determine how much the country gains or loses from international trade. For instance, countries that have more liberalised policies, and also provide trade investment incentives, tend to grow faster than countries with restrictive policies on trade and investment.

This paper focuses broadly on regional integration and co-operation, with particular focus on Southern African region. It has been accepted globally, both in developed and developing countries, that regional integration is a potentially effective means to facilitate rapid economic growth and sustainable development. This is manifested by the global trend towards regionalisation, free trade areas, common currencies and the emergence of regional trading blocs around the world since the 1980s. The European Union, in which a single currency used, is the evidence of this in developed countries, while there is MERCOSUR in Latin America.

Africa has also acknowledged the importance of regional integration and co-operation for economic growth and development. Hence, they have attempted in many ways to adopt the regional approach, as they formed regional structures such as COMESA, Common Monetary Area, East African Community, ECOWAS and SADC. More specifically, this research focuses on the formation of a free trade area in SADC. The SADC Trade Protocol, signed in 1996, is an instrument for development of the free trade area. It has been generally accepted by all the

member states and as of August 2001, all member states that are signatory to the Protocol on Trade have submitted their instruments of implementation. The only exceptions are Angola, DRC and Seychelles, which have not signed the Protocol on Trade yet due to disagreements during negotiations on issues such as the rules of origin and improvement of tariff offers, among other things. Thus, they are not part of the Free Trade Area yet.(Interview: DTI, 2001)

A key concern is whether the Protocol has potential to promote economic growth and sustainable development by attracting investment capital into the region. This thesis attempts to render answers, particularly with respect to the South African clothing and textiles industry.

The clothing and textiles industry has been one of the most protected industries in South Africa, due to its role as one of South Africa's largest manufacturing employers. At the dawn of liberalisation, this industry has been challenged with strict competition from cheap imports as well as illegal imports.(Horton, 1998: 5) Hence, it is classified as one of the sensitive industries that require special provisions in the SADC Trade Protocol, together with the agriculture and automotive industries.

The major clothing and textile industries in the region are in Zimbabwe, South Africa and Mauritius. However, Malawi has been a major source of South African clothing and textile imports. With the changing trade and investment climate due to the free trade area that is proposed in the Protocol, what are the implications on the South African clothing and textile industry? The paper will examine this question. According to the theory, the expected impact of the Protocol is to induce competition in the market for the liberalised products. This will tend to reduce the

prices for these products compared to the domestic products, as the companies will have access to cheaper imported inputs; and also lead to more efficient allocation of resources.

Chapter two provides an overview of the Southern African Development Community. It focuses on the structure and nature of production and markets in the SADC region, with the aim of assessing the challenges and opportunities that can be brought about by the Protocol and the proposed free trade area. It provides general background to the provisions of the Trade Protocol and highlights the objectives of SADC as well as those of the protocol.

Chapter three focuses on the clothing and textiles industry. It provides a historical overview of the developments and trends of the South African clothing and textiles industry. It further discusses the impact of the changes in legislation on this industry and its competitiveness. It examines the provisions of the Trade Protocol as they relate to the clothing and textiles industry.

Chapter four deals with the trade and investment flows in the SADC region and in South Africa. It gives a brief overview of investment, particularly its trends, factors affecting investment in general and in the SADC region in particular. It also looks at intra-SADC trade flows as well as South Africa's trading arrangements with other SADC member states. Furthermore, it looks at investment related to the trade flows, and finally, the impact of the Protocol on trade and investment.

Chapter five deals with the case study of Pepkor, one of the largest clothing companies in South Africa, based on questionnaire and telephonic interviews. The case of Pepkor is used to illustrate the impact of the Protocol on the South African

clothing and textile industry and on investment flows in the region. Then, **chapter six** sets out the policy conclusions and recommendations.

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CHAPTER TWO: THE SADC TRADE PROTOCOL

2.1 Introduction

This chapter focuses on Southern African Development Community. It provides an overview of the structure and nature of production and markets within the SADC region, aiming to assess the opportunities and challenges that can be brought about by the SADC Trade Protocol and the proposed free trade area. The chapter further provides a brief summary of the general background to main features of the SADC Trade Protocol. In chapter 3, the Trade Protocol will be discussed more within the context of the clothing and textile sector.

Although the Southern African region is made up of a large number (14) of relatively small countries, it has a large market with the combined population currently estimated at 199million people. In 1998 this figure was approximately 190million.(See table 2.2) The SADC region covers a total area of 9.3 million square miles.(Tsikata, 1999:3) The real GDP of the whole SADC economy is estimated at US\$176 billion. The average GNP per capita of the region, based on data of the African Development Bank, amounted to US\$988 in 1997.(SADC, 2000)

2.2 Southern African Development Community

Southern African Development Community (SADC) is a regional arrangement between Southern African states, which was formed in April 1980 as Southern African Development Co-ordination Conference (SADCC). These countries established SADCC as an action against the Apartheid State of South Africa in Lusaka, Zambia, following the adoption of the Lusaka Declaration, *Southern Africa: Towards Economic Liberalisation* by the founding member states. SADCC grew out of efforts by the "frontline" (or founding) states to liberate Southern

Africa and to protect the region against South African aggression, after realising that they had common interests.¹ Namibia also joined SADCC as a tenth member, after their independence and demise of apartheid in 1990.

The main objectives of SADCC, initially, were to:

- “reduce, and eventually, eliminate economic dependence [especially and not exclusively] on South Africa;
- forge the links to create a genuine and equitable regional integration;
- mobilise resources to promote the implementation of the national, inter-state and regional policies;
- secure international co-operation for economic liberation and collective self-reliance.”(Chipeta, 1997; Tsikata, 1999)

In order to pursue these objectives, SADCC/SADC developed a Programme of Action that defined priority economic activities and also developed programmes that need to be addressed. Hence, sectoral programmes, which focused on functional co-operation, were designed to deal with the underdeveloped areas of infrastructure and productive sectors of agriculture, mining, and tourism. In 1985, the initial project-based approach of SADCC was modified and more emphasis shifted towards sectoral co-ordination of programmes, which enhanced the Member States’ capacity to address issues of mutual benefit effectively. Thus, the SADCC Programme of Action was adopted with the aim of allocating sectoral responsibilities among Member States based on their various strengths, with each member forming sector co-ordinating unit that carries specific sectoral co-

¹ The frontline states are Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe

ordination responsibilities using that particular country's resources. (Chipeta, 1997)

"In January 1992, SADCC adopted a framework of co-operation that provided for deeper economic co-operation and integration on the basis of balance, equity, mutual benefit, providing of cross-border investment and trade, freer movement of factors of production across national borders; and common economic, political and social values and systems such as free enterprises, free elections and multi-party systems, respect for the rule of law, and guarantee of human rights."(Chipeta, 1997)

Although SADCC failed to meet its objectives, it managed to instil the sense of regional identity.(Roelfse-Campbell, 1996) It was also successful in establishing solidarity among its members confronting the hostile South Africa and gaining acceptance of the view that closer economic co-operation and integration was imperative for economic growth and development."(African Development Bank, 1993)

In August 1992, the SADCC Heads of State held a Summit in Windhoek, Namibia, in which they signed a Treaty to transform the organisation from a co-ordination conference into a development community.(SADC, 2000) The basis of co-operation of the Member States was then redefined from a loose association to a more legally binding arrangement. Hence, the SADC treaty was signed by Angola; Botswana; Lesotho; Malawi; Mozambique; Namibia; Swaziland; Tanzania; Zambia and Zimbabwe. South Africa only joined SADC in 1994, followed by Mauritius in 1995 and then Democratic Republic of Congo (DRC) and Seychelles in 1997.

SADC focuses more strongly on economic co-operation and integration, and seeks to integrate the economies of all the SADC into one regional economy. SADC (like SADCC) takes the of sector-coordination approach, through which each of the member states is responsible for coordinating one or more of the different sector programmes on behalf of the others. "That involves proposing sector policies, strategies and priorities, and processing projects for inclusion in the sectoral programme, monitoring progress and reporting to the Council of Ministers."(SADC, 2000)

- Angola co-ordinates energy;
- Botswana co-ordinates Agricultural Research, Livestock Production, and Animal Disease Control;
- Lesotho co-ordinates Environment and Land Management, and Water;
- Malawi co-ordinates Inland fisheries, Forestry, and Wildlife;
- Mauritius co-ordinates Tourism;
- Mozambique co-ordinates Culture and information, Transport and Communications (which is partly because it was the main transit country before South Africa joined the group), Culture, Information and Sport;
- Namibia co-ordinates the Legal sector, Marine Fishing and Resources;
- South Africa co-ordinates Health, Finance and Investment;
- Swaziland co-ordinates Human Resources Development;
- Tanzania co-ordinates Industry and Trade;
- Zambia co-ordinates Employment and Labour, and Mining; and
- Zimbabwe co-ordinates the Crop sector, Food, Agriculture and Natural Resources.

The Democratic Republic of Congo and Seychelles have not been allocated any sectoral responsibilities since they only joined the group in 1997.

2.2.1 Aims and Objectives of SADC

SADC's main objectives as stated in the Treaty include to:

- further liberalise the intra-regional trade in goods and services on basis of fair, mutually equitable and beneficial trade;
- ensure efficient production within SADC, reflecting the current and dynamic comparative advantage of its members;
- contribute towards the improvement of the climate for domestic, foreign and cross-border investment;
- enhance the economic development, diversification and industrialisation of the region, and;
- eventually establish a Free Trade Area within the SADC region.(Holden, 1996; Tsikata, 1999)

"SADC (also) aims for deeper economic integration that provides for cross-border investment and trade, free movement of factors of production, subscribing to a common set of social values, and prompting democracy and popular participation in the reduction and eventual eradication of poverty."(SADC, 2000)

Roelfse-Campbell (1996) describes some of SADC's objectives as ambitious and these are: "the harmonisation of the members' macroeconomic policies; creation of the free trade area (FTA); achievement of a customs union; and establishment of a full economic union with integrated monetary and fiscal systems and a regional parliament."

2.2.2 Structure of the SADC Economies

There are huge disparities among the SADC member states in terms of the total population and land area. The DRC is the largest country in the region, geographically, covering the land area of 2 345 409 square kilometres and has the highest population, estimated at 49million people in 1998.(SADC, 2000)

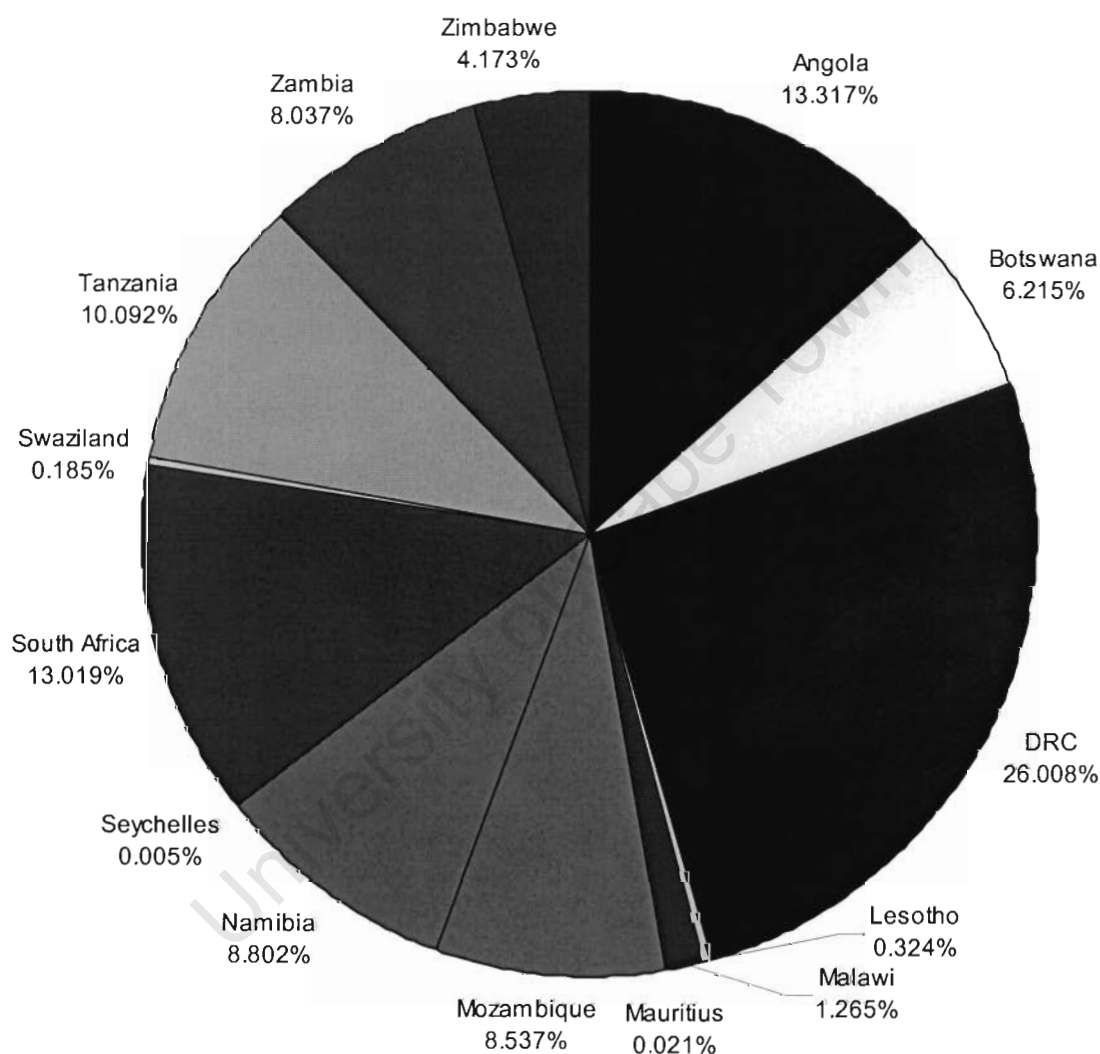
Table 2.1: SADC Land Area and social indicators (1998 estimates)

COUNTRY	Land Area (in kilometres) Square	Population (in Millions)	Urbanisation rate (%)
Angola	1 247 000	11.8	26
Botswana	582 000	1.57	46
DRC	2 435 409	49	Not available
Lesotho	30 355	2.2	23
Malawi	118 484	9.8	13
Mauritius	1 968	1.16	43
Mozambique	799 380	16.1	23
Namibia	824 268	1.64	27
Seychelles	455.3	0.75*	Not available
South Africa	1 219 090	41.4	56
Swaziland	17 364	1.0	24
Tanzania	945 000	32.4	30
Zambia	752 612	10.0	38
Zimbabwe	390 757	11.04	32
TOTAL	9 364 142.3	189.86	--
* 1997 estimate			
<i>Sources: Muradzikwa, 1999; www.sadcreview.com</i>			

At the other extreme, Seychelles is the smallest country in the region, with total population estimated at 75 000 (i.e. 0.75million) people in 1997 and covering an

area of only 455.3 square kilometres.(See Table 2.1) The other member states vary considerably between the two extremes. This is illustrated in figure 2.1 below.

Figure 2.1: Land Area (%) as a Percentage of Total SADC Land Area



These include South Africa, which is one of the largest countries with a population of about 41.4million people (1998 estimate), and covering land area of 1 219 090 square kilometres. Table 2.1 shows that South Africa is the most urbanised country in the region, with the urbanisation rate of 56%, followed by Botswana with the urbanisation rate of 48%. Malawi, on the other hand, has the urbanisation rate of only 13%.

Table 2.2: Share of Manufacturing Sector to GDP (%)

Country	1991	1992	1993	1994	1995	1996	1997	1998
Angola	12.8	12.5	5.7	4.9	4.0	3.4	4.4	6.5
Botswana	4.0	4.0	4.9	4.5	4.9	5.0	4.9	4.8
Lesotho	12.8	12.5	14.6	13.8	15.2	15.3	15.7	17.0
Malawi	13.0	15.0	11.8	17.4	16.1	14.2	13.6	13.2
Mauritius	23.1	12.5	23.2	23.2	23.7	24.2	24.4	24.7
Mozambique	-	11.3	15.5	15.5	13.3	14.5	15.4	14.7
Namibia	-	7.4	13.2	13.2	12.4	10.1	14.2	...
South Africa	25.0	25.0	23.5	23.5	24.3	23.7	23.9	23.7
Swaziland	-	-	27.4	27.4	27.8	25.8	25.9	...
Tanzania	8.2	8.1	7.5	7.5	7.2	7.4	6.9	...
Zambia	36.0	36.0	26.4	26.4	9.9	11.8	11.8	12.0
Zimbabwe	20.0	20.1	21.0	21.0	19.2	15.7	15.4	15.2

Note: ... figures not available; - between 0 and ± 0.5 .
Sources: Member States; www.sadcbankers.org; www.sadcreview.com

The SADC region has a large market, with combined population estimated at approximately 199million people (as mentioned above), and a combined GDP of about US\$176 billion.(SADC, 2000) However, economic disparities among member states continue to be a serious problem in the SADC region. Most of the SADC economies rely mainly on primary activities such as agriculture and mining, and manufacturing contribution to the GDP is very low, except in Mauritius, South Africa, Swaziland, Zambia and Zimbabwe.

Table 2.3: SADC Economic Variables (1998 estimates)

COUNTRY	GDP (in US\$billions)	GDP/capita(in US\$)	Total external debt (in US\$billion)
Angola	10.0	427	10.540
Botswana	4.922	3 175	0.651

DRC	5.5	119	13.9
Lesotho	0.871	396	0.675
Malawi	1.686	156	2.222
Mauritius	4.25	3 664	1.894
Mozambique	2.158	134	5.928
Namibia	3.059	1 865	0.124
Seychelles	0.538*	7 087*	0.149*
South Africa	116.7	2 819	25.7
Swaziland	1.203	1 203	0.175
Tanzania	8.305	256	8.343
Zambia	3.571	409	7.19
Zimbabwe	6.233	565	4.501
All SADC	176**	--	--

* 1997 estimates
** See Introduction of SADC Review 2000
-- Not available
SOURCE: www.sadcreview.com

Table 2.4 reproduces table 1 of SADC Trade, Industry and Investment Review 2000, which contains the real GDP growth rates for individual SADC economies, the whole SADC region, as well as for the rest of the African continent. According to table 2.4, the real GDP growth has been declining after reaching a peak of 4.1% in 1996, although the economy of the SADC region has been growing (in real terms) in the 1990s. The real GDP growth rate fell to 2.2% in 1997 and then to 1.7% in 1998. The real GDP growth rate of the sub-Saharan region followed a similar trend.

Table 2.4: Real GDP Growth Rates (%) in SADC

Country	1981-90	1995	1996	1997	1998
Angola	2.1	11.2	12.1	5.9	1.7
Botswana	16.9	3.1	7	6.9	8.3

DRC	0.7	1.6	0.9	-6.4	-3.5
Lesotho	3.9	8.9	12.7	3.5	-5.8
Malawi	2.2	10	12	5.3	6.2
Mauritius	4.9	5.6	6	5.2	5.6
Mozambique	0.1	1.4	6.4	6	11.6
Namibia	-0.6	3.6	2.1	2.4	2.6
Seychelles	3.6	-0.6	1.5	7.9	3
South Africa	1.5	2.9	3.1	1.7	0.1
Swaziland	6.6	2.7	3.9	3.8	2.5
Tanzania	3.3	3.6	4.2	3.3	4
Zambia	1	-2.3	6.5	3.5	-1.8
Zimbabwe	4.2	-1.1	7	2	1.6
SADC	...	3.1	4.1	2.2	1.7
Sub-Sahara Africa	2.3	4.1	5.4	3.9	2.9
Africa	2.5	3.1	5.8	3.1	3.4
Advanced Countries	2.4	2.5	2.5	2.9	2.9

Sources: Data for Sub-Sahara Africa, Africa and Advanced Countries was derived from IMF World Economic Outlook, 1999; otherwise Member States; www.sadcreview.com

SADC economic growth is unevenly distributed among the member states. There continues to be a huge inequality problem in terms of income and growth between as well as within individual SADC countries. Most of the member states have been experiencing positive growth rates, with exception of DRC, Lesotho and Zambia with negative growth rates in 1998. Although the real GDP of DRC has been declining, the situation has been improving over time. In 1998, its real GDP fell by only 3.5% compared to a decline of 6.4% in real GDP in 1997. The real economic activity in Lesotho and Zambia, on the other hand, has been deteriorating because their real GDP growth rates fell from positive values in 1997 to negative values for 1998. (See table 2.4)

South Africa dominates its SADC counterparts economically. This is shown by the fact that South Africa accounts for about two-thirds of the GDP of the entire SADC region. (See table 2.3) South Africa has the highest GDP in the region, estimated at about US\$116.7 billion in 1998. Angola has the second highest GDP, at

US\$10billion in 1998, and this value accounts only for about 5.7% of the GDP value for the whole of SADC.

Per capita income of the region has also been falling. The GNP per capita of the region fell by 1.3% in 1998. "Based on data of the African Development Bank, average GNP per capita for the SADC region amounted to US\$988 in 1997 (as mentioned above). When South Africa is excluded, this figure fell to an average income per capita of \$334."(SADC, 2000)

There is a wide variation in per capita incomes of the individual Member States, measured by GDP per capita.(See table 2.3) Only 6 out of 14 Member States have per capita incomes exceeding US\$1000. Although the GDP per capita for Seychelles is a 1997 estimate, at US\$7 087, it exceeds the 1998 estimate for South Africa (US\$2 819) very significantly. On the other extreme, there are countries with GDP per capita that is less than \$200. Those are DRC, Mozambique, and Malawi at \$119, \$134 and \$156, respectively.

2.2.3 Nature and composition of production

Most of the SADC economies rely mainly on the primary activities, especially agriculture and mining, for their income. Manufacturing contributes only a small amount to the GDP of the SADC member states. Only a few of the member states have a manufacturing sector that accounts for a sizeable share of the GDP. (See table 2.2) In 1991, only four of the member states had a share of manufacturing to GDP exceeding 20%, and these are South Africa, Mauritius, Zambia and Zimbabwe.

These figures have been declining for all the member states throughout the 1990s, except for Mauritius. For Mauritius, the share of manufacturing to GDP has

grown from 23.1% in 1991 to 24.7% in 1998.(See table 2.2) Hence, in 1998 Mauritius remained the country with the highest share of manufacturing to GDP, followed by South Africa. Botswana, Lesotho, Mozambique, and Namibia also experienced growth in the contribution of manufacturing to GDP, although this figure remains at only 4.8% for Botswana.

2.2.4 SADC Trade protocol and the Proposed Free Trade Area

On its formation, the government officials from each of the SADC Member states agreed that protocols would be formulated as policy instruments, which will help to implement the proposed Free Trade Area (FTA). The SADC Protocol on Trade is one of the most important policy instruments of the Southern African integration. The SADC Protocol on Trade was signed, as a framework document, providing basis for economic integration through creation of the FTA, in a Summit that was held in Maseru in August 1996 by all the Heads of Member States or Governments, except that of Angola.

The SADC Protocol on Trade is the cornerstone of regional integration in Southern Africa as it aims to establish a free trade area and free movement of goods, services, labour and capital within the region. The major objective of the SADC Trade Protocol is creating a duty-free trade area in Southern Africa over a period of eight years after its implementation. This is a process involving removal of tariffs and non-tariff barriers to trade, and eventual harmonisation of external trade regimes, fiscal and monetary policies; and achieving regional integration – a process of co-operation while promoting a common identity in an economic community. The removal of tariffs and non-tariff barriers would be accompanied

by adoption of policy measures aimed at investment and trade promotion and facilitation.

2.2.4.1. Ratification and Implementation

In order for this protocol to be implemented, it is required that at least two-thirds majority of the Member States must have ratified. (DTI, 1999a; Kalenga, 1999; SADC, 2000; SARDC&SADC, 2000) When the trade protocol was signed in August 1996, the expectation was that it would have been implemented already at the beginning of year 2000. However, the whole process of ratification and implementation of the protocol has taken much longer than was initially planned.

The delay in the implementation process can be attributed, partly, to the fact that the countries that signed the trade protocol did not all ratify immediately. Only five countries (Botswana, Mauritius, Namibia, Tanzania and Zimbabwe) had ratified the Trade Protocol until the SADC Summit that was held on 18 August 1999, in which two more members, Malawi and Lesotho also ratified.

However, some economic experts² were of the opinion that it is unlikely for the protocol to be put into action before ratification by SA, since South Africa accounts for about two-thirds of the entire SADC economy. This is regardless of Mbuende's confident statement that "SADC would proceed with ratifying the protocol if they achieved the majority needed to do so - with or without South Africa."(The Namibian, 1 September 1999)

In 1997, Dr Mbuende – Executive Secretary of SADC then - pointed out that some of the member states would only ratify the trade protocol after the conclusion of

² Charles Harvey, a Senior Research Fellow at Botswana Institute for Development Policy Analysis (BIDPA), is also of the opinion that the free trade area would be negligible without South Africa. Harvey also points out, in "macroeconomic policy and trade integration in Southern Africa" that was published in May 2000, that South Africa seems to be caught between ratifying the protocol, to protect its existing markets in the non-SACU members of SADC (especially from Far

the negotiations on tariff reductions. The Mozambican Trade Minister, Oldemiro Baloi confirmed in 1999 that ratification by Mozambique was conditional on conclusion of those negotiations and that "this was also the South African position"(PanAfrican News Agency, 25 September 1999). The issue of the exact method of reducing tariff barriers on trade has also been a stumbling block to the ratification of the trade protocol.

Three more countries: South Africa, Swaziland and Mozambique had promised to ratify by the end of 1999, and South Africa ratified the SADC trade protocol in November 1999. On 12 January 2000, Prega Ramsamy – the Deputy executive secretary of SADC - announced ten members that have already ratified the trade protocol as: Botswana, Lesotho, Malawi, Mauritius, Mozambique, Namibia, South Africa, Swaziland, Tanzania, and Zimbabwe. "Angola signed the protocol but (had) not yet ratified it. Zambia too (had) not ratified."(Business Day, 13 January 2000) The DRC and Seychelles, on the other hand, are expected to accede automatically to the trade protocol on implementation.

The Protocol needs to be supplemented by a schedule for tariff elimination and supplementary rules of origin in order for it to be ready for implementation, since the sensitive products require special treatment. Hence, South Africa and its SACU partners made a comprehensive tariff offer and supplementary Rules of origin, which are compatible with the SADC Trade Protocol.(DTI, 1999a: 2)

The Protocol came into force on 25 January 2000, following its ratification by two-thirds of the signatory Member States.(DTI, 2000:1) Since the protocol that was signed in August 1996 is only a framework agreement, "no effect can be given to

Eastern competition); and not ratifying because South African manufacturers that are fearful of competition, from Zimbabwe and Mauritius in particular, may lobby with success to prevent establishment of the free trade area.

it until instruments and schedules for implementation have been finalised”, although it is now enjoying the legal standing.(ibid) Its implementation is supposed to take place by 1 September 2000.

According to the DTI spokesperson, implementation is supposed to take place on a reciprocal basis. This means that although South Africa implemented the Protocol in September 2000, they have no obligation to extend the benefits to Member states that have not yet implemented the Trade Protocol.(Interviews, 2000)

2.2.4.2. Trade negotiations

The ratification and implementation of the trade protocol involved a long process of negotiations, in an attempt to address various concerns raised by some of the SADC member states. As the negotiations progressed, there emerged a need to review and consolidate some of the provisions of the Trade Protocol, especially those relating to the Rules of Origin. One of the major issues that raised concern of some Member States (including South Africa) has been the need to formulate product-specific rules of origin in order to protect their local industry, especially the “sensitive” sectors.³

Product-specific rules of origin have been developed to ensure that sufficient processing and manufacturing takes place in respect of goods receiving preferential tariff treatment. The Member States have reached an agreement on market access arrangement for clothing and textiles, particularly towards products from the Least Developed Member States (LDMS).⁴ The provisions for dispute settlements were also raised as a matter of concern during the negotiations.

³ The sensitive sectors include: clothing and textile, automotive, leather, footwear, and processed agricultural industries.

⁴ The LDMS countries (also called the MMTZ states) are Malawi; Mozambique; Tanzania and Zambia.

The negotiations on rules of origin, dispute settlement and customs co-operation have also highlighted a need to amend some of the provisions of the protocol to pave the way for implementation. Hence, the dispute settlement provisions of the protocol were revised to ensure efficient and speedy resolution of disputes arising between Member States under the Protocol and, additional provisions were developed to strengthen co-operation between SADC customs authorities to jointly combat customs offences.(DTI, 2000)

2.2.4.3. Objectives of the SADC Trade Protocol

The Trade Protocol has clear objectives and goals. It has an immediate goal of creating a free trade area (FTA), which involves the progressive removal of all the tariffs and non-tariff barriers (NTBs) to trade over eight years and eventual harmonisation of the external trade regimes, fiscal and monetary policies in the region. Its long-term goal is to achieve economic integration, which promotes development of common economic, political and social values and systems, while the ultimate goal is to achieve regional integration, a process of co-operation while promoting a common identity in an economic community.

The objectives of the trade protocol are to: "further liberalise intra-regional trade on the basis of fair, mutually equitable and beneficial trade arrangement completed by a program of sectoral co-ordination and integration; establish the conditions for realising the economies of scale through creation of a large regional market; develop integrated industrial and agricultural strategies for international competitiveness; increase productivity and competitiveness of production processes; boost cross-border trade and mobilise national, regional as well as international investment; promote efficient production within SADC region, reflecting current and dynamic economic growth levels (as well as the comparative

advantages of the SADC member states); and enhance the economic development, diversification and industrialisation of the SADC region.” (DTI, 1999a)

a) Originating Goods:

“Originating goods are goods of a member state as provided for in Annex 1 on rules of origin.”(SADC, 1996:2) For goods to be accepted as originating from the Member states (as stated in Rule 2 of Annex 1 in the SADC Trade Protocol), they should have been wholly produced in that country. This means that they should not contain any element that is either imported or of undetermined origin. This rule most of the time, applies to primary goods as cotton, wool and other textile fibres. It also provides for the processed products, which may be produced in the Member State wholly or partially from materials imported from outside. These products can acquire originating status provided that the imported materials used in producing those products have undergone substantial (or sufficient) transformation, as per rules of origin.

b) Rules of Origin:

These are the rules that are used to determine whether or not the originating status may be conferred to products that are either imported or exported by the SADC member states. The rules of origin are there to ensure that benefits provided through the SADC protocol and the proposed free trade area are confined to the products originating in the member states. They are aimed at preventing goods from countries outside the region that are simply trans-shipped or have undergone insufficient local processing, from enjoying the benefits of trade preferences, i.e. Community Treatment.

The general rules of origin are provided for under Annex 1 of the SADC protocol on trade. Most important in that Annex is Rule 2, which provides that "any goods will be accepted as originating in a Member State if they are consigned from a member state to a consignee in another Member State and the products have been wholly produced in the Member state as provided for in Rule 4 of Annex 1."⁵ (SADC, 1996:26)

Rule 2 also provides for processed goods that have been produced from imported materials. It states that those products can acquire originating status provided that the imported raw materials have undergone substantial transformation such that: either "the c.i.f. value of those materials does not exceed 60% of the total cost of the materials used in the production of the goods; or the value-added resulting from the process of production accounts for at least 35% of the ex-factory cost; or there is a change in the tariff heading of a product arising from a processing carried out on non-originating materials." (SADC, 1996; DTI, 1999a; DTI, 1999b*)

The provisions of Rule 2 also apply in a case of goods that have acquired originating status that are used in the production of other goods, regardless of whether the status was acquired inside that factory or in another factory in the SADC region⁶.

This rule further provides for cumulative treatment of raw materials and semi-finished goods that have been conferred originating status. This means that "raw

⁵ Rule 4 is that rule which provides conditions under which a product is considered to have been wholly produced within the Member States. Some those conditions are that the product must have been produced within the boundaries of the Member State and without using any materials of either foreign or undetermined origin in its production process.

* 1999b refers to: "Rules of Origin". (1999). Pretoria: Department of Trade and Industry

⁶ Since the SADC region is treated as one territory in the trade protocol.

materials or semi-finished goods undergoing processing either in one or more states shall for the purpose of determining origin of a finished product be deemed to be originating from the Member State where the final manufacturing or processing takes place.” (SADC, 1996:27)

The rules of origin specify minor operations that are insufficient to support a claim that products originate in a Member State. These, amongst other processes, include packing, packaging in preparation for the shipping and sales; mere dilution, blending or any other form of mixing; simple assemble or combination of operations; and other minor operations. (SADC, 1996:28)

On the 15th of July 1999, the Ministers of Trade reached agreement on a well-defined set of Rules of Origin “that would help stimulate economic activity in the region, enhance value-added processing, and circumvent the trade of illicit or counterfeit goods and fraudulent supply of the third party products. (It was also agreed that) sensitive sectors such as: processed agricultural products, clothing, textiles, leather, footwear and auto industry will require product-specific, complementary rules of origin detailing sufficient processing and substantial transformation to confer an originating status as proposed in the rules of origin of the SADC Protocol. ”(DTI, 1999a^{*}: 2)

The complementary rules of origin are necessary for tightening the protection of products of particular importance to the region against the transshipment of foreign goods⁷. They are “also aimed at the fostering greater use of the regional resources and upgrading the level of manufacturing processes in the region through adoption of new technology and investment in the manufacturing

^{*} 1999a refers to: “*Ratification of the SADC Trade Protocol: An Explanatory Note*”. (1999). Pretoria: Department of Trade and Industry.

sector.”(SADC & SARDC, 2000) Hence, these rules are expected to increase intra-SADC trade.

SADC Committee of Ministers responsible for Trade (CMT) established a High Level Committee (HLC), which is responsible for finalising all matters related to the Rules of Origin. Progress was made and a consensus has been reached on Rules of Origin for all chapters of the Harmonised System, although there are still outstanding issues in some chapters.⁸(DTI, 2000:6) According to the DTI spokesperson, the outstanding issues on rules of origin and these will be dealt with in Ministerial meetings that will be held on a month-to-month basis.

c) Safeguard Measures:

The SADC Trade Protocol also provides for safeguard measures against unfair practices. Safeguards allow a country to temporarily protect a domestic industry from serious injury due to increased imports. Member States would have recourse to anti-dumping action in instances of unfair practices and apply counter-vailing measures to import trade that distorts fair competition. The protocol also prohibits granting of production and export subsidies that may distort or threaten fair competition. Hence, it is proposed that preferential treatment under the trade protocol should not be granted to those products benefiting from direct and auctionable subsidies that may distort fair competition, and these include export subsidies such as the export processing zones (EPZs).

⁷ Rules of origin pertaining the clothing and textiles have been an area of interest to all the member states

⁸ The chapters in which there are still outstanding issues on rules of origin are: Chapter 9(coffee, tea, mate and spices), Chapter 11(products of the milling industry; malt; starches; inulin; wheat gluten), Chapter 39(plastics and articles thereof; rubber and articles thereof), Chapter 84 (nuclear reactors, boilers, machinery and mechanical appliances; parts thereof) and Chapter 85 (electrical machinery and equipment; sound recorders; television image and sound recorders etc.), Chapter 87(Vehicles[excluding railway and tramway rolling stock] and parts and accessories thereof), and Chapter 90 (optical; cinematographic; measuring; checking; medical or surgical instruments and apparatus; parts and accessories thereof).(DTI, 2000:6)

"The Member States are required to notify the non-tariff measures that they apply in their trade policies and to make firm undertakings on the removal of those that distort or prohibit trade." (DTI, 1999a: 3) With regard to this, the removal of trade distorting measures in agricultural trade such as the quantitative import and export control, single channel marketing, and price controls is a matter of urgency and this has been part of negotiations.(ibid)

d) Elimination of tariffs and non-tariff barriers to intra-SADC trade:

The trade protocol (in articles 3 to 11) provides for the elimination of tariffs and non-tariff barriers to trade as well as for general exceptions on grounds of public morals, public order, health safety and security considerations. According to the trade protocol, all barriers to intra-SADC trade shall be eliminated within a period of 8 years, except where it is provided for in the trade protocol.(See SADC, 1996)

For example, the protocol will not prevent the SADC members from taking corrective measures such as imposing export duties or export quantitative restrictions 'to prevent erosion of the prohibitions or restrictions that apply to exports from outside the region', on condition that member states will not be granted 'less favourable treatment than third countries.'(SADC, 1996) Furthermore, the member states shall not be allowed to apply any new non-tariff barriers in relation to the intra-SADC trade after the protocol is implemented.

It has been proposed that tariff liberalisation will be brought about in three different schedules according to product categories. The first category is that of immediate liberalisation for the goods where intra-SADC trade is already taking place at low tariffs. The second category is that of gradual liberalisation of higher tariff products. And then, there is a third category for particularly sensitive products for which liberalisation will take place more towards the eighth year.

In order to counter the imbalance among the SADC economies, with South Africa being the dominant partner, the SADC protocol is governed by principles of asymmetry, which require South Africa to have lesser time to eliminate the intra-SADC trade barriers than the weaker partners. However, South Africa is a member of SACU, which implies that the South African free trade offer becomes an offer by all the (five) SACU members⁹. Thus, South Africa (and its SACU partners) will be required to eliminate tariffs and NTBs much faster than non-SACU SADC partners.

e) South Africa's (and therefore SACU's) proposal:

Initially, South Africa and its SACU counterparts (Botswana, Lesotho, Namibia and Swaziland) have forwarded their free trade offer to the non-SACU SADC countries. In their free trade plan, they provided for wider access to the SACU markets for products from all the signatories. The plan will be implemented in three phases, as proposed for the Trade Protocol.

The first category, immediate liberalisation, is that of products attracting less than 17% import duty. These products will be made duty free immediately on implementation of the trade protocol. They include copper, iron products and steel, wood and articles made of wood, machinery and appliances, paper and paperboard and printed materials, hides, skins and leather. (Mail & Guardian, 15 June 2000)

The second category is gradual liberalisation. It offers removal of duties on products attracting 17%-25% import duty in the first three years of implementation. These products include furniture and bedding, selected chemicals, paper products, machinery and appliances. (ibid) Products that attract more than 25% will be duty-free within the first five years of implementation and

⁹ SACU is a trading arrangement in which there is a common pool of customs revenue that is shared among all its

these include articles of leather, rubber, selected textiles, vehicles, parts and commodities. (ibid)

The third category is the list of sensitive products^a. "These are largely textiles, clothing and footwear products that are subject to disagreement and outstanding negotiations among the SADC member states They constitute 0.78% of the tariff lines and represent 3.04% of SADC imports."(ibid)

The SACU plan also proposed that non-SACU members of SADC should have more time to eliminate duties. Mbuende mentioned in his update on the trade protocol that tariff schedules are in such a way that under the joint offer, "the SACU countries will liberalise their tariffs faster than the rest of SADC member states."(SADC & SARDC, 2000) However, concern has been raised that the BLNS economies do not have as much strength as the South African economy. Hence, it is unfair for them to be required to open up their economies faster than the other countries in the region.

f) Customs Co-operation:

Another issue that has always been major cause of concern to some SADC members is the problem of porous borders and illegal imports. The trade protocol provides for co-operation by member states on matters such as customs administration, in order to ensure effective and harmonious application of provisions of the trade protocol.

g) Trade – related issues:

"The protocol (in articles 22 to 26) deals with issues that are related to trade such as the promotion of cross-border investment; trade in services; intellectual

members using a specified formula, weighted in favour of the weaker economies

^a SADC members agreed that the list of sensitive sectors should be kept as short as possible.

property rights; co-ordination of trade policies and co-operation with third parties.” (DTI, 1999a: 4)

In order to achieve economic growth and development, diversification and industrialisation in the member states, they will adopt policies and implement, within the community, measures that will promote cross-border investment regime; prohibit unfair business practices and promote competition; protect intellectual property rights; liberalise trade in their services sectors (in terms of WTO’s General Agreement on Trade in Services); and promote trade development in close cooperation with the business sector. (SADC, 1996)

“In part eight (i.e. articles 27 to 30), the protocol regulates trade relations, including preferential trade arrangements, co-ordination of trade policies and co-operation with third parties.”(DTI, 1999a: 4) As long as such arrangements are consistent with the provisions of the trade protocol, member states will be allowed to retain and even enter into new trading arrangements among themselves and with third parties when the protocol enters into force.

However, in occurrence of trading arrangements between a member state and a third party, the benefits will have to be extended to the rest of the member states. A good example of such arrangement is the proposed FTA between South Africa and the European Union. In order to secure the market for their products in the South African markets and to meet the objectives of the protocol, it is required that any benefits (in form of concessions, privileges, or power) granted under that arrangement be extended to all the other SADC members. The protocol does not, however, put any obligation on a Member State, that has membership in another

trading bloc at the time of entry of the protocol into force, to extend its preferences in that other trading bloc.

All the bilateral trading arrangements between individual Member States will be dissolved on implementation of the Trade Protocol, and the terms of the protocol will take effect.

2.3 Conclusion

This chapter has provided a brief overview of SADC, its objectives, the structure of the SADC economies as well as the nature of production. It also provided a brief analysis of the SADC protocol. Its objectives as well as the ratification and implementation process have also been highlighted in order to provide enough background to the region as well as the trade protocol and the proposed SADC FTA. Chapter 3 provides a section on the SADC trade protocol within the context of clothing and textiles.

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CHAPTER THREE: CLOTHING AND TEXTILE INDUSTRIES

3.1 The South African Clothing and Textile industries

Clothing and textiles received special attention in 1980s and this is shown by the fact that various reports - both minor and major - have been released on these industries as a response to an application from the industries as well as belief on part of government for restructuring. (Cassim, 1990) The report of the *Steenkamp Committee of Enquiry into the Policy of protection in regard to Clothing and Textiles* was published by the BTI in 1983. The Steenkamp report set a foundation for a follow-up report, called an *Enquiry into Apparel Textiles and Clothing Industries* that was released by the BTI in 1989.

The 1989 report was biased towards export promotion. It called for structural readjustment for clothing and textile industries, a process that was launched in 1988. Although the process of structural adjustment targeted a variety of industries, clothing and textiles were the first to undergo such a programme. In 1990, the government launched a General Export Incentive Scheme (GEIS) for the promotion of exports in general, with specific emphasis on manufactured products. However, these policy initiatives, structural Adjustments and GEIS, have generated conflicting responses. (Cassim, 1990:5)

The clothing and textile industries received greater emphasis because they are ideally suited to the South African socio-economic conditions. Given South Africa's relative shortage of skilled labour and abundance of unskilled and semi-skilled labour, they - especially the clothing industry - absorb a large pool of unskilled and semi-skilled labour. Government also realised that for the South African economy to grow and achieve industrial development, they needed not only the readjustment of tariffs policy, but also to expand the local market. Thus, many

economists argued that the only way out was the concept of “inward industrialisation.” (ibid: 6)

Clothing and textiles have some structural differences but, both of them are generally considered to be high added value industries, large employers, relatively low cost per job opportunity, and certain components of them appear to have comparative advantages.¹⁰ (See BTI, 1989) “These industries are concentrated in certain coastal areas of South Africa, with Durban as the main centre and to a lesser degree Cape Town, Port Elizabeth, and East London.” (Cassim, 1990:43)

3.2 Trends and Historical overview

3.2.1 The textile industry

The South African textile industry dates back to the late nineteenth (19th) century. The first textile factory was a weaving company, which was established before 1900. It produced blankets for the “native territories”, although later, the factory failed together with others in Orange Free State. The blanket industry only developed later, in 1925. In 1933 there were about twelve (12) factories, manufacturing woollen, woollen-and-cotton, and cotton blankets.(Steenkamp Report, 1983:7) By 1944, the number of factories had grown to 16, producing 90% of the country’s needs in the line of blankets, rugs and sheeting; and with employment of 3711 jobs. (ibid)

The industry only became a major sector in overall manufacturing after the Second World War (WWII), as the production expanded to include the apparel and furnishing fabrics. (Steenkamp Report, 1983:32) During the period after WWII, the state began to intervene in form of financing and regulating the

¹⁰ The textile industry is more capital-intensive while the clothing industry is largely labour intensive.

industry. The Industrial Development Corporation (IDC) offered the financial support while the Board of Trade and Industry (BTI) administered the regulation.

The BTI deemed the vulnerability of the local market in the face of growing international competition. The BTI's concern was induced by growing international competitiveness of developing countries in the Far East. These countries exported cheap textiles, which destabilised production in advanced countries and other developing countries. This resulted in the formation of the Multi-Fibre Arrangement (MFA), which introduced a "...global system of quantitative restrictions on imports." (BTI, 1988:8)

The quantitative import restrictions were introduced in the South African manufacturing sector in 1949. The import restrictions imposed between 1949 and 1957 benefited the South African textile industry considerably. 'The industry flourished under tariff protection from the 1950s until the early 1970s, such that its market share increased consistently and it supplied almost half of South Africa's demand for textiles by the early 1970s.'(Cassim, 1991:36)

Since the BTI wanted to ensure that the local industry secured a larger share of the domestic market, they conducted research on the industry in 1950. In their research report BTI made recommendations to nurture development of the local industry.

The development of the industry was even better between 1950 and 1960. There were about 8 cotton factories in 1950 with employment of 3000 jobs and an investment of R18million. These factories satisfied 15% of local demand for the woven fabrics. The number of factories grew to 18 in the next two years while; the number of employees increased to 5500 by the end of 1952. The local supply

satisfied 80% of the local demand for cotton yarns and 20% of the demand for cotton fabrics.(ibid)

The processing of Synthetic fibres in South Africa only began in 1959 and was put under protection in 1963.¹¹(Steenkamp Report, 1983:70) Government's protectionist policies accelerated the growth of the synthetic fibres industry such that by 1974 there were 15 other companies, apart from South African Nylon Spinners (SANS) and Hoechst, producing unprocessed yarn and fibre and processed stretch and bulked yarns.¹² Although numerous applications were made to the BTI to increase the import duties to 30%, this was contravention of the GATT, which stipulated a maximum duty of 17.5%. (ibid: 71)

The technological change also influenced the industry, and the major change was "integrated drawtexturising process". This reduced the number of independent filament yarn processors.(ibid)

The period 1981-1985 displayed a decline of 22% in output and a decrease in employment by 16%. This decline can partly be attributed to the depreciation of the Rand in 1985 and the ensuing recession. The lack of domestic demand led local textile producers to export in order to maintain capacity utilisation.(BTI, 1988:1) Towards the end of 1985, the local demand for textile increased but orders could not be met sufficiently due to low inventories.(ibid) The excess local demand for textiles could not be maintained by importing textiles since the Rand had depreciated.

¹¹ The processing of synthetic fibres involves the texturising and dyeing nylon.

¹² Government's protectionist policies such as tariff protection and quantitative import restrictions

Production and employment increased only briefly until 1989, and then declined between 1989-1992. In 1994, the Panel and Task group for the Textile and Clothing industries published their report (the Swart Report) in March.

3.2.1.1. Multi-Fibre Arrangement (MFA)

MFA was signed in 1974, following a boom in the development of clothing and textile industries in the developing countries, to protect markets of the textile importing countries from any harm or disruption caused by increased clothing and textile imports from another country. MFA enabled textile importing and exporting countries to negotiate and establish bilateral quota restrictions, until the end of the Uruguay Round of the GATT negotiations in 1994. This was a major departure from basic GATT rules such as principle of non-discrimination and GATT's general preference for customs tariffs instead of quantitative measures of restriction, since it allowed discrimination between countries and these quotas were selective on a case-by-case basis.

Although Pakistan and India were allowed to maintain high barriers under the agreement, MFA quotas have been applied mostly by developed countries against developing countries. (See Cline, 1990 and www.wto.org) For instance, "as of 1994, the United States had negotiated bilateral import restraint agreements with about forty (40) countries, covering about two-thirds of US textile and apparel imports." (Salinger et al, 2000:20)

"This system of regulated textile and apparel trade helped to spawn increase internationalisation of production of these very products. As quotas were used up in one country, international clothing entrepreneurs frequently sought new production platforms in which to establish commercial relations with already existing manufacturers or even establish new manufacturing operations

altogether. This quota-hopping behaviour of international clothing industry, defined by its low fixed capital requirements as internationally "footloose" industry, is one of the factors which enhanced the establishment of clothing operation in developing countries"(Salinger et al, 2000:20)

Since South Africa has not been restricted much under the MFA and therefore faced minimal restrictions in the exports markets, the country had a competitive advantage. However, the foreign firms that relocated because of the MFA are more mobile than companies that produce for the South African domestic market. (ibid.)

The MFA was phased out when the WTO Agreement on Textiles and Clothing (ATC) was adopted by the WTO member states in January 1995, with the aim of fully integrating clothing and textiles sector into the GATT rules by 1 January 2005. However, the ATC also poses a threat of causing instability in the clothing industry in South Africa since the mobile foreign companies may leave the country when they no longer need to avoid quotas.

3.2.2 The Clothing industry

The South African clothing industry developed at the dawn of the 20th century by replacing clothing imports. The local clothing production was stimulated by important developments such as the First World War (WWI), which severely restricted the supply of foreign goods into the country. The introduction of protection and economic boom in 1933 also assisted the development of this industry.

The first factory that manufactured clothing in South Africa was established in 1907. This factory was located in the Cape and it manufactured men's suits. More

clothing factories were opened soon after that, responding to increasing consumer demand for clothing in other major centres such as Johannesburg, Port Elizabeth and Durban.(Cassim, 1991:28)

The industry developed very rapidly in terms of output, employment, number of factories and variety of products that were manufactured, such that by 1925 the Cape Clothing Manufacturing Association and the Transvaal Clothing Manufacturing Association were already formed. The clothing sector employed 3995 people by 1915, a contribution of 4.9% to the whole manufacturing industry.(ibid) The employment in the clothing industry increased rapidly from 5580 by 1920, to 14276 employees during the period 1933-34, 18250 and 30321 employees during the periods 1938-39 and 1945-46, respectively. (Steenkamp report, 1983)

The rate of growth in number of factories had doubled that in the pre-war years. The urgent demand for military uniforms resulted in formation of additional clothing factories.(Nicol, 1984 cited in Cassim,1991: 30) Local clothing production decreased during the period 1920-25, as the foreign competition began. The local clothing factories met 25% of South Africa's clothing requirements at the end of WWI. Although the local market expanded throughout the 1920s, this amount fell to about 20%.(ibid)

The negative impact of foreign competition led to introduction of tariff protection in 1925, aimed at protecting the local industry. The duty on the men's outerwear was increased to 20% ad valorem. Although tariffs were applied on various manufactured products, "clothing was one of the first major areas of import substituting industrialisation in the South African economy."(Cassim, 1991:30) The

tariff protection had a major contribution towards expansion of the clothing sector, and manufacturing industry as a whole, in the late 1920s. The growth of the clothing and textile sector combined surpassed that of manufacturing as a whole during the same period.

During the great depression, between 1930 and 1933, the clothing and textiles combined were exceptional cases to the whole manufacturing sector, which showed decline in the net value. The net value of clothing and textile industries increased during the same period, and the growth of the clothing industry could be attributed to the industry gaining a larger share of the local market.

During the time of the economic boom in South Africa, 1933-1939, the clothing industry grew further. A large number of small firms entered the industry, which severely increased the number of factories manufacturing clothing. WWII boosted the manufacturing sector significantly, and its effect on the South African clothing industry was even more dramatic. The growth in clothing production during the war can be ascribed to factors like the increase in demand for military clothing, the deficiency of clothing imports in the local market and continued opportunity for import substitution, introduction of import control in 1949, and the general improvement in purchasing power.

The South African economy continued to grow rapidly after WWII and by 1945, the growth of the clothing industry surpassed that of the manufacturing sector. However, South Africa's industrial development during the post-war period was characterised by more government intervention. The National Co-ordinating Council for Clothing, the predecessor of the National Clothing Federation of South Africa (NCF), was formed during the same year with the aim of applying for

higher tariffs protection, which was recommended by the BTI.(Steenkamp Report, 1983)

The nature of the South African protective policy changed as a result of SA entering the GATT negotiations in 1947, which restricted its tariff policy, and the balance of payments problem in 1948. The quantitative import restrictions that were introduced in 1947 were more effective and had positive as well as negative impact on the South African industry. Although they served to reduce competition from imported clothing, import restrictions also limited the access to essential imported raw materials and machines that are not manufactured in South Africa.(Steenkamp Report, 1983)

The other negative impact of the import restrictions was the fact that irregular sequence of measures of adjustment tend to disturb both production and demand, frustrate management and bring about loss of manufacturing efficiency.(Cassim, 1991:35) Hence, the growth in output in the clothing industry was lowest during the first five years of import control.

During the period 1950-1960, there was an adjustment in the clothing industry after WWII, import control and increase in exports. The industry supplied 90% of the domestic market by 1950 and there was growth in employment in the clothing industry. However, some of the small clothing producers that benefited from the cheap textiles imports were driven out of the market when import restrictions on various textile products were introduced in 1952 drove some of the small clothing producers out of the market.

Furthermore, large volumes of clothing and textile imports entered the South African market, following the 1949 trading agreement between SA and Rhodesia

(now known as Zimbabwe), which encouraged free trade of various products. However, the South African clothing manufacturers were constantly lobbying for government protection against the Rhodesian exports that entered the local market duty free in the 1950s. In the early 1960s the South African economy experienced a recovery, and this helped improve the conditions in the clothing industry.

Table 3.1A: Relative Contributions Of Clothing & Textiles To Manufacturing Output

RELATIVE CONTRIBUTIONS (%) TO MANUFACTURING OUTPUT						
	1970	1972	1976	1979	1984	1990
FOOTWEAR	1.2	1.1	1.0	1.0	1.0	--
CLOTHING	3.9	3.7	3.2	2.7	2.7	2
TEXTILES	6.9	6.4	5.3	5.3	3.9	--

Source: Cassim, 1991: 56

There was a consistent negative trend in relative percentage contributions of clothing, footwear and textiles to total manufacturing output after 1960. The contribution of the clothing sector fell from 5.8% of manufacturing output in 1960 to 2.7% in 1984. This contribution continued to decrease to only 2% in 1990. (See table 3.1A) A similar trend is evident in the contributions of clothing and textiles to total manufacturing sales. Table 3.1B shows negative trend in the contributions of clothing and textiles to total manufacturing in the 1990s.

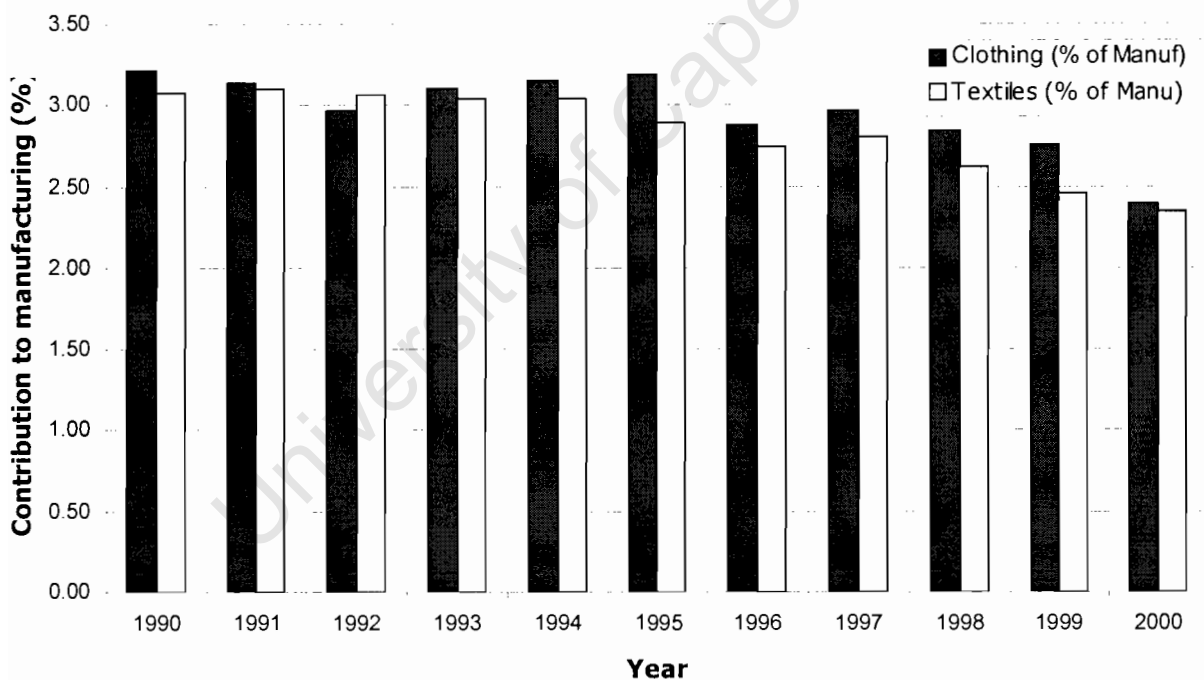
Table 3.1B: Contributions of Clothing & Textiles to Manufacturing Sales

NOMINAL CONTRIBUTIONS TO TOTAL MANUFACTURING SALES (%)											
	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
CLOTHING	3.2	3.1	3.0	3.1	3.2	3.2	2.9	3.0	2.8	2.8	2.4
TEXTILES	3.1	3.1	3.1	3.0	3.0	2.9	2.7	2.8	2.6	2.5	2.3

Source: Statistics South Africa

In 1990 the contribution of clothing to total manufacturing sales was about 3.2%, and this fell to only 2.4% in 2000. The textiles contribution also declined from 3.1% to 2.3% during the same period. This is further illustrated in figure 3.1 below.

Figure 3.1: Contributions to Manufacturing Sales (%)



In 1989, an agreement was reached between the clothing and textile industries to commit themselves to a Structural Adjustment Programme (SAP). In terms of this

agreement, the import tariffs would be kept at the same level for a specified period (5 years), after which they would be gradually phased down.

3.2.3 The South African clothing and textile industry in the 1990s

In the 1990s, the clothing and textile industry, globally, saw significant changes. Trade in textiles and clothing was one of the “burning” issues in the Uruguay Round of the GATT negotiations in the early 1990s, as a result of the sensitivity of this industry. An Agreement on textiles and clothing (ATC) was reached under the GATT in 1994, with the aim of formulating “modalities that would permit the eventual integration of the textiles and clothing sector into GATT on the basis of strengthened GATT rules and disciplines, and thereby contributing to the objective of further liberalisation of trade”(BTT, 1995:13). It required members to “allow for continuous, autonomous industrial adjustment and increased competition in their markets.”(ibid)

Under the ATC, all members were required to “abide by the 1994 GATT rules and disciplines as to:

- improve market access through such measures as tariff reductions and bindings, reduction or elimination of non-tariff barriers, and facilitation of customs, administration and licensing formalities;
- application of policies relating to fair and equitable trading conditions as regards textile and clothing in such areas as dumping and anti-dumping rules and procedures, subsidies and countervailing measures, and protection of intellectual property rights;
- and avoid discrimination against imports in the textiles and clothing when taking measure for general trade policy reasons.”(BTT, 1995)

"The textile industry, globally, was faced with a changing competitive environment, following the reduction of import protection agreed upon at the latest round of the GATT negotiations."(Jaftha, 1999) In almost every country, the industry was seeking protection in the 1990s, and the only exception was the "Little Tigers of the third world."¹³(Financial Mail, 31 May 1991) The early 1990s also mark the beginning of serious disputes among the textile and clothing manufacturers regarding tariff protection.

The reduction of duties in 1989, erosion of effectiveness of the import duty structure, a number of preferential trading arrangements (PTAs) and lifting of import controls resulted in many problems which include floods of textile imports as well as the dumping of cheap clothing and textiles into the SA economy. The increasing inflows of textile imports into the SA economy, together with the floods of second hand clothing for charity purposes, had a negative impact on the local clothing and, particularly, textile industry.

The increased competition resulted in many South African clothing and textile factories (large and small) closing down in 1990, while some of the large companies in the industry considered restructuring as an alternative. "The various forms of structural change (apart from closures) include: mergers, investment in new plants and equipment, and the internal efforts to reorganise the operations."(Jaftha, 1999)

The rising level of imports had detrimental effects on the cotton farmers, and cotton prices increased.(Business Day, 28 September 1990) There were also huge job losses and therefore labour unrest in the early 1990s. The textile industry was

¹³ The Little Tigers of the third world include countries such as China and Korea.

one of the industries that were affected severely. "About 9000 jobs were lost in the textile industry..."(Star, 5 February 1991) There was a 30% drop in the local textile sale volumes in 1991, and the "Textile Federation of South Africa (TEXFED) attributed this to the removal of the 20% duty on fabric imports"(Business Day, 5 February 1991) "The South African clothing and textile retail trade remained more buoyant while, the textile industry operated about 10-15% below full capacity."(Business Day, 29 November 1990)

The textile prices increased such that they were expected to continue following that trend at a rate higher than the rate of inflation measured by CPI. (Business Day, 3 March 1990) The National Clothing Federation of South Africa (NCF) described the textile industry as uncompetitive in prices. In fact, the clothing industry disputed protection of the South African textile industry because they argued that it would exacerbate the supply problem in South Africa as well as undermine South African clothing and textile industry's level of international competitiveness.

Following an agreement that was reached by the South African clothing and textile industries in 1989 to embark on Structural Adjustment Programmes (SAPs), with the aim of promoting exports and improving international competitiveness in 1989, exports increased in both industries during 1991-1992. The export figures were expected to double in 1991.

While the clothing industry supported the SAPs, which allowed fabric makers and clothing makers to use the SAP permits to import duty-free, the textile industry was against such programmes. This is partly because the SAPs led to an increase

in the amount of textile imports that entered the local market, therefore reducing market share of the local textiles.

Although there was improvement in the performance of the clothing and textile industry, dumping of Chinese and Korean cheap textiles imports; floods of second-hand clothing for charity purposes; and political violence in certain parts of South Africa in 1992, resulted in factory closures and further job losses.(Sunday Times, 22 March 1992; Sowetan, 28 October 1992) Towards the end of 1992, a new minimum import duty was to be introduced with the aim of protecting South African clothing and textile industries against the cheap imports.(Cape Times, 28 October 1992)

When a new tariff structure was introduced in 1993, the clothing industry was against it, arguing that it protected the inefficient textile industry at the expense of the 'downstream' clothing producers. (Sunday Times, 24 October 1993) The MFA that was operative from 1974 to 1994, and which allowed countries to establish bilateral import quotas in individual products categories whenever their trading partners' exports threatened their domestic markets, was replaced by an Agreement on Textiles and Clothing that was signed under GATT in 1994. This agreement "manages textile and apparel trade after the MFA and lays out a process of liberalisation of import bilateral quotas from 1994 until 2004."(Clothing Industry News, March/May 1998)

In 1994, the Panel Group for the Textile and Clothing industries in South Africa published its report, 'Long-term Strategic Plan for the Textile and Clothing Industry' - commonly known as the Swart Report. The Swart report reflects the extent to which past government policies have influenced the situation in the

textiles and clothing industries in South Africa. Those policies created an environment of import replacement and employment creation, regardless of the costs involved, a non-competitive environment and price and supply controls at the input ends of the industries' pipelines.(Swart Report, 1994)

Reports following the investigations that were conducted on the South African clothing and textile industry, including the Swart report, which was conducted in 1994, "contained two fundamental recommendations: the need to reduce high input costs problem and the need for an industrial policy (that is) based on the concept of comparative advantage."(Clothing Industry News, June/August 1996) This implied the need to phase down the punitive duties on imported fabrics, yarns and fibres sooner in order to enable the clothing and textile industries unhindered access to the internationally competitive inputs.(ibid) According to the clothing federation of South Africa, an industrial strategy to improve employment is that which is aimed at improving domestic and export competitiveness of manufacturing, such as GEIS and Duty Credit Certificates Scheme (DCCS).(ibid)

Table 3.2: Recommended Duty Phase Down Vs GATT Bindings

TARIFFS AFTER THE FINAL YEAR OF THE PHASE DOWN	SWART REPORT RECOMMENDATION (after the 10th year) (%)	GATT BINDINGS (after the 12th year) (%)
Clothing imports	40	45
Household textiles	30	40
Fabrics	22	25
Yarns	15	17.5
Fibres	17	10
SOURCE: The Swart Report, 1994; Sunday Times, 21 August 1994		

The Swart report (1994) also recommended a duty phase down such that after 10 years the tariffs would be 40% on clothing imports, 30% on household textiles, 22% on fabrics, 15% on yarn and 17% on fibres.(See Table 3.2)

Table 3.3: Textiles And Clothing Duty Phase-Down

	1998	1999	2000	2001	2002
Ad Valorem (%)					
Polyester Fibre	17	15	13	11	7.5
Filament yarn	15	15	15	15	15
Spun yarn	24	22	20	18	15
Woven fabric	33	30	27	24	22
Knitted fabric	33	30	27	24	22
Domestic textiles	43	40	37	34	30
Clothing	66	60	54	48	40
Specific Duties (c/kg) Minimum					
Spun yarn/woven fabric	0.557				
Knitted fabric	0.656				
Domestic textile/clothing	0.590				
Maximum	1	1	1	1	
3rd Schedule Rebates					
Yarn	Full less 6%	Full less 8%	Full less 10%	Full less 12%	
Fabric	Full duty	Full less 5.5%	Full less 11%	Full less 16.5%	
Source: Jaftha, 1999:2					

In terms of the GATT, the duty phase down for South African clothing and textiles should take place over 12 years. However, in 1995 South Africa offered to remove

the protective tariffs faster and within a shorter period of 7 years, with the intention of completing the process by 2002.(Jaftha, 1999) This means that by 2002, the final year of the tariff phase down, duties on imports will have declined to 7.5% on fibres, 15% on yarns, 22% on fabrics, 40% on imported clothing and 30% on textiles.(See Table 3.3)

The Duty Credit Certificates Scheme (DCCS), which replaced the export incentives under SAP, was introduced in 1993 to support the clothing and textile exports. The DCCS was aimed at enhancing export competitiveness by offering duty certificates to qualifying exporters. (Jaftha, 1999: 4) "When local producers export products that are covered by the scheme, it earns them credits, which could then be used to cover the import duties normally payable on clothing and textile products."(ibid)

In order to qualify for the credit certificates, the exporters are required to meet some government-specified targets, which are set in terms of the Productivity Performance Monitoring Scheme (PPMS). The exporters are also required to spend a targeted amount (at least 4%) of their wage bill annually on training for the work force.(ibid)

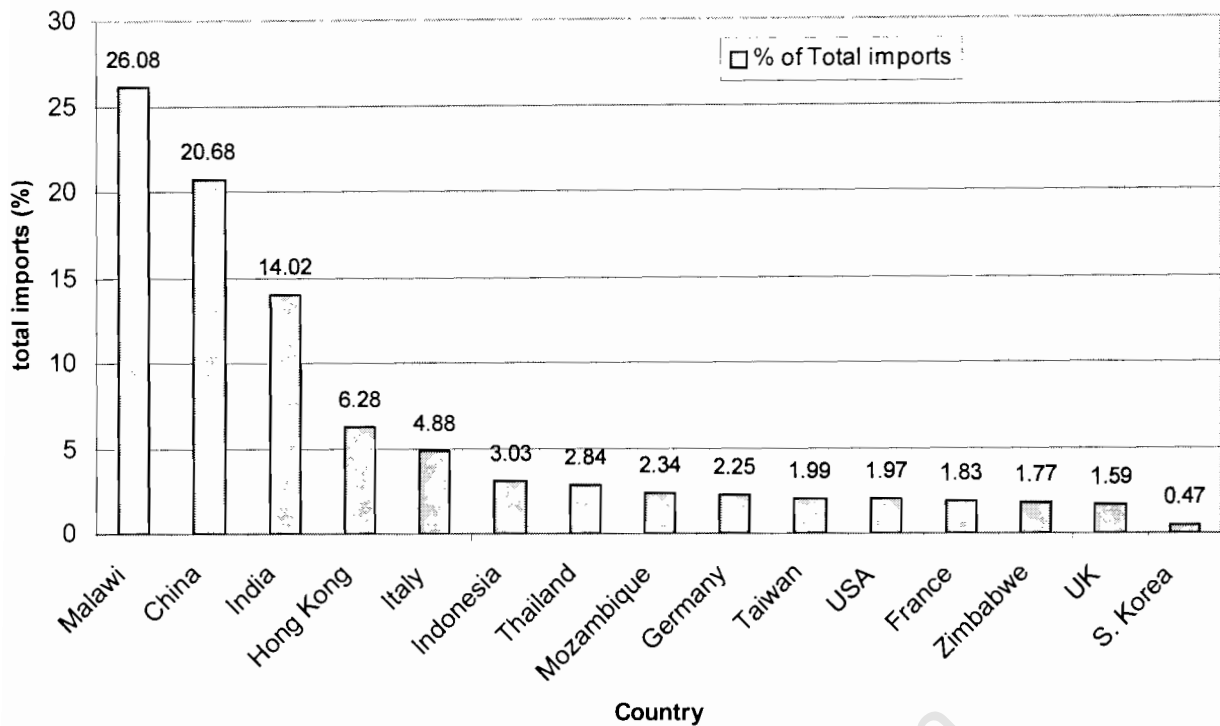
The expectations were that the DCCS and GEIS would be removed, since direct subsidies are against the rules of GATT – now World Trade Organisation (WTO). The DCCS received a lot of criticism from the WTO. Although the scheme was supposed to end on 31 March 1998, "the Minister of Trade and Industry extended its lifespan until March 2000, to give more time to restructure."(Jaftha, 1999: 5) The extension of the DCCS was a cause of great concern to the clothing industry.

The local clothing and textile manufacturers were against proposals that were made to restore the preferential tariff treatment of Zimbabwean clothing and textiles, which offered them better than Most Favoured Nation (MFN) preferences in the local market.(Cape Times, 25 August 1995) The trade unions were also concerned about the competition from the growing imports, which could drive many small manufacturers out of the market, therefore threatening loss of thousands of jobs in the clothing and textile industry.

Following the government's decision to undertake a 7-year tariff phase down in 1995, and faced with "stiff" competition from growing imports into the local market, South African clothing companies were exploring opportunities of relocating their operations to neighbouring countries with the aim of reducing costs.(Business Day, 25 October 1995)

Many local clothing and textile firms closed down their operations in 1997, particularly in Gauteng and Kwazulu-Natal and these were predominantly small in size.(Clothing industry News, June/August 1997) Both imports and exports were growing during that period. However, the growth of imports exceeded that of exports.(ibid) There was an increase in input costs for the clothing industry as a result of an increase in textile prices, which was reflected by the rising PPI for the textile industry.(Clothing Industry News, June/August 1997) Some of clothing companies were already moving their operations to low wage areas, both within and outside South Africa during that year.

Figure 3.2: 1998 SA Clothing imports - Top 15 countries



Source: Clofed Handbook 2000/1, Page 81

There were also new developments during that time, which include closure of entry points for smuggled products; while the US opened its market to Southern African clothing and textile products, which in turn, improved the potential for increased South African exports to the USA.¹⁴ China was South Africa's major source of clothing and textile imports, followed by Malawi. However, in 1998 Malawi overtook China and became the major source of South African Clothing imports. (See Figure 3.2) According to this graph, about 26.08% of South African total clothing imports originated from Malawi while 20.68% were from China.

Note that only 1.77% of these imports originated from Zimbabwe. The significant and progressive increase in Malawian imports entering the South African market raised serious concerns on part of the South African local manufacturers. They

¹⁴ Since US congress was considering a free trade bill for Sub-Saharan African clothing and textile exports to access their economy quota-free and duty-free. (Clothing Industry News, March/May 1998)

were concerned that "Malawi was being used as the conduit for the cheap clothing and textile imports from the Far East, and to circumvent SA customs duty on garments as well as on fabric through legitimate manufacturing operations."¹⁵(Clothing Industry News, September/November 1997) According to the DTI spokesperson, there was a time when Malawi exported more than what they produced.(Interview, September 2000) CLOFED (1997) suggested introduction of the rules of origin and the accumulation principle as a solution to the problem of trade distortion resulting from preferential trading arrangements.

In 1998, the trend of growth in clothing exports was more promising.(Clothing Industry news, March/May 1998) In fact, the 1999 annual report of the CLOFED highlighted 1998 as the year of consolidation, while 1999 has been the year of agreements. This report also mentioned illegal imports as one of the major threats to the South African clothing and textiles in the late 1990s, together with the abuse of rebates for second hand clothing, and lack of effective action to overcome these activities.

3.3 Competitiveness in the South African Clothing and textiles industry

The South African clothing and textiles industry has always been protected by high tariffs and non-tariff barriers and this had a negative impact on the industry's level of competitiveness, since it made South African exports more expensive in the international markets because of higher input costs. "As a result, the clothing and textile industry in South Africa has been inwardly focused, rather than export-oriented."(Salinger, Bhorat, Flaherty & Keswell, 2000: 5) The policy of protection also made goods, both domestically produced and imported, more expensive than

¹⁵ Malawi/SA bilateral trading arrangement provides duty-free access of the Malawian goods into SA and MFN access of South African goods into Malawi.

they would be without protection in South Africa. However, the protection was justified by the fact that the industry is one of the largest manufacturing employers, especially the labour-intensive clothing sector (as mentioned above). The South African government, in the face of the increasing trend towards regional economic integration and cooperation as well as globalisation of the world markets in the 1990s, has been faced with the challenge of formulating policies to regulate and adjust the competitiveness of its manufacturing industries.

Since the openness of South African economy has been accompanied by increasing inflows of cheap foreign clothing and textile imports into SA, thereby imposing "stiff" competition, there is a challenge for local manufacturers to improve their level of competitiveness. Although the clothing industry is not competitive overall, some research on the industry indicates that it is price competitive when the costs of local inputs are excluded. This explains why the clothing industry strongly lobbied for liberalisation of the textile industry within a shorter period of time.

Literature on the clothing and textile industry indicates that South African firms have reacted in different ways to the challenge brought about by liberalisation. Some textile firms have taken initiative in form of training, re-organisation and re-modernisation to ensure their survival within the international markets as well as within South Africa, given their stiff competition with more cost-effective producers from other countries in the region and abroad, especially from the Far East.

The local clothing sector, on the other hand, benefited in terms of competitiveness and cost-effectiveness since the liberalisation has extended its access to cheaper

textile inputs. Hence, the clothing industry became one of the major manufacturing exporters in South Africa in the late 1990s.(See Table 3.4 below)

Table 3.4: Showcasing South Africa's High performance Sectors

BEST EXPORT ORIENTED INDUSTRIES		BEST PERFORMING MANUFACTURING SUBSECTORS
<i>As per Revealed Comparative Advantage</i>	<i>As per Degree of penetration in World Markets</i>	<i>As per Competitiveness Index</i>
Food and related products Sugar, starches, insulin and wheat gluten, vegetable and fruit (fresh and preserved)	Food and related products Cereals and preparation thereof, beverages	Wearing apparel
Textiles, clothing and related Textile yarn, woven fabrics of synthetic fibres	Textiles, clothing and related Men's suits and trousers Footwear, travel goods, handbags, etc.	Footwear Tanneries and leather finishings
Wood-related products Wood and cork, chemical wood pulp, paper, and articles thereof	Wood-related products Wood and cork, and manufacture thereof, Furniture and parts thereof, Chemical wood pulp	Furniture Paper containers
Chemicals Inorganic chemicals, Fertilizers, petroleum jelly, mineral waxes	Chemicals Inorganic chemicals, Fertilizers, petroleum related products, tyres	Industrial chemicals
Non-metallic mineral products Building and monumental stone	Machinery Agricultural machinery or parts thereof, trailers and other vehicles (not motorised), railway equipment	Industrial and other machinery Electrical appliances
Basic metals Basic iron and steel products, ferro-alloys, non-ferrous basic metal products	Basic metals Basic iron and steel products	Non-ferrous metal products Basic iron and steel
	Metal products Wire, cables and cordages or iron and steel	Fabricated metal products

Source: Investment South Africa, 2000:12

The 1999 annual report of the CLOFED outlines a number of factors that can affect the success of the industry and these include: human capital development

through the improvement of education and skills; policy stability; access to investment capital; and export promotion. However, problems of porous borders, dumping and floods of cheap illegal clothing and textile imports and second hand clothing entering the South African market tend to undermine the efforts made by local companies to become both domestically and internationally competitiveness.

3.4 The Protocol within the context of Clothing and Textiles Industry

The clothing and textiles industry is one of the sensitive sectors, as mentioned above, that have been the main focus in the negotiations that delayed implementation of the trade protocol; through complexities and difficulties in implementing some of the rules provided for in the trade protocol. The clauses of the protocol that are important for the clothing and textile industry include those on: rules of origin, dumping, competition, intellectual property and customs co-operation.

3.4.1 Rules of Origin:

Most important for this industry is the Rules of Origin clause. In case of clothing, the country of origin is determined by the fact that any imported product - e.g. cloth, or yarn - should undergo at least two manufacturing processes in that country before it can qualify for duty-free access to the importing country.

SADC member states agreed on the need for sensitive sectors to have product-specific rules of origin, and the clothing and textiles industry is amongst the sensitive sectors that will require specific list of rules detailing sufficient processing and substantial transformation to confer the originating status as proposed in the rules of origin in Annexure I of the SADC protocol.

The product-specific rules of origin for clothing and textiles industry have been among the main areas of disagreement during the ongoing negotiations. It has been proposed that a differentiated approach be taken on the clothing and textile sectors, such that for a certain period, the least developed members of SADC will be allowed to use less stringent rules. In order to promote industrialisation in the region, the rest of the SADC members, on the other hand, "have to agree on a stricter regime that requires extensive processing of products before they can be traded duty-free in the SADC region." (Business Day, 8 November 1999)

Due to concern of some member states (including South Africa) about their local industry, it is required that "extensive processing" (also known as substantial transformation) for clothing and textiles must be a two-stage conversion process. This means that the product has to undergo at least two stages of local manufacturing operations before it can be traded duty-free in the region. For example, if a company imports yarn, then the first stage will be transforming yarn into a fabric, and the second stage would be to transform the fabric into a garment.¹⁶

During the course of negotiations, there has been an ongoing textile war based on a piece of fabric, with South Africa and the BLNS economies on one side and the Non-SACU SADC members on the other side. "The area of disagreement among the member states has been around the issue of production, manufacture and retailing of fabric; how it should be traded across the political borders; the originality of the fabric; and what quantity should be traded."(Mail and guardian, 15 June 2000) "South Africa prefers a sub-continental agreement that forbids

¹⁶ An example of a garment is a shirt. This means that if one imported a shirt, attaching a label to that shirt would not be enough to grant the product originating status, and therefore community treatment.

member states to import fabric from outside the region and that requires development of a value chain. [In this value chain], the yarn must be acquired within the region, woven into fabric and finally made into a garment.”(ibid) South African position is justified by the consequent benefits to the region in terms of job creation, and promoting more use of the cotton produced by Zimbabwe, Tanzania and Malawi. Sifiso Ngwenya of DTI, in his comment to the Mail and Guardian (15 June 2000) emphasised the perceived benefit of value chain, from yarn to fabric, for the clothing and textile industry in the whole economy of Southern Africa, especially in terms of the ancillary activities related to the textile industry such as the dyeing and printing of fabric.

The Non-SACU SADC members, however, prefer to import fabric cheaply from Asia. Their argument is that Asia produces at high quantities while the small textile producers in the region produce the fabric at slightly higher prices, and “thereby alienating domestic clients.”(Mail and Guardian, 15 June 2000) It is crucial for the two groups of member states to agree on issues pertaining to the rules of origin and local content requirements so that the protocol can finally be implemented and FTA formed for the whole of Southern Africa.

The rules specifying local content and the extent of manufacturing required for clothing and textiles to qualify for preferential tariff treatment are listed in chapters 50 to 62 of the product-specific rules of origin. These rules specify minimum amount of processing required for conferring originating status. More processing of non-originating materials than that which is specified in the list of rules will also confer originating status.

3.4.2 Dumping and Customs Co-operation:

The issue of dumping of cheap clothing and textile products from outside the region, especially from Far East Asia, has been one of the major concerns in the SADC region. The SADC region has also been faced with problems of porous borders and smuggling of clothing and textile products illegally into the region, and these flood the Southern African markets. Meanwhile the trade protocol is not implemented, some countries tend to take advantage of the gap that exists because of the preferential trade arrangements between individual SADC member countries to avoid import duties.

The SADC trade protocol provides for the safeguard measures against such unfair practices as 'dumping' of cheap products into the SADC markets. In such instances Member States would have recourse to take anti-dumping action and apply counter-veiling measures to import trade that distorts fair competition, as mentioned above.

It is proposed that products benefiting from direct and auctionable subsidies that may distort fair competition, including the export processing zones (EPZs), should not be granted preferential treatment under the Trade Protocol. The member States are required to notify the non-tariff measures that they apply in their trade policies and to make firm undertakings on the removal of those that distort or prohibit trade.

The objectives of customs co-operation - according to the trade protocol -include establishing common institutions that are appropriate at national and regional levels, and co-operating to prevent fraud and illicit trade.

3.4.3 Intellectual Property:

The protocol also acknowledges the importance of the intellectual property rights. Intellectual property rights are rights given to persons over the creations of their minds. They usually give the creator an exclusive right over the use of his/her creation for a certain period of time. These rights can be divided into two: copyright and rights related to copyright; and industrial property such as industrial designs, invention and trade secrets, distinctive signs, in particular trademarks, and geographical indications.

The main social purpose of protection of the intellectual property is to: encourage and reward creative work; stimulate and ensure fair competition; protect consumers by enabling them to make choices between various goods and services; and foster investment in development of new technology by providing incentives and means of financing research and development activities.

The SADC trade protocol states that the policies for protection of intellectual property rights according to the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights shall be adopted and implemented within the community. (SADC, 1996:15)

3.5 Conclusion

It is evident that the South African clothing and textiles industry is very old, and it has changed over time. The world wars, especially WWII, had a major contribution towards the growth and development of this industry in South Africa. The South African clothing and textiles industry had always been inward oriented and highly protected. However, with the global trends towards liberalisation of investment and trade policies, this industry has gradually been moving towards openness since the 1990s.

The move towards liberalisation has both positive and negative effects on the South African local industry. On a positive note, the local industry is forced to improve its competitiveness, while the local clothing producers have access to cheaper imported textile inputs. On the other hand, a number of factories had to close down while some relocated to low cost areas, as there has been erosion of the market for local clothing and, especially, textile products resulting from growing imports. Hence, the implementation of the SADC trade protocol has been delayed, as the member states have been engaging in negotiations, in an attempt to protect their clothing and textiles among other sensitive industries.

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CHAPTER FOUR: TRADE AND INVESTMENT FLOWS IN THE SADC REGION

4.1. Introduction

SADC economy, being at the dawn of free trade, is becoming more liberalised. Trade is continually strengthening while investment, especially foreign and cross-border investment, has been growing in the 1990s. Despite its growth, the level of investment in the region remains low. The growth in investment in SADC is still too low to boost economic growth of the region enough to reduce the poverty that is prevailing in the region. Literature detailing work done on this subject identifies the obstacles to trade and investment in the region. Hence, there are ongoing initiatives in the region to remove the remaining obstacles to trade and investment in SADC.

The decision of a company to invest is affected by a number of microeconomic as well as macro-economic factors and these vary from company to company. In fact, the location aspect of an investment decision is very crucial. The location decision is strongly influenced by the incentives prevailing in the countries, as well as the market access from that location. According to Gumede (2000), the extent of the impact of each of the different factors varies depending on size and export orientation of that particular company. "For example, taxation, capital constraints, and public investment are more relevant for small enterprises, while the exchange rate and trade regime are more relevant for exporting enterprises."(Gumede, 2000:3)

Important factors that influence investment behaviour, such as uncertainty and instability, have often been overlooked in the past South African studies on investment.(TIPS, 2000:i)

This chapter provides an overview of investment and trade flows in the SADC region. It gives a brief overview of investment, particularly its trends, factors affecting investment in general, and in the SADC region in particular; as well as the trade and investment incentives offered in the SADC member states. It further focuses on South African and SADC trade flows. Finally, it looks at investment related to trade flows.

4.2. Determinants of Investment Behaviour

Literature on investment reveals many factors that influence a company's decision to invest in a particular location (i.e. country or region). Teal(1999), in examining the determinants of investment in Africa, identified macro as well as micro determinants.(p1) Macro determinants include investment rates, openness of the economy as well as uncertainty created by macroeconomic policy management.

Teal further draws evidence on how the firms tend to respond to the incentives they face in terms of investment and decisions to export, and these are referred to as micro determinants. These include profit rates and financial constraints, and the level of their impact differs depending on the size of the firm.(Teal, 1999)

In examining the determinants of foreign investment in South Africa, Van der Walt and de Wet (1995) argued that although numerous variables affect investment decision, expected profits is the key variable in an investor's decision to invest. Some of the factors that affect expected profits include: exchange rate controls, political stability, fiscal discipline and economic role of the government, labour discipline and the economic role of public debt, inflation, and protectionism.(Van der Walt & de Wet, 1995).

Mbekeani (1997) looked at factors that impact on a company's decision to invest in the developing countries at large. These include the market size, changes in the level of GDP, manufacturing profitability, relative production costs, availability of skilled labour force, US interest rates and size of (i.e. large) external debts. Mbekeani (1997) also pointed out that developing countries put too much emphasis on policies to attract FDI flows instead of attracting those FDI flows that will promote economic growth. Hence, he suggests that the developing economies should rather concentrate on promoting domestic investment, with FDI used as a supplement, since the contribution of FDI to economic growth is less relative to that of domestic investment.

Gumede (2000) in his paper that focuses on fixed investment, among other factors that influence investment, has mentioned public investment; infrastructure; public deficit; taxation; exchange rates; regulatory environment; public debt; privatisation; human resources; costs of borrowing; interest rates; sales outlook; uncertainty; and foreign trade.(p2) Teal, in his findings, indicates that uncertainty plays a vital role in limiting investment at macro as well as micro scale, and profits effect investment, despite that this effect is small.(1999: 12)

In order to promote investment Mbekeani (1997) suggests, among other measures, improvement of infrastructure, blending trade and investment policies, targeting sectoral investment, particularly sectors with comparative advantages, positive externalities and export-orientation, moderate investment incentives, and government intervention to solve market failures.

4.3. Investment and export incentives in the SADC member states

The location decision is an important aspect of an investment decision. When investors seek potential investment locations, they first look at the overall investment environment, including political and economic stability, as well as expected rates of return among other things, before making an initial decision. The location decision is strongly influenced by investment and export incentives prevailing in each country, since market access is a key concern when a company takes a decision on where to locate their investment.

“Incentives are tools used primarily to attract and focus investment. Thus, a favourable environment, coupled with a set of attractive incentives would guarantee a host country its fair share of investment. However, incentives alone are not sufficient to attract the kind of investment that is necessary to help the SADC members grow and therefore all countries must firstly strive for a stable macro economy” (DPRU, 2001:1).

“Incentives must be well structured (in terms of simplicity as well as bureaucratic considerations) so as to encourage investment without creating any instability in the economy”(Ibid.). Consistency and sustainability of incentives are imperative and their timely phasing in is crucial to their success. Incentive systems generally consist of a set of incentives available to most new investors, and in addition to those a variety of other incentives that aim to promote certain types of investment in the economy are introduced.

The main interest of investors is in the direct incentives such as tax concessions, capital and other allowances, and customs discounts offered; as well as other factors when making their investment decisions. Such factors include the ease of

entry into the market, the ability to obtain internal finance as well as (in the case of foreign investors) the ability to send profits to their home country. Investors are also concerned with the effective tax rate that often exceeds the rate quoted by the investment promotion agencies (IPAs). IPAs therefore play a vital role in attracting investors via their promotional activities as well as the level of informational and technical support they provide.

It is therefore essential to examine various incentives offered in the SADC region. This section essentially focuses on the incentives offered in each of the SADC countries.

4.3.1. Angola

The Institute for Foreign Investment is responsible for the administration of Angola's incentive programme. Their major objective is to eliminate institutional barriers that discourage foreign investment in all sectors of the economy. In an attempt to attract foreign direct investment, Angola's main focus has been improvement of infrastructure and privatisation. "The infrastructure improvements made include the onshore and downstream oil operations; the national power grid; and telecommunications. 30 state-run companies plus the Bank of Commerce and Industry have been nationalised." (DPRU, 2001)

Angola also has foreign investment incentives entailed in the 1994 Foreign Investment Law that transformed their economy from one that was hostile to FDI to one that embraced it. "The law includes the following:

- Foreigners are guaranteed equal treatment.
- All sectors are open to FDI.
- Private commercial banking is permitted.

- International participation is welcomed in the mining sector.
- Foreigners are allowed to transfer dividends, profits and investment proceeds to their home country.
- Incentives encourage foreigners to employ locals.
- FDI procedures are simplified and made faster.
- Investments of less than \$5 million not subject to government approval.”(Ibid.)

Angola's export incentives include their provision for applications to be made to the government for tax exemptions and other benefits. However, successful applicants must contribute substantially to Angola's foreign exchange reserves.(Ibid.))

4.3.2. Botswana

Botswana has a strong, well-structured incentive programme and attracts FDI by promoting its sound economy. The government has invested heavily in economic infrastructure. Botswana has good internal and external communications and transport networks. Grants are awarded on a case-by-case basis and the terms and conditions are negotiable. The incentives are outlined as follows: general incentives, the Financial Assistance Policy (FAP), development centre initiatives and then export incentives. (Ibid.)

The general incentives include the corporate tax of 15% for manufacturers; profits, dividends and capital can be readily repatriated; and there is no foreign exchange control. (Ibid.)

The Financial Assistance Programme is run by the Department of Industrial Affairs, and “the following productive enterprises are eligible for the grants:

- Manufacturing
- Small and medium scale mining
- Agriculture (excluding cattle)
- Linking services and tourism

Grants are available for capital equipment, unskilled labour and training and the value of the grant depends on the size of the project. Small projects qualify for investments in fixed assets less than 75000 pula; medium sized projects qualify for investments between 75000 and 2 million pula; and large projects qualify for investments over 2 million pula.”(Ibid.)

The funding for small projects is provided on condition that the businesses are locally owned. “The value depends on location, female ownership and employment generation. The maximum value of the initial grant plus 2 expansion grants is 150000 pula. The maximum size of the initial grant is 50000 pula (calculated as 90% of investment less than 50000 pula plus 40% of investment greater than 50000 pula). The first expansion grant is only awarded once the business has operated successfully for 1 year.” (Ibid.)

The conditions for the large and medium scale project grants are as follows:

- “The initial criteria are that the projects must be less than 6 months old and must yield an expected return in excess of 6%.
- One set of grants per project is available per annum.
- The value of the capital equipment grant depends on location and is a maximum of 1500/1000 pula for local/joint or foreign investments per job created.

- Part of the wage bill for unskilled labour is reimbursed in the first five years, as long as the wage rate falls between the minimum and double minimum. In the first two years 80% is reimbursed, 60% in the third year, 40% in the fourth year, and 20% in the fifth year.
- Training grant: 50% of off-the-job training costs (tuition, accommodation, travel, materials, wages) for local employees during the first five years of a project are refunded (subject to productivity improvements).
- Both the unskilled labour and training grants cannot exceed 50% of value added (sales less tradable inputs less transfers to foreigners).
- A proportion of the grants must be repaid if the project fails." (Ibid.)

Botswana also has Development Centre Initiatives, and Selebi-Phikwe has been designated as the Priority Development Centre in Botswana. "Companies located there pay corporate tax at 15% for the first 5 years of a project and are exempt from paying withholding taxes on dividends paid on the share of profits derived from exports for 10 years. The following large-scale light manufacturing industries have been earmarked for development in Selebi-Phikwe: garment manufacturing, jewellery, automotive accessories, structural engineering, sanitary ware, furniture and mining accessories." (Ibid.)

The export incentives include the duty drawback facility in the procurement of raw materials used in exports. In addition to this, there are no import duties on machinery and equipment used to manufacture exports.

4.3.3. The Democratic Republic of Congo

DRC does not have a specific list of investment incentives. However, there is realisation by government that FDI will be imperative to its economic recovery.

Hence, its aim is to attract FDI "by opening all sectors to potential investors."(Ibid.)

4.3.4. Lesotho

The purpose of Lesotho's incentives in general, is to increase the profitability of production in Lesotho for both foreigners and local businesses. Their incentives include FDI incentives, capital allowances and export incentives.

Lesotho's FDI incentives include free repatriation of profits and unlimited access to foreign exchange; no withholding tax on dividends; and provision of loans, equity participation and loan guarantees by Lesotho National Development Corporation.

Capital Allowances comprise of 40% in year one for new buildings, plant and machinery; additional allowances for mining, bad debts, rent paid, interest on property; training allowance of 50% of the cost of approved courses for local employees; and tax holidays can be granted (for 10 years, whereafter the normal Corporate tax of 15% applies).(Ibid.)

The export incentives include the following:

- Export Finance Scheme, which is comprised of a credit guarantee scheme, pre and post shipment credit schemes, refinance arrangements and counter guarantee arrangements;
- Duty drawback facility in the procurement of raw materials used in exports; and
- Machinery and equipment used in manufacturing to produce exports is exempt from General Sales Tax (GST).

4.3.5. Malawi

In Malawi there is active promotion of investment in manufacturing, agriculture, tourism and mining is actively by the use of tax concessions (as opposed to cash grants). This country offers FDI incentives, tax concessions, and export incentives.

FDI is promoted through free entry and exit of foreign exchange; foreigners are granted easy access to local finance; profits and dividends can be repatriated easily; and there are no restrictions on the payment of interest and principal on international loans. The tax concessions consist of tax allowances and tax holidays.

Malawi offers tax allowances of 40% on new and 20% on old buildings and machinery, plus an additional 15% if the investment is in a specific region; 50% for qualifying training costs; and 100% on operating expenses accumulated 18 months prior to business opening. There is no withholding tax on dividends, while "losses can be carried forward indefinitely to allow companies to take full advantage of tax allowances". (Ibid.)

Malawi also offers tax holidays for investments of between US\$5million andUS\$10 million, with a choice between a tax holiday of 5 years, or indefinitely paying a corporate tax of 15%¹⁷. For investments greater than US\$10 million, there is a choice between tax holiday of 10 years or indefinite 15% tax. In addition to the above, "Malawi has a number of double tax avoidance agreements in place. As an incentive to enhance the heavy duty vehicle fleet in Malawi, those vehicles with payloads greater than 10 tonnes are not subject to import duty." (Ibid.)

¹⁷ Compared to the normal corporate tax of 38% in Malawi.

The export incentives include export processing zones (EPZs), wherein there is no corporate tax, no withholding tax on dividends, no VAT, no duty on capital equipment and raw materials and no excise taxes on local raw materials and packaging. There is a transport tax allowance of 25% for international transport. Non-traditional exports are given an export tax allowance of 12% of export revenues. For manufacturers in bond, there are no duties on imported capital equipment used to manufacture exports, no excise taxes on local raw and packaging materials plus a duty drawback facility for the aforementioned materials. In case of horticultural products for export, equipment and raw materials used in their production can be imported duty free. (Ibid.)

4.3.6. Mauritius

“Mauritius has a very structured incentive programme and the incentives can be divided into various categories as outlined in the Industrial Expansion Act. The agricultural and tourism sectors have been pinpointed as sectors worthy of additional development efforts.” (Ibid.) The wide range of concessions offered in Mauritius include Strategic Local Enterprise; Modernisation and Expansion Enterprise; Industrial Building Enterprise; Pioneer Status Enterprise; Small and Medium Scale Enterprises; Off-shore business; Agriculture Development Scheme; Investors in the hotel industry; and Export incentives (including EPZs; Export Service Zones (ESZs) and Mauritius Freeport Authority (MFA)).

“Strategic Local Enterprise concessions apply to local manufacturing industries that supply the local market and can prove that their activity is likely to enhance the industrial and technological capacity of Mauritius. Their benefits include permanent corporate tax rate of 15% and tax-free dividends for 20 years.” (Ibid.)

“Modernisation and Expansion Enterprise concessions benefit two types of investment projects”. The first type is available to “firms investing in productive machinery and equipment (for example, automation equipment and processes, computer-aided design (CAD) and computer-aided-maintenance (CAM) applications). Its benefits include exemption from customs duty; 10% income tax credit over 3 years for investments over R10 million; and capital allowances of 125% of capital expenditures.” The other type is available to “firms investing in antipollution and environmental protection technology, whose benefits include all the type one concessions plus an initial allowance of 80% for expenses relating to the antipollution machinery or plant.” (Ibid.)

“Industrial Building Enterprise concessions are available for companies that build and lease industrial buildings or levels greater than 1000 square meters.” Their benefits include “15% corporate tax rate; tax-free dividends for 10 years; 50% exemption on registration dues for land purchase; and no rent control as stipulated by the Landlord and Tenant Act” (Ibid.).

“Pioneer Status Enterprise concessions are offered to new companies (formed after 1 July 1993) that fall into the new technology, support or service industry categories, if they are likely to enhance industrial and technological development in Mauritius”. Their benefits include “corporate tax rate of 15% for 10 years; tax-free dividends for 10 years; no customs duty or sales tax on scheduled equipment or materials; and free repatriation of profits, dividends and capital.”(Ibid.)

“Small and Medium Scale Enterprises concessions are offered to SMES (that is, enterprises with production equipment valuing less than R5 million) involved in any manufacturing activity.” Their benefits include permanent corporate tax rate

of 15%; and exemption from customs duty/import levies on production equipment.”(Ibid.)

“Offshore business concessions are accessible to “businesses involved in offshore banking, insurance, pension fund and fund management; international financial and management consultancy services; international trading and asset management; operational headquarters; shipping and ship management and aircraft financing and leasing; international financing and franchising; international data processing and IT services, and; international employment services. These businesses receive a range of benefits if all business is performed with non-residents in foreign currencies.” Their benefits include tax-free profits; no impediments to the free flow of foreign exchange and profits can be expatriated free of charge; concessionary personal income tax rates for expatriate staff; two staff members are exempt from paying duty on imported cars and household equipment; tax-free importation of office equipment; no withholding tax on non-residents deposit interest payable from offshore banks, or dividends and benefits payable by offshore entities; no estate duty or inheritance tax on inherited shares; and no capital gains tax.”

Agriculture Development Scheme offers the following benefits:

- 15% corporate tax;
- Tax-free dividends for 20 years;
- Free repatriation of capital, dividends and profits;
- No customs duty on machinery, equipment and spare parts;
- 50% exemption on registration fees for land and buildings purchased.

There are also incentives schemes available for investors in the hotel industry. The first type is "hotel management incentives that include tax-free dividends for 10 years; free repatriation of profits, dividends and capital (provided the investment is rated A status by the Central Bank); preferential rates for term loans and overdraft; and corporate tax rate of 15%. There is also hotel development certificate that offers all the benefits available under the hotel management scheme, except the corporate tax rate is 5%. It also offers exemption from duty on approved imported equipment."(Ibid.)

"Export incentives offered in Mauritius include EPZs, ESZs and MFA. There are a number of EPZs that involve activities such as include manufacturing, deep-sea fishing, printing and publishing, IT and agro-industries." Their benefits include the following:

- "The Development Bank of Mauritius offers preferential finance to these enterprises.
- Corporate tax is 15%;
- Tax-free dividends for 20 years;
- No capital gains tax;
- Profits, capital and dividends can be repatriated free of charge;
- Two expatriate staff are fully exempt from personal income tax;
- Raw materials, machinery, equipment and spare-parts (excluding those for vehicles) are exempt from customs duties, import levies and sales taxes;
- Imported vehicles, with a capacity of 15 to 25 people, are exempt from 60% of the duty paid.

Export Service Zones (ESZs) are about service companies, involved in the export of their services (for example, accountancy, law, medicine, international

marketing, quality testing, pre-shipment services, civil engineering, management consulting, reinsurance, entry port trade and transshipment), that must have a 70% local participation rate to qualify for the benefits.”(Ibid.)

Their benefits include corporate tax of 15%; tax-free dividends for 20 years; profits, capital and dividends can be repatriated free of charge; and no import levy or customs duty on machinery, equipment, spare parts and goods to be re-exported.” (Ibid.)

Mauritius Freeport Authority (MFA) benefits apply to firms involved in the transshipment and re-export trade. The activities include warehousing and storage, breaking bulk, sorting, grading, cleaning, mixing, labelling, packing and repackaging, minor processing and simple assembly. The benefits of MFAs include no corporate tax; no customs duty or sales tax on machinery, equipment and materials imported for exclusive use in this zone, or on goods to be re-exported; access to offshore banking; and lower warehousing and storage fees.

4.3.7. Mozambique

The government is committed to providing assistance to businesses that are not performing well and encouraging investment in new projects. A set of incentives is available to encourage new activity in all sectors of the economy, and most incentives are in the form of tax concessions.

New investment projects are entitled to relief from customs duty and consumption and circulation tax, plus a 50% reduction in customs handling fees for feasibility study equipment; equipment and building materials used in approved projects; company cars (value must be less than 1% of the total project) and foreign staffs' personal goods; raw materials, intermediate products and packaging materials for

the production of exports, medicines, educational materials and foodstuffs; and raw materials, intermediate products and packaging materials for all other articles' first production run.

Operating ventures are eligible, for 5 years, for a reduction in taxable income by the total sum of investment in infrastructure, and plant and equipment. The following expenses qualify as losses for tax purposes: the construction and rehabilitation of public infrastructures; the private purchase of art and other cultural undertakings; and 5% of the taxable profits of training workers.

There is also area specific tax concessions for new and poor performing companies in certain areas, to which additional tax incentives (for a maximum period of 10 years) are offered. "These concessions are as follows:

- Niassa, Tete and Cabo Delgado: for which corporate and supplementary tax is reduced by 80%. The normal tax rate is 45% plus a 10% circulation tax on invoices;
- Other provinces outside the provincial capitals: taxes are reduced by 65%;
- Other provinces within the provincial capitals: taxes are reduced by 50%.

Investment in less developed provinces is rewarded by the further reduction of corporate tax as follows:

- Niassa, Tete and Cabo Delgado: 50% for 6 more years;
- Sofala, Manica, Zambezia and Nampula (excluding provincial capitals): 40% for 3 more years;
- Inhambane, Gaza and Maputo: 25% for 3 more years.

Mozambique has identified a number of areas that are classified as Industrial Free Zones (IFZs). These zones are in the process of being developed - including

Industria de Mocambique site in Maputo Province, Sofala Province near the Port of Beira, Nampula Province and the Port of Nacala. Companies in these areas receive benefits such as tax-free dividends for 10 years; and no customs duties, export or import taxes on construction material, machinery and equipment.”(Ibid.)

The Mozambique Institute of Export Promotion is responsible for drawing up the export incentive programme, whose details are not available.

4.3.8. Namibia

Namibia's incentive programme includes general incentives, FDI incentives, special incentives for manufacturers and exporters, EPZ incentives and SME incentives. The emphasis of the Namibian government in promoting the country as a place in which to do business is on its low corporate tax structures. “The general incentives in place are as follows:

- No capital gains tax;
- 10% tax on non-resident shareholders;
- No tax on dividends owed to companies;
- Buildings depreciated at 20% in year one and then at 4% per annum for the following 20 years;
- Manufacturing machinery and equipment is exempt from import taxes; and
- Tax deductions for direct wages, training costs and exports.

Namibia also offers FDI incentives. The Foreign Investment Act provides for a Certificate of Status Investment to be awarded. The certificate depends on the size and nature of the investment, and its benefits include:

- Easy access to foreign exchange for the servicing of foreign loans, and the transfer of net profits, dividends, proceeds of sales and remittances;

- Currency gained from exports can be retained;
- Exemption from restrictions relating to business categories reserved for Namibian citizens.” (Ibid.)

There are special incentives for manufacturers and exporters. “Manufacturers only pay 50% of corporate tax for 5 years with a linear phasing out of the abatement over the next 10 years; no GST/ASD on the purchase or importation of machinery and equipment; establishment tax package that is negotiable; special building allowance with buildings depreciated at 20% in year one and then at 8% per annum for the following 10 years; export promotion allowance wherein the taxable income is further reduced by 25%; training and production wages of between 25% and 75% deductible from taxable income; cash grants amounting to 50% of the direct costs of approved export promotion activities. Exporters of manufactured goods produced inside or outside of Namibia are entitled to reduce taxable income by 80% of the income derived from the exports.” (Ibid.)

“SME incentives programme is run by the Ministry of Trade and Industry and is supported by a Steering Committee that includes NGOs and private players. It consists of the following:

- The Small Business Guarantee Fund that deposits money in commercial banks to serve as collateral for SMEs making loans. If an SME borrower defaults, the borrower assumes 10% risk, the commercial bank 10% and the SMGF 80% of the capital lent.
- The following areas have been identified as SME modules/industrial parks: Otjiwarongo, Gobabis, Epako, Uutapi, Ohangwena, Keetmanshoop, Karibib, Oshikango, Ondangwa and Windhoek.

- These areas house Technology Demonstration Centres and Common Facility Centres. To further assist in technology transfer, a database has been set up identifying contacts that can assist in providing the required technologies.
- Merchandising intermediaries and export promotion officers are responsible for helping SMEs to identify and gain access to local and overseas markets.
- A Group Purchase Scheme has been set up to co-ordinate the bulk buying of goods plus the sharing of shipping costs. An international database has been set up to aid in the sourcing of materials.
- The Institute of Management and Leadership Training runs a government sponsored intensive entrepreneurial training programme.

Enterprises satisfying these criteria are eligible for the EPZ incentives:

- Manufacturing, assembling, repackaging or break-bulk operations;
- Export most of the goods to countries outside Southern African Customs Union (SACU) (30% production for local market allowed);
- Earn foreign exchange; and
- Employ Namibians.”(Ibid.)

Since there is no physical location for the Export Processing Zones (EPZs), exporters may set up anywhere in Namibia.

Namibia also offers tax incentives that include: no corporate tax, GST, additional sales levies, stamp and transfer duties. Other incentives include the following: training grant; foreign exchange can be held in Namibian banks; no strikes or lock outs are allowed in the zone; and industrial facilities are provided at preferential rates.

4.3.9. Seychelles

Seychelles has no formal incentive programme in place. However, a number of institutions aim to assist investors in their projects. "The Investment Desk offers advice to potential investors and helps investors source finance. The Development Bank of Seychelles (DBS) assists both locals and foreigners (subject to certain conditions) in finance for SMEs in agriculture, construction, fisheries, industry, tourism and transport.

The Seychelles International Business Authority (SIBA) is an independent body that aims to develop Seychelles as an international business and financial centre. It is responsible for registering offshore companies and trusts, managing the Seychelles International Trade Zone and (together with the Central Bank and the Insurance Authority) overseeing the offshore banking and insurance companies."(Ibid.)

4.3.10. South Africa

The South African Incentive Programme is administered by the Department of Trade and Industry, with the investment side managed by Trade and Investment South Africa (TISA) and the export side managed by the National Exports Advisory Council (NEAC). This programme is aimed at boosting fixed investment and thereby improving the international competitiveness and international trade; and at the same time encourages export-enhancing industrialisation. It aims to support the transformation of South Africa from a highly protected and inward-looking economy towards into a globally integrated economy.(Tagg, 2001:1)

The main features of the South African programme are tax incentives, industrial financing incentives, the Small Medium Enterprise Development Programme (SMEDP), and it is complemented by programmes such as Research and

Development (R&D) grants, Industrial Development Zones (IDZ's), Spatial Development Initiatives (SDIs), Community Public Private Partnerships (CPPPs) and various export incentives. (Ibid.)

Tax incentives offered in South Africa include the following accelerated depreciation allowances and tax write-offs:

- "R&D expenditure: 25% of capital expenditure approved by the Council for Scientific Industrial Research (CSIR), of compensation payments should be made if research is discontinued.
- Employee housing: This comprises 50% of the cost of a house built for any employee (or money donated/advanced for the building of a house), with a maximum value of R6000. Or 10% in year one and 2% thereafter for the building of 5 or more houses to let/ house employees.
- For new and expanding businesses (both local and foreign) plant and machinery is depreciated over three years and land and buildings over five years. The rates for plant and machinery are 20% (manufacturing), 2% (hotel equipment) and for farming equipment the rates are 50%, 30% and then 20% over the three years. Buildings are depreciated at 5%(industrial), 5% (hotels) or 20% (hotel expansions).
- Other non-manufacturing fixed assets are depreciated at variable rates between 10% and 20%.

South Africa has double tax agreements in place with many countries¹⁸, while it also has limited sea and air agreements with Brazil Greece, Portugal and Spain."(Ibid:1-2)

¹⁸ Algeria, Australia, Austria, Belgium, Botswana, Canada, Croatia, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Germany, Hungary, India, Indonesia, Iran, Ireland, Italy, Israel, Japan, Korea, Lesotho, Luxembourg, Malawi, Malta, Mauritius, Namibia, Netherlands, Norway,

Industrial financing incentives are offered with the aim of assisting development of the private secondary manufacturing sector. Medium to long term loans are provided by the state-owned Industrial Development Corporation (IDC) for most projects at a (current) fixed rate of 17% and a variable rate at 2% below prime lending rate or at 4.5% below prime lending rate for entrepreneurial or job creation projects. The variety of available financing services include the following:

- **Employment Promotion Scheme:** through which companies creating at least 10 new jobs have access to 3 year, as long as the capital cost of creating the job is less than R50000 and the total assets of the company are less than R100 million. In a case where the cost per job falls between R50000 and R100000, half the loan will qualify for the low rate and the other half will be charged IDC's normal rate.
- **Export of Capital Goods and Services Scheme:** which avails loans for 2 to 10 years.
- **Import Financing:** that provides importers of capital goods and services with access to credit and guarantee facilities. Examples of such facilities are Deferral of Payment Scheme and Duty Drawback Scheme.
- **Economic Empowerment Scheme:** through which industrialists from previously disadvantaged communities receive preferential treatment in terms of project financing.
- **Venture Capital Finance:** that makes loans available for entrepreneurs starting up a high technology business.
- **Eco-tourism Scheme:** through which loans are given to "projects that develop, improve or expand tourist facilities in conservation areas/national

parks (greater than 10000h), provided the owner finances 40% of total assets." (Ibid:3)

- **General Tourism Scheme:** through which loans to the maximum value of R10 million are given to hotels that provide accommodation for foreigners. This requires that the turnover from accommodation inclusive of meals should be 70% of total turnover and 40% of total assets must be financed by owner.
- **Orchards Scheme:** makes loans available projects that generate employment in rural areas.
- **Multi-Shift Employment Creation Scheme:** is available for independent industrialists with assets that exceed R1 million and equity of more than 33% of the value of total assets. They receive funding at low rates for a period of 3 years for projects that add at least one extra 8-hour shift.
- **International Competitiveness Finance:** this scheme existed from 1995 to 1999 and was meant to assist industrialists that were unfavourably affected by tariff reduction regarding the importation of capital equipment. They were provided with funding at low rates for a 3-year period, after which they would pay the IDC rate.
- **Bank Indemnity Scheme:** is applicable to SMEs where contribution and collateral equals 50% of the facility granted. The bank is given indemnity against 60% of any loss for SMEs borrowing up to R400000."(Ibid:4)
- **Standard Leased Factory Building Scheme:** is a scheme through which properties are leased at competitive rents to industrialists by IDC.

There was also a ***tax holiday scheme***¹⁹ available to manufacturing enterprises formed subsequent to 1 October 1996 and those approved prior to 30 September 1999. Applicants that were successful within this period are entitled to income tax exemption for a maximum period of 6 consecutive years, and must utilise that tax holiday within 10 years of approval. "Two years tax free income is granted for each of the following criterion met: product on the approved list, plant in a designated location and Human Resource (HR) remuneration to value added ratio greater than 55%." (Ibid) This scheme has been phased out despite its success in stimulating investment, and was replaced with other incentives.

There are specific key industries that have been identified as designated priority areas. They include motor vehicle assembly and components, clothing, building materials, textiles, household electrical durables, electrical distribution equipment and professional electronics, pulp and paper, commodity plastics, mineral and mineral-based fabrication, food processing, beverages, footwear, engineering and labour intensive agro-industries. There is commitment from government assist productivity increases in industry through promotion of HR and technical development, and workplace restructuring in terms of organisation and democratisation. "In addition, the development of forward linkages between primary commodities and manufacturing industries will be encouraged."(Ibid.)

R&D Grants available are targeted at skills development and promotion of innovation of new products and processes. South Africa has four of such programmes:

- Support Programme for Industrial Innovation (SPII): is made up of two schemes, the matching scheme and the feasibility scheme. The Matching

¹⁹ Replacing the Regional Industrial Development Programme

Scheme grants funding equal to 50% (with a maximum value of R1.5 million) of the direct costs of a development activity. The Feasibility Scheme on the other hand, for which only small, medium or micro enterprises qualify, provides a grant of 50% of the costs of a feasibility study undertaken by a consulting company.

- The second one is the Partnerships in Industrial Innovation (PII), which is a fund that supports large R&D projects. Development projects are granted tax-free loans are awarded for a maximum of 50% of their qualifying costs.
- Technology and Human Resources for Industry Programme (THRIP): is a programme that is administered by the National Research Foundation (NRF). It makes grants available to joint research teams that consist of members from government, industry and academic institutions. Preference is given to research in the natural sciences, engineering and technology.
- Innovation Fund: provides funding for R&D in areas of information society, genetic biotechnology, value added in the exploitation of natural fauna and flora, value added in advanced materials and manufacturing. Such projects qualify for funding of between R1 and R5 million over 3 years.

Incentives for SMEs include the Small Medium Enterprise Development Programme (SMEDP), the three-year incentives; Skills support Programme and Critical infrastructure programme.

SMEDP grant is available for new and expanding businesses with maximum value of the investment equal to R100 million. It replaced the small/medium manufacturing development programme (SMMDP) that set its maximum investment at R3 million. Businesses are required to apply within 180 days from the date of production, and "the production must have commenced on or after 1

September 2000.”(Ibid: 5) SMEs that qualify for the incentive packages are: manufacturing, agricultural projects and agro-processing, aqua-culture, biotechnology, tourism, information and communication technology, culture industry and business service. They can be private or public incorporated entities, close corporations, sole properties, partnerships or co-operatives; and projects should either be new activities or expansion of existing activities.

The following assets qualify for the grants: owned (at cost) and leased (capitalised) land and buildings, equipment and commercial vehicles plus R&D capital costs. The following minimum equity requirements should be met: “10%, 25% and 35% for projects with qualifying fixed assets up to R5m, between R5 and R15m and above R15m respectively. With respect to expansion activities (defined for machinery and equipment as additional investment of at least 35%), each entity is only eligible for one expansion grant, and this grant cannot be used in conjunction with other incentive programmes.”(Ibid.)

There can be no loss of jobs resulting from the expansion, while “the turnover must increase by at least 25% and then 50% of the predicted application figures for the first and second grant years respectively.”(Ibid.)

The 3-year incentive package entails strategic investment programmes, foreign investment grants, and tax-free grants.

- Strategic Investment Programme (SIP): makes provision for an investment grant to be given for a period of two years on qualifying assets on a regressive scale, and on the third year provided that HR remuneration accounts for 30% of manufacturing costs (that is gross operating surplus plus HR remuneration).

- Foreign Investment Grant (FIG): provides sponsorship of imported plant and equipment provided by foreign investors, and the "grants are limited to US\$150000 (US\$50000) for new machinery and equipment costing less than US\$20 million (US\$5 million
- The value of the tax-free grant is calculated as follows: for the first R5m - 10%; for the next R10m (5-15m) - 6%; for the next 15m (15-30m) - 4%; for the next R20m (30-50m) - 3%; for the next R25m (50-75m) - 2%; for the next R25m (75- 100m) - 1%)."(Ibid: 6) The value is dependent on whether it is for a new or expansion project.

The Skills Support Programme (SSP) is complementary to the SMEDP and only companies that qualify for SMEDP may be eligible for this programme. It involves 3-year cash grant, based on performance, to help in the training of new skills required for a new or expansion project. It consists of training (on the job or off the job), curriculum development and capital grants. 50% of the training costs are subsidised, and this amount is capped at 30% of the annual wage bill.

It also provides for a capital grant for training equipment, and provides facilities to assist in the construction of course materials.

Critical Infrastructure Facility (CIF) is a scheme for "economic infrastructure that supports strategic, economically robust and competitive investments that aim to generate employment as well as improve environmental performance. Thus, it supplements infrastructure that is provided by existing public and private players. Grants are provided for economic infrastructure required for specific committed productive investment (as opposed to investments in basic infrastructure). Projects must have a value of over R100 million, and grants of between 10% and

30% of the capital costs incurred may be made to municipalities and the private sector. "(Ibid.)

South Africa has Industrial Development Zones (IDZs), which is an initiative that is modelled on Export Processing Zones (EPZs) and is driven by the Department of Trade and Industry. It is still at preliminary phase of its establishment, with the ultimate aim of boosting manufacturer's international competitiveness within a structured environment. It will be complemented by state of the art transport, communication and utility networks, and will be situated near an airport or seaport with efficient customs operations (to minimise transport costs) and duty-free incentives stimulating the production of goods for export. Some of the areas identified for development of IDZs are the Coega harbour near Port Elizabeth, Saldanha Bay, Richards Bay and the West Bank near East London. Each IDZ will have within it a Customs Secured Area (CSA), with the purpose of clearing goods efficiently and speedily. "The following incentives are offered:

- Raw materials and inputs are exempt from duty if used for the production of exports;
- Local supplies used in production are not subject to VAT;
- Goods manufactured in the zone and sold within South Africa are treated as imported goods;
- Imported final goods for sale within South Africa can be received in these zones; and
- There is no minimum export quota."(Ibid)

The other component of the IDZ is the Industries and Services Area (ISA), which consists of industrial/office parks. The major emphasis will be on "human resource development and labour friendly policies within the IDZs with the government

providing learnership programmes as well as skills audits and recruitment selection and training.

Another important facet of the programme is government's commitment to insuring that all companies comply with the new 'green' standards of production. This is becoming increasingly important in the global economy and South Africa cannot afford to be 'left behind' on this count."(Ibid: 7)

Spatial Development Zones (SDIs) is an initiative that has been driven the DTI, which "has been responsible for the research, joint planning, investment packaging and promotion of these initiatives. The implementation of the plans (as well as follow up activities) will be undertaken by appropriate national, provincial or local government departments."(Ibid.) The locations were chosen on the basis of their under-utilised potential as areas to accommodate productive investment, and the lead sectors for this investment have also been identified.

"There are 11 local and 3 transnational SDIs at varying stages of delivery. They are: Blyde River SDI in the Northern Province; Durban SDI; Fish River SDI (split into 2 nodes - eMonte Kei and Greater Algoa Initiatives) in the Eastern Cape; Gauteng SDI; Gariep SDI (a transnational initiative in Namibia and the Northern Cape Province); Lubombo Initiative including the Greater St Lucia Wetland Park (a transnational SDI in KwaZulu Natal, Swaziland and Mozambique); Maloti Drakensburg Initiative (a transnational SDI in Lesotho, northern Eastern Cape, KwaZulu Natal and Free State); Maputo Development Corridor (a transnational initiative in Swaziland, Mozambique and Mpumalanga); Phalaborwa SDI in the Northern Province; Pietermaritzburg/Msunduzi SDI in KwaZulu Natal; Platinum SDI in North West Province; Richards Bay-Empangeni SDI in KwaZulu Natal; West

Coast Investment Initiative in the northern Western Cape; and, Wild Coast SDI in the Eastern Cape.”(Ibid.)

These SDIs include approximately 800 investment opportunities worth approximately US\$32.4 billion and, an estimated 85000 new jobs are to be generated by the schemes.

Community Public Private Partnerships (CPPPs) programme facilitates investment in rural economies, with the ultimate goal of boosting employment and education of people on how to achieve a sustainable livelihood within rural areas. The key element of these programmes is sustainable resource usage, and the management expertise and finances for upliftment of these areas are provided by joint partnerships.

Export Incentives available in South Africa are as follows:

- The Export Marketing and Investment Assistance (EMIA) Scheme: which provides funding for promotional activities, trade missions as well as research activities. “Exporters are assisted with undertaking the following activities: primary export market research (PMR), FDI research, exhibition assistance, outward selling trade missions, outward investment recruitment missions, inward buying trade missions, inward investment missions and assistance to industry specific sectors. In each programme there are a number of rules and regulations that exporters have to comply with. The criteria for approval of a trip are strict and all receipts/invoices must be produced when claims are made. With regards to research trips, reports must be submitted to the DTI detailing the undertakings/findings.”(Ibid.)

- The Export Credit and Foreign Investment Reinsurance Scheme: provides credit at preferential rates and also provides insurance companies with reinsurance for loans to exporters. The Credit Guarantee Insurance Corporation of Africa Limited (CGIC) provides all the facilities, and offers short-term insurance, medium/long term insurance, export finance for capital goods or projects, foreign investment guarantees and export finance guarantees for SMEs.

“Short-term insurance consists of pre-shipment cover, post-shipment cover and consignment stock cover. It is used with respect to commercial or political risk where credit terms are less than 180 days. Medium/long term insurance consists of: contractor's cover, cover against the unfair calling of bonds, financial credit cover, foreign exchange risk cover and investment guarantees.”(Ibid:8)

- The Export Finance for Capital Goods and Projects Scheme: is aimed at enhancing exporters competitiveness by fixing exchange rates, which enables exporters to offer quotes/tenders in US dollars. “In terms of repayment of capital projects (amortisation period of 10 years), exporters can offer extended repayment at fixed international market related interest rates (expressed in US dollars). When the project is delivered, the IDC or a participating commercial bank will pay the exporter and extend a loan to the foreign buyer (denominated in rands or US dollars). The fixed rates for export credit loans denominated in dollars are 6.25% (up to 7 years) and 6.5% (between 7 and 10 years) (the rates include a foreign exchange premium of 0.5%) and for loans in rands the rate is floating.”(Ibid: 9)

South Africans investing a minimum of R100000 abroad are provided with foreign investment guarantees to protect them against expropriation, confiscation and nationalisation.

Export finance guarantees for SMEs provide these businesses with CGIC guaranteed finance (loans between R50000 and R1m and not greater than 90% of the value of the export order) that is reinsured with the DTI.

- Customs and excise duty refunds, drawbacks and rebates are provided for manufacturers of exports and businesses importing goods for re-export.
- Rail, road and shipping costs concessions include: reduced rail rates for commodities exported on a contractual basis; road transport concessions that are negotiable with the local Road Transportation Board; reduced Ocean Freight Rates that are negotiable directly with shipping companies or with the South African Shipping Board if exporters are of the view that shipping costs are prohibiting them from exporting their products at competitive prices.
- The formation of industry based export councils is encouraged by the DTI, which also provides funding for the formation of these councils. The purpose of the councils is to choose target markets and set export targets for the whole industry. "There are 20 existing export councils: structural steel, steel pipes and tubes, wire, stainless steel, aluminium, jewellery, furniture, footwear and leather, plastics, cosmetics, food and wine, cut flowers, clothing, textiles, electrical and electronics, motor assembly and auto components, water treatment and chemicals, capital equipment, small exporters programme and arts and crafts."(Ibid: 9)

4.3.11. Swaziland

The aim of the incentives offered in Swaziland is to promote investment in manufacturing, mining, tourism, commerce and the service industry. Generous capital allowance is used to attract capital investment.

The country also offers depreciation allowances at "50% on new and used plant and machinery in year one, with the balance written off using a wear and tear allowance of between 10 and 15%; and 50% on industrial buildings and hotels in year one, and at thereafter.

Other incentives offered in Swaziland include:

- Training expenditure is 200% tax deductible;
- Losses can be carried forward to offset against future profits for tax purposes;
- An allowance is granted for employee housing;
- For new companies, corporate tax is 10% for 10 years, and they are exempt from withholding taxes on dividends for the same period." (DPRU, 2001)

Attention is paid to the upgrading of infrastructure in all areas, with the "Matsapha Industrial Site having been earmarked as a priority area. Tibiyo Taka Ngwane operation was formed in 1968 and holds a trust portfolio of various Swazi projects. The scheme operates with the support of major companies and international development bodies."(Ibid.)

"Swaziland also offers export incentives that include a duty drawback facility on raw material inputs; 5 year tax holiday for newly established export manufacturing

Companies; and Central Bank's Export Credit Guarantee Scheme that provides commercial banks with guarantee bonds to cover the risk of pre and post-shipment loans from these banks to investors.”(Ibid.)

4.3.12. Tanzania

Tanzania offers a variety of incentives, including certificate of incentives; mining operations; incentives for FDI; and export incentives.

Companies that qualify for the Certificate of Incentives are provided with corporate tax and depreciation incentives. One of the qualifying conditions is that “the value of the investment must be greater than US\$100 000 for local businesses, or US\$300 000 for foreign businesses. The benefits of the certificate include:

- A maximum corporate tax rate of 30%;
- Withholding taxes of 10% on dividends and 0% on loan interest;
- Capital expenditure on industrial buildings, plant and machinery can be totally written off in year one;
- - Losses can be carried forward indefinitely to offset against future profits;
- Reduced import tariffs;
- VAT can be deferred on project capital; and
- Duty is 5% for investment in priority areas and 0% for investment in lead sectors.” (Ibid.)

“Mining operations are offered straight-line accelerated depreciation of capital goods and yearly appreciation of unrecovered capital investment”; while oil companies are offered “long exploration periods (an initial 4 years, a 4 year extension and then another 3 year extension) and large exploration areas.”(Ibid.)

Tanzania attracts FDI by "making the business climate as foreign investor friendly as possible. All projects are automatically entitled to employ 5 foreigners; 100% of foreign exchange, profits and capital may be transferred abroad; and residence/work permits and trading licences are easy to obtain.

Tanzania also offers export incentives. There is an EPZ in Zanzibar, and companies in the zone are entitled to a 10 year tax holiday; no duty on the imports of raw material and capital equipment; no VAT on manufactured exports; as well as an import duty drawback facility on raw materials."(Ibid.)

4.3.13. Zambia

Zambia's aim is to boost its economy by attracting investment in industry, as well as encouraging smaller private sector initiatives. Capital allowances are used to encourage investment in the mining, manufacturing and tourism industries. For buildings, the allowance is 10% in year one, 5% thereafter. For plant and machinery, a 50% wear and tear allowance is provided in year one and two. Commercial vehicles qualify for a 20% wear and tear allowance, while other income generating capital expenditure qualifies for 25% wear and tear allowance.

Other incentives offered in Zambia include the following:

- Expenditure on R&D and technical education is tax deductible;
- No duty on imported agricultural and mining machinery;
- No duty on certain raw materials - chemicals, iron, steel, rubber and plastics;
- Customs duty: 5% on capital equipment and other raw materials, 15% on intermediate goods and 25% on final products;
- Listed companies pay a lower corporate tax rate of 30% (as opposed to the normal tax rate of 35%);

FDI incentives include free repatriation of profits and there are no exchange controls. Zambia also offers incentives specific to farming. "The include 15% tax on farming income; exemption of dividends received by farmers from tax; exemption of rural enterprises from customs and sales duty on machinery and equipment; implements and machinery used exclusively for farming, qualify for a wear and tear allowance of 50% (straight line depreciation); and a number of farming allowances are available, which reduce a farmer's taxable income in the year in which the expense was incurred. These allowances include:

- Development allowance for capital expenditure on tea, coffee, banana and citrus farming, such that taxable income is reduced by 10% of this expenditure;
- Farm work allowance for capital expenditure on soil erosion prevention work, borehole and well construction, aerial and geographical surveys and water conservation projects. The taxable income is reduced by 100% of this expenditure; and
- Farm improvement allowance for capital expenditure on farm improvements, and the taxable income is reduced by 100% of this expenditure."(Ibid.)

Zambia offers an "incentive programme for non-traditional exporters, producers of agro-products for export, tourism operators (provided foreign exchange earnings are 25% of gross annual earnings), companies involved in import substitution and rural enterprises. These investors are exempt from customs and sales duties on machinery and equipment used to establish, expand or rehabilitate their company."(Ibid.)

4.3.14. Zimbabwe

Zimbabwe offers the following categories of incentives: general incentives, incentives for setting up in Growth Point Areas (GPAs) and EPZ incentives.

“General incentives entail the following:

- Foreign ownership: foreigners may have up to 100%, 35% and 70% share in companies in preferred sectors, reserved sectors and construction/specialised service sectors of the economy respectively.
- Dividend remittance threshold: for companies established before 1979 the threshold has increased from 25% to 50% of net after tax profits. For companies established after 1993 it is 100%.
- Free access to foreign exchange and free repatriation of investment capital, profits and dividends.
- No restrictions on local borrowing.
- Foreign Currency Accounts (FCAs): all export proceeds; investment inflows and capital transfers can be deposited into these accounts.
- Losses can be offset against future profits for 6 years (and indefinitely for mining).” (Ibid.)

These general incentives also incorporate capital allowances. “A special initial capital allowance of 25% (on cost) for industrial buildings, farm improvements, staff housing, tobacco barns, railway lines, equipment and vehicles is offered. Thereafter, the wear-and-tear allowance is between 10 and 33.3% (reducing balance) for equipment, between 20 and 33.3% (reducing balance) for vehicles and 5% (on cost) for the other capital expenditure. Commercial buildings are depreciated at 2.5% per annum, while 100% of the capital expenditure for mining

operations is tax deductible. For farmers, 100% of capital expenditure on boreholes, fencing and water conservation works is tax deductible.

Training investment allowance equivalent to 50% of the cost of buildings and equipment (over and above the capital allowance outlined above) is also provided.”(Ibid.)

Tax exemptions offered in Zimbabwe are as follows:

- “Imported equipment and machinery is exempt from import tax, surtax and customs duty;
- There is no tax on the sale of the following goods: unprocessed agricultural produce; goods intended for resale, raw materials to be processed further and packaging materials; goods to be used in the production of agricultural, industrial or manufactured products; and
- Certain prescribed goods are tax-free.”(Ibid.)

Businesses in the identified growth point areas (GPAs) are allowed an additional capital allowance of 15% for buildings and equipment. They pay reduced corporate tax of 10% for the first 5 years of operation. Agriculturists, hoteliers, industrialists, manufacturers and miners in these areas do not pay sales tax on capital goods (excluding road motor vehicles) and building materials.

Export incentives in Zimbabwe are divided into two: incentives for the EPZs and incentives for exporters outside the EPZs.

“Only new and expansion projects in the manufacturing, processing, assembly and service sectors qualify for EPZs. The companies must export 80% of output; and the project must boost employment and technical skills transfer. There are two types of EPZs: industrial park type EPZs and stand-alone EPZs”. The benefits of

EPZ companies include “a 5-year tax holiday and then 15% corporate tax after the holiday”. The EPZ companies also enjoy “tax exemptions as there are no withholding taxes on dividends, royalties and fees; no duty on imported goods; no fringe benefits tax for employees; and no capital gains tax, surtax and sales tax on goods and services.”(Ibid.)

“Incentives for exporters outside the EPZs include tax deductions, at 8% for existing concerns that export 50% of their output and 10% for new concerns that export 40% of their output. To encourage employment generation, manufacturers receive a double tax deduction on wages and salaries if a certain number of permanent jobs are created by the project.”(Ibid.)

4.4. Investment flows in the SADC region

Foreign investment flows into the region have been increasing over the past few years. However, they have declined as a percentage of total investment flows into the developing countries. South Africa is main centre of attraction for the foreign investment flows into the SADC region. This is a result of the sophisticated infrastructure that South Africa has compared to the rest of the region, as well as the economic performance of the country. South Africa has economic policies as well as financial and physical infrastructure that make this country the main entry point for foreign trade and investment in the region.

“South Africa provides nearly 50.6km of paved roads per 1000km² of land, which is 15 times the African average; and approximately 17km of railway track per1000km² of land, which is 10 times the African average.” (Investment South Africa, 2000:5) There are numerous commercial ports that are utilised globally for

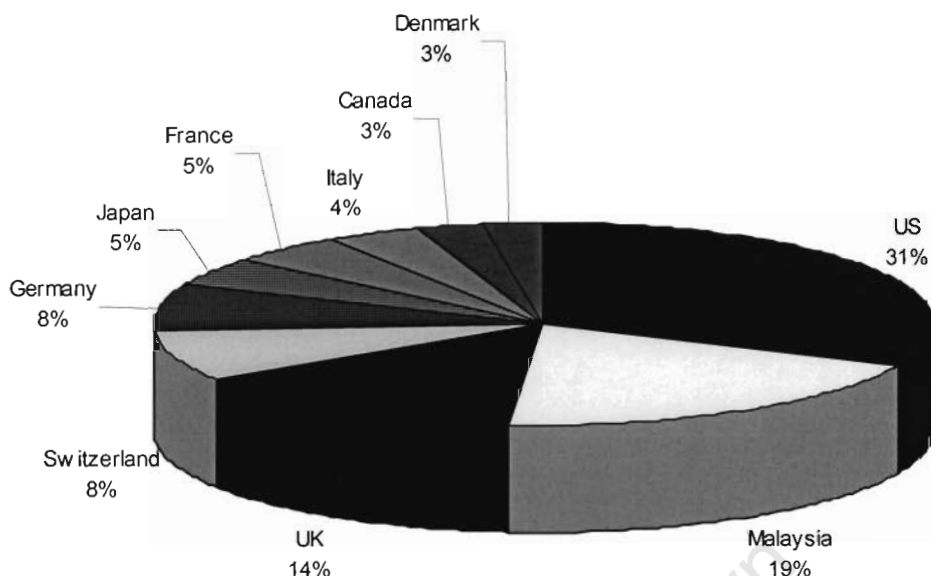
transporting goods to and from the rest of the world, particularly Europe and Asia. South Africa also has an advantage of skills and more sophisticated technology across a number of industry sectors which is recognised internationally; particularly in the fields of energy and fuels, steel production, deep level mining, telecommunications and information industry.(Investment South Africa, 2000:6)

In addition to this, South Africa has a variety of investment incentives schemes and treaties, Spatial Development Initiatives, and Industrial Development Zones; all aimed at promoting investment, sustainable job creation and economic growth.

Despite the fact that South Africa is one SADC member state that dominates investment flows into the region, the level of investment in this country remains low and has been decreasing in the 1990s. In fact, "low investment levels in the South African economy are consistently identified as a principal factor behind the sub-optimal growth rates" in the country.(TIPS, 2000:i)

Meanwhile South Africa's investment capital outflows go into the rest of SADC, major sources of the South African investment inflows originate from outside the region. Figure 4.1 below illustrates the major sources of the FDI inflows into South Africa. It indicates that US, Europe and Asia dominate the investment inflows into the country. The US contributes 31% to these, followed by Malaysia at 19% and then UK at 14%.

Figure 4.1: 10 Major Sources of South African FDI inflows



Source: Investment South Africa, 2000:4

4.4. South Africa's Trading Arrangements with SADC Countries

Apart from the SADC regional trade arrangement, South Africa has entered into trading agreements with some smaller groups of SADC states as well as with individual SADC member states. On bilateral basis, South Africa has trading agreements with Malawi, Mozambique and Zimbabwe.

4.4.1. South African Customs Union

South Africa is a member of South African Customs Union (SACU) together with Botswana, Lesotho, Namibia and Swaziland (the BLNS states). Under the customs union, external tariffs received on imports from third countries are the same for all member states and the customs revenue of all members is combined in one revenue pool, and then shared among the members using a specific formula. The revenue sharing formula is used "to level the playing fields" since some members are less advanced than others. South Africa dominates trade in SACU as it

accounts for more than two-thirds of the SACU trade. In SACU, just like in SADC, South African exports exceed its imports from other SACU members by far.

4.4.2. Malawi / South Africa Bilateral Trading Arrangement

The Malawi/South Africa bilateral trade agreement was concluded on 19 June 1990, on non-reciprocal basis.(Kabemba, 1996:19) It provides for duty-free and quota-free access into South Africa for all goods that are grown, produced or manufactured in Malawi except for agricultural products that need a permit. Agricultural products that are subject to import controls are sugar, tea, and coffee.(ibid) This agreement further authorises goods of South African origin to be imported into Malawi at Most Favoured Nation duty.

The rules of origin under the terms of this agreement are as follows:- goods are regarded as originating from South Africa if the last process of manufacture has been performed in South Africa, and such goods contain not less than the "specified local content", or have been subjected to a "specified process of manufacture in South Africa".(ibid) Goods will be deemed as originating from Malawi if at least 25%, or any less agreed upon percentage by the parties involved, of the production costs is represented by materials produced and labour performed in Malawi and the last process in the production or manufacture of such goods shall have taken place in Malawi.

The agreement also allows the trading parties to impose countervailing duties where there are subsidies provided for the imported goods, and to take anti-dumping measures when necessary. This has been the most successful of South Africa's bilateral trade agreements.(ibid) In fact, several South African

CapeTown Assistant

From: Tasneem George [Tasneem.George@travel.rennies.co.za]
Sent: Monday, May 23, 2005 4:14 PM
To: CapeTown Assistant
Subject: RE: Travel Request - Izak Swanepoel

Hi Claire,

Options as follows:

SAA**SWANEPOEL/IZAK WILHELM MR**

SA 362 Y 31MAY CPTJNB HK1 1740 1940

SA 367 Y 01JUN JNBCPT HK1 1900 2110

FARE: R3 670.00 incl taxes + R171.00 service fee

BA

BA 6422 Y 31MAY CPTJNB HK1 1700 1900

BA 6407 Y 01JUN JNBCPT HK1 1845 2055

FARE: R3 923.00 incl taxes + R57.00 service fee

NATIONWIDE

CE 729 Y 31MAY CPTJNB HK1 1645 1845

CE 740 Y 01JUN JNBCPT HK1 1820 2030

FARE: R3 139.00 incl taxes + R57.00 service fee

Avis group B

Regards,

Tasneem

From: CapeTown Assistant [mailto:CapeTownAssistant@acml.com]
Sent: Monday, May 23, 2005 12:24
To: Tasneem George
Subject: FW: Travel Request - Izak Swanepoel

5/23/2005

Kind regards,

Claire Soden

Alliance Capital Management (Pty) Ltd

Tel: +27 21 409 7680

Fax: +27 21 409 7687

-----Original Message-----

From: CapeTown Assistant

Sent: Monday, May 23, 2005 11:09 AM

To: 'Tasneem George'

Subject: Travel Request - Izak Swanepoel

Hello Tasneem, please see the attached travel request.

Kind regards,

Claire Soden

Alliance Capital Management (Pty) Ltd

Tel: +27 21 409 7680

Fax: +27 21 409 7687

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of this message, the purpose of which is to inform and update our clients, prospects and consultants of developments relating to our services and products, would not like to receive further e-mail correspondence from the sender, please "reply" to the sender indicating your wishes. In the U.S.: 1345 Avenue of the Americas, New York, NY 10105.

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University of Cape Town

5/23/2005

manufacturing companies relocated some of their production operations to Malawi in the 1990s, in order to maximise their benefits from this trading arrangement.

4.4.3. South Africa / Mozambique Bilateral Trading Arrangement

The South Africa/Mozambique bilateral trade agreement is an arrangement for non-reciprocal tariff concessions granted by South Africa to a short list of specified goods produced or manufactured in Mozambique, so that they will enter South Africa in a form of full rebate of import surcharge or customs duty. The list of goods is open-ended and most favoured nation duties will be charged on Mozambican goods that enter South Africa. Duties that are less than 3% will be removed, but this is subject to quotas.(Kabemba, 1996:27)

Goods that are not on the list and those which exceed the quotas are excluded from concessions. The rules of origin apply only if less than 35% of production cost of the goods is represented by materials produced and labour performed in Mozambique.(ibid)

Under the terms of the agreement, goods imported from Mozambique are for consumption in South Africa. The preferential concessions only apply for consumption of Mozambican goods in Botswana and exclude all the other SACU members (i.e. Lesotho, Namibia and Swaziland). When Mozambican goods are re-exported from South Africa to Lesotho, Namibia and Swaziland, import surcharge and the difference in duty should be paid to South African customs authorities.(See Kabemba, 1996) Hence, this agreement promotes discrimination, and therefore violating the non-discrimination principle of the WTO.

4.4.4. South Africa / Zimbabwe Bilateral Trade Arrangement

The South Africa/Zimbabwe bilateral arrangement is the oldest of all South African bilateral agreements, dating back to 01 April 1949. The agreement is currently standing as it was after revision in 1964. It provides for preferential duties, rebates and quotas on certain goods traded between South Africa and Zimbabwe. Under the agreement, Most Favoured Nation rates are charged on Zimbabwean goods on entering South Africa, and a specified rate charged on South African goods on entering Zimbabwe.

In case of clothing manufactured in Zimbabwe, unless the local content is not less than 20% and all the operations such as cutting and sewing required to manufacture such clothing from piece goods have been performed in Zimbabwe, the goods will not qualify for concessions. If the local content exceeds 75% or they have been produced from natural, synthetic or artificial fibres, such goods will enter South Africa duty free. If local content is less than 75% but not less than 50%, one quota of the MFN duty will be paid; and if local content is less than 50%, a duty equal to one half of the MFN rate will be charged.(Kabemba, 1996:45-46)

All the agreements with South Africa, which grant tariff preferences only to certain SADC member states, are in conflict with the ultimate goals and objectives of the SADC Trade Protocol. According to the provisions of the SADC trade Protocol, all the concessions on duties offered in these agreements will be dissolved on implementation of the SADC Trade Protocol. Hence, this will have an impact on the trade and investment flows in the region.

4.5. Intra- Regional Trade in SADC

Despite the fact that intra-regional trade in the Southern Africa has been continually growing in the 1990s, it still remains low. There is bias towards bilateral trade rather than regional trade in SADC. "Between 1970 and 1993, SADC intra-regional trade remained around 5%..."(Visser, 2000:7) Data compiled by the SADC Industry and Trade Coordination Division indicates that total intra-SADC trade grew from US\$ 4.16 billion in 1995 to about US\$9.9 billion for 1996.(SADC, 2000) "Intra-SADC trade is estimated between 5% and 10% of total trade in the region. In 1995 South Africa accounted for almost three-quarters of intra-regional exports, but only 19% of intra-regional imports."(Muradzikwa, 1999:24).

Regional trade as a percentage of the global trade also strengthened as it grew to about 17.9% by June 1996, and this shows a substantial growth in intra-regional trade.(SADC,2000) Trade in the SADC region is dominated by South Africa, which "supplies between 75 and 90 percent of the imports of all SACU states, 40% of Malawi's imports and between 15 and 20% of all imports of Mozambique, Zambia and Zimbabwe."(Muradzikwa, 1999:24) South Africa also generates half the electricity on the entire African continent, while its road network is estimated to be 40% of SADC's road network.(ibid.) South African Ports handle between 80 and 89 percent of the region's total port tonnage.(ibid)

Table 4.1 below shows the total trade of the individual Member States in 1998, and South Africa is very dominant with total exports worth US\$28.1 billion. It further shows that South African trade is in surplus to the rest of the region. South Africa's trade surplus to the region has been growing and in 1998, it was estimated to have grown to R13.3billion compared to R12.8billion in 1997.(Business Day, 10 May 1999)

Table 4.1: SADC Trade Statistics (1998)

COUNTRY	Exports (in US\$ billions)	Imports (in US\$billions)
Angola	3.510	2.014
Botswana	2.061 ^a	1.983 ^a
DRC	1.3 ^a	0.88 ^a
Lesotho	0.193	0.866
Malawi	0.455	0.537
Mauritius	1.775 ^a	2.184 ^b
Mozambique	0.248	0.868
Namibia	1.278	1.450
Seychelles	0.172 [*]	0.339 [*]
South Africa	28.1	26.9
Swaziland	0.925 ^a	1.004 ^a
Tanzania	0.952 ^a	1.0462 ^b
Zambia	0.903	1.020
Zimbabwe	2.047 ^a	1.968 ^a
* 1997 estimates a fob values b cif values SOURCE: www.sadcreview.com		

The fact that South African exports are as high as 10 times the imports from Zimbabwe and at a rate of 7 to 1 to the region further emphasizes the uneven balance in SADC trade in favour of South Africa.(Muradzikwa, 1999:25) South Africa tends to import most products from the developed countries such as USA, Japan, Germany and UK. A large proportion of South Africa's exports to the region are manufactured products, while its primary commodity exports are channelled mainly to Europe and North America.(Muradzikwa, 1999) For instance, "the most important markets for South African textile exports are Europe and Asia, which account for about 63% of all textile exports."(Salinger, et. al, 2000:48) "[However], other data indicate that a high share of textile exports enter developing country regions of Africa and Asia; while a very low share (about 24%) of clothing exports go to the developing country regions."(ibid.)

According to Salinger et.al. (2000), five countries account for more than half of both clothing and textile exports from South Africa into the African continent.(p.48) Meanwhile the main destination for South African clothing exports in Africa is Mozambique (20.13%), followed by Zambia (16.65%); in textiles, it is Zimbabwe (39.09%) followed by Zambia (10.57%).(ibid.) Regional integration is expected to enhance the momentum of growth in the export flows within the Southern Africa region.

Almost all SADC countries expanded their exports, but the top performers were South Africa, Zimbabwe, Botswana, Swaziland, Namibia and Zambia. The 1996 data shows a substantial increase in the share of the total intra-SADC trade to the member countries' total world trade. However, availability of accurate and up-to-date trade data is still a problem.(See SADC, 2000) Most of the trade figures for the SACU countries are reported for the whole customs union instead of individual countries. Furthermore, South Africa dominates SACU trade and trends in South African trade are very similar to those of SACU trade.

Table 4.2 shows the relative importance of SACU in the regional exports of different SADC states in 1996. The last column shows that the share of regional exports that is destined for the SACU market in almost all the non-SACU SADC states ranges between 55 and 99 percent. The only exception is Mauritius, where only 36 % of its regional exports go to the SACU markets. It further indicates that SACU accounted for 79 percent of total intra-regional exports in 1996.

Table 4.2: Relative importance of SACU in the Regional Exports of Different SADC countries in 1996

SADC Country	All exports to the world (\$million)	All exports to the region (\$million)	Share of total exports to World exports	Share of total intra-regional exports	SACU's share of regional exports
Angola	4918755	786	0.15	0.00	0.99
DRC	1614675	113247	0.05	0.03	0.99
Mozambique	225568	60276	0.01	0.02	0.72
Mauritius	1730147	33640	0.05	0.01	0.36
Malawi	479669	16011	0.01	0.00	0.66
SACU	19014052	3088221	0.59	0.79	-
Seychelles	138547	1404	0.00	0.00	0.71
Tanzania	797456	7689	0.02	0.00	0.67
Zambia	1162615	37471	0.04	0.01	0.60
Zimbabwe	2144026	574711	0.07	0.15	0.55
SADC	32225510	3933456			

SOURCE: Visser, 2000:18

On contrary, Zimbabwe has highest interaction with the region, with high intra-regional trade figures as a percentage of total trade. "Zimbabwe is a significant exporter to and importer from the region", also being South Africa's major source of imports apart from the European countries. (Muradzikwa, 1999: 25)

Table 4.3 lists the regional imports of the different SADC member states in 1996. It shows that only 2.4% of SACU imports originate from the region. On the other hand, between 76 and 97 percent of the total imports of each of the other SADC member states originate from SACU. SACU as a whole accounts for only 15.5 percent of total intra-regional imports (compared to 79 percent of total intra-regional exports); while Zimbabwe, Zambia and Mozambique account for 33%, 13.6% and 13.2% respectively.

Table 4.3: Relative importance of SACU in the Regional Imports of Different SADC countries in 1996

SADC Country	All imports from the world (\$million)	All imports from the region (\$million)	Share of total imports with respect to World imports	Share of total intra-regional imports	SACU's share of each SADC country's regional imports
Angola	1945061	120942	0.062	0.032	0.937
DRC	1010883	150018	0.148	0.040	0.956
Malawi	465129	291168	0.626	0.077	0.768
Mauritius	2180367	206462	0.095	0.055	0.972
Mozambique	915917	498997	0.545	0.132	0.829
SACU	25012372	583307	0.023	0.155	-
Seychelles	347815	47292	0.136	0.013	0.845
Tanzania	1268829	113527	0.089	0.030	0.878
Zambia	938520	513760	0.547	0.136	0.818
Zimbabwe	2530572	1247884	0.493	0.331	0.950
SADC	36615465	3773357			

SOURCE: Visser, 2000:18

Despite the huge disparity in economic performance of the SADC member states, "South Africa's manufacturing success and industrial development is linked to the region's growth and development, and the region's economic development cannot be achieved unless the member states assume a common trade and industrial policy stance."(ibid.) Hence, the South African government has committed itself to enhancing the development of the region. More capital is invested in the neighbouring states; while there are also spatial development initiatives undertaken by South Africa in collaboration with the neighbouring states. One example of such initiatives is the Maputo Development Corridor, which is an initiative of South Africa and Mozambique to improve the industrial development and infrastructure, as well as to enhance capital flows between these countries.

Once in operation, the process of building the free trade area is expected to induce and promote even more trade and investment in the region. This should give every Member State a renewed inspiration and determination to live up to the

spirit and principles for which SADC was created. However, there are concerns that some members will benefit more than others from the Free Trade Area. Hence, special provisions have been made to accommodate the least developed countries in the region, Malawi; Mozambique; Tanzania and Zambia. According to the DTI spokesperson, the member states agreed that these four countries will be allowed a five-year transition period before they start liberalising their trade, as per the trade protocol.(Interview, September 2000)

4.6. Investment in SADC linked to Trade Flows

Trade policy, and particularly the regional trade arrangements that confer preferential access to markets, is essential for investment flows. It is evident that as result of the South African bilateral arrangements with the neighbouring states, there have been large amounts of capital flows from South Africa into the neighbouring states.

Another important milestone for South Africa and the rest of Africa has been the Africa Growth and Opportunity Act (AGOA), which was signed by US President Bill Clinton in May 2000. AGOA provides preferential access for African products, including clothing and textiles that have been excluded from the General system of preferences (GSP), into the US markets.(Salinger et.al, 2000:22; Federal Register, October 2000) This has potential of attracting foreign investment from the rest of the world into South Africa and other sub-Saharan African economies. Foreign companies will bring their clothing and textile production operations to the African continent, with the aim of exploiting the access to the US markets as provided for in AGOA.

The formation of the SADC and eventually the free trade area will encourage more cross border initiatives to develop infrastructure as well as improve the economic environment within the region as a whole. This will play a major role in attracting more foreign investment into the SADC region. Furthermore, the improved economic infrastructure will enhance intra-regional trade and investment flows across the borders of the member states.

4.7. The Impact of the SADC Trade Protocol on trade and investment

The comments of the SADC officials and literature on the Trade Protocol show optimism about the impact of the Protocol on the SADC region. Producers in the individual states will gain access to a bigger market with the population of about 199million people and GDP of about US\$176 billion.

Implementation of the Protocol will open up the economies of the individual member states, through gradual removal of all tariffs and non-tariff trade barriers, and therefore promoting trade among neighbours. Thus, it will help to boost intra-regional trade, which is already strengthening, and attract foreign direct investment into the region. Smaller SADC countries, which are currently unable to attract sufficient foreign investment to sustain growth will also benefit since investors may use them as their locations to secure access into the bigger economies within the region. The Protocol will also boost cross border investments in the region.

However, it also has a potential of promoting polarisation within the region such that bigger economies in the region with good infrastructure, such as South Africa, will attract more investment than the least developed member states. Spatial

Development Initiatives such as the cross-border corridors across a number of SADC states attempt to limit such polarisation in the region.

The protocol requires the member states to use inputs from within the region when producing goods that will be exported, in order for those exports to be deemed originating from the region. The costs of such inputs within the region are still expensive compared to those produced in third countries where there is better technology and efficiency. This is why prices of goods produced in the region remain high, and this has a potential to alienate the SADC states from the rest of the world while trying to remain loyal to the region.

Although free movement of people within the region and easy access to cheaper imported inputs to production in the region may reduce employment levels, SADC officials are optimistic that growth in exports and investment in the region will counter this by creating new jobs.

Many investments that already exist have been encouraged by the preferential tariff treatment provided under the bilateral trading arrangements prevailing in their current locations, and these have a potential of being negated by the provisions of the trade protocol. This would mean capital flight from smaller member states that used bilateral trading arrangements to attract investment and achieve industrial development in their economies.

4.8 Conclusion:

This chapter has provided an overview of trade and investment flows in the SADC region. It has highlighted factors that influence investment decisions and these range from micro to macro-economic factors. Although trade and investment in SADC has been growing over time, the investment growth is still not enough to

promote enough economic growth to eradicate poverty in the region. This chapter also confirms that South Africa dominates the region's trade and investment inflows.

Since the domestic investment contributes more than the FDI to GDP of the developing countries, the SADC countries need to focus more on promoting domestic investment, and promote only the FDI that contributes to their development. Furthermore, trade policies tend to influence the investment flows. The bilateral trade arrangements among the SADC countries led to increases in the capital flows within the region. In fact, AGOA and the SADC Trade Protocol among other trading arrangements have a great potential of attracting even more foreign investments into the SADC region.

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CHAPTER FIVE: CASE STUDY: PEPKOR

5.1 Background on Pepkor

PEPKOR is a South African based investment holding company that was started in Uppington as Pep Stores in 1965. The name of holding company, Pep Stores, was changed to Pepkor Limited in 1982. Its operations are mainly focused on cash value retail market, mainly for food and clothing. However, Pepkor also has some manufacturing operations. These include *Pep clothing*, which is the main focus of this case study. The Pepkor Group consists of seven subsidiaries: Pep Limited, Ackermans, Best and Less, Shoprite, Brown and Jackson, Stuttafords, and Cashbuild. Most of these are based in South Africa except two, Brown & Jackson and Best & Less, which are based overseas.

5.1.1. Subsidiaries of Pepkor

Pep limited is the core clothing business of the Pepkor group. It operates about 873 Pep stores outlets throughout South Africa and it targets the lower end of the market. Pep limited is mainly a retailing company, although it has some manufacturing operations as well. ***Pep clothing*** is a subsidiary of PEPKOR that manufactures clothing products, which are traded at the Pep stores retail outlets. According to the Pep clothing spokesperson, it was established because of the realisation of the need for manufacturing over time.

Ackermans retails clothing and household textiles in South Africa mainly to the middle to lower end income consumers. *Best and Less*, based in Australia, also retails clothing and household textiles at highly competitive prices and targets the lower end of the middle market. *Brown and Jackson*, which targets consumers with low disposable income, is based in United Kingdom (UK). It is a group of three companies focused on clothing, footwear, toiletries, and houseware.

Stuttafords, on the other hand, specialises in fashion and beauty products in South Africa. It sells exclusive local and imported brands, as well as selected housewares, targeted at the top end of the market.

Shoprite Checkers group, which incorporates OK Bazaars since November 1997, is one of the largest retailers in Southern Africa. It retails a large variety of products, including clothing; food; furniture and houseware in its outlets in South Africa and Africa. It also targets the low-income group of population as its market

Cashbuild, in its retail outlets, sells building materials to large and small home-builders and renovators as well to the general public.

5.1.2. Pep Clothing

Pep Clothing focuses on clothing manufacturing. Its manufacturing operations are located in Parow Industria in the Western Cape. Pep Clothing has three factories, although these are all located in one building. They produce ladies' and children's underwear and outerwear, boys' underwear, men's underwear, and school clothing (i.e. shirts, shorts and girls schools dresses) In the three factories, they employ about 1700 people.

Although Pep clothing manufactures products that are traded at Pep stores, it does not produce all the products that are sold at the Pep stores retail outlets. Some of the products sold at Pep stores are imported from the Far East. These include underwear, dresses, men's outerwear, and school wear, as well as all the other products that are sold at Pep Stores but not produced at Pep clothing.

Pep stores also import products that are produced at Pep clothing not because it is cheaper to import than to produce them, but because Pep clothing manufactures these products only in limited quantities.

5.2 Relocation of PEP CLOTHING to Malawi

5.2.1. Background

In the early and mid 1990s, the economic conditions were changing rapidly in South Africa as well as globally. During this time, the economic conditions in South Africa and globally were not very favourable for the clothing and textile industry as a result of the trend towards global economic liberalisation and regional integration. In the early 1970s, due to the industry's sensitive nature, clothing and textiles have been protected globally by means of the Multi-fibre Arrangement (MFA), which was signed in 1974 by all GATT member states.

Until the end of the Uruguay round of GATT negotiations in 1994, clothing and textile quotas were governed by the rules of the MFA. Within this agreement, developed countries were allowed to apply selective quantitative restrictions such as clothing and textile quotas, which were negotiated bilaterally among trading partners, whenever the growing textile and clothing imports of the trading partner became threatening to the local industry of the importing country. (See Cline, 1990 and www.wto.org)

In the early 1990s most economies were moving towards trade liberalisation, following the resolutions of the GATT negotiations, since all the members of GATT (now WTO) were required to eliminate barriers to trade within a specified period of time; while the MFA was phased out and subsequently replaced by the WTO Agreement on Textiles and Clothing (ATC) on 1 January 1995. The ATC sets out a transitional process for the ultimate removal of bilateral import quotas in four broad product groups namely tops and yarns, fabrics, made-up textiles, and clothing within a period of 10 years. Hence, under this agreement, the WTO members have committed themselves to fully integrate clothing and textiles sector

into GATT rules by 1 January 2005. This obligation applies to countries or counter groupings that maintained restrictions under the MFA (viz. Canada, European Community, Norway and the US); as well as fifty-five other countries, which adopted transitional safeguard mechanisms.(Salinger et.al, 2000:21)

When ATC became effective in 1995, countries integrated product categories equivalent to about 16% of their 1990 import volumes and a further 17% in January 1998; while a further 18% is scheduled for the third phase in January 2002.(ibid.)

The fast growing East and South-east Asian economies implemented liberalised trade facilitation policies in combination with human resources investment, and this has resulted in their current "dramatic growth rates."(Salinger, Borat, Flaherty and Keswell, 2000: 16) These countries include South Korea, with an annual per capita income of 8.2% over the period 1980 – 1993; 6.4% for Thailand; 4.2% for Indonesia; and 3.5% for Malaysia. (ibid.) Other developing countries, which were not growing as fast as East and Southeast Asian countries as a result of fierce competition in the international markets, were assisted to achieve similar economic growth results by means of Structural Adjustment programmes (SAPs) that were introduced in the 1980s.

According to the GATT bindings, South Africa is expected to eliminate its barriers to trade within a timeframe of 12 years. However, government decided to eliminate barriers within a shorter period of 7 years compared to the required 12 years, to show country's political will to fulfil the GATT requirements. This induced ongoing negotiations among the different stakeholders of the South African economy – government, business, and labour sectors.

The high level of protection for the textiles, expensiveness of the local textiles and high wages in South Africa relative to its neighbouring states all had a negative impact on competitiveness of the local clothing industry in the local as well as international markets. They also had a negative impact on the South African labour markets. In the mid-1990s, there was labour unrest as the trade unions were bargaining for higher wages for their members. Labour was fairly expensive in South Africa, and this contributed to high production costs for textile and clothing manufacturers.

Many South African manufacturing companies relocated their production operations to lower wage neighbouring states in the mid-1990s, but "only a limited range of clothing items and household textiles underwent foreign processing."(Horton,1998:15) According to Horton (1998), a total of R2.9 billion had been approved by the South African Reserve Bank for investments into SADC during the period from March 1995 until End May 1998.(p.15) However, the decision taken by these South African manufacturing companies to relocate was challenged by trade unions, especially SACTWU, who were concerned about thousands of jobs that were lost as a result of this. Companies, on the other hand (in defence of their investment decisions) argued that wages were too high in South Africa, which allegedly made local clothing uncompetitive against the cheap imports from the Far East.(Cape Argus, 28 October 1995) However, the strong bargaining power of trade unions and labour regulation in South Africa may have also contributed to the relocation of local companies to neighbouring countries.

Another contributing factor, as mentioned by Gumede (2000) among other factors that influence investment decisions of individual companies, is the cost and

procedures of hiring and firing employees. This factor tends to affect smaller companies more than large companies.

The relocating companies further argued that labour and textile inputs were cheaper in the neighbouring African countries and thus, their movement would result in a significant reduction of their production costs. Furthermore, they argued that they were losing their share of the lower end of the South African market to companies based in the Far East, many of which were dumping cheap clothing and textile products in South Africa via those neighbouring countries which have preferential trade arrangements with South Africa.(Business Day, 1 February 1996) Some of these companies claimed that their factories outside the country would manufacture only the products that were no longer viable to produce in South Africa.

South Africa also had a problem of porous borders, with illegal imports flooding the South African market and further threatening domestic clothing and textile products. In fact, the domestic markets of the whole SADC region experienced similar problems, as the member states lack the necessary technical expertise to stop illegal imports from entering the region. However, the expectation is that illegal imports will not be a major concern to the SADC states once the trade protocol is implemented and the region becomes one large market.

5.2.2. Movement of Pep Clothing to Malawi?

In 1995 Pepkor moved some of its manufacturing operations out of South Africa. These included Ackermans and Pep clothing manufacturing operations. However, this study focuses mainly on the movement of Pep clothing to Malawi. Only a small part of Pep Clothing manufacturing operations was moved to Malawi, and

more than 80% of its manufacturing operations remained in their three factories in South Africa.

Several factors have influenced the company's decision to relocate some of PEP CLOTHING production operations from South Africa and invest in Malawi. These include labour market conditions in South Africa and in Malawi, access to production inputs, relative production costs, economic policy regime on investment and trade, access to the South African market, export promotion, and preferential trading arrangements.

According to spokesperson of Pep Clothing, factors that influenced their investment decision, in order of importance, are the following:

- the bilateral trade agreement between South Africa and Malawi;
- the export processing zone (EPZ) status within Malawi, which the company would enjoy;
- labour market conditions and regulation and relative costs of production, particularly the labour costs;
- economic policies on investment and trade; access to textile inputs;
- trade liberalisation and the degree of trade union intervention.(Interview, September 2000)

a) South Africa – Malawi Bilateral Trade Agreement

South Africa and Malawi signed an agreement in 1990, on an asymmetric basis, which provides duty-free access into South Africa for all products that are manufactured or produced in Malawi, except the few agricultural products that were restricted by quotas. The local content requirement for Malawian products to qualify for duty free access to South African market is 25% only. The agreement further provides for South African goods most favoured nation status in Malawi.

Pep clothing realised that South Africa was an uncompetitive location for producing low-end products. Then, they decided to move their manufacturing operations of such products to a location with lower production costs, Malawi, and re-export those to South Africa. In that way they would make lots of profits.

b) EPZ status within Malawi and easy access to cheap imported textiles

Another main reason for the company's decision to relocate their manufacturing operations, according to the spokesperson of Pep Clothing, was to assist the Malawian government to establish Export Processing zones (EPZs). The EPZ-status they were given in Malawi came with benefits for the company. According to Pep Clothing spokesperson these benefits include not paying taxes in Malawi for a period of 10 years, and Pep Clothing did not have to pay any duties for the inputs they brought into Malawi, as long as they processed and exported them. (Interview, September 2000)

While the government imposed high import duties on foreign textiles that entered South Africa, cheap textiles from China, India and other countries in the Far East were very easily accessible in Malawi. Hence, the input costs were lower in Malawi. This further encouraged the decision of Pep clothing to invest in Malawi, together with the EPZ status that the company managed to secure.

c) Labour market conditions and relative production costs

South African labour market was experiencing a lot of disturbances, with thousands of jobs lost and frequent strikes, as the local clothing and textiles became uncompetitive against the cheap foreign products and many factories had closed down in the early 1990s. The labour was expensive (as mentioned above), therefore increasing relative production costs and making Pep Clothing products uncompetitive, especially in the lower end of the market.

Malawi, on the other hand, had cheap labour and other inputs such as foreign textiles. "Low wage rates and stable social and political environment" are among the attractive investment incentives in Malawi.(Du Mhango, 2000:11) Hence, relative production costs were much lower in Malawi compared to South Africa. Pep clothing spokesperson also mentioned that the wide skill base in Malawi (compared to South Africa) was an added advantage for the company.

d) Economic policies towards trade and investment

South African economic policies were still very protective, especially in the clothing and textile industry. The local industry enjoyed the highest levels of tariff protection in South Africa during the time when Pep clothing moved. The government imposed import duties to protect the "uncompetitive textile industry" against foreign products since it was one of the biggest employers in South Africa. Government's decision to liberalise trade within a shorter period of 7 years, without providing any supply side measures for the local companies to counter the pressure of competition from foreign goods also influenced Pep clothing's decision to relocate.

Malawi, on the other hand, had one of the most liberalised economic policies in the region, (see Kabemba,1996). The structural adjustment reforms programme that was initiated in the 1980s assisted to liberalise the Malawi economy as well as to successfully eliminate monopoly power of some industrial and manufacturing companies.(Du Mhango, 2000:10) Most of the protectionist policies have been removed and more liberalised foreign trade and investment policies adopted in Malawi, especially in the 1990s.

Malawi also has special investment incentives for foreign companies that invest in that country. For example, they promoted exports through the formation of export

processing zones. Some of these investment incentives include: "additional 15% allowance for investments in designated areas; allowance up to 20% for used buildings and machinery; allowance for manufacturing companies to deduct for all operating expenses up to 24 months prior to the start of operations; a 50% allowance for certain training costs of Malawian personnel; zero duty on raw materials needed in manufacturing; indefinite loss carry forward enabling companies to take advantage of tax allowance; duty free importation of heavy commercial vehicles with payloads of at least 10 tonnes; agreement for the reduction of withholding taxes on remittances and payments to foreign investors; low wage rates and stable social and political environment; a 5 years holiday or 15% corporate tax rate for new investments of between US\$5-10million, and up to 10 years tax holiday for new investments in excess to US\$10million; and general investment licences had been abolished. These incentives, inter alia, have resulted in a steady growth in real fixed capital investments and capital formation in this sector."(ibid: 11-12)

On contrary, the South African government had decided to remove direct cash subsidies and other export incentives. For example, there was a strong possibility that the Duty Credit Certificates Scheme, which helped to boost the export performance of some local companies, was going to be phased out and the General Export Incentives Scheme payments were to be abolished in 1997. However, this was not a major factor in the company's decision to move to Malawi.

e) Trade liberalisation

The government's decision to eliminate tariffs and other barriers to trade within a shorter period than that required by GATT also contributed to the Pep clothing's

decision to relocate. The elimination of tariffs and other trade barriers made the local textile industry uncompetitive against the cheap imports in the local market and abroad, and this led to clothing companies relocating to more cost-competitive countries to reduce their costs, and to maintain international level of competitiveness.

f) Intervention by trade unions

The strong intervention by trade unions in South Africa, especially in the clothing and textile industry, also contributed to movement of Pep Clothing out of South Africa through its bargaining for higher wages. This, in turn, put an upward pressure on labour costs and therefore pushing up the total production costs. In Malawi, there was no trade union intervention in the labour markets. As a result, wages and salaries in Malawi were much lower than in South Africa.

5.2.3. Why relocate to Malawi and not elsewhere?

Pep clothing had a wide choice of locations in which they could invest when deciding to move out of South Africa. Their options include countries in the Far East, e.g. China and India, which are among the most efficient countries in terms of advanced technology and low production costs. However, Pep clothing did not move to any of those countries.

This is justified by an African initiative that was adopted by the South African government to invest in and trade with other SADC countries as well as South Africa's commitment to development of the Southern African region as a whole. This initiative was partly stimulated by the strong belief that South Africa cannot sustain its growth and development in the midst of impoverished and economically stagnant neighbours. Hence, South Africa needs to invest in and trade with her neighbours to stimulate economic growth for the benefit of the region as a whole.

Furthermore, the long-term costs of moving their operations to Africa were significantly less than the costs the company would pay if they were to move to the Far East because of its proximity.

Although the company considered the country's responsibility in the region when they took their decision to invest within the Southern African region, Pep clothing had a wide choice of investment locations within the SADC region. Since they were mostly influenced by whether or not the country of location would offer them preferential treatment, they could have chosen to invest either in Mozambique or Zimbabwe, which also have bilateral trading arrangements with South Africa. However, Pep clothing wanted to maximise the returns to their investment, and were of the view that investing in Malawi would benefit them more than any investment in other neighbouring states.

Pep clothing intended to exploit the loopholes in the Malawi's trade and investment policies and the Malawi/South Africa bilateral arrangement, which opened an opportunity for the company to manufacture goods in its Malawi plant at lower costs and export them back to the South African market duty-free. That way they would make better profits. Thus, the nature of the trade agreement between South Africa and Malawi was the main reason why Pep clothing decided to invest in Malawi instead of all the other locations.

The bilateral agreements that South Africa signed with Mozambique and Zimbabwe are not as profitable for Pep clothing as the Malawian trade arrangement because they do not provide for duty free access of goods into South Africa. For instance, goods produced, grown or manufactured in Zimbabwe had to pay 3% import duty when they enter the South African market; while the

agreement with Mozambique was such a most-favoured nation duties would be paid for the goods of Mozambican origin to enter the South African market and any duty that is less than 3% is lifted subject to quotas, (see Kabemba, 1996).

Under the terms of the Malawi/South Africa agreement the rules of origin are simple and less stringent compared to the other two bilateral agreements. These require that at least 25% of production cost of goods should be represented by materials produced and labour performed in Malawi; and the last process in production or manufacture of such goods should have taken place in Malawi in order to confer originating status.

The rules of origin under the agreement with Zimbabwe, on the other hand, are much more complex and much stricter for the manufactured goods, especially for clothing and textiles. Unless the last process in manufacture of goods has taken place in Zimbabwe and the Zimbabwean content is not less than 25%, the manufactured goods shall not be deemed to fall within this bilateral agreement. (Kabemba, 1996; 45-46) In case of clothing manufactured in Zimbabwe, the goods that have been manufactured in Zimbabwe from natural, synthetic or artificial fibres (regardless of the whether or not those fibres were produced in Zimbabwe) or contain local content of not less than 75% shall enter South Africa duty free. Or, if they contain less than 75% but more than 50% local content, they will be charged a rate of duty equal to one quota of the most favoured nation rate. Or, if the local content is less than 50%, a duty equal to one half of a quota of the most favoured nation rate will be charged. (Kabemba, 1996:45)

Under the bilateral agreement with Mozambique, rules of origin apply only if less than 35% of the production cost of goods is represented by materials produced

and labour performed in Mozambique.(ibid:27) In addition to this, goods imported from Mozambique are for consumption only in South Africa. This preferential agreement applies only to goods of Mozambican origin for consumption in Botswana, and any exports of Mozambican goods from South Africa to all the other SACU members (Lesotho, Namibia and Swaziland) are subject to import surcharge.(ibid) This condition would therefore limit the access of Pep clothing's production into SACU market.

Furthermore, non-tariff measures are used in Malawi to control the concessions and the agreement is quota-free. Zimbabwe bilateral agreement, on the other hand, provides for preferential duties, rebates and quotas to control trade between Zimbabwe and South Africa; and Mozambique bilateral provides for MFN duties that are subject to quotas on goods produced in Mozambique entering South Africa, (see Kabemba, 1996).

Therefore, considering all of these, the benefits of relocating would only be maximised by locating their manufacturing operations in Malawi, where they would be able to import textiles duty free from Far East, manufacture products relatively cheaply and export those finished products back to South Africa duty-free and quota-free.

As mentioned above, Pep clothing managed to secure EPZ status in Malawi, which implied tax exemption for 10 years and bringing in inputs to Malawi duty-free [as mentioned in section 5.2.2 b) above]. The fact that Malawi is easily accessible by road transport was an added advantage for Pep clothing. Moreover, Malawi uses English as their medium of instruction and this eased communication and signing of contracts easy for trading parties. Mozambique on the other hand uses

Portuguese language as a medium, and this would cause difficulties in conclusion of contracts. While Zimbabwe also uses English as their medium, their labour was more expensive compared to Malawi.

5.2.4. Company's expectations when relocating

When Pep clothing moved some of its operations to Malawi in 1995, they had certain expectations. According to Pep clothing spokesperson, these include getting cheaper intermediate goods used in production, such as textiles; and increased profits. Furthermore, they expected that there would be more skilled and cheaper labour, as well as extension of their market to other countries and opportunity to exploit benefits of Malawi's agreements with other countries globally, e.g. the Lome agreement which allows goods produced in Malawi to enter the European markets.(Interview, September 2000)

5.2.5. Pep clothing in Malawi

The Pep clothing plant in Malawi employed more than 750 people and most of their expectations were met. They imported textiles cheaply from the East either duty free or at a reasonable import duty, processed them in Malawi, and exported them back to South Africa. The labour conditions were favourable, as expected and the labour was cheap, with a broad skill base. Although the labour is skilled, they found them unproductive compared to those working in the manufacturing plant that remained in South Africa.

The output per unit of time in the Malawi plant was much less compared to that of the labour force in the Cape Town plant. The pace of the labour force working in the Malawi plant was slow and there was high labour turnover. There was also a problem of absenteeism in the Malawi plant. Although the workers were very keen to learn during training, they had a lot more socio-economic problems compared

to their South African counterparts. For instance, their general health was poor and the company had to provide basic health care for their employees in the plant in Malawi. Many employees had debts within their families while others had to walk long distances to work because of inefficient and expensive public transport. All these factors contributed to the slow pace of employees and low output per employee per unit of time.

According to the Pep clothing spokesperson, the cost of infrastructure such as electricity, transportation and fuel was very high in Malawi and yet infrastructure is not on concessions. They were faced with the problem of logistics. There was also a customs problem. For instance, there were six border posts to pass before the goods reached their Malawi plant and the insurance premium was high. As a result the total overhead costs were very high.

5.3 SADC Trade protocol and investment in Malawi

When Pep clothing invested in its manufacturing operations in Malawi in 1995, the SADC Protocol on trade had not been signed. The trade protocol was signed in August 1996, and South Africa only ratified in November 1999. Initially, Pep clothing "was in favour" of the SADC protocol and the rules of origin clause and its local content requirements. They found the accumulation principle and the concept substantial transformation (i.e. performing at least two stages of operation before re-exporting imported goods) acceptable since companies are expected to use regional imports to make up for local content.

However, the trade protocol eroded the benefits that were provided by the bilateral trading agreement between Malawi and South Africa bilateral agreement. The conditions of the SADC protocol include the requirement that all preferential

agreements between individual member states have to be dissolved when the Protocol is implemented.(See SADC, 1996) This made it impossible for the Pep Clothing and other companies to continue operating in Malawi because it meant that they can no longer exploit the "loopholes" that were created by the bilateral agreement in the market to make profits. As a result, their market access for the products they produced in Malawi was completely eroded. For example, they cannot use the cheap cloths from India to produce shirts that will be exported back to South Africa because those would not qualify community treatment.

Products from the Malawi Pep clothing no longer qualify for access into South African market since they do not meet the two-phase transformation requirements of the SADC protocol. Hence, Pep Clothing lost its entire market share. Pep clothing and other companies' share of the market went to China because there were not enough economies of scale within the region to make their textile production viable. The efficiency levels within the region are low and therefore textiles and other inputs are expensive, which makes production costs high. Even in countries like Mauritius, Malawi and Zimbabwe, which dominate clothing and textile in the region, the textile mills are not efficient enough to benefit from economies of scale. The textiles produced within the region remain relatively expensive, and they tend to push up the total costs of producing clothing and textiles in the region. Hence, the cost effective and efficient countries in the East Asia, such as China, tend to get the market share of the SADC region as well.

This and the potential change in the cost structure resulted in complete reversal of Pep clothing's initial investment decision, and the company closed down their manufacturing operations in Malawi early in year 2000. They sold their machinery

to local companies in Malawi and to some companies in Zimbabwe. They also brought some of the machines back to the Pep Clothing plant in Cape Town.

Pep clothing remains very pessimistic about reopening their plant in Malawi in future as long the two-stage processing and accumulation principle still hold. This is because textile mills in Malawi and in the whole SADC region cannot compete with those in countries like China and Bangladesh in the lower end of the market, unless they improve their levels of productivity or find themselves niche markets.

The textile industry, overall, will suffer because the textile mills in the region are not competitive enough in terms of quality and costs. They cannot produce in large enough quantities to lower average costs of production and therefore price of local textiles. As a result they stand to lose their market share of the lower end production to India on implementation of the SADC Trade Protocol, as they would lose some of the incentives (that helped to bring their production costs down at their Malawi plant) when the bilateral trade arrangement gets phased out. They would therefore not be able to maintain their supply to India at the cheap prices for which they had been exporting.

5.4 Conclusion

The investment decision of Pep clothing was taken with the purpose of improving their production in the lower end of the market. The provisions of the bilateral trade agreement between South Africa and Malawi together with global liberalisation of trade seem to have opened a loophole in the markets. South African companies, including Pep clothing could make profits by using cheap textile imports in Malawi to produce finished products, and exporting them back to South Africa duty free.

Although labour was cheap in Malawi, labour costs formed only a very insignificant fraction of the budget of Pep clothing, and they found labour productivity to be lower in Malawi. According to the Pep Clothing spokesperson, the structure of their cost of sale in Malawi, "in technical terms", was such that 18% was overhead costs, 16% total labour costs, and 66% raw materials. Hence, the influence of the labour markets on the company's investment decision in 1995 and its reversal in 2000 was very insignificant because these conditions did not change during this period.

However, according to the clothing and textile trade union SACTWU, the labour markets played a very important role to influence the company's investment decision, although Pep Clothing does not admit. The basis of this argument is that it was not the first time Pep Clothing moved their production operations. The company once moved its manufacturing operations to Butterworth in Transkei before the integration of the homelands into South Africa after 1994. During that time, the South African Basic conditions of Employment Act did not apply to the homelands, and therefore Pep Clothing could pay very low salaries to their workers. When Transkei got incorporated into the new South Africa, the South African labour regulations applied all over the country and the company closed down its operations.

The spokesperson of SACTWU strongly believes that labour market conditions influenced Pep clothing's decision to move to Malawi. As far as the SACTWU spokesperson is concerned, the company's move to Malawi was motivated by the following: - they could pay very low wages there compared to South Africa, as Malawi is one of the countries with lowest wage rates in the region; the labour regulation is not as strong as in South Africa; and there is also not much trade

union intervention in Malawi since the trade unions do not have as much bargaining power as in South Africa. Thus, Pep Clothing realised an opportunity to reduce their costs and therefore maximising their profits through the low wages they would pay in Malawi.

The rules of origin clause of the SADC trade protocol, through its impact on the provisions of bilateral trade arrangement between South Africa and Malawi, was the principal cause of the reversal of the investment decision of Pep clothing.

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CHAPTER SIX: POLICY CONCLUSIONS AND RECOMMENDATIONS

The changing intra-regional and global trade environment brings challenges not only to the industries in the region, but also to specific firms. It makes the responsibility of governments of the SADC states to develop and implement appropriate industrial policies a challenging task. It has been widely accepted that the closer regional co-operation and integration in SADC region is an effective means of facilitating industrial growth and economic development of the region.

The SADC Trade Protocol is the cornerstone of regional integration in Southern Africa. It aims to encourage intra-regional trade and investment based on comparative advantage, and to eventually form a free trade area in the region. Agreements like this have implications that are sector-specific as well as firm-specific. According to the theory, the reduced protection will tend to reduce output and employment in the industry concerned, depending on the nature, structure and policies prevailing in the economies of the different member states; while the benefits accrue to the other sectors in the economy. However, the situation is different and more complicated in reality.

Although intra-regional trade has been growing in the SADC region, the region still remains very much dependent on international trade and investment in primary commodities. South Africa dominates the small share of trade that still takes place within the region, with trade biased towards South African exports to the region. The other trading arrangements in which the individual member states are involved, like the bilateral agreements, SACU and COMESA, tend to complicate the trade patterns in the region. However, on implementation, the Protocol will dominate over all the other trading agreements in the region.

While the trade protocol will open access to a larger market, there are also some challenges that will come with the implementation of the Protocol. Since all the bilateral trading agreements among member states will be dissolved on implementation of the protocol, chapter five of this paper shows clearly that this will affect investment and trade flows negatively in smaller countries, where the investment incentives provided for under such agreements were used to attract investment capital into their economies. This means that the Protocol may lead to polarisation in the region, since there may be capital flight from the smaller economies with poor infrastructure to larger countries with better economic policies and more sophisticated infrastructure.

The main objective of this research has been to investigate the impact of the Trade Protocol on the clothing and textiles industry in the region and in South Africa. This industry dates as far back as the early 20th century, and it used to be one of the most protected industries in South Africa due to its sensitive nature. But with the global trends towards investment and trade liberalisation, the industry has seen a gradual reduction in its protection; and therefore more exposure to fierce competition from cheap as well as the illegal imports.

Furthermore, the Protocol requires that inputs originating from the region be used in production of goods in order for these goods to be granted trade concessions as per the provisions of the Protocol. However, the textiles mills in the region remain expensive compared to their Asian counterparts. This means that the clothing and textiles produced in the region will still remain more expensive relative to those from cheaper and more efficient producers in other parts of the world, as long as the manufacturers continue to use the relatively expensive inputs from within the region. Thus, while the trade protocol aims to promote trade and investment

within the region, this has potential to alienate the SADC region by reducing its competitiveness in the world markets. However, the SADC clothing and textile industries can still become competitive if they can identify niche markets in this sector.

Given that the clothing and textiles industry is one of the larger manufacturing employers in South Africa, it is necessary for the government to adopt sector-specific approach to policy making. In fact, this research suggests to policy makers that in policy formation they need to look at the impact of policies not only at the macro-economic level. They also need to consider the impact of the macro-economic policies on the firms at individual level. Meanwhile some policies may have the intended effect at the macro level, the same policies may have a very costly impact on the economy at a micro level.

Chapter 5 clearly shows that the trade policies influence investment policies. This is partly due to the fact that companies tend to consider their market share and access when they decide on the location of their investment. Hence, they tend to invest in locations where their products will have access not only to the domestic market but also to the international markets. Furthermore, labour policies have potential to influence the location of companies in the region as well as within the individual countries. Although investors tend to locate their capital in areas where there is cheap labour and less interference by the trade unions, they have found productivity to be lower. Low labour productivity is potentially a disincentive for investors when making location decisions, and countries can make their economies more attractive investment locations by encouraging training of their low-skilled and unskilled labour force.

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<http://www.sadcbankers.org>

<http://www.wto.org>

Woza News

University of Cape Town

ANNEXURE A: QUESTIONNAIRE – THE PEPKOR GROUP

SECTION A: Company Details

1. Name and address of the company: _____

2. Interviewee details

Name : _____

Position: _____

Contact numbers: _____

E-mail address (optional): _____

3. Year of establishment: _____

4. Structure of the company

a) Manufacturing

b) Retailing

c) Other, please specify _____

5. How many people are employed in your company's

a) Manufacturing operations? _____

b) Retailing operations? _____

6. Location of the company:

6.1. Where are your manufacturing operations located? _____

6.2. Where are your retail outlets located? _____

7. What products does the company produce? _____

8. Do you produce all the products you sell? _____

9. If not, where do you get those products that your company does not produce? _____

SECTION B: Movement of Pepkor's Clothing Manufacturing operations to Malawi

10. When did Pepkor move its clothing manufacturing operations to Malawi? _____

11. Why did you move your manufacturing operations? _____

12. What were the labour market conditions in South Africa when you moved? _____

13. What legislation was regulating SA labour markets then? _____

14. What about world trade liberalization? Did the phasing down of tariffs and non-tariff barriers to trade, (which protected the South African textiles against the tough competition from cheap textile imports), over a shorter period of 7 years in SA instead of 12 years, as proposed/allowed by GATT influence your decision to move? _____

15. What about the industrial policy approach that was moving away from tariff protection of clothing and textile industries? _____

a) Government's decision to remove direct cash subsidies and other export incentives?

- b) Possibility of gradual phasing out of the Duty Credit Certificates scheme within a short period of time? _____
- c) Export incentive schemes such as GEIS payment were to be abolished within a short period (as early as July 1997)? _____

16. You could have chosen any other location for your operations, but you chose the SADC region. Can you explain why you chose to invest in the region? _____

17. What were the investment incentives in the region when you relocated your clothing production operations? _____

18. Why did you choose to move to Malawi in the whole SADC region? _____

19. Did the South Africa/Malawi bilateral trade agreement influence your decision in any way?

20. If so, please explain how _____

21. Why not locate in Zimbabwe or Mozambique (which also have bilateral trade arrangements with SA)? _____

22. What made Malawi a more attractive option than all the other countries in the region?

23. Was there any particular package that the Malawian government offered to the international investors, then? _____

24. What were investment incentives in Malawi when you moved? (please rank them)

24.1. How were the labour market conditions in Malawi at that time?

24.2. What about (relative) costs of production (labour costs, in particular)?

24.3. And Trade union intervention?

24.4. What about the duty-free, quota-free access of Malawian products into SA (with permit) offered by the SA/Malawi bilateral trade agreement?

24.5. And Malawi's regime of liberalized economic (trade and investment) policies?

24.6. Easy access to the abundant, cheap imported textiles (most of which enter Malawi in "floods", originating from countries outside the SADC region into Malawi, especially from the Far East Asian countries)?

24.7. Other?

If other, please specify _____

25. What were the trade and investment conditions in SA when you moved your company activities to Malawi? _____

25.1. What were the industrial policies in SA when Pepkor moved to Malawi? _____

25.2. What about the:

a) Export promotion?

b) Declining levels of protection?

c) Stiffer Competition from increasing clothing and textile imports?

d) Customs controls (given the problem of illegal imports)?

e) Bilateral trade agreement that provided for Duty-free, quota-free access for

clothing, textile and other products from Malawi into SA; and Most Favoured Nation (MFN) access of SA products into Malawi?

f) Other?

If other, please specify _____

26. What expectations did you have when you opened your plant in Malawi? _____

27. What about the following (*please choose and rank the relevant options*):

- a) Cheaper labor;
- b) Availability of (more) skilled labor,
- c) Cheaper intermediate goods used in production (partly due to the advantage of cheap textiles imported by countries with lower costs of production to Malawi);
- d) Low direct input costs, overall;
- e) Increased output (as a result of low overall production costs);
- f) Increase in Pepkor's exports to South Africa (almost duty-free),
- g) Extension of Pepkor's market to other countries, and opportunity to exploit the benefits provided by the Lome agreement to enter the European and other markets;
- h) More profits;
- i) Other?

If other, please specify _____

SECTION C: The SADC Trade Protocol and the Proposed Free Trade Area

28. When did Pepkor reverse the decision to invest in Malawi? _____

29. Was it before or after the SADC trade protocol was signed? _____

30. What made Pepkor reverse their investment decision later (when you closed down your

production plant in Malawi)? _____

31. Were there any changes in your initial investment incentives? _____

31.1. What about (*please rank the relevant ones*):

- a) Labour markets conditions?
- b) Terms of the Malawi/SA bilateral trade agreement;
- c) Trade policy and regulations in the region, Malawi in particular;
- d) Other?

If other, please specify _____

32. What is Pepkor's impression of the SADC trade protocol that was signed in August 1996? _____

33. Was the reversal of your investment decision influenced in any way by the SADC trade protocol? _____

34. If it did, can you please explain how the trade protocol influenced your decision concerning closure of pepkor's clothing manufacturing operations in Malawi? _____

35. What is your impression of the Rules of Origin clause of the protocol, in particular? _____

35.1. Where does Pepkor stand concerning the concept of substantial transformation (i.e. the process of 2-stages of operation and 35%local content), and accumulation

principle? _____

36. Do you think the Rules of Origin clause of the SADC trade protocol influenced your decision in any way? _____ If so, please explain _____

37. Is there a possibility that the Rules of Origin stated in the SADC protocol, fully or partially, offset your benefits from your investment in Malawi? _____

37.1. Did they, directly or indirectly, have adverse effects on your product's access to the South African market? If so, to what extent? _____

37.2. Did the requirement of substantial transformation, in particular, affect your operations?

37.3. If so, can you please explain how? _____

37.4. What about:

a) Limiting the opportunities Pepkor had to exploit the textile imports abundant in Malawi?

b) Or reducing the volume of Pepkor products that qualify to access the South African market?

c) Or limiting volume of Pepkor products that can access the market in other SADC countries?

38. Why else would your company close down its operations in Malawi?

38.1. What about changes in the economic climate of Malawi?

38.2. Or decline in potential profits of your operations?

38.3. Or, were there any changes in terms of the SA/Malawi bilateral trade agreement?

38.4. Or is there any other reason? _____

If yes , please state the reason _____

39. How did Pepkor deal with the situation? (*Choose the relevant options below*)

39.1. Did you:

a) Relocate your clothing manufacturing operations in Malawi to other neighbouring states?

b) Or, Relocate those operations back to South Africa?

c) Or, Completely close down your operations in Malawi?

d) Other?

If other, please specify _____

40. How likely is it for the protocol and the proposed SADC FTA to have impact on other clothing and textile companies? _____

41. To what extent can these other companies be affected? _____

42. What advice would you give to the companies affected concerning this?

a) Reduce output;

b) Relocate other countries;

c) Shut down their plants;

d) Improve their level of domestic and international competitiveness by training workers and management;

e) Other.

If other, please specify _____

43. Any other comments? _____

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