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THE SACU-US FREE TRADE AREA (FTA) NEGOTIATIONS IN LESOTHO: AN OVERVIEW

SACU member states are currently engaged in Free Trade Area (FTA) talks with the US as a block. The future of the FTA, the first between the US and sub-Saharan Africa, largely hinges on an established success with African Growth and Opportunity Act (AGOA)…

Background

The Southern African Customs Union (SACU) was established in 1910 as a trade arrangement under which member states have agreed to abolish tariffs and non-tariff barriers to trade in commodities produced within the union and maintain a common tariff structure against non-union members. The current member states include a larger economy of South Africa, and the peripheral economies of Botswana, Lesotho, Namibia and Swaziland (BLNS). All the five SACU countries are leading beneficiaries of the US trade preferences under the AGOA, which has likelihood to be extended to 2015 (originally, it was set to expire in 2008) AGOA was designed by the US as an effective and pragmatic tool to help Sub-Saharan African countries to make a transition from reliance on aid to that on trade. Consequently, the US market provides duty-free access to substantial exports from sub-Saharan Africa.

Lesotho, as the first of the BLNS countries, the second in SACU and the fifth of the 35 sub-Saharan African countries to qualify for the enhanced benefits under AGOA, became eligible on the 23rd of April 2001. Its exports have since enjoyed duty-free access into the US market. The export-led economic growth strategy has been promoted with an emphasis on manufacturing sub-sector which has seen great growth levels in textiles and clothing. These exports grew from 16 per cent of GDP in 2000 to 30.6 per cent in 2003. Of course, the positive spill-over effects from this are many, and range from: Export growth, GDP growth, improvement in employment levels, and improvement in foreign exchange earnings, to mention a few. The increase in employment from 21 886 in December 2000 to 51 160 in December 2003 underscores the improvement due to AGOA benefits. As a result, this sector is the biggest employer in the country. The contribution of the manufacturing sector is truly significant because it accounts for around 20 percent of GDP. Since AGOA appears to be doing so well why negotiate a FTA?

The Rationale for the SACU-US FTA Strategy

Obviously, AGOA will expire in 2015 and its reinstatement cannot be definitely ascertained, nor can it be ascertained that all SACU members would be eligible in subsequent initiatives. Thus the benefits that accrue from this arrangement may soon disappear. This dictates to the government to look for long-term trade opportunities with sustainable benefits, and this justifies the rationale behind the negotiations for a FTA. A FTA is a trading arrangement under which member states agree to eliminate all tariffs, and non-tariff barriers to trade in commodities produced within the area. However, members maintain independent commercial policies with respect to non-members. AGOA has demonstrated that there is a huge trade potential for growth in SACU-US trade links. Hence, a FTA would continue to exploit this potential. The envisaged FTA arrangement with the US is expected to have several advantages for SACU.

The major advantage is that it will provide a more stable framework under which long-term commercial relations between SACU and the US would flourish. The final agreement on these talks may bolster confidence in the SACU economies and investors would be able to make commitments over a longer horizon. Second, it would enable members of a FTA to expand market access for wider variety of products and encourage greater foreign direct investment. Third, a FTA would also promote regional economic integration and growth and cement trade as one of the leading economic development strategies for SACU countries. Lastly, the success of a FTA would be permanent unlike AGOA, and would, as a result, help to stem the unacceptable use of domestic industries, as a launch pad for speculative investors who want easy access into lucrative markets, such as the US.

The main benefit for the US is that, this envisaged FTA would ensure a move from one-way trade preferences as under AGOA, to full partnership through a reciprocal free trade agreement. SACU as a block presents good opportunities for the US as it is the oldest customs union in Africa (tried and tested). Currently SACU is the largest market for US machinery, vehicles, aircraft, medical instruments, plastics, chemicals, cereals, pharmaceuticals, wood and paper products, in Sub-Saharan Africa. The total US exports into SACU were estimated at US$2.5 billion in 2002. Secondly, a FTA would further level out the playing field in areas where US exporters are disadvantaged by the European Union's free trade agreement with South Africa. Finally, the SACU-US FTA would be a major step for the US in an effort to facilitate SACU integration into the global market.

There are also several disadvantages of a FTA; for example, a FTA may erode the already dwindling SACU revenues because as the US imports enter the SACU markets duty-free the revenue of the Union will surely decline. The current contribution of this revenue source is about 45 percent to the government budget in Lesotho. Hence customs revenue losses arising from the FTA with SACU may have severe effects on the Lesotho' budget. Second, a FTA can open domestic economies to international giants that have the potential to swallow the infant industries within SACU. Third, there may be an "innocent-bystander" problem, which results when the members of a FTA discriminate against non-member countries. For instance, FTA may lead to trade diversion, which means that a FTA may encourage SACU to buy supplies from the US even if there are low-cost producing countries outside the area. In the SACU case these countries may include other SADC members, and hence the FTA would be in conceptual conflict with the African Union's integration agenda. Finally, the adjustment costs of FTA would be disproportionately allocated towards SACU. That is, SACU would have to eliminate tariffs on a number of US goods whereas for US, most of the tariffs have already been phased-out on SACU exports.

The Content of the negotiations

SACU-US FTA negotiations have been ongoing since June 2003 in an effort to address the above-mentioned concerns. A conference in Lesotho, was held on the 4th-07th of May 2004, and to complete a fifth round of talks following that hosted by Namibia on the 2nd -26th of February. The negotiations are expected to be wrapped up sometime in December 2004.
The negotiation agenda covers a substantial range of issues. For instance, both the SACU and the US identified capacity building on trade process as central to the success of a FTA, as well as the fact that the differences in economic structures of SACU members in terms of size, development levels, institutional, financial and human resource endowments, call for the flexibility in the programme. Since, the menu of negotiations on a FTA, does not only deal with tariffs, but also seeks to establish new disciplines on trade related issues, including services, investment, government procurement, electronic commerce, labour and environment, it should help SACU to acquire technical assistance and technological transfer.
Both negotiating parties are aware that a FTA would enhance the competitiveness of SACU economies by granting greater market access for both agricultural and manufactured exports, and thus facilitate a meaningful integration of SACU within the global economy. This would ensure that destructive consequences of opening up of SACU economies for US products, on SACU infant industries, may not ensue. In addition, the parties are trying to ensure that deeper cooperation process would take into account the fact that the FTA should be compatible with and support the integration process in SADC. Moreover, SACU seeks US commitment towards a programme to provide assistance to the BLNS for adjustment of their economies from the revenue loss effects. Furthermore, in view of the variability of each country characteristics, both parties agree to implement an asymmetric approach favouring SACU in relation to the tariff phase-down process. A period of 10 – 12 years is being planned for SACU economies' adjustment.

Conclusions and Recommendations
From the preceding discussion, it is evident that Lesotho has so far greatly benefited from AGOA in areas of employment, foreign exchange earnings, and export expansion and economic growth. It has also been shown that agreeing a FTA with the US would further boost the economy as it would attract investment, improve market access for most of local producers and hence continue to safeguard the gains from trade achieved under AGOA. However, the ongoing FTA negotiations should strive to address the negative externalities identified.

In the long-run, in order to accrue optimal benefits from the envisaged SACU-US FTA, more emphasis should be placed on addressing the following major challenges to the country:

- The diversification of the export product base; the current export base covers mainly textile and Clothing and this is risky;
  The need to strengthen the linkages between the various sectors of the economy such that the booming manufacturing sector, may also contribute in the development of other sectors in the economy;
- The involvement of local entrepreneurs in the manufacturing sector; for instance, in joint ventures between

local and foreign investors would tend to transfer the technological know-how; and

- To remain attractive to investors, the Government should continue to increase its capital stock, improve the human resources capacity, and uphold the enabling environment for investment as under AGOA.

Notwithstanding the expected benefits from the FTA, the Government has the responsibility to ensure:

- The diversification of the markets in an effort to spread the risk away from the US; currently the country's trade is concentrated on textiles and apparel destined to the United States (US) instead of being diversified to take advantage of SACU market, SADC trade protocol, EU and other trade initiatives with Canada and Scandinavian countries;
- and Reduction of dependency on SACU revenue. To achieve this there is a need to broaden the tax base or continue to improve the efficiency in tax collection.

Table 1. Monetary and Financial Indicators+

	March	April	May
1. Interest rates (Percent Per Annum)			
1.1 Prime Lending rate	12.50	12.50	12.50
1.2 Prime Lending rate in RSA	11.5	11.5	11.5
1.3 Savings Deposit Rate	2.31	2.31	2.31
1.4 Interest rate Margin(1.1 – 1.3)	10.19	10.19	10.19
1.5 Treasury Bill Yield (91-day)	9.21	9.21	9.36
2. Monetary Indicators (Million Maloti)			
2.1 Broad Money (M2)	2308.4	2225.5	2294.0
2.2 Net Claims on Government by the Banking System	-319.9	-786.7	-693.6
2.3 Net Foreign Assets – Banking System	3480.3	4090.6	3962.7
2.4 CBL Net Foreign Assets	2576.9	3267.0	3070.6
2.5 Domestic Credit	273.5	-186.1	-88.5
2.6 Reserve Money	302.6	324.1	326.2
3. Spot Loti/US$ Exchange Rate (monthly average)	6.6054	6.5920	6.7844
4. External Sector (Million Maloti)	**2003**		**2004**
	Q3	**Q4**	**Q1**
4.1 Current Account Balance	-300.6	-299.8	-194.7
4.2 Capital and Financial Account Balance	155.5	320.0	-23.5
4.3 Reserves Assets	391.7	-156.6	257.5

+These indicators refer to the end of period. Prime and deposit (savings) rates are averages of all commercial banks' rates operating in Lesotho. The Statutory Liquidity Ratio in Lesotho is 25 percent of commercial banks' short-term liabilities.

Table 2. Selected Economic Indicators

	2000	2001	2002*	2003+

1. Output Growth(Percent)				
1.1 Gross Domestic Product – GDP	1.3	3.2	3.8	3.3
1.2 Gross Domestic Product Excluding LHWP	0.0	3.5	3.3	3.2
1.3 Gross National Product – GNP	-3.2	0.6	2.5	2.7
1.4 Per capita –GNP	-5.0	-1.7	2.1	2.2
2. Sectoral Growth Rates				
2.1 Agriculture	2.9	0.6	-4.0	-0.4
2.2 Manufacturing	4.4	7.9	6.9	5.0
2.3 Construction	9.7	1.3	6.9	4.0
2.4 Services	-0.9	2.2	3.3	3.6
3. External Sector – Percent of GNP Excluding LHWP				
3.1 Imports of Goods	71.9	74.9	87.3	80.6
3.2 Current Account	-8.8	-2.9	-8.6	-7.8
3.3 Official Reserves (Months of Imports)	8.9	11.7	6.4	5.5
4. Government Budget Balance (Percent of GNP)	-4.9	-1.0	-2.7	-2.5

*Preliminary Estimates +Projections