What do the COMESA Customs Union and COMESA-EAC-SADC Tripartite Free Trade Area mean for Zambia's import trade and trade tax revenue?

Caesar Cheelo

Njeleka Malata and Joseph Tembo

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Caesar Cheelo is a Research Fellow on trade and investment at ZIPAR

Njeleka Malata is Managing Consultant for Equilibria Consulting Limited

Joseph Tembo heads the BOP and Trade Statistics Division of the Central Statistical Office

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Zambia Institute for Policy Analysis & Research (ZIPAR)
CSO Annex Building
Cnr John Mbita & Nationalist Roads
PO Box 50062
Lusaka
Zambia

Tel: +260 211 252559
Fax: +260 211 252566

Email: info@zipar.org.zm
Web: www.zipar.org.zm

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Acronyms

AGOA	African Growth and Opportunity Act
CET	Common External Tariff
CD	Customs duty
CIF	Cost, insurance and freight
CMR	Customs Management Regulations
CTN	Common Tariff Nomenclature
COMESA	Common Market of Eastern and Southern Africa
EAC	East African Community
FNDP	Fifth National Development Plan
FTA	Free Trade Area
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
MFN	Most Favoured Nation
MMTZ	Mozambique, Malawi, Tanzania and Zambia
PSDRP	Private Sector Development Reform Programme
PTA	Preferential Trade Area
ROW	Rest of world
SACU	Southern African Customs Union
SADC	Southern African Development Community
SNDP	Sixth National Development Plan
TRIPS	Trade-Related Aspects of Intellectual Property Rights
TRIST	Tariff Reform Impact Simulation Tool
VAT	Value Added Tax
WDI	World Development Indicators
WTO	World Trade Organisation
ZRA	Zambian Revenue Authority

EXECUTIVE SUMMARY

Zambia has participated actively in the Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC) regional integration programmes. Within SADC it is now reportedly a full participant in the SADC Free Trade Area (FTA), granting duty-free and quota-free access to goods originating from the SADC region. It is also a founding participant in the COMESA FTA and is now looking ahead to participate in the establishment of the COMESA Customs Union. The country is also committed to participate in the recently announced Tripartite FTA, which will establish a free trade area and then eventually a customs union, consolidating the regional economic communities of COMESA, SADC, and the East African Community (EAC).

Quite often the actual or potential short-term or transitional impacts of the tariff reforms associated with regional integration are not well known. This is the case with respect to Zambia's commitments to further integration under the forthcoming COMESA Customs Union and Tripartite FTA. ZIPAR therefore undertook a study to assess the potential effects for Zambia of the forthcoming trade reforms implied in both the COMESA Customs Union and the Tripartite FTA. The study made two starting-point observations: on the one hand, the Tripartite FTA is expected to consolidate the *internal* markets of the three regional economic communities and facilitate duty- and quota-free trade within the common market, subject to rules of origin. This means the Tripartite FTA will define Zambia's internal trade policy position with other member states. On the other hand, the COMESA Customs Union, with its Common Tariff Nomenclature, Common External Tariff structure and common Customs Management Regulations, will define Zambia and other COMESA Member States' common *external* trade policy position. Given Zambia's ratification of these trade arrangements, it is important for policy-makers to understand the significance of the trade policy reforms implied in both the COMESA Customs Union and the Tripartite FTA.

This paper therefore seeks to determine the implications for Zambia of the trade reforms that the country will undertake. It applies the following methods of ex-ante analysis: (1) *Import trade and tariff profiling* using simple descriptive statistical analysis of trade for the period 2000-2010 and of tariff structures in 2010; (2) *Analysis of required trade policy reforms*; and (3) *Analysis of revenue implications and economic effects* using the World Bank's Tariff Reform Impact Simulation Tool (TRIST). Trade and customs data as well as other data were obtained from authentic national and international sources including the Zambia Revenue Authority, COMESA Secretariat, Central Statistical Office, Ministry of Finance, World Trade Organisation and World Bank, among others. The paper's reference period is 2010.

Based on the above analysis, the study makes a number of observations that are presented in the following five parts:

1. Zambia's trade policy

2. Trade taxes, tariff structure and implications of regional integration
3. Trade profile: outcomes
4. Trade reform simulations and revenue implications
5. Implications of trade reforms for import prices, protection and competitiveness

The study elaborates Zambia's bilateral, regional and multilateral trade policy arrangements as well as some of its trade policy intentions. It explained the country's Most Favoured Nation (MFN) tariff structure and the tariff structures under the SADC trade protocol in 2010 and currently. In 2010 Zambia was in a tariff phase-down stage towards fully implementing the FTA and, reportedly, in 2012, it has started applying a full FTA with SADC countries, having completed the phase-down. On the other hand, it has been in an FTA under COMESA since 2000 and is looking to achieve deeper integration through the COMESA Customs Union. The implications of aligning with the Common External Tariff (CET) under the COMESA Customs Union are that Zambia will have to restructure about 61% of its 6,009 MFN tariff lines (2010). The anticipated import trade changes and revenue losses associated with this move are considered later on.

The assessment of Zambia's trade performance suggests that the country's share of world trade grew significantly during the latter part of the study's reference period, albeit from a very small base. The openness of the economy to trade was found to be consistently high throughout the reference period, closing at 77.3% of Gross Domestic Product (GDP) in 2010. The trade balance became positive in 2005 and stayed that way until the close of the reference period with a period high of 57.2% of GDP in 2010. This was most likely sustained by the global rebound in copper demand and prices since about 2005 as well as the Zambia's Private Sector Development Reform Programme that was pursued from about 2004. The adverse effects of the global economic crisis of 2008/2009 were evidenced in downturns in some of Zambia's trade performance indicators during that period. In relation to trade efficiency, Zambia only managed to take advantage of about 2.2% of its trade potential on the African continent, suggesting significant scope for the economy to expand its trade performance on the continent.

It was observed that South Africa was Zambia's main import trading partner, accounting for 37% of total trade in 2010. Other main trade partners in 2010 included Kuwait, DR Congo and China, which had replaced some of the more traditional partners like the UK and Zimbabwe. Imports were a significant part of the Zambian economy, accounting for about 32% of GDP or one and a half times the national budget in 2010. The total import trade tax revenues associated with 2010 imports were equivalent to about 41.2% of the total tax revenue of the government, excluding grants and other (non-tax) revenues. In the same year, Zambia granted exemptions amounting to about 8.6% of total tax revenue.

Against the actual outcomes highlighted above, the study estimated that the economy would have potentially lost total trade tax revenues equal to about 2.3% of total tax revenue due to the combined effect of consolidation of the COMESA FTA and then implementation of the

COMESA CET under a Customs Union reform. On the other hand, pursuing tariff reforms under COMESA FTA consolidation and then a Tripartite FTA, Zambia would have potentially lost tax revenues equivalent to 4.5% of the total tax revenue. Revenue losses could naturally be expected to be higher under the Tripartite FTA because this trade reform arrangement would involve liberalising trade with South Africa, Zambia's largest trading partner. Both avenues of tariff reform would be significantly less than the revenue of 8.6% of total trade taxes that the country actually lost due to exemptions in 2010. Indeed, the combined effects of consolidation of the COMESA FTA, implementation of the COMESA Customs Union, and establishment of the Tripartite FTA would have been resulted in potential revenue losses of 6.9% of total tax revenue –smaller losses than the duty exemption losses of 2010.

For the COMESA tariff reform route, options for mitigating the (somewhat marginal) adverse effects are elaborated. More detailed TIRST analysis suggests that reductions in tariff protection, where they are likely to be significant, would generally favour the competitiveness of domestic industries.

From the marginal potential increases in imports observed in the simulation results, tariff reforms alone are unlikely to result in significant trade and competitiveness gains. Deeper regional cooperation that integrates the fragmented regional markets in African and effectively addresses non-tariff barriers (NTBs) will be required. Given Zambia's early reformer status, the country is an advantageous position to negotiate for such cooperation, targeting regional support that promotes the economy as a preferred regional destination for investment, preferential treatment in regional infrastructure support projects, and so on.

In view of the forgoing, there are a few policy issues that will be important for national authorities to carefully consider and possibly pursue:

First, as an important step towards deeper regional integration and cooperation, **Zambia should continue on its path of tariff reform and regional integration**. Specifically, the country should move ahead with its commitment to fully participate in the COMESA Customs Union, particularly as the adjustment costs are likely to be relatively lower than the costs associated with other tariff strategies the country has pursued (e.g. exemptions).

Second, **policy-makers must define a country policy position and a set of strategies on offensive and defensive trade interests that should, as a minimum, be negotiated as part of regional trade policy**. For instance, the country's bilateral trade ambitions with China, India, and other countries and trading blocs should be carefully articulated and recommended for inclusion in common external trade policies. Considering that tariff reform is a defensive trade strategy, Zambia could perhaps do well to focus on formulating offensive strategies. These should be synchronised with the COMESA common regional trade policy that Zambia has committed to, clearly and explicitly taking into account the economy's trade, financial, investment and social cooperation interests in different countries and regions. Importantly, such negotiating positions should be formulated in close consultation with the private sector and based on the available evidence.

Third, using the revenue loss estimates of this study, **policy-makers should engage the COMESA Secretariat with a view to establishing if the country can benefit from partial or full revenue loss compensation under the COMESA Adjustment Facility, to mitigate any adverse effects of reform**. Zambian policy-makers should also consider drawing on other safeguard measures in COMESA provisions such as the Council Regulations, including the provisions for countries to formulate sensitive products lists and exemptions lists from tariff adjustments. The empirical insights from this study could be used as a starting point in determining strategically important products that are revenue sensitive or of significance under bilateral trade agreements.

Finally, **further work should be undertaken to quantify the costs of NTBs for Zambia**. The work should specifically seek to understand the NTBs that serve as the main business cost drivers and how to convert these drivers into a trade facilitator to eliminate or at least minimise the barriers. The discriminatory and often ineffective policies and strategies that countries often insist on pursuing regarding NTBs are likely to limit the regional integration benefits of tariff reform and create an impression that trade liberalisation is not worth it. Zambia should move away from these and should act as a champion for regional integration, encouraging other countries to do the same.

Ultimately, tariff reform should be viewed as simply one small step on the long and hard road to regional cooperation, competitiveness, trade expansion and diversification and overall economic development. Many other steps that facilitate trade expansion and diversification will have to be taken as the first steps – trade liberalisation – begin to be concluded. As an early reformer, Zambia is poised to take this first step and subsequent steps towards freer trade.

1 INTRODUCTION

As part of a broad development agenda, many African governments have sought to continuously improve the structure of incentives offered to their domestic economies by promoting outward looking trade and competitiveness strategies. Among these strategies, regional economic communities have been very popular for some time now. This can be seen in the establishment of a number of regional economic communities such as the Common Market of Eastern and Southern Africa (COMESA), the East African Community (EAC), the Southern African Development Community (SADC), the Economic Community of West African States (ECOWAS), and others. These regional economic communities often formulate regional trade arrangements that necessitate trade reforms for member states. The implications trade reforms are not always obvious; member states often need a deeper understanding based on empirical analysis.

In early 2011, the Zambia Institute for Policy Analysis and Research (ZIPAR) undertook a study to assess the potential trade and trade tax revenue effects for Zambia of the forthcoming trade reforms implied in both the COMESA Customs Union and the COMESA-EAC-SADC Tripartite Free Trade Area (Tripartite FTA). The study's genesis was a twofold observation: on the one hand, the Tripartite FTA is expected to consolidate the internal markets of the three regional economic communities and facilitate duty- and quota-free trade within the common market, subject to rules of origin. This means the Tripartite FTA will define Zambia's trade policy position with respect to its tariff and non-tariff treatment of the other member states in the FTA. On the other hand, the COMESA Customs Union, with its Common Tariff Nomenclature (CTN), Common External Tariff (CET) structure and common Customs Management Regulations (CMR), will define the common external trade policy position for Zambia and other COMESA Member States as they relate so-called to third parties (that is, countries with which Zambia does not share the Tripartite FTA). It is important for policy-makers in Zambia to understand the significance of the trade policy reforms implied in both the COMESA Customs Union and the Tripartite FTA.

On this premise, this paper presents the results and conclusions of the analysis of the potential influences of the trade reforms. Broadly, the paper seeks to determine the implications for Zambia of the trade reforms that the country will undertake in the course of deeper integration with the COMESA Customs Union and the Tripartite FTA. Specifically it seeks to address four main concerns, namely: (1) to determine Zambia's trade profile and tariff structure prior to the establishment of the COMESA Customs Union and the Tripartite FTA; (2) to determine the likely trade reforms implied for Zambia in the tariff systems of both the Customs Union and the Tripartite FTA; (3) to estimate the trade and trade tax revenue effects of the tariff reforms related to deeper integration under the Customs Union and the Tripartite FTA; and (4) to highlight some of the main economic (competitiveness and industrial development) implications of the tariff reforms for Zambia. The paper presents the findings, conclusions and

recommendations in a manner that is relevant for policy-makers to take quick decisions based on sound empirical evidence.

The rest of the paper is structured as follows: Section 2 presents some background insights into regional integration, focusing on (but not limited to) the COMESA Customs Union and the Tripartite FTA (this section can be skipped without much loss of understanding to the reader, particularly for the more adept reader of international economics); Section 3 presents the study methodology in brief (details of the technical methodology are presented in Annex 1); Section 4 presents the main findings of the study; and Section 5 closes with concluding remarks and policy recommendations.

2 A PRIMER ON REGIONAL INTEGRATION PRINCIPLES AND POLICY

Although the history of regional integration in Africa (including Zambia's history) is quite long, a few highlights are useful for explaining the main recent developments in African regional integration. This section presents some highlights, focusing on the history of the three regional economic communities of main interest to this paper, namely: COMESA, EAC and SADC.

It is noteworthy that all the three regional economic communities broadly followed the stages of trade-related regional integration that have been prescribed in international trade theory and supported by the multilateral trading system. In theory, regional integration is about establishing an arrangement for enhancing cooperation among countries of a spatial grouping through regional rules and institutions entered into by those countries. Regional integration will usually have as its broad objective some mix of political, economic or even social goals. Regional integration will usually be supported by an intergovernmental or supranational organisation or set of organisations (Mirus and Rylska 2001). In practice, economic and particularly trade-related goals have dominated the regional integration agenda in most parts of the world. Table 1 presents the main elements associated with the different stages of regional integration in principle. These are briefly explained in the ensuing paragraphs.

Table 1. Basic elements of the stages of regional integration

Preferential Trade Area (PTA)	Reduced tariffs between member countries and preconditions for deeper integration (e.g. establishment of rules, disciplines and institutions).
Free Trade Area (FTA)	Zero tariffs between member countries and reduced non-tariff barriers; PTA is not a necessary precondition for FTA.
Customs Union (CU)	FTA + common external position (common external tariff, trade nomenclature, customs management, and rules and disciplines)
Common Market (CM)	CU + free movement of capital and labour, some policy harmonisation
Economic Union (EU)	CM + common economic (fiscal, monetary, etc) policies and institutions
Political Union (PU)	EU + common political systems and institutions

Source: adapted and modified from Mirus and Rylska (2001) and House of Commons (2002)

In some cases, a **Preferential Trade Area** (PTA) is the first stage of regional integration. This is usually a formative stage of the FTA, where rules, disciplines, regulations and institutions are established, and trade is gradually liberalised (through duty and quota phase-down schedules) until full free trade is established. The PTA is not, however, a *necessary* precondition for an FTA.

The **Free Trade Area** is the first "necessary" stage of regional integration. It is established based on free trade agreements that member countries commit to. The FTA entails eliminating import tariffs or duties as well as import quotas between signatory countries. The agreement

underpinning the FTA can be limited to a few sectors or can encompass all aspects of international trade between countries. FTAs can also include formal mechanisms, rules and disciplines to resolve trade disputes within the bloc. Although the FTA may contain provisions in these areas if the signatory countries are agreeable to them, these are not a must. That is beyond the duty and quota liberalisation no further harmonisation of regulations, standards or economic policies is necessarily required as part of the FTA, nor is the free movement of capital and labour a necessity as part of an FTA.FTA member countries also retain independent trade policy with all third countries (or countries outside the FTA)[1] (House of Commons 2002; Mirus and Rylska 2001).

The **customs union** is the next stage of regional integration and builds on the FTA. In this case, over and above the removal of internal barriers to trade (mainly internal duties and quotas), member countries are also required to harmonise their external trade policy positions. A customs union therefore involves establishing a Common External Tariff (CET) based on common trade nomenclature and a common system of tariff revenue management and administration.[2] In this arrangement, other common trade restrictions like import quotas on products entering the region from third-party countries may be imposed. An important characteristic of a well-established customs union is the formulation of common external trade policies including trade remedies such as anti-dumping and countervailing measures. A customs union may also prohibit the use of trade remedy mechanisms within the union. Another important feature of a well-established customs union is that its members typically negotiate any bilateral trade agreements and multilateral trade initiatives as a single bloc with a common negotiating position. In principle, countries with a well-established customs union no longer require rules of origin, since any product entering the union area should be subject to the same tariff rates and/or import quotas regardless of the point of entry.

According to Mirus and Rylska (2001), the elimination of the need for rules of origin is the main benefit of a customs union over an FTA. This is because the maintaining of rules of origin requires extensive documentation by all FTA member countries as well as enforcement of those rules at borders within the FTA. This is a costly and trade constraining process that can lead to disputes or other delays. A well-established customs union should result in significant administrative cost savings and efficiency gains. Other cost savings and efficiency gains stem from common revenue collection and sharing mechanisms, and common mechanisms for negotiating with third countries.

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[1] However, as many observers agree, in order for an FTA to function properly, member countries must establish common rules of origin for all third-country goods entering the FTA. In this way, goods produced within the FTA would be allowed to cross borders tariff- and quota-free, but goods produced outside the FTA would be subject to rules of origin requirements, which they must meet to avoid goods produced in third countries enjoying the same benefits as goods in the FTA. In the absence of rules of origin, therefore, third-party countries seeking trade access to the FTA area would choose the path of least resistance – the country where they face the lowest opposing tariff – in order to gain effective entry to the entire FTA region on duty- and quota-free basis.

[2] Many observers argue that the system of common tariff management and administration should include common tariff revenue collection and a revenue sharing mechanism, the absence of which implies the Customs Union is not fully established and is perhaps simply a Common External Tariff areas.

A further benefit of a customs union – something that is usually not highly appreciated – is the higher level of political trust and goodwill it fosters. As countries sacrifice their individual sovereignty in relation to trade policy space, they must trust each other to look out for the greater good of all citizens in the union. This sets an important stage for active dialogue, negotiations and consensus building for the common good of all member states.

As many observers would argue, though, surrendering some degree of policy freedoms, including the space to set independent trade policy and to freely engage bilaterally with third countries, is not easy. Moreover, because of the increasing importance of trade–investment interrelationships as foreign policy tools, limits on the independence of national foreign direct investment and foreign relations policies is another disincentive.

A leap of faith into the unknown and the emergence of trust and commitment usually happen only after a defining political moment. A classic example of a defining moment relates to the formation of the European Union in the wake of the human and economic cost of World War II. Without a defining moment, the technical solutions provided in regional integration strategies seem to hold little sway in influencing political will or traction. Therefore the anticipated losses of autonomy will perhaps remain among the most significant challenges for African regional economic communities in fully implementing customs unions.

A **common market** represents a major step towards significant economic integration. In addition to the provisions of a customs union, a common market removes all barriers to the mobility of people, capital and other resources within the area, as well as eliminating non-tariff barriers to trade, such as the regulatory treatment of product standards. Establishing a common market typically requires significant policy harmonisation in a number of areas. Free movement of labour, for example, necessitates agreement on worker qualifications and certifications. A common market is also typically associated – whether by design or consequence – with a broad convergence of fiscal and monetary policies due to the increased economic interdependence within the region and the effect that one member country's policies can have on other member countries. This necessarily places more severe limitations on member countries' ability to pursue independent economic policies.

The principal advantage of establishing a common market is the expected gains in economic efficiency. With unfettered mobility, labour and capital can more easily respond to economic signals within the common market, resulting in a more efficient allocation of resources. The challenge is that, like the customs union, it calls for political trust and willingness to sacrifice national policy space (arguably, though, the challenge is less onerous once a customs union stage is achieved).

The deepest form of economic integration is an **economic union**, which adds to a common market the need to harmonise a number of key policy areas, most notably the formal coordination of monetary and fiscal policies as well as labour market, regional development, transportation and industrial policies. Since all countries would essentially share the same economic space, it would be counter-productive to operate divergent policies in those areas.

An economic union frequently includes the use of a common currency and a unified monetary policy. The European Union is an example of an economic union, although, without much attention to the formal nomenclature, quite a few observers think of the European Union as a monetary union (as special form of economic union). Eliminating exchange rate uncertainty improves the functioning of an economic union by allowing trade to follow economically efficient paths without being unduly affected by exchange rate considerations. The same is true of business location decisions. Supranational institutions would be required to regulate commerce within the union to ensure uniform application of the rules. These laws would still be administered at the national level, but countries would abdicate individual control in this area.

Against this background, some retrospective and prospective views about the regional integration efforts of COMESA, EAC and SADC are presented in the following sub-sections.

2.1 The past and future of COMESA

The origins of COMESA can be traced back to the mid-1960s. The idea of regional economic cooperation gains considerable momentum in most of Africa in the post-independence era; it is underpinned by optimism about the then new independence of many states, a drive for pan-African solidarity, and prospects for collective self-reliance. COMESA was preceded by the negotiation of the Preferential Trade Area for Eastern and Southern Africa (PTA). The treaty establishing the PTA was signed in December 1981 by heads of state and government in Lusaka. The PTA treaty was formulated with an inherent process and timeframe for transforming the PTA into a common market. In conformity with this, the treaty establishing COMESA was signed in November 1993 in Kampala and was ratified in December 1994 in Lilongwe.

COMESA currently has 19 member states.[3] In accordance with its treaty, COMESA's vision is to "be a fully integrated, internationally competitive regional economic community with high standards of living for all its people ready to merge into an African Economic Community." A wide range of protocols and COMESA Council regulation are the main means of implementing the treaty and ultimately fulfilling its vision. According to COMESA's (2010c) Medium Term Strategic Plan, the milestone and targets of the region's trade agenda are as summarised below:

- The period 2000 to 2008 involved implementation of the FTA, putting in place essential structures for a functional customs union and laying the foundation for a common market.
- The period 2009 to 2012 has been dedicated to working out the operational mechanics for a fully functional customs union.

[3] Burundi, Comoros, DR Congo, Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Libya, Madagascar, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda, Zambia and Zimbabwe.

- Towards establishing a common market, COMESA adopted a Protocol on Free Movement of Persons, Labour, the Right of Establishment and Residence. The timeframe for is not indicated in the strategic plan.
- COMESA has been implementing a monetary cooperation programme, which, among other things contributed to the adoption of a macro-economic convergence plan (a road map to limited currency convertibility) and to fast-tracking monetary union by 2015.

Looking ahead in relation to regional integration, COMESA has tried to maintain the momentum of its trade and economic cooperation. Pursuant to the establishment of the COMESA FTA in 2000, the region has been pursuing the establishment of a customs union, as further explained in more detail further below. For instance, member states that had not yet joined the FTA as of the time of the meeting of the COMESA Council of Ministers (the supreme regional decision making body of COMESA) in December 2010 in Lusaka were urged, as a Council decision, "to join as soon as possible given that the region is moving towards the Customs Union" (COMESA 2010a, 49), the decision on the timeframe for establishing the Customs Union having been reached in June 2009. Give a number of outstanding implementation challenges with the union and the political nature of the decisions that need to be made to resolve the challenges, this paper cannot provide a reliable view about the likely timing and nature of the full establishment of the COMESA Customs Union. Negotiations and the eventual establishment of the Tripartite FTA are also likely to play a key role in the timing and nature of COMESA Customs Union's establishment.[4]

2.2 EAC: Where from and where to

The EAC is a regional economic cooperation bloc comprising of five member states (Burundi, Kenya, Rwanda, Tanzania and Uganda). The origins of the EAC are found in the long history or trade and economic cooperation relations that the member states of the community share. This history dates as far back as 1917 when the first customs union, between Kenya and Uganda, was established. After that, at least four other regional economic cooperation arrangements were established – including the East African Co-operation (1993–2000) – before the East African Community was finally established.

The Treaty for Establishment of EAC was signed on 30 November 1999 and entered into force on 7 July 2000 following its ratification by the original three Partner States – Kenya, Uganda and Tanzania. Rwanda and Burundi acceded to the EAC Treaty in June 2007 and became full members of the community in July of the same year.

The vision of EAC is to become "a prosperous, competitive, secure, stable and politically united East Africa", and its mission is "to widen and deepen Economic, Political, Social and Culture integration in order to improve the quality of life of the people of East Africa through increased competitiveness, value added production, trade and investments". The EAC region has

[4] This section was drawn from various official COMESA documents, including information posted on the official website (www.comesa.int)

undertaken to pursue deeper regional integration having already achieved a number of integration milestones:

- The 3rd EAC Summit of November 2001 in Arusha, which established the East African Legislative Assembly and East African Court of Justice
- The EAC Summit of March 2004 saw the signing of the Protocol for Establishment of the EAC Customs Union
- The EAC Customs Union became operational in January 2005, with a five-year transitional period
- Rwanda and Burundi acceded to EAC Treaty in June 2007 and became full members of the EAC in July 2007
- In July 2009 Rwanda and Burundi joined the EAC Customs Union
- The Protocol for the Establishment of the EAC Common Market was signed in November 2009
- EAC became a fully-fledged Customs Union in January 2010, following the end of the five-year transitional period
- The EAC Summit of Heads of State (December 2010) adopted the EAC Anthem.

Looking ahead, EAC is poised to undertake a number of steps to further deepen its integration. According to its Third Strategic Development Plan (2006–2010), having achieve the major milestone of establishing a fully fledge customs union, the community will seek to establish a common market and then graduate to a monetary union and ultimately, a political federation (in that order). The timeframe and pace of establishing these stages of integration is not clear. However, the advent of the Tripartite FTA is likely to have an influence on the region's integration agenda.[5]

2.3 SADC in retrospect and in prospect

SADC currently consists of 15 member states.[6]The original motives for regional cooperation in Southern Africa included the struggles for political independence, security, and regional solidarity as well as the fight against apartheid. The motives inspired Angola, Botswana, Lesotho, Malawi, Mozambique, Swaziland, Tanzania, Zambia and Zimbabwe to establish the Southern African Development Coordination Conference (SADCC) in April 1980. With the changing times, in August 1992, the heads of state and governments of SADCC signed the SADC Treaty and a Declaration, establishing SADC with a mission "to promote sustainable and equitable economic growth and socio-economic development through efficient productive systems, deeper cooperation and integration, good governance, and durable peace and security, so that the region emerges as a competitive and effective player in international

[5] This section was drawn from various official EAC documents, including information posted on the official website (www.eac.org)

[6] Angola, Botswana, Democratic Republic of Congo (DR Congo), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe.

relations and the world economy". The SADC Treaty provides the legal basis and framework for pursuing and achieving this mission.

Among the most important trade and regional development-related instruments for implementing the SADC Treaty are the SADC Protocol on Trade (signed in 1996 and effective since 2000) and the Regional Indicative Strategic Development Plan (RISDP) (approved by SADC Summit in 2003), which set ambitious targets for regional integration:

- An FTA: aiming to have 85% of trade in goods as free trade by 2008
- Completion of negotiations of the SADC Customs Union by 2010
- Completion of negotiations of the SADC Common Market by 2015
- SADC Monetary Union and SADC Central Bank by 2016
- Launch of a regional currency by 2018.

As might be expected, the integration targets have not been met in accordance with the timetable that was original agreed upon. For instance, the first stage of establishing a fully operational SADC FTA was only completed at the end of 2011. All SADC countries except Angola and DR Congo are participating in the SADC FTA, trading on a duty- and quota-free basis.

Looking ahead, the timelines on the other integration targets are likely to be rolled forward significantly, although the extent and nature of these time adjustments is unclear. In similar manner to the other two regional economic communities, a likely decisive factor in setting new timelines for SADC will be the negotiations surrounding the Tripartite FTA (discussed in more detail below) and the outcome in relation to its eventual establishment. Currently it is difficult to pass any sort of judgment about the new timeframe that is likely to emerge for negotiating and establishing the customs union and other integration arrangements.[7]

2.4 Origins of the Tripartite FTA

The origins of the Tripartite FTA is found in the high level negotiations regarding the establishment of a Grand TFA, which have been taking place since 2008. This is pursuant to the meeting of the heads of state and government of COMESA, EAC and SADC in October 2008 in Kampala which considered economic cooperation and integration in Africa. One of the most important decisions taken during that meeting was about the establishment of a single free trade area, the Tripartite FTA, which was envisioned to cover the 26 countries of COMESA, EAC and SADC (COMESA 2010a; COMESA 2010b). It was agreed that the Tripartite FTA would form a huge economic market, covering 48% of Africa's 54 countries.

The secretariats of the three regional economic communities were given the responsibility of preparing all the legal and technical documents necessary for establishing the FTA as well as identifying the required steps for implementation. They jointly prepared a draft agreement,

[7]This section was drawn from various official SADC documents, including information posted on the official website (www.sadc.int)

which covers various complementary areas that are necessary for effective functioning of a regional market. The main proposal is to establish the FTA on a tariff-free, quota-free, exemption-free basis by simply combining the existing FTAs of COMESA, EAC and SADC. A preparatory period of early 2010 to June 2011 was agreed to. It was further expected that by 2012, all three FTAs would have eliminated all exemptions or sensitive lists internally.

In the interim, regional trade policy is complicated in that the EAC is already implementing its customs union launched in December 2004, while in June 2009 COMESA initiated its own process for establishing a customs union with a transitional period of three years (2010–2012). This is pursuant to COMESA's establishment of a COMESA FTA that was launched October 2000, to which Zambia is a member. Finally, in the Southern African region, the Southern African Customs Union (SACU) – Botswana, Lesotho, Namibia, South Africa and Swaziland – was established in 1910, making it the world's oldest customs union. All SACU member states are also members of SADC. The SACU states all participate in the SADC FTA, which was launched in August 2008. The legal basis for the SADC FTA is the SADC Protocol on Trade (aforementioned), which was signed in 1996 and has been in effect since 2000. SADC originally aimed to become a customs union by 2010, but the timetable for this was revised (although the new timing is not clear).

Table 2 illustrates the regional integration efforts among the Tripartite FTA regional economic communities, showing the participation of all the countries in each of the three economic communities and the main trade arrangements involved.

Clearly, there is a considerable amount of overlapping membership among the 26 countries that are undertaking to establish the Tripartite FTA. These countries participate variously in the customs unions and FTAs established in the region. Only 9 of the 26 countries are members of just a single regional economic community, participating in only one trade arrangement. As they are constantly required to evolve, all these agreements and arrangements impose constant trade policy revisions on member states.

Some of the implications of the trade reforms for one country, Zambia, are the focus of this paper, but other salient aspects will have to be taken up as areas for further research. For instance, since a customs union is a deeper form of regional integration than a FTA, the presence of three customs unions – each potentially with its own CTN, CET and Customs Management Regulations among other things – and the legal, economic and political interface connecting the three unions under the Tripartite FTA, will be important concerns. Will the Tripartite FTA have an external trade policy position and, if so, what will this look like? What will the implications be for administrative revisions, policy domestication, implementation, customs management, and what will the trade results be? These questions are undoubtedly important, but are left alone for now.

Table 2. Country participation in regional economic communities and regional trade arrangements

	COMESA	SADC	EAC CU	SACU	COMESA FTA	SADC FTA
Angola		√				
Burundi	√		√		√	
Botswana		√		√		√
Comoros	√				√	
DR Congo	√	√				
Djibouti	√				√	
Egypt	√				√	
Eritrea	√					
Ethiopia	√					
Kenya	√		√		√	
Lesotho		√		√		√
Libya	√				√	
Madagascar	√	√			√	√
Malawi	√	√			√	√
Mauritius	√	√			√	√
Mozambique		√				√
Namibia		√		√		√
Rwanda	√		√		√	
Seychelles	√	√			√	√
South Africa		√		√		√
Sudan	√				√	
Swaziland	√	√		√		√
Tanzania		√	√			√
Uganda	√		√			
Zambia	√	√			√	√
Zimbabwe	√	√			√	√
Total Members	19	15	5	5	14	13

√*means "is a member of" or "is participating in"*

Since the imminent trade reforms inherent in the formation of both the COMESA Customs Union and the Tripartite FTA are likely to have significant trade, revenue and economic (competitiveness and industrial development) effects for countries like Zambia, understanding these more immediate effects is more important for this paper.

2.5 Regional integration and the multilateral trading system

It is tempting to ask whether regional integration is, in effect, against the rules, disciplines and legal provision of the multilateral trading systems of the World Trade Organisation (WTO). The Preamble to the WTO Agreement highlights "the elimination of discriminatory treatment in international relations" as an objective of the multilateral trading system (WTO 2012). That is, the multilateral trading system basically works on the principle of trade without

discrimination. This means under the agreement, member countries are not normally allowed to discriminate between trading partners. This literally means countries cannot grant one trading partner special favours like lower tariff rates or no quotas for certain products without granting the same special favours to all other WTO members. This principle is known as most-favoured-nation (MFN) treatment, and is in place to ensure that a country that grants trade advantages to its "most favoured nation" or most favour trading partner nominally extends this same treatment or these same advantage to all other members of the WTO (WTO 2012).

According to the WTO (2012), the MFN principle is "so important that it is the first article of the General Agreement on Tariffs and Trade (GATT), which governs trade in goods. MFN is also a priority in the General Agreement on Trade in Services (GATS) (Article 2) and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) (Article 4), although in each agreement the principle is handled slightly differently".

Some exceptions to the MFN treatment rule are allowed, with the MFN treatment changing quite fundamentally when dealing with regional trade integration. When establishing a regional trade agreement, Members of the WTO who are party to the regional agreements were originally required to seek derogation of one form or another to avoid legal inconsistency with the MFN rule. Over time, the system itself has developed a series of conditional exceptions which members can draw on when their regional agreements cause them to depart from the MFN commitment. These exceptions are contained in GATT Article XXIV, Enabling Clause, Understanding on GATT Article XXIV and GATS Article V. Thus, for instance, countries can set up free trade agreements that apply only to goods traded within the group, discriminating against goods from outside the trading bloc. In other cases, more advanced economies can grant developing and least developed countries special access to their markets. In yet other cases, countries are allowed to raise barriers against products that are considered (and can be proven) to be trading unfairly from specific countries. Regarding services, countries are allowed in "limited circumstances" to discriminate, although the agreements reportedly only permit these exceptions under strict conditions. In general, regional integration is permissible under WTO and in view of GATT Article XXIV, GATT Article XXIV and GATS Article V, and bears no direct inconsistency with MFN treatment rules.

3 STUDY METHODOLOGY

The study focuses on Zambia as the country case and covers the country's bilateral trade and tariff relations with its major trading partner countries and economic communities. It draws on the quantitative empirical methods of analysis described below and on official national sources of trade, customs and other data.

3.1 Methods of analysis

The study used the following methods of *ex-ante* analysis:

- **Import trade and tariff profiling**: this was done as a simple descriptive statistical analysis of Zambia's trade profile for 2000–2010 and tariff structures in 2010. Zambia's trade profile captured bilateral import trade shares with the country's top ten trading partners. For the tariff profiling, Zambia's tariff structure was summarised according to tariff bands and rates of protection.
- **Analysis of required trade policy reforms**: this was a simple comparative content analysis of Zambia's tariffs with regional tariff structures. The national tariff structure is linked to tariff structures under other trade protocols, namely the SADC structure (abbreviated as "SDC" in the customs nomenclature) as existed in 2010, the South Africa only structure ("SSA" in the customs nomenclature), and the COMESA CET structure. This helped to determine the extent of required tariff changes under each protocol.
- **Analysis of revenue implications and economic effects**: the study utilised the World Bank's Tariff Reform Impact Simulation Tool (TRIST; see Brenton et al.2009). TRIST has been used extensively by the COMESA Secretariat to simulate potential short-term impacts of tariff reforms, including for Zambia (see Annex 1 for more details). The simulations of TRIST have a strong focus on revenue and trade effects of trade reforms and less on economic effects per se such as domestic production competitiveness or competition effects, employment effects and poverty reduction, welfare effects. This is a limitation that Annex 1 readily acknowledges. The TRIST results are mainly presented as marginal effects or changes between the pre- and post-reform simulation scenarios. However, given the trade and revenue focus of the main part of the study's methodology, the results are also presented as a proportion of the Zambia economy's total actual tax revenue of the relevant year (2010), excluding grants and other non-tax revenues.

3.2 Data requirements

The data required for the analysis on trade, tariff and tariff revenue are mainly customs data. These were mainly obtained from the Automated System for Customs Data of the Zambia

Revenue Authority (ZRA), with the COMESA Secretariat providing data collection facilitation and technical data management support.[8]

The detailed data were collected for 2010 (and for 2009) at the Harmonised System (HS)-8 digit (or "aggregate transactional") level. Data specifications on trade values, trading partners, customs procedure codes, tax rates (statutory tariffs, VAT and excise duty), all applicable exemptions and special preferences, were elaborated in a Data Requirements Form, which was the main instrument used for data collection. The data obtained from the ZRA were sufficient for most of the above methods of analysis.

Additional data such as on CETs were obtained from the COMESA Secretariat. For basic background analysis and macroeconomic aggregates like GDP and government revenue figures, extra data were obtained from the Central Statistical Office, Ministry of Finance and National Planning, the WTO's World Integrated Trade System (WITS) database, and the World Bank's World Development Indicators (WDI), among others.

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[8] The study acknowledges the important roles that both institutions playing in assisting the data collection.

4 STUDY RESULTS

The results are presented in five parts as follows:

- Zambia's trade policy
- Trade taxes, tariff structure and implications of regional integration
- Trade profile: outcomes
- Trade reform simulations and revenue implications
- Implications of trade reforms for import prices, protection and competitiveness.

4.1 Zambia's trade policy

Zambia's trade policy seeks to enhance domestic productivity through imports, and the competitiveness of Zambian export products abroad. Trade policy is closely linked to the country's development plans, the Fifth National Development Plan (FNDP), which covered the period 2006–2010, and the Sixth National Development Plan (SNDP), which covers 2011–2015; both plans articulate the country's medium-term development objectives (MoFNP 2006; MoFNP 2011). Among other things, the FNDP focused on strengthening the linkages between the resource sectors and manufacturing and fostering a competitive and outward-oriented economy. The SNDP reinforces these objectives, emphasising trade liberalisation, economic diversification promotion, and export-led growth enhancement.

In recognition of the importance of trade in supporting the achievement of economic growth and development, the FNDP mainstreamed trade into Zambia's national development plan for the first time. In line with its vision, it positioned the commerce and trade sector to become export driven, competitive, and commercially viable. The goal was to improve the quality of locally produced goods and services and to increase the country's share in world exports. To further support commerce and trade, in 2004 Zambia embarked on the Private Sector Development Reform Programme (PSDRP) aimed at reducing the cost of doing business in the country and encouraging competitiveness in the private sector.

The government appears poised to continue pursuing a liberal trade policy at both the regional and international levels: Zambia has continued to work towards a wider integration agenda by participating actively in SADC, COMESA, the Tripartite Framework, and the multilateral trading system. The SNDP pronounced that during its implementation period, the government will expand the scope and coverage of its multilateral, regional and bilateral arrangements (such as FTAs and Economic Partnership Agreements) to ensure greater access to markets, trade and investment opportunities. The country will also continue participating actively in the multilateral trading system and ongoing negotiations under the Doha Development Agenda (WTO 2009; MoFNP 2011).

Some of the specific trade agreements that Zambia is party to include the following:

- African Growth and Opportunity Act (AGOA)

- General System of Preferences
- COMESA FTA
- SADC Trade Protocol and the special SADC Mozambique, Malawi, Tanzania and Zambia (SADC–MMTZ) Agreement

Regarding so-called *originating imports* from member states that have ratified particular preferential trade agreements with Zambia, in most cases certificates of origin are required. Currently, Zambia accepts certificates of origin for the following trade agreements:

- COMESA
- SADC
- AGOA (status not clear as at the time of preparing this report)
- European Union (status not clear as at the time of preparing this report)
- China bilateral trade agreement (status not clear as at the time of preparing this report).

In recognition of the strategic importance of bilateral trade arrangements in enhancing exports, Zambia has been negotiating bilateral trade arrangements with DR Congo, Mozambique, Nigeria, Tanzania and Zimbabwe in Africa as well as with China and India. There are two main concerns regarding the bilateral agreements that Zambia is negotiating or implementing. First, the processes and systems for negotiation are quite closed, while those for notifications to WTO, regional bodies like COMESA and SADC, and national stakeholders are nearly non-existent. As a result there is a serious paucity of information about which agreements are actually under negotiation or have been finalised and what their benefits to the domestic private sector are expected to be. The status of most bilateral agreements is just not clear and information sharing is weak.

Second, as a result of the weak information sharing systems, the policy commitments that Zambia is bound to in these agreements is not well known. Whether these agreements are net beneficial or detrimental to the country, particularly to the private sector, is unclear. There is an urgent need to establish a transparent and up-to-date information sharing system that reliably informs all stakeholders (private and public sectors and donors) about the status and content of bilateral trade and investment agreements that are being negated or implemented.

Zambia's participation in regional and bilateral trade arrangements is particularly high by regional standards (recall Table). This means the country has to contend with reconciling multiple trade policies simultaneously, as dictated by regional and multilateral trade negotiations and positions. Harmonising its multiple memberships and participation in a number of trade arrangements could help Zambia to overcome some of the complexities that come with overlapping membership and could improve its trade negotiation, trade facilitation and ultimately trade performance outcomes. It will therefore be important to determine the state of play with regard to the above mentioned bilateral trade agreements and understand their interface with the country's commitment to regional integration under COMESA and SADC. One way of supporting this would be to harmonise the regional arrangements and

regional economic communities themselves, something that is currently underway in the region. But beyond this, it will be helpful for bilateral agreements to be negotiated in relation to a common external trade policy position.

4.2 Trade taxes, tariff structure and implications of regional integration

At the border, Zambia applies trade taxes as follows:

- **Customs duty**: a customs duty rate (either MFN or under special preferences such as FTAs) is applied on the cost, insurance and freight (CIF)value of the import consignment at the border.
- **Excise tax**(on selected products) is applied on a compounded basis on the CIF value of imports plus the monetary value of customs duty tariff revenue collected.
- **Value added tax (VAT)**: is applied on a compounded basis on the CIF value of imports plus the monetary value of customs duty tariff revenue collected and the monetary value of excise duties collected.

Customs duties are inherently discriminatory since they are not equally applicable to domestic production. On the other hand, excise taxes and VAT are non-discriminatory since they are equally applicable in Zambia's domestic economy; they are only referred to as trade taxes in this case because they are applied on imports at the border.

The above formulae for trade tax application are unlikely to change with trade reforms such as those implied under regional integration; that is unless a form of customs union involving the common collection of customs duties in adopted in one of the regional economic communities to which Zambia is a member. What is likely to change is the structure of the discriminatory component of trade taxes: the customs duty. Indeed, Zambia's participation in regional and multilateral trade arrangements has had implications on how the country engages in import trade. As of 2010, Zambia's multilateral (or MFN) trade was based on a fairly streamlined ad valorem external tariffs structure, comprising four bands: 0%, 5%, 15%, and 25% (see Table 3). Within this structure, tariffs are applied on an MFN basis on goods from other WTO member states.

In 2010 there were 6,009 tariff lines at the HS 8-digit (transactional) level, a reduction from the estimated 6,234 lines in 2004. This suggests some amount of tariff simplification and harmonisation. As the table reveals, during 2010 the largest portion of MFN tariffs were in the 15% tariff band (31% of all tariff lines across all bands) and rather fewer were in the 5% band.

Table 3 also shows Zambia's tariff structures under the SADC trade protocol. In 2010, while Zambia was granting duty-free and quota-free access to all goods originating from COMESA FTA member countries, it was concurrently was applying two sets of tariff structures to SADC and to South Africa under the SADC trade protocol. For goods from the "rest of SADC" (i.e., all SADC excluding South Africa), most tariff lines (73%) were at a 0% duty rate and only 3% were

at the 25% rate; Zambia did not import from SADC on 24% of the 6,009 tariff lines in 2010. For South African goods particularly, 48% of the tariff lines were at 5% duty while 35% were at 0%; relatively smaller allocations, 1 and 3% respectively, were at 15% and 25%. Even though relatively low tariffs were applied to South Africa, import tax revenue collections on South African goods accounted for 10.3% of total trade tax revenues on imports in 2010. This was about 4.3% of government's total tax revenue (excluding grants and other non-tax revenues) in the same year. Therefore even before applying the detailed simulations in the analysis, it was clear that trade with South Africa posed significant fiscal revenue implications for Zambia.

Table 3. Zambia's tariff structure, 2010

	CD		SSA		SDC	
	Lines	**(%)**	**Lines**	**(%)**	**Lines**	**(%)**
0%	1,328	22%	2,114	35%	4,399	73%
5%	884	15%	2,913	48%	3	0%
10%	0	0%	21	0%	0	0%
15%	1,923	32%	36	1%	25	0%
25%	1,874	31%	175	3%	154	3%
Blank lines	0	0%	750	12%	1,428	24%
Lines not matched	0	0%	0	0%	0	0%
All bands	6,009	100%	6,009	100%	6,009	100%

Note: CD = MFN customs duty rate; SSA = rate to goods originating from South Africa only; SDC = rate to goods originating from other SADC member states excluding South Africa
Source: constructed from ZRA customs data

It is important to note with regard to Zambia's implementation of the SADC Trade protocol that on 1 January 2012 the country was supposed to start complying fully with the duty-free, quota-free stipulations of the SADC FTA. This was based on completion of the tariff phase-down period concluded in 2011. Reportedly, the domestication and full implementation of the FTA was provided for in Zambia under Statutory Instrument number 103. That is, the authorities claimed that, as of 2012, goods originating from all SADC Member States including South Africa were enjoying free access into Zambia. Whether the trade and customs statistics for 2012 will support this claim is yet to be determined.[9] Overall, since January 2008 when SADC attained the status of an FTA, producers and consumers have been eligible to not pay import tariffs on an estimated 85% of all trade in community goods in the initial 12 FTA countries. The remaining tariff lines should be almost completely phased out by the end of 2012 (see Box below).

[9] The study was also not able to obtain a copy of the Statutory Instrument (SI 103) sanctioning the application of duty-free and quota-free access of goods originating from SADC into Zambia.

However, as the World Bank has pointed out, there are many non-trade barriers (NTBs) to free trade, and proper free trade is still a long way off. For instance, the World Bank estimated that one South African grocer was spending as much as $20,000 per week in import permits to take meat, milk and other goods to its stores in Zambia. And depending on the composition of the cargo being transported, a truck might require as many as 1,600 documents to cross borders from South African through transit countries and into Zambia. Reportedly, some South African retailers exporting goods to their stores in Zambia opted to pay the full tariffs rather than seeking SADC Trade protocol documents; the latter process was simply too costly and bureaucratic. Clearly, if not addressed, "red tape" and other NTB trade barriers will continue to cost Zambian consumers and producers significantly through higher than necessary import prices.

Apart from the existing FTAs that Zambia now fully participates in(COMESA and SADC), the country is gearing up to join the COMESA Customs Union. The Customs Union will imply adoption of a CET structure, a CTN, and a common CMR. This will essentially define Zambia's common external trade policy position. The CET for COMESA has been proposed as shown in Table 4:

Table 4. COMESA CET structure

CET Category	Lines	% of total lines on CET
0%	2,709	39%
10%	2,196	32%
25%	1,998	29%
Total tariff lines	6,903	100%

Source: author's contraction (CET data provided by COMESA Secretariat)

The CTN that underpins this CET is based on the 2007 version of Harmonised System (HS2007), or

SADC FTA tariff phase down

The liberalisation of tariffs has taken place at different rates. The more developed member states have reduced tariffs at a faster rate, with South Africa and the other SACU countries removing most tariffs in 2000. Middle-income countries like Mauritius gradually reduced their tariffs each year between 2000 and 2008, while least developed countries like Mozambique and Zambia introduced tariff reductions during 2007/2008. These gradual reductions, or so-called tariff phase-downs, apply to all goods classified into four tariff categories: A, B, C and E. Different timeframes for tariff reductions apply. Angola and DR Congo are not part of the FTA phase-down.

Tariff phase-down schedule

Category A: Immediate liberalisation: all tariff lines within this category are immediately reduced to 0% from the date of implementation.

*Category B: Gradual liberalisation (The Principle of Asymmetry):*Front loading – gradual liberalisation by SACU – tariff lines are reduced by equal instalments from year 1 to year 8.Mid loading – gradual liberalisation by Mauritius and Zimbabwe – tariff lines are reduced by equal instalments from year 4 to year 8.Back loading – gradual liberalisation by MMTZ – tariff lines are reduced by equal instalments from year 6 to year 8.

Category C: Sensitive goods: These refer to goods of economic importance to member states. Tariff reduction on such goods only starts after the 8 year period. They represent 15% or less of tariff lines.

Category E: Exclusion list: This list consists of very few goods such as, for example, firearms.

so-called HS3. Clearly, the CET structure does not match with Zambia's MFN tariff structure, which was highlighted in Table 3.

A detailed tariff-line-by-tariff-line comparative analysis of the duty rates allocated to the various transactional lines in Zambia's MFN structure versus those in the COMESA CET is summarised in Table 5. The table basically captures what the 2010 MFN structure looks like in comparison to the CET. It tries to determine how many tariff lines in the MFN structure are matched or mismatched with the CET. The 2009 MFN structure is also included for purposes of explanation and basic comparison only.

Table 5. Distribution of Zambia's MFN tariffs across the COMESA CET

	CD 2010		CD 2009	
	2010	**(%)**	**2009**	**(%)**
0%	1,155	19%	1,209	20%
10%	-	0%	-	0%
25%	1,225	20%	1,283	21%
CD < CET	492	8%	596	10%
CD > CET	3,039	51%	2,912	49%
Mismatches	98	2%	-	0%
Total	6,009	100%	6,000	100%

Note: CD = MFN customs duty rate

Source: author's construction

Generally, a significant proportion (59–61%) of Zambia's MFN tariffs is not aligned to the COMESA CET. Only 19% of Zambia's tariffs assigned to 0% duty in the MFN are also at 0% in the CET, while only 20% of tariffs assigned to 25% in the MFN are also assigned to 25% in the CET. The rest (61%) are either: assigned a lower tariff rate than would obtain in the CET (8%) and would have to be appropriately increased during reforms; assigned a higher tariff than in the CET (51%) and would have to be appropriately reduced during reforms; or do not match with CET definitions at all (2%) due to tariff nomenclature differences between Zambia's 2010 MFN structure and the CET. This means that Zambia will have to undertake a considerable tariff and trade policy reform (including the legislation of COMESA's CTN) to implement the CET effectively. The tariff reforms will mainly mean further liberalisation through tariff reductions as the country aligns to the COMESA CET.

An important point to note is that the comparison in 2010 relates the 2007 COMESA CET (based on HS3) with the 2010 MFN, which was reportedly based on a variant of HS3 that had not fully migrated to the HS3 version and its tariff nomenclature. This perhaps explains the mismatches on 2% of all tariff lines. As confirmed by the authorities, in 2012 Zambia reportedly fully migrated to HS2007 (HS3) and is now reportedly fully compatible with

COMESA CTN and CET,[10] although some observers have reservations about the validity of this claim because Zambia has not domesticated the COMESA CTN through appropriate legislation such as a Statutory Instrument.

The four main points from this section are that:

1. **There is an element of non-transparency and a paucity of information** regarding the way bilateral trade agreements are negotiated and implemented, suggesting an urgent need to establish a transparent and reliable bilateral trade (and investment) tracking information system and enhance information sharing with all stakeholders (private and public sectors and donors).
2. From 2012 onwards, **the implications of formation of a Tripartite FTA should essentially be a non-issue** if all import trade, revenue and competitiveness adjustments have already taken place as Zambia will be fully applying with the COMESA and SADC FTAs. However, understanding the import trade and revenue implications of the trade reform is nonetheless useful and important for policy.
3. Even with Zambia's considerable trade liberalisation record achieved through tariff reductions under both the COMESA and SADC FTAs**, the widespread presence of NTBs (e.g. highly bureaucratic processes, restrictive rules and disciplines on origin, prohibitively expensive import licenses) continue to impose high cost Zambian consumers and producers high import prices**. NTBs are an important constraint, limiting the benefits of trade, regional integration and economic cooperation.
4. Looking ahead, **the formation of the COMESA Customs Union will require that Zambia takes on more tariff liberalisation and trade reform** (e.g. legislation of the COMESA CTN and adoption of the COMESA CET). The economic implications of this reform are not known and will be important to quantify. Similarly the political implications of this trade reform, including potential loss of trade policy space and autonomy to negotiate bilaterally – aspects that are beyond the scope of this study – will have to be carefully weighed against the anticipated benefits such as customs administration efficiencies, greater power when negotiating from a common regional front, political trust and strides in pan Africanism, and so on.

4.3 Zambia's trade profile: outcomes

Before qualifying the implications of the trade reforms discussed above, a short historical view of trade performance is useful.

Bearing in mind that a key trade policy objective in the FNDP was the expansion of Zambia's share in world trade, the country's 20-year trend of shares of global imports and exports is interesting. Figure 1 shows that while the country's share in world trade is very small (less than 0.05%), Zambia did manage to expand the share during the FNDP period (2006–2010).

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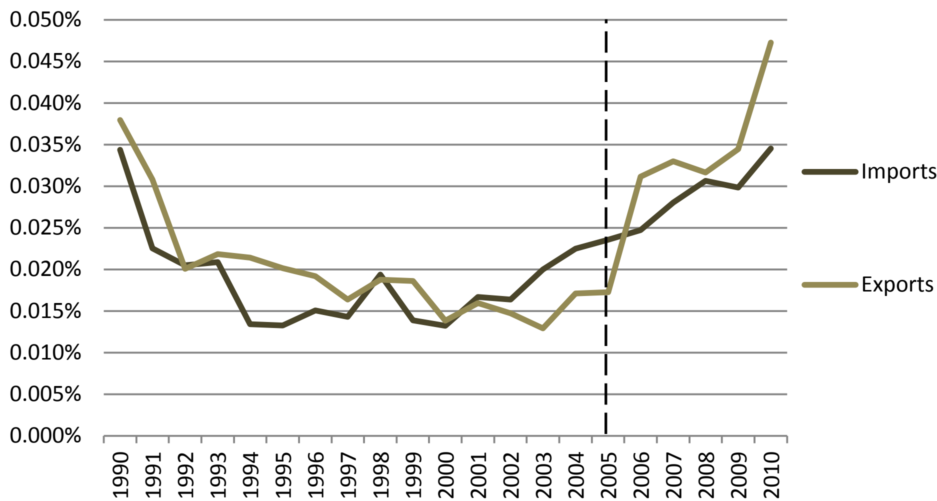
[10] This position was provided by the revenue authorities, but was not verified through direct observations as the study was unable to obtain Zambia's 2012 tariff nomenclature for comparison. Indeed, this was outside the scope of this study, given the study's reference period of up to 2010.

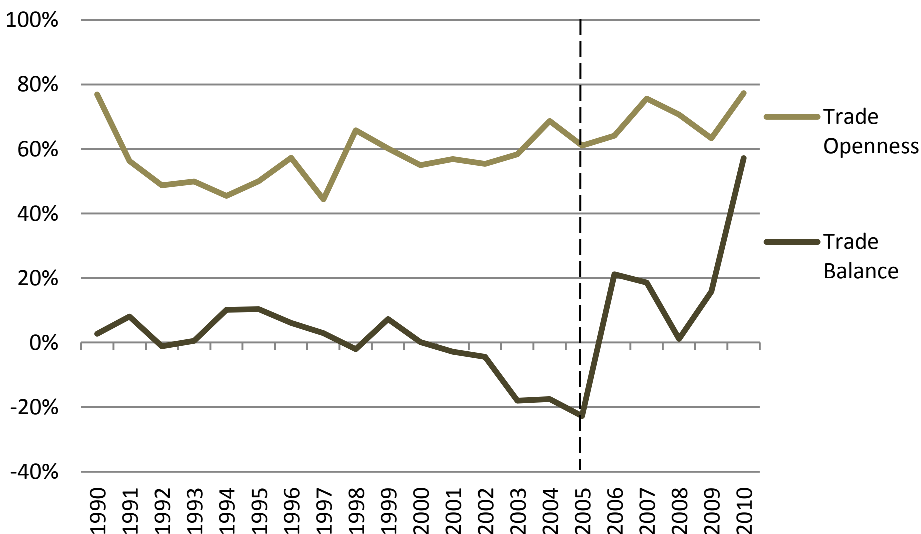
Figure 1. Share of Zambian trade (imports and exports) in world trade



Source: constructed from WDI

In a descriptive statistical sense, 2005 marked a clear turning point in Zambia's trade in the world, particularly as relates to exports. This is possibly closely related to the PSDRP that the country embarked on in 2004.It is also possibly closely related to the global rebound in copper prices along with a rebound in Zambia's production and export of the commodity. Notable improvements in the country's trade openness and particularly its balance of trade positions were witnessed from 2004, and they maintained an upward trend despite the destabilising effects of the global economic crisis in 2008–2009 (Figure 2).

Figure 2. Trade openness (exports + imports) and trade balances (export – imports), % of GDP



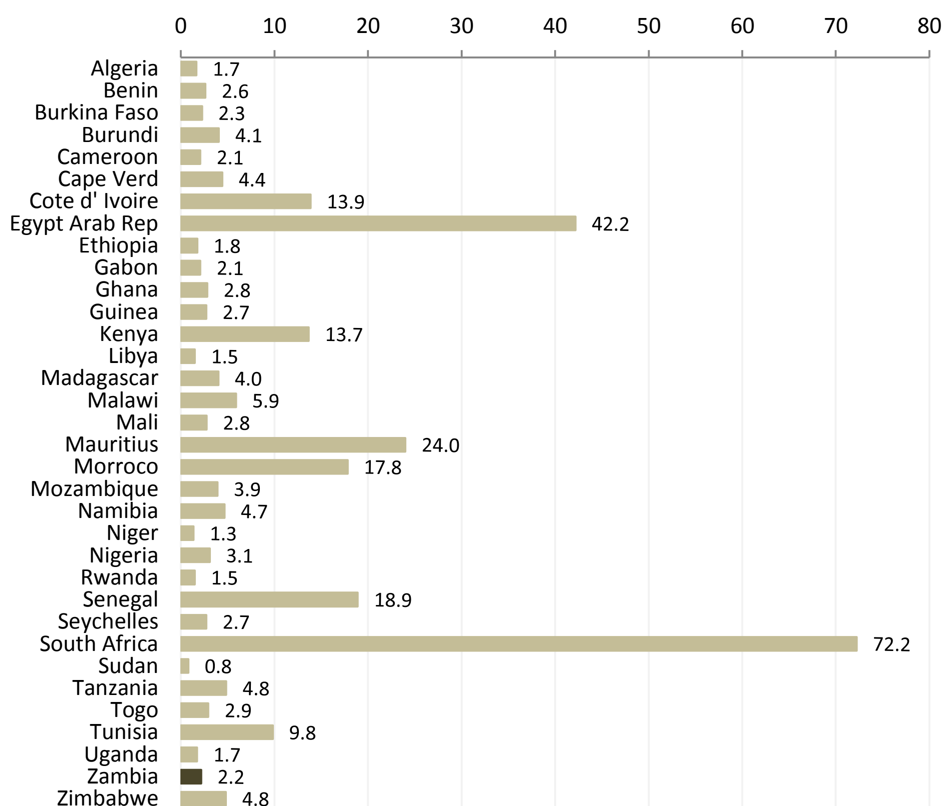
Source: Constructed from WDI and WTO datasets

Despite the improvements, Zambia's share in world trade is still very small. Considering its endowments, the country's trade performance remains dismal compared to other countries in the world or even in Africa.

Munalula and Cheelo (2011) provide clear evidence of the dismal performance of Zambia's trade, although their analysis focuses on export trade, not imports (Figure 3). They analyse a sample of 34 countries comparing actual trade outturns in terms of trade efficiency relative to stochastic trade frontiers for African trade – that is, frontiers that represent the maximum possible trade achievable, in the absence of any trade inhibitors under given circumstances (Armstrong 2007).[11] Figure 3 shows that Zambia's trade efficiency was very far from its full potential African trade efficiency outcome, beating only 10 out of the 34 countries considered. While export promotion strategies might have helped to expand exports, the expansion is from a very small base indeed. And more importantly, the ease-of-doing-business in Zambia, though massively improved, poses serious constraints on the economy. This is underpinned by, among other things, very high costs of doing business. Commercial strategies that seek to lower the cost of doing business by making inputs (including imported raw materials), intermediate products and raw materials going into industrial goods, cheaper are likely to make a huge positive impact if formulated and applied correctly. Tariff reform can be a powerful tool for reducing business input costs, particularly for a landlocked country like Zambia with limited domestic input choices.

[11]For purposes of explanation the frontier is calculated as 100% and country outturns reflect the extent of trade efficiency relative to the 100% frontier. The distance between the frontier and the actual outturn therefore represents the unmet trade potential of each country.

Figure 3. Average trade performance on African trade frontier (%), 2002–2007



Source: Adapted from Munalula and Cheelo (2011) forthcoming

To determine how the trade reforms under the Tripartite FTA and the COMESA Customs Union might affect Zambia's imports and trade revenue position, it is important to consider, as a baseline, the state of play prior to the reforms. As earlier noted, in this study 2010 is taken as the baseline reference period prior to reforms, the subsequent trade policy adjustments discussed in Section 4.2notwithstanding.

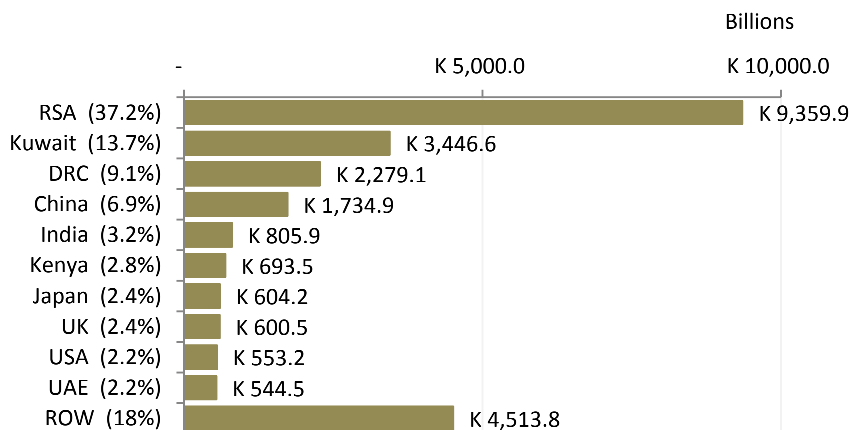
In 2010, Zambia's total imports amounted to ZMK 25.1 trillion. This was about 150% of the 2010 national budget and 32% of 2010 GDP. Imports therefore formed a significant part of Zambia's economic activity.

In terms of bilateral trade, South Africa dominated the trade profile in 2010, accounting for over 37% of Zambia's total imports (Figure 4). Kuwait, DR Congo and China were other significant import sources in 2010. The profile closely mimics Zambia's overall pattern of bilateral trade over the 13 years prior to 2010 (i.e., 1997-2009) with South Africa consistently at the top (Figure 5) and with some traditional partners such as UK and Zimbabwe losing ground, and less traditional partners like DR Congo,[12] Kuwait and China gaining considerable

[12] DR Congo's new dominant position as an import source mainly stemmed from its copper ore exports that were imported into Zambia for processing and re-export as copper cathodes and sheets.

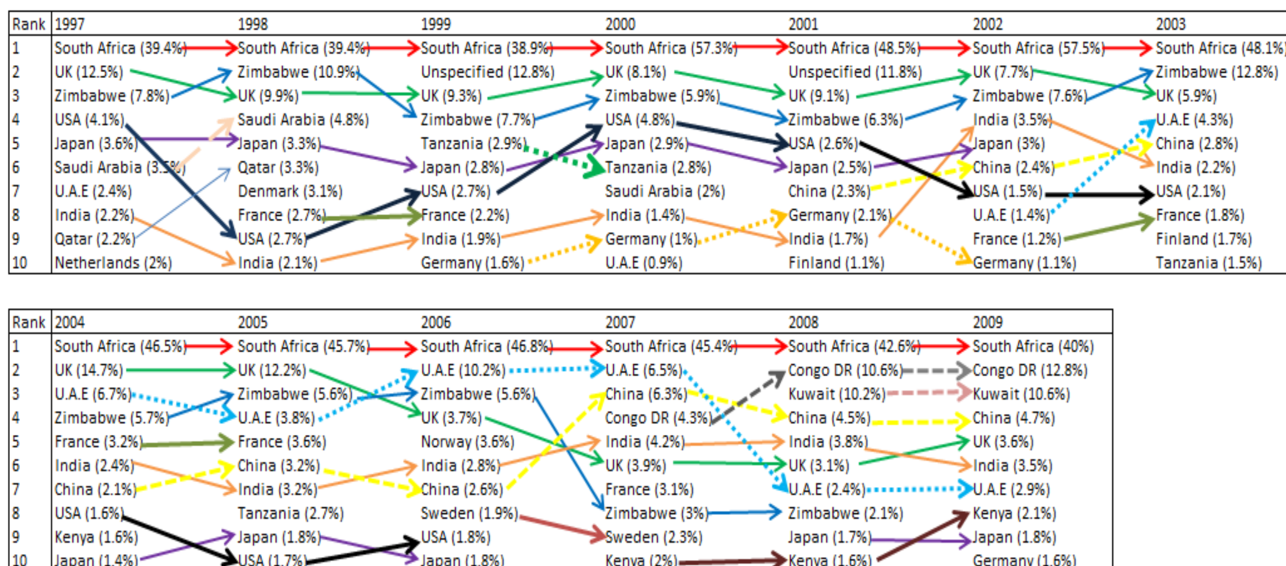
ground. The traditional import structure appears to have undergone a significant shift over the last one and a half decades.

Figure 4. Zambia's bilateral import trade with top ten partners, 2010



Source: Calculated from 2010 customs (ZRA) data using TRIST

Figure 5. Top 10 import sources for Zambia, by country, rank and share, 1997–2009



Rank	1997	1998	1999	2000	2001	2002	2003
1	South Africa (39.4%)	South Africa (39.4%)	South Africa (38.9%)	South Africa (57.3%)	South Africa (48.5%)	South Africa (57.5%)	South Africa (48.1%)
2	UK (12.5%)	Zimbabwe (10.9%)	Unspecified (12.8%)	UK (8.1%)	Unspecified (11.8%)	UK (7.7%)	Zimbabwe (12.8%)
3	Zimbabwe (7.8%)	UK (9.9%)	UK (9.3%)	Zimbabwe (5.9%)	UK (9.1%)	Zimbabwe (7.6%)	UK (5.9%)
4	USA (4.1%)	Saudi Arabia (4.8%)	Zimbabwe (7.7%)	USA (4.8%)	Zimbabwe (6.3%)	India (3.5%)	U.A.E (4.3%)
5	Japan (3.6%)	Japan (3.3%)	Tanzania (2.9%)	Japan (2.9%)	USA (2.6%)	Japan (3%)	China (2.8%)
6	Saudi Arabia (3.5%)	Qatar (3.3%)	Japan (2.8%)	Tanzania (2.8%)	Japan (2.5%)	China (2.4%)	India (2.2%)
7	U.A.E (2.4%)	Denmark (3.1%)	USA (2.7%)	Saudi Arabia (2%)	China (2.3%)	USA (1.5%)	USA (2.1%)
8	India (2.2%)	France (2.7%)	France (2.2%)	India (1.4%)	Germany (2.1%)	U.A.E (1.4%)	France (1.8%)
9	Qatar (2.2%)	USA (2.7%)	India (1.9%)	Germany (1%)	India (1.7%)	France (1.2%)	Finland (1.7%)
10	Netherlands (2%)	India (2.1%)	Germany (1.6%)	U.A.E (0.9%)	Finland (1.1%)	Germany (1.1%)	Tanzania (1.5%)

Rank	2004	2005	2006	2007	2008	2009
1	South Africa (46.5%)	South Africa (45.7%)	South Africa (46.8%)	South Africa (45.4%)	South Africa (42.6%)	South Africa (40%)
2	UK (14.7%)	UK (12.2%)	U.A.E (10.2%)	U.A.E (6.5%)	Congo DR (10.6%)	Congo DR (12.8%)
3	U.A.E (6.7%)	Zimbabwe (5.6%)	Zimbabwe (5.6%)	China (6.3%)	Kuwait (10.2%)	Kuwait (10.6%)
4	Zimbabwe (5.7%)	U.A.E (3.8%)	UK (3.7%)	Congo DR (4.3%)	China (4.5%)	China (4.7%)
5	France (3.2%)	France (3.6%)	Norway (3.6%)	India (4.2%)	India (3.8%)	UK (3.6%)
6	India (2.4%)	China (3.2%)	India (2.8%)	UK (3.9%)	UK (3.1%)	India (3.5%)
7	China (2.1%)	India (3.2%)	China (2.6%)	France (3.1%)	U.A.E (2.4%)	U.A.E (2.9%)
8	USA (1.6%)	Tanzania (2.7%)	Sweden (1.9%)	Zimbabwe (3%)	Zimbabwe (2.1%)	Kenya (2.1%)
9	Kenya (1.6%)	Japan (1.8%)	USA (1.8%)	Sweden (2.3%)	Japan (1.7%)	Japan (1.8%)
10	Japan (1.4%)	USA (1.7%)	Japan (1.8%)	Kenya (2%)	Kenya (1.6%)	Germany (1.6%)

Source: constructed from COMSTAT data (COMESA Secretariat)

The country generated sizable trade tax revenues from 2010 import trade. Actual trade tax revenues are presented in

Table 6. The total amount collected was ZMK 7.9 trillion, equivalent to 32.3% of the national budget (or 7% of GDP). Because of the compounding formula applied in tax collection at the border, VAT represented the largest share of trade taxes (69.7%). Customs duty (CD) collections were 24.8% of the total; tariff revenue represented 8% of the 2010 national budget or 1.7% of 2010 GDP.

Table 6. Zambia's trade taxes, 2010

	Statutory tariff*	Collected CD	Excise tax	VAT	Total
Total Value (ZMK billions)	2,463.3	1,339.8	296.2	3,766.3	7,865.5
Share of total revenue	-	24.8%	5.5%	69.7%	100.0%
Simple average rate	15.1%	12.9%	0.6%	14.7%	-
Weighted average rate	9.8%	5.3%	1.1%	14.1%	-
Share total tax revenue**	-	10.2%	2.3%	28.7%	41.2%

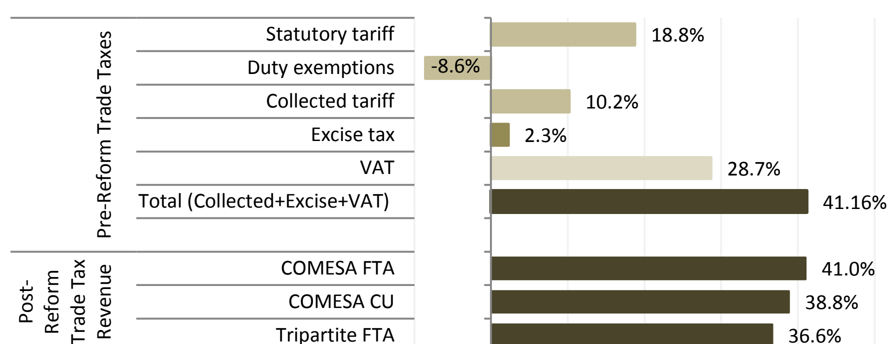
** Statutory tariffs are not actual collection of revenue; they depict what would have been collected had the tariff book been applied to the letter; the difference between collected CD and statutory tariffs provides an estimate of duty exemptions that Zambia granted.*

*** Total tax revenue for 2010 was measured as the total tax revenue of GRZ, excluding grants and other (non-tax) revenues, which was estimated at ZMK 13.1 trillion.*

Source: Calculated from 2010 ZRA customs data using TRIST

An important observation is that actual customs duty collections in 2010 were 45.6% less than they would have been had the statutory duty rates been applied to the letter in accordance with the tariff book. The difference captures the significant amount of exemptions that Zambia grants on its imports under various trade protocols and bilateral trade agreements as well as to special importer groups such as State House, selected non-profit making organisations and other holders of appropriate holders of Statutory Instruments exempting them from paying customs duties. This means Zambia lost approximately ZMK 1.1 trillion or 8.6% of total tax revenue in import duty exemptions in 2010. Figure 6presents a graphical illustration of the pre-reform situation.

Figure 6. Import trade tax revenues, % of total government tax revenue, 2010



Source: Calculated from 2010 ZRA customs data using TRIST

The actual simple average and trade weighted average rates of protection were 12.9 and 5.3% respectively, suggesting that Zambia's effective rate of protection (or customs duty) is quite low when the pattern of trade on which tariffs are applied is taken into account. Actual or effective protection was lower than statutory protection in both simple and trade-weighted terms. The effective VAT rate applied at the border (14.1%, trade weighted average) was also lower than the statutory rate of 16%.

4.4 Trade reform simulations and revenue implications

As earlier indicated, we use 2010 trade and customs data for Zambia to simulate the "would-have-been" or potential impacts on the country's imports and trade tax revenues had Zambia implemented the COMESA Customs Union and Tripartite FTA in 2010. The study used the Trade Reform Impact Simulation Tool (TRIST) – described in detail in Annex 1 – as the framework for the analysis. TRIST is an interactive Microsoft Excel based trade model that helps to simulate the short-term impacts of tariff reform on fiscal revenue, import volumes (measured in monetary value terms) and protection at country level. Its purpose is to allow policy-makers to quickly evaluate the adjustment costs associated with trade reforms.

The ensuing sub-sections present the assumptions of the TRIST simulations and the main results on trade and trade tax revenue outcomes.

4.4.1 Implementing TRIST: assumptions and simulation scenarios

To assess the potential trade and revenue impacts of the trade reforms of interest, the simulations were deliberately designed to disaggregate the impacts according to Zambia's existing and forthcoming bilateral and regional trade policy commitments as of 2010. As already noted, in 2010 Zambia was already implementing the COMESA FTA on a reciprocal basis with fellow COMESA FTA members only. As such it was expected that its trade with COMESA FTA countries was already zero rated whereas its intra-COMESA trade with non-FTA members – DR Congo, Eritrea, Ethiopia, Seychelles, Swaziland and Uganda (recall

Table 2) – was expected to still be yielding customs duty revenue collections as this was based on reciprocal reductions.

On the other hand, according to the schedule for establishment of the COMESA Customs Union, Zambia and other countries have until mid-2012 to fully implement the Customs Union. This means by that time the countries should have fully migrated to the COMESA CTN (something Zambia has already done as of the time of writing this report), aligned its MFN tariffs to the CET and adopted and domesticated the CMR. However, in 2010 these steps were not being undertaken: the country's trade and customs were not yet affected by customs union liberalisation.

Finally, in relation to the SADC FTA, while Zambia is currently granting duty-free and quota-free access under this trade arrangement, in 2010 it was not; it was in the back loading or gradual liberalisation stage of the tariff phase-down and was annually reducing duty rates on selected tariff lines by equal instalments until 31 December 2011. Hence when considered from the perspective of the forthcoming Tripartite FTA, it was reasonable to assume that Zambia's liberalisation would still be influenced by SADC liberalisation given that only partial liberalisation had been achieved under the SADC FTA in 2010.

This understanding of the 2010 state-of-play in terms of application of trade policy commitments as well as the forthcoming arrangements was the main aspect used to determine the selection of simulation scenarios for gauging the potential impacts of trade reform on Zambia's 2010 trade and trade tax revenue.

In TRIST a bilateral trade partner country or group is mutually exclusive in the sense that each country can only belong to one group or bloc. The country groups on which simulations were based include 11 mutually-exclusive trading partner configurations (groups/countries), namely COMESA[13], SADC[14], RSA (Republic of South Africa), Kuwait, UAE (United Arab Emirates), China, India, UK (United Kingdom), USA (United States of America), Japan and the ROW (Rest of the World). The selection of these country groups was based on two considerations: first, the focus on impacts of the customs union and the Tripartite FTA implied focusing on Zambia's prospective implementation of regional trade policy commitments under SADC and COMESA; and second, the focus on trade and trade tax revenue impacts meant focusing on Zambia's major import trading partners. In the relevant scenarios where South Africa was included, that country was deliberately singled out from the regional partners in SADC in order to assess its singular impact. Any country that was not placed under any of the specific groups or blocs described was designated as part of ROW.

In the absence of appropriate data, the simulations assumed that there were no sensitive product or exclusion lists on Zambia's imports. The default TRIST Model elasticities of 1.5, 1

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[13] COMESA Group: DR Congo; Djibouti, Egypt, Eritrea, Ethiopia, Kenya, Malawi, Mauritius, Rwanda, Seychelles, Sudan, Swaziland, Uganda and Zimbabwe.

[14] SADC Group: Angola, Botswana, Mozambique, Namibia, Swaziland and Tanzania.

and 0.5 for export substitution effects, domestic substitution and demand effects, respectively, were applied.

The TRIST simulations were run for full free trade scenarios (0% tariff for all tariff lines) on the country groups of interest as well as for a full customs union applying the COMESA CET (recall Table 4) for other countries of interest. Specifically, the following simulations were made:

- **Impact of COMESA Customs Union.** In this scenario, a full intra-COMESA FTA was assumed to be established in 2010, with no change to the 2010 pattern of trade and tariffs with SADC countries given the partially implemented SADC FTA (i.e. it was assumed that SADC trade with Zambia would be left as it applied in 2010). The trade and revenue changes due to China, India, the Gulf States (Kuwait and UAE), UK, USA, Japan and ROW were modelled. The marginal effects of each sequential simulation step were calculated along with the cumulative total effect.
- **Impact of Tripartite FTA**. In this set of scenarios, we again assumed a full intra-COMESA FTA was established and initially no change to the 2010 pattern of trade and tariffs with China, India, the Gulf States, UK, USA, Japan and ROW. The trade and revenue changes due to an amalgamation of full COMESA and SADC FTAs were modelled. The marginal effects of each sequential simulation step were calculated along with the cumulative total effect.

In a final step of analysis, we compared the marginal effects under the Tripartite FTA to those under the COMESA Customs Union.

4.4.2 Simulation results: full liberalisation under the COMESA FTA

The summary results for a scenario of full liberalisation under the COMESA FTA and then application of the COMESA CET under the Customs Union, with no sensitive products or exclusions are shown in Table 7. The first results column of the table shows the potential impacts on 2010 trade and revenues if a full free trade was established under the COMESA FTA, assuming countries like DR Congo, Eritrea, Ethiopia, Seychelles and Uganda joined the COMESA FTA, enabling Zambia to reciprocate on imports for these countries.

The potential marginal effect of implementing the customs union compared to the baseline trade and customs values of 2010 was estimated as a small increase (0.03%) in imports and similarly a small reduction in customs duty (or tariff) collections of 1.4%. Total trade taxes would reduce by a smaller amount (0.4%) given the compensating effects of higher trade tax revenue collections on excise duty and VAT as imports expand. Thus there was potentially little scope for Zambia to benefit from further trade expansion and to experience significant revenue losses through deeper intra-COMESA integration under the COMESA FTA.

In sequence, the largest-to-smallest potential trade and revenue collection changes of the Customs Union are reflected in the second to eighth columns of Table 7.

Table 7. Potential impact of COMESA Customs Union on Zambia's 2010 imports and revenue

	COMESA FTA	Gulf States	ROW	China	USA	UK	India	Japan	Cumul.
Impact on imports									
Change in imports (ZMK m)	8,628.3	129,713.4	26,664.6	13,989.4	5,847.8	5,382.2	-2,688.9	-9,397.5	178,139.4
% change in imports	0.03%	0.52%	0.11%	0.06%	0.02%	0.02%	-0.01%	-0.04%	0.71%
Impact on revenue									
Change in tariff revenue (K m)	-18,096.6	-188,440.6	-63,192.1	-31,123.5	-13,566.8	-11,335.1	2,215	18,354.2	-305,185.6
% change in tariff revenue	-1.4%	-14.1%	-4.7%	-2.3%	-1.0%	-0.8%	0.2%	1.4%	-22.8%
Total tax revenues on imports									
Change in total revenue (ZMK m)	-19,589.8	-197,823.	-68,569.6	-33,767.1	-14,744.8	-12,179.6	2,182.6	20,946.7	-323,544.6
% change in total revenue	-0.4%	-3.7%	-1.3%	-0.6%	-0.3%	-0.2%	0.04%	0.4%	-6.0%
Collected tariff rate									
Collected applied tariff rate (pre)	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	5.3%
Collected applied tariff rate (post)	-0.1%	-0.8%	-0.3%	-0.1%	-0.1%	0.0%	0.0%	0.1%	4.1%
% change in collected applied tariff rate	-1.4%	-14.5%	-4.8%	-2.4%	-1.0%	-0.9%	0.2%	1.4%	-23.3%

Source: author's construction from TRIST simulation results

The largest potential increases in trade and revenue losses would be associated with the CET being applied on the Gulf States (Kuwait and UAE) followed by ROW, China, USA and UK, in that order. The potential reductions in the trade tax revenues would range from -3.7 to -0.2%. The most significant potential revenue losses from the Gulf States stems from the fact that petroleum product imports from the two countries in 2010 accounted for ZMK 3.5 trillion or 13.7% of the total import bill and yielded revenues worth ZMK 173.7 billion (or 13% of the total import trade tax revenue in that year). These revenues, along with the revenue from other imports from UAE would be lost under this COMESA CET TRIST scenario.

The potential increases in imports would range from 0.02% in relation to UK imports to 0.52% for the two Gulf States combined. On the other hand, potential import trade reductions and potential trade tax increases would be expected with respect to a CET on trade with India and Japan. These latter observations have to do with the types of goods being imported from these two countries. A major part of imports from India are pharmaceutical products, to which Zambia grants duty-free access, whereas in the Customs Union scenario these are assumed to move to the appropriate CET levels.

Overall, the establishment of full free intra-COMESA trade and then a customs union would potentially result in a 0.7% increase in 2010 imports and a trade tax revenues loss of 6% or ZMK 323.5 billion. The estimated potential tax revenue loss would be equivalent to about 2.5% of total tax revenue. With such a small revenue loss and a less than one percentage point potential increase in imports, it would be expected that the trade reforms associated with the customs union would not change the pattern and size of Zambia's import trade significantly.

In viewing the potential revenue loss, estimated to be around 6% of original revenue levels in 2010, a number of things must be borne in mind in determining whether the losses would be easy or difficult for Zambia to bear. First, in terms of impact mitigation, there may be options for at least partial compensation of trade tax revenue losses for COMESA member states through the COMESA Adjustment Facility as well as through other Aid for Trade arrangements.

Second, the COMESA Council Regulations (COMESA 2009) make various provisions for guiding the process of establishing the COMESA Customs Union and provide important safeguard measures and other impact mitigation clauses, which policy-makers could explore in view of the above evidence. This is particularly important as a customs union requires countries to forfeit a fairly large degree of autonomy in setting trade and investment policies and in seeking bilateral relations with third party countries outside the union. So, for instance, Zambia's policy and negotiation space for engaging China, India and other potential trade partners – as highlighted in Section4.1– would be constrained under a customs union; and the country's interest would have to be presented through a common regional platform that balances Zambia's unique interest with the interest of all other COMESA member states. Furthermore, to ensure that the offensive and defensive trade interests of Zambia's private sector are adequately represented on the regional platform, the country's internal coordination and consultative capacities and its regional trade negotiation profile would have to be raised considerably.

Third, benefits from reduced trade transactional costs can be expected under harmonised common systems, rules and disciplines. Common approaches to addressing NTBs, applying standards, applying common nomenclature on tariffs, administering customs procedures and managing customs regulations, dealing with sensitive products, treating trade in services, facilitating the movement of goods and people through harmonised transportation systems, and so on, can be beneficial in ensuring trade facilitation and trade expansion. The application of consistent and regionally harmonised rules of origin is another import potential benefit as it can be expected to improve trade facilitation. Furthermore, the implicit advantages for Zambia of hosting the COMESA Secretariat (such as positive net private transfers to COMESA that show up in the country's balance of payment and improve its position) have not been factored into this analysis. All these advantages are important aspects that should not be ignored in weighing the sacrifices of import tax revenue loss.

Finally, as seen in the next section (Section 4.5), the domestic production and consumption competitiveness effects of lowering customs duties (and thus import prices) should also not be ignored by policy-makers.

In view of these factors, one could expect that Zambia could bear the potential revenue losses implied in the COMESA Customs Union. This is particularly true considering the sizable amount of duty exemptions the country is already granting in the absence of trade reforms.

4.4.3 Simulation results: full liberalisation under the Tripartite FTA

Table 8 shows the summary results for a scenario of full liberalisation under the Tripartite FTA, assuming no common external trading position (i.e. without COMESA CET under the customs union) and no sensitive products or exclusions. For internal consistency, the scenario also assumes that in moving to a wider internal market under the Tripartite FTA, the COMESA FTA would first be consolidated.

As before, then, the analysis first assesses the potential impact of tariff-free and quota-free COMESA trade. The estimated potential impacts of a full COMESA FTA were established, assuming DR Congo, Eritrea, Ethiopia, Seychelles and Uganda join the COMESA FTA (results column 1). The results are naturally exactly the same as those in Table 7 (thus, we do not repeat their narrative presentation and discussion here).

The results on the potential marginal effect of subsequently fully liberalising trade with all SADC countries, including South Africa (which is singled out for reasons explained above), are presented in the third and fourth results columns. As before, they are read in comparison to the baseline trade and customs values of 2010 and represent changes from the baseline.

Table 8. Potential impact of Tripartite FTA on Zambia's 2010 trade and revenue

	COMESA FTA	SADC (excl. RSA)	RSA only	Cumulative
Impact on imports				
Change in imports (ZMK millions)	8,628.3	13,969.5	229,431.8	252,029.6
Percentage change	0.03%	0.06%	0.91%	1.0%
Impact on revenue				
Change in tariff revenue (ZMK millions)	-18,096.6	-31,862.2	-510,581.9	-560,540.7
Percentage change	-1.4%	-2.4%	-38.1%	-41.8%
Total tax revenues on imports				
Change in Total revenue (ZMK millions)	-19,589.8	-35,098.4	-558,347.	-613,035.3
Percentage change	-0.4%	-0.6%	-10.3%	-11.3%
Collected tariff rate				
Collected applied tariff rate pre	0.0%	0.0%	0.0%	5.3%
Collected applied tariff rate post	-0.1%	-0.1%	-2.1%	3.1%
Percentage change	-1.4%	-2.4%	-38.6%	-42.4%

Source: author's construction from TRIST simulation results

The potential impact of removing tariff barriers with all SADC countries excluding South Africa would be: a 0.06% increase in imports compared to the baseline value; a 2.4% reduction in tariff revenues relative to baseline; and a 0.6% reduction in overall trade tax collection. On the other hand, the potential impact of duty-free importation of South African goods would be an increase in imports of 0.9% of the baseline value, a tariff revenue reduction of 38.1% relative to the baseline, and an overall trade tax revenue reduction of 10.3%. South African's potential impact would be much the single most significant impact of regional integration trade reforms. This sizable impact reflects the dominance of South African imports as a share of Zambia's total imports in 2010 (37.2%). The potential trade tax revenue loss associated with South Africa alone would be 4.3% of Zambia's 2010 total tax revenue.

Overall, Zambia joining the Tripartite FTA would result in a potential increase in imports of 1% and a reduction in trade tax revenue of 11.3%. The potential increase in imports would be equivalent to 1.9% of the total tax revenue (and 1.7% in relation to South Africa alone), while the potential reduction in collected trade taxes would be 4.7% of the budget (4.3% for South Africa alone).

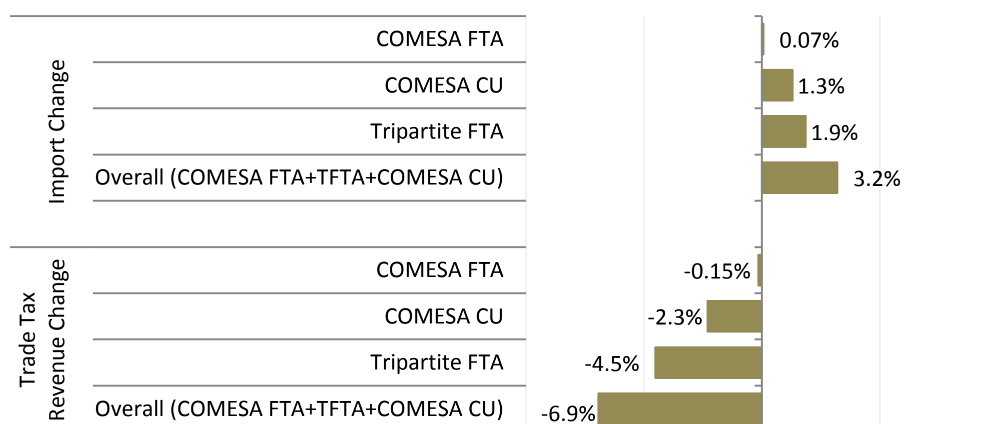
In viewing the Tripartite FTA results it is important to note that actual impacts similar to those reflected in the results are probably already taking place in 2012 in Zambia. This is because, as earlier stated, the customs authorities claim that as of 1 January 2012 Zambia has been granting duty-free and quota-free access to all SADC originating products, including those coming from the country's main import trade partner, South Africa. Essentially, this means that

what this study has defined as "potential changes" – given its retrospective (2010) point of view – is probably actually happening in 2012, although the magnitudes of the estimated changes are likely to be different depending on the pattern and volumes of actual trade in 2012. So the Tripartite FTA per se, once it becomes fully operational, will mean virtually no additional tariff reform for Zambia.

This raises an important issue concerning the additional benefits for Zambia of participating in the Tripartite FTA, considering that it will have already fully liberalised trade with all the countries of the Tripartite bloc under either the COMESA or SADC FTAs. In coordination with the ministries of finance and of commerce, Zambian stakeholders in the public and private sectors will do well to consult carefully and clearly define the potential benefits of participating in regional free trade under the FTA. Such interests might include regional support in marketing Zambia as a preferred regional destination for foreign direct investment, or priority treatment of the economy in regional infrastructure and human development projects, both of which could be justified as rewards for being an early trade reformer or a "trail blazer" of trade reform.

In summary, Figure 7shows the potential import trade and collected trade tax revenue impacts if Zambia established full intra-COMESA free trade under the COMESA FTA and then either applied a CET under the COMESA Customs Union or established full free trade in the Tripartite FTA. It also shows the overall potential effects of the COMESA FTA, the COMESA Customs Union and the Tripartite FTA. All the potential impacts are given as proportions of the 2010 total tax revenue. The largest effects would be associated with the establishment of the Tripartite FTA, mainly on account of the underlying influence of trade with South Africa. Under the Tripartite alone, Zambia's 2010 imports could be expected to increase by 1.9% of the total tax revenue compared to potential increases of 0.07% and 1.3% of the tax revenue under the COMESA FTA consolidation and COMESA Customs Union scenarios, respectively. The overall potential import increase would thus be an estimated 3.2% of total tax revenue.

Figure 7. Trade reform impacts on imports and trade tax collections (% of total government tax revenue) 2010



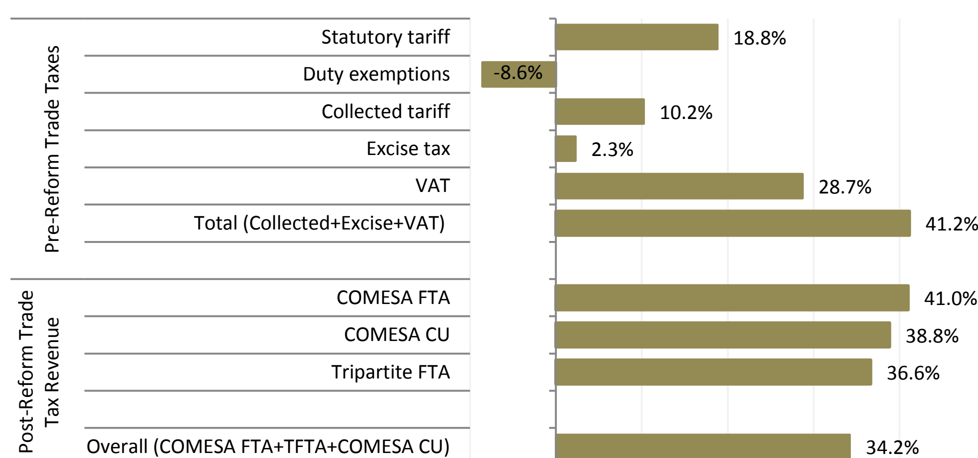
Source: author's construction from TRIST simulation results

Similarly, but in the opposite direction, trade tax revenues would potentially reduce by 4.5% of tax revenue under the Tripartite FTA (the largest potential revenue loss) and by 0.15 and 2.3% of total tax revenue, respectively, under the COMESA FTA and the COMESA Customs Union. Overall, the potential combined effect of full trade reform (COMESA FTA consolidation plus COMESA Customs Union establishment and Tripartite FTA establishment) was estimated at 6.9% of total tax revenue. Revenue losses could naturally be expected to be higher under the Tripartite FTA because this trade reform arrangement would involve liberalising trade with South Africa.

Both avenues of tariff reform would be significantly less than the revenue of 8.6% of total trade taxes that the country actually lost due to exemptions in 2010. Indeed, the overall or combined effects of consolidation of the COMESA FTA, implementation of the COMESA Customs Union and establishment of the Tripartite FTA would have resulted in potential revenue losses of 6.9% of total tax revenue –smaller losses than the duty exemption losses of 2010.

To further understand the potential revenue effects, we compare them with the pre-reform levels of trade tax revenue collection and non-collection (Figure 8). As earlier observed, there is a deviation between what was collected and what could have been collected had statutory tariffs been collected exactly as designed in the tariff book. The deviation or level of customs duty exemptions was estimated at 8.6% of total tax revenue whereas the duty collected was estimated at 10.2% of total tax revenue. This essentially means that even before any reforms, the country was forfeiting nearly half (46%) of its would-be duty collection as statutory exemptions.

Figure 8. Pre- and post-reform aggregate outcomes on imports and trade tax collections (% of total government tax revenue) 2010



Source: author's construction from TRIST simulation results

The total pre-reform trade tax revenue collection would be 41.2% of total tax revenue, reflecting the important of trade taxes to Zambia's overall fiscal revenue position. The different trade reforms explored in this study would potentially result in trade tax revenue collections

ranging from 36.6% to 41% of total tax revenue. Overall, with all trade reforms undertaken in combination, the trade tax revenue collection would be an estimated 34.2% of total tax revenue. The trade reforms implied in the regional integration commitments would therefore not be expected to significantly change the contribution of trade taxes to total government tax revenue. Revenue losses would not be among Zambia's main concerns under the explored trade reforms, particularly bearing in mind the reforms that maybe already be taking place under the SADC FTA.

4.5 Main revenue source, protection and competitiveness

In this section, we look at the main sources of revenue and revenue loss at a more disaggregated (HS8 or commodity transactional) level and also look at the changes in the levels of protection offered to specific sectors under the main two trade reforms considered thus far. Unless otherwise stated, the analysis considers only the top ten elements (i.e. top ten revenue products or top ten protection change sectors). This is to keep the analysis manageable and enable a clear illustrative elaboration of the implications of the changes for revenue sensitivity and domestic competitiveness.

4.5.1 COMESA Customs Union: source of revenue loss and changes in protection

The commodity concentration levels of the potential impacts of applying the COMESA Customs Union's CET are presented in Figure 9. Specifically, the figure identifies the top ten HS8-digit level tariff lines that would potentially make up the largest *collected revenue losses* associated with implementing the COMESA CET.

Other than the tariff line on palm oil and its fractions, all the tariff lines that would potentially generate the largest losses were related to goods that typically serve as various forms of industrial raw materials, capital goods and intermediate inputs into production. Thus it can be expected that the tariff reduction would improve domestic competitiveness through reduced prices mainly on industrial inputs for the importing industry, other things being equal. This suggests that the revenue losses would probably be a fair trade-off because the trade reform would essentially entail improving domestic production.

Figure 9. Top ten revenue loss products, COMESA Customs Union

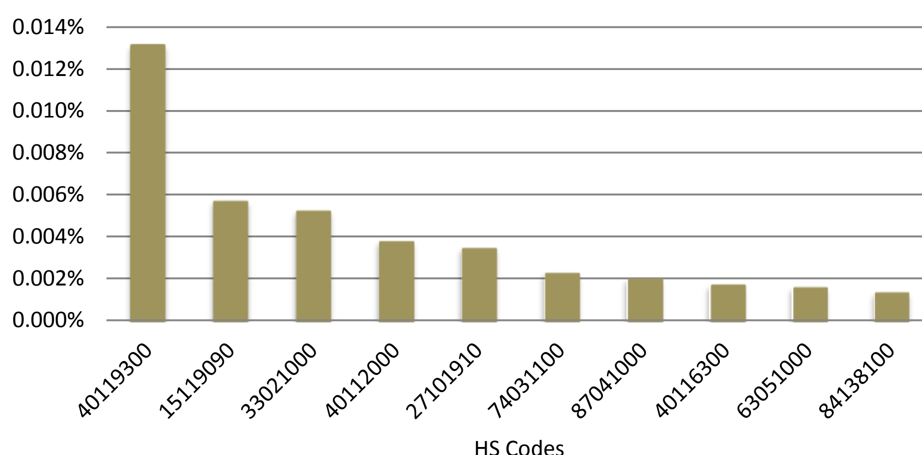


Table 9. HS code descriptions for Figure 9

HS code	HS code descriptions
40119300	New pneumatic tyres of rubber of a kind used on motor vehicles of a kind used on construction vehicles and machinery
15119090	Other palm oil & its fractions, whether ornot refined
33021000	Mixtures/with basis of/odorifer's substances incl. alcohol solutions for food/drink
40112000	New pneumatic tyres of rubber
27101910	Gas oils
74031100	Cathodes and sections of cathodes of refined copper
87041000	Dumpers for off-highway use
40116300	New pneumatic tyres of rubber of a kind used on construction or industrial
63051000	Sacks and bags, used for packing goods, of jute
84138100	Pumps for liquids

***Source**: author's construction from TRIST simulation results*

As a second step, an analysis of potential sector level changes in protection[15] associated with the COMESA Customs Union was undertaken. Table 10 presents the results. Zambia's top ten sectors likely to be affected by the CET reforms suggest an overall potential reduction in the average industrial applied tariff ranging from -0.83% to -0.24%. This suggests that only marginal potential effects would be experienced in terms of reduced protection for the respective sectors. For sectors that depend significantly on tariffs to protect their so-called infant industries, the potential effect of the customs union is likely to be very small, meaning that such industries would have little to worry about in terms of protection losses. Conversely, the levels of additional competitiveness on imported inputs that the sectors are likely to experience under the customs union would also be potentially relatively small.

[15] Protection is defined as the trade-weighted average tariff rate by sector. TRIST uses a concordance of HS codes with ISIC (international standard industrial classification) and hence is able provide such outputs on sector-specific protection changes.

Table 10. Protection Changes by industry

	Protection levels		Change
	Pre-reform	Post-reform	
012 Farming of animals	3.91%	3.09%	-0.83%
251 Manufacture of rubber products	14.18%	13.37%	-0.81%
272 Manufacture of basic precious and non-ferrous metals	4.73%	3.98%	-0.75%
351 Building and repairing of ships and boats	6.65%	5.99%	-0.65%
369 Manufacturing n.e.c.	17.46%	16.91%	-0.56%
172 Manufacture of other textiles	8.47%	8.01%	-0.46%
173 Manufacture of knitted and crocheted fabrics and articles	21.91%	21.56%	-0.35%
155 Manufacture of beverages	2.95%	2.62%	-0.32%
151 Production, processing and preservation of meat, fish, fruit, fats	3.07%	2.83%	-0.24%
221 Publishing	3.58%	3.33%	-0.24%

Source: author's construction from TRIST simulation results

4.5.2 Tripartite FTA scenario: source of revenue loss and changes in protection

In relation to the commodity concentration of the potential impacts of the Tripartite FTA, Figure 10 identifies the top ten tariff lines that would account for the largest collected revenue losses.

Figure 10. Top ten revenue loss products, Tripartite FTA

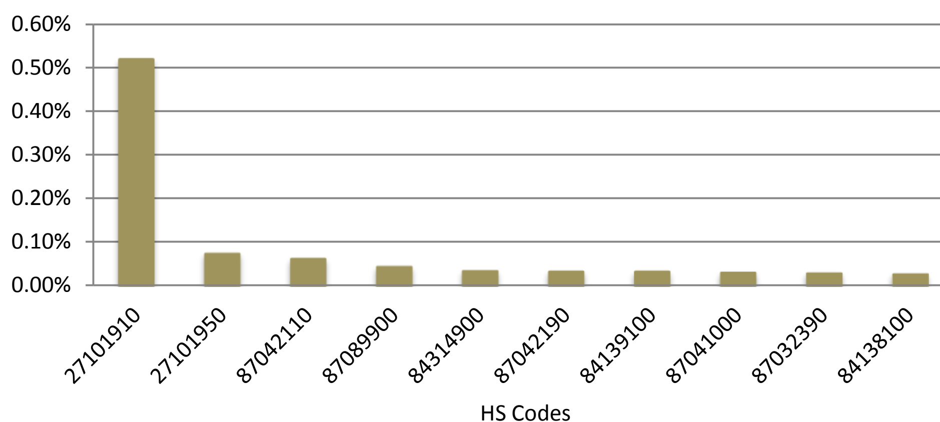


Table 11. HS code descriptions for Figure 10

HS codes	HS code descriptions
27101910	Gas oils
27101950	Cutting oil, grease cutting oils, cleaning oils etc.
87042110	Diesel dual purpose vehicles for both persons
87089900	Parts and accessories, for vehicles of 87.01
84314900	Parts of machinery of 84.26, 84.29 and 84.30
87042190	Diesel Non dual purpose vehicles for either person
84139100	Parts of pumps for liquids
87041000	Dumpers for off-highway use
87032390	Vehicles with engine capacity exceeding 1500cc
84138100	Pumps for liquids

Source: author's construction from TRIST simulation results

A large proportion of the tariff lines that generate the largest losses are for gas oils and motor vehicles, including mainly those imported from South Africa. These typify imports going into domestic industries as production inputs. Thus the tariff reduction will, other things being equal, improve domestic prices on industrial inputs, thereby helping to improve the competitiveness of the importing industry in question. Moreover, many of the products are likely to have no domestically produced substitutes that the imports would compete with; this suggests that tariffs on these items are unlikely to have been protecting domestic industry. The associated revenue losses are likely to be partially compensated for through the increased competitiveness created by the lowering of duties and import prices. (These arguments are not conclusive and would have to be confirmed through a more detailed survey and analysis of domestic production.)

Regarding sector level potential changes in protection associated with the Tripartite FTA, the top five ISIC sectors that would experience potential reductions in their protection levels are highlighted in Table 12. The top ten industries in Zambia that would probably be affected by the reform would record reductions in the average industrial applied tariff, ranging from 9.04 to 15 percentage points. The majority of the potentially affected sectors would be in the manufacturing and processing industries. Activities related to the production, collection and distribution of electricity followed by manufactures of gas and then manufactures of wearing apparel would experience the largest potential reductions in protection levels under the Tripartite FTA in 2010. The simulation results suggest that the majority of industries potentially affected would be in the manufacturing and other industrial sectors. The advantage of the associated trade reforms is therefore that it would strengthen the competitiveness of some of Zambia's manufacturing and industrial sectors through the lowering of duties on their imported factors of production. This is particularly plausible considering that none of the highlighted protected industries can be described in the Zambian context as infant industries worthy of protection.

Table 12. Top ten changes in levels of protection by ISIC sector, Tripartite FTA

	Protection levels		Change
	Pre-reform	Post-reform	
401 Production, collection and distribution of electricity	15.00%	0.00%	-15.00%
402 Manufacture of gas; distribution of gaseous fuels through mains	14.90%	0.00%	-14.90%
181 Manufacture of wearing apparel, except fur apparel	21.94%	8.10%	-13.84%
191 Tanning and dressing of leather; manufacture of luggage, handbags, saddlery and harness	22.14%	10.23%	-11.91%
182 Dressing and dyeing of fur; manufacture of articles of fur	11.31%	0.21%	-11.10%
232 Manufacture of refined petroleum products	11.24%	0.29%	-10.95%
173 Manufacture of knitted and crocheted fabrics and articles	21.91%	11.52%	-10.38%
749 Business activities n.e.c.	12.20%	2.03%	-10.17%
192 Manufacture of footwear	18.75%	8.70%	-10.05%
222 Printing and service activities related to printing	20.33%	11.29%	-9.04%

Source: author's construction from TRIST simulation results

4.6 Limits of tariff reforms

From this analysis, Zambia's imports would potentially have grown by 1.7% (ZMK 419.3 billion) in 2010 alone from the combined impact of COMESA FTA consolidation, implementation of the CET under the COMESA Customs Union, and full participation in the Tripartite FTA.

Under the reforms explored in this paper, the country potentially stood to experience a 16.8 percentage point reduction of its trade tax revenue in 2010; actual monetary losses were estimated at ZMK 909.8 billion in the same year. But some mitigation measures were highlighted in the analysis that could partially compensate for the potential loss. These include negotiations to benefit from regional adjustment compensation funds and facilities, drawing on safeguard provisions in regional trade protocols, and so on. For instance, it is possible that up to 35% of overall revenue loss adjustment costs (or ZMK 316.4 billion) associated with the application of COMESA tariff reforms (under the FTA and Customs Union) could be partly or fully compensated under the COMESA Adjustment Compensation Facility.[16] On the other hand, as of 2012 Zambia is reportedly already implementing the SADC FTA commitments (including free trade with South Africa) which are associated with the larger part (65%) of the overall revenue reduction; the country is therefore already forgoing the revenues that this paper estimates would have been forgone in 2010 had Zambia applied reforms then.

One of the main expected benefits of regional integration is the growth of trade. This means that regional imports that become cheaper with the reforms must increase and, through multiplier effects of domestic production and value-addition, contribute to an expansion in

[16] That is, if the funding is available in COMESA and if Zambian policy-makers can demonstrate empirically the extent of the potential revenue losses through studies such as this one.

regional exports. Many observers would argue that the 1.7 percentage point potential increase in Zambia's 2010 imports is a worrying sign that the benefits of regional integrations are limited. However, this would be far from the truth. As the World Bank has clearly illustrated: "a lesson from successful regional integration experiences in Asia and Latin America is that to maximise the benefits of RTAs, countries should aim to facilitate trade in the region not only through tariff reductions but also through addressing other at- and behind-the-border issues, such as tackling restrictive product standards, non-tariff barriers and trade facilitation" (World Bank 2011, 25).

An unresolved policy issue that arises for regional integration in Southern Africa is that regional markets are still highly fragmented due to barriers to trade, not always related to tariffs. The World Bank maps the different types of non-tariff barriers (NTBs) reported by SADC countries to both the products they affect and the regional trade in these products.[17] Its report shows that "the set of NTBs that have been notified by firms in SADC affect products which, in 2008, jointly accounted for US$3.3 billion, or one-fifth, of regional trade. In other words, even those NTBs which have been reported (and others may have yet to be notified) affect products in which there is already significant regional trade" (World Bank 2011, 25).

Despite the favourable macroeconomic fundamentals (including sustained positive GDP growth) and efforts to increases trade liberalisation through tariff reforms, intra-regional trade in Southern Africa has diversified only slowly and regional trade as a percentage of total trade has remained relatively constant at very low absolute levels. This is despite the fact that Southern African economies having grown faster than the world average throughout most of the period 2000–2010.

Indeed for Zambia, as seen in the simulation results, the various tariff reforms are unlikely to significantly change the size or pattern of import trade. Thus, while tariff reforms are a particularly good sign of deeper regional integration, the benefits of regional integration will remain potentially small for most African countries, including Zambia. These countries will continue trailing in terms of realising the potential benefits of integration outlined in international trade literature (World Bank 2011). Zambia and the other regional economies will need to pay close attention to formulating and applying reliable trade and investment policies and strategies that go beyond the first step of tariff liberalisation into deeper regional cooperation. Tariff reforms alone will offer limited gains.

With respect to the customs union specifically, trade policy-makers must fully comprehend the offensive and defensive trade interests of the private sector in Zambia. They will have to articulate these interests in regional trade negotiations and ensure that they become an integral part of the common negotiating position of the customs union.

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[17] NTBs listed by the World Bank: import bans; import quotas; import levies; preferences denied; import permits and licensing; single marketing channels; rules of origin; export taxes, standards/SPS/TBT; and Customs- related NTBs.

5 CONCLUSION AND RECOMMENDATIONS

This study has sought to establish the implications for Zambia of the trade reforms implied in adopting the COMESA Customs Union and the Tripartite FTA. It has elaborated Zambia's bilateral, regional and multilateral trade policy arrangements and intentions. It has explained the country's MFN tariff structure as well as the tariff structures under the SADC trade protocol in 2010 and currently. The implications of the COMESA CET for Zambia's MNF tariff structure have also been described.

The assessment of Zambia's trade performance suggests that the country's share of world trade grew significantly during the latter part of the study's reference period, albeit from a very small base. The openness of the economy to trade was found to be consistently high throughout the reference period. The trade balance became positive in 2005 and stayed that way until the close of the reference period. Zambia has taken advantage of only about 2.2% of its trade potential on the African continent.

South Africa is Zambia's main import trading partner, accounting for 37% of total trade in 2010. Other main trade partners in 2010 included Kuwait, DR Congo and China, which had replaced some of the more traditional partners like the UK and Zimbabwe. Imports were a significant part of the Zambian economy, accounting for about 32% of GDP or one and a half times the national budget in 2010. The total import trade tax revenues associated with 2010 imports were equivalent to about 41.2% of the total tax revenue of the government, excluding grants and other (non-tax) revenues. In the same year, Zambia granted exemptions amounting to about 8.6% of total tax revenue.

Against the actual outcomes highlighted above, the study estimated that the economy would have potentially lost total trade tax revenues equal to about 2.3% of total tax revenue due to the combined effect of consolidation of the COMESA FTA and then implementation of the COMESA CET under a customs union. On the other hand, pursuing tariff reforms under COMESA FTA consolidation and then a Tripartite FTA, Zambia would have potentially lost tax revenues equivalent to 4.5% of the total tax revenue. Revenue losses could naturally be expected to be higher in under the Tripartite FTA because this trade reform arrangement would involve liberalising trade with South Africa, Zambia's largest trading partner by far in 2010. Both avenues of tariff reform would be significantly less than the revenue of 8.6% of total trade taxes that the country actually lost due to exemptions in 2010. Indeed, the overall or combined effects of consolidation of the COMESA FTA, implementation of the COMESA Customs Union and establishment of the Tripartite FTA would have been resulted in potential revenue losses of 6.9% of total tax revenue – smaller losses than the duty exemption losses of 2010.

For the COMESA tariff reform route, options for mitigating the adverse effects were elaborated. More detailed analysis suggested that reductions in tariff protection, where they were likely to be significant, would generally favour the competitiveness of domestic industries.

From the marginal potential increases in imports observed in the simulation results, tariff reforms alone are unlikely to result in significant trade and competitiveness gains. Deeper regional cooperation that integrates the fragmented regional markets in African and effectively addresses NTBs will be required. Given Zambia's early reformer status, the country is an advantageous position to negotiate for such cooperation, targeting regional support that promotes the economy as a preferred regional destination for FDI, preferential treatment in regional infrastructure support projects, and so on.

In view of the forgoing, there are a few policy issues that will be important for national authorities to carefully consider and possibly pursue:

First, as an important step towards deeper regional integration and cooperation, **Zambia should continue on its path of tariff reform and regional integration**. Specifically, the country should move ahead with its commitment to fully participate in the COMESA Customs Union, particularly as the adjustment costs are likely to be relatively lower than the costs associated with other tariff strategies the country has pursued (e.g. exemptions).

Second, **policy-makers must define a country policy position and a set of strategies on offensive and defensive trade interests that should, as a minimum, be negotiated as part of regional trade policy**. For instance, the country's bilateral trade ambitions with China, India, and other countries and trading blocs should be carefully articulated and recommended for inclusion in common external trade policies. Considering that tariff reform is a defensive trade strategy, Zambia could perhaps do well to focus on formulating offensive strategies. These should be synchronised with the COMESA common regional trade policy that Zambia has committed to, clearly and explicitly taking into account the economy's trade, financial, investment and social cooperation interests in different countries and regions. Importantly, such negotiating positions should be formulated in close consultation with the private sector and based on the available evidence.

Third, using the revenue loss estimates of this study, **policy-makers should engage the COMESA Secretariat with a view to establishing if the country can benefit from partial or full revenue loss compensation under the COMESA Adjustment Facility, to mitigate any adverse effects of reform**. Zambian policy-makers should also consider drawing on other safeguard measures in COMESA provisions such as the Council Regulations, including the provisions for countries to formulate sensitive products lists and exemptions lists from tariff adjustments. The empirical insights from this study could be used as a starting point in determining strategically important products that are revenue sensitive or of significance under bilateral trade agreements.

Finally, **further work should be undertaken to quantify the costs of NTBs for Zambia**. The work should specifically seek to understand the NTBs that serve as main business cost drivers

and how to convert the drivers into a trade facilitator to eliminate or at least minimise the barriers. The discriminatory and often ineffective policies and strategies that countries often insist on pursuing regarding NTBs are likely to limit the regional integration benefits of tariff reform and create an impression that trade liberalisation is not worth it. Zambia should move away from these and should act as a champion for regional integration, encouraging other countries to do the same.

Ultimately, tariff reform should be viewed as simply one small step on the long and hard road to regional cooperation, competitiveness, trade expansion and diversification and overall economic development. Many other steps that facilitate trade expansion and diversification will have to be taken as the first steps– trade liberalisation–begin to be concluded. As an early reformer, Zambia is poised to take this first step and subsequent steps towards freer trade.

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ANNEX 1: TRIST ANALYSIS

The study used the Trade Reform Impact Simulation Tool (TRIST) to simulate the potential trade reform impacts of Zambia implementing a Tripartite FTA and a Customs Union.

TRIST was authored by Brenton et al. (2009) for the World Bank. It is an interactive Microsoft Excel based trade model that helps to simulate the short-term impacts of tariff reform on fiscal revenue, import volumes (measured in monetary value terms) and protection at country level. Depending on the robustness of the available data for a given country, the tool also provides useful insights about which sectors of the domestic economy are likely to be most affected in terms of output and employment. Its purpose is to allow policy-makers to quickly evaluate the adjustment costs associated with trade reforms.

TRIST is based on data on imports and tariffs, VAT and excise revenues at the tariff line (HS8-digit) level (Brenton et al. 2009). The data for TRIST are required to be broken down by trading partner groups. The tool uses actual data on trade and tariff outcomes, and things like tariff exemptions can readily be accounted for. Import responses to tariff changes are modelled in a partial equilibrium framework taking into account substitution of imports from different sources, substitution of domestic production with imports, and the effect of tariff liberalisation on overall demand.

Conceptually, TRIST is a simple partial equilibrium model that consists of two Excel files: the first, a *Data Aggregation Tool*, organises and appropriately formats the data to be imported into the second, the *Simulation Tool*. The Data Aggregation Tool allows the user to create country and product groups that are relevant to the formulation of trade policy scenarios in the country specific context. In the Simulation Tool the user defines the tariff reform scenarios, can choose the parameters of the trade model underlying the calculations, and reviews the simulation results at the aggregate, sector and tariff-line levels.

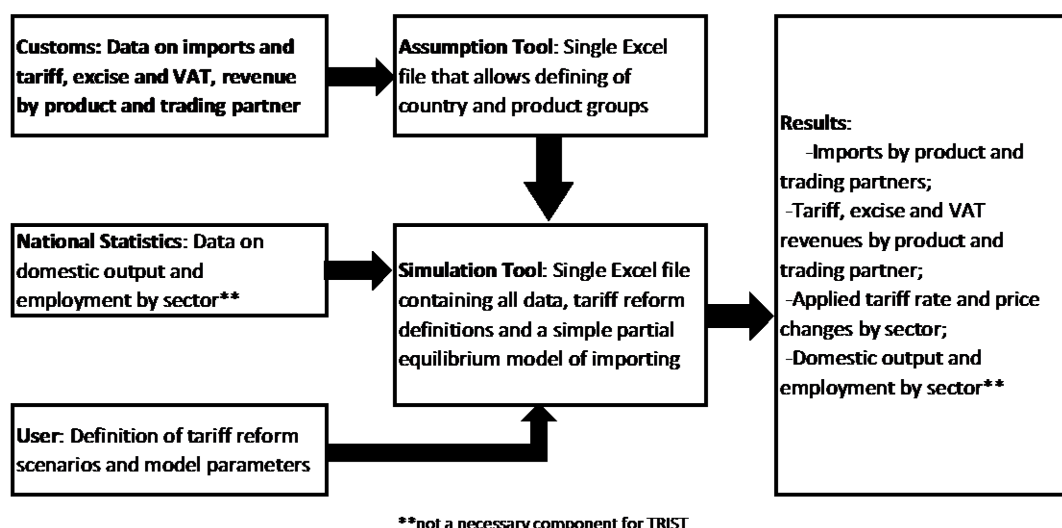
In order to implement TRIST for a given country, detailed and complete data on import transactions for a given year is required (data averaged across a number of years can also be used). For each import transaction, the data must identify the type of product (tariff line level, typically HS 8 digit), the country of origin of the trade flow, the customs procedure code defining the customs regime under which the good enters the country, the import value of the transaction, the statutory tariff, the tariff actually applied (to calculate tariff exemptions) as well as the value of VAT, excise and other import taxes.[18] The cleaned and reorganised data can

[18] Such data is typically readily available from the customs authorities in countries that have implemented computerised customs systems such as Asycuda and TradeNet. In Zambia, the Zambia Revenue Authority (ZRA) can provide these data as it operates the Asycuda system.

directly be imported into the Data Aggregation Tool via a drop-down menu built into the tool. Finally, it is important to have information on the mode of calculation for the different taxes.[19]

Figure 11, taken from Brenton et al. (2009), gives an overview of the structure of TRIST and how it works. First, the customs data are organised within the Data Aggregation Tool and then uploaded into the Simulation Tool. In the Simulation Tool, the relevant tariff reform scenarios for each trading partner can be defined and the elasticities of the trade model underlying TRIST can be parameterised. A separate worksheet within the Simulation Tool presents the results of the chosen reform scenario. It illustrates the impact on tariff, excise and VAT revenues as well as on prices at the sector level. When available, production data can be read directly into the Simulation Tool. This additional information is however not a requirement for TRIST to function.

Figure 11. Design of the TRIST software



Source: adapted from Brenton et al (2009)

As noted in Brenton et al (2009), TRIST has the following advantages:

- It is based on data for actually collected revenue, so collection efficiency and exemptions can be taken into account.
- It is flexible enough to incorporate any tariff reform scenario.
- It is policy relevant. It allows users to simulate the impact of tariff reform on total fiscal revenue (including VAT and excise), and revenue results are broken down to the product level so products that are sensitive in terms of revenue impact can be identified. Results for changes in imports, protection and domestic output and employment can help to analyse the impact of tariff reform at sector level.

[19] For instance, in most countries, tariffs are paid as a percentage of the Cost Insurance and Freight import value, excise taxes are paid as a percentage of the tariff inclusive import value and VAT is paid as a percentage of the tariff and excise inclusive import value. However, a range of countries follow a different mode of calculation. Failure to account for these differences could distort the estimation results.

- It is transparent: The whole tool is set up in Excel so all formulas and calculation steps are visible for the user. It is open-source in the sense that users are free to change, extend or improve according to their needs.
- It is simple to use: The underlying modelling is intuitive and simulations can be made by anyone within minutes once the appropriate tariff scenarios have been entered.

The textbox on the next page, taken directly from Brenton et al. (2009) with minor editorial adjustments, provides additional details about the TRIST methodology.

For the reader interested in even more detail about TRIST, including the theoretical underpinnings, the details of the model assumptions and the detailed technical calculations for the different steps of the models, Brenton et al. (2009) provides a comprehensive description.

The main limitation of TRIST is that it is only relevant for partial equilibrium analysis of short-term impacts of trade reform. It cannot be used to provide an overall (medium to long term) estimate of the impact of a reform scenario. Moreover, with respect to production and employment (depending on the availability of relevant data), TRIST should only be used to assess the short-term relative adjustments of the different sectors of the economy. This limitation concerning the short-term nature of the tool is however a minor one considering the short-term nature of the timelines associated with operationalising the Tripartite FTA.

More on the TRIST methodology (Brenton et al. 2009)

An integral part of TRIST is the trade model that underlies the quantification of the effects of trade reform scenarios on imports, revenues and production. For each product, the model first determines the domestic duty and trade tax inclusive import price change for each trading partner in response to the tariff reform. The trade response to the resulting percentage price change is then modelled in three consecutive steps. First, the model allows for the substitution of imports from one trading partner for imports from another trading partner following changes in relative prices of different suppliers due to preferential changes in tariffs. Second, the model allows for substitution between imports and domestic production as the relative price of overall imports of the product changes relative to the price of domestic production. Third, the model allows for a demand (real income) effect according to which the overall consumption of a product changes in response to a change in the overall price of the product.

The trade model in TRIST is based on five core assumptions that are consistent with economic theory. First, the model is derived from standard consumer demand theory and utilises elasticities to determine the magnitude of the demand response to the price changes that result from a tariff reform. Second, the calculations are based on the standard Armington (1969) assumption of imperfect substitution between imports from different trading partners since consumers distinguish products by the place of production. This intuitive assumption is standard in empirical international trade work and implies that a fall in the price of imports from country A relative to country B will only lead to a partial and not complete substitution of imports from country B with imports from country A.

Third, the model does not allow for direct substitution between different products. In other words, each product is modelled as a separate market and in isolation from other markets. This is perhaps the strongest assumption used in the model. However, a relaxation would not only complicate computations but would also generate a need for a range of additional ad hoc assumptions regarding the precise design of the additional substitution effect and its parameterisation. In the light of our goal to keep the model simple and transparent and to facilitate country ownership of the tool, we do regard this simplifying assumption a sacrifice worth making.

Fourth, it is assumed that all changes in tariffs are fully passed on and that the world price remains unchanged. That is to say that we assume an infinite supply elasticity of imports so that changes in demand in the importing country have no effect on the world price of the product; a realistic assumption for small low income economies.

Fifth, the trade model in TRIST is a partial equilibrium model that treats demand for each product in isolation from the rest of the economy. Hence, it does not take into account inter- and intra-sectoral linkages or the economy wide impacts of tariff changes. But this is not the primary objective of TRIST, which is designed so as to avoid the degree of aggregation of the data that would be necessary in order to implement economy wide computable equilibrium models and to remain simple and transparent in its assumptions, with the flexibility to adjust the key parameters. Thus, TRIST has been designed with the specific task of providing policy-makers with important insights into the short-term effects of trade reform. It has not been designed for making longer-term predictions about the broad economy wide impact of trade reform. By its comparative static nature TRIST allows the comparison of two states - one in which the base values of policy instruments (such as tariffs) are unchanged and another in which these base values are exogenously changed.

In TRIST, elasticities play a crucial role as the parameters of the model. Elasticities are difficult to estimate and so detailed and robust estimates of the three model elasticities (exporter substitution, domestic substitution, demand) are not readily available in the literature. TRIST includes sensible default values for each of these three parameters that are common across products and import suppliers. The sensitivity of the results can be easily assessed by changing the values of the elasticities. When detailed local knowledge on these elasticities is available, TRIST allows users to define trading partner and product specific elasticities. Furthermore, there is an option to include the most well-known estimates of elasticities in the literature.