POLICY BRIEF

What do regional trade reforms mean for Zambia?

Based on the ZIPAR report *What do the COMESA Customs Union and COMESA-EAC-SADC Tripartite Free Trade Area mean for Zambia's import trade and trade tax revenue?* by Caesar Cheelo, Njeleka Malata and Joseph Tembo

Zambia is participating actively in regional integration programmes, but little is know about the impacts of tariff reforms associated with such initiatives. This paper assesses the potential effects for Zambia of the trade reforms implied in both the COMESA Customs Union and the Tripartite Free Trade Area, specifically by comparing data for 2010 with simulations reflecting what would have happened if Zambia had implemented the required reforms in that year. The results show small increases in imports and decreases in trade tax revenues, with the largest changes being associated with the Tripartite FTA because of the underlying importance of South Africa as Zambia's main trade partner. The total revenue losses would actually be less than the revenue lost from duty exemptions in 2010. Tariff reforms ultimately have limited impact, however: the overall expansion of trade associated with regional integration programmes will be small unless non-trade barriers are removed.

Zambia has participated actively in the Common Market for Eastern and Southern Africa (COMESA) and Southern African Development Community (SADC) regional integration programmes.

It is now 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**.

Furthermore, it is also committed to participate in the new **Tripartite FTA**, which will establish a free trade area (and eventually a customs union) consolidating the regional economic communities of COMESA, SADC, and the East African Community.

But little is known about the impacts of tariff reforms associated with these regional integration initiatives.

ZIPAR therefore undertook a study to assess the potential effects for Zambia of the trade reforms implied in both the COMESA Customs Union and the Tripartite FTA. Using the World Bank's Tariff Reform Impact Simulation Tool (TRIST), the authors simulated the import and trade tax revenue impacts Zambia would have felt had it implemented the COMESA Customs Union and Tripartite FTA in 2010.

Map: SADC (green) and COMESA (blue) FTAs

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Understanding integration

The differences between types of integration are summarised below.

Preferential Trade Area (PTA)	Reduced tariffs between member countries and preconditions for deeper integration
Free Trade Area (FTA)	Zero tariffs between member countries and reduced non-tariff barriers
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 policies and institutions
Political Union (PU)	EU + common political systems and institutions

Regional integration and the multilateral trading system

The multilateral trading system basically works on the principle of trade without discrimination. Under the World Trade Organisation (WTO) agreement, member 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. Some exceptions to the MFN treatment rule are allowed, however. More advanced economies, for instance, can grant developing and least developed countries special access to their markets. Countries are also allowed to raise barriers against products that are considered (and can be proven) to be traded unfairly from specific countries. Most importantly, the MFN treatment changes quite fundamentally when dealing with regional trade integration. 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 general, regional integration bears no direct inconsistency with MFN treatment rules.

A liberal trade policy: Integration and tariff reform

Zambia pursues a liberal trade policy and has continued to work towards a wider integration agenda by participating actively in SADC, COMESA, the Tripartite Framework, and the multilateral trading system.

In 2010 Zambia was moving towards fully implementing the SADC FTA. In 2012 it is reportedly fully implementing it. It has been participating in the COMESA FTA since 2000 and is looking to achieve deeper integration through the COMESA Customs Union. The COMESA Customs Union, unlike the Tripartite FTA, will define Zambia and other COMESA Member States' common *external* trade policy position (see box above).

As well as multilateral cooperation, Zambia has also signed *bilateral* trade arrangements with DR Congo, Mozambique, Nigeria, Tanzania and Zimbabwe in Africa as well as with China and India. However, there is little transparency in the way bilateral trade agreements are negotiated, so consultation and information-sharing needs to be improved.

Even with Zambia's considerable record of trade liberalisation, the widespread presence of non-trade barriers (NTBs, e.g. highly bureaucratic processes, restrictive rules and disciplines on origin, prohibitively expensive import licenses) continues to impose high cost Zambian consumers and producers high import prices. NTBs limit the benefits of trade, regional integration and economic cooperation.

In 2010 (the reference period for this study) many of Zambia's customs duty tariff lines (under the MFN) were not aligned to the common external tariff of the COMESA Customs Union. Zambia would have to restructure about 61% of its 6,009 MFN tariff lines to be aligned.

That means that the formation of the COMESA Customs Union will require Zambia to take on more tariff liberalisation and trade reform. The economic and political implications will have to be carefully considered.

Simulation results

The ZIPAR authors used 2010 trade and customs data to simulate the import and trade tax revenue impacts Zambia would have felt had it implemented the COMESA Customs Union and Tripartite FTA in 2010.

Figure 1

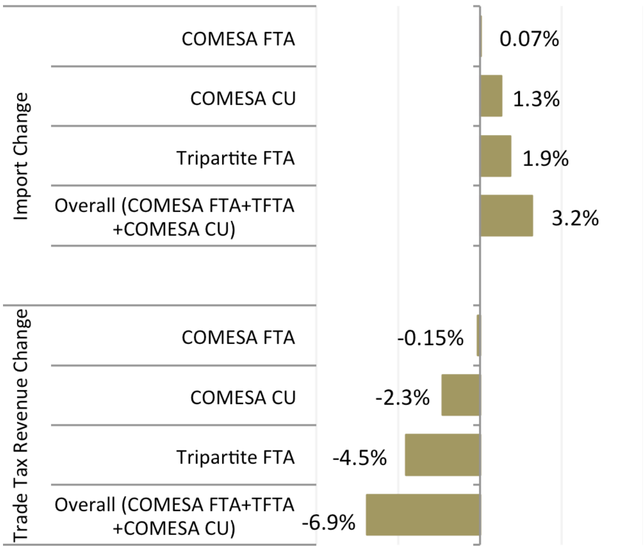


Figure 1 shows the results if Zambia had established full intra-COMESA free trade under the COMESA FTA and then either applied a common external tariff under the COMESA Customs Union or established full free trade in the Tripartite FTA. It also shows the *overall* potential effects of the COMESA FTA, 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 importance 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.

Trade tax revenues would potentially reduce by 4.5% of tax revenue under the Tripartite FTA 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 was estimated at 6.9% of total tax revenue.

Zambia's trade profile 2010

Zambia's **share of world trade** was small – less than a half of one per cent – but it has grown significantly since 2000 (and especially since 2005). Given its resources, it should be capable of much more – one study calculated that Zambia only managed to take advantage of about 2.2% of its trade potential on the African continent.

Zambia's **trade balance** is positive, and has been since 2005.

Zambia's top **trading partner** is South Africa, which accounted 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 accounted 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.

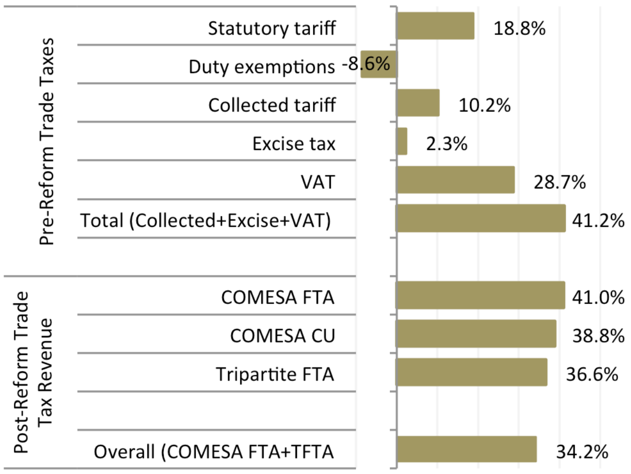
Importantly, this would be significantly less than the *8.6% of total trade taxes that the country actually lost due to exemptions in 2010*.

To further understand the potential revenue effects, we compared them with the pre-reform levels of trade tax revenue collection.

Figure 2 shows that total pre-reform trade tax revenue collection was 41.2% of total tax revenue, reflecting the importance 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.

Looking at the reforms at a more disaggregated level, many of the tariff lines with the largest trade tax revenue losses relate to imports going into domestic industries as production inputs. Thus the results suggest that tariff reduction would, other things being equal, improve domestic prices on industrial inputs, thereby helping to improve the competitiveness of the importing industry.

Figure 2



Revenue losses would not be among Zambia's main concerns under the explored trade reforms. Any potential losses, though, might be mitigated by regional adjustment compensation funds and facilities, drawing on safeguard provisions in regional trade protocols, and so on.

The main expected benefit of regional integration is the growth of trade. However, with the small 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 Africa and effectively addresses NTBs will be required. Given Zambia's early reformer status, the country is an advantageous position to negotiate for such cooperation.

Recommendations

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

Policy-makers must define a country policy position and a set of strategies to be negotiated as part of regional trade policy. 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. Negotiating positions should be formulated in close consultation with the private sector and be based on the available evidence.

Policy-makers should engage the COMESA Secretariat with a view to establishing if Zambia can benefit from partial or full revenue loss compensation 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.

Further work should be undertaken to quantify the costs of non-trade barriers (NTBs) for Zambia. 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 an early reformer, Zambia is poised to take these steps towards freer trade.

Notes:

For full references and sources refer to the full-length paper: *What do the COMESA Customs Union and COMESA-EAC-SADC Tripartite Free Trade Area mean for Zambia's import trade and trade tax revenue?* by Caesar Cheelo, Njeleka Malata and Joseph Tembo

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