International Journal of Innovation and Applied Studies
ISSN 2028-9324 Vol. 10 No. 2 Feb. 2015, pp. 745-751
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http://www.ijias.issr-journals.org/

The Feasibility of Movement to a Customs Union (CU) in the Southern African Development Community (SADC)

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ABSTRACT: The predecessor of the Southern African Development Community (SADC) was the Southern African Development Co-ordination Conference (SADCC), established in 1980 in Lusaka, Zambia. In 1992, Heads of Government of the region agreed to transform SADCC into SADC, whose focus is on integration of economic development. SADC members are Angola, Botswana, DR Congo, Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe. The targets and timeframes for the integration milestones are as follows: Free Trade Area, Customs (CU), Common Market, Monetary Union and Single Currency. A Customs Union is where a group of countries that have established a free trade area agree on common external tariffs and a common external trade policy. The first major challenge of the proposed transition from the SADC Free Trade Area to a SADC CU is the establishment of a single Common External Tariff (CET), which is a complex process to negotiate. Within SADC there are currently 11 individual tariff policies that will need to converge into a single and uniform tariff regime. Addressing the conflicts that may arise from attempting to service obligations from membership in multiple regional and international bodies, such as customs unions and common markets is difficult and the development of policies and strategies that are targeted at supporting vulnerable groups, rural and urban poor, small businesses, informal operators and women within SADC is insurmountable. For the SADC to succeed, the creation of SADC Customs Union (CU) will be obligatory. The goal of this paper is to analyze various economic and political-economy-related issues associated with the process of creating an SADC CU whose thrust is liberalization of intra-union trade that creates incentives for all parties to reduce their remaining tariffs.

KEYWORDS: common external tariff, customs union, free trade area, regional integration, SADC

1 INTRODUCTION

This research probed into the neo-classical theory of regional integration and how it has shaped the idea of regional integration in SADC. Migrating to a customs union (CU) is the next stage in achieving deeper regional integration within SADC if the linear model of regional integration, as poised by the neo-classical theory is to be adhered to. Literature reviewed tends to mostly look at how SADC has missed its deadline for the CU and the implications of a CU in SADC. There is dearth of literature on the feasibility of a customs union in SADC hence t his study tries to address this anomaly. Customs unions are arrangements among countries in which the parties do two things: (a) agree to allow free trade on products within the customs union, and (b) agree to a common external tariff (CET) with respect to imports from the rest of the world. Customs unions and preferential trade arrangements have become increasingly important in recent years. The most famous example of a customs union is the European Union (EU). Trade among the member states of the EU flow tariff free, and regardless of which country in the EU imports a product, the same tariff is paid. The CET is what distinguishes a customs union from a free trade area. In a free trade area, trade among the member states flow tariff free, but the member states maintain their own distinct external tariff with respect to imports from the rest of the world. The North American Free Trade Agreement (NAFTA) is the best known example of a free trade agreement. Canada, the United States, and Mexico (member states of NAFTA) do not share a common external tariff, despite allowing free trade on products traded among the three countries.

2 OBJECTIVES

The study sought to establish the feasibility of a Customs Union within SADC.

3 THEORETICAL FRAMEWORK

The theories surrounding regional integration (RI) are many, and these include functionalism, relativism, inter-governmentalism, neo-classical theory, trade theory among others. However this research is premised on the neo-classical theory.

3.1 NEO-CLASSICAL THEORY

Neoclassical theory starting with Viner in 1937, further refined first by Meade and later by Balassa in 1961 developed a six-stage model of economic RI. Each step is regarded as a precondition for reaching the next as it provides the required achievements for further regional integration. The underlying principle of the neo-classical theory is that of market integration, implying that increasing liberalization of goods, services, labour and capital is the path to a fully integrated region and this should happen through linear stages [1] The stages are as follows;

- Preferential trade area-an arrangement in which members apply lower tariffs to imports produced by other members than to imports produced by non-members. Members can determine tariffs on imports from non-members.
- Free trade area - a preferential trade area with no tariffs on imports from other members, as in preferential trade areas, members can determine tariffs on imports from non-members.
- Customs union - a free trade area in which members impose common tariffs on non-members, members may also cede sovereignty to a single customs administration.
- Common market - a customs union that allows free movement of the factors of production (such as capital and labour) across national borders within the integration area.
- Economic union - a common market with unified monetary and fiscal policies, including a common currency.
- Political union - is the ultimate stage of integration, in which members become one nation. National governments cede sovereignty over economic and social policies to a supranational authority, establishing common institutions and judicial and legislative processes including a common parliament. Countries can start with any of these arrangements but most begin by removing impediments to trade among themselves. They then introduce deeper and wider integration mechanisms [2].

[3] however highlights that the limited achievement of the market integration efforts following independence has opened a debate about the efficacy of such a policy under present African conditions. Critics have declared market integration a failure. They argue that the model, taken from the experience of highly industrialized European countries that have a high level of trade among them, is not relevant to Africa, where both trade among countries and the levels of industrialization are low. The range of tradable commodities is seen as limited, and the transport and communication infrastructure inadequate. They recommend that the market integration approach be abandoned and that a new approach that emphasizes broadening the regional production base take its place.

[1] argue that theory and practice often differ when it comes to implementation of the market integration approach in developing economies. In the case of RI, the discrepancies between the neoclassical theoretical approach and reality have been particularly big when applied to RI amongst developing countries; hence this could be a reason why regional integration has been largely unsuccessful in Africa. He however criticizes the model when he emphasizes that the neoclassical approach to regional integration does not usually sufficiently take into account the differences in the resource endowment, political power and economic opportunities between the member states of a regional integration scheme. He also concurs with [3] that pure neoclassical approaches tend to overlook developmental requirements of RI outside the industrialized North as the concept was not developed for developing countries, further highlighting that the approach does not offer any real strategy for regionally integrated developing countries to react to the challenges of globalization. [4] posit that African governments have been preoccupied with negotiating preferential agreements and have given less attention to the real issues: the non-competitiveness of products of member states compared with third-country suppliers, the high cost of doing business, the shortage of foreign exchange and credit, and the restrictions on free trade, services and movement.

[5] further criticizes the neo-classical model highlighting that part of the problem of African RIAs may lie in the paradigm of linear market integration, marked by stepwise integration of goods, labour and capital markets, and eventually monetary and fiscal integration. She argues that this model tends to focus more on border measures such as the import tariff, whereas supply-side constraints may be more important. She highlights that the modern trend in regional integration now describes a deeper integration agenda to include services, investment, competition policy and other behind-the-border issues which can address the national-level supply-side constraints far more effectively than an agenda which focuses almost exclusively on border measures and that African RECs should consider adapting to these trends in order to obtain the most out of regional integration.

4 Movement to a SADC Customs Union

SADC's road map for deepening regional integration aims to follow the neo-classical approach to integration through progression through the various stages of integration. To achieve this, SADC laid out benchmarks for achieving deeper regional integration objectives. According to [6] SADC was scheduled to have an FTA by 2008, a Customs Union by 2010, a Common Market by 2015, a Monetary Union by 2015 and a regional currency by 2018, as highlighted in the Regional Indicative Strategic Development Plan (RISDP), a document that provides direction with respect to SADC programmes, projects and activities [7]. However these plans have been stalled as the FTA is still not consolidated. An audit portrayed in [8] shows that the Southern African Customs Union (SACU) countries within SADC (Botswana, Lesotho, Namibia, Swaziland and South Africa) have completed their tariff liberalisation commitments under the SADC FTA, other countries are lagging behind, Zimbabwe has requested for derogation from implementing tariff phase downs on certain products and DRC, Seychelles and Angola are not yet participating in the FTA. As a result, migrating to the next stage of a customs union presents challenges as all members have to be on the same page with regards to tariff phase downs under the FTA.

[6] argues that the lack of technical and financial capacity of the SADC Secretariat was the main driving force behind the failure by SADC to launch a Customs Union in the planned timeframe. The Customs Union launch, once missed in 2010 was rescheduled for 2012, then 2014 and now is scheduled for implementation after 2016. According to Peters-Berries (2010), the positive effects to be expected from abolishing internal trade barriers within the FTA are increased intraregional trade (within the region) and increased intraregional investments (inside the FTA) from within and from outside the FTA. The creation of an FTA increases the market volume in terms of potential customers and makes it thus attractive for businesses to invest. If an FTA has achieved its objectives (abrogation of internal tariffs), its member states may feel it is time to progress to the stage of a CU. In contrast to an FTA, a CU has not only liberalized its internal trade, but also unified the external customs tariffs of its members.

5 Benefits of a Customs Union

The positive effects to be expected from the establishment of a CU can be summarized as follows according to [1]

- Efficient allocation of production factors in the most suitable country within the union: if all countries have the same external customs tariffs and there are no tariffs inside the regional grouping, new investments will naturally take place in the country where the best conditions can be found.
- Trade creation effects as a result of the efficient allocation of production.

6 Limitations of a customs union

However, [1] also highlights that CUs are far from being the ultimate and most efficient stage of regional integration. They also have potential inherent problems that express themselves most often as;

- An increase of the joint external tariffs, which enhances the immediate danger of trade diversion.
- An unequal distribution of customs revenue, which causes friction between member states.

Schiff and Winters (2003) propose that from the neoclassical point of view, a CU only makes economic sense if the effect of trade creation outweighs that of trade diversion. Under most circumstances, Customs Unions are more efficient than FTAs and allow greater market integration, but they also require more coordination and place tighter constraints on individual member policies and sovereignty. A major worry for FTA members is trade deflection; the redirection of imports from third countries through the FTA member with the lowest external tariff. The usual solution is rules of origin, the apparently reasonable requirement that goods qualifying for tariff free trade should be produced in a member country rather than just pass through member countries.

In practice, rules of origin often become instruments of protection. Trade diversion will result if the rules of origin create an incentive for producers in one partner to purchase higher cost inputs from another even though cheaper inputs can be had from the rest of the world. The more restrictive the rules of origin, the greater the scope for trade diversion on intermediate products. At some point, however, the rules become so restrictive that producers opt to source inputs from outside the free trade area and forgo duty-free access. Rules of Origin (RoOs) also pose governance problems for developing countries. They take considerable effort to negotiate and are opaque and complex to operate [9] According to [10] the importance of flexible rules of origin is witnessed by the experience of Lesotho under the African Growth Opportunities Act (AGOA). As a developing country, Lesotho is allowed more flexible RoO than non-LDCs where it is allowed to source textiles from anywhere in the world to use in its garment manufacture and these exports still classify as originating from Lesotho. Since 2001, Lesotho has seen its exports to the USA increase by 63% to US$130 million, and the garment sector is now the largest employer in the country. What this derogation in the RoO allows is for Lesotho to source from the cheapest producer of fabric and therefore its exports are more competitive.

However, SADC Rules of Origin are restrictive, and are hence a contentious issue. Migrating towards a Customs Union without reaching a consensus on the SADC RoOs is highly unlikely as member states may not be cooperative. [11] in [10] argue that the current rules of origin [in SADC] are both complex and restrictive and the continuation of this approach to rules of origin will seriously impede regional integration in SADC, even when tariff barriers on intra SADC trade disappear. Furthermore they will make SADC, at best, irrelevant in promoting integration and competitiveness of SADC industries in the global economy. However, [9] further explain that Customs Unions have common external tariffs and so do not formally need rules of origin. Provided that they also define and enforce any non-tariff protection measures at the bloc level, they can, at one stroke, avoid all the administrative costs and distortions associated with rules of origin. Hence a Customs Union could eliminate all the conflicts within SADC with regards to RoOs.

The formation of Customs Union between neighbours is to reduce the transactions costs involved in border formalities. [9] highlight that these are often more important hindrances to trade than customs duties and are far more likely to be avoidable between contiguous than between distant countries. Even for neighbours, however, eliminating these costs can be a complex process; the EU took from 1957 until the mid-1990s to get close to having “invisible borders” between even a subset of its members. However, in Africa, such Non-Tariff Barriers to trade are prominent. Non-tariff barriers to trade may have similar effects to tariffs: they can increase domestic prices and impede trade to protect selected producers at the expense of other economic agents; they may also tax exports [12]

According to [13] shipping a car from Japan to Abidjan costs US$ 1,500, while shipping that same vehicle from Addis Ababa to Abidjan would cost US$ 5,000. This implies high transport costs within Africa as compared to other regions. Therefore unless NTBs, such as, regional infrastructure and reduction in border formalities through harmonized procedures are addressed to facilitate trade, formation of a customs union may not necessarily reduce NTBs and hence member states may not benefit from the Customs Union as is expected and this reduces the feasibility of a Customs Union. [9] also highlight that a customs union can also help avoid the costs of smuggling or tax competition. Senegal has long sought to form a customs union with The Gambia to remove the incentive for its citizens to smuggle in imported manufactures from that country. [14]; [9] estimates that for many years such smuggling generated a significant proportion (an estimated 25 percent in 1980) of The Gambia’s revenues from import duties at Senegal’s expense. Harmonizing non-tariff barriers, however, is a demanding requirement. In effect; a customs union needs to have not only a common external tariff (CET) but also a trade policy that is common in all respects. Customs unions are thus a good deal more complex to create than FTAs. Although they offer greater market integration and lower costs, they also require more ongoing coordination. Adopting a CET means reconciling the interests of member states and then establishing continuing political arrangements to deal with subsequent adjustments for example, modifications stemming from global trade talks, or the imposition of temporary safeguards, antidumping duties, or anti-subsidy duties. Those arrangements may imply substantial loss of sovereignty over trade policy instruments and revenue sources. For the SADC Secretariat, a Customs Union would entail more work in terms of on-going coordination and other administrative requirements. However, with the current low levels of technical and financial capacity of the REC, this may be an insurmountable task. It is therefore crucial for the SADC Secretariat to be adequately capacitated before the movement to a Customs Union.

7 INTRA-SADC TRADE

Regional Economic Communities (RECs) have fostered trade development through programmes aimed at achieving a free-trade area, a customs union, and a common market. However, numerous initiatives and decades of experimentation with integration in Africa have brought no significant improvements to intra-REC and intra-African trade [13].

According to [12] the main regional driver of trade within SADC, in terms of both exports and imports, is South Africa. Its regional importance is much more pronounced as a source of other members' imports than as a destination for their exports. Angola is a lesser, but increasingly important regional partner in terms of its imports as well as its exports (which are concentrated in fuels). All SADC countries depend heavily on the EU for export sales. Botswana has the highest dependence, selling 76 percent of its exports to the EU (primarily diamonds in the mining sector). Other SADC countries send between 28 percent (Zambia) and 39 percent (Malawi and Mozambique) of their total exports to the EU. There is little trade among the SADC countries, with the exception of South Africa being an important destination for [15].

[16]; [12] point out that empirical evidence on the effectiveness of regional trade agreements in promoting intra-African trade is limited. By this they thus entail that RIAs do not necessarily promote intra-African trade. However, one can argue that other RIAs such as the EU and the ASEAN have experienced massive growths in intra-REC trade which has spurred economic development in their member states. One intended effect of a regional trade agreement (RTA) is, through the reduction and removal of tariffs, to enable more efficient producers in a region expand production (and reap economies of scale and scope) to the advantage of consumers and the detriment of less competitive producers. However, this potential may be limited unless other barriers to trade are also addressed, and harmonized. The process of fostering closer regional integration means developing new policy tools. This includes the development of regional Non-Tariff Measures (NTMs) to increase intra-regional trade flows, such as harmonized standards to facilitate trade, as well as rules of origin (RoO) which are required to avoid trade deflection [12]. [12] in their analysis on impediments to intra-SADC trade also suggest that the imposition of Non-Tariff Barriers (NTBs) by SADC countries is usually handled better by non-SADC than SADC countries, and within SADC by the economically larger members. In light of these results, initiatives aimed at tackling NTBs and their impacts on trade at the regional level become even more important.

[12] further revealed that because intra-regional trade in Africa covers only a small percentage of total trade, any trade (and hence economic) effect of lower tariffs is likely to be small. Others have therefore argued that an alternative approach could be to foster deeper integration through the harmonization of trade rules and standards and institutional co-operation [17]: [12] The reduction of NTBs and harmonization of other non-tariff measures (NTMs) such as standards and customs clearings procedures constitute a deeper form of integration, with the potential for more dynamic gains in terms of trade creation if harnessed correctly. [18] argues that a greater potential for welfare gains exists from trade between countries with vastly different factor endowments. This could take the form of the inclusion of a more developed country within South–South FTAs, leading to North–South–South arrangements. It is usually emphasized that countries with more diversified exports base are suitable candidates for a successful RTA [19].Given that SADC countries have concentrated and similar comparative advantages, an analysis carried out by [19] suggested that the room for further trade within SADC is limited.

Sub Saharan Africa (SSA) has the lowest share of intra-regional exports as a proportion of total trade in the world and this has been the case since the 1980s. There has been growth in intra-regional exports since the 1990s, from 6% in 1990 to 12% in 2000, compared to an increase of just 3% between 1980 and 1990. But this growth has not been sustained: intra-regional exports were 12% of total exports in 2008, the same level as in 2000. Despite this, it is important to point out that unlike some other regions such as developing America; SSA has not seen its intra-regional exports decrease. But nor has it seen a rapid increase in intra-regional exports as other regions such as developing Asia, which managed to almost double its intra-regional exports over the period 1980–2008 [12] .

[19] point out that some results and ongoing researches show that development of intra industry trade might have trade creation effects in the region. Even though regional integration might be seen as a tool to increase the power of negotiation vis-à-vis other trading blocs, it is important that SADC countries give weight to their national industrial development strategy which can be complementary to the regional initiative. Chauvin and Gaulier (2002) further posit that indeed, regional trade integration by itself is not a sufficient tool to contribute to economic development. In this respect and as an example, the improvement in infrastructure may be a prerequisite for successful trade integration and growth. There are hence a number of other factors to consider in the development of the regional integration agenda within SADC. Movement to a customs union should be preceded by measures which will enhance intra-SADC trade in order for the successful implementation of a customs union.

8 MEASURES TO IMPROVE THE IMPLEMENTATION OF THE CUSTOMS UNION IN SADC

A number of measures could be co-opted to improve the movement of SADC into a customs union and finally into a single currency regional bloc. Some of these measures include the following ;

- Establishment of Effective Monitoring and Evaluation Mechanisms: There is need to institute effective monitoring and evaluation mechanisms to measure achievements of milestones and accomplished targets. This should be preceded by timely and effective dissemination of agreed decisions at the SADC level to the operatives for implementation.
- Consider instituting measures to enhance adherence by Partner States to the provisions of the CU Protocol and timely implementation of Community Decisions: This will also aid transparency and uniform application and implementation of the Treaty and CU Protocol across all Partner States, This could be in the form of penalties, sanctions or compensations should such delays cause injury to the economies of the other Partner States
- Embark on maintaining uniform protection of sensitive products and avoid arbitrary pre budgetary reviews at national levels: The protection of sensitive products should remain uniform within all the Partner States. This will, not only discourage smuggling but also, enhance predictability and credibility in the eyes of investors.
- Streamline the application of rules of origin: Effort should be made to avoid delays in the issuance of certificates of origin. This is particularly important for traders of perishable products such (as dairy products, vegetable, fruits, etc) and will go a long way in bringing into the formal sector the small-scale traders involved in informal cross-border trade. This will also help in capturing more of the unrecorded cross-border trade.
- Evaluate the value of the exemptions and remissions system: Remissions should be harmonized with the national investment incentive packages in order to rationalise the incentive regime throughout the region.
- Simplify and rationalize cross-border trade procedures: Disparities in the administration and application of clearance procedures in major border points should be removed. This is brought about by shortages of various customs documents and in-adequacies of staffing levels which affect the duration and other requirements for cross-border trade. There is need to standardise all procedures and ensure all documents are readily available.
- Accelerate harmonisation, development and implementation of SADC standards: For successful operation of the CU, the issue of standards is very critical and must be address quickly. Lack of standards means that goods cannot move freely within the region or are traded with national standards which must be certified first by the national bureaus of standards, often leading to delays. Harmonization, adoption and implementation of regional standards not only ease the flow of goods across borders, but they also guarantee quality and safety of traded goods.
- Domestication and sensitization about SADC competition law: There is need for all Partner States to domesticate the regional laws into the existing national competition laws and regulations.
- Establish rapid response units to address reported NTBs: the establishment of rapid response units within the ministries of trade will facilitate faster and effective means of dealing with reported cases of NTBs: , most of which arise out of ignorance or lack of information on the part of technical officials or temptations for rent seeking. In addition, this will allow the national NTB monitoring committees to deal with .These focal points should be established within the ministries of trade with contacts (mobile telephone numbers, e-mail addresses) which should be accessible twenty four hours.
- Augment knowledge regarding the customs union: The study established a relatively low level of awareness about the customs union, this could be improved in form of lectures, briefs, workshops, press interviews, meetings, etc. greater awareness about the CU and its potential advantages (such as existing production and market opportunities) will stimulate further intra-regional trade in both agricultural and manufactured commodities.
- Assess and reinforce the penalties for distortion of clearance documents and related fraud cases: Cases of falsification of clearance documents by traders lead to loss of revenues, but also encourage ‘rent-seeking’ thereby enhancing hidden trade costs.
- SADC need not discard everything to do with, e.g., the European integration model as totally unbefitting for Africa to follow because there are lessons which Africa can learn from the way regional integration progressed in these countries which can be beneficial for SADC to follow. For example, SADC could follow the route being followed by most RECs in the developed world nowadays, of pursuing regional value chains or component manufacture of products, where a raw material for a certain good may be produced in one country, processed in another country and marketed in another leading to an end result which can be labelled a SADC product.
- CU needs to be supported by other measures such as development of infrastructure and addressing member states’ supply-side constraints and link production areas to markets. In addition, measures to support development of human resources across the region are similarly important.
- Due to the limited diversification of industrial output in African economies, SADC member states are presented with an opportunity in diversifying their products through creativity and innovativeness in order to gain a competitive edge within the large market created by the SADC trading bloc.

9 Conclusion

The study sought to establish whether the customs union, (which is the next stage that SADC seeks to achieve according to the linear model proposed in the neo-classical approach to integration) is feasible. The study found out that the establishment of a customs union is to a larger extent, not feasible in the short term given the current state of affairs within SADC but could be considered as a long term objective, provided the status quo changes.

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