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The Business Environment in Southern Africa: Issues in Trade and Market Integration

(In Two Volumes) Volume I: Summary

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Abbreviations and Acronyms

BEC	Broad Economic Categories
BNS	Botswana, Namibia, and Swaziland
COMESA	Common Market of Eastern and Southern Africa
DRC	Democratic Republic of Congo
EU	European Union
EAC	East African Community
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
FTA	Free Trade Area
GDP	Gross Domestic Product
ICA	Investment Climate Assessment
LOP	Law of One Price
MFN	Most Favored Nation
OECD	Organization for Economic Co-operation and Development
PPP	Purchasing Power Parity
RISDP	Regional Indicative Strategic Development Plan
SACU	South African Customs Union
SADC	Southern African Development Community
SSA	Sub-Saharan Africa
TFP	Total Factor Productivity
TIFI	Trade Industry Finance and Investment
TMCM	Trade Compliance and Monitoring Mechanism
WTO	World Trade Organization
US	United States

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PREFACE

This is an extended summary of a longer report of the same title and assesses some of the key barriers to greater trade and factor market integration in the Southern Africa Development Community (SADC). The full report is available as a separate volume and provides details of the analysis and results summed up in this volume. Information on econometric methods and conceptual framework is given in a technical annex to the full report.

When the SADC was established back in 1980, the objective of the regional body was to coordinate the development policies of member countries in order to limit their dependence on apartheid South Africa. Following South Africa's transition to democracy, the SADC was transformed into a development community in 1992, with the key objectives of alleviating poverty and promoting economic growth among member countries through greater trade and factor market integration. Today South Africa's economy is the anchor for the regional economy, accounting for two-thirds of its total annual output and 20 percent of the regional population. The next three largest economies, Angola, Tanzania, and Botswana, account for only one-sixth of regional output. Per capita income in about half of the member countries is US\$500 or less. In terms of population, the region also exhibits considerable diversity. The largest country by population, Democratic Republic of Congo (DRC), accounts for nearly a quarter of the region's population (but only 2.2 percent of the regional output). Six member countries each have a regional population share of less than 1 percent. Many are either small islands in the Indian Ocean or small mainland populations of less than 1.5 million.

There are 15 member countries at the moment, namely, Angola, Botswana, Democratic Republic of Congo (DRC), Lesotho, Madagascar, Malawi, Mauritius, Mozambique, Namibia, the Seychelles, South Africa, Swaziland, Tanzania, Zambia, and Zimbabwe. About one-third of these are resource-rich, with the share of exports of natural resources higher than 30 percent. Forty percent of members are landlocked, and rely on other members for access to seaports. In 2005, per capita income in the region ranged from US\$120 in the Democratic Republic of Congo to US\$9700 in the Seychelles. Including South Africa, five members are classified as upper middle-income and three are lower middle-income as per the World Bank's Development Indicators. The other members are classified as poor.

EXECUTIVE SUMMARY

The SADC has been a free trade area since 2009, and has an ambitious agenda for further trade integration. This includes the establishment of a customs union by 2012 and the creation of a common market by 2015. The Free Trade Area (FTA) protocol provides for the elimination of import tariffs and nontariff barriers to trade among participants, and the harmonization of customs procedures and technical standards. The SADC also has a Finance and Investment Protocol (FIP), which is designed to facilitate FDI in the region by harmonizing the policies of member countries in investment promotion policies, labor codes, and immigration laws.

This is a summary of an assessment of the roles that cross-country differences in business environments have had in impeding cross-border trade flows and the cross-border integration of credit markets and the labor market based on the analysis of microeconomic data on firms and households. The aim of the assessment is to help inform the policy and business environment harmonization agenda of the Community.

The report draws on a variety of data sources, of which the most important are the following: (a) the World Bank Enterprise Surveys, which were carried out in thirteen of the SADC member countries at various points over the period 2006 to 2009 as part of national level investment climate assessments; (b) the UN Comtrade database (c) the World Bank's Doing Database (2004 to 2010), and Governance Indicators (1999-2009); (d) the World Bank's Development Indicators; (e) National labor force surveys for Botswana, South Africa, Tanzania, and Zambia, and the Continuous Multi-Purpose Household Survey of Mauritius; (f) the WTO Tariff Profile of 2009; and (g) the Worldwide Cost of Living Survey of the Economist Intelligence Unit.

Trends in trade integration

SADC economies are far more integrated today within the region and with the global economy than they were in the mid-1990s. Most Favored Nation (MFN) tariffs have been reduced, intraregional trade flows have increased, and trade has risen as a share of GDP. On average, SADC countries export and import as much as would be expected relative to their income and distance from international and regional markets. Further, intra-SADC trade is relatively high in relation to what intraregional incomes and distance would predict. However, much of the increase in intraregional and extra regional trade occurred in the 1990s, and all indications are that progress has halted in recent years. In addition, substantial imbalances in trade flows persist. The South African Customs Union (SACU) continues to dominate intraregional trade flows, as both a destination for other SADC member exports and a source of their imports. Trade flows among non-SACU countries in the SADC area remain low.

Key findings

Trends in trade policy and trade integration There is greater trade integration within the SADC and the region is more integrated to the global economy today than was the case two decades ago. But this is primarily thanks to the trade liberalization measures members undertook in the early 1990s. Progress in intra regional trade integration has stalled since then. Moreover, intra regional trade continues to be dominated by SACU countries, and SADC exports are overwhelmingly concentrated in primary commodities.

Further progress in intra regional and extra regional trade integration requires more tariff reforms designed to reduce effective rates of protection and harmonize MFN rates between member countries. It also requires concerted efforts to reduce other source of trade costs including transport costs and the streamlining and harmonization of customs admin and regulation of cross border transactions more generally.

Business environment and trade integration High trade costs are holding back badly needed diversification of the region's exports into labor intensive manufactures and services, where productivity is too low in many countries for export growth because of other problems of business environment as well, including unreliable power supply, inadequate access to formal external finance, high business start up costs and corruption.

These problems have reduced productivity, first, by generating technical inefficiency (that is, by adding to the average cost of doing business across the board and for all firms) and, secondly, by taxing some firms and sectors more than others (that is, by generating allocative inefficiency).

Business environment reforms and FDI Problems of business environment have also held back domestic investment and inward FDI. Over the past two decades, member countries have attracted more FDI than other developing regions on a per capita basis. This has been in no small part thanks to improvements in political stability and business environment reforms that have reduced corruption and cut business start up costs. However, it is also clear that more reforms are needed in these areas even to sustain current levels of FDI in many countries, and to correct exiting imbalances in the allocation of FDI within the region.

Financial development and financial integration Financial development and financial integration are key ingredients of increasing investment and trade integration and improving the allocation of capital within the region. However, at the moment there is relatively little financial integration as indicated by large cross country disparities in interest rates and the availability and accessibility of financial products.

Key factors in the lack of financial integration in the region are the lack of credit information systems and the weakness of contract enforcement institutions in many member countries.

Regional labor market integration Labor market integration is measured by how quickly wages in one part of the SADC respond to sharp wage rises or declines in another. It is also a powerful gauge of the state of trade integration and the ease of mobility of capital across the region. The reason for this is that labor markets would be integrated within the region even in the complete absence of the cross border mobility of labor as long as there is free cross border flow of goods and capital. Conversely the lack of regional labor market integration is a reflection as much of restrictions on cross border flow goods and capital as of those on the cross border migration of people.

At the moment the degree of labor market integration is low in the region compared to other parts of the world where there is less restriction on trade and cross border capital flows such as the US-Mexican border. Thus the report finds that it would take 3.6 months for a sudden rise in wages in South Africa to be full reflected in wage changes in Botswana, Namibia or Swaziland as compared to one month that wages in Mexican border towns are estimated to require to fully adjust to a major wage change in the U.S.

Another feature of the nature of integration to date, posing a major policy challenge, is that, excluding South Africa, SADC exports to the rest of the world and within the SADC are comprised mainly of primary products, although Mauritius, Malawi, Swaziland, and Lesotho

also export clothing and textile products. The high concentration in commodity-based exports has limited intra-industry trade flows and the productivity gains associated with the economies of scale and the diffusion of innovation that such flows facilitate. To realize productivity gains from intra-regional trade, many member countries need to diversify into nontraditional exports, including manufactured and service exports. Trade in manufactured goods and services is more sensitive to trade barriers and other cross-border transaction costs than the current trade in resource-based products. Its development in the region would therefore require greater openness to trade of member countries and significant reforms of the business environment within the region.

Adding to the urgency of diversifying members' exports is that most SADC countries are labor-surplus economies, and many face problems of high unemployment and widespread poverty. To successfully grow out of these problems many need to diversify production and exports into labor-intensive industries in manufacturing and services. Future progress in further trade integration within the region will indeed largely depend on how far member countries succeed in this type of diversification.

Monitoring goods market integration

The full report discusses and illustrates the use of price data in monitoring intraregional trade integration. Although integration is normally evaluated by looking at trade flows, a more reliable approach is to assess the extent to which prices are similar or tend to converge across borders. Price dispersion is a preferred metric of market integration because, unlike prices, trade volumes are also affected by many other factors unrelated to market integration. On the other hand, changes in goods market integration will be reflected in prices regardless of whether trade has actually taken place, as it is the potential for arbitrage that determines how far prices can diverge.

The various methods of analysis of price trends used in the report provide additional evidence of increased market integration in SADC countries. Consumer price inflation has converged within the region and the volatility of real exchange rates has fallen. A detailed price-level analysis also reveals a decline in price dispersion within and across SADC and other African countries, although this decline was concentrated in the 1990s with little progress made subsequently.

Business environment and trade integration

The cross-country differences in manufacturing and service productivity and exports that we observe today among SADC members have a great deal to do with differences in business environment. Specifically, more successful exporters of manufactures and services are, on average, more open to trade; have lower trade costs on account of more conducive geography and lower transport and regulatory costs; have lower regulatory barriers to business formation; provide better access to long-term finance; and have more reliable public utilities and better governance in the sense of having less corruption in government agencies. Above all, more successful exporters of manufactures and services suffer far less from allocative inefficiency resulting from disparities in access to long-term finance, public utilities, and to government services among sectors, business size groups, and entry cohorts, as they provide a more level playing field to everyone on those key dimensions of the business environment.

The top exporters of manufactures and services in the region currently are South Africa, Mauritius, Lesotho, Namibia, Swaziland, and Malawi. These are also among the most open to trade. All except Lesotho owe their exporting status to the higher productivity of their manufacturing sectors relative to almost everyone else in the region, including Angola, DRC, and Zambia, which have the least productive and least exporting manufacturing and service sectors in the region. One major source of the productivity gap between the two extremes of successful exporters of manufactures and services (South Africa, Mauritius, Namibia, Swaziland, and Malawi), and nonexporters of the same (DRC, Angola, and Zambia), is differences in technical efficiency. The typical manufacturer in the former group operates closer to the global technological frontier of its respective industry than does its counterpart in the second group, and in that sense, is more technically efficient.

A second source of the manufacturing productivity gap between the two groups of countries is that, within the typical domestic industry, low productivity firms tend to have higher market shares in the non-exporting group than they would have in the other group—a reflection of the greater allocative inefficiency that characterizes industry in the nonexporting group. The relatively higher allocative inefficiency of industries in the non-export group in turn is partly caused by the fact that there is greater in-country disparity of business environment in those countries than there is within the more successful exporters, where the playing field is more level for all firms regardless of how large they are, how long they have been in business, and where in the country and in which sector they are operating.

Business environment reforms and FDI

Cross-country differences in the business environment have also been a major factor in recent trends in inward foreign direct investment (FDI) in the region and in its allocation among member countries. In recent years the SADC has attracted higher FDI on a per capita basis than most other developing regions. Though most of the inflow has been to mining, resource-poor countries have also attracted more than their share of FDI. In almost every case, FDI inflows have financed large shares of domestic savings and helped improve productivity, without which growth rates would have been significantly lower than they turned out to be.

However, given cross-country patterns in expected rates of return, Tanzania, Malawi, Mozambique, Swaziland, and Namibia should have attracted far more FDI than they actually did, while Angola, DRC, and Zambia are unlikely to sustain current levels of FDI. Sustaining high levels of FDI in the second group and raising levels in the first group will require significant improvements in the countries' business environments. The type of improvements needed differ among countries, however. In at least one country, what is needed is reduction of investment risk through greater political stability. In almost all the others, there is an urgent need for reducing corruption and business start-up costs.

In the recent past, reforms that lowered start-up costs in Madagascar, Mauritius, and Mozambique have drastically positive and visible impacts on FDI flows, while greater political stability in Zambia and Mauritius had a similar effect in those countries. On the other hand, major declines in the control of corruption seem to have led to a sharp fall in FDI in Namibia and

Swaziland in the early 2000s. One indication of the scope for positive changes in these business environment factors is that start-up costs have steadily declined in nearly all resource-poor countries to converge with or to less than the South African norm, while start-up costs are very high and have generally remained unchanged in most resource-rich countries.

DRC and Zimbabwe aside, the trend in the SADC as a whole has been one of members' convergence towards greater political stability, with steady improvements in every country's score on the stability index. Botswana, Mauritius, and Namibia are the most politically stable members; the larger countries—South Africa, Mozambique, Malawi, and Zambia—converge around something of a normal (or mean) score for the region.

On the other hand, there is not much evidence of convergence over time among SADC members in terms of control of corruption. Indeed, countries in the region fall into three distinct groups: relatively “corruption free” members, namely, Botswana, Mauritius, Namibia, Madagascar, and Lesotho; those with moderate corruption, namely, Zambia, Malawi, Mozambique, and Swaziland; and those where corruption is a serious problem—Angola, DRC, and Zimbabwe.

Issues in financial market integration

Greater financial integration in the SADC should help improve the allocation of FDI and capital more generally within the region. It should also help promote trade integration. Some of the influence of business environment on investment and trade integration therefore occurs as an effect on financial integration and financial development.

At this point the level of financial integration is quite low, an indicator of which is the large variance in real interest rates among member countries: some have excessively high rates (Mozambique, Tanzania, and Zambia), while others report negative rates (DRC, Botswana, Madagascar, and Angola). Countries also vary hugely in terms availability of financial products and their accessibility to different sectors of the economy.

One major impediment to greater financial integration is that institutions of contract enforcement are weak in many member countries. The SADC scores lowest among all regions on time to enforce contracts, with Angola, Mozambique, Botswana, and Swaziland recording the longest times. Another barrier is that credit information is lacking in several countries, including DRC, Lesotho, Madagascar, Malawi, Tanzania, and Zambia. Capital controls constitute the third impediment. The SADC region has the most restrictions on capital flows, both in de jure measures of capital account restrictions and in de facto measures of actual capital flows during the past few years.

Employment regulation and labor market integration

Compared to other regions, employment contracts are not heavily regulated in the SADC. Seven countries have an overall Doing Business employment rigidity index that is well below the OECD average. The same index is below Sub-Saharan Africa's average for three other members. However, there is enormous variation in the degree of employment regulation within the region itself. Angola, DRC, Zimbabwe, Botswana, and Madagascar regulate the labor market the most heavily. In Lesotho, Malawi, Mauritius, Swaziland, Namibia, and Zambia, employment contracts are the least regulated.

These differences in the intensity of labor regulation have significant implications for cross-country differences in employment and earnings, and for cross-country differences in trade integration. It is not by coincidence that the countries where employment is least regulated have attracted more FDI per capita and have more export-oriented manufacturing and service sectors than other member countries. Intraregional differences in employment regulation also generate differences in the price of labor and in labor market integration.

To provide a sense of how large wage differences are within the region, the report compares the potential earnings of a typical male worker, with no schooling and some work experience, across the region. He earns about 90 percent less in DRC, Zambia, and Tanzania than he would in South Africa. Compared to working in South Africa, he would earn about 50 percent less in Swaziland and Angola. Other middle-income countries in the region exhibit pay rates of 65 to 75 percent of South Africa's.

These differences are consistent with variations in regulation of employment noted above. However, it should also be noted that the differences reflect insufficient trade integration, and inadequate mobility of capital, as much as contrasts in labor market institutions. In the long run, cross-country gaps in pay and in labor market institutions would be inconsistent with the free flow of goods and factors of production in a region. Cross country data on gaps in pay and in returns to human capital are thus an important tool, not only for monitoring the degree of labor market integration in the SADC, but also as an indirect gauge of trade integration and capital mobility within the region.

The reason for this linkage is that a country cannot sustain wage rates that exceed a global or regional norm unless it somehow restricts the flow of goods, services, capital, and people across its borders. Even where trade is restricted, labor market integration can be driven by the flow of capital among countries. When FDI is driven by a positive wage shock in the sending country labor market, it creates a link with the recipient country's labor markets. For example, FDI from South Africa to Zambia, motivated by a sudden rise in wages in South Africa, increases the demand for labor and, ultimately, wages in Zambia. International migration is another mechanism linking wages and labor markets across countries.

The report evaluates the extent of integration of labor markets among members the statistical agencies of which regularly collect the minimum data required for this purpose, which are South Africa, Mauritius, the BNS (Botswana, Namibia, and Swaziland), Tanzania, and Zambia. The evaluation involves measuring the speed with which wages in one country respond to shocks to

the labor market in the rest of the region. The rule of interpretation of the measurement is that faster adjustment indicates a more regionally integrated market. The results show that, although there is considerable integration of South Africa's labor market with many others in the region, the degree of integration is rather low. This reflects the fact that both trade and capital flows are far more restricted in the region than in places where there is greater cross-border labor market integration.

One such place is the U.S.–Mexican border, where a study showed that wages in Mexican border towns fully adjusted to wage shocks in the US in around one month. This is 3.6 times shorter than the time it takes for wages in the BNS to fully adjust to wage shocks to the South African labor market. As would be expected, adjustments to the shock would take even longer as we move further away from South Africa's border. For example, it takes 5.5 months for Tanzanian wages and 11 months for wages in Mauritius to adjust to the same shock to South African wages.

Recommendations

Based on its main findings the report provides policy recommendations relating to measures needed to promote integration. The measures advocated include:

- (a) increasing harmonization of import tariffs among SADC members and reducing nontariff barriers to regional and extra regional trade,
- (b) reducing trade costs by improving and harmonizing customs administration,
- (c) reducing transport costs by improving railway and port services,
- (d) improving the power supply situation,
- (e) reducing business start-up costs, particularly in resource-rich countries,
- (f) combating corruption, and
- (g) promoting financial development and regional financial integration by opening up capital accounts, fostering competition in the banking industry, instituting credit information systems, and improving and harmonizing contract enforcement institutions.

POLICY RECOMMENDATIONS

The key harmonization issues emerging from the report's findings concern import tariffs and nontariff barriers, transport and other significant components of trade costs, provision of infrastructure, control of corruption and issues of financial development and regional financial integration. In this note we list the main policy recommendations that emerge from the report's analysis and those that have been made in other studies including the national investment climate assessments that the World Bank carried out in many SADC member countries in the last two to three years.

Member state agencies are the primary drivers and executors of most of the measures or intervention the report recommends. However, in almost every case, the SADC Secretariat is empowered by one or more of the organization's protocols to initiate, facilitate, or coordinate the harmonization of members' actions in the relevant policy areas. .

In many cases recommended measures are long overdue vis-à-vis the time frame specified in the Regional Indicative Strategic Development Plan (RISDP) of the SADC and can be implemented in a short term time line of 3 years or less. However, in some cases, implementation is possible only over the long term.

Eliminate intra regional import tariffs in the short term and harmonize the level and structure of MFN tariffs in the long term.

As a result of the MFN tariff reduction that the SADC countries have undertaken since the mid-1990s, average tariff rates are now quite modest in the region. There has also been a phasing down of tariffs among SADC members in line with the provision of the Trade Protocol according to which all intra regional trade would be duty free by 2012 and, since the coming into effect of the Free Trade Area (FTA) in August 2008, 85 percent of all intra regional trade is assumed to be duty free.

However, there remain two critical issues that need to be addressed in the area of tariff reforms. Over the next two to three years, there is a need to eliminate all intra regional customs duties in line with the stipulations of the Trade Protocol and as part of the move towards the establishment of the envisaged customs union. Over the long term, there is a need to (a) harmonize the level as well as structure of MFN tariffs of member countries in the context of establishing the common external tariff as part of the move towards a customs union by 2012, and (b) reduce effective rates of protection. On the whole, effective rates of protection are quite high in the region, as tariff rates on consumer goods are significantly higher than those on intermediate goods. Tariffs on production inputs are also significant almost everywhere, and some of the anti-export bias of the 1980s tariff structure is still in place.

The role of the SADC Secretariat

While power resides in members states in relation to both sets of measures, the responsibility for advocating the measures on behalf the SADC rests with the Trade Monitoring and Compliance Mechanism (TMCM) of the Trade, Industry, Finance and Investment (TIFI) Directorate of SADC Secretariat and, ultimately, the Committee of Ministers Responsible for Trade (CMT) that the TMCM serves.

Lower nontariff barriers and reduce trade costs

The reduction in MFN tariffs in the early 1990s and the intra-regional tariff phase downs that have occurred since 2000 have brought to the surface the importance of non tariff barriers to regional trade, the removal of which is provided for by the Trade Protocol and is a requirement of the consolidation of the FTA. There are a range of nontariff barriers to intra-regional trade for the removal of which the RISDP and the 2010 USAID audit of the implementation of the Trade Protocol recommend a set of measures to be carried over the short term. These include:

- (a) the adoption of the a common customs code of harmonized regulation and procedures for the region;
- (b) the establishment of a single common customs declaration document;
- (c) simplification of the existing SADC rules of origin; and
- (d) the formulation of an SADC plan and time table for the removal other non-tariff barriers to intra regional trade

Regional and National responsibilities

These are all measures that have to be initiated at the level of the SADC secretariat. However, the magnitude of the change that needs to take place on the ground varies a great deal from member state to member state, being greatest in those countries where non-tariff barriers contribute the most to trade costs.

Trade costs are high, particularly in Angola, DRC, Zambia, Botswana, and Zimbabwe. Although high transport costs are often the main part of the problem, non-tariff barriers arising from customs administration and regulatory costs of cross border transactions, and activities in general, are often major contributors to the costs in those countries and though out the region.

In many of these countries there is a need to streamline clearance procedures as an important means of facilitating trade. In Zambia, Tanzania, and Lesotho the measures being advocated include simplifying import procedures and increasing the use of inland clearance facilities in order to shorten processing times.

In Madagascar, the reforms that have reduced customs clearance times down to four days are often cited as examples of the possible scope and method of achievement in the area and the

region. The Madagascar reforms involve the use of TradeNet to connect most of the entities involved in the import and export process together in a single online platform that lets customs authorities share data and transmit their approvals electronically. In addition to cutting clearance time, this has helped reduce corruption by injecting greater transparency into the clearance system.

Reduce transport costs by improving roads, railways and port services

National solutions

Over the long term, the key to bringing down trade costs is to cut transport costs. In many, countries investment in road conditions will help reduce transport costs significantly, as Zambia has recently demonstrated. However, Zambia's experience also shows that opening up the road transport sector to foreign competition (in this case competition by South African operators) would help cut freight tariffs even more. Zambia is also one of the countries where reducing delays involved in border crossing is an obvious potential source of cost savings.

In Mozambique, high transport costs are associated with inefficiency in railway and port services. The government has therefore begun a series of structural reforms to improve operations in those sectors, including some aimed at expanding private participation in their management. Investment in the rehabilitation and expansion of the network also should be promoted, and the coordination between rail and port networks should be improved to reduce turn-around times.

Improving rail services is also considered the key to cutting transport costs in Lesotho, where the rail sector is reportedly dysfunctional at the moment, resulting in exporters relying exclusively on road transport, which costs three times as much as rail. The government is therefore being advised to promote investment in the rail yard and warehousing facilities in Maseru as a way to remove major bottlenecks in the growth of garments and textiles exports.

Regional solutions

At the regional level, the SADC's strategy for reducing transport costs is based on the Protocol for Communication, Transport and Meteorology and is articulated in the RISDP in terms of two strategic objectives increasing the capacity of member states to maintain existing transport infrastructure and enhancing intra-regional connectivity by investing in new infrastructure. The RISDP envisages four measures that the Secretariat should carry out over the short term in the pursuit of the two objectives. Although all four measures are overdue in terms of the time lines originally set for them in the plan document, a start has yet to be made on everyone of them. The measures are:

- (a) assisting member states develop sustainable maintenance funding schemes through a regionally harmonized user fee systems
- (b) developing regional investment financing mechanisms including a regional framework for public-private partnerships in transport projects

- (c) developing a legal framework for a multi-lateral liberalization of regional transport markets
- (d) developing a framework for harmonizing border post procedures, operating licenses and third party motor insurance systems

Developing and harmonizing competition policies over the long term

As member countries liberalize intra regional trade and capital flows, care needs to be taken that first arrivals on the domestic scene from other parts of the region do not erect barriers to entry to domestic markets and domestic industries by design or otherwise. Combined with regionally harmonized trade policies, well crafted, effectively enforced, and regionally harmonized competition policies will help safeguard against such an outcome. At the moment South Africa is the only member country that has an internationally well regarded competition policy regime. However, even it needs further competition policy reforms.

Again primarily responsibility for legislation on competition policies and their implementation resides in member states, but there are also clear roles for the Secretariat in providing a framework for regional harmonization of policies and peer review mechanisms.

Improve power supply

National solutions

After freight transport and port facilities, problems of power supply pose the most important infrastructure related obstacle to export diversification in many countries within the SADC. Power shortages are holding back manufacturing productivity and exports, particularly in Madagascar, Malawi, Angola, and Zambia. In each of these countries, start-ups can wait for months to be connected to the public grid while established businesses report significant losses of revenue due to frequent outages. The proximate cause of the shortages in all of these cases is years of underinvestment in the power sector. As a result, governments have sought to promote large investments in maintenance and additional generating and transmission capacity, as the long term solution to the shortages. However, the root causes of the shortages include the deliberate under pricing of electricity, the failure of poorly managed state-owned operators to collect payments, and the absence of a workable legal and regulatory framework for private sector investment, all of which need to be addresses urgently in a 2 to 3 year time line.

In Zambia, the government is being advised to address some of these problems by revising its electricity tariffs, which are currently said to be 45 percent below the cost of services. The government also should reform the state-owned power company to strictly commercial footing, to improve the payment collection and minimize transmission and distribution losses.

Instituting cost recovery tariffs, establishing efficient billing and collection, and limiting transmission and distribution losses are also among the measures recommended to the government of Angola. Unlike Zambia, Angola has yet to legalize private investment and private operators in the power sector. Nor has Angola instituted a truly independent regulator for the

industry. The country is being advised to separate power generation and transmission and distribution activities into independent operations of independent enterprises.

Regional solutions

At the regional level, the legal framework for role of the SADC Secretariat in addressing the power supply problem is provided in the Energy Protocol and the Energy Sector Action Plan of 2000, based on which the RISDP recommends two measures that can help ease the region's power shortage problem in the long term. These are:

- (a) The establishment of a regional market in electricity as a component of an integrated regional energy market;
- (b) Promoting cross border power pooling by extending existing power grid connectivity to cover more, and eventually all, member states.

In order to make these measures feasible over the long term, the Secretariat needs to take the lead in harmonizing the regulatory and legal framework in which power companies operate and public-private partnerships function in the sector over the short term.

Reduce start-up costs, particularly in resource-rich countries

Member states' responsibilities

Reducing business start up costs is an immediate priority in all resource-rich countries of the region. With the exception of Lesotho, all resource-poor countries have reduced business start-up costs steadily and significantly over the past five years through a series of administrative and legislative reforms; costs now have converged with or even fallen below South Africa's start-up cost levels, which are low relative to other emerging market economies. The steepest declines have been achieved in Tanzania, Mauritius, Madagascar, and Mozambique. However, start-up costs and the time it takes to set up the standard Doing-Business company remain excessively high in all resource-rich countries and Lesotho.

Among the resource-rich countries, reform efforts have been significantly more robust in Angola. However, there is still quite some distance to cover to reach what is now emerging as the regional norm. Specifically, the government is being advised to increase the effectiveness of the central government agency that authorizes business start-ups, and to reduce the time required to obtain the Commercial Operations Permit and to register with the Registry of Companies from the current 40 and 30 days, respectively.

Similarly, the government in Lesotho is being advised to consolidate and streamline the processes of business registration and industry licensing procedures as key steps towards reducing business start-up costs.

The Secretariat's role

The role of the Secretariat in reducing business start up costs and simplifying administrative barriers to business formation and liquidation is primarily to provide proactive advisory and peer- monitoring services.

Reduce corruption

Member states' responsibilities

Just like that for bringing down business start up costs, reducing corruption is an immediate priority in member states that have not done as well as others in terms of controlling graft. Among the countries where corruption is a major or significant problem, Tanzania appears to have taken the most extensive initiatives. These include the launch of the National Anti-Corruption Strategy and Action Plan (NASCAP) and the publication of a new code of conduct for civil service. In order to translate initiatives into practical results, the government is advised to roll out anticorruption action plans at local authority levels. Incentives for firms to pay bribes also should be reduced by minimizing the discretion that officials have in interpreting regulations. This can be achieved by streamlining regulations, particularly in customs, employment regulation, tax administration, municipal licensing, and municipal policing.

Like Tanzania, Zambia has also been proactive in combating corruption, and has its own anti-corruption agency, the Anti-Corruption Commission. However, that agency is badly in need of revitalization, as petty corruption clearly remains widespread. Among the measures the agency should consider to reduce demands for bribes are a review of civil service employee salaries and the institution of meritocratic management and promotion procedures. Another potentially effective method of deterring demand for bribes is establishing mechanisms for public feedback in agencies, such as the central tax authority, or the Zambia Revenue Authority.

In Angola, where corruption is likely more pervasive than elsewhere in the region, the most important missing ingredient in anticorruption efforts is a clear and explicit political commitment to such efforts on the government's part. In addition to calling for such a commitment, experts are advising the government to establish an anticorruption agency and to commit adequate resources to support its activities.

In Mozambique, the government needs to undertake a key anticorruption measure—introducing codes of conduct for civil servants similar to those provided in Tanzania. Another badly needed measure is modernization of the current conflict-of-interest regulations.

The role of the Secretariat

Here also the primary role of the Secretariat should be to provide a peer-review and a peer-learning mechanism to enhance the scope and efficacy of member country's anti-corruption programs. In the SADC's Protocol against Corruption, the secretariat has a firmer legal basis for taking the initiative in this area than it has in the area of business regulation or that of competition policy. The protocol is intended to promote the harmonization of policies and laws relating to the prevention and eradication of corruption and requires member states to establish:

a) standards of conduct in public office, b) mechanisms of transparency in public sector hiring and procurement, c) a system of whistle blowers' protection; d) a specialized anti-corruption agency, and e) mechanisms for promoting public awareness of anti-corruption laws.

Promote financial development and financial integration

One indication of the relative lack of financial integration in the SADC is that both real and nominal interest rates vary enormously across countries. Cross-country differences in access and usage rates of basic financial services are also substantial. Both types of disparity reflect differences in the scale and structure of the banking industry, the availability and quality of credit information, the degree of capital controls and, ultimately, the quality of contract enforcement institutions. Therefore, the key challenges in promoting financial integration and financial development in the region involve improving the availability of credit information; improving small businesses' access to finance; liberalizing the capital accounts; opening the banking industry to greater competition; and improving the quality of contract enforcement institutions. All of these are potentially important instruments for promoting financial development and financial integration in the region.

Member states' responsibilities

Open up capital accounts

The countries that have relatively open capital accounts are Zambia, Mauritius, Botswana, and Madagascar. If the SADC is to achieve greater financial integration, all of its members need to reduce or eliminate capital controls, as provided for in the RISDP.

Foster competition in the banking industry

Except for South Africa, the banking industry is quite small in SADC countries. The banking sector is generally highly concentrated throughout the region and characterized by extensive government involvement. These are all rationales for the pursuit of regional financial integration as a way to promote market competition for financial services within smaller economies. This also means that member countries need to take measures that could promote new domestic and foreign entry into the industry. Where there is a large government ownership of banking assets, measures should be undertaken to reduce the extent of government's financial stakes, such as in Tanzania, where the government is advised to complete the bank privatization process that started some time ago with the National Microfinance Bank (NMB), Tanzania Investment Bank (TIB), and Tanzania Postal Bank (TPB).

Improve credit information

Yet another obstacle to financial integration and financial development is the lack of credit information available in several member countries, particularly in DRC, Lesotho, Madagascar, Malawi, Tanzania, and Zambia.

Improve and harmonize contract enforcement institutions

Achieving financial integration requires harmonizing the legal and judicial systems for enforcing contracts, and regulation and supervision systems of financial institutions in the short term. Ultimately, harmonization implies common sets of rules for financial transactions and reporting requirements, and common standards of cross-border supervision of institutions.

Additionally, in countries where small business utilization of financial products is particularly low, governments are being advised to undertake measures that would reduce key barriers to access to finance. For example, the government of Angola is advised to create an efficient land registration system to facilitate the use of land titles as collateral in bank financing.

The role of the Secretariat

The Finance and Investment Protocol of the SADC clearly mandate the Secretariat to take the lead to help harmonizing laws and regulations relating to capital controls, the structure of banking industries, the functioning of contract enforcement institutions and the establishment and workings of credit information systems.

1. INTRODUCTION

1. The Southern Africa Development Community (SADC) has been a free trade area (FTA) since 2009 and plans to form a customs union by 2012. The free trade area entails the elimination of import tariffs and nontariff barriers to trade among members and aims for, among other things, the harmonization of customs procedures and technical standards, and the liberalization of trade in services within the free trade area. Since 2006, the SADC has also had a Finance and Investment Protocol (FIP) that seeks to harmonize the policies of member countries in the areas of investment promotion, labor codes, and immigration laws, with the objective of setting up the region as an “Investment Zone”.

2. This is a summary of a diagnostic report that aims to identify the main business environment constraints to greater integration of goods and factors markets in the SADC in order to help inform the policy and business environment harmonization agenda of the Community in the context of the FTA and as set out in its Finance and Investment Protocol. Within that context, the report provides a quantitative assessment of the scope for increasing intraregional and extra regional trade in general, and trade in manufactures and services in particular. It also discusses the role that cross-country differences in business environments have had in impeding cross-border trade flows and the cross-border integration of credit markets and the labor market. In addition, it discusses and demonstrates the use of price, employment and earnings data currently collected by government statistical agencies for monitoring trade and factor market integration within the region.

3. The key harmonization issues concern import tariffs and nontariff trade barriers, transport and other significant sources of trade costs, provision of infrastructure, competition policy, the regulation of entry and business formation, control of corruption and access to finance. The discussion underscores the need for the following: greater harmonization of import tariffs among SADC members and reducing nontariff barriers to regional and extra regional trade; reducing trade costs through the improvement and harmonization customs administration; reducing transport costs by improving railway and port services; improving the power supply situation; the institution and harmonization of competition policies ; reducing business start-up costs, particularly in resource-rich countries; controlling corruption; opening up capital accounts more; fostering competition in the banking industry and instituting credit information systems; and improving and harmonizing contract enforcement institutions.

4. These issues are grouped in the summary under the following themes:

- Trends in trade policy and trade integration
- The role of business environment in trade integration
- The interaction between business environment reforms and inward FDI
- Financial development and financial integration
- Regional labor market integration

2. TRENDS IN TRADE POLICY AND TRADE INTEGRATION

5. The combined share of SADC countries in world trade has declined over the past decade because, although exports grew throughout the region, the rate of growth fell short of the world average growth rate of 7 percent per annum in most member countries (figure 2.1). Only five member countries (Mozambique, Lesotho, the Seychelles, Angola, and Tanzania) exceeded this average, and in only two cases (Mozambique and Lesotho) did exports grow at a faster rate than the developing country average of 11 percent per annum. In DRC and Zimbabwe, the growth rate was barely 2 percent per annum. Nonetheless, SADC economies are far more integrated today within the region and with the global economy than they were in the mid-1990s, as imports and exports have grown relative to GDP (figure 2.2.), although much of the increase in intraregional and extra regional trade integration occurred in the 1990s, progress has halted in recent years.

Figure 2.1: Annual growth in export volumes in SADC countries (1990–2007)

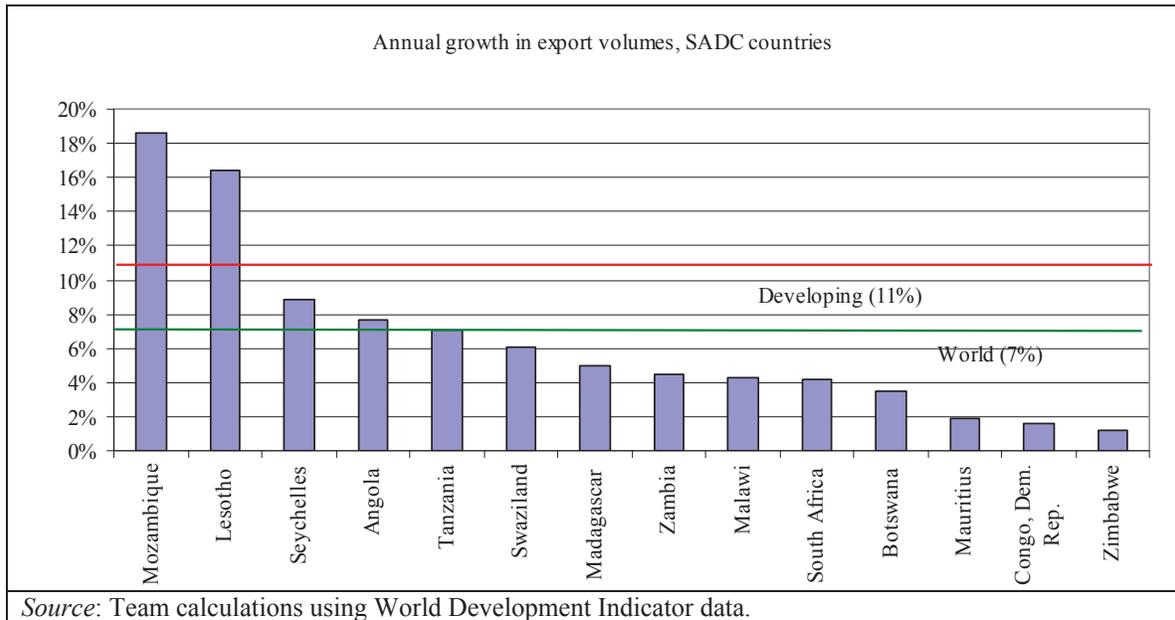
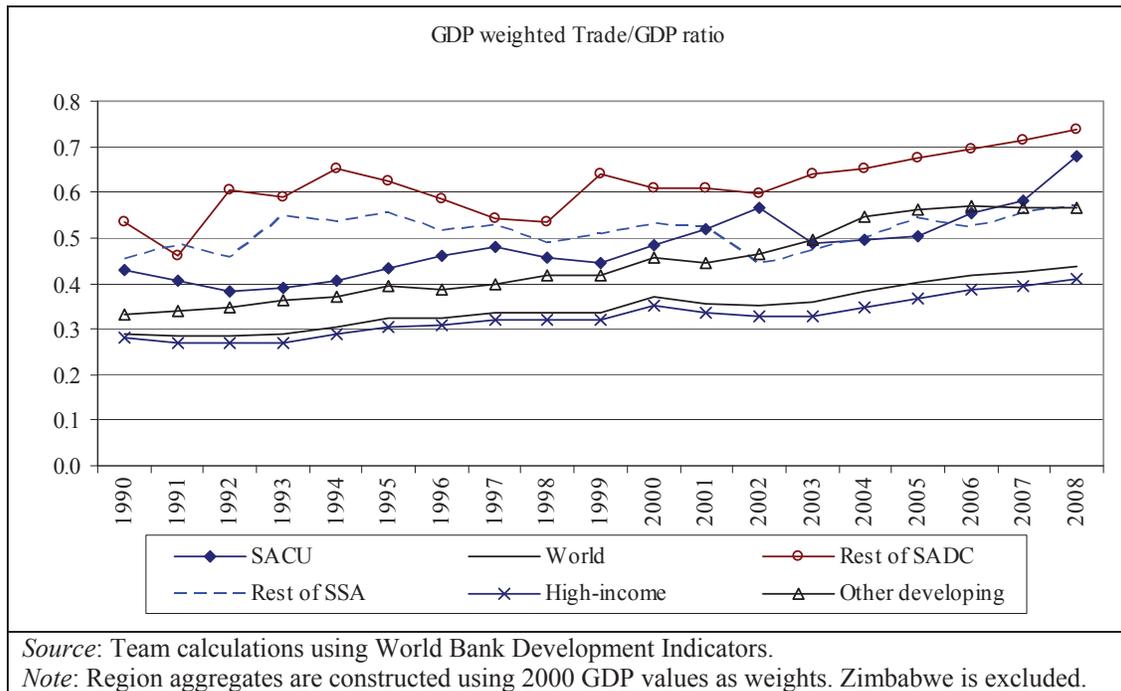


Figure 2.2: Merchandise trade (sum of exports and imports) as share of gross domestic product, weighted by GDP for year 2000



6. The period since 1990 has been one of globalization in the world economy, during which the trade-to-GDP ratios also rose for other countries in Sub-Saharan Africa and the rest of the world. Indeed figure 2.2 suggests that practically all of the growth in trade observed over that decade in the SADC reflected that global trend. Moreover, a closer look at the data shows that, on average, SADC countries export and import as much as would be expected relative to their income and distance from international and regional markets even though intra-SADC trade relatively high in relation to what intraregional incomes and distance would predict.

Trade integration and prices

7. Trends in the spread of prices within the region provide additional evidence of increased market integration in SADC countries. Consumer price inflation has converged among member countries and the volatility of real exchange rates has fallen everywhere within the region. There has also been substantial decline in prices of individual product groups within and across SADC and other African countries. However, like the trends in trade flows those in prices also suggest that progress in intra regional trade integration has stalled in recent years: although intra regional price dispersion is less today than it was in the late 1980s, the decline in price spreads was concentrated in the 1990s with little progress made subsequently.

8. To some extent, price dispersion measures market integration more reliably than trade flows do. Trade volumes reflect price differences, but are also affected by many other factors unrelated to market integration. Changes in goods market integration will also be reflected in prices, whether or not trade occurs, as it is the potential for arbitrage that determines how far prices can diverge. Unfortunately, product level price data are currently available for only a few

SADC countries. This inhibits a rigorous analysis of the determinants of price integration in the region. SADC governments have invested in negotiating protocols for enhancing regional integration. It is therefore important that some investment is also made on price data needed for proper evaluation of their consequences.

Table 2.1: Simple average applied MFN tariff, percent

	1997	2001	2007	Change 1997-2007 (%)
Angola		8.81	7.2	-1.48 ^a
Madagascar	6.94	4.61	12.4	5.11
Malawi	25.3	13.1	13.3	-9.58
Mauritius	28.7	18.4	3.15	-19.85
Mozambique	15.7	13.8	10.3	-4.67
Seychelles		28.3	7.12	-16.51 ^a
SACU	11.3	8	7.74	-3.20
Tanzania	24.3	16.3	12.6	-9.41
Zambia	14.1	12.6	13.7	-0.35
Zimbabwe	23.8	19.6	14.1	-7.84
Pooled simple average	18.8	14.4	10.2	-7.24
Pooled import-weighted	8.42	6.95	6.45	-2.00

Source: Team calculations using TRAINS data at HS 6-digit level;

Import tariffs

9. Much of the growth in the SADC's trade over the period had to do with the multilateral tariff liberalization that member countries undertook during the 1990s and 2000s despite getting limited offers in the Uruguay round to reduce bound rates. The liberalization brought down average Most Favored Nation (MFN) tariffs as well as their spreads. The simple average tariff declined from 18.8 percent in 1997 to 10.2 percent in 2007 (table 2.1), which was equivalent to a 7.24 percent reduction in the border price of imported goods. Tariff reductions were particularly large in Mauritius, the Seychelles, Malawi, and Tanzania.

Imbalances in trade flows, commodity concentration and the diversification imperative

10. Trends in intraregional trade flows corroborate those in average import protection and openness, which suggest that the region is now more integrated than it was in the 1990s. Tables 2.2 and 2.3 present data on the share of intra-SADC trade in the region's exports and imports from 1980 to 2003. The data show, first, that intra-SADC trade has grown significantly over the period, rising from less than 2 percent of the combined exports and imports of member countries in 1980, to over 10 percent in 2008. Similarly, the share of intra-SADC exports as a share of total exports grew from 0.9 percent to 12 percent in 2008.

Table 2.2: Share of SADC trade in SADC country exports

	1980	1985	1990	1995	1999	2003	2008	Percentage to SACU 2003 (%)	Percentage to SACU 2008 (%)
Angola	0.03	0	0.01	0.03	0.7	Na	1.8		99.9
DRC	0.05	0.03	0.1	6	0.3	Na	6.7		3.3
Malawi	12.4	15.4	1.6	17.2	16.9	20.1	21.8	74	50.4
Mauritius	1.4	0.1	1.2	1.4	1.4	2.1	11.3	76	32.8
Mozambique	1.1	0.3	0.2	32.1	17.41	24.6	17.2	74	65.4
SACU	0.7	2.8	2.5	10.7	11.5	9.7	10.5		
Tanzania	5.2	0.1	0.5	1.4	7.4	9.4	17.2	45	55.7
Zambia	0.9	3.1	0.8	3.8	7.8	40.6	20.0	50	54.1
Zimbabwe	1.3	25	30.7	31.7	28	30.5	64.4	79	81.2
Seychelles							1.2		
Madagascar							3.1		
Intra-SADC	0.9	3.4	3.1	9.9	10	10.6	6.1	68	72.8 ^a
excl. Angola, DRC, Madagascar, and Seychelles							12.1		62.9
<i>Source:</i> Updated table from Arndt et al. 2007 and Chauvin and Gaulier 2002.									
<i>Note:</i>									
*Intra-SACU trade is excluded. 2002 values used for Zimbabwe in 2003.									
*72.8 percent of SADC (excluding SACU countries) exports to the region are sold to SACU.									

11. However, much of the intra regional integration, as measured by increases in intra-SADC trade flows, took place during the 1990s. Progress in this regard appears to have halted in recent

years. In addition, substantial imbalances in trade flows persist. SACU continues to dominate intraregional trade flows, both as a destination for other SADC member exports and as a source of their imports. Trade flows between non-SACU countries within the region remain low, which also can be seen from tables 2.2. and 2.3. Although four SADC countries outside the SACU—Malawi, Mozambique, Zambia, and Zimbabwe—depend heavily on imports from other SADC members, this is part of a pattern whereby the region is more dependent on South Africa as a source of imports than as a market for exports.

Table 2.3 Share of SADC trade in SADC country imports

	1980	1985	1990	1995	1999	2003	2008	Percentage from SACU 2003 (%)	Percentage from SACU 2008 (%)
Angola	0	0.6	0.8	7.1	10	Na	6.5		99.9
DRC	0.4	1.6	1.1	18.1	31.5	Na	42.8		3.3
Malawi	36.7	53	24.8	49.2	64.4	57.5	58.3	65	46.4
Mauritius	14.5	4.2	9.9	11.3	11.2	13.2	9.9	97	84.8
Mozambique	3.7	5	7.6	55.5	58.6	39.5	38.0	97	94.7
SACU	0.1	1.8	1.8	2.1	1.9	2.7	5.6		0.0
Tanzania	0.7	0.7	1.3	13.9	13.3	15	11.5	66	90.4
Zambia	1.2	10.9	7.9	49.1	65.5	65	59.1	95	74.1
Zimbabwe	8.3	31.7	33.1	51.2	51.2	56.1	76.1	94	91.8
Seychelles							10.7		55.6
Madagascar							9.3		72.1
Intra-SADC	1.6	4.7	5.1	9.9	10.2	10.6	12.3	90	80.3 ^a
excl. Angola, DRC, Madagascar, and Seychelles							12.3		78.8
<i>Source:</i> Updated table from Arndt et al. 2007 and Chauvin and Gaulier 2002.									
<i>Note:</i>									
*Intra-SACU trade is excluded. 2002 values used for Zimbabwe in 2003.									
*80.3 percent of SADC (excluding SACU countries) imports from the region are sourced from SACU.									

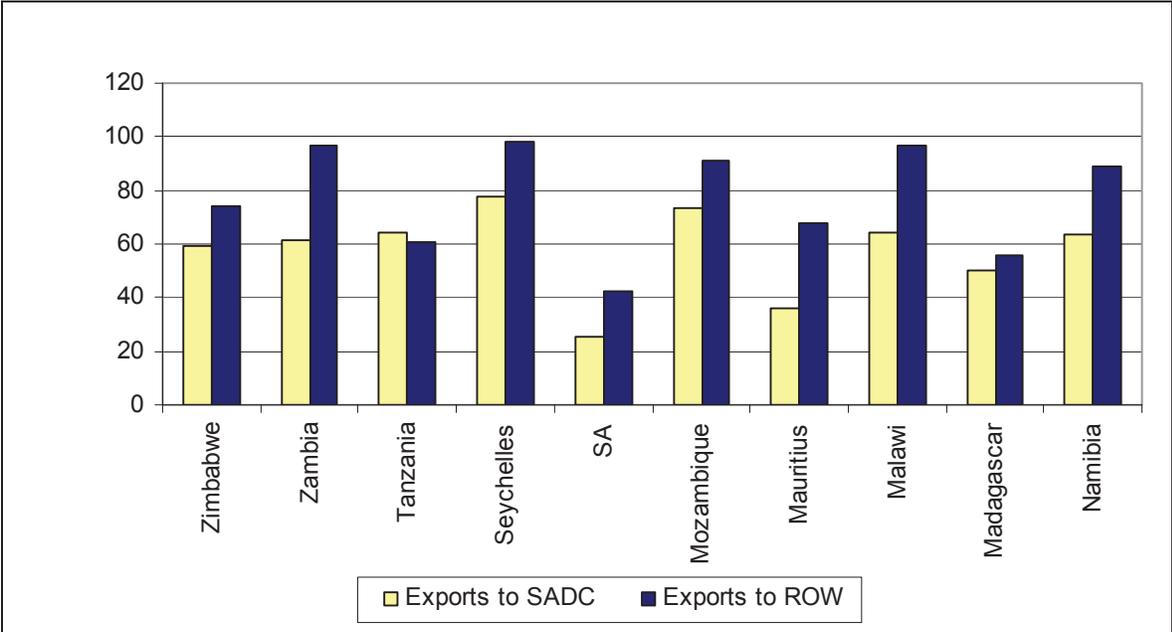
12. A second form of imbalance in trade flows in the region is that, excepting South Africa's, SADC exports (intra regional as well as extra regional) are comprised mainly of primary products, although Mauritius, Malawi, Swaziland, and Lesotho also export clothing and textile products. This pattern can be seen in figure 2.3, which presents the 2008 share of total exports to SADC made up of the top 10 export products (according to HS 6-digit lines) to each region by export value. The top 10 export products account for over 60 percent of exports for SADC

members outside of SACU. In some cases (Malawi, Mozambique, Zimbabwe) the top 10 products account for over 90 percent of export volumes.

13. Such a high degree of concentration in commodity-based exports is associated with very low intra-industry trade flows, and therefore limits productivity gains from trade through improved allocative efficiency, greater economies of scale, and greater incentives for innovation associated intra-industry trade. For the region to benefit from these gains there is a need for diversifying exports into agro-processing, manufacturing and services, in which the scope for intra-industry flows is greater.

14. An additional source of urgency for this kind of diversification is that those sectors are relatively labor intensive and most SADC countries are labor-surplus economies and face high unemployment and widespread poverty. Growing out of these problems might be possible only to the extent countries succeed in diversifying production and exports into labor-intensive sectors. However, greater diversification of exports into these sector will require a more liberalized trade regime than exists presently as trade in manufactured goods and services is more sensitive to trade barriers and cross-border transaction costs than the current trade in resource-based products.

Figure 2.3 Share (%) of top 10 export products in total exports to SADC and rest of world, 2008



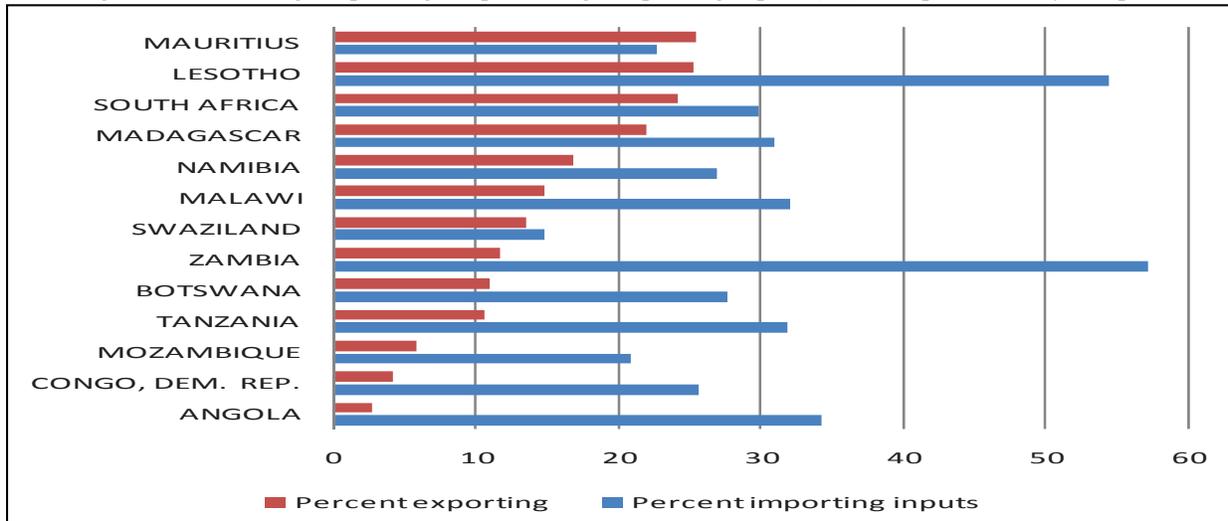
Source: Team calculations using 2008 data obtained from UN Comtrade.

3. BUSINESS ENVIRONMENT AND TRADE INTEGRATION

Productivity and non-traditional exports

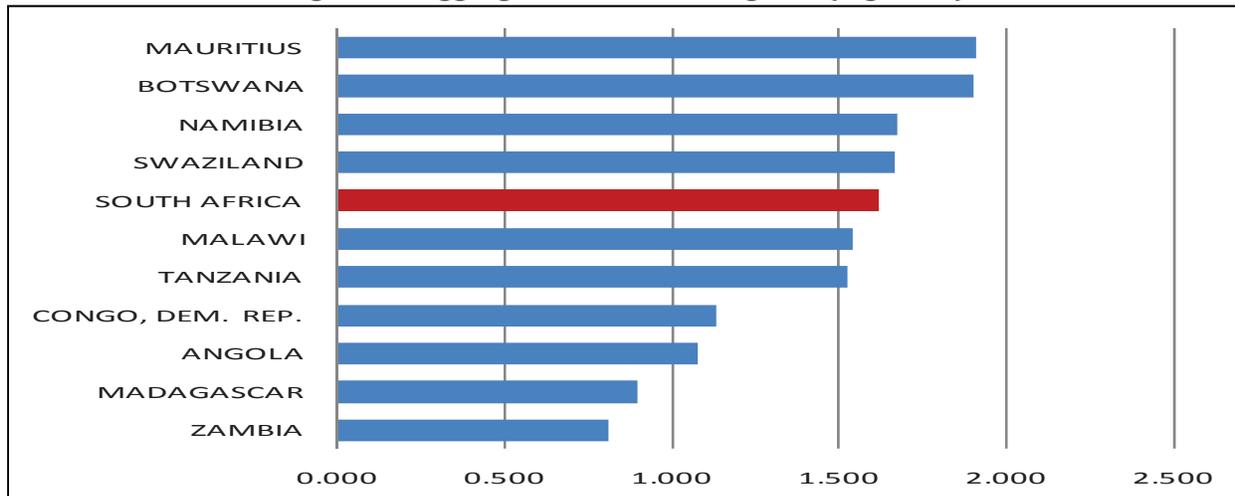
15. The top exporters of manufactures and services in the region are South Africa, Mauritius, Lesotho, Namibia, Swaziland and Malawi (figure 3.1). All of these six countries except Lesotho owe their exporting status to higher productivity in those sectors relative to almost everyone else in the region. Exact ranking puts Mauritius at the top of the list with the highest aggregate total factor productivity (TFP), followed by Botswana, Namibia, Swaziland, and South Africa, in that order (figure 3.2). The bottom four countries (in descending order) of TFP are: DRC, Angola, Madagascar, and Zambia.

Figure 3.1Percentage exporting vs. percentage importing inputs (%)Enterprise Survey samples



Source: World Bank Enterprise Surveys

Figure 3.2Aggregate manufacturing TFP (log units)

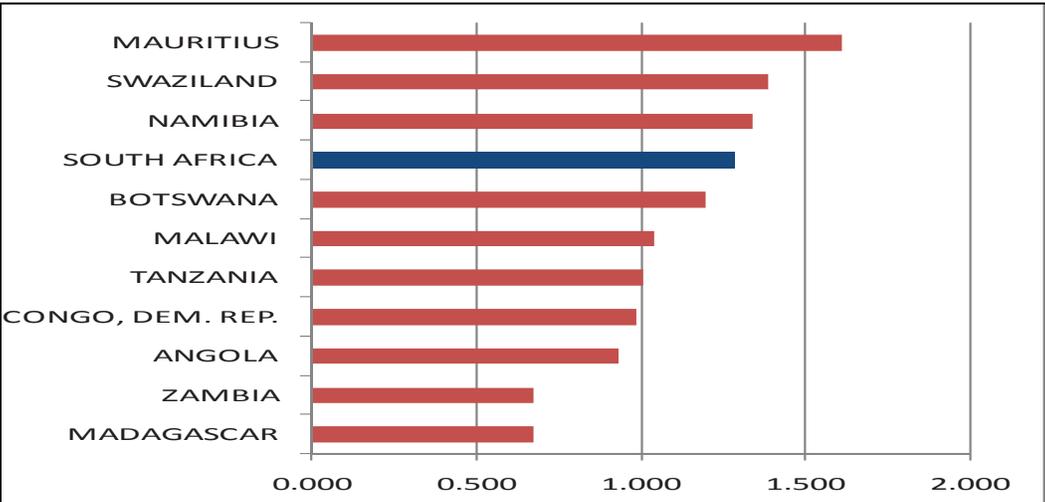


Source: World Bank Enterprise Surveys

16. The aggregate TFP shown in figure 3.2 is a weighted average of index of individual enterprises constituting the industry sample, with enterprise market shares serving as weights. In other words, it is calculated as the sum of the (unweighted) average within-firm TFP (shown in figure 3.3) and the sample covariance between enterprise TFP and enterprise market share, which we call the allocative efficiency index, and is shown in figure 3.3. A positive covariance term implies that more productive firms have higher market shares. Considering changes over time, this means that it is not necessary for average within-firm TFP to increase for aggregate industry productivity to grow. Aggregate (or industry-level) TFP often increases or falls even in the absence of significant changes in the average within-firm TFP, as a result of the reallocation of market share from low-productivity to high-productivity firms—that is, as a result of improvements in the allocative efficiency of the industry.

17. There are thus two sources of the productivity gap between the more successful exporters of manufacturing and services in the SADC (South Africa, Mauritius, Namibia, and Swaziland) and the member countries that have been least successful in that regard (DRC, Angola, and Zambia). One of these is within-firm TFP (or technical efficiency): the typical manufacturer in the exporter group operates closer to the global technological frontier of its respective industry than does its counterpart in the second group of non-exporters as depicted in (figure 3.3). The second source is that industry is characterized by a higher allocative efficiency index in the exporting group in the sense that high productivity firms tend to have higher market shares in the exporting group than they would have in the non-exporters (figure 3.4).

Figure 3.3: Average within-firm TFP (log units)



Source: World Bank Enterprise Surveys

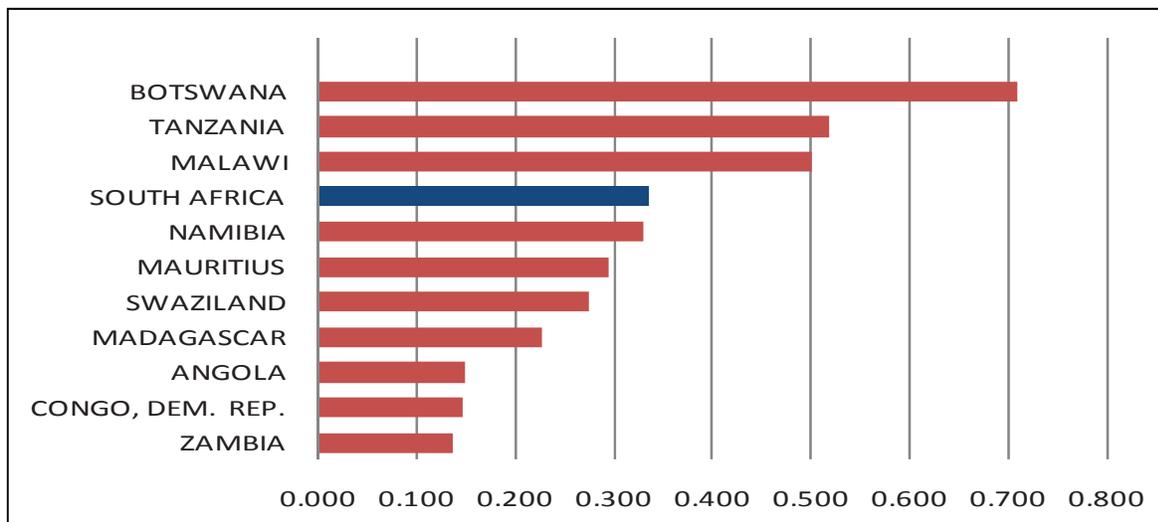
Business environment, productivity and non-traditional exports

18. The cross-country differences in manufacturing and service productivity and exports that we observe today among SADC members have a great deal to do with differences in business environment. Specifically, more successful exporters of manufactures and services, on average, have more reliable public utilities, better governance, lower and fewer regulatory barriers to business formation, and lower trade costs, and are more open to trade overall. All of these affect manufactured and service exports directly or through the effect they normally have on productivity because they influence either the technical efficiency of firms or the allocative efficiency of industries or both.

19. A significant source of cross country differences in the allocative efficiency index as defined in connection with figure 3.3 are cross country differences in the extent of market distortions arising from disparities in business environment among sectors, business size groups, and cohorts of entry within each country. Markets are distorted when firms cannot shift resources from low profit activities or sectors to more profitable ones whenever the opportunity arises, which is what would happen if the ability of some businesses to do so is impeded, say, because they do not have as much access to finance or electricity than other, or have to pay more for the same services, or are taxed more by corrupt officials.

20. Cross country differences in this kind of market distortions amount to differences in the variance of the cost of doing business, which ultimately translates to differences in employment and productivity in a pattern whereby higher variance of cost means less employment and less output, and typically less productivity even in countries where the average cost of doing business were the same as anywhere else.

Figure 3.4: Manufacturing industry allocative efficiency index



Source: World Bank Enterprise Surveys

21. Market distortions arising from within-country disparities in the cost of doing business reduce aggregate productivity because, by impeding the mobility of firms and resources from

low-profit lines of business to more profitable ones, they in effect protect the market shares of incumbent firms in high profit industries from entry by potentially more productive new players. The allocative efficiency index used in figure 3.4 therefore tends to be lower in countries where there is greater disparity in business environment between sectors, regions and size groups of firms, and is higher in those where the business environment is more uniform and the “playing field more level”.

Competition policy reforms and harmonization

22. The allocative efficiency index also tends to be lower in countries where industry is more concentrated and more protected from competition from imports, which often create scope for dominant incumbents to engage in entry deterring behavior. For that reason, the generally weak correlation between firm level productivity and market shares that figure 3.4 suggests to exist in the region indicates that there are significant competition policy issues everywhere. In all other member countries industrial concentration appears to be holding down aggregate manufacturing productivity by raising the market shares of low productivity firms well above what it would be in other parts of the world, notably, upper middle income countries. The establishment of the SADC Free Trade Area adds to the urgency of member countries instituting regionally compatible competition policies as part of their broader policy harmonization agenda. The liberalization of trade should help increase aggregate productivity by helping increase the market shares of low cost domestic producers and by increasing domestic firms’ incentives for innovation. However, as noted by Hartzenberg (2002), trade policy reforms could be undercut in their role of enhancing productivity if the foreign companies from which the imports originate end up exercising market power in the countries to which they are exporting, and their presence and actions erect barriers to entry by other potential sources of imports or direct investors in domestic production.

23. A well crafted and effectively enforced competition policy can help prevent such an outcome and is needed also as a necessary component of the policy framework for the increase in intra-regional FDI envisaged in the SADC’s Finance and Investment Protocol. It is highly significant in this context that South Africa is the main source of intra-regional FDI in the SADC since this means that some of the competition policy issues that the South African economy faces are likely to arise when South African based companies make investments across the border in other SADC member countries.

24. Thanks to its Competition Act of 1998, South Africa itself has a well regarded, transparent and pro-competition mergers and acquisitions review process driven by three complementary institutions, namely, the Competition Commission, the Competition Tribunal, and Competition Appeal Court. The jurisdiction of these institutions has recently expanded to respond to complaints against anti-competitive behavior more generally, and there are clear indications that many South African industries are today less concentrated as a result of the new competition policy regime and have grown more productive as a result. Nonetheless, overall, South African industry remains highly concentrated by the standards of other upper middle income countries, which is believed to have held back productivity and investment and posed an important barrier to SME entry in many industries. There are therefore calls for the institution of a more activist competition policy than has been the case so far as a means of generating further

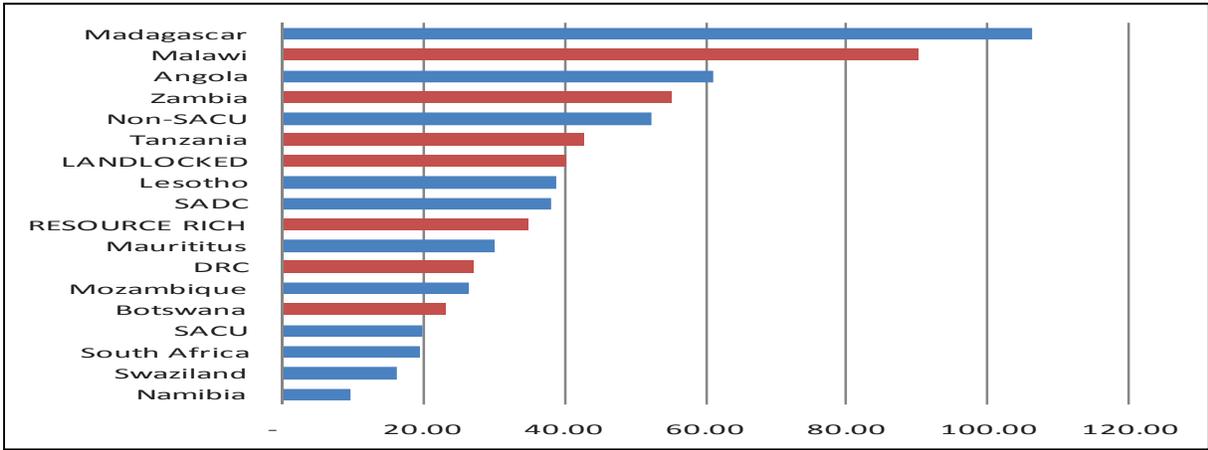
productivity gains and encouraging the development of a more vibrant SME sector in the economy.

25. These concerns are likely to be relevant and pose similar competition policy challenges throughout the SADC region. And yet, at this point, there are only four countries in the region that have active competition policies other than South Africa. These are Malawi, Mauritius, Tanzania, Zambia and Zimbabwe. Namibia, Swaziland and Madagascar have just enacted competition laws, but implementation has yet to start or has barely started. Mozambique, Botswana and Lesotho are in the process of drafting competition laws.

Improving public utilities- power supply

26. Almost everywhere in the region, power supply is a significant constraint to productivity and exports and is invariably better in countries that also score better in both. Power shortages are holding back manufacturing productivity and exports, particularly in Madagascar, Malawi, Angola, and Zambia (figure 3.5). In each of these countries, start-ups can wait for months to be connected to the public grid while established businesses report significant losses of revenue due to frequent outages (figure 3.6).

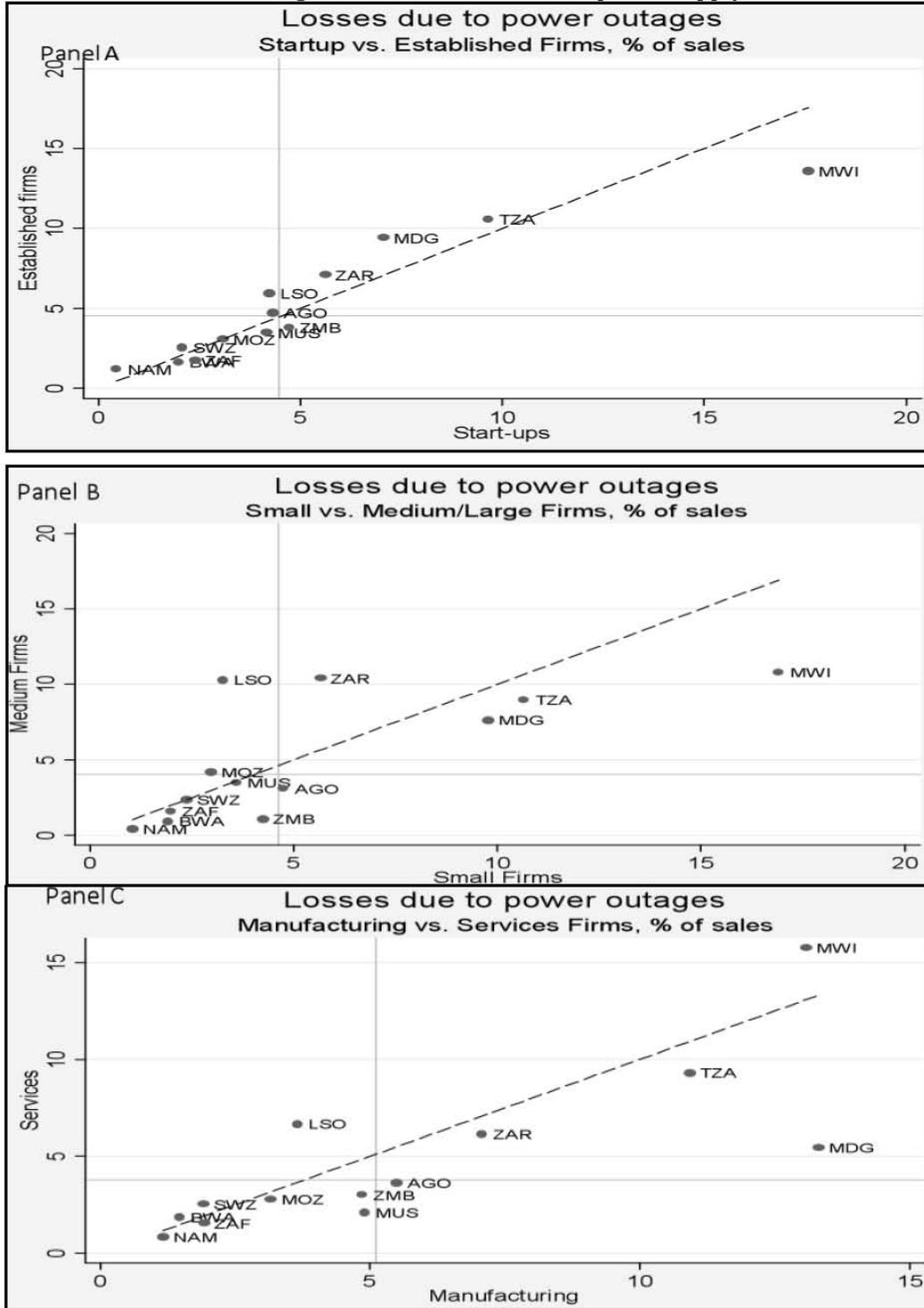
Figure 3.5: Average number of days needed to connect to a public grid



27. Like many other business environment problems, power shortages add significantly to the average cost of doing business in countries where they are more severe relative to countries where they are less so. They have also been a source of significant allocative inefficiency in most countries. The inefficiency occurs partly because the shortages affect smaller firms more than larger ones in some countries, and partly also because long waiting periods to get electrical connection in effect reduce firm formation and entry rates. The former effect can be seen from the second panel in figure 3.6, which suggests that power shortages could be a major source of allocative inefficiency, not only in Malawi, Tanzania, Madagascar, and Zambia, where reported losses to outages are much higher for smaller firms, but also in Lesotho and DRC, where larger firms tend to report higher losses. The panel measures output losses due to power outages vertically for medium sized or larger firms and horizontally for smaller firms. An observation lies on the 45-degree line (of equality) dividing the panel when power shortages add to the cost of doing business on smaller and larger firms to the same degree. In this case the shortages do

not produce allocative inefficiency although they may reduce employment and productivity across the board.

Figure 3.6: Cost of unreliable power supply



Source: World Bank Enterprise Surveys

28. On the other hand, observations below the line of equality represent cases where outages generate allocative inefficiency by penalizing smaller firms more than larger ones, as is the case with Angola, Malawi, Tanzania, Madagascar, and Zambia. Power shortages also have result in allocative inefficiency in Lesotho and DRC, but this time because they are penalizing larger firms more than smaller ones.

29. A second channel of allocative efficiency losses resulting from power shortages is the disparity in their incidence between the manufacturing and service sectors. In panel C of figure 3.6, losses due to power outages are significantly larger for manufacturing firms in Madagascar, Mauritius, Zambia, Angola, DRC, and Tanzania, although service firms report higher losses in Malawi and Lesotho.

30. The proximate cause of the shortages in all of these cases is years of underinvestment in the power sector. As a result, governments have sought to promote large investments in maintenance and additional generating and transmission capacity. The root causes include the deliberate under pricing of electricity, the failure of poorly managed state-owned operators to collect payments, and the absence of a workable legal and regulatory framework for private sector investment.

31. In Zambia, the government is being advised to address some of these problems by (a) revising its electricity tariffs (currently said to be 45 percent below the cost of services); (b) reforming the state-owned power company to strictly commercial footing; (c) improving payment collection; and (d) minimize transmission and distribution losses.

32. Instituting cost recovery tariffs, establishing efficient billing and collection, and limiting transmission and distribution losses are also among the measures recommended to the government of Angola. Unlike Zambia, Angola has yet to legalize private investment and private operators in the power sector. Nor has Angola established yet a truly independent regulator for the industry. The country is also being advised to separate power generation and transmission and distribution activities into independent operations of independent enterprises.

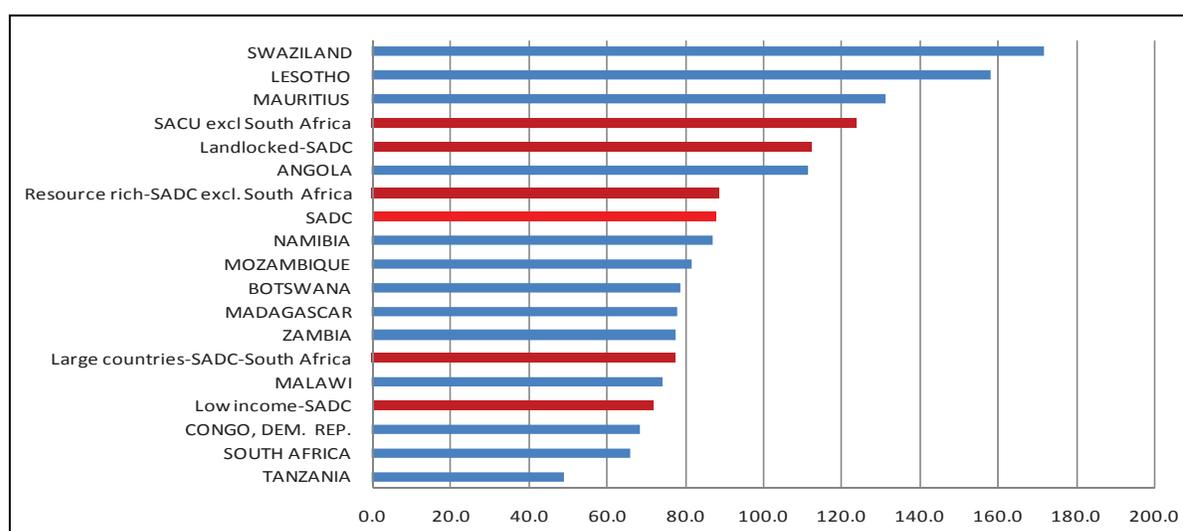
Import Tariffs nontariff barriers

33. Among the key aspects of the business environment on which public action is needed in most member countries in order to boost productivity and non-traditional exports are those directly relating to openness to global trade. One of these is trade policy in general and tariff policy in particular. The others are business environment variables influencing trade costs. These include non tariff barriers to trade and transport costs. The top exporters of manufactures and services in the region tend to be most open to trade. Openness to trade also increases productivity by providing greater incentives for innovation and by improving the allocative efficiency of domestic industry.

34. The average tariff rates are now quite modest in the region as a result of the MFN tariff reduction that member countries have undertaken since the mid-1990s. There has also been a phasing down of tariffs among SADC members since the implementation of the SADC Free

Trade Agreement Protocol began in 2009. Nonetheless there are at least three important issues that remain to be addressed from the point of view of the promotion of productivity growth and nontraditional exports. First, the levels and structure of MFN tariff rates vary significantly within the region and there is a need to harmonize rates. Second, effective protection rates remain quite high everywhere, as tariff rates on consumer goods are significantly higher than those on intermediate goods. Third, tariffs on production inputs are significant in many countries, and some of the anti-export bias of the pre-reform tariff structure is still in place (table 3.1).

Figure 3.7: Trade as percentage (%) of GDP, SADC countries, 2002–08 annual average



35. Furthermore, despite the establishment of a free trade area, only 85 percent of trade in goods produced in the region is free of customs, many nontariff barriers remain in place, customs procedures still need to be harmonized; and significant progress needs to be made in liberalizing intraregional service trade.

Trade costs

36. As a barrier to trade, trade costs are high, particularly in Angola, DRC, Zambia, Botswana, and Zimbabwe. Figure 3.8 compares SADC members in terms of the Doing Business cost of exporting a standard cargo to the United States by ocean transport. This cost ranges from US\$737 in Mauritius to US\$1,531 in South Africa and US\$3,280 in Zimbabwe. Other relatively low-trade-cost economies besides Mauritius are Mozambique, Tanzania, Madagascar, Lesotho, and Malawi. Typically, shipments take longer in countries where the cost is higher, but figure 3.9 also shows that countries that rank well in terms of pecuniary trading costs do not necessarily perform as well in the time taken to export the standard cargo. Angola ranks last on time to export, behind DRC, Zambia, Botswana, and Zimbabwe. Lesotho, which ranks far better than Swaziland and DRC in the cost of trade, also ranks behind both countries in time to export. Overall, the very countries that do not perform well in manufacturing exports and productivity, as described earlier, are also among those that have the highest trading costs.

Table 3.1 Simple average protection by end-use classification

	Consumption goods	Capital goods	Intermediate goods	Passenger vehicles
1997				
Angola				
Madagascar	10.6	7.8	5.3	15.6
Malawi	34.1	20.6	22.8	40.0
Mauritius	49.0	22.9	21.9	54.2
Mozambique	32.6	8.4	10.5	30.6
Seychelles				
South Africa	25.3	1.9	7.9	36.3
Tanzania	27.4	15.6	24.9	18.3
Zambia	22.3	10.0	11.8	20.0
Zimbabwe	49.3	11.7	16.4	36.1
Average	31.3	12.4	15.2	31.4
2001				
Angola	14.5	3.4	7.7	9.4
Madagascar	9.8	5.0	2.5	11.7
Malawi	21.4	7.3	11.1	24.0
Mauritius	44.2	7.6	10.5	10.0
Mozambique	27.8	8.0	9.5	26.4
Seychelles	44.0	20.2	23.2	163.0
South Africa	18.1	1.8	5.7	29.3
Tanzania	23.6	11.4	14.6	10.0
Zambia	21.6	5.7	10.6	16.3
Zimbabwe	38.0	10.8	14.2	44.9
Average	26.3	8.1	11.0	34.5
2007				
Angola	13.0	3.1	5.8	9.4
Madagascar	18.8	10.8	10.3	15.6
Malawi	21.4	7.1	11.4	23.4
Mauritius	7.9	1.1	1.8	0.0
Mozambique	18.6	7.0	7.8	15.0
Seychelles	19.3	0.9	3.0	156.0
South Africa	16.9	1.8	5.5	21.6
Tanzania	23.4	4.0	10.3	12.0
Zambia	22.3	9.2	11.2	15.0
Zimbabwe	28.0	8.7	11.1	44.9
Average	19.0	5.4	7.8	31.3
1997 sample, average	19.7	6.2	8.7	18.4
Change 1997-07, consistent sample	-8.9	-5.5	-5.7	-9.9
Change 2001-07	-5.8	-2.6	-2.8	-2.4

Source: Team calculations using TRAINS data.

37. Figure 3.9 shows the time needed to export the standard cargo from a country against the average of the exporting time of countries that have the same level of per capita income as traced out by the solid line shown between the dotted lines marking out confidence intervals. Higher values of the index mean less trading time: 1 (worst outcome) to 7 (best outcome) The only countries that do as well as their income group or better in the region while doing as well as or better than the SADC average are Mauritius, Madagascar, Mozambique, Lesotho, and the Seychelles. The worst performers in terms of having longer trading time than the region average are Angola, Zambia, Zimbabwe, Malawi and DRC. South Africa and other SACU have shorter trading times than this group, but they too do poorly relative to their income group of countries.

Figure 3.8: Trade costs—exports (US\$)

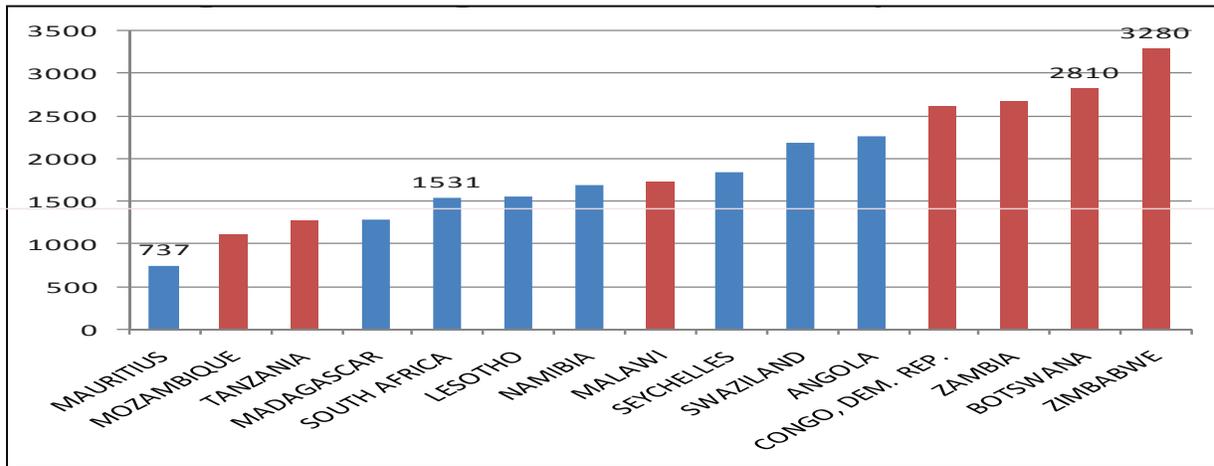
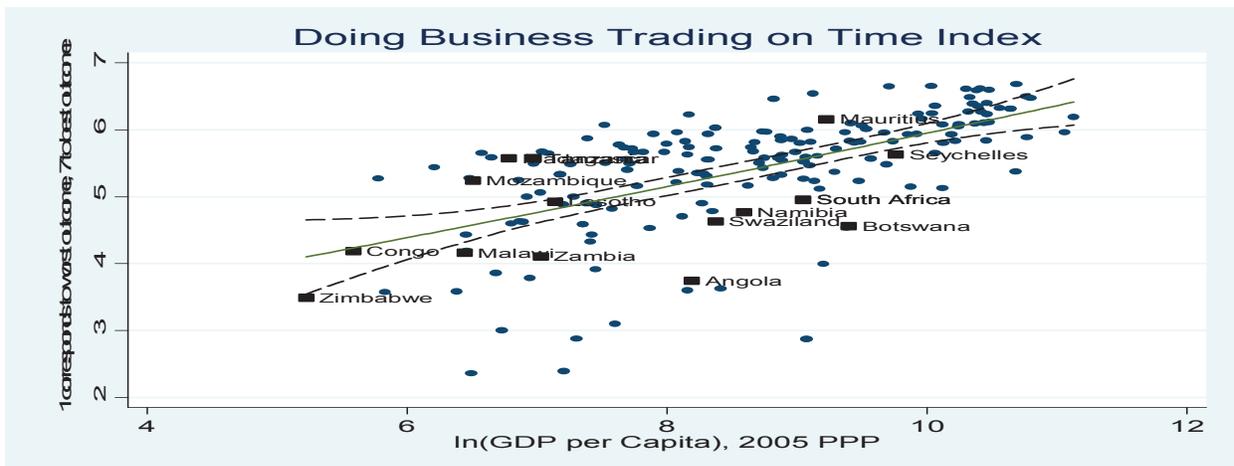


Figure 3.9: The trading -on -time index



Customs administration

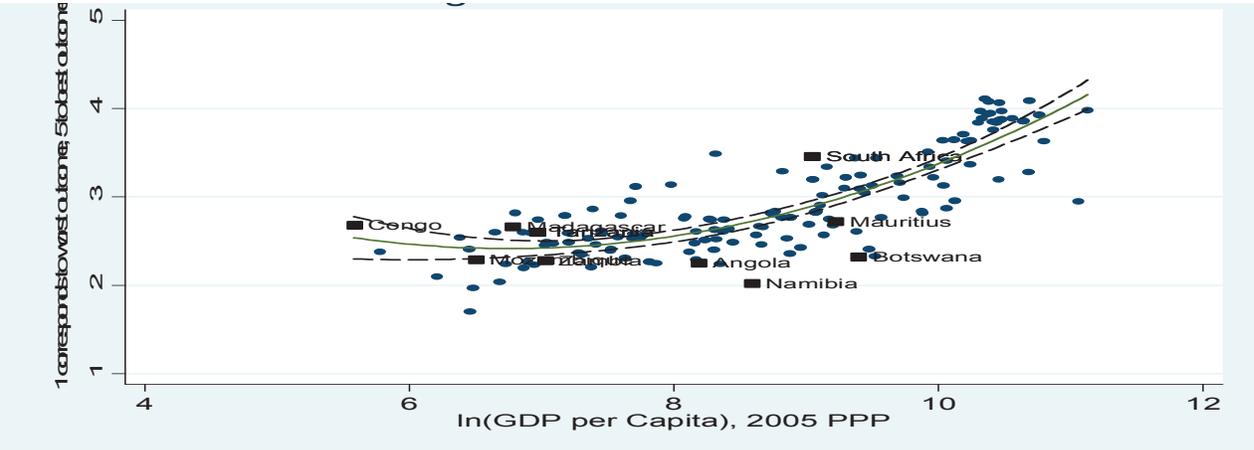
38. In many countries burdensome customs and trade regulations are part of the source of higher trade costs. In such countries there is a need to streamline clearance procedures as an important means of facilitating trade. In Zambia, Tanzania, and Lesotho there is a need for simplifying import procedures and increasing the use of inland clearance facilities in order to shorten processing times.

39. In Madagascar, the reforms that have reduced the time taken for a shipment to clear customs times down to four days are often cited as examples of the scope for potential improvement in the region as a whole in this very important area. The Madagascar reforms involved the use of TradeNet to connect most of the entities involved in the import and export process together in a single online platform that lets customs authorities share data and transmit their approvals electronically. In addition to cutting clearance time, this has helped reduce corruption by injecting greater transparency into the clearance system.

Transport costs

40. Almost everywhere in the region transport accounts for the largest component of trade costs, but the means of cutting transport costs vary among countries. We describe the extent of this variation in figure 3.10 in terms of the World Bank’s Logistics Performance Index, of which transport costs are a major component. The Logistics Performance Index is a summary of various areas of the logistics environment relating to customs clearance, trade and transport-related infrastructure, logistics services, and so on. The areas are: (a) efficiency of the customs clearance process, (b) quality of trade and transport-related infrastructure, (c) ease of arranging competitively priced shipments, (d) competence and quality of logistics services, (e) ability to track and trace consignments, and (f) frequency with which shipments reach the consignee within the scheduled or expected time. Here also observations are shown against the income group norm. South Africa, Madagascar, and Tanzania perform well relative to the norm for their income. Although Mauritius, Botswana, Angola, Namibia, and Zambia, score well for the region, they all fall short of the norms for their income groups.

Figure 3.9: Logistics Performance Index



41. In many countries improvement in road conditions will help reduce transport costs significantly, as Zambia has recently demonstrated. However, Zambia's experience also shows that opening up the road transport sector to foreign competition (in Zambia's case competition from South African operators) would help cut freight tariffs even more. Zambia is also one of the countries where reducing delays involved in border crossing is an obvious potential source of cost savings.

42. In Mozambique, high transport costs are associated with inefficiency in railway and port services. The government has therefore begun a series of structural reforms to improve operations in those sectors, including some aimed at expanding private participation in their management. Investment in the rehabilitation and expansion of the network should also be promoted, and the coordination between rail and port networks should be improved to reduce turn-around times.

43. Improving rail services is also considered the key to cutting transport costs in Lesotho, where the rail sector is reportedly dysfunctional at the moment, resulting in exporters relying exclusively on road transport, which costs three times as much as rail. The government is therefore being advised to promote investment in the rail yard and warehousing facilities in Maseru as a way to remove major bottlenecks in the growth of garments and textiles exports.

4. BUSINESS ENVIRONMENT REFORMS AND FDI

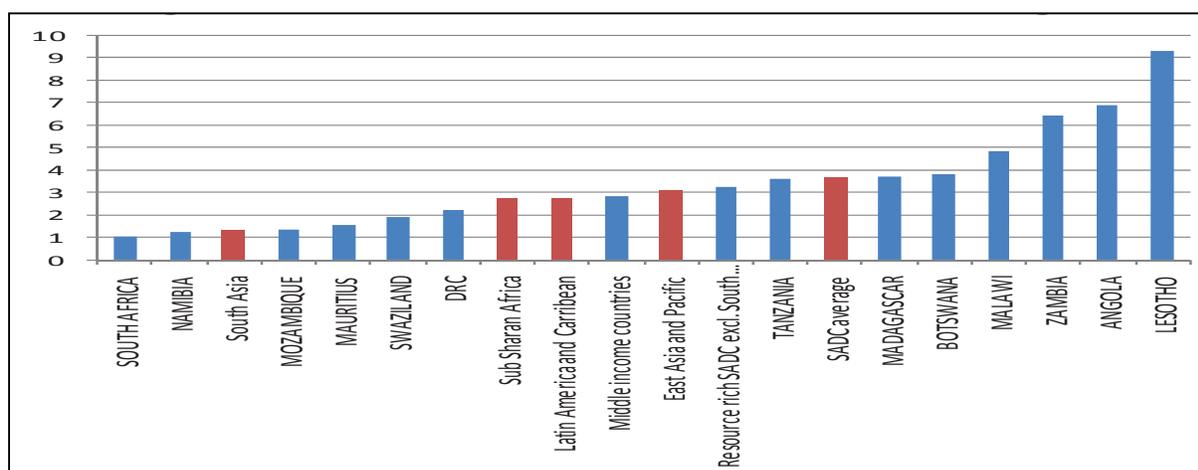
44. Cross-country differences in the business environment have also been a major factor in recent trends in inward foreign direct investment (FDI) in the SADC and in its allocation among member countries. In a world of international inequality, where goods do not cross borders freely and domestic savings and growth rates vary among countries, cross-border capital mobility is a major source of growth and regional economic convergence. In that context, FDI provides a benefit that domestic investment does not necessarily: FDI projects are often vehicles for the international transfer of technology and knowhow. It is therefore highly significant that the SADC has attracted higher FDI on a per capita basis in recent years than most other developing regions. In almost every case, FDI inflows have financed large shares of domestic savings shortfalls and have led to substantial growth in productivity, which have both made growth rates significantly higher than they would otherwise have been.

Imbalances in FDI flows

45. At the same time, there have been serious imbalances in the allocation of inward FDI among member countries in the sense that some countries have had disproportionately high shares of inflows seen from the perspective of needs as well as investment opportunities. At the level of needs, resource-poor countries that typically need higher inflows to finance domestic savings shortfalls have attracted far less FDI per capita than resource-rich countries, which often have unusually high saving rates. At the level of opportunities, there are very large cross-country differences in the expected rate of return to capital in the region that seem to warrant far higher

levels of inward FDI to some SADC members than they have actually realized in recent years. In particular, South Africa, Tanzania, Mozambique, Malawi, Swaziland, Namibia, and Mauritius should have attracted far more inward FDI than they currently realize. On the other hand, it seems unlikely that Angola, DRC, Zambia, and Madagascar would be able to sustain the level of FDI inflows they have seen in recent years given the low expected rates of return on their existing capital stock relative to other member countries.

Figure 4.1: FDI as percentage (%) of GDP (2002–08 annual average)



Source: World Development Indicators

46. These imbalances partly reflect cross country differences in key business environment variables within the region that have raised the risk premium in high-rate-of-return countries. Sustaining high levels of FDI in the second group, and raising levels in the first, will require significant improvements in the countries' business environments. The type of improvement differs among countries, however. In at least one country, what seems to be needed is a lowering of investment risk through greater political stability. In almost all the others, there is a need to reduce corruption and business start-up costs.

Table 4.1: Key economic indicators (2002–08 average)

Country	GDP Growth	FDI as % of GDP	Savings as % GDP
ANGOLA	14.75	6.87	24.59
BOTSWANA	3.86	3.78	50.03
LESOTHO	3.99	9.29	26.31
MADAGASCAR	3.59	3.69	12.51
MALAWI	7.61	4.82	9.87
MAURITIUS	4.11	1.56	22.58
MOZAMBIQUE	5.23	1.31	5.20
NAMIBIA	5.39	1.23	28.31
SWAZILAND	2.76	1.87	13.26
TANZANIA	6.91	3.56	10.75
SOUTH AFRICA	4.30	1.02	14.73
DRC	5.97	2.20	6.19
ZAMBIA	5.35	6.41	16.27
SADC average	5.68	3.66	18.51

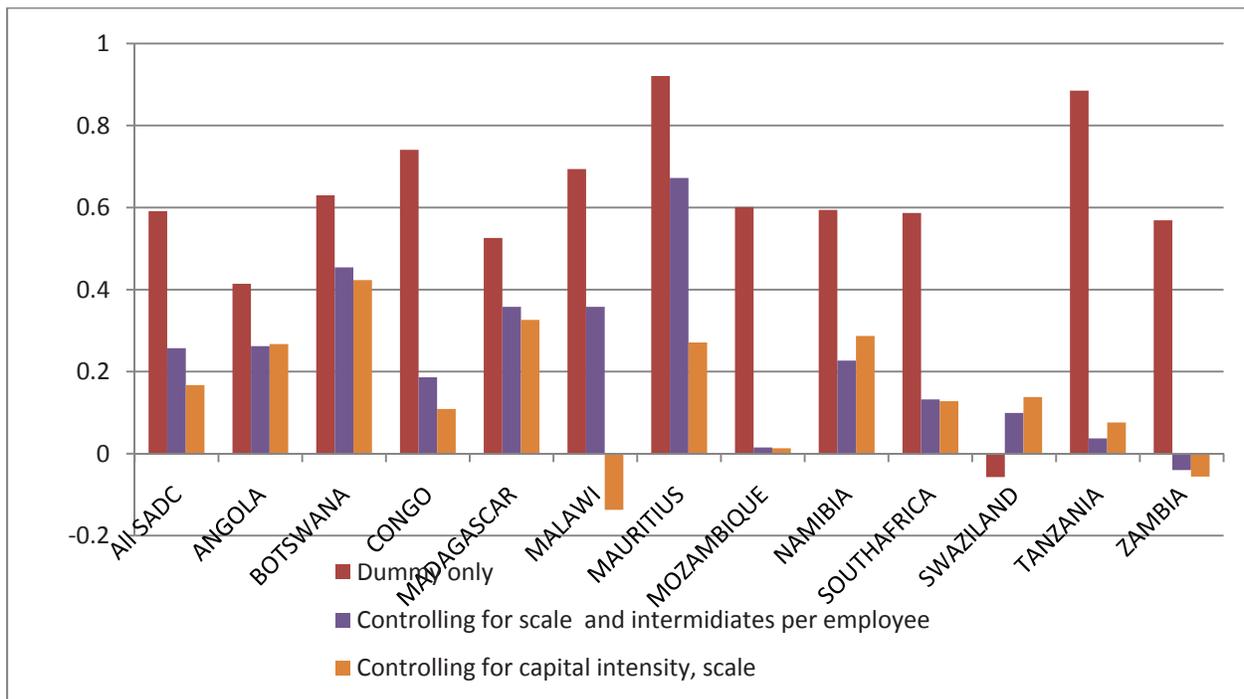
Source: World Development Indicators

47. The countries that have attracted the highest level of FDI relative to GDP in recent years are Malawi (4.8 percent), Zambia (6.4 percent), Angola (6.7 percent) and Lesotho (9.4 percent) (figure 4.1). Two of these, namely, Malawi and Lesotho, are low-income and resource-poor, but have done better in attracting more FDI per capita than far wealthier, resource-rich countries including South Africa, Namibia, and Botswana. The countries that have attracted the least FDI per capita are South Africa (1.1 percent), Namibia (1.2 percent), Mozambique (1.3 percent) and Mauritius (1.6 percent).

Inward FDI and productivity growth

48. With the exception of Namibia, almost all of the countries in both groups always have had a domestic savings shortfall, so it is likely that growth would have been less than what was actually observed with less FDI than they managed to attract (table 4.1). In fact, from 2000 to 2008, FDI financed shortfalls in domestic savings in more than half of the SADC member countries, namely, Mauritius, South Africa, DRC, Malawi, Mozambique, Madagascar, and Zambia). World Bank Enterprise Survey data also indicate that, inward FDI has boosted growth throughout the region by inducing productivity growth in almost all countries.

Figure 4.2: Labor productivity premium of foreign invested enterprises



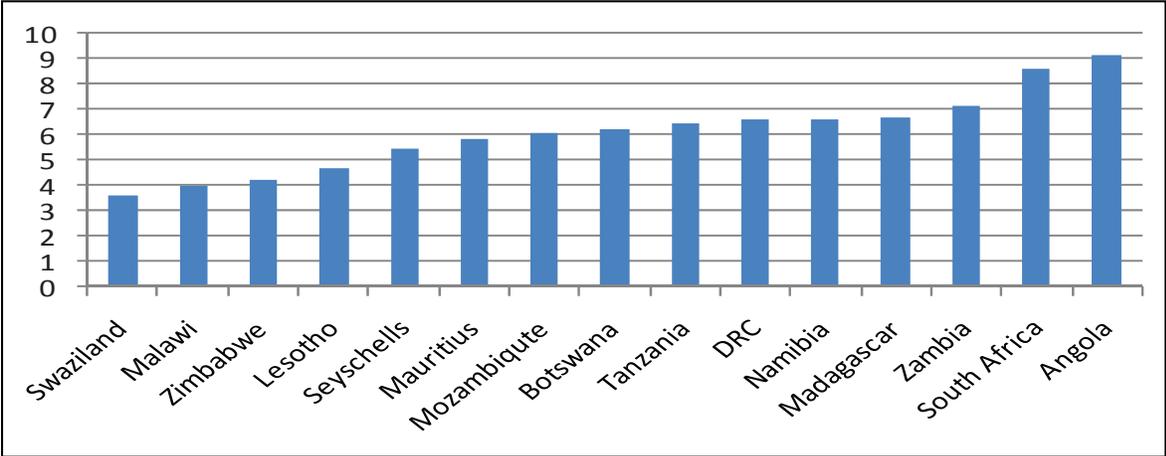
Source: World Bank Enterprise Surveys

49. Inward FDI has boosted manufacturing and service productivity in the region largely because it has led to the establishment of larger and better equipped businesses in manufacturing and services and has facilitated the transfer of know-how and technology from abroad. Across the region, labor productivity is about 60 percent higher in foreign-invested enterprises than in businesses that are entirely owned by domestic entities (figure 4.2). This obviously masks significant cross country variation in the magnitude of the effect. The labor productivity of foreign-invested firms exceeds that of the other firms by as high as 90 percent in Mauritius and Tanzania, while being comparatively low in Angola, and negligible in Swaziland. Indeed, as a general pattern, the labor productivity advantage of foreign invested companies ranges between 40 percent and 60 percent in all other countries of the SADC—being significantly higher, on average, in low-income than in middle-income countries, in resource-poor than in resource-rich countries, in large countries than in smaller ones, and in coastal or island nations.

50. Much of this labor productivity premium represents the economies of scale that foreign-invested enterprises typically have, which indeed appears to be the sole source of the premium in DRC, Mozambique, South Africa, Tanzania, and Zambia (figures 4.2). In the other countries, the premium reflects that foreign-invested companies are typically more capital-intensive, deploying fewer but more skilled workers equipped with more and better fixed assets. This is particularly the case in Angola, Botswana, Madagascar, Malawi, Mauritius, and Namibia, and is, as a rule, more the case with middle-income than low-income economies, and more true of small countries than larger ones.

51. In many countries FDI has also led to significant growth in total factor productivity (TFP), part of which might be associated with better business management practices or the use of better know-how in other technical fields. The TFP premiums of foreign-invested enterprises are particularly high in Botswana, Madagascar, Mauritius, Namibia, and Angola, ranging from 22 percent to 40 percent (figure 4.2). As a rule, the premiums are higher in small countries than in larger ones, in resource-poor countries than in resource-rich ones, and in middle-income countries than in low-income ones.

Figure 4.3: Inward FDI in log units of US\$ million at current prices (2007)



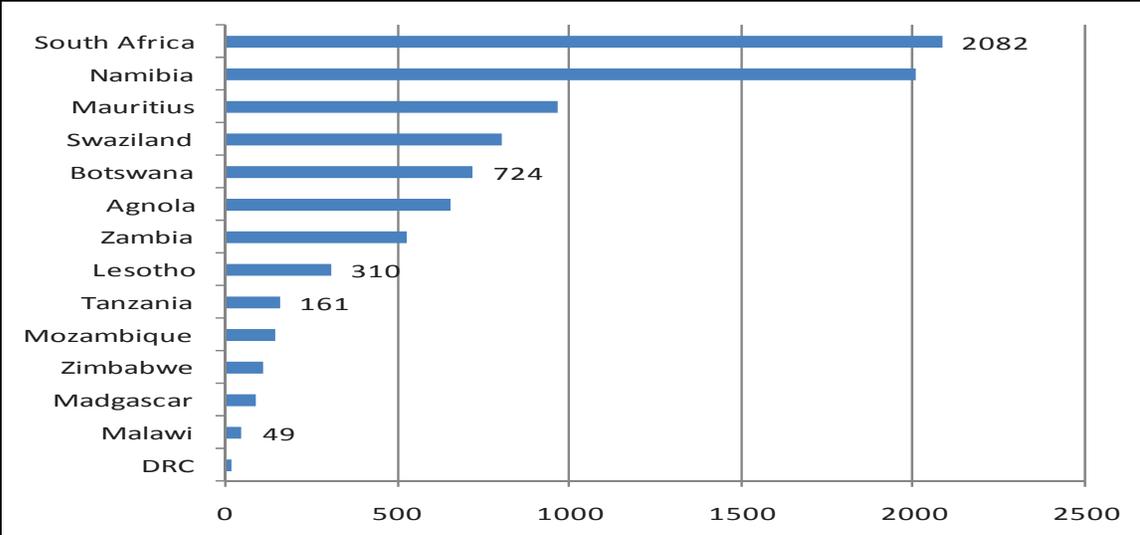
Source: World Development Indicators

52. Figure 4.3 compare SADC countries in terms of the absolute volume of inward FDI for 2007, immediately before the global recession in 2008. Not surprisingly, South Africa and other resource-rich countries are by far the dominant destinations of FDI to the region; South Africa accounts for approximately 25 percent of the regional total, followed (in descending order) by Angola, Zambia, Madagascar, Namibia, DRC, Mozambique, and Mauritius. Although FDI is still low on a per capita basis in several of these other destinations (figure 4.1), the increase in FDI inflows to these countries has been significant over the past decade. In more recent years, the growth in inward FDI has been steepest in resource-poor economies, namely, Mauritius, Malawi, Lesotho, and Madagascar. Among resource-rich countries inward FDI grew the fastest in recent years in Angola and Zambia.

Stocks vs. Flows

53. Among the factors influencing FDI inflows is the existing stock of FDI and capital (in general). It is therefore useful to compare countries in terms of FDI stocks as well in order to understand better the role of other influences on current flows including business environment variables. This is done in figure 4.4, where with a per capita FDI stock of US\$2,000, or more, South Africa and Namibia are clearly at the top of list, followed by Mauritius at some distance. At the other extreme of that list are DRC, Malawi, Madagascar, Zimbabwe, Mozambique and Tanzania, for which per capita FDI stocks range from US\$22 to US\$161. In between these extremes are Lesotho, Zambia, Angola, Botswana and Swaziland for which the per capita stock ranges from US\$310 (Lesotho) to US\$810 (Swaziland). The basic pattern suggests that low-income countries, resource-poor countries, and landlocked countries have accumulated far less FDI stock over the years, mainly by virtue of having attracted very little of the resource-seeking FDI that went into the mining sectors of their resource-rich counterparts.

Figure 4.4: Stock of inward FDI per capita at current prices (US\$) (2007)



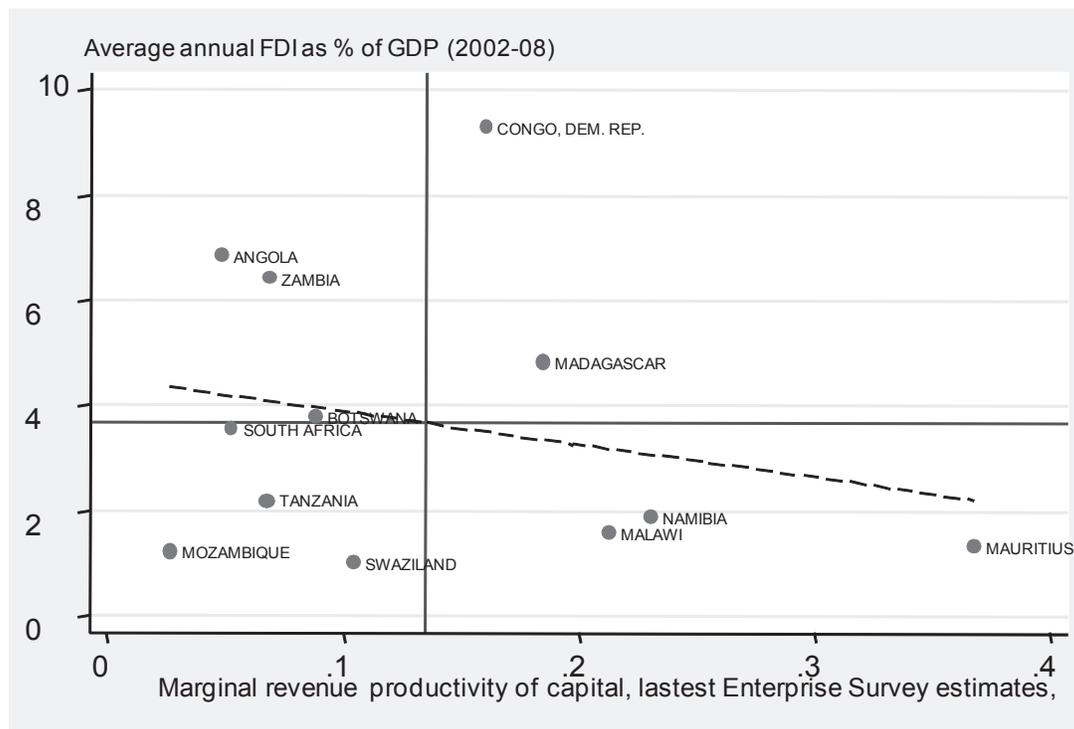
Source: World Development Indicators

Is FDI being misallocated within the SADC?

54. Beyond showing the role that FDI is playing as a source of productivity growth, World Bank Enterprise Survey data also provide some evidence that some member countries suffer from underinvestment in the sense that they should have attracted more FDI than they actually did based on their record on the rate of return to capital, while there is apparent overinvestment in others. A form this evidence is shown in figure 4.5 in which inward FDI is plotted against the marginal revenue productivity of capital, that is, the return firms would make on a dollar worth of investment given their current stock of capital and the scale of production.

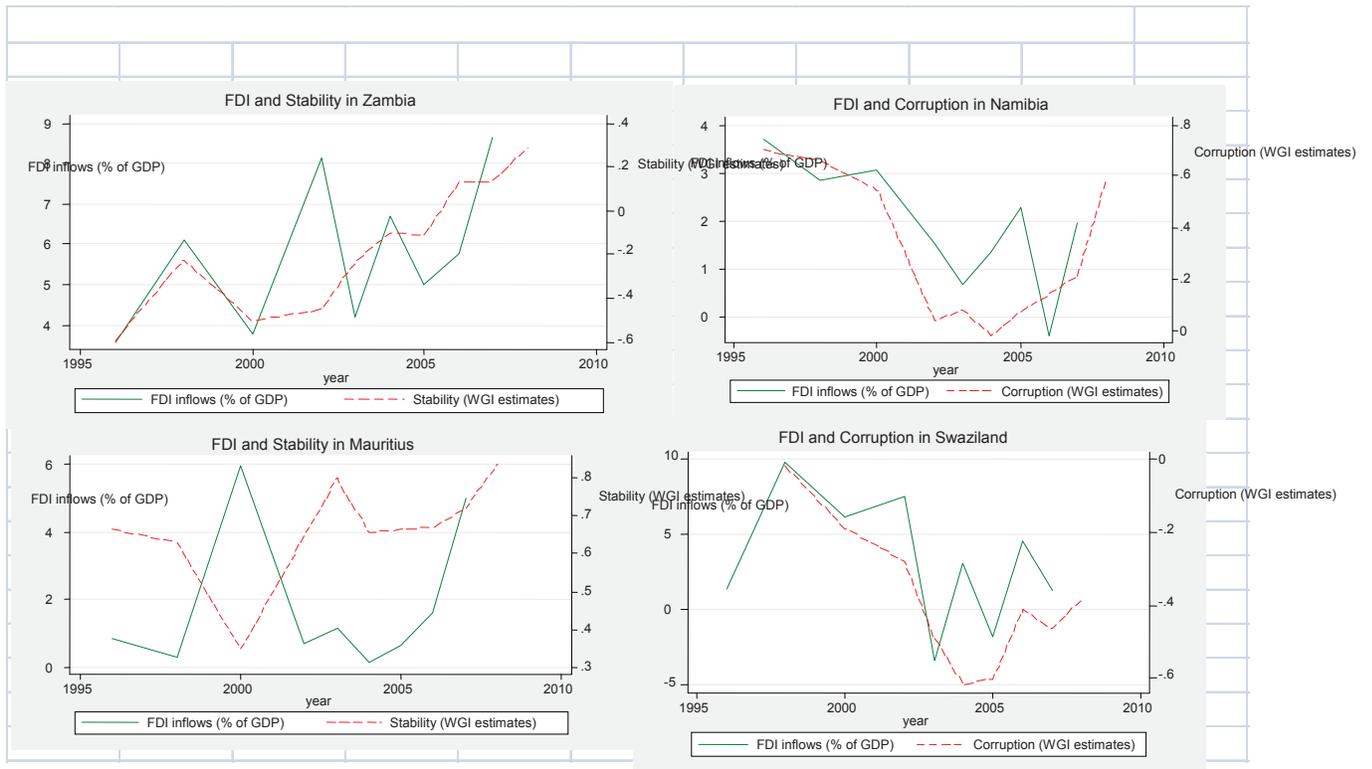
55. The dashed line in the chart represents the normal rate of return (measured horizontally) for every conceivable investment rate (measured vertically). Other things being equal, countries that are observed below the norm –that is below the dashed line- should have attracted more FDI since they offer a higher enough rate of return on the next dollar’s worth of additional capital, than the others could. This is basically the case with Mauritius, Malawi, and Namibia, South Africa, Mozambique, Tanzania and Swaziland. On the other hand the evidence is one of overinvestment in Angola, DRC, Madagascar and Zambia, for all of which the rate of FDI is well above that warranted by the rate of return they have to offer.

Figure 4.5: FDI inflows and marginal productivity of capital



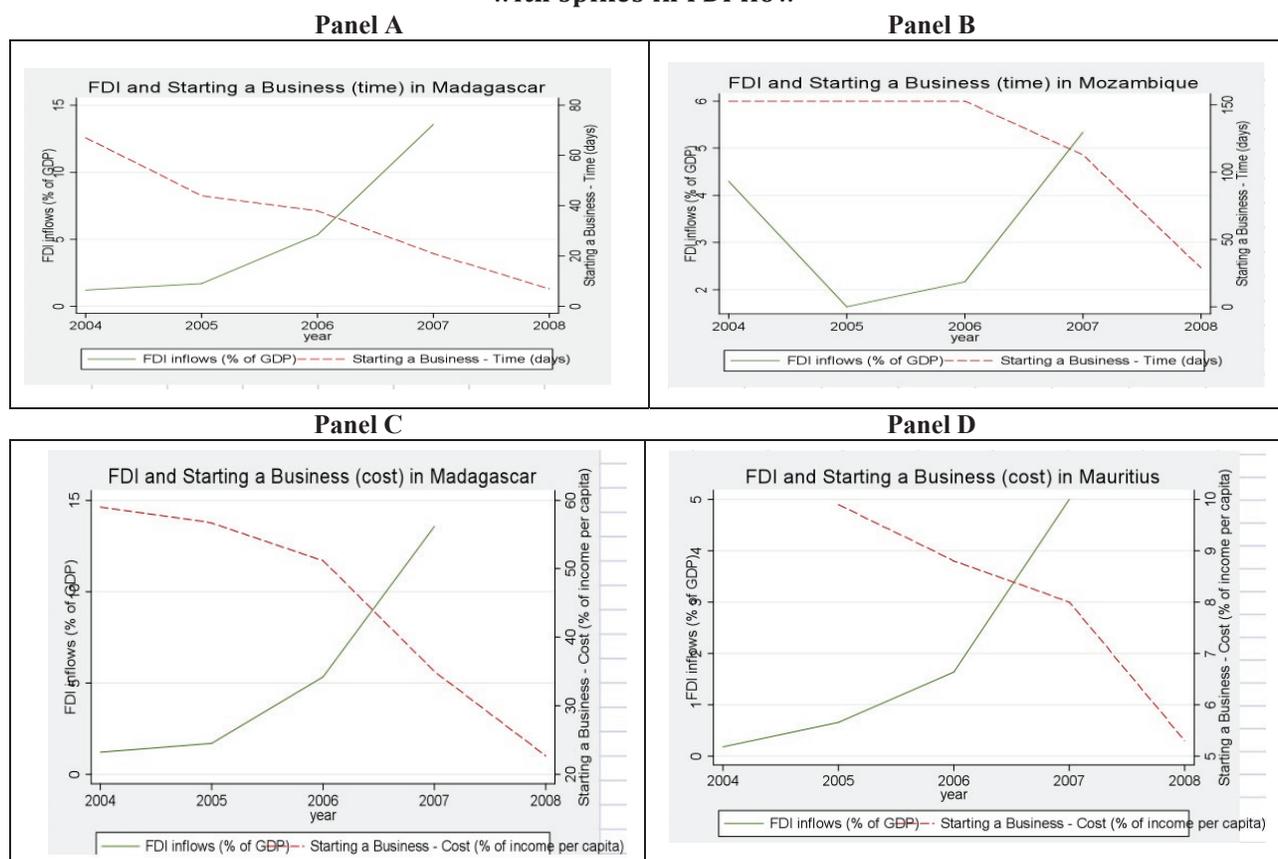
56. Part of the explanation for this apparent misallocation of FDI could be that what is shown in figure 4.5 is a transient phenomenon, that, eventually, FDI will decline in countries where there is overinvestment but go up in countries where there is currently underinvestment without any significant change in the policies or the circumstances of the economies involved. But there

Figure 4.6: FDI and the quality of governance in Mauritius, Namibia, Swaziland and Zambia



are also indications that the FDI gaps as well as the rate return differences have persisted for some time and therefore reflect cross country differences in investment risk and/or in barriers to investment. There are also indications that some of these differences in investment risk and barriers to investment have to do with cross country differences in key business environment variables, which suggests that not all of the misallocation at issue would be removed without significant policy changes or institutional reforms in the high-rate-of-return member counties.

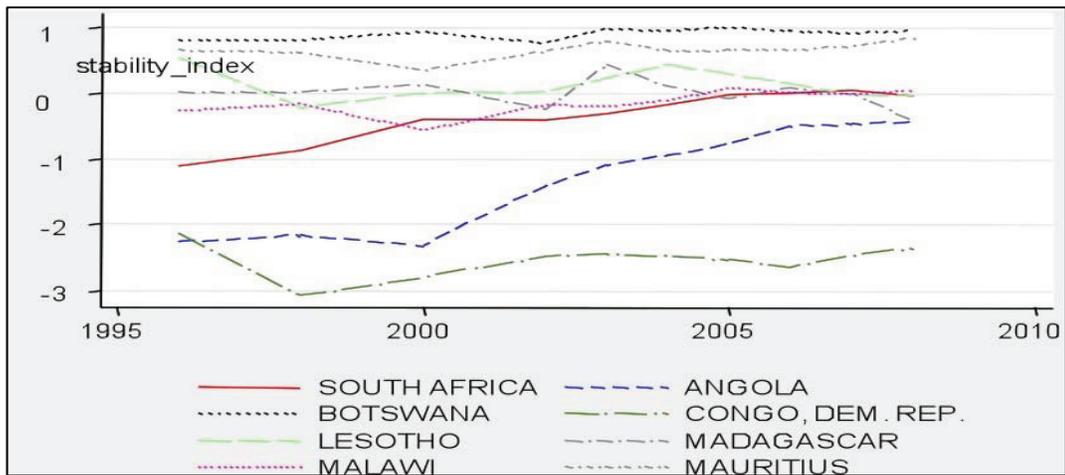
Figure 4.7: In at least three countries, decline in start-up costs has followed or coincided with spikes in FDI flow



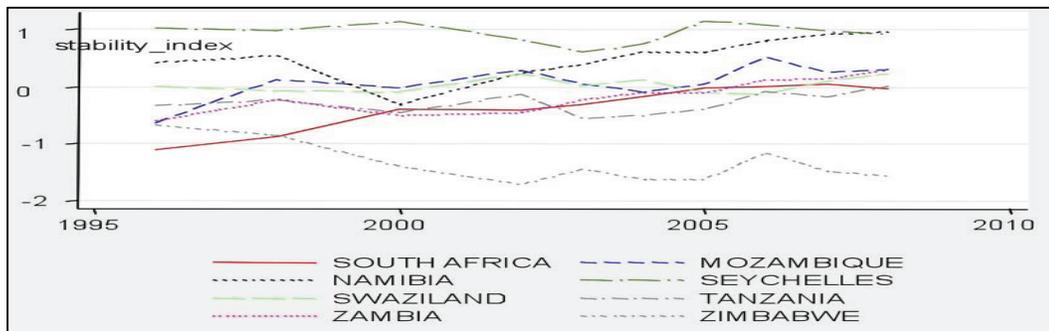
57. Part of the indication is that, in the recent past, reforms that reduced start-up costs in Madagascar, Mauritius, and Mozambique raised FDI inflows significantly, while greater political stability in Zambia and Mauritius had a similar effect in those countries (figure 4.6). On the other hand, major declines in the control of corruption seem to have led to a sharp fall in FDI in Namibia and Swaziland in the early 2000s (figure 4.6). The association in FDI and start up costs is illustrated in figure 4.7, Panel A of which relates the sharp increase in inward FDI per capita between 2005 and 2008 in Madagascar to the 2004 admin reforms that reduced the number of days needed to set up the standard Doing Business company. The 2004 reforms also drastically reduced start-up costs the association of which with the increase in FDI in 2005 to 2008 is shown in panel C of figure 4.6. Panel D shows the association between reforms that reduced start-up costs in Mauritius from 2005 and the sharp increase in inward FDI in that country from 2006. Panel B also shows that reforms that reduced the number of days needed to set up a business in Mozambique in 2006 were followed by large increases inward FDI.

Figure 4.8: Index of political stability

PANEL A



Panel B



Political stability

58. Looking at recent developments in the main business environment influences on FDI inflows, one trend in the SADC as a whole has been members’ convergence towards greater political stability, with steady improvements in every country’s score on the stability index, with the clear exceptions of DRC and Zimbabwe. This is shown in figure 4.8, which describes changes in the World Bank’s Governance Indicators of Political stability from 1995 to 2010. Botswana, Mauritius, and Namibia are the most politically stable members; the larger countries—South Africa, Mozambique, Malawi, and Zambia—converge around something of a normal (or mean) score for the region.

Control of corruption

59. There is less evidence of convergence among SADC members in terms of control of corruption over time according to figure 4.9. Indeed, countries fall into three distinct groups: relatively “corruption free” members, namely, Botswana, Mauritius, Namibia, Madagascar, and

Lesotho; those with moderate corruption, namely, Zambia, Malawi, Mozambique, and Swaziland; and those where corruption is a serious problem—Angola, DRC, and Zimbabwe.

60. Among the countries where corruption is a significant problem, Tanzania appears to have taken the most extensive reform initiatives. These include the launch of the National Anti-Corruption Strategy and Action Plan (NASCAP) and the publication of a new code of conduct for civil service. In order to translate this strategy into practical results, the government is advised to roll out anticorruption action plans at local authority levels. Incentives for firms to pay bribes should also be reduced by minimizing the discretion that officials have in interpreting regulations. This can be achieved by streamlining regulations, particularly in customs, employment regulation, tax administration, municipal licensing, and municipal policing.

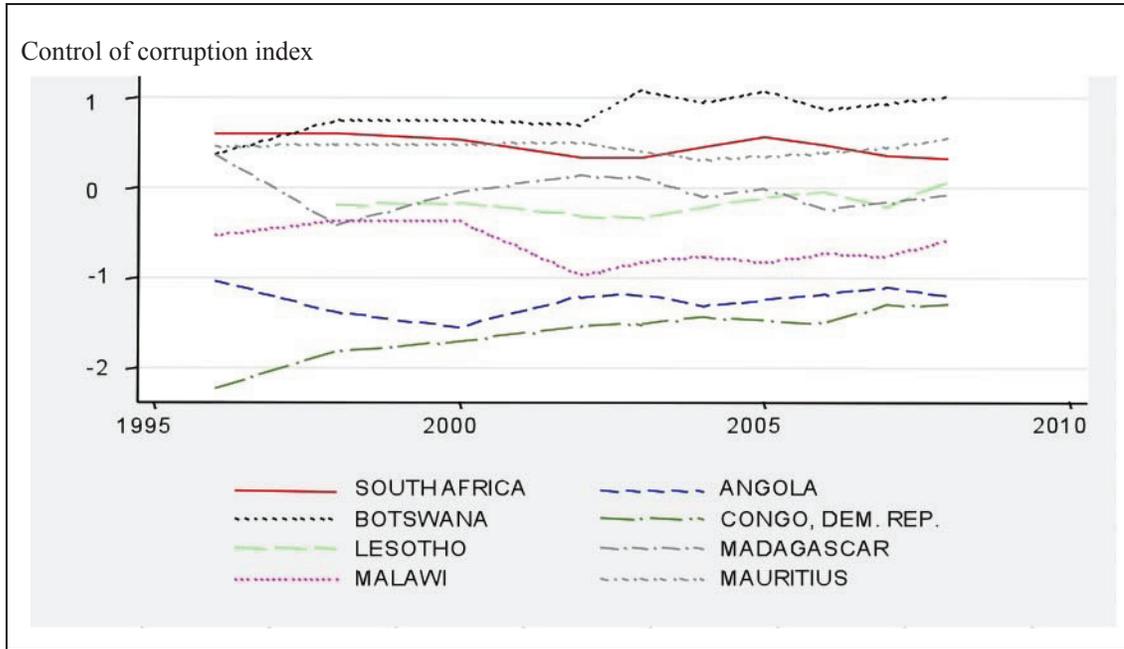
61. Like Tanzania, Zambia has also been proactive in combating corruption, and has its own anti-corruption agency, the Anti-Corruption Commission. However, that agency is badly in need of revitalization, as petty corruption clearly remains widespread. Among the measures the agency should consider to reduce demands for bribes are a review of civil service employee salaries and the institution of meritocratic management and promotion procedures. Another potentially effective method of deterring demand for bribes is establishing mechanisms for public feedback in agencies, such as the central tax authority, or the Zambia Revenue Authority.

62. In Angola, where corruption is likely more pervasive than elsewhere in the region, the most important missing ingredient in anticorruption efforts is a clear and explicit political commitment to such efforts on the government's part. In addition to calling for such a commitment, experts are advising the government to establish an anticorruption agency and to commit adequate resources to support its activities.

63. In Mozambique, the government needs to undertake a key anticorruption measure—introducing codes of conduct for civil servants similar to those provided in Tanzania. Another badly needed measure is modernization of the current conflict-of-interest regulations.

Figure 4.9 Control of corruption index (World Bank governance index)

Panel A



Panel B

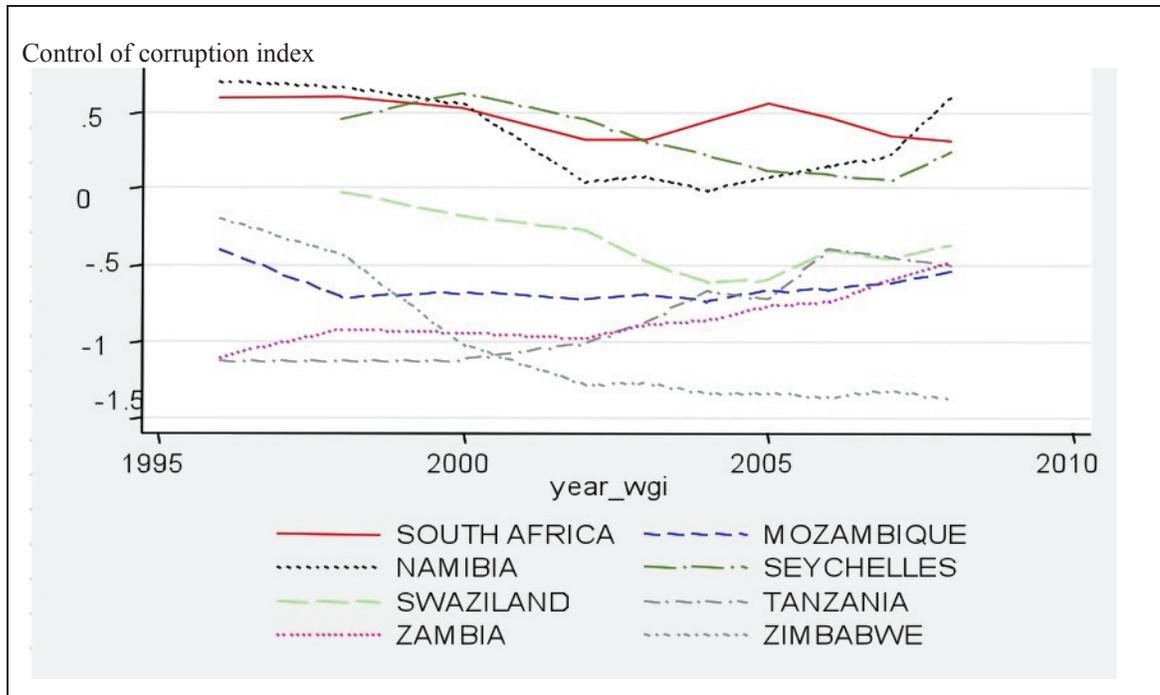
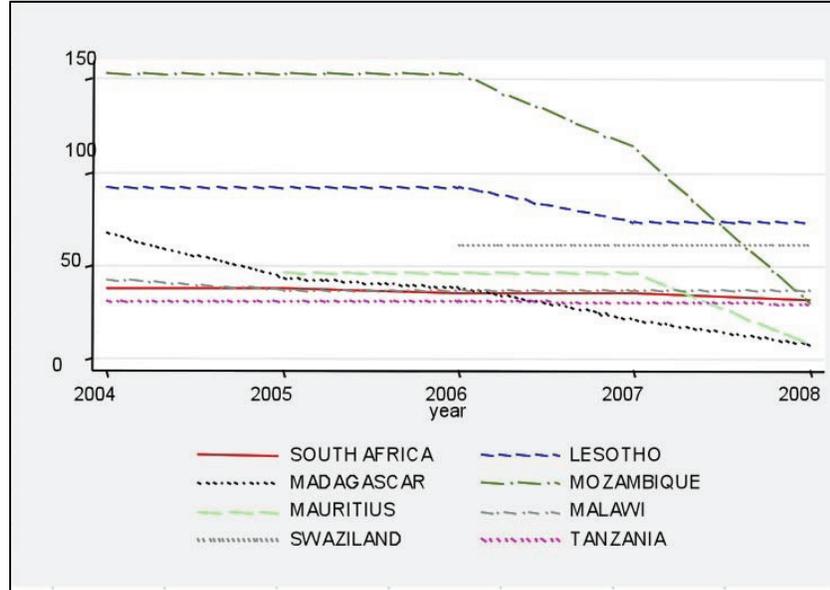
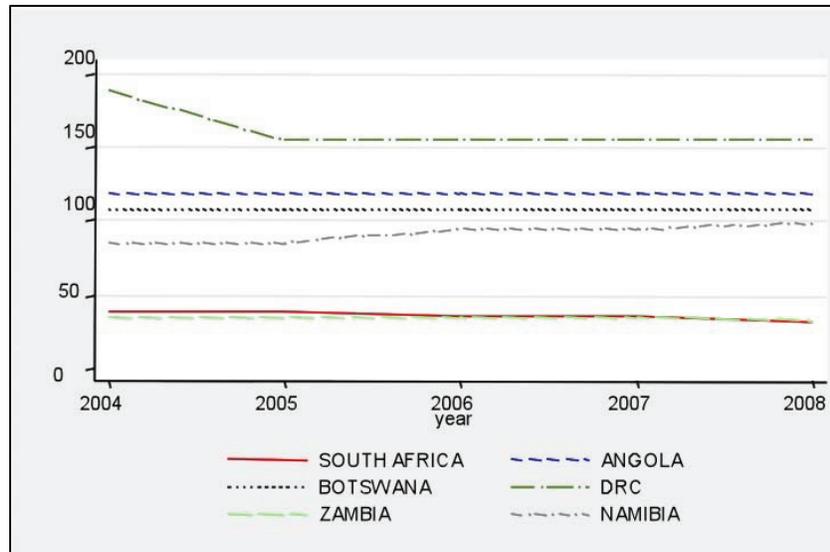


Figure 4.10: Days needed to start a business (Doing Business)

Panel A: Resource poor countries



Panel B: Resource rich countries



Start-up costs in resource-rich countries

64. With the exception of Lesotho, all resource-poor countries have reduced the number of days needed to set up a business steadily and significantly over the past five years through a series of administrative and legislative reforms (figure 4.10). As a result the number of days needed have converged with or even fallen below South Africa's, which are low relative to other emerging market economies. The steepest declines have been achieved in Tanzania, Mauritius, Madagascar, and Mozambique. However, start-up costs and the time it takes to set up the standard Doing Business firm remain to be excessively high in all resource-rich countries and Lesotho.

65. Among the resource-rich countries, reform efforts have been significantly more robust in Angola. However, there is still quite some distance to cover to reach what is now emerging as the regional norm. Specifically, the government in Angola is being advised to increase the effectiveness of the central government agency that authorizes business start-ups, and to reduce the time required to obtain the Commercial Operations Permit and to register with the Registry of Companies from the current 40 and 30 days, respectively.

66. Similarly, the government in Lesotho is being advised to consolidate and streamline the processes of business registration and industry licensing procedures as key steps towards reducing business start-up costs.

5. FINANCIAL DEVELOPMENT AND FINANCIAL MARKET INTEGRATION

67. Some of the influence of business environment on investment and trade integration occurs as an effect on financial integration and financial development. This is because greater financial integration helps improve the allocation of FDI and capital more generally within the region. It also helps promote trade integration.

68. Ruf (2006) notes that the financial systems in the SADC is relatively liberalized in that exchange rates are market determined, there is full current account liberalization in all countries, and foreign bank ownership is not prohibited anywhere in the region, as a result of which many South African and other foreign banks operate in all member countries. That latter has helped foster competition in the Banking sector. However, despite these features, the level of financial integration is quite low at the moment. An obvious indicator of this is the large variance in real interest rates among member countries (figure 5.1): Some have excessively high rates (Mozambique, Tanzania, and Zambia); others report negative rates (DRC, Botswana, Madagascar, and Angola). Countries also vary hugely in terms availability of financial products and their accessibility to different sectors of the economy. This is particularly true of bank loans and credit lines, with the lowest rates reported for DRC, Angola, Mozambique, and Tanzania (figure 5.2). Indeed, outside of South Africa, the only member countries that have reasonably developed financial markets are Botswana, Namibia and Mauritius.

Figure 5.1: Nominal and Real Interest Rates in SADC

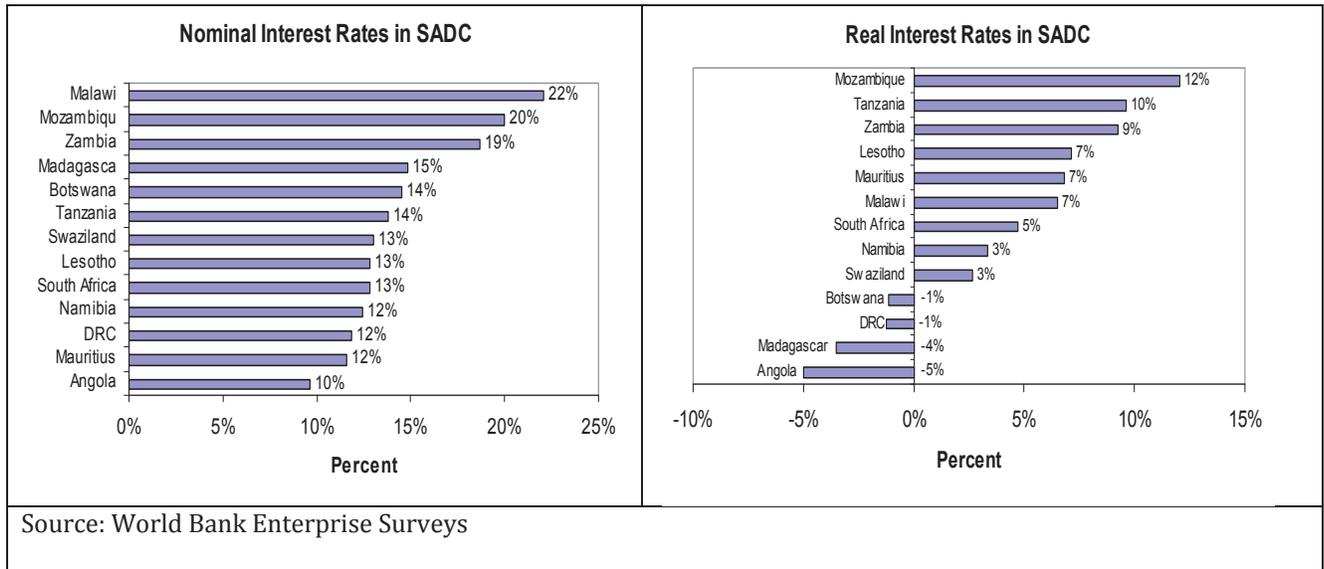
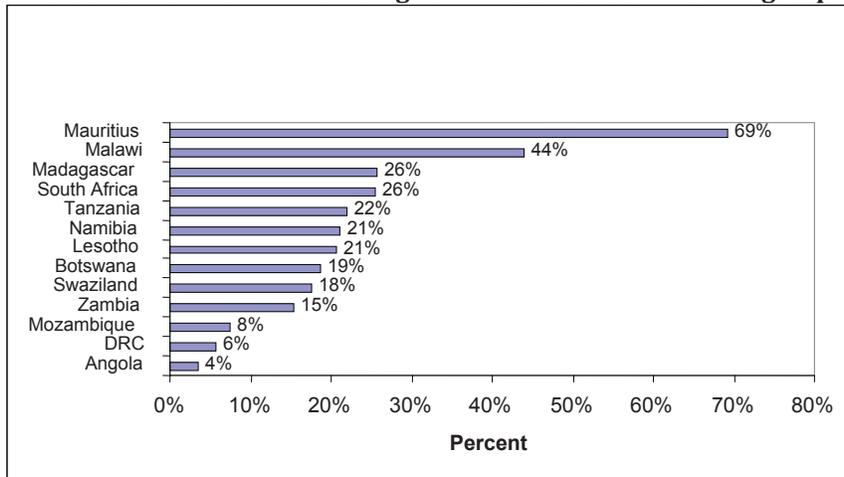


Figure 5.2: Percent with Bank Financing for investment or Working Capital in SADC

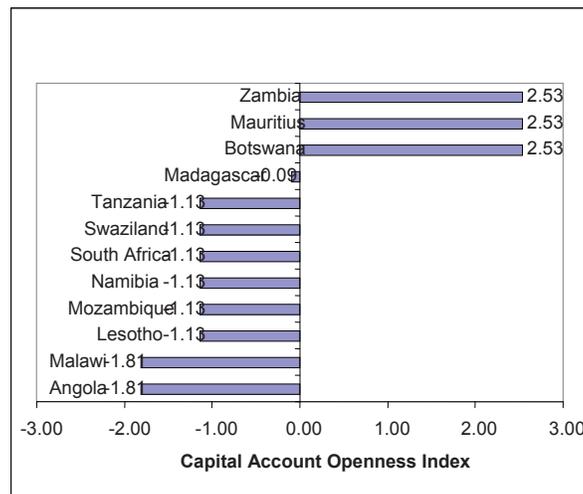


69. These disparities reflect very large differences in the degree of capital controls in the scale and structure of the banking industry, the availability and quality of credit information, and, ultimately, the quality of contract enforcement institutions. Therefore, the key challenges in promoting financial integration and financial development in the region involve liberalizing the capital accounts; opening the banking industry to greater competition; improving the availability of credit information; improving small businesses' access to finance; and improving and harmonizing contract enforcement institutions.

Capital account openness

70. Among member countries, Zambia, Mauritius, Botswana, and Madagascar have relatively open capital accounts as can be seen from their scores for the Chinn-Ito measure of capital account openness shown in figure 5.3. However, the SADC as a whole has the most restrictions on capital flows compared to other regions, both in de jure measures of capital account restrictions and in de facto measures of actual capital flows during the past few years, and it is clear that capital controls pose significant impediment to financial integration within the region.

Figure 5.3: Capital Account Openness in SADC



Competition in the banking industry

71. A more fundamental factor in the lack of financial integration is that, except for South Africa, the banking industry is quite small in SADC countries. The banking sector is also highly concentrated throughout the region and characterized by extensive government involvement. As can be seen from figure 5.4, bank concentration rates are particularly high in Botswana, Lesotho, Mozambique, Malawi, and in South Africa, where 90 percent of assets or more are held by the largest five largest banks. This tends to undermine competition in the sector and is indeed one of the rationales for the pursuit of regional financial integration as a way to promote market competition for financial services within smaller economies. It also means that member countries need to take measures that could promote new domestic and foreign entry into the industry. Where there is a large government ownership of banking assets, measures should be undertaken to reduce the extent of government's financial stakes, such as in Tanzania, where the government is advised to complete the bank privatization process that started some time ago with the National Microfinance Bank (NMB), Tanzania Investment Bank (TIB), and Tanzania Postal Bank (TPB).

Figure 5.4 Percent of assets held by the five largest banks in 2005

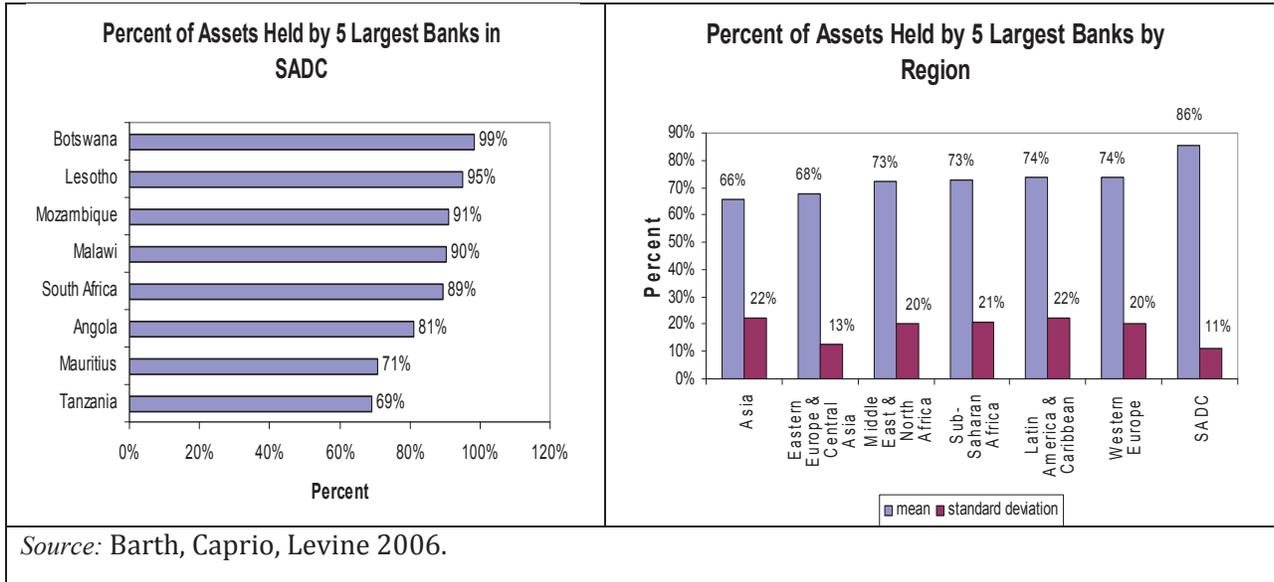
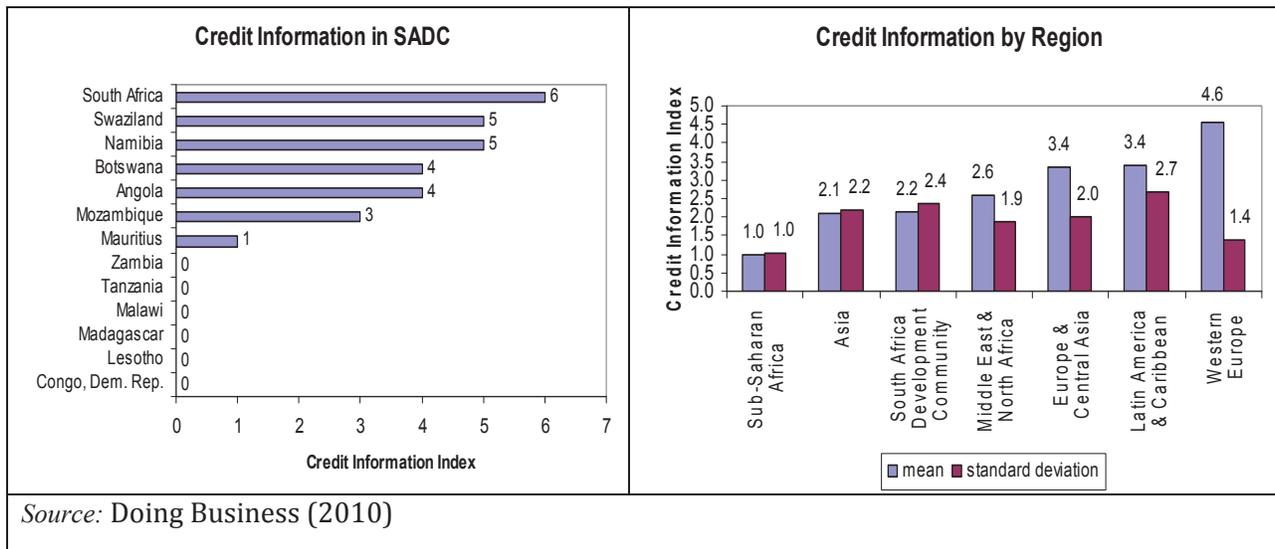


FIGURE 5.5: CREDIT INFORMATION

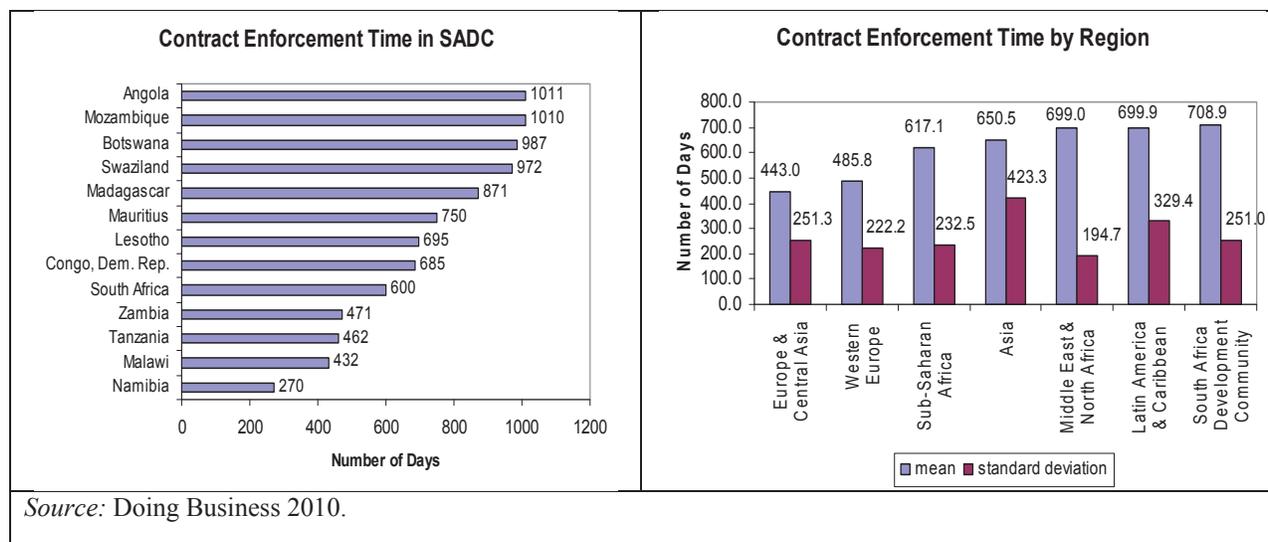


Credit information

72. A competitive banking sector is a necessary ingredient for improving small business access to finance in the region, which also requires radical improvement in the availability of credit information. As can be seen in figure 5.6, where values of the Doing Business credit information index is reported, several member countries have no credit information system at all.

These are DRC, Lesotho, Madagascar, Malawi, Tanzania, and Zambia. In countries where small business utilization of financial products is particularly low, governments are being advised in addition to undertake measures that would reduce key barriers to access to finance. For example, the government of Angola is being advised to create an efficient land registration system to facilitate the use of land titles as collateral in bank financing.

Figure 5.6: Contract enforcement time (days)



Contract enforcement

73. The most fundamental impediment to financial development and financial market integration is that institutions of contract enforcement are weak in many member countries. For example, the SADC scores lowest among comparable regions and groupings on time to enforce contracts, with Angola, Mozambique, Botswana, and Swaziland recording the longest times. Achieving financial integration also requires harmonizing the legal and judicial systems for enforcing contracts, and regulation and supervision systems of financial institutions among member countries. Ultimately, harmonization implies common sets of rules for financial transactions and reporting requirements, and common standards of cross-border supervision of institutions.

6. REGIONAL LABOR MARKET INTEGRATION

74. The labor market is a key channel linking the cross-border flow of goods and capital with household welfare through the effects such flows normally have on jobs and earnings. The more internationally integrated is the labor market in an economy, the stronger is this linkage. The labor markets of two economies of comparable sizes are said to be integrated when wage rates in one country respond readily to wage changes in the other country. The unresponsiveness of wage rates in a country to major wage changes in another large enough economy therefore signifies lack of integration between their labor markets.

Why monitoring labor market integration is important

75. Cross country differences in labor regulation and labor market institutions across a region are important influences on the degree of labor market integration in the region. However, it should also be stressed, first, that the harmonization of labor market institutions within the region is not necessary for achieving labor market integration, and, secondly, that the degree of labor market integration says a great deal about the degree of integration of product markets and other factor markets as well. This is because the absence of labor market integration in any region implies the fragmentation of goods markets and the insufficient mobility of capital across the region. Over the long term, a country would be able to sustain high domestic wage rates in the face of low wages in neighboring countries only as long as it can limit the migration of people as well as the cross-border flow of goods and of capital. On the other hand, labor markets would be integrated in a region of free trade as long as either capital or labor is fully mobile across the region. Indicators used to monitor labor market integration therefore provide insights into the states of trade integration and regional mobility of capital.

Cross country pay gaps are large

76. Table 5.1 describes pay gaps for different skills groups among nine member countries of the SADC for which comparable wage data are available. The data come from the World Bank's Enterprise Surveys of earnings and human capital data on samples of workers from the enterprises they covered. The table reports median monthly earnings (in 2008 South African rand) for skilled and unskilled workers separately, and by occupational categories.

77. Across each of these groups, South African businesses pay the highest median wages. For example, the monthly median South African pay for production workers is R 4,340 and R 2,830, respectively. The next highest paid production workers are in the other middle-income countries—Botswana, Swaziland, Mauritius, Angola and Namibia—who earn just over 50 percent and 75 percent of South African earnings. Production workers in DRC and Tanzania earn less than 20 percent of what a similar worker (in terms of pre-work attributes) in South Africa makes.

78. These are large gaps, but a significant portion of them reflects cross-country differences in skills within occupational and skills categories in the table: within each skills and occupational group the typical South African worker is more skilled than the typical worker in DRC. The gaps may also partly reflect cross-country differences in the age and gender composition of each

skills and occupational group. Strictly speaking, we should compare the prices of comparable grades of labor, meaning we should control for a wide range of employee characteristics, including gender, education, and experience when we make the wage comparisons.

Table 6.1: Median monthly earnings, R (2008)

Country	Managers	Professional	Skilled	Unskilled	Non-production	Total
Angola	2433	3475	2363	2224	1877	2224
Botswana	1241	7302	1825	1168	1599	1460
DRC	1384	1097	652	713	715	713
Mauritius	3666	1561	2178	1452	1742	1573
Namibia	12802	4711	2356	1471	2478	2051
South Africa	21960	10980	4344	2833	3305	3843
Swaziland	1041	1614	2235	1180	1912	1490
Tanzania	1712	1956	734	571	571	652
Zambia	3720	3224	1116	1004	1116	1116

Source: Calculations from World Bank Enterprise Surveys

Measurement of labor market integration

79. The pay differences that remain when we do that are nonetheless still very large. For example, a male worker of a given age, who has had no schooling, but has been employed in a given industry for a given number of years would earn about 90 percent less in DRC, Zambia, and Tanzania than he would in South Africa. Compared to working in South Africa, he would earn about 50 percent less in Swaziland and Angola. His pay in other middle-income countries would also range between 65 to 75 percent what his pay would be in South Africa. However, large as they are, these gaps do not tell us how far labor markets in the region are integrated or fragmented. Even in the best of circumstance, where there is free trade and unrestricted mobility of capital, any snapshot of labor markets across a region can reveal large international differences in wage rates of comparable workers for a variety of reasons, including cost of living differences across locations and the fact that labor is an extremely heterogeneous factor of production in the sense that there are often significant skills differences among workers in fairly narrow occupational and demographic groups that may not be observed from labor market data. Most importantly, a significant part of the wage gaps between any two countries or two regions of a country that we might observe at any point in time will likely be temporary, and could eventually disappear once the employers and workers in both countries have had enough time to react to them. In assessing whether the labor markets in the region are integrated, the correct question is not whether there are cross-country differences in pay rates or in returns to human capital—there are bound to be permanent pay gaps, even among regions and provinces within a country. Rather, the correct question in evaluating the state of labor market integration in the region is whether or not large and sudden jumps in cross-country pay gaps due to labor market shocks in one part of the region are corrected quickly enough as the rest of the region reacts to them.

80. International trade, capital flows, and migration all play a role in the mechanism that adjusts cross-country wage gaps to their normal (or steady state) levels. However, they do not react instantaneously to excessive wage differences among countries—other factors affect reaction time. These, in turn, affect the timing and duration of the reaction. For example, potential immigrants need to arrange for transportation to and accommodation in the host country. Similarly, goods need to be transported across borders, and plant and equipment need to be acquired and established in the host country. The reaction time will be shorter and the adjustment of wages across borders faster where the transport of people and goods is easier, and where there are fewer and less stringent restrictions on the employment and cross-border flow of goods, people, and capital. In any event, the task of evaluating the degree of labor market integration between two countries boils down to measuring the time it takes for a sudden rise or fall in wage rates in one country to be fully to reflected in a similar change in the other country.

Labor market integration is quite low in the SADC

81. The full report presents results of an evaluation of the bilateral integration of the South African labor market and labor markets of other member countries of the SADC for which the required data are available, namely, Mauritius, Tanzania, and BNS (or Botswana, Namibia and Swaziland collectively). The data that were used in the analysis consist of employee survey data from the World Bank Enterprise Surveys and Household Survey data as described in table 6.2. The conclusion drawn from the analysis is that, although there is considerable integration of the labor markets of many economies in the region with South Africa's, the degree of integration is rather low. This probably reflects the fact that both trade and capital flows are far more restricted in the region than in places where there is greater cross-border labor market integration.

Table 6.2 Household data availability across selected SADC members

Country	Years available (2000–07)	Type of survey
South Africa	2000–07: biannual	LFS
Mauritius	2001–07	LSMS
Tanzania	2001(2), 2007	LSMS; LFS (2001)
Botswana	2003, 2006	LSMS; LFS (2006)
Namibia	2004	LSMS
Zambia	2002, 2004, 2005	LSMS; LFS (2005)

Source: Government Statistical Agencies

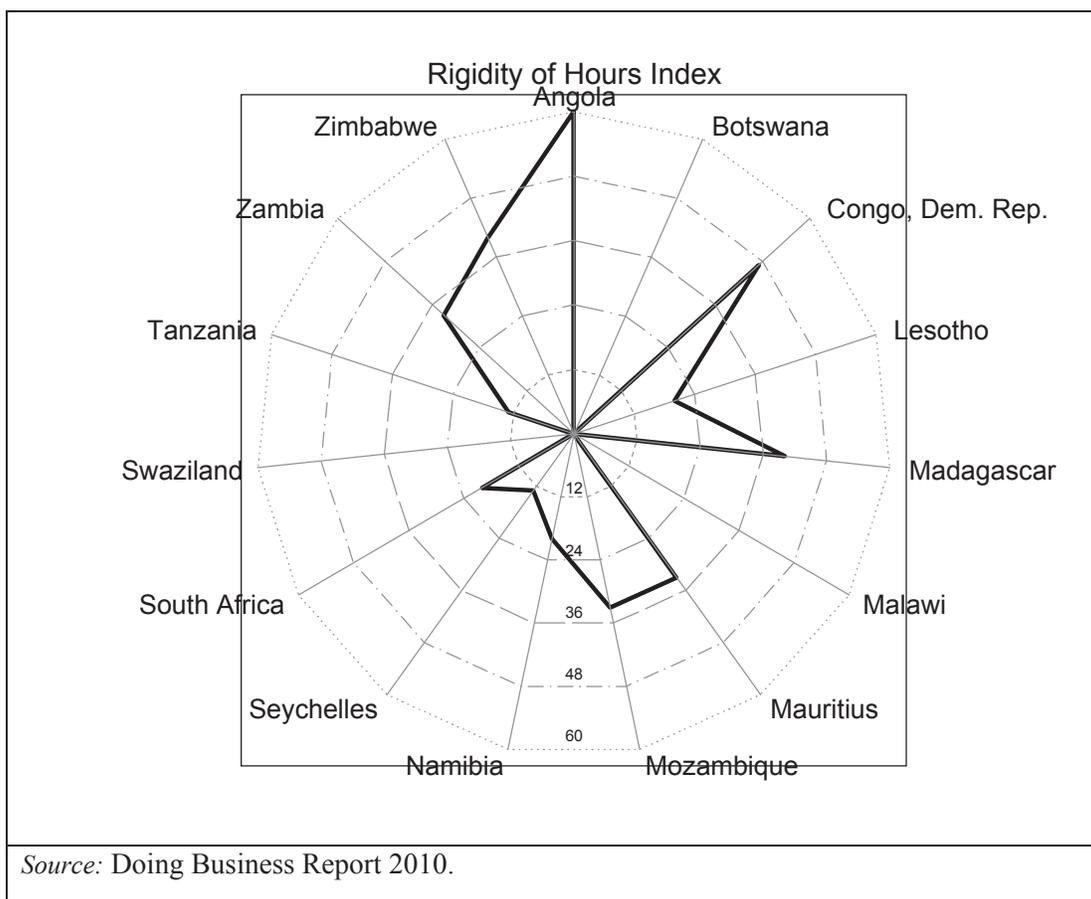
82. One such place is the U.S.–Mexican border, where a study showed that wages in Mexican border towns fully adjusted to wage shocks in the US in around one month. This is 3.6 times shorter than the time it takes for wages in the BNS to fully adjust to wage shocks to the South African labor market. As would be expected, adjustments to the shock would take even longer as we move further away from South Africa's border. For example, it takes 5.5 months

for Tanzanian wages and 11 months for wages in Mauritius to adjust to the same shock to South Africa wages.

Employment regulation

83. In arguing that the relative absence of labor market integration in the SADC reflects on restriction on cross border mobility of goods we do not wish to imply that cross country differences in labor market institutions do not have any role to play in labor market integration. On the contrary, it should be stressed that, given those same restrictions on the flow of goods and as factors, a key determinant of the speed of adjustment of wages to regional developments is the extent to which employment is regulated within each country in the region and how the institutions of regulation vary between countries.

Table 6.3: Labor regulations—rigidity of hours



84. Compared to other regions, employment contracts are not heavily regulated in the SADC. Seven countries have an overall Doing Business employment rigidity index that is well below the OECD average. The same index is below Sub-Saharan Africa's average for three other members.

However, there is enormous variation in the degree of employment regulation within the region itself as is illustrated in figure 6.1, which describes variation in the Doing Business rigidity of the rigidity-of-hours index. Angola, DRC, Zimbabwe, Botswana, and Madagascar regulate the labor market the most heavily. In Lesotho, Malawi, Mauritius, Swaziland, Namibia, and Zambia, employment contracts are the least regulated.

85. These differences in the intensity of labor regulation are bound to have had significant implications not only for cross-country differences in employment and earnings, but also for cross-country differences in trade integration and the cross border mobility of capital. It is not by coincidence that the countries where employment is least regulated have attracted more FDI per capita and have more export-oriented manufacturing and service sectors.

7. CONCLUSION

86. This is a summary of a report that has provided an assessment of business environment issues in trade and factor market integration in the SADC based on microeconomic data. The report and the summary have identified some of the main issues in harmonizing regulatory policy, institutions, and procedures for promoting investment and facilitating trade. The key harmonization issues concern import tariffs and nontariff barriers, competition policy, transport and other significant components of trade costs, provision of infrastructure, control of corruption and financial development and regional financial integration. We conclude the summary with a listing of the main recommendations that flow from the analysis made in each of these areas.

Harmonizing import tariffs and reducing nontariff barriers to trade

87. Although average tariff rates are now quite modest in the region, the structure of MFN tariff rates vary significantly within the region, effective protection rates are quite high with a built-in anti export bias, many nontariff barriers remain in place within the FTA, and customs procedures have yet to be harmonized. As a result, the growth in regional and extra regional trade has slowed down in recent years. There is thus an unfinished agenda for tariff reforms that should include the harmonization of MFN tariffs among SADC members and reduction of effective protection rates.

Developing and harmonizing competition policies

88. As member countries liberalize intra regional trade and capital flows, care needs to be taken that first arrivals on the domestic scene from other parts of the region do not erect barriers to entry to domestic markets and domestic industries by design or otherwise. Combined with regionally harmonized trade policies, well crafted, effectively enforced, and regionally harmonized competition policies will help safeguard against such an outcome. At the moment South Africa is the only member country that has an internationally well regarded competition policy regime. However, even it needs further competition policy reforms.

Reducing trade costs

89. Perhaps the most prominent reason that intraregional and extra regional trade in the SADC are not growing is that trade costs also remain high for reasons that are not necessarily related to trade policy. Trade costs are high, particularly in Angola, DRC, Zambia, Botswana, and Zimbabwe. High transport costs are often the main part of the problem, but problems with customs administration and regulatory costs of cross border transactions, and activities in general, are often major contributors.

90. In many countries, burdensome customs and trade regulations have added significantly to trade costs. In such countries there is a need to streamline clearance procedures as an important means of facilitating trade. Nearly everywhere there is a need to reduce transport costs by improving roads, railways and port services, although the specific means of achieving these differ from country to country.

Improving power supply

91. After freight transport and port facilities, power supply is the most important infrastructural obstacle to export diversification in many countries within the SADC. Power shortages are holding back manufacturing productivity and exports, particularly in Madagascar, Malawi, Angola, and Zambia. In each of these countries, start-ups can wait for months to be connected to the public grid while established businesses report significant losses of revenue due to frequent outages. The proximate cause of the shortages in all of these cases is years of underinvestment in the power sector. As a result, governments have sought to promote large investments in maintenance and additional generating and transmission capacity.

92. The root causes of the shortages also include the deliberate under pricing of electricity, the failure of poorly managed state-owned operators to collect payments, and the absence of a workable legal and regulatory framework for private sector investment. Instituting cost recovery tariffs, establishing efficient billing and collection, and limiting transmission and distribution losses are also among the measures that some governments in the region are being advised to take.

Reducing start-up costs, particularly in resource-rich countries

93. Although nearly all resource-poor countries have reduced business start-up costs steadily, these costs as well as the time it takes to set up the standard Doing Business company remain excessively high in all resource-rich countries, where government are being advised to carry out the administrative reforms needed to bring both down to international and regional norms.

Promoting financial development and financial integration

94. At the moment financial integration in the SADC is impeded by capital controls that are more stringent than in many other parts of the world, the lack of credit information in several member countries, and huge disparities in the quality of contract enforcement institutions among member countries. Improving availability of credit information, opening capital accounts, opening the banking industry to greater competition, and improving the quality of contract enforcement institutions are thus potentially important instruments for promoting financial development and financial integration in the region.

Monitoring market integration

95. In most SADC countries, government statistical agencies collect price data and household and labor force survey data with variable degrees of regularity and quality standards. Unfortunately, in many member countries, the quality of data is so poor that they cannot be used to monitor the integration of regional goods markets or labor markets. And yet, well designed and disaggregated product price data are usually a more effective means of monitoring trade integration than are trade flows while measures of labor market integration provide an indirect but quite powerful and indispensable indicator of barriers to trade and investment flows. Much effort has been expended by policy makers of member countries in negotiating mechanisms for achieving integration. To monitor these, sufficient investment needs to be made in collecting the necessary price and labor market data in all member countries.

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