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Opportunities and Challenges of Regionalism: Zimbabwe in the Comesa Customs Union

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Abstract
A case study of Zimbabwe in the COMESA customs union is given to analyse the opportunities and challenges countries may face from different Regional Integration Agreements (RIA). The tools that are used to assess the costs and benefits of the COMESA customs union are applicable to any regional trade agreement; therefore, many countries who want to evaluate their membership gains and losses from various regional groups may find this study very useful.
Keywords: Regionalism, Opportunities, Challenges Custom Union, Economic Communities.

1. INTRODUCTION

The past 20 years, or so, have seen a great explosion of Regional Economic Communities. Almost all countries in the world belong to one or more RECs; often known as regional trading blocs. In Africa the highest is D. R. Congo who has membership in four blocs. Do such blocs allow countries to obtain benefits that cannot be achieved through autonomous actions or multilateral cooperation and how can countries rate the contribution of these blocs to their economies?

With deepening integration within the different economic groups, there is a stage where countries are forced to choose one group to belong to and forgo the rest. Such a stage is when regional trading blocs want to form a customs union. Zimbabwe is a member of both COMESA and SADC regional trading blocs. However, with COMESA aiming for a Customs Union by 2008 and SADC by 2010, Zimbabwe had to choose which customs union to join since it is not possible for her to be a member of both customs unions.

2. PROBLEM STATEMENT

By the end of year 2007, it was announced that Zimbabwe has decided to join the COMESA customs union. The Zimbabwean export sector approached the economic officer in the Ministry of Industry and International Trade asking for justification of this decision arguing that SADC presents a better and viable market for Zimbabwean commodities than COMESA. The researchers decided to use the TRAINS Database and Literature review, to measure the amount of gains and losses Zimbabwe accrues by belonging to COMESA customs union so that she can provide informed explanations to the business community. The results will also be used to comment on whether the decision to join COMESA customs union was an informed decision.

3. OBJECTIVES

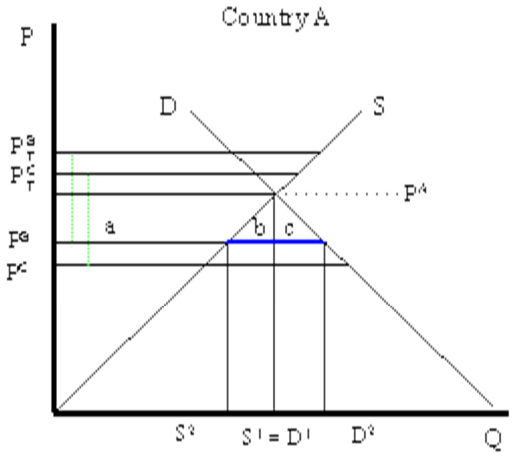
This paper examines the gains and losses Zimbabwe derive from being a member of the COMESA Customs union. The paper also seeks to highlight the factors that should be considered when assessing the contribution of each bloc to member states.

4. LITERATURE REVIEW

A customs union is an agreement between two or more member states to facilitate trade between them through removal of tariffs levied on imports from members of the union (Viner 1950: Meade 1956), the member nations establish a free trade zone amongst themselves and a common external tariffon non-member nations. Economic effects of this movement are assessed on the basis of the degree to which ‘trade creation’ outweighs ‘trade diversion’.

4.1 Trade Creation

Trade creation refers to a situation where a country moves from an expensive source outside the economic grouping to a less expensive source within the grouping. In other words, it is the creation of trade that would not have existed otherwise.



S= supply curve
D= demand curve
P= price of imports
P^B= price of imports of country B
P^C= price of imports of country C
$P^B{}_T$= price of imports of country B plus tariffs
$P^B{}_C$= price of imports of country C plus tariffs

Figure1: Trade creation effects of Free Trade Agreement (FTA)

In the absence of a FTA, country A imposes tariffs on imports from her trading partners, in this case country B and C. This raises the prices of imports from P^B to $P^B{}_T$ and P^C to $P^C{}_T$ respectively (see figure 1 above). These prices are higher than the domestic price P^A, therefore, country A will import nothing from either B or C. If A enters into a FTA with B, imports from B will become cheaper by $P^B{}_T$- P^B. Consumers in country A will now shift their demand from domestic products to imports from country B because of this new price reduction. Since trade now occurs within the FTA, and it did not occur before, trade is said to be *created*.

4.2 Trade Diversion

Trade diversion occurs when a FTA diverts trade away from a cheaper source outside the customs union, towards an expensive supplier within the integrating countries.

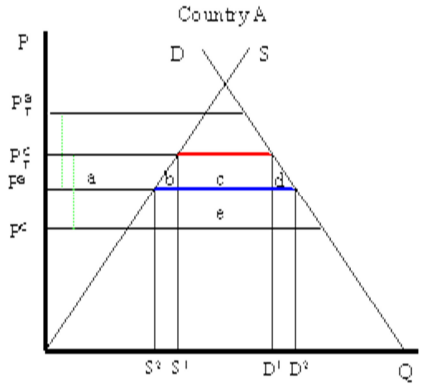


Figure 2: Trade Diversion effects of a FTA

In figure 2, in the absence of FTA country A will trade with country C which presents relatively cheaper goods than those from B. If A signs an FTA with B, tariffs formally imposed on products from B are eroded and products from B will become cheaper than those from C. Demand will now shift to imports from country B. Since the non-distorted price in country C, that is $P^C{}_T$, is less than the price in country B - $P^B{}_T$, trade is said to be *diverted*. The larger the difference between the non-distorted prices in the FTA partner country and in the rest of the world, the more likely that trade diversion will reduce national welfare.

4.3 Aggregate effects of trade creation and trade diversion

The aggregate welfare effect for the country is found by summing the gains and losses to consumers and producers. The net effect consists of two positive components: a positive production efficiency gain, (b in Figure 1) and a positive consumption efficiency gain (c in Figure 1). This means that if trade creation arises when a FTA is formed, it must result in net national welfare gains. Imagine that a country entering a FTA may have some import markets in which trade creation would occur and other markets in which trade diversion would occur. The markets with trade creation would definitely generate national welfare gains while the markets with trade diversion may generate national welfare losses. When the positive effects from trade creation surpass the negative effects from trade diversion, then the FTA will improve national welfare and vice versa. The concepts of trade creation and trade diversion are central to the evaluation of import side impacts of discriminatory trade

liberalization. According to Emiko and Martin (2001), the impact of tariffs removal can also be assessed from the exporter side.

4.4 Effects on the Export Side

The removal of tariffs, by importing countries, result in increase in exports through changing the real exchange rate. This occurs when the price of imports is lower than the price of non-traded goods. The lower import prices shift demand from domestic products to imports. This in turn leads to a reduction in the price of these non-traded goods relative to the price of traded goods- 'a relative price change frequently termed real exchange rate depreciation' (Salter1959). This reduction in the profitability of non-traded goods makes production for export relatively more viable and increases the supply of export. The real exchange rate depreciation is represented by an outward shift of the export supply curve in Figure 3 below, from ESo- ESi. This outward shift increases exports by Xi-Xo.

In a customs union, there is reciprocal liberalization by all members. In the importing country, the demand for imports will also increase resulting in a shift of the demand curve from $\mathbf{D^p_0}$ to $\mathbf{D^p_1}$. Before the liberalization, the price received by a country for its exports equals the price in the partner country less the tariff applied by this partner, so the net price is ($\mathbf{P^p - t^p}$). This is equal to the world price since the domestic price in the partner country is assumed to be world price plus tariff. With the agreement, the price received by the exporters Pp in the diagram above. The benefit to the exporter is represented by the increase in price, tp ($\mathbf{P^p - P^w}$) multiplied by the initial quantity of exports, Xi plus the gains resulting from the exporter's ability to increase her export supply- depicted by **fgh** in the figure above. Therefore, the total gains $=\mathbf{t^p.Xi + fgh.}$ If the exporter is treated as a small country in its export market, this term of trade gain is a net gain to the country.

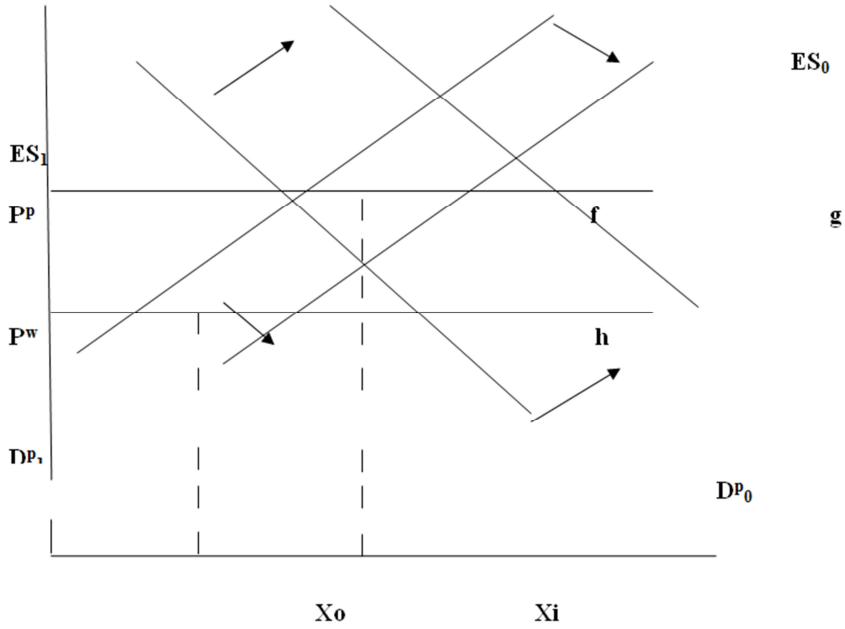


Figure 3: Terms of Trade impacts resulting from increased export supply

5. DISCUSSION

In light of the theory above, we review the trade pattern and the structure of protection between Zimbabwe and her SADC and COMESA trading partners, which forms the key variables determining the cost and benefits of the customs union. The table below shows that indeed Zimbabwe's exports, for the past 3 years, were high in the SADC region than in the COMESA region. In 2005 exports to SADC were 95% versus only 5% that went to COMESA. The same condition prevailed in 2006 when exports to SADC were higher than those to COMESA by more than 90% and also in 2007 when the exports to COMESA were almost 100% less than the value of exports to SADC.

Table 1: Zimbabwe's Exports to COMESA and SADC (given as COMESA and SADC's imports from Zimbabwe in us$000)

YEAR	2005	2006	2007
COMESA	19858.96	21502.05	175.896
SADC	355896.7	547034.2	710130.3

Source: Trains Database

According to the literature review, the larger the exports to the importing partner, the larger the scope for improvement in the terms of trade to the exporting country resulting from the importing country's tariff concessions.

However, this is not true in the case of Zimbabwe versus SADC and COMESA. Although exports are higher in SADC than in COMESA, Zimbabwe does not gain much in terms of trade from joining the SADC customs union. This is because the gains to Zimbabwe also depend on the current MFN protection level of countries in either COMESA or SADC and the concessions they give. Clearly, the higher the initial protection level, the larger the scope of export side gains.

From further analyses of the statistics from TRAINS data, it is evident that more than 90% of Zimbabwe's exports to SADC for the given period went to South Africa. (See figure 4 below).

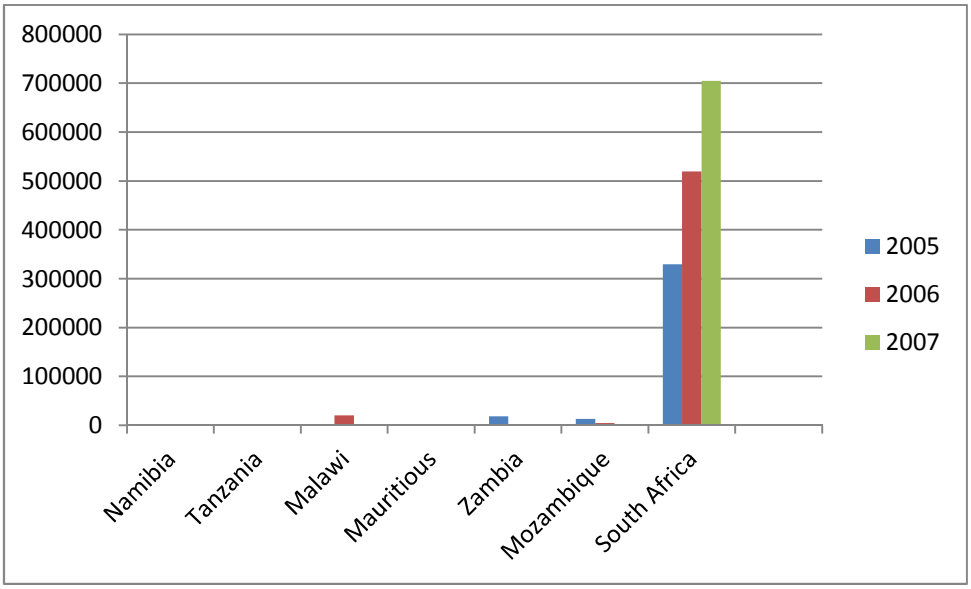


Figure 4: Zimbabwe's exports to SADC countries; 2005-2007

Zimbabwe and South Africa signed a Preferential Trade Agreement in 1993. This means that because of the existence of this agreement, most of the goods that were exported to South Africa were enjoying lower tariffs and a further reduction/ elimination of these tariffs in form of a customs union will add little to Zimbabwe's exports to this region. Therefore, Zimbabwe will gain more from a COMESA customs union where the MFN tariffs are remarkably higher than the preferential trade tariffs.

According to figure 3 above, the removal of tariffs on exports from Zimbabwe to COMESA raises the prices of Zimbabwe's exports to the region as well as export volumes. The increase in the volume of exports generates welfare gain to Zimbabweans through trade creation. High export earnings imply that the country's foreign currency reserves improve. This can be used to increase government expenditure as well as reducing government debt. The government can also use part of this amount to offset its BOP deficit. Zimbabwe will also be exposed to a wider market for her products which implies that producers will benefit from economies of scale.

6. RECOMMENDATIONS AND CONCLUSION

Based on the review, we may recommend that Zimbabwe should consider the degree to which trade creation outweighs trade diversion when evaluating the contribution of different economic blocs to her economy.

From the exporter side, Zimbabwe has to consider three basic factors when rating the possible gains from each bloc that is the level of tariffs imposed by member countries against their exports, the price elasticity of their exports as well as the magnitude of existing trade flows with the different partners.

Although Zimbabwe will lose in form of trade diversion, COMESA has a large membership than SADC and therefore, the total trade created will be higher than trade diverted. Zimbabwe will, therefore, benefit more from joining the COMESA customs union through the multiplier effect. Zimbabwean exporters will benefit from the creation of a larger market for their exports. Therefore, Zimbabwean policy makers made an informed decision when they decided that Zimbabwe will join the COMESA customs union.

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