South African Trade Strategy: Rearranging the Deck Chairs?

02 August 2006
Jan Smuts House

Record of Discussion

Chair:

- **Elizabeth Sidiropoulos, National Director, SAIIA**

Panel:

- **Xavier Carim: Chief Director - Trade Negotiations, the South African Department of Trade and Industry**
- **Dr Lawrence Edwards: Senior Lecturer, School of Economics, University of Cape Town**
- **Peter Draper: Research Fellow, Development through Trade, SAIIA**
- **Mark Pearson: Director: Regional Trade Facilitation Programme**

1. Background

On the surface South Africa's trade strategy seems beset with problems: the Doha round is likely to join free trade talks with the United States in the deep freeze; the European Union is reshaping the regional agenda through its Economic Partnership Agreement initiative; SACU is mired in institutional inertia; Chinese companies are carving open regional markets; and free trade talks with India and China are on hold in the face of strong domestic opposition. This is an opportune time to look beyond the horizon and ask what the future of South African strategy is.

Note: the last three of the four speakers used PowerPoint slides, which may be accessed on the SAIIA site.

2. Proceedings

Xavier Carim – "Doha: where do we stand?"

- Following the recent, indefinite suspension of the WTO negotiations, the question facing South African is how to find a way forward. As explained in the official DTI statement, South Africa remains committed to a successful Doha Round.
- WTO Director General Pascal Lamy's "negotiating triangle" (domestic support in agriculture, agricultural market access, and non-agricultural market access) notwithstanding, the key to the breakdown was gridlock on the two agriculture issues—specifically the US's domestic support and the EU's tariff protection.
- In the few days before the last G-6 (US, EU, Japan, Australia, Brazil, and India) meeting, the US had not been able to commit to cutting domestic supports from \$49 billion to \$22 billion. Even if it had done so, this amount remains above current estimated annual spending of \$19 billion, implying that actual support could in fact increase. The US is arguing that further concessions will only be possible if there are significantly higher reductions in farm tariffs by other countries, particularly the EU. The EU's official on tariff reduction is 39%. It has hinted at being able to move closer to the more ambitious G-20 position, but has made no clear offer (the G-20 proposal is 54%). The US proposed average of 65% tariff cut.
- What worries the US
    - EU offer was not clear
    - There is a number of loopholes in the offer:
        - The EU wants 8% of tariff lines designated as sensitive products (subject to no or lesser tariff reductions—this too still has to be decided). 8% involves about 160 product lines, and could represent all of the most heavily protected products. The EU has indicated it would be willing to reduce this number, but again has made no formal offer.
    - The US has similar misgivings about carve out for "special products", as proposed by the G-33 (led by India and Indonesia). The G-33's position states that unless there is a reduction of agricultural subsidies from the US, it would seek to designate as sensitive as many products as possible.
- Industrial tariffs were not discussed at the G-6 meeting.
- The next window of opportunity will probably be after the November US Congressional elections. Extension of the US Trade Promotion Authority ("fast-track") is vital to the success of the Round, while the extension of the US Farm Bill will potentially complicate things further by building less flexibility into the US position.
- Way forward:
    - There is a broad-based desire amongst the Membership to see the conclusion of the Doha round. EU commissioner for trade Peter

Mandelson has suggested carving out a "development package" until the tougher market access issues can be dealt with. This has encountered opposition from a number of quarters, including both South Africa and Lamy himself, as this runs fundamentally against the so-called "single undertaking" (dealing with all issues on the agenda together), one of the WTO's founding principles.

- Implications for South Africa
    - SA is committed to the resumption of the negotiations as soon as possible
    - However, the delay provides an opportunity to do some more technical work on key issues. It is also a chance to consult more intensively with SACU, and to begin to pay more attention to the dispute settlement procedure.
    - A major distraction at the moment is the EPA negotiations. Negotiations with India should begin soon, but negotiations with China will take longer to initiate. South Africa is considering alternatives to an FTA with China, such as cooperative arrangements that can help facilitate trade, rather than simply focusing on extensive tariff negotiations. There also needs to be much more focus on non-tariff barriers.

Lawrence Edwards – "The Scope for unilateral liberalisation in SA"

- No country's trade policy should be determined by the outcomes of trade negotiations, multilateral or otherwise. Trade policy is a domestic policy tool used for addressing domestic economic problems. Its direction and formulation should be based on domestic economy considerations, not on 'what you can get in the WTO'.
    - Much, if not all of the empirical evidence on the *economy-wide* impacts of SA's 1990s liberalisation points to three things:
        - Productivity has improved drastically
        - The net effect on employment has been neutral at worst
        - Significant restructuring has taken place both within and across sectors, with import penetration and export orientation rising almost across the board.
    - However, export performance has fallen short of expectations; primary and manufactured export growth has much room to improve. Research indicates that the most important challenge in this regard is supply constraints in SA, i.e., SA's export performance is not primarily determined by access to foreign markets
    - This implies that policy ought to be doing all it can to improve the profitability of exporting. This includes a variety of things, some of which are:
        - A stable real exchange rate (the jury is out on what level it should be)

        - Lower transaction costs (better infrastructure)
        - Lower input costs, including labour
        - Tariff reform (as many intermediate inputs are imported, and we have seen that it is instrumental to improved productivity)

- However, the rules-based multilateral system is crucial to addressing the stark imbalances in patterns of world trade and protection. It is also useful for "tying governments' hands" in the face of strong protectionist lobbies. Nevertheless, too heavy a focus on multilateralism detracts from the benefits to be gained from implementing trade and other regulatory reform in a unilateral fashion.
- There is therefore scope to simplify and rationilise the tariff structure, and reduce tariff peaks in the process. The current complexity only adds to the costs of doing business in South Africa, as well as to the prices paid for final goods. There has been significant rationalisation of the tariff structure since 1994, but SA has fallen well short of what it was aiming for in the mid-1990s.
- The main reason for SA's seemingly irrational tariff structure is that there is clear strategy driving trade policy; it is driven instead by negotiations on different levels, in which the focus on domestic economic interests is often lost. Will the proposed industrial strategy fill that gap? That remains to be seen, but there is good reason to be cautious of so-called 'selective' or 'strategic' trade policymaking based on the perceived needs of industrial policy. SA has a poor record with 'strategic protection', which in the past was one of the major contributors to the gross inefficiencies seen in the economy today.
- Finally, although there is scope for unilateral trade reform in SA, effective implementation requires flanking policy reforms, including a focus on how to better help firms and industries adjust to changes in the pattern and level of protection.

Peter Draper – "South Africa's Free Trade Agreements Agenda"

- FTAs have grown exponentially since the early 1990s. Ironically this is when the Uruguay Round of the GATT was finalised and the WTO created (in 1995).
- FTAs: building or stumbling blocks?
    - Potential for trade diversion
    - Spaghetti bowl of institutional requirements
    - Are FTAs building blocks or stumbling blocks?
        - They are inevitable if multilateral reform stalls
        - But their costs are real and should not be ignored. Hence economists prefer the unilateral and multilateral routes.
- Political considerations are always important, but politics should not trump economic rationale
- SA's completed FTAs:

    - EU DCA (review underway—could include services and investment on top of deeper commitments on goods).
    - SADC FTA (review also underway)
    - Preferential deal with the European Free Trade Association (Norway, Switzerland, Iceland and Lichtenstein).
    - These agreements each cover a substantial amount of goods trade, but overall account for only about 40% of SA's total goods trade.
    - None as yet include areas increasingly important to world trade, such as services, and none deal adequately with regulatory issues, such as investment and intellectual property.
- Future South African FTA negotiations
    - USA on 'life support'
    - Mercosur very limited
    - India likely to be too
    - The plan to strike a deal with and African country outside SADC remains unrealised.
    - India-Brazil-SA?
    - China??
- The principle questions in SA's FTA strategy are how they should be designed, and who should be the partners.
    - Should target the major markets first (USA, China, and perhaps India)
    - Should not be interested in patchy deals focussing on sector-specific concerns. That is, the coverage should always be comprehensive, and the concessions substantial.
        - The questionable success of the Motor Industry Development Plan is a good example in this regard. Since officials regard the MIDP in a very favourable light, how might our sensitivities in this sector influence positions in FTA negotiations, indeed all negotiations?
    - SA must broaden the agenda when in future FTAs
        - Regulatory issues; services
        - Could Singapore, an unthreatening, small economy prove a good test case for a comprehensive FTA?
    - Timing and sequencing is important
    - Must alter the mindset and understand that imports are not 'bad' while exports are 'good'. Both are critical.
    - Overall, FTAs are only worthwhile if they actively contribute to the domestic reform agenda.

Mark Pearson – "How does Southern and Eastern Africa feature in SA's trade policy?"

- SADC trade overview
    - Bulk of SADC imports come from OECD countries
    - SACU countries source 17% of all imports from within SACU, and only 2% from the rest of SADC
    - SADC countries generally export raw materials to South Africa in exchange for manufactured goods and some capital equipment
    - The SADC region is important to South African exports
    - Bout 70% of current intra-SADC trade occurs under various regional trade agreements. SACU is most important, but the COMESA agreement is important for some countries in SADC.
    - There are 19 bilateral deals in SADC, and some countries are members of more than one multi-country regional agreement.
- SADC Trade Protocol was signed in 1996, implemented in 2000, with an FTA by 2008
- SADC Protocol: Who needs it?
    - South Africa does not seem to need the SADC TP to expand its own trade in the region, but does need it for opening itself to the rest of Africa in order to build the envisaged African Economic Community.
- Are Eastern and Southern African integration goals achievable?
    - SADC Customs Union by 2010? Will it be and expansion of SACU? If so, what are the revenue sharing implications? What is SA's position?
    - What about Tanzania, which s already part of the EAC CU?
    - And what about the COMESA CU process, which involves 6 countries and is on track for 2008 implementation
    - One option for SADC may be to strengthen/expand SACU with a view to eventually linking with the EAC and the COMESA CU.

3. Synopsis

The two discussion sessions revealed sharply contrasting views on trade policy in South Africa, including our approach to the Doha Round of WTO negotiations. Many feel further liberalisation of the South African economy through negotiations would have negative implications for employment creation and poverty reduction, and are therefore strongly opposed to the idea that South Africa should do it unilaterally.

On the other hand, similar levels of concern were expressed about the apparent intent to use trade policy 'more strategically', i.e., to have the imminent industrial strategy, including sector-specific interventions, driving trade policymaking. This, it was argued, holds potentially large risks the economy, and misinterprets much of the empirical evidence concerning the links between liberalisation and South Africa's economic performance.

The future of South Africa's trade strategy clearly remains an important, controversial question in the broader economic policy debate.