`PROMOTING DIALOGUE ON TRADE REFORM IN SOUTH AFRICA'

Trade, Industrial Policies and the Exchange Rate: Proceedings of the Critical Thinking Forum Pretoria; 23rd March, 2010

Background

The recent economic recession coupled with the strengthening currency has prompted analysts and politicians to debate whether South Africa should leave its currency to be determined by market forces or intervene to manage it. The current mix of a lower current account deficit, steady commodity prices and solid performance of emerging markets assets worldwide can result in the rand remaining strong and stable for some time to come. But the relative rigidity of inflation means that even a stable exchange rate implies an appreciation in real terms, and a resulting further loss of competitiveness. This is particularly true for manufacturing. The consequence is that even as global demand recovers, South African exports are faced with competitiveness constraints, and the pattern of 2003-06 (real export growth underperforming against global trends) may well be repeated.

Meanwhile, the plunge in imports - which was the one reason behind the marked narrowing in the external deficit, but which mainly reflected the collapse of inventories - is bound to reverse once the demand cycle turns. Huge current account deficits could again become the norm and if foreign investors reduce their purchase of or sell local assets we could then see a sharp rand correction.[1]

These issues were the focus of a recent Critical Thinking Forum co-hosted by SAIIA and the Mail and Guardian newspaper, in conjunction with Business Unity South Africa (BUSA), Business Leadership South Africa (BLSA), and the Graduate School of Business at the University of Cape Town. The forum assessed the desirability of currency intervention versus

[1] Much depends on one's view regarding the sustainability of the current account deficit. Draper and Freytag argue that concerns over its sustainability are overdone, and deflect attention from the microeconomic structural reforms that have to be undertaken if the economy is to sustain its position in the global economy. Draper, P and Freytag, A (2008) 'South Africa's Current Account Deficit: Are Proposed Cures Worse than the Disease?', *SAIIA Trade Policy Report*, 25.

flexible exchange rate systems, the scope for South Africa to pursue active currency management, and the associated impacts on trade and industrial policies.

Part 1: The Exchange Rate - To Intervene or Not to Intervene?

Those in favour of intervention argue that without a lower currency, efforts to boost South African industry would not work as domestic producers cannot compete abroad and are overwhelmed by cheap imports through "Dutch disease"[2] effects. Hence there is alarm in certain quarters rooted in fears of "deindustrialization"[3], notably amongst groups committed to an active industrial strategy designed to boost labour-intensive industries. In this view a strong industrial policy combined with a looser macroeconomic policy and competitive currency is required to address the unemployment crisis. Advocates of this stance also suggest that the current mandate of the central bank will have to be reviewed to include more active management of the currency.

Those against intervention argue that the country does not have adequate foreign exchange reserves in the market to weaken the currency; in other words the sustainability of exchange market interventions in South Africa is in doubt. The rand's recovery is viewed as a normal correction from depreciation, accompanying normalisation of global investor appetite for emerging markets assets such as equities, currencies and commodities. These analysts argue that seeking "competitive devaluations" is the easy way out for companies that fail to undertake the necessary productivity and diversification efforts - in essence, devaluations delay structural reforms. Furthermore, it is asserted that the appreciation reduces the risk premium on local financial assets and, in turn, the cost of financing the economy. In the current case, the stronger rand has two other benefits for South Africa: it helps lower the rate of inflation, and reduces the cost of imported components of the infrastructure investment programme – thus easing pressure on public finances. Ultimately in this view the real issues are structural weaknesses in the economy and cost drivers, whereas focussing on

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[2] This refers to the situation in which the price of one (or several) commodities exported by a country rises in relative terms, leading to a real appreciation of that country's currency, which in turn undermines the external competitiveness of other sectors of that country's economy. At its worst, Dutch disease can force companies to close, increase the dependency of the country on exports of unprocessed goods, and increase the volatility of both its real and financial aggregates.

[3] Engineering News Online, "Domestic Manufacturers Warn of de-industrialization threat", 24 October, 2005.

the currency is regarded as a way of avoiding dealing with those more important fundamentals.

In the keynote address **Lesetja Kganyago**, Director General of the National Treasury, began by noting that the level of economic debate in South Africa leaves much to be desired, and that empirics need to be brought back to the centre. He argued that whilst the exchange rate is important, other economic factors such as interest rates and productivity can be equally, if not more, important. He noted that prudent monetary and fiscal policies pursued since 1994 are responsible for macroeconomic stabilisation; whilst the real exchange rate steadily depreciated. Even measured by the nominal exchange rate (R/$) the economy is much more competitive now than it was in 1991. Consequently, in his view the exchange rate per se cannot be to blame for South Africa's poor export performance. He pointed out that even if we wanted to manage the nominal exchange rate down, history tells us this can be very expensive: South Africa's experience in the Asian economic crisis of the late 1990s, where $25 billion was expended to protect the currency, is instructive in this regard. Furthermore, he argued that a fixed exchange rate would require South Africa to abandon its monetary policy sovereignty and adopt the lead country's domestic macroeconomic policy stance. He noted that the recent Greek experience shows us clearly that bad macroeconomic management and low productivity magnify the problems. How then to moderate rand volatility? He averred that the South African Reserve Bank (SARB) would have to play a key role by financing foreign exchange purchases to smooth the cycle, which it is already doing.

His key take-aways were:

1. Allowing domestic inflation loose in order to promote productivity is wrong;
2. There is a trade-off involved in trying to manage the exchange rate, in terms of fiscal deficits and monetary policy – it is not costless.
3. Whilst change is important, macroeconomic policy is not a silver bullet. Continuous learning, re-skilling, and microeconomic reforms are keys to sustained competitiveness;
4. Therefore, we have to take a longer term view of productivity issues; productive capacity takes time to develop.

In conclusion he argued that the keys to export growth are lower domestic costs and therefore inflation; productivity growth underpinned by reforms to key product and factor market regulations; and higher savings at home in order to minimise the need to import capital.

In the **questions and answer** session, the following issues were raised:

- ✓ Can South Africa be like China, which sustains a currency peg? Only if we are prepared to take on the full package of Chinese macroeconomic management, including active inflation-fighting through monetary policy and fiscal prudence.

- ✓ How do we plan to sort out the microeconomic story when government service delivery is inadequate? The bottom line is that macroeconomic reforms cannot do this.

- ✓ What prevents progress on microeconomic reforms? It is spread across many government agencies and levels of government, as opposed to macroeconomic policies where the locus is much clearer.

- ✓ Shouldn't we be worried about the current account deficit? Definitely, and the way to address this is by promoting savings especially in government. This has to be buttressed by counter-cyclical fiscal policy, but ultimately it's the productivity reforms that remain central to long-run competitiveness and growth.

In **session 1** Professor **Robert Lawrence** of Harvard University noted that in order to have coherent policy an integrated and holistic view is required since all the variables interact. In the short run, nominal exchange rates can have real effects, but only until other nominal variables adjust. Therefore, the key is to understand the real exchange rate, and how it could be influenced by the current account and protectionist actions. Depreciation of the real exchange rate acts both as an import tax and an export subsidy; the overall effect is to raise the relative price of tradeable goods and services thereby raising their production. But the real exchange rate is ultimately not controllable since it is affected by many variables. Amongst these, two key variables are spending patterns (savings and investment) and protectionism. Changing the exchange rate will not change trade patterns unless it affects savings and investment. Countries that experience trade deficits will have real exchange rates that are higher than they otherwise would be; and vice-versa.

What are the dynamics in South Africa? The complaints are that the exchange rate is too strong and volatile, and that real interest rates are too high. What can be done? Lawrence highlighted three possibilities: weaken the exchange rate through intervention; offset it through protection; and weaken the exchange rate through increasing national savings:

1. Weakening through intervention can be done by accumulating reserves (resist strengthening); the problem is containing inflationary pressures as the money supply expands. Ultimately you need to either decrease investment or increase domestic savings, otherwise prices will increase and the real exchange rate will appreciate.

2. The problem with using industrial policy is that it ignores the exchange rate response: a protectionist tariff policy will initially raise demand for domestically produced goods, discourage imports, and therefore strengthen the trade balance; the dynamic effects of this down the line will lead to a real exchange rate appreciation, which over time will inhibit exports. The opposite is true with a tariff reduction, which should lead to reduced real exchange rates over time.

3. Therefore the key over the long-term is to use fiscal and monetary policies wisely, specifically smaller budget deficits or bigger surpluses which enable looser monetary policies. In other words the key is mobilising more domestic savings – either private or public. Since the former is difficult to influence he argued that the focus should be on the latter. This forces tough choices on policy makers and requires a lot of political will.

Professor Andreas Freytag responded that investment and savings decisions are ultimately driven by what individuals think about the future and hence their savings behaviour, not changes in nominal exchange rates per se. Furthermore, he stated that a current account surplus or deficit is not good or bad per se. Germany for example has been running a surplus for many years, meaning their savings are invested abroad whilst there are high rates of unemployment at home – in other words it can be questioned whether surpluses are good for the domestic economy. Furthermore, much depends on what is done with capital inflows – are they invested or consumed? If the former then a deficit may be sustainable especially if invested in export industries. Trade protection should be considered if temporary; the question is how to ensure that it is temporary? This raises the vexed issue of the political economy of protection. In his view a far higher priority should be to un-block bottlenecks in network services[4]; one way of advancing this would be to reduce the number of government departments in order to minimise bureaucratic in-fighting.

[4] Transport, finance, telecommunications, and energy.

Ms Niki Cattaneo posited that the Lawrence framework is perhaps too deterministic. For example, exchange rate pass-through to domestic prices is affected by a number of factors, meaning that it may not be as smooth as suggested. In South Africa research indicates that pass-through is high, particularly in the case of depreciation. But more work is needed to establish the extent, mechanisms, sectoral dynamics, and the responsiveness to volatility. With respect to the use of trade and industrial policy, Ms Cattaneo pointed out that the emphasis in the recent IPAP and trade policy strategy frameworks is not one of advocating a uniform increase in tariff protection or uniform provision of export subsidies either as a general strategy or to deal with the exchange rate issue. While tariffs are identified as instruments of industrial policy, there is an emphasis on the reduction of key input tariffs, and on the possible use of tariffs in accordance with particular sector strategies, if there is leeway between bound and applied tariff rates. She also noted that there are three countries in SACU that are part of the common monetary area and that would be affected by any currency management practices adopted in South Africa; she averred that their views should be taken into account.

Lawrence responded that much of South Africa's borrowings these days are infrastructure related, but the key question is how the debt will be serviced if investment is not made in tradeables (exports), or alternatively import-substitution reduces the forex bill. Ultimately he sees a weaker real rand as being key to promoting those exports in the long-term. Furthermore, regarding the industrial policy in South Africa he expressed concern that no targets and benchmarks are set, meaning there is a fundamental problem with the way the policy is being focused. In this regard he agreed that the political economy of protection is crucial. He argued that the key focus of industrial policy should be on reducing the prices of key inputs into industry. Ultimately though in his view industrial policy is about much more than money, and should really focus on key issues inhibiting business investment related to exports.

In the **questions and answer** session, the following issues were raised:

- ✓ If savings are encouraged wouldn't looser monetary policy encourage dis-savings thereby defeating the policy thrust? Much depends on the responsiveness of savings to investment, which in South Africa is indeterminate.

- ✓ Is it possible to have 'just a little bit of protection'? How can you discipline one or two sectors whilst allowing others to have protection? Is this not a disease that will creep across the 'body economic'? It would seem that government is not bent on widespread protection so perhaps this is not a major concern.

- ✓ Can we learn anything from Germany, which for decades has had a strong currency yet is a major global exporter? Basically one stratum of the German economy is geared for exports under strong currency conditions, but there is a large part of the economy which has not adapted well to structural change owing to microeconomic rigidities.

- ✓ If savings are the key, how can they be encouraged – particularly in the private sector? It may be necessary to introduce some form of compulsion such as pension schemes, but this needs to be buttressed with public savings since it is difficult to get private actors to save. At the end of the day people respond to the incentives they confront.

- ✓ Does it make sense to encourage savings now, in our current crisis conditions? Clearly short-term fiscal support is necessary to enable the economy to ride out the crisis, but once the crisis abates it will be necessary to pursue counter-cyclical policies and therefore encourage savings.

- ✓ How can South Africa manage the politics of economic reform? The challenge is to stimulate growth and manage political change at the same time; in South Africa this is very challenging indeed. In the long-run the focus should be primarily on economic growth – transformation without it is a recipe for disaster. Decisions are too often held up when growth should take priority. A good case in point is South Africa's response to the commodities price boom – mines were very slow to respond. A second key priority is skills, and not just local skills. South Africa's immigration procedures are too onerous in this regard.

- ✓ Where will the future growth and export proceeds come from, and does manufacturing have the potential to drive this? Related to this, to whom will we export those goods in light of market access constraints and the need to plug into global production networks? It is better to have a general view on this focused on 'self-discovery' without regard to a specific focus on manufacturing.

- ✓ Isn't it problematic to rely on foreign debt for our development? There are very few cases of countries that have successfully developed using debt unless very well-governed and invested in domestic productive capacity. Furthermore, a prudent macroeconomic policy promotes avoidance of such debt-dependence and reinforces the need for counter-cyclical fiscal policy.

Session 2 focused on dynamics around the rand in relation to a potential currency management scheme. **Rudolf Gouws** began by noting that currency intervention presupposes knowledge as to what the desired level is; yet this is a highly contestable proposition. When is an exchange rate 'right or fair'? He posited that it is probably when exporters and importers are equally unhappy. Regarding the rand he noted that on a trade weighted basis it is actually back to where it was in 2008, meaning it is not particularly strong. Nonetheless, the current global context of renewed investor risk appetite, rising commodity prices, and improvement in our external accounts is conspiring to strengthen the rand. In this context can a policy to weaken the rand actually work? His answer is no, because those global forces are too powerful.

Furthermore, he noted that South Africa's inflation rate is amongst the highest whilst our inflation targeting regime is amongst the most lenient amongst peer group emerging markets; therefore inflation targeting per se cannot be blamed for our high rates of unemployment as is alleged in some quarters. Instead, he argued that our own inflation is to blame for our rising real effective exchange rates, in other words rising domestic costs are the principle problem. In his view such conditions necessitate tighter, not looser, domestic monetary policy.

So what are the policy options for dealing with the strength of the rand? He identified the following:

1. Abolish or ease exchange controls on South African residents, even if politically and economically risky.

2. Purchase forex at a faster pace. This has fiscal and monetary implications and the outcome is not assured.

3. Talk the currency down. However credibility can be seriously tested when the market turns.

4. Reduce interest rates to discourage short-term flows. But this has limitations owing to our inflation targeting regime and structural inflation pressures plus the outcome is uncertain.

5. Create a sovereign wealth fund. However South Africa has a current account deficit, not a surplus so how would this be financed?

6. 'Fix the exchange rate'. But South Africa has insufficient reserves to maintain this and it would require the reintroduction of exchange controls plus loss of monetary policy sovereignty whilst not addressing the trade-weighted index problem. If history

is a guide we could also be decimated when the dollar (the most likely currency to which the rand would be pegged) strengthens and hits exports.

7. Limit portfolio inflows through policy ‘speed bumps’. But these are not practical in the South African case.

In his conclusion he noted that the rand is not as strong as often supposed and what strength there is is as a result of global forces over which we have no control. Even if we want to influence its level we have limited tools; and such intervention would only work if accompanied by tighter monetary and fiscal policies. A depreciation on the other hand would trigger higher inflation. Furthermore, and notwithstanding the global financial crisis there is no movement away from inflation targeting internationally whilst our regime is not rigorous. Finally, our slow growth and high unemployment cannot be blamed on inflation targeting but is rather the outcome of structural rigidities; therefore we should protect our sound macroeconomic policies, focus less on the currency and more on the structural rigidities.

Johan Delport noted that The Bank has in the past monitored, and will continue to monitor developments in the exchange rate of the rand, and will intervene in the foreign exchange market when necessary. The extent of intervention, however, must be limited given the cost implications of this exercise. In addition, the level of reserves the Bank has accumulated thus far (some $40 billion) is not at all high relative to daily trade volumes in the rand foreign exchange market, which often exceeds $10 billion on a given day. This necessarily limits the sustainability of exchange market interventions.

In the **questions and answer** session, the following issues were raised:

- ✓ Is South Africa as a developing country negatively affected by China’s currency peg? Not really since the nominal rate has depreciated relative to the Yuan.
- ✓ Doesn’t the current policy structure favour the financial interest over industrial interests? This is not clear, since inflation affects everybody especially the poor.

Part Two: Industrial and trade policies

Session 3 focused on exchange rate issues in relation to trade and industrial policies. Government's broad developmental strategy aims to promote and accelerate economic growth along a path that generates sustainable, 'decent' jobs in order to reduce the poverty and extreme inequalities that characterize South African society and economy. The National Industrial Policy Framework (NIPF) is a central component of this strategy. Driven by the Department of Trade and Industry (DTI), the NIPF seeks to encourage value-added, labour-absorbing industrial production and diversify the economy away from its current over reliance on traditional commodities and non-tradable services and, in this way, catalyse employment growth. The DTI's Trade Policy and Strategy Framework outlines how trade policy and strategy in South Africa can make a contribution to meeting the objectives of the NIPF, i.e. upgrading and diversifying the economic base in order to produce and export increasingly sophisticated, value added products that generate employment.

Against the backdrop of the global economic crisis and the recent domestic recession, there is an ongoing debate on South Africa's industrial and trade policy trajectory. These matters have moved into sharp relief in light of calls by some in government and the Tripartite Alliance to raise import tariffs, particularly on certain clothing items. Under joint COSATU-SACP influence, emphasis is placed on stimulating or protecting chosen sectors – particularly automotive, transport, chemicals, clothing and textiles and on shifting the economy away from reliance on commodity exports and toward higher labour-intensity and greater labour productivity. COSATU has made an impassioned plea to parliamentarians for greater protectionist measures in South Africa's trade arena arguing that emerging industries should be protected from imports that are subsidised or where they posed a risk to domestic employment. The organization argues that protectionism is necessary to afford domestic producers the space to restructure their operations in order to survive foreign competition. They further argue that the state should strategically protect selected industries in order to build local industrial capacity and thus promote industrialisation. They attribute employment and poverty reduction successes to protectionist trade strategies and proclaim that this is the path to growth and development for the country. East Asian "tiger economies" are regarded as the essential example in this genre, more broadly of establishing "developmental states" privileging industrial policy.

Furthermore proponents of trade liberalisation assert that reduction of import protection encourages specialisation, competition and efficiency and allocates resources from uncompetitive sectors to sectors with comparative advantage. Advocates postulate that trade policy reform has the potential to offer significant positive impacts on economic performance and poverty. They also note the development success of the East Asian countries amongst others but credit this to those countries' relatively open trade policies and factor endowments. In the South African government Treasury is known to support this view; for example in the latest Budget Policy Review reference is made to this approach in the context of promoting microeconomic reform: 'opening up the economy to investment and trade opportunities that can boost exports'.[5] Furthermore, it is possible the National Planning Commission under Minister Manuel could tilt in this direction through its likely emphasis on cross-cutting microeconomic reform.

The Minister of Trade and Industry does not have the final say since tariffs are ultimately a revenue issue; hence the Minister of Finance could hold the key – depending on what role in this issue is ultimately accorded to the Minister for Economic Development. Given the current attention afforded to the role of the Treasury in domestic economic policy-making (i.e. its "control" over other government departments) this could sharply raise the stakes in the internal struggles being waged within the Tripartite Alliance over South Africa's economic policy agenda. Whether this would translate into a debilitating inter-agency turf war would have to be seen but in our view is unlikely, yet this possibility cannot be ruled out since COSATU and the SACP have set much store in the industrial and trade policy agendas.

Against this backdrop, **Professor Lawrence Edwards** noted that empirically there is a strong relationship between trade flows and the real effective exchange rate (REER). Since the early 1990s there has been a sustained decline in the REER, with some fluctuations around the mean not altering the general trend. A depreciation allows us to reduce the price (for commodities the dollar price) of our export goods. This depends on the elasticity of demand for those exports, which can be low thereby defeating the purpose of the depreciation. Hence Edwards agreed with Cattaneo that the pass-through rate is critical, albeit difficult to measure. He argued that in the South African case recently there has been some divergence in the pass-through, but historically it closely matched the depreciation. In other words in his view South Africa is a price-taking economy, not a price-setter, therefore depreciation is not likely to have much effect on export prices. This is because South Africa is primarily a resource-based economy.

So how could depreciation influence exports? Edwards noted this is primarily through supply since it makes exports more profitable in rand terms. However, containing cost inputs is critical to sustaining competitiveness. Yet he pointed out that capital and intermediate inputs are major components of our import basket and are generally priced at world prices, and these would rise following depreciation. Furthermore, ne noted that the costs of non-

[5] National Treasury (2010) *Budget Review*, Ch1, P6.

traded inputs such as electricity would have to be contained, which seems unlikely in the current conjuncture, and historically depreciations have been eroded by inflation and wage costs. Therefore, in his view currency depreciation is unattractive as a policy tool. In this light it is more important to manage exchange rate volatility through counter-cyclical macroeconomic policies rather than target a specific level for the exchange rate.

What implications does the dti's industrial policy action plan have for trade policy? Edwards argued that in general it represents a change in sentiment regarding liberalization, to the extent that it may constitute a policy reversal rather than a halt to the process. This is particularly evident in proposals to reduce input costs which would raise effective protection[6], combined with statements that tariffs on final goods may also be raised. In his view this does not adequately reflect the South African experience of the 1990s: tariff liberalization reduced incentives to supply the domestic market thus pushing firms to export whilst at the same time reducing input costs. Therefore he argued that liberalization actually helped to achieve export diversification and more exports rather than defeating this shared objective and promoting de-industrialization. In his view it was also neutral with respect to the trade balance. Therefore he argued that further liberalization would be beneficial, and consequently the IPAP seems to go in the wrong direction. He noted that import tariffs are a regressive tax which ultimately impacts on the poor the most since they spend a high percentage of their income on consumption goods – which are typically subject to the highest tariffs. Furthermore, he contended that the process that will govern tariff reforms is vague, inviting un-transparent behaviour and rent-seeking, and therefore requires reform. In his view this should extend to establishing rules for tariff changes and at the same time simplifying the tariff book since existing tariffs reflect previous industrial policies.

In response **Catherine Grant** noted that exporters are twice as likely to use imports than domestic producers; about 50 percent of South African exporters only export to the SADC region (based on the number of exporters) which in turn highlights the regional implications of South Africa's trade and industrial policies; and that companies most likely to export really need supply-side support measures for sustainable competitiveness rather than currency depreciation per se. Furthermore, she pointed out that the exclusive focus on manufactures may not be correct – what about services which are now the dominant component of South African GDP? And she averred that exchange rate issues are not really important for this sector since many products are not traded. In this light she argued that it is not obvious that

[6] Effective protection refers to the fact that as input tariffs, for example on textiles, are reduced whilst tariffs on final goods, in our example on clothing, remain the same, so effectively domestic clothing producers enjoy greater protection.

the sectors targeted for support under the IPAP (eg capital equipment) will create jobs on a large scale. However, she expressed confidence that there will not be major reversals of trade policies and noted that the IPAP needs to be read in conjunction with the Trade Policy and Strategy Framework document which in her view does not seem to point in this direction. And she expressed doubts that tariff simplification via tariff band rationalization will have the desired impacts; asking how exactly it would help to achieve those goals? She also queried whether international experience bears this out?

Tengo Tengela stated that the trade union movement are not exchange rate fundamentalists. However, they are concerned with industrialization in order to achieve social objectives, particularly the objective of achieving 'decent work'. In his view the IPAP is motivated by these concerns and is therefore appropriate, particularly its emphasis on levelling the playing fields for international competition.

In response **Edwards** noted that tariff simplification is consistent with prior South African government policy pursued since 1994 and since tariffs are taxes it is important that they are transparently implemented – and a plethora of rates and bands does not lend itself to that objective. Furthermore, he asserted that when it comes to industrial policy insufficient attention has been paid to the criteria by which interventions will be judged.

Concerning the alleged untransparent process whereby tariffs are reviewed, **Siyabulela Tsengiwe**, Chief Commissioner of the International Trade Administration Commission, stated that tariff applications are reviewed on the basis of evidence and are not simply available on-demand. Furthermore, he asserted that insufficient credit is given in public discourse to previous reforms undertaken although he agreed that this doesn't mean further reforms shouldn't be undertaken.

In the **questions and answer** session, the following issues were raised:

- ✓ In the current South African context of high unemployment and low growth does it make political sense to advocate tariff reductions? Other countries have liberalized in difficult domestic circumstances so there is precedent for this. Furthermore, there is an extensive academic literature reviewing the impact of liberalization on the South African economy from many perspectives and which generally points to the beneficial impacts; therefore further reform should proceed on the basis of a proper evaluation of this literature. Such reform should be sensitive to subsidies offered by our trading partners to their domestic producers since this constitutes unfair competition.

- ✓ Is it true that infant industry protection promotes industrial upgrading? Historical experience in some parts of the world suggests that the rents generated may end up being simply spent in the sector/firms rather than used to diversify or upgrade. The example of import quotas on Chinese textiles into South Africa may serve to reinforce this point.

- ✓ It was pointed out that the South African cost-structure is already high and rising in key areas; the economy experiences a natural 'protection by distance' from major markets; and the regulatory burden is growing consistently. In this light shouldn't the imperative be to reduce costs further in order to promote competitiveness, in which case raising tariffs would not fit with this objective? Picking winners and losers is inherently fraught and could distract from the very serious business of driving down administered prices plus sorting out logistics. Distance to markets is not necessarily the major obstacle but then it is essential to sort out the logistics issues.

- ✓ Have consumer interests been ignored in the trade strategy? No, in value-chain analyses of tariff protection applications consumer interests have to be taken into account.

- ✓ Shouldn't we compare our tariff structure and management with other countries? Yes, but ultimately it is what is in our own best interests that counts and this is where there is a disagreement. Furthermore, if other countries have terrible tariff structures should we try to emulate them?

Concluding Observations

Nic Dawes noted that the real clash of views seemed to take place once the discussion moved away from exchange rates to trade policy and tariffs, and wondered whether this might reflect our mercantilist predilections? The question is how to move these issues to the centre of national debate given their importance to the domestic economy? Therefore he highlighted the forthcoming debate series that SAIIA and the Mail and Guardian would be hosting in the pages of the Mail and Guardian and encouraged people to participate.

Overall, several key strands of consensus did seem to emerge during the course of the day:

- ✓ Rather than focus on nominal exchange rates – which much of the current public discourse does – the key is to take inflation into account and focus on the REER. The REER has steadily decreased in line with South Africa's relatively high inflation rate;

reducing the nominal exchange rate would boost inflation further thereby penalising exporters and consumers and would ultimately be self-defeating.

- ✓ Furthermore, even if it is desirable to devalue the nominal exchange rate, owing to exchange market dynamics and South Africa's relatively small foreign exchange reserves such a policy intervention would be unsustainable.
- ✓ Therefore, more needs to be done to boost domestic competitiveness particularly of network services. In this regard the emphasis placed on tariff increases by the DTI's IPAP and Trade Policy Review and Strategy Framework may be misplaced.
- ✓ However, contrary to some perceptions these documents do not seem to represent substantial policy reversals; yet if they are to be useful they should focus sharply on removing bottlenecks and promoting competitiveness in the economy as a whole.