2nd Public Forum: Promoting Dialogue On Trade Reform In South Africa

Panel 3: Trade Protection in South Africa – Costs versus Benefits

CUMULATIVE COSTS OF TRADE PROTECTION IN THE SOUTH AFRICAN ECONOMY

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1) Background

Protectionism is to the disadvantage of the very country behaving in a protectionist fashion, because it is selective and economically distortive.

Some industries gain and some lose.

So why is trade protection such a politically attractive policy tool?

➢   Gains from free trade are long-term, losses from adjustment to structural change are short-term
➢   information about this
➢   Political rationality > economic rationality

2) Channels of Protection: Theoretical Considerations

a) The static view: four channels

Exchange rate channel
Input demand channel
Purchasing power channel
Retaliation channel

Two further effects:

Less consumer's (or industries') choice. Product variety is reduced. It is difficult to estimate costs of reduced choice for downstream industries and consumers, but they definitely exist.

Finally, administrative and trade finance costs are substantial.

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b) The dynamic perspective

First, protected firms facing little or no **competition** do not have the incentives to fully serve the needs of the customers, quality is being reduced and innovations are not as necessary as under full competition from world market participants.

Second, and most importantly, one has to consider the structure of imports and particularly the **structure of import protection** in an emerging economy.

In general, the following picture is valid: the higher the share of unskilled labor, the higher regional concentration, the lower the value added, profits and sectoral growth are, the higher is the degree of protection for this sector. In other words, governments concentrate their support on the losers of worldwide structural change.

Remedy:

The state takes the role of a **developmental state**, driving industrialization and creates comparative advantages.

Problems:

➢ lack of knowledge;

➢ other people's money;

➢ political constraints: governments are not benevolent.

3) South African Channels of Protection

Computational general equilibrium (CGE) analysis for SA show substantial gains through unilateral liberalization.

Problems:
➢ strict assumptions;
➢ old data;
➢ information requirements high;
➢ no information about service protection in the CGE database.

Therefore, we do a qualitative survey.

Tariff structure

The South African tariff structure and rates have declined remarkably since 1994. There are less tariff bands (1994: 723, 1998: 275; 2007: 102), less tariff lines (1994: 11,231; 1998: 7,773; 2007: 6,667) and lower applied tariff rates (simple average 1994: 23 per cent; 2006: 6.7 per cent) than at the end of Apartheid
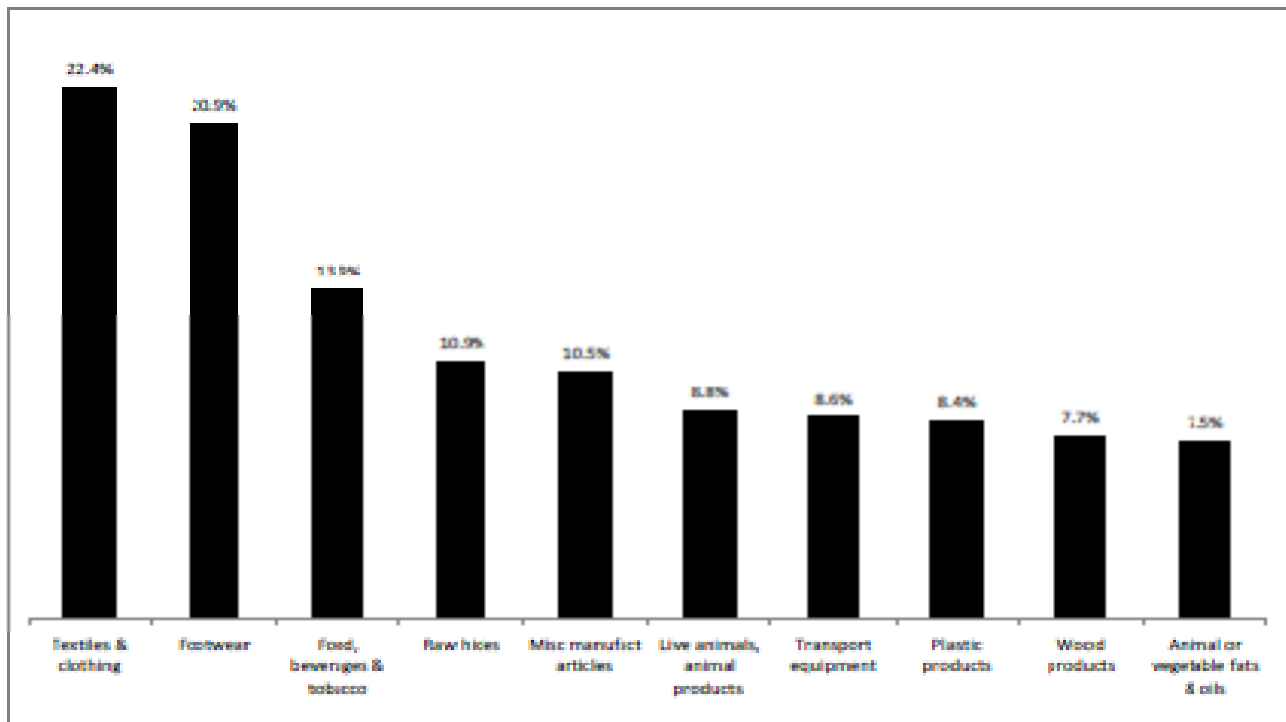
Nevertheless, the average tariff is still twice as much as in the European Union.

Source: Draper and Biacuana (2009), p.13.

Box 2: Purchasing power channel simulation for clothing and textiles, food and beverages, 2008

	S	T	PE	G
Food and Beverages:	18.28	13.9	-0.8	0.446
Clothing:	3.13	22.4	-0.8	0.115
Footwear:	1.29	20.9	-0.8	<u>0.045</u>
Sum:				**0.606**
Food and Beverages:	18.28	13.9	-0.2	1.784
Clothing:	3.13	22.4	-0.2	0.460
Footwear:	1.29	20.9	-0.2	<u>0.180</u>
Sum:				**2.424**

$$\varepsilon = \frac{dQ / Q}{dp / p}$$

G= S*(1-PE)*T/(100+T)   Symbols:

S: share of spending (weight in CPI)   T: tariff rate
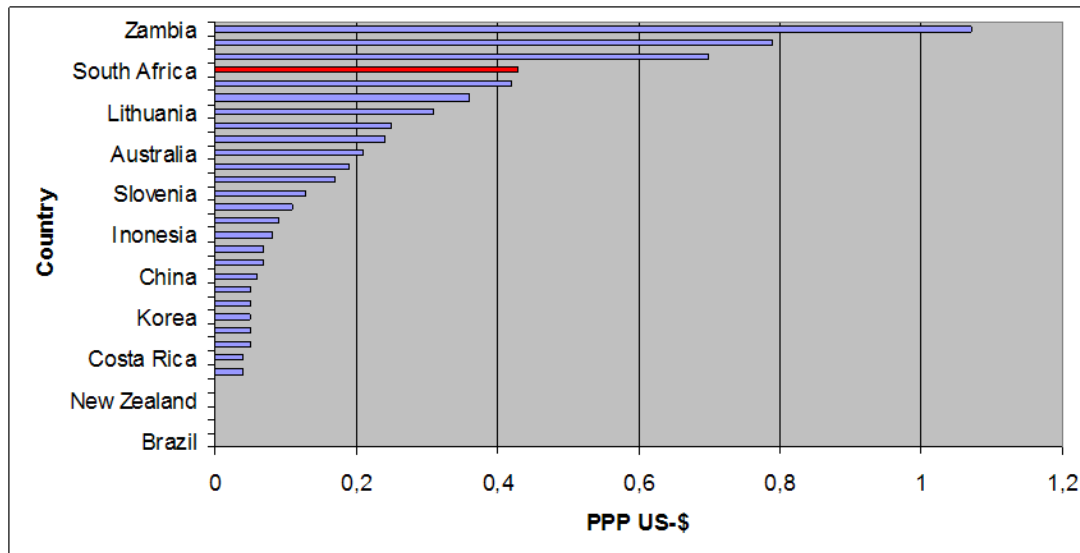PE: price elasticity   G: gain in purchasing power from zero tariff in per cent

Protection of Services

Particularly relevant:

➢ electricity
➢ transport
➢ communication

Figure 2: Telephone tariffs (3 min local call at peak time) around the world (selected countries)

South Africa is 106th of 118 countries.

Average is 0.20 US-$

Median is 0.06 US-$

Source: WEF and INSEAD (2010).

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Apart from direct protection, indirect measures can also be barriers to trade, even if not by purpose.

Trading across border 2009: international comparison

	Botswana	Brazil	China	India	Korea	Malaysia	Singapore	SA
Exports								
Documents[1]	6	8	7	8	3	7	4	8
Time[2]	30	12	21	17	8	18	5	30
$/container	2,810	1,540	500	945	742	450	456	1,531
Imports								
documents[1]	9	7	7	9	3	7	4	9
time[2]	41	16	14	20	8	14	3	35
$/container	3,261	1,440	545	960	742	450	439	1,807

[1]: number of necessary documents, [2]: time in days.
Source: World Bank (2009) and World Bank Website.

4) South African Trade Policy Initiatives

The South African government has issued two related strategy papers in 2010, the Industrial Policy Action Plan (IPAP, DTI 2010a) and the South African Trade Policy and Strategy Framework (TPSF, DTI 2010b).

In both documents the government addresses the problem of mastering structural changes and increasing employment.

The government also seems to be – at least partly – aware of the costs of trade policy, in particular with respect to the dynamic aspects. It states that the tariff structure is not adequate to support a modernization of the economy and concedes that "…we have chosen to focus not on upstream capital intensive projects, but on downstream, more labour intensive, and employment creative activities" (DTI 2010b, p.17).

In detail, the following components of the policy strategy can be discussed in relation to costs of trade protection:

➤ tariff structure;
➤ trade in services;
➤ procurement policy;
➤ technical standards;
➤ competition policy;
➤ capital costs;
➤ sectoral developments.

General comments:

➤ reference to the theory of strategic trade policy is very shaky;
➤ both initiatives show high trust in state bodies' ability to foresee the future;
➤ not much trust in private agents.

5) Policy Options

➤ tariff structure (Box 4)

➤ trade in services

➤ competition policy

➤ soft industrial policy

Box 4: Swiss formula

A given tariff (t^{old}) for industry (i) is changing to t^{new} the more, the higher the tariff is because a parameter (r) is added:

$$t_i^{new} = \frac{rt_i^{old}}{r + t_i^{old}}$$

In Table A1, the results for two simulation wit r = 30 and r = 5 are shown.
If r = 5, the maximum applied average tariff (for textile & clothing) is reduced to about 4.09 per cent, with r = 30, it still is 12.82 per cent.