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Dialogue on Promoting Trade Policy Reform in South Africa

Wednesday 23rd of March 2011

The Attic, Sunnyside Park Hotel, Johannesburg

Workshop Report

Background

The debate around the future direction of economic policy in South Africa continues and the focus is currently on the New Growth Path (NGP) that was unveiled by the Minister of Economic Development, Ebrahim Patel, late last year. Building on the events that we have hosted in previous years to discuss South Africa's trade policy, this dialogue aimed to contribute to the current economic debate through the discussion of topical issues that impact on the trading environment globally, in the region and at a domestic level. The Dialogue on Trade Policy Reform focused on:

- Scenarios for the global trade policy environment: including the impact of an outcome in the WTO Doha Development Round. What is the likely direction of shifts in 2011 and what will be the implications for South Africa?
- Services trade liberalisation: international focus from India; regional focus on services sectors in Southern Africa and recent negotiations of new regimes as well as a domestic focus on the impact of services liberalisation in South Africa, including on employment.
- Growing South African exports: what policy measures could be taken to assist exporters, especially small and medium enterprises, and is there a role for trade zones in this debate?

Keynote address - Enoch Godongwana, Deputy Minister, Department of Economic Development

Deputy Minister Enoch Godongwana raised the issues of employment creation and growth as the key objectives being pursued by the South African Government as far as trade policy is concerned. He emphasised how trade policy should be understood within the broader context of SA's developmental strategy. Government aims to address the structural constraints in SA's economy and also diversify the economy. Policy is guided in this context by the New Growth Path as well as the National Industrial Policy Framework. The basic thrust is to encourage value-added, labour-

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absorbing industrial production and reduce the reliance on commodity exports. This process is also guided by the international experience of successful developing economies that have adopted a 'strategic, gradual and selective approach' to tariff policy, rather than the big bang approach adopted by SA in the early 1990s.

On the WTO Doha negotiations, the Deputy Minister opined that the current texts would perpetuate inequalities in the global trading system and as far as the NAMA negotiations are concerned, the outcome would be particularly harsh for SA. This is partly because SA was classified as a developed country in 1994 and therefore had to implement huge tariff cuts. He stressed that a development outcome was far more important than an early outcome in the Round.

On services, the Deputy Minister stressed that SA's services are relatively open and at par with developed countries. He acknowledged the significant contribution of services to the SA economy and also as a fast growing sector.

In agriculture, he made note of the protectionist sentiment by developed countries and that agriculture continues to haunt multilateral negotiations. This is despite the fact that agriculture contributes less than 2% of GDP in developed countries. Yet, developed countries still demand greater market access in NAMA negotiations as well as services without making any concessions in the agriculture negotiations.

The challenge of regional integration to development was also cited. Deputy Minister Godongwana stressed the importance of building regional services infrastructure as well as harmonizing regional regulations.

In conclusion, the Deputy Minister emphasized the need to reinforce global structural shifts that favour emerging economies; to deepen links with emerging markets and to consolidate developing country solidarity.

In the Q and A session, the following issues emerged:

Some countries have transcended the notion of perpetual inequalities in the global trading system and have achieved this through market opening – examples would be Brazil, India and Malaysia as well as China in the build up to its WTO accession.

The demise of the television and bicycle industries in SA was questioned, particularly as both industries were historically protected. The participant also questioned SA's failure to compete in light manufacturing industries.

Other questions were on how competition policy fits in with the whole strategic objective of industrialization?

On the issues of South Africa's development strategy and regional integration, a participant questioned the compatibility of the two, arguing that SA's approach to industrial policy does not lend itself to deeper regional integration.

Another question was raised on the level of coordination between government departments to achieve government's development objectives.

Session One: WTO Scenarios for 2011

A presentation was made by Peter Draper from SAIIA, with Brendan Vickers from **the dti** and Joshua Setipa from the WTO Secretariat as discussants. The following key issues emerged.

The general situation is the current texts are unbalanced, particularly where the developed countries are demanding increased market access in NAMA and services while seeking to continue to protect their agricultural sectors and not willing to concede much.

In assessing whether agreement is possible in the current negotiations, opinion was varied as to whether the 'blockers' to a successful conclusion were the US and the EU, which broadly shares the US position; or the ACP countries; or the US and China combined. According to Peter Draper, one reality is that the US is the central actor in the WTO since the very formation of GATT and the current Round is where it is because of trade policy hibernation in the US. If the US can deliver on Doha, they would do so at a price and demand more ambition from developing countries on NAMA and services. In return, they might tinker with their agricultural subsidies but there is no optimism of real progress being attained in that regard. As far as the other players are concerned, Brazil has more wiggle room and is likely to come on board if offered more agricultural market access. China and India are defensive for all sorts of reason but they could possibly be enticed into a deal. With the US, EU, China, India and Brazil running together, SA could find itself isolated. The key issue for SA is the uneven NAMA - agriculture exchange rate.

Another view, from Brendan Vickers, was that the US and EU were failing to come to the party and join the majority consensus of developing countries. This view sees the DDA as a struggle terrain between developed and developing countries. The two major challenges to a resolution being that the level of ambition from the US and EU is too low and, there is no appetite for reciprocity, with the two not willing to pay for concessions made by developing countries. As far

as the US and EU are concerned, the only outstanding issues are the services and NAMA negotiations; the agriculture negotiations are already done. Dr Vickers sees a crisis looming in the Doha Round, with one alternative being that of the Director General of the WTO will put forward a text of his own accord. However there does not seem to be a role for the DG yet and no scope for a text by Easter 2011.

Joshus Setipa was of the view that the key to the deal is the US and China, and particularly if they can find agreement on services as well as the NAMA sectoral negotiations. In that case, Brazil would most likely come to the table. The EU trade policy now works on a weighted majority and therefore the DDA needs to be aligned with CAP reform as there are some countries in the EU that are very concerned about agricultural sensitivities. As far as SA is concerned, the need for flexibilities has already been established and agreed to. SA just needs to work out the details with the BLNS countries. In the agriculture negotiations, SA has failed to provide leadership and African leadership has actually come from the Cotton Four. The agriculture negotiations could be pursued more aggressively by SA and it could show more leadership in Africa on this issue. There is no DDA deal that can be achieved without a resolution of the cotton issue. While the question of a compromise text from the DG is a remote possibility, Mr Setipa sees a 60 – 65 % chance of concluding the Doha negotiations in 2011.

On the impacts and implications for SA, drawing from the views of the key stakeholders in South African trade policy, it emerged from Mr Draper's presentation that there was agreement by the stakeholders that developed country flexibilities in agriculture need to be curtailed. On the other hand, Mr Draper cautioned that while SA would want to be seen to support other developing countries, as an agricultural exporter, SA should be wary of other developing countries cutting out huge chunks of 'special products' in the flexibilities offered. On NAMA, the exchange rate with agriculture is lopsided. Developed countries expect bigger cuts of developing countries while they continue to pay subsidies. The agreement to give SACU a special deal is also very important from an SA perspective as there is a lot of contestation around tariff cuts. There does not seem to be a coherent position on services. This is long standing and one of the hurdles is the lack of a coherent voice from business in the services sector and no identification of key interests.

There is very little by way of new agricultural market access on the table. The NAMA carve –out for SA is still not complete. There are questions on how the special treatment for SACU will look, especially as there are very different interests across the SACU countries that would need to be satisfied. Once NAMA and agriculture are sorted, the pressure on SA will come in services trade. The view is that domestic liberalisation of the services sector, if properly implemented, would be in the

best interests of SA, especially in such key areas as telecommunications, finance, transport and electricity. (The Deputy Minister, during the Q and A session, stated that calling for the liberalisation of some of these sectors is like pushing an open door.) Dr Vickers countered this by saying that SA's services offer in the Uruguay Round negotiations goes way beyond other developing countries as well as the US. On NAMA, Dr Vickers stated that SA stood to lose more than it gained and also stood to lose future policy space on industrial policy. A development outcome, which is at the heart of the DDA, was more important than concluding the Round.

In the Q and A segment, the following issues were raised:

Has there been a clear strategic assessment of SA's interests in the agriculture negotiations?

There seems to be a gap between the agriculture negotiations and the food crisis as this crisis is not being factored into the negotiations.

One of the participants pointed to the need to differentiate between static and dynamic gains when discussing the gains from the DDA.

What happens if there is a total failure to resolve the DDA negotiations? What would SA's recourse be – greater recourse to the dispute settlement mechanism? Would SA get shut out of some markets, such as the Asia Pacific rim, through the proliferation of bilateral and regional trade agreements?

Session Two: Trade in Services

This session was focused on services trade from an international, regional and domestic perspective. Three papers were presented: one by Rupa Chanda and Pralok Gupta looking at services trade liberalisation from the Indian perspective, another by Matthew Stern looking at developments in SADC and the last one by Nicolette Cattaneo looking at the domestic impacts of services trade liberalisation, including on employment.

Pralok Gupta gave an overview of the services sector in India as the fastest growing part of the Indian economy, contributing more than 60% of GDP and also with a growing share in world services exports. Giving the examples of the telecommunications sector, the banking sector as well as the higher education sector, Mr Gupta highlighted the three key constraints that have challenged the liberalisation process: inadequate infrastructure, regulatory bottlenecks as well as political interference.

The general approach to services liberalisation in India has been to liberalise unilaterally and then gradually bind this liberalisation at multilateral level, either to the full extent or just below the autonomous level. The approach has been cautious and gradual, with a 'learning by doing' approach. In the DDA negotiations, India has left out the sensitive sectors in its offers as well as the sectors where there is stiff domestic opposition to liberalisation, although there are deeper openings operational in practice. Overall, liberalisation offers have been determined by political economy considerations.

As for the key lessons from India's reform experience, the issues have been different across sectors but the reform experience has not been smooth, it has been a drawn out process that involves new legislation and it has also been saddled by lack of political will. There has been a concerted effort to learn from experience; hence reforms have been gradual, with the intention of implementing evidence based reforms, drawing from partial liberalisation experiences within sectors. The liberalisation process has also served to highlight the inherent conflict of interest between certain stakeholders e.g. government versus private players; government versus independent regulators; public sector entities versus private players; large versus small private domestic players; large domestic versus large foreign players; and regulatory bodies/professional councils versus the government or versus foreign players. The pace and extent of liberalisation has been shaped by market structure and the regulatory framework, although private player dominated services have proven much harder to liberalise than government dominated monopoly type services. Liberalisation has also raised issues of balancing equity and efficiency concerns; balancing private and public interests and trying to find a balance between institutional autonomy and regulation.

It is very important in the liberalisation process to institute appropriate regulatory bodies with clearly defined roles, supported by improved governance. This is particularly paramount if regulation is to become effective. On the multilateral front, the bindings made or the offers made have been driven by the autonomous liberalisation process. The services sector has not increased its share in employment very significantly, it has been found that there is need for more broad-based growth within the service sector itself, in order to ensure balanced, equitable and employment-oriented growth, with backward and forward linkages to the economy.

Speaking to the regional dynamic of services trade, Matthew Stern outlined how services account for a large part of the FDI in the SADC region as well as an increasing share of overall employment. The services exports as well as the imports appear to be concentrated in certain specific services sectors.

Services trade liberalisation in the region is determined by three things: unilateral liberalisation; the EPA negotiations and the SADC Protocol on Trade in Services. Domestic liberalisation in the region is

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constrained by a range of factors that include domestic opposition to liberalisation, lack of the requisite expertise and resources, inability to improve access for domestic exporters, inability to address anti-competitive behaviour by foreign firms and lack of international credibility.

The EPA with the European Union seeks to cover trade in telecommunications, financial services as well as international maritime transport services and seeks to eliminate trade barriers on 'substantially all' trade in services within four years of the EPA coming into force. The region, however, is lagging behind on progress to achieve the 'substantially all trade' milestone.

The SADC Protocol offers a carve–out for MFN treatment and allows countries to negotiate bilateral preferences and exclude some sectors from MFN treatment. Countries are given the freedom to regulate for policy and development objectives and particular flexibility is allowed for countries disadvantaged by reason of size, structure, vulnerability and level of development. Six sectors have been identified for priority negotiation and these are: financial services; telecommunications; transport; energy services; as well as construction and tourism. However, negotiations on these sectors will only be assumed once the Protocol has been signed and ratified.

The key characteristics of services trade in SADC are that the service industries are large and increasingly important; however, they are largely uncompetitive. The region thus needs more competition in the services sector in order to improve efficiency. The EPA agreement provides such an opportunity, especially as the SADC Protocol is unlikely to move the SADC countries beyond their current commitments but the major problem is that it is largely driven by EU interests. Liberalisation of the services sector would result in increased FDI in the region; increased competition which would result in lower prices and better quality of services; the local industry would be able to access regional economies of scale; and it will also allow for the importation of international best practice.

Niki Cattaneo's presentation was focused on the domestic impacts of services trade liberalisation in SA, especially in relation to employment, growth and poverty. She identified the services sector as supportive and facilitative to manufacturing production and trade. In SA particularly, manufacturing is a significant source of demand for the services sector and hence a decline in manufacturing would adversely impact upon services as well as growth. While the services sector is important for employment creation, there is a distinction between sectors important for growth and sectors important for employment creation; with important policy implications. Dr Cattaneo particularly noted the pressure that is often exerted upon developing countries to liberalise their services sectors even before domestic regulatory frameworks and legislation have been put in place. Services liberalisation called for careful sector by sector analysis as the benefits of such liberalisation are usually simply assumed.

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With regard to SA, the country made significant commitments during the Uruguay Round of negotiations but little progress has been made on the multilateral front since then. The only sign of movement on the services liberalisation front is within SADC through the SADC Protocol on Trade in Services, while there is little movement in SACU on a common position for services trade liberalisation, partly due to the tensions surrounding the EPA negotiations. The EPA negotiations have also brought to the fore the debate around multilateral versus regional/bilateral services liberalisation as well as the importance of South-South configurations versus North-South ones. Some economic analysis suggests that a South-South regional approach would be more beneficial, especially in view of the targeted limitations in a North-South approach. Further research is needed to assess, in the SA context, which services should be: supplied within countries; internationalised within SADC; and/or sourced outside SADC. This needs to be carefully coordinated and aligned with the country's industrial policy.

SA has a critical unemployment problem and growth has been stagnant for a few years. While manufacturing and services have differing employment performances, manufacturing comprises a key source of demand for services and therefore a decline in manufacturing would have serious consequences for growth and employment. This is especially as, while employment multipliers for services exceed those for manufacturing in the aggregate, the opposite applies for low-skilled labour. In light of this, policies around services liberalisation need to be imaginative. SA should find ways of orienting FDI destined for the services sectors to support development goals. There are new opportunities for this in the innovations around energy, water, green and environmentally sustainable industry and services.

Wamkele Mene's presentation as a discussant focused more on the negotiations at the WTO. He identified the four key areas of negotiation: market access; rules; domestic regulation; as well as the LDC waiver. Mr Mene reiterated the importance of the services sector to the SA economy, both from a GDP and employment perspective. Also, the fact that SA's service sector is significantly open, flowing from the bindings made under the Uruguay Round. Mr Mene encouraged the use of sectors of 'comfort' to leverage concessions. SA has a particular interest in the domestic regulation negotiations as well as in the market access negotiations. On market access negotiations, while the *demandeurs* expect to get developing countries to bind their current levels of market opening they are not willing to eliminate restrictions in Mode 4 and make 'enhanced' Mode 4 offers. SA expects to see an LDC waiver as well as flexibilities for developing countries in the outcomes of the negotiations.

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Jonas Mosia responded to the presentations from the perspective of organised labour in SA. He noted the lack of job creation despite the growth of the services sector in the economy. Services have not been spared from the impact of the global economic crisis and there have been significant job losses. COSATU remains concerned about the further limitation of policy space for economic development in SA through multilateral and bilateral trade negotiations on services.

The following questions were raised in the Q and A session:

How many jobs has services liberalisation created? Of these jobs created, how many were sustainable? Are there prospects for employment creation in the future?

One participant stressed the need for the differentiation between liberalisation and regulation.

What will be the effect of the EPAs on services liberalisation as well as regional integration in the long run?

Session 3: The role of trade zones in growing South African exports

This session spoke to the role of trade zones in growing SA exports.

Neil Rankin gave some policy recommendations in his presentation, designed to support SA exporters. Exports break the domestic market constraint and have the potential for rapid growth while creating jobs – in line with the SA government imperative. However, exporting is a minority activity in SA and the typical exporter exports less than 10% of its output. Exporters are distinguished by the fact that they are larger; have higher labour productivity; are more capital intensive; and pay better than other firms. Important for exporters are the cost of doing business as well as trade facilitation and in SA the costs are very high. This means that firms have to be more productive in order to overcome business costs, particularly transport costs, as they have to be able to absorb these additional expenses. To start with, entry into the export market is costly and the volatility of future revenue streams can discourage entry.

In terms of policy, what the above translates to is that only large firms can become successful exporters. The pool of potential exporters can only be increased through firm growth and the entry of new firms. Promoting small firms is a waste of money while policies that are size dependent impose additional hurdles for exporters. Firms need to be high productivity and low cost to be competitive.

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EPZs therefore, would provide an opportunity to experiment with policies that are impossible and impractical to implement country-wide and whose outcomes are not certain. These are the kind of policies that would cover such things as: labour costs and bargaining council coverage; labour regulations and administrative burdens; company tax; as well as port costs.

Linking the above to SA's pressing employment needs as well as the development strategy; only 2 in 5 people of working age have jobs and creating 5 million new jobs would need the creation of approximately 13 600 firms in manufacturing alone.

Andre Erasmus' presentation was on industrial development zones in SA. IDZs provide tax and other incentives to export firms so as to attract new business and foreign investments in labour intensive manufacturing. In SA, IDZs were established by the Manufacturing Development Act whose objective is to promote manufacturing growth by way of incentives or concessions with regard to requirements within the framework of the economic policy in SA. Pursuant to this Act, Richards Bay, East London, Coega and ORTIA have been established as IDZs.

Mr Erasmus stated that while SA only recently introduced IDZs, our major trading partners have been running IDZs for decades – all with similar objectives. However, IDZs are important to attract investment but, in SA, the benefits of an IDZ alone are not sufficient to attract investors nor are there sufficient additional incentives available. The government has, in the recent budget proposals, undertaken to expand incentives for labour-intensive projects in IDZs and to offer Greenfield investments in IDZs additional tax relief.

There are additional measures that SA can implement to improve the situation of IDZs. Mr Erasmus identified some of them. Easing the labour-market related administrative requirements placed on investors for example, as well as 'site equalisation outlays' such as infrastructure subsidies and job-training subsidies. Relocation costs would also need to be paid to investors. Also needed in this equation are incentives to correct market imperfections and overcome transaction costs. Other options would be deductions or tax credits against profits that are re-invested in the host economy; incentives for transferring technology. Nonetheless, careful note should be made not to limit this support to manufacturing but to extend it to services and support industries as well.

Using the Walvis Bay as an example of IDZ, Mr Zunaid Pochee outlined the structure and operations of the Walvis Bay Corridor Group (WBCG). WBCG is a public-private partnership whose core business is business development; cross border trade facilitation as well as infrastructure. It has three main transport corridors: Transkalahari; Transcunene; as well as Walvis Bay-Ndola-Lubumbashi. The advantages of using these corridors are that: it offers an alternative trade route; it decreases the supply chain cost; it decreases the transit time; and also offers enhanced safety and

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security with a zero pilferage rate. Regionally, the benefits include reduced transport costs; the facilitation of regional trade and regional integration; alternative and more efficient trade routes; as well as a positive economic impact on export production.

In the discussion session, the following matters were raised:

A participant from the labour constituency wanted further clarity on what was meant by 'the easing up of labour market requirements'.

Given the distance of SA from other markets, there is motivation for the creation of a working and efficient IDZ.

Another participant called for a portfolio of bankable projects in IDZs and their advantages in order to entice investors.

There is a need for a broader discussion on promoting greater levels of exports and investing, especially as Export and Investment Promotion Agencies are basically glorified advertising agencies operating in a very competitive environment.

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