THE IMPACT OF TRADE LIBERALISATION ON THE SOUTH AFRICAN AUTOMOBILE AND TEXTILE INDUSTRIES

by

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Abstract

The impact of trade liberalisation on the South African automobile and textile industries

It is widely accepted that a country's foreign trade sector has a fundamental role to play in creating economic growth and development. It is therefore argued that one of the key objectives of any country's macro economic policy should be to create and maintain an internationally competitive manufacturing sector.

From a macroeconomic perspective it is of fundamental importance to South Africa to keep improving its export position if the country wants to achieve an economic growth rate of six percent per annum as set out in the GEAR strategy. South Africa's competitiveness and share in world trade can only increase if there is an increase in the levels op exports.

In order to achieve an increase in exports, the country had to travel a path of trade liberalisation. Due to different applicable tariffs and different reforms according to the GATT, it is difficult to examine the impact of trade liberalisation on all sectors of the economy. The aim of this study is to evaluate the impact that trade liberalisation in South Africa had on the South African automotive and textile industries. These two sectors were chosen due to the fact that they were formerly the most protected sectors and the assumption was made that the impact of liberalisation would be more evident in these two sectors than in those that were not so much protected.

The automotive industry has in recent years of trade liberalization experienced an increase in production and exports, but there was a reduction in employment levels. However, this can be ascribed to more effective production methods. Although the automotive industry experienced a rough

and sometimes difficult time to adapt to the liberalization process, it has completed the process of adaptation and is focused on being an international role player. On the other hand, the textile industry is experiencing difficulties in adapting to the process of liberalization and a more open economy. This is evident from the fact that the sector experienced a decline in production and employment levels.

The conclusion can be made that trade liberalization had some success in the automotive industry, but that the textile industry is struggling without protection. However, there is still a long road to travel before a definite conclusion can be drawn on the effect that trade liberalization had on the South African economy, especially with regards to exports as a means to boosting growth.

Opsomming

Die impak van handelsliberalisering op die Suid-Afrikaanse motor- en tekstiel-industrië

Daar word oor die algemeen aanvaar dat 'n land se buitelandse sektor 'n fundamentele rol speel in die ontwikkeling van ekonomiese groei en ontwikkeling. As gevolg hiervan word daar geredeneer dat een van die belangrikste doelwitte van enige land se makro-ekonomiese beleid, die ontwikkeling en instandhouding van 'n mededingende vervaardigingssektor is.

Vanuit 'n makro-ekonomiese perspektief is dit vir Suid-Afrika van kardinale belang om sy uitvoerposisie te bevorder, indien Suid-Afrika 'n ekonomiese groeikoers van ses persent per jaar wil bereik, soos dit in die GEAR strategie gestipuleer is. Suid-Afrika se mededingendheid en aandeel in wêreldhandel kan slegs verhoog indien daar 'n verhoging in die vlak van uitvoer is.

Suid-Afrika moes 'n pad van handelsliberalisering volg ten einde 'n verhoging in uitvoer te bewerkstellig. Die verskillende toepasbare tariewe en veranderinge wat in lyn met die Algemene Ooreenkoms insake Tariewe en Handel geimplementeer moet word, maak dit moeilik om die impak van handelsliberalisering op alle sektore van die ekonomie te ondersoek. Die doel van hierdie studie is om die impak van handelsliberalisering in Suid-Afrika op die Suid-Afrikaanse motor- en tekstielindustrië te evalueer. Hierdie twee sektore is gekies vanweë die feit dat dit die sektore was wat voorheen die meeste beskerming ontvang het. Die aanname is gemaak dat die impak van handelsliberalisering duideliker sou wees in hierdie twee sektore, as in ander sektore wat nie soveel beskerming ontvang het nie.

Die motorindustrie het gedurende die onlangse jare van handelsliberalisering

'n toename in produksie en uitvoer ervaar, alhoewel daar 'n afname in indiensname vlakke was. Hierdie daling in indiensname vlakke kan egter heel moontlik toegeskryf word aan meer effektiewe produksiemetodes. Ten spyte van die feit dat die motorindustrie 'n rowwe en somtyds moeilike tyd deurgegaan het om by die proses van handelsliberalisering aan te pas, het dié industrie die aanpassingsproses voltooi en is hul nou gefokus daarop om 'n internasionale rolspeler te word. In teenstelling hiermee het die tekstielindustrie probleme ondervind om aan te pas by 'n vryer ekonomie en die proses van handelsliberalisering. Dit blyk duidelik uit die feit dat dié sektor 'n afname in produksie en indiensname vlakke beleef het.

Die gevolgtrekking kan gemaak word dat handelsliberalisering sekere suksesse in die motorindustrie ervaar het, maar dat die tekstielindustrie steeds sukkel om sonder beskerming te funksioneer. Daar is egter nog 'n lang pad alvorens 'n definitiewe gevolgtrekking gemaak kan word oor die effek wat handelsliberalisering op die Suid-Afrikaanse ekonomie gehad het, veral met betrekking tot uitvoer as 'n maatstaf om groei te stimuleer.

To Jacques, Jeané and Bettie

Table of Contents

CHAPTER 2

TRADE LIBERALISATION

CHAPTER 4

OVERVIEW OF SOUTH AFRICA'S TRADE POLICY

CHAPTER 5

THE IMPACT OF TRADE LIBERALISATION ON THE SOUTH AFRICAN AUTOMOTIVE AND TEXTILE INDUSTRIES

List of tables

List of figures

ABBREVIATIONS

BTI	Board of Trade and Industry
BTT	Board of Tariffs and Trade
CBU	Completely build-up vehicles
CKD	Completely knocked down vehicles
DCCS	Duty Credit Certificate Scheme
DFA	Duty Free Allowance
DTI	Department of Trade and Industry
EMIA	Export Marketing Assistance Scheme
EOI	Export-oriented industrialisation
EPZs	Export processing zones
EU	European Union
FDI	Foreign direct investment
GATT	General Agreement on Tariffs and Trade
GDP	Gross domestic product
GEAR	Growth, Employment and Redistribution programme
GEIS	General Export Incentive Scheme
IDC	Industrial Development Corporation
IMD	International Institute for Management Development
IMF	International Monetary Fund
IRCCs	Import Rebate Credit Certificates
ISI	Import-substituting industrialisation
ISP	Industrial Strategy Project

ITRISA	International Trade Institute of Southern Africa
MIDP	Motor Industry Development Programme
NAAMSA	National Association of Automobile Manufactures of South Africa
OECD	Organisation for Economic Co-operation and Development
OEMs	Original equipment manufactures
PAA	Productive asset allowance
PGM	Platinum Group Metal
QRs	Quantitative restrictions
RDP	Research and Development Programme
SADC	Southern Africa Development Community
SAP	Structural Adjustment Programmes
SARB	South African Reserve Bank
SKD	Semi-knocked down vehicles
UNCTAD	United Nations Conference on Trade and Development
VEP	Value of export performance
VERs	Voluntary export restraints
WTO	World Trade Organisation

Chapter 1

INTRODUCTION

"While other sectors of the economy are important, the export sector is the engine of South Africa's growth into the global economy" (Alec Erwin, as cited in Wadula, 2002).

1.1 Problem statement

1.1.1 Introduction

Over the last 40 years of the previous century, several countries have been highly successful in increasing their incomes and reducing poverty levels. All of these countries increased their exports, as well as their trade to gross domestic product (GDP) ratio, and are now active partakers in the international trading environment. On the other hand, there are no examples of countries that have significantly reduced poverty without significantly increasing exports (Hoekman, Michalopoulos, Schiff & Tarr, 2002:3).

Greenaway (1993) described the foreign trade sector as having a fundamental role to play in economic growth and development - stating that it is the "handmaiden of growth". It can, therefore, be argued that one of the key objectives of a country's macroeconomic policy, and specifically its trade and industrial policy, is to create and maintain a sustainable internationally competitive manufacturing sector. This will be a factor in achieving socio-economic goals such as job creation, higher income generation and higher economic growth rates.

Several studies have tried to determine the relationship between exports and economic growth and in particular the causality (Greenaway

& Stapsforth, 1994).

Du Plessis, Smit & McCarthy (1998) argue that since exports are a component of GDP, it follows that an increase in exports will result in an increase in the GDP. It cannot be stated irrefutably that exports cause growth, but it will be difficult for an economy to grow without exports. Trade, and for the most part exports, forms an important component of growth.

Openness to trade has long been seen as an important element of good economic policy, and trade liberalization as a necessary step for achieving it. There is a growing consent in the economic literature and amongst policy makers that an outward-looking trade policy is constructive for economic growth and exports and there are little evidence that it is harmful to growth. Countries that pursue strategies based on export promotion and export-led growth tends to achieve greater success in terms of real gross domestic product (GDP) growth than those that sought to achieve growth based on import substitution and domestic demand (Winters, 2000:1). The reason is stated that, in part, outward-looking trade policies improve productivity growth. This argument has also gained status in debates on the South African economic policy (Valodia, 1998:2).

Various individual country studies over the past 30 years suggest that trade seems to create growth and even sustain higher growth. Winters (2000:11) argued that openness is an important element of any policy aimed at promoting growth. Openness to trade and investment promotes integration into the global trading environment. This also makes the import of diverse and modern technologies possible, which is necessary for productivity improvements (Hoekman *et al.*, 2002:1).

1.1.2 The importance of trade

1.1.2.1 Theoretical evidence

Theoretically, the impact of trade liberalization on economic growth is uncertain. In a typical neoclassical growth model, trade does not affect the equilibrium or steady state rate of output growth because, by assumption, growth is determined by an exogenously given technological progress. In two-sector models of this kind, trade policy affects the resource allocation between sectors and thus the steady state level of savings and capital accumulation. This can have a one-off effect on the steady state level of output (which can be positive or negative depending on how savings and capital accumulation are affected by trade policy) but not on the rate of growth (Johnsson & Subramanian, 2000:198).

In endogenous growth models, however, the impact of trade liberalization on output growth can be positive or negative, depending on model-specific assumptions. Increased trade *per se* can have a number of widespread impacts. For example, trade enables a country (i) to employ a larger variety of intermediate goods and capital equipment which could enhance the productivity of other resources; (ii) to acquire technology developed worldwide; (iii) to increase the diversity of products produced and consumed; and (iv) to improve efficiency with which resources are used. However, as emphasized by Rodriquez and Rodrik (2000:12), the impact of trade policy changes cannot be indicated without conviction. If the resource allocation effect of trade policy supports sectors or activities that cause more long run growth, the impact is positive, and negative otherwise.

The new trade theory implications have also been supported by research findings on liberalization. Although positive association has been found between exports and growth, the relationship with liberalization is unsure

(Roberts, 2000:612).

1.1.2.2 Macro-advantages of international trade

The important role that exports plays in the competitiveness of a country can be seen in the various advantages it holds. The advantages for a country involved in international trade are, *inter alia,* an increase in the level of technological development, better use of natural resources in terms of their comparative advantage, greater job opportunities, an increase in the demand for a country's output, more efficient management, the opportunity to develop and expand beyond the domestic market together with international competition as well as the ability to earn the necessary foreign currency to pay for essential imports and services (Blatch, Parry & Smith, 1995:7; Krugell, 1999:10).

It is widely held that the failure to participate in international trade gives surety to a country of a decline in economic influence and its citizens of a decrease in their standard of living. Countries and firms that successfully trade internationally enjoy an improved quality of life, a more peaceful world, a better society and higher profits and wages (Czinkota, Ronkainen & Moffet, 2000:18).

1.1.2.3 The importance of trade in the globalised world

The value of global merchandise exports in 2003 were estimated at 7 482 241 million US dollars, while global merchandise imports were approximately 7 764 943 million US dollars (WTO, 2004a). More countries are becoming aware of the fact that is essential to trade with one another, and they appreciate the importance of being part of a global economy (DTI, 1997:5).

Globalisation is a phenomenon whose economic component involves increases in the flows of capital, information and commerce, as well as the mobility of people across borders (ITRISA, 2001:5; Kusi, 2002:1). The last five decades have witnessed an increase of global economic integration and the opportunities and challenges it presents to both developed and developing countries. This period of increased globalisation has also been associated with an expansion in global trade as well as a rise in the standard of living. The globalisation process has been driven by a powerful convergence of forces, reflecting liberalization of economic policies and technological advancements in transport and communication networks (Kusi, 2002:1).

While increased international trade and capital flows associated with globalisation have been the causes of the unparalleled rise in living standards around the world, neither the process of globalization nor the returns thereon are guaranteed. Not all countries have benefited from the process of globalization, nor have all citizens of a given globalised country prospered. Countries that have shared in the benefits of globalization are those that have pursued outward-looking export promotion rather than inward-looking policies of import substitution. These countries have also put structural reforms in place in order to develop the institutions necessary for good governance and economic growth and to increase the agility of their economies (Masson, 2001:2).

1.1.2.4 The role of trade in a country's competitiveness

Competitiveness refers to a country's ability to realise central economic policy goals, especially growth in income and employment, without running into balance of payments difficulties. Competitiveness, however, may also be defined as the ability of an economy, or sectors of it, to compete in world markets. Traditional sources and indicators of competitiveness in this sense are movements in real exchange rates, productivity and unit labour costs, which are all indications of price-competitiveness. As distinct from these, there are various sources of non-price competitiveness, such as product differentiation and innovation, as well as access to finance (Bell, Farrel & Cassim, 1999:1).

One measure of competitiveness is the one that is used by the International Institute for Management Development (IMD) and defines competitiveness on economic performance, government efficiency, business efficiency and infrastructure (IMD, 2004a:1).

1.1.3 Trade liberalisation

1.1.3.1 Arguments in favour of trade liberalisation

Studies on the outcomes of the global trade reform have found that openness is associated with more rapid growth. Reducing tariff and non-tariff barriers is estimated to have produced annual increases in global GDP of between US$ 100 billion – US$ 300 billion, which is 1,5 to 5 times the total aid that flows to developing nations. Moreover, most of the benefits go to countries that offered the most reduction in tariff and non-tariff barriers (Harrison, Rutherford & Tarr, 1997; Whalley, 2000).

According to World Bank classification of countries, based on the extent to which countries increase trade relative to income in the post-1980 period, the top third of developing countries – classified as the "new globalizers" – lowered average import tariffs by 34 percentage points and increased trade relative to income by 104 percent. In these countries, per capita income grew by 3,5 percent per annum in the 1980's and 5 percent in the 1990's. In contrast, the remaining developing countries – termed the "marginalized countries" – lowered tariffs by only 11 percentage points and experienced little or no growth in GDP per capita in the post 1980 period (Dollar &

Kraay, 2001:2).

Numerous studies agree that, over the long term, the most successful economies are, for the most part, open and geared for international competition rather than seeking to defend inefficiency and inward looking from the realisms of the world (Anon, 1999:11). Although there is no final answer, most studies seem to indicate that exports do indeed contribute to growth (Greenaway & Stapsforth, 1994).

Empirical evidence on trade policy and growth shows differences in growth performance associated with liberalisation and protection. The empirical evidence, however, suggests that promoting openness, and supporting it with sound domestic policies, leads to faster growth. The earlier strategy of attempting to grow through import substitution has been conclusively shown to have failed, as there are no successful cases of fast-growing countries that have followed this strategy in the recent past (Kusi, 2002:2).

A growing body of literature demonstrate that trade liberalisation is more important in terms of its distributional effects than it is important directly to growth. The main reason for this assertion is that resources get re-allocated from one sector to another as the economy is opened to international competition (Cassim, Onyango & Van Seventer, 2001:5).

1.1.3.2 Arguments against trade liberalisation

As with technological change, however, not everyone benefits from trade reform. As countries make better use of their comparative advantage, formerly protected sectors may shrink and their workers suffer. However, detailed studies of trade reform suggest that the gains are far greater than the costs (Matusz & Tarr, 1999:34).

1.1.4 The South African situation

1.1.4.1 Background

South Africa has been engaged in international trade since the mid - 1600s when a provisioning station for passing ships was established at the Cape of Good Hope. For the first few centuries thereafter, South Africa exported agricultural products and imported virtually everything that could not be made from local resources. The discovery of diamonds and gold in the 1870s and 1880s and the subsequent development of the world's largest diamond and gold mining industries changed the shape of the South African economy and its international trade patterns. Gold and diamonds became South Africa's major exports, although agricultural produce still featured. Imports subsequently included mining machinery and related equipment, as well as consumer goods, building materials and all the other items required by the country in general (Anon, 2002:34).

In nominal terms, exports increased steadily from 1950 onwards. From a total of $1 150 million in 1950, exports increased to some $3 344 million in 1970, $23 549 million in 1990, and finally to $36 452 million in 2003 (WTO, 2004a:1). However, as stated in Kusi (2002:9), exports as a share in nominal GDP declined from a peak of 33 percent in 1980 to 22 percent in 1990. Thereafter, it increased steadily, reaching 25 percent in 2000. As percentage of world exports, exports from South Africa experienced a steady decline throughout the 1980s and 1990s. Exports declined from 1,3 percent of world total exports in 1980 to 0,5 percent in 1999 and 0,3 percent in 2002 (WTO, 2004b).

The relationship between South Africa's merchandise exports and world merchandise exports is illustrated in table 1.1 (in US dollar millions).

Table 1.1: Relationship between South Africa's merchandise exports and world merchandise export in US dollar millions

Year	World merchandise exports	South Africa's merchandise exports	South Africa's merchandise exports as percentage of world merchandise exports
1980	2 034 137	25 525	1.25
1981	2 010 178	20 658	1.03
1982	1 882 845	17 673	0.94
1983	1 845 775	18 508	1.00
1984	1 956 259	17 163	0.88
1985	1 953 753	16 293	0.83
1986	2 138 125	18 385	0.86
1987	2 515 571	21 219	0.84
1988	2 868 690	21 871	0.76
1989	3 097 844	22 191	0.72
1990	3 448 747	23 549	0.68
1991	3 514 880	23 279	0.66
1992	3 765 626	23 440	0.62
1993	3 777 099	24 222	0.64
1994	4 325 623	25 308	0.59
1995	5 161 533	27 853	0.54
1996	5 391 228	29 221	0.54
1997	5 577 102	31 027	0.56
1998	5 495 966	26 362	0.48
1999	5 708 045	26 707	0.47
2000	6 446 296	29 983	0.47
2001	6 196 205	29 258	0.47
2002	6 477 366	29 723	0.46
2003	7 482 241	36 452	0.49

Source: Own calculations of data from WTO, 2004

From table 1.1 it is clear how South Africa's share in world merchandise exports has declined from 1980 to 2003.

Although South Africa is a middle-income, developing nation with an abundant supply of resources (Anon, 2002b:3), it only managed to achieve an economic growth rate of three percent in 2001 and 2002 respectively (WTO, 2004b:1). From being a very protected economy, South Africa is now far more open than many other semi-developed and developing nations, with a trade to GDP ratio for the period from 2000 to 2002 of 58,7 (WTO, 2004b:1).

South Africa is ranked among the top 40 trading nations in the world, but is still a rather small player in the field of international trade, contributing only 0,48 percent to total world exports and 0,45 percent to total world imports in 2002 (WTO, 2004a:1). The World Competitiveness report ranked South Africa in the 49th place out of 60 countries in terms of overall ranking in 2004 (IMD, 2004b:1).

1.1.4.2 The importance of trade in the South African economy

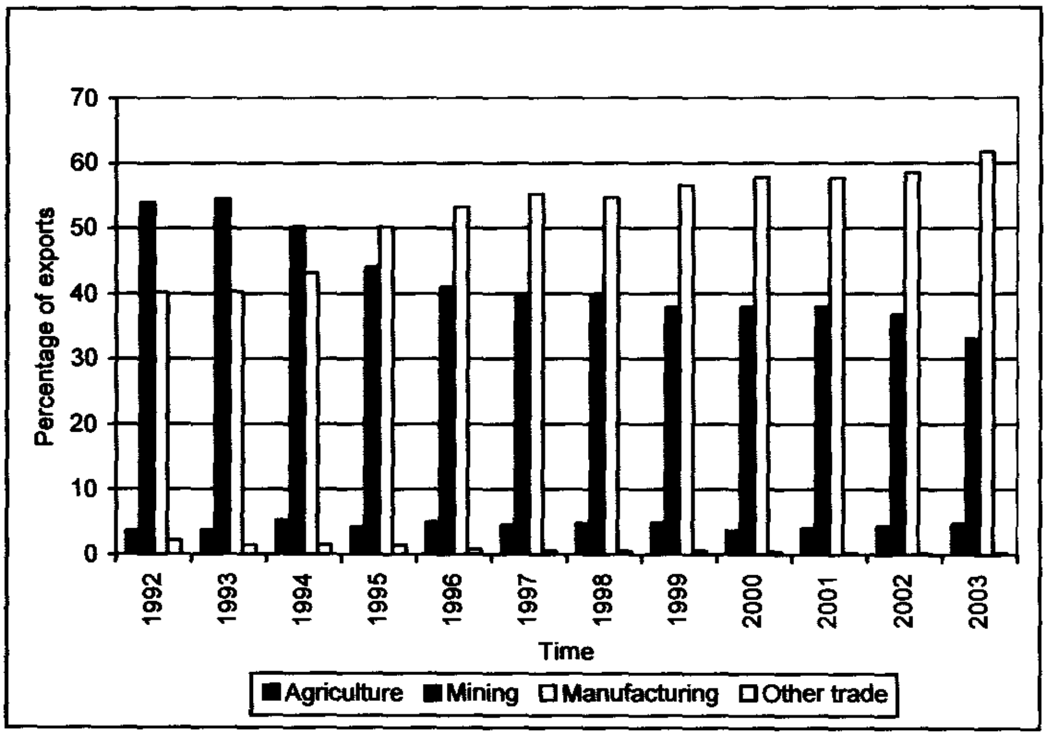
From a macroeconomic perspective it is of fundamental importance to South Africa to keep improving its export position if South Africa wants to achieve a real economic growth rate of six percent, repay international debt and provide a necessary source of income and foreign exchange to pay for essential imports and services (Anon, 1999:34).

One of the means of boosting growth, which is vital if the country has to deal with its own pressing developmental needs and play its full role in helping revive the prosperity of the African continent, is tapping efficiently into world trade (Hobday, 2002:43). South Africa's competitiveness and share in world trade can only increase if there is an increase in the level of exports. Although statistics show that exports have increased in recent years, from 24,50 percent of GDP in 1996 to 28,19 percent in 2002 (WTO, 2004a), it is not enough to sustain an economic growth rate of six percent.

Seldom has the South African economy needed successful exporters as it does today. A study in 1995 by Calof and Viviers showed that approximately ninety percent of South Africa's enterprises fall into the category of small- or medium-sized, but only three percent of them are exporting (Calof & Viviers, 1995). This relationship is probably still valid. This means that there are a few large exporters who are relied on to bring in foreign currency and that only a small number of South Africa's small businesses, which form the biggest part of the South African economy, are involved in international trade.

Another concern is that South Africa's exports are mainly taken up by mineral and primary manufactured products as can be seen in figure 1.1

Figure 1.1: Structure of South African exports from 1992 to 2003



Source: DTI, 2004a

The vision of the South African government to incorporate the South African economy into global markets is set out in its official macro-economic strategy, the "Growth, Employment and Redistribution (GEAR)" strategy, that was published in 1996 (RSA, 1996).

South Africa is seriously dependant on a buoyant export sector if it is to come anywhere near achieving the kind of high and vitally sustainable rates of increase in annual real GDP of six percent which are projected in the GEAR-strategy. This is strongly indicated in the general correlation between real economic growth in South Africa and real rises in export volumes, and equally the negative effect on South Africa of a slowdown in global trade (Preece, 1997:19).

1.1.4.3 Trade liberalisation in South Africa

To share in the benefits of globalisation, South Africa has been engaged in a strategy of trade liberalisation since the early 1980s. However, the drive for liberalization gained momentum in the first half of the 1990s, during which period broad reforms in trade policy were introduced. During this period South Africa adopted a two-pronged approach to trade policy, namely multilateral and unilateral trade liberalisation (Cassim *et al.*, 2001:5; Kusi, 2002:1).

However, of specific importance is the signing by South Africa of an agreement with the WTO in 1994, which duty-bound the country to an eight-year trade reform programme from January 1995 (Jenkins & Siwisa, 1997:1). On at least four occasions in the first three years of the programme, tariff reduction and subsidy removal were actually accelerated. The government is clearly confidant that trade reform is more apt for job creation than is further protection of domestic firms (Gunning, 1998:56).

The tariff liberalisation programme goes further than required by the General Agreement on Tariffs and Trade (GATT), and has been justified in the South African Government's macro-economic strategy (GEAR) as being crucial for the generation of export-led growth (Roberts, 2000:607).

The key causes for this progress are found in the export-supporting measures of the South African government. An improved export position can be a major mechanism for economic growth in South Africa. South Africa has considerable potential for ongoing economic growth and a role as a major competitor in the world economy. The future of the country, however, will largely depend on the extent to which the government succeeds in accomplishing the goals of the Reconstruction and Development Programme (RDP) and the GEAR (Kievit, 1997:15).

1.1.5 Conclusion

Higher and sustained export growth seems to be a necessary prerequisite if South Africa is to relax its monetary policy stance and stimulate domestic demand. Higher export volumes could increase South Africa's foreign exchange reserves and thus diminish the hold of what has been described as the "iron law of the balance of payments" (Naudé, 2000:246).

From a policy point of view, an assessment of the influence of the trade reforms on economic growth is imperative, as liberalisation forms a critical element in the government's efforts to boost the foreign trade sector of the economy. Due to different applicable tariffs and different reforms according to the GATT, it is difficult to examine the impact of trade liberalisation on all sectors of the economy. This study focuses on the effect that South Africa's trade liberalisation from 1990 to 2004 had on the automotive and textile industries. The reason that these two sectors are selected are the fact that these two sectors were previously the most protected sectors and the impact of trade liberalisation on these two sectors will most likely be more evident than in the other sectors that were not so protected.

1.2 Objective

The aim of this study is to evaluate the impact of South Africa's trade liberalisation on the South African automotive and textile industries.

1.3 Method

In this study a literature study will be done where secondary sources of information are collected via the World Wide Web, research papers, textbooks etc. In addition to the literature study, data from a number of sources will be used, including the DTI, WTO, NAAMSA and the Textile Federation. The data will be analysed and used in calculations with the aim of making comparisons and identifying trends to determine the impact of trade liberalisation on the South African automotive and textile industries.

1.4 Demarcation of the study

This study will focus on South Africa's trade policy and process of trade liberalisation and the effect it had on the South African automotive and textile industries respectively. The study will focus only on the impact of trade liberalisation on these two sectors with regards to production, trade and employment and not on the relevance of any particular trade policy.

1.5 Chapter outline

Chapter one will give an overview and introduction to the study by means of the problem statement, objective, methodology, chapter outline and demarcation of the study field.

Chapter two provides an in-depth discussion of the theory, importance and necessity of trade liberalisation. Focus will be placed on the various types of trade liberalisation and theoretical evidence in favour of and against trade liberalisation. The timing and sequencing of trade liberalisation and the impact of trade liberalisation on the economy will be discussed. Complementary policies to the process of trade liberalisation will also be stated.

Chapter three will define trade policy and discuss the various trade policy instruments that policy makers can implement in order to influence trade.

Chapter four will give an historic overview of South Africa's trade policy. Detailed overviews will be given to the policies that were applicable during the following periods: 1925 to 1972, when a policy of import-substitution was followed, 1972 to 1983, which was regarded as the first liberalisation episode, 1983 to 1991, when the second period of trade liberalisation took place and finally from 1994 onwards.

Chapter five undertakes an analysis on the impact that trade liberalisation in South Africa had on its automotive and textile industries. Specific focus will be placed on the impact of liberalisation on these two sectors' production, exports and imports, as well as employment.

Chapter six concludes the findings of the study and presents recommendations.

Chapter 2

TRADE LIBERALISATION

2.1 Introduction

In practice, the most practical way of stimulating trade and opening up to the international arena is through liberal trade regimes, rather than through a multifaceted structure of protection and export incentives. Trade liberalisation is the means by which outward-orientated regimes are put in place.

In this chapter an in-depth discussion will be given of the definition of trade liberalisation and the elements of a liberal trade regime, different types of trade liberalisation, the arguments in favour of and against trade liberalisation, and the timing and sequencing of reform. The impact of trade liberalisation on economic growth, macroeconomic stability, government revenue and spending, the prices of goods and services, wages and employment, adjustment costs and poverty will be analyzed. In the last section the use of complementary policies in the process of liberalising an economy will be discussed where after conclusions will be drawn.

2.2 Definition

It is important at the outset to be clear what is meant by the expression 'trade liberalisation'. In a two sector Heckscher-Ohlin world the following prevails: The removal of a tariff, or indeed any other intervention that re-establish the free trade set of relative prices is unambiguously trade liberalisation (Greenaway, 1998:2; Kusi, 2002:2).

Bienen (1990) gives a broader definition of trade liberalistion: The relaxation or elimination of tariffs and removal of duties and/or quotas on exports, modification in non-tariff barriers such as import quotas and quantitive restrictions, alterations in licensing and direct allocation of foreign exchange and in specific regulations for products, and removal or relaxation of export subsidies.

However, in practice things are more complex and there are at least two other definitions which are used: firstly the changes in policy that reduce anti-export bias and, secondly, the move of the relative prices of tradeables towards neutrality and the substitution of more efficient for less efficient forms of intervention. These two have common characteristics: since protection is a relative concept, reducing import barriers will reduce anti-export bias and move relative prices towards neutrality. However, they do not map on to one another on a one-to-one basis. It is possible to engineer a more neutral set of relative prices by introducing export subsidies against the background of a pre-existing import tariff and, of course, the resource allocation effects of the two may be at variance (Greenaway, 1998:2).

Although trade theory indicates some striking non-equivalences between tariffs and quotas, the theorist might not regard the substitution of the latter with the former as liberalisation. Policy analysts do, and this particular reform is a standard constituent of World Bank liberalisation packages. Thus, trade policy liberalisation is any policy reform that unambiguously moves the relative prices of tradeables towards neutrality. Not only does this include the first notion, it incorporates a wider set of choices of policy reforms (Greenaway, 1998:2).

2.3 What is a liberal trade regime?

The key fundamentals of a good trade policy regime include predictability, transparency, and uniformity. The following aspects describe in a nutshell the things that signify a liberal trade policy regime. These provide a benchmark against which to judge the existing trade regime and provide guidance for the direction of reforms (Hoekman *et al.*, 2002:30):

- No licensing or other approvals, except for health, safety and environmental reasons and automatic licensing used for statistical purposes.

- No other quantitive restrictions.
- Low and uniform tariffs. If the tariff is not uniform, it should have little dispersion, with only a small number of bands. A few sectors with very high tariffs should be especially avoided.
- If tariffs are important for revenue generation, uniformity implies that the overall level of the tariff should be such as to generate the revenue required. However, some products – such as alcohol and tobacco products – may be subjected to high duties to raise revenue, as long as correspondent excise taxes are imposed on domestic production.
- An efficient customs clearance process with little red tape that guarantees tariff-free access to intermediate imports for exporters.
- Only one instrument of contingent protection – a safeguard provision – and no antidumping.
- Contestable service markets: Measures should be established to ensure that competition prevails and that there is no discrimination against foreign suppliers that seek to establish a presence in the market.

2.4 Types of trade liberalisation

Trade liberalisation can be categorised into three dimensions, namely:

2.4.1 Economy-wide trade liberalisation

Economy-wide trade liberalisation is evident in countries that steered away from non-tariff barriers or made use of low uniform tariffs, such as Hong Kong, Singapore and China.

2.4.2 Protection with offsetting policies for exporters

Hoekman *et al.*, (2002:3-4) argues that several countries that experienced rapid growth in trade and GDP did so in the framework of trade regimes characterised by major import controls on the domestic market. The key to understanding these occurrences has to do with looking at all the factors that have an effect on competitiveness and the incentives to producers to sell in the local market versus the global market. Protection gives rise to incentives to produce and sell to the domestic market, i.e. protection creates a bias against exports. Indeed, protection of intermediate products and services creates a significant handicap to export industries because it raises their expenditure to levels that are higher than those of their potential competitors in global markets, and they are disheartened through the impact of protection on the real exchange rate.

2.4.3 Protection with export processing zones (EPZs)

In a protected trade regime that dissuades exports, export-processing zones (EPZs) may be used to partly place exporters on an even footing to producers for the domestic market. Exporters in an EPZ have tariff free access to intermediate inputs and often have fewer regulatory constraints on their dealings (Hoekman *et al.*, 2002:3-4).

2.5 Theoretical evidence

2.5.1 Arguments in favour of trade liberalisation

2.5.1.1 Economic growth

Economic growth is defined as an increase in the level of the production of goods and services by a country over a certain period of time, usually one year (Anon, 2004:1). One measure for calculating growth is the use of a country's GDP.

It is stated in chapter one that since exports are a component of GDP, it follows, that by definition, an increase in exports will result in an increase in GDP.

The fast growing East Asian economies are an example of the economic growth benefits of more open and outward-oriented economies

(Loots, 2002:2).

2.5.1.2 General efficiency gains

2.5.1.2.1 Macro perspective

The rationale for liberalisation rests on the broad efficiency gains to be achieved from international trade through unregulated markets. This is premised on a specific causality, namely that cutting protection and reducing tariff levels leads to a country producing and exporting according to its comparative advantage. Under this viewpoint, liberalisation enhances allocative efficiency and eradicates dead-weight losses. In other words, it is argued that liberalisation increase the benefits from trade as there is further specialisation in production and increased exports, allowing greater imports and consumption (Roberts, 1998:3; Roberts, 2000:610; Cassim, 2001:1).

2.5.1.2.2 Micro perspective

Trade liberalisation puts more pressure on domestic manufacturers who respond by increasing their efficiency. Secondly, trade liberalisation may lead to larger markets for local producers through exports. This will lead to an increase in production that will then enable producers to take advantage of economies of scale. Thirdly, producers can source products internationally and therefore at competitive prices. Manufacturers will also be able to alter production processes to make use of inputs that are not readily obtainable in the local market (Gouws, 2002).

2.5.1.3 Dynamic gains

In addition to the static allocative efficiency gains, dynamic gains such as increased dispersal of knowledge and technology, increased competition, more production in sectors with higher income and price elasticities and increased investment are mentioned in support of an outward-looking policy (Roberts, 2000:610).

2.5.1.4 *Poverty alleviation*

Trade liberalisation is commonly a collaborator in the fight against poverty as it tends to increase average incomes, providing more resources with which to challenge poverty, and, while it will generally affect income distribution, it does not do so in a systematically adverse way (Winters, 2000:1).

2.5.1.5 *Financial assistance*

Multilateral establishments such as the International Monetary Fund (IMF), the World Bank, and the Organisation for Economic Co-operation and Development (OECD), encourage developing countries to embark on trade liberalisation and to open their economies as a prerequisite for receiving financial assistance (Loots, 2002:2).

2.5.1.6 *Reduced risk*

A common concern is that the opening up of an economy will expose it to increased risk. Certainly, it will expose it to new risks, but very often the net effect will be to reduce overall risk because global markets are more stable than domestic markets. Moreover, if trade liberalisation allows producers to combine foreign and domestic risks more economically (because part of their output or input relies on foreign markets and part on domestic ones) they will encounter lower variability overall because it is very unlikely that domestic and foreign markets will both be very good or both be very bad together (Winters, 2000:9).

Sometimes, however, openness will increase risk either because effective approved stabilisation programmes are undermined or because residents turn fully from one activity to another that offers higher average rewards but greater vulnerability (Winters, 2000:10).

2.5.2 *Arguments against trade liberalisation*

2.5.2.1 *Diffuse nature of trade liberalisation*

Even when trade liberalisation will benefit the poor and the economy broadly, it will often be defied. The sectors with the utmost protection know they receive concentrated benefits from protection and they will be against the liberalisation. The expansion of exports due to liberalisation is likely to spread throughout the economy, often with new and sometimes unforeseen industries arising. It is often difficult to identify future exports and exporters. Thus, the employment and income benefits form liberalisation are likely to be diffused. The same is true for the consumers who will benefit from the liberalisation through lower prices and greater choice. The diffuse nature of the benefits to consumers and producers explains why those who contest liberalisation often are assertive in political lobbying. The redistributive effects of trade liberalisation can be a key factor obstructing the launch of welfare-improving policy changes (Rodrik, 1998).

2.5.2.2 *Unsuitable assumptions of traditional trade theory*

The move towards an unbiased trade regime rests on traditional trade theory and its assumptions of perfect competition, constant or decreasing returns to scale, no externalities, homogenous products and the country being 'small'. There has, however, been a mounting accord in the trade theory literature that imperfect markets, externalities and imperfect competition are not only significant realities to be considered, but are often determinants of trade flows (Roberts, 2000:611).

A mass of 'new trade theories' attempt to include these factors, with outcomes that depend on the particular assumptions made. In general, however, they establish that it is not justified to take for granted that free trade is most favourable as an end point (Krugman, 1987:131-144). It is also far from certain in the incidence of omnipresent market failures and imperfect competition that industry will respond to changed incentives under liberalisation in the way predicted by traditional trade theory based on efficient markets. New trade theories may also be more pertinent to developing countries due to the small size of the domestic markets, greater concentration of industry and more widespread market failures in, for example, financial markets (Rodrik, 1992:309-320). In addition, dynamic effects such as those outlined above will not inevitably be realized under free trade and may instead constitute a case for government intervention (Dasgupta & Stiglitz, 1988:246-268; Schydlowsky, 1984:439-450; Roberts, 2000:612).

2.6 Empirical evidence

Many comparative studies on the impact of liberal trade policies on the growth and economic performance of a number of countries have been done since the 1970s. According to Loots (2002:2) well-known economists such as Bela Balassa, Anne Krueger and Jagdish Bhagwati, to name a few, were involved in these different studies.

According to Krugell (1999:10-11), Edwards (1993) distinguishes a two-stage methodology in this regard. First it is assumed that more liberalised economies experience faster growth in exports. The second stage tests whether countries with a faster growth of exports have also experienced a more rapid rate of growth of GDP. Michaely (1977) used Spearman's rank correlation and found a positive association between exports and economic growth and that a minimum level of development is essential for exports to benefit growth. This was later supported by Heller and Porter (1978). Balassa (1978) determined that exports have a positive effect on economic growth over and above the contributions of domestic and foreign capital and labour. Krueger (1981) found that export promotion strategies may not always cause export growth, but policies to encourage import substitution may hinder growth. Tyler (1981) stated that a positive and noteworthy relationship exists between economic growth and manufacturing export growth. Kavoussi (1984) examined the effect of export growth on total factor productivity and found that a positive relationship is receptive to the share of manufactured goods in total exports. Ram (1985, 1987) found that exports are vital for growth, also in low-income less developed countries. The stronger positive relationship for low-income, less developed countries was also found by Moschos (1989). Regarding the direction of causality, Chow (1987) finds unidirectional causality where exports promote economic growth and structural transformation of the economy. Bhomani-Oskooee *et al.* (1991) determined that there is a positive causality form economic growth for countries that are well known cases of successful export promotion strategies. Dodaro (1993) claims that in poor, less developed countries the direction of causality will be from economic growth to export growth and in more advanced, less developed economies, from export growth to economic growth. In specific trade policy studies, Dollar (1992) determined that outward orientation hastens the technological development of the economy and an important positive relationship exists between growth and outward orientation. Edwards (1992) concluded that more open economies with less distortive trade policies tend to grow faster. Venebles (1996) supported this and stated that trade liberalisation prompts expansion to a higher output equilibrium.

Numerous studies of liberalisation in practice suggest the need to consider a variety of factors in order to understand the results of trade liberalisation. Although positive associations have been found between exports and growth, the relationship with liberalisation is uncertain. As stated in Roberts (1998:5), Thomas and Nash (1992) performed a statistical study of 40 countries receiving trade policy related World Bank loans over a period from 1980 to 1987 and found minor rewards from trade liberalisation (based on a link between exports and growth), although the study incorporated preservation of a stable competitive real exchange rate as an element of trade liberalisation. According to Roberts (1998:5), Helleiner (1994) and Pack (1992) found stronger associations for a linkage between productivity and output, with a subordinate relationship with exports. In addition, export growth is more likely to be the result of investment and infrastructure measures, or other forms of export promotion, than liberalisation. 'Openness' or an 'outward orientation' may therefore be the result of industrial promotion measures rather than the reverse of industrial development being the outcome of outward orientation (Rodrik, 1995:46).

There are very compelling economic arguments in favour of free trade. It is not too difficult to show that, in the lack of market imperfections, free trade is optimal for a small open economy, as found in most developing countries. Of course, the world is not free of imperfections and there are a numerous arguments for second best intervention. However, trade policy is rarely the most efficient form of intervention and even where it is, the results are not easily generalisable, as a recent study of strategic trade policy has shown. Moreover, that case which is comparative static has been reinforced by new growth theory, which links openness and factor accumulation. The theoretical case for trade liberalisation is therefore a robust one (Greenaway, 1998:5).

The advantages and disadvantages of trade liberalisation will however depend on the timing and sequencing of reform. The following section discusses the timing and sequencing of reform.

2.7 Timing and sequencing

When embarking on a programme of trade liberalisation, governments face a number of issues relating to the timing and sequencing of reforms. Greenaway (1998:19) asks the following questions: Should trade liberalisation begin immediately or is macro stabilisation a necessary requirement? Should capital and current account transactions be liberalised concurrently or is there an ideal order? Should quantitive restrictions (QRs) be converted into tariffs at the outset or should QRs be liberalised directly along with tariffs. What role, if any, is there for export incentives? Should the liberalisation be swift or slow but sure?

These questions will be subsequently answered.

2.7.1 *Initial timing*

Various arguments have been put forward for conducting any necessary stabilisation in advance. For example the contractionary and adjustment effects of stabilisation can be detached from the effects of trade liberalisation, and thereby improve the sustainability of the trade reforms. Reducing the degree of political resistance to the trade liberalisation programme may also increase its credibility. Indeed the stabilisation programme may reduce the burden on the trade reforms by reducing the burdens on the export sector of an overvalued exchange rate. Against these arguments, evidence suggests that the adjustment costs of trade liberalisation are moderately small and likely to go unnoticed alongside stabilisation. One might be able to quickly obtain efficiency gains from trade liberalisation, before political opposition to it builds up (Greenaway, 1998:19).

2.7.2 *Sequencing*

The common analysis, based on theory (of second best and of relative speeds of adjustment) rather than experience, is that liberalisation of the capital account should be held back until well into the process of trade liberalisation. There is also a general assumption that the early stages of trade liberalisation should see the liberalisation of QRs, and possibly the introduction or review of tariffs.

The cost of rent seeking and monopoly are cited against QRs, while the reward of greater transparency, increased tariff revenue and credibility are often used to defend the introduction or review of tariffs (Greenaway, 1998:20).

On export incentives the general accord appears to be in favour of giving exporters access to inputs at world prices, and against export subsidisation (Greenaway, 1998:20).

2.7.3 Speed of liberalisation

Economic theory would suggest that, in the absence of distortions and with full factor mobility, liberalisation should be rapid. There are several arguments for rapid liberalisation. First, it gives robust signals to economic agents, reveals government commitment and thereby increases the effectiveness and credibility of the reforms. Second, it limits the time and opportunities for resistance from affected lobby groups. Third, the optimal structure of tariffs at any one moment and the pattern of tariff reduction across industries adjusting at different speeds are very difficult to design or 'tailor'. Further gradual trade policy reform will also uphold unwanted consumption costs (Greenaway, 1998:20).

However, there are various debates that might validate gradualism and, in turn, increase the sustainability and credibility of the reforms. First, government revenue may decline too swiftly if trade taxes are eradicated in advance of non-trade tax reforms. Second, distortions that give rise to adjustment costs do not automatically justify gradualism on efficiency grounds but may do so on political economy grounds. This is particularly so if gradualism slows down the pace of income distribution, away from losers of trade liberalisation. Third, although rapid/radical reform may be observed as a means of signalling dedication, over ambitious reforms may also lend credibility if the government already lacks 'reputation'. Ultimately, given the limited foreign exchange reserves and external credit-worthiness of many developing countries, it is important that trade liberalisations are well matched with other policy changes. Unexpected trade liberalisation may require sudden exchange rate depreciation. If this is not politically viable, gradual trade liberalisation may be necessary if it is to hold on to credibility (Greenaway, 1998:21).

2.8 Impact of trade liberalisation

2.8.1 Economic growth

There is a preponderance of cross-country evidence that trade liberalisation and openness to trade increases the growth rate of income and output. In adjunct, several individual country analyses over the past 30 years suggest that trade seems to create growth and even to sustain higher growth (Srinivasan & Bhagwati, 1999:8).

Countless studies have been done for both developed and developing countries: it has been estimated that over 20 000 growth regressions have been run using Summers and Heston (1991) data, which allow for comparisons between countries. One overriding conclusion to surface globally is that openness to trade is unambiguously associated with higher rates of economic growth, or, on the contrary, that a lack of openness to trade is related with poor growth performance (Jenkins & Siwisa, 1997:22).

Reducing tariff and non-tariff barriers is estimated to have produced annual increases in global GDP of between US$ 100 billion – US$ 300 billion, which is 1,5 to 5 times the global aid flows to developing countries. Moreover, most of the returns accrue to countries (including especially advanced countries) that presented the most reductions in tariff and non-tariff barriers (Whalley, 2000).

Loots (2002:2) stated that Edwards (1993:1365) concludes that the literature on the subject matter has not always been successful in dealing with rigid definitions of trade regimes and trade orientation. To address this issue, the World Bank in 1987 constructed an index of trade liberalisation. The index has values of between 1 and 20 (1 representing cases of a highly oppressed external sector and 20 representing cases of fully liberalised trade). However, most of the cross-country analysis during the 1970s and 1980s were beleaguered by empirical and conceptual shortcomings. They also focused mostly on whether inward or outward trade policies are favourable for economic growth and development, which was one of the issues of the time. During the late 1980s the appearance of the theory of endogenous economic growth by Romer and Lucas provided new evidence on the long-run equilibrium relationship between openness and economic growth, although empirical evidence was still lacking.

In examining the impact of liberalisation on growth as quoted in Valodia, (1998:6), Greenaway and Sapsford (1994) adopted a production function approach parallel to that adopted by Feder (1983). They differentiate between two possible ways in which liberalisation of the trade regime may impact on growth. Firstly, liberalisation could lead to an increase in the volume of exports. Secondly, and more importantly against the background of the relationship between exports and productivity growth, liberalisation could influence the export/growth relationship, such that exports have a greater impact on growth (than was previously the case). Using time series data, they found little evidence that liberalisation affects the export/growth relationship.

The case that openness incites long-run growth has a good deal of empirical support, but has still not been fully proven; there is, however, no evidence that it is detrimental to growth. Overall, openness is probably an important element of a growth-promoting policy package, not least because it places constraints on the negativities of other policies. Thus, in the growth aspect, although policy makers must try to verify that, in their case, the growth effects of liberalisation are benign, they should not generally expect the opposite (Winters, 2000:11; Strydom, 1995:560).

Clearly, more liberal trade does not explain everything about a country's economic growth rate. There are a diversity of other important explanatory factors, like education, the extent and perseverance of external shocks, deficient public service provision, and political and economic stability (Jenkins & Siwisa, 1997:22).

2.8.2 Macroeconomic stability

The direct relationship between trade policy reform narrowly defined and macroeconomic stability is quite limited. Trade policy determines the practical openness of the economy, but the equilibrium between national income and expenditure determines the trade balance. It is exchange rate overvaluations and fiscal deficits that are the important connection with macroeconomic balances and stability. Although trade reform can indicate government commitment to inflation control, it can also interfere with the prevention of real exchange rate appreciation. It is usual for countries liberalising trade policies to devaluate their currency to reimburse for the liberalisation impact on the balance of payments. The potential inflationary effects of depreciation are likely to constrain the use of nominal exchange rate policy, with the result that sustained trade liberalisation is likely to involve some deterioration in the external balance until there is an export response (Greenaway, 1998:23).

2.8.3 Government revenue and spending

Trade liberalisation can have an effect on government revenue, but much less frequently and less adversely than is generally imagined. There is a linkage between trade liberalisation and stabilisation through the power of trade taxes on the fiscal balance. Given the high dependence of African economies on trade taxes and the sluggishness of any non-trade tax reforms, trade liberalisation need to be designed with the fiscal effects in mind. Substitution of quotas by tariffs, greater simplicity and consistency in tariff structures and reduced tariff rates are in fact likely to be fiscally enhancing (Greenaway & Milner, 1991:95-132).

One criticism directed towards globalisation is that it makes it more difficult to tax mobile factors of production, particularly capital. To the degree that this is true, it is a universal trend, which requires treatment at international level. An individual developing country is not likely to be able to influence its own ability to tax by altering its trade or foreign investment policies. It is true that high tariffs might attract inward investment in large developing countries, but only as a means of avoiding the tariff in the first place. Thus, if companies respond to cuts in tariffs by obtaining their local sales from out of the country, the loss of company taxation is really just another aspect of the loss of tariff revenue (Winters, 2000:9).

2.8.4 *The prices of goods and services*

The effect of trade liberalisation on prices clearly depends on what the previous policy was achieving. Thus, the consequences of trade liberalisation can be described no more generally than can those of the trade policies they undo, and experience suggests that governments have a wide variety of objectives for trade policy. The effects might also depend on spillovers from one market to another. As households adjust to a shock in one market they shift its effects to others. If the latter are particularly narrow, these spillovers can be very significant (Winters, 2000:5).

2.8.5 *Wages and employment*

Trade liberalisation is likely to have major consequences on earnings and employment. If liberalisation increases the demand for labour-intensive products, it boosts the demand for labour and then either or both income or employment will increase.

For countries that are fairly abundant in unskilled labour, trade liberalisation will usually increase demand for this sector. However, not all developing countries are, in fact, abundant in unskilled labour. For example, many Latin American and some African countries have very strong endowments of mineral and agricultural resources and so liberalisation will stimulate these sectors rather than labour-intensive ones (Winters, 2000:7).

2.8.6 *Adjustment costs*

The advantages from trade rely largely on adjusting a country's output bundle; there is also likelihood that people will suffer temporary adverse shocks in the process of adjustment. This is mainly true of workers who suffer bouts of unemployment. The initially non-poor can usually tide themselves over these periods, so that public policy should focus on whether those who are poor to begin with, suffer such temporary setbacks and on policies to help them get out of trouble as soon as possible

(Winters, 2000:11).

2.8.7 *Poverty*

Trade liberalisation can be expected to help the poor on the whole, given the positive relationship between openness and growth. Equally important, the political economics of trade policy is such that, in practice, it is unlikely that the poor have much power on the pattern of protection that exists in a country. As trade policy inherently has the effect of redistributing income, this implies that trade policy often acts to tax the poor, and that liberalisation can therefore do much to improve the income of the poor. However, in the short run, liberalisation may have a negative influence on some of the poor, depending on their sources of income and the impact on prices of goods and services that the poor consume (Hoekman *et al.*, 2002:1).

2.9 Complementary policies

While a liberal trade policy is required for growth and poverty alleviation, it alone is not enough for the growth of trade. When trade liberalisation has been implemented in an unstable macroeconomic environment or without efforts at strengthening trade-related domestic institutions and suitable corresponding policies, it has often either been reversed or failed to encourage growth. This includes a regime that promotes investment and competition, including openness to foreign direct investment, so that business services are supplied at competitive prices, and macroeconomic policies that encourage stable prices and a competitive real exchange rate (Hoekman *et al.*, 2002:2).

Trade liberalisation entails reducing discrimination against foreign suppliers of goods and services. This is accomplished not simply by eradicating quotas and reducing average tariffs and dispersion across tariffs, but also by strengthening trade-related institutions, in particular customs and standards organisations (Hoekman *et al.*, 2002:14).

Hoekman *et al.* (2002:14-19) conclude that the following complementary policies are needed to support trade liberalisation.

2.9.1 Macroeconomic and exchange rate policies

To be continuous and contribute to an efficient allocation of resources, a stable macroeconomic environment and a competitive real exchange rate must sustain trade liberalisation. Trade liberalisation works through the transmission of price signals. These are concealed in a regime of high and erratic inflation. Thus, macro-stability is a key complementary policy.

A competitive real exchange rate is also essential to create circumstances for continuous support of liberal trade policies. With an overvalued exchange rate, industries competing for imports are at a competitive drawback, and this causes political pressures for protection that are hard to resist in the face of rising trade deficits and declining foreign exchange reserves (Shatz & Tarr, 2000:7).

At the outset, trade liberalisation is likely to lead to a trade deficit because the increase in imports has a propensity to occur faster than the export supply response. A depreciation of the real exchange rate will help to re-establish a balance between exports and imports since it makes imports more costly and exports are more lucrative in domestic currency. Under a flexible exchange rate regime, the real exchange rate will adjust through market forces. Under a fixed exchange rate regime, major trade liberalisation should go along with a devaluation of the domestic currency. The required depreciation is larger the greater the level of trade liberalisation and the greater the lags in the supply response (Hoekman *et al.*, 2002:14-15).

2.9.2 Fiscal revenue and the design of tariff reform

Policy-makers in low-income countries may be worried that liberalisation might, to a large extent, reduce government revenue, yielding larger fiscal deficits and inducing inflation. While these concerns have some merit, trade liberalisation need not necessitate diminished revenues. Many countries have implemented successful trade liberalisation programmes without significant loss of revenue (Hoekman *et al.*, 2002:16).

Perhaps the primary reason that trade liberalisation need not lead to a loss of revenue is that developing countries have conventionally relied heavily on quantitative restrictions of imports. Government revenue increases when quantitative restrictions are transformed into tariffs. Reduction of tariffs should start with the largest. Also, where tariff rates are very high at the outset, they will generate little or no revenue. Reductions of the tariffs to more modest levels will increase imports and thus revenues, as the inducement to smuggle is reduced. Moreover, exemptions often are a significant source of revenue loss and their reduction increases tariff collections. Finally, an exchange rate depreciation, which should accompany major tariff reduction, will elevate the local currency value of imports and thus tariff revenue.

According to Hoekman *et al.* (2002:16), Sharer *et al.* (1998) summarises the the impact of trade liberalisation on revenue as follows:

Table 2.1: Impact of trade liberalisation on revenue

Trade reform	**Expected revenue impact**
Replace NTBs with tariffs	Positive
Eliminate tariff exemptions	Positive
Eliminate trade-related subsidies	Positive
Reduce tariff dispersion	Ambiguous/Positive
Eliminate state trading monopolies	Ambiguous/Positive
Reduce high average tariffs	Ambiguous
Lower maximum tariff	Ambiguous
Reduce moderate or low average tariffs	Negative
Eliminate export taxes	Ambiguous/Negative

When tariff rates are already standardised and in the modest to low range, then additional tariff reduction is likely to result in revenue loss. Only in this latter case does revenue represent a real problem for trade liberalisation. Alternate broad-based and non-discriminatory revenue sources should be sought, and trade liberalisation sequenced to correspond with the availability of these alternate revenue sources. Such alternative, broad based tax instruments will be more efficient than trade taxes. For many products, such as alcohol, tobacco and petroleum, collection of taxes on local production as well as imports will have very low extra administrative costs, and will reduce the incentives to develop unproductive import-substituting firms. Even very poor countries such as Cambodia have been able to introduce broad-based consumption taxes that reduce reliance on customs duties, and raise much-needed revenues for development costs (Hoekman *et al.*, 2002:16).

2.9.3 Labour and other factor markets

According to Hoekman *et al.* (2002:16), Nogues (1991) argues that where labour market elasticity is low, reforms to develop the operation of labour markets should go together with trade liberalisations in order to improve labour mobility. For instance, in Peru in the 1980s, a trade reform failed to create any supply response because of rigorous labour market rigidities. Labour legislation barred firms shedding labour, closing plants or even changing activities. This led to many bankruptcies and contributed to foreign exchange and financial crises and to a failure of the reform.

The poor are often concentrated in the informal sector and liberalisation policies that increase labour mobility in the formal sector can, when combined with trade liberalisation, have an influence on reducing poverty by opening up extra jobs in the formal sector for workers formerly in the informal sector. The commonly supportive relations between trade, macroeconomic, labour market and other policies may then serve to increase the credibility and payoffs of each (Hoekman *et al.*, 2002:17).

2.9.4 Competition policies

In manufacturing, prices paid by consumers are affected by competitive circumstances in the country. It is possible to increase the competitiveness of markets for manufactured goods in developing countries, that is, cut the mark-up over the cost of production by bringing down external barriers to international competition as well as by reducing government imposed barriers to entry against local firms. Both are vital in providing goods to consumers with low monopoly markups. In small countries, an open trade regime is particularly crucial, since there are fewer domestic firms contesting the market. In large countries, administrative and legal barriers against domestic entry are relatively more important than in small countries since there are more potential entrants blocked by domestic barriers to entry (Hoekman, Kee & Olarreaga, 2001:25).

Distribution is an important sector in the context of trade liberalisation. If there are barriers to entry into distribution, those who control this sector may be the main beneficiaries of trade liberalisation, pocketing much of what used to be collected as tariff revenue and not passing the tariff cut on to the consumers. In agriculture, parastatal marketing boards often strongly limit competition for the products of farmers and restrain their incomes. The removal of these boards should help the producers, provided that, during the change, attention is giving to continuity of supply of key ancillary services such as transport and credit provided by these parastatals. Competition among private firms is also vital. Thus, exclusive government licenses to the private sector should also be avoided so that farmers do not have to pay too much for their inputs or receive monopsonistically depressed prices for their outputs. The prescription applies to import monopolies and exclusive distribution arrangements (Hoekman *et al.*, 2002:18).

2.9.5 Foreign direct investment and intellectual property protection

Foreign Direct Investment (FDI) is a key channel of technology transfer across national borders. A study by the United Nations Conference on Trade and Development (UNCTAD) suggests that multinational corporations account for a large portion of the world's research and development, and more than 80 percent of royalty payments for technology transfers flow from subsidiaries of foreign companies to their parent firms. Econometric studies tend to support the view that developing countries receiving FDI perform better in terms of productivity than their counterparts that are not FDI beneficiaries (Hoekman *et al.*, 2002:18).

They stated further that, as far as employment is concerned, it is imperative from a short run viewpoint that FDI involves labour-intensive production and results in the transfer of skills through education. Improvements in communications, transport and information technology, together with global trade policy liberalisations, have made it much more alluring to companies to engage in so-called outsourcing and processing trade, where the labour-intensive parts of production are to be found in developing countries. In the 1970s, such FDI focused in particular on textiles, and more recently it has also included electronics and auto parts sectors.

Given the importance of low trade expenditure for such activities, policy makers should steer clear of offering trade protection to foreign investors, since this will be a magnet for the 'wrong' type of investment from an employment creation perspective by depriving the host country of the gains from participating in international production and distribution networks. Protection may also result in losses to the host economy by providing rents to foreign investors at the cost of domestic consumers (Hoekman *et al.*, 2002:19).

According to Hoekman *et al.* (2002:18-19), Lall & Streeten (1997:172–174) studied some 90 foreign investments, using a cost-benefit method, and found that more than 33 percent reduced national income; this was mainly due to extreme tariff protection that allowed high cost firms to produce for the local market at very high prices, even though they could have been imported much more cheaply. Futhermore, Hoekman *et al.* (2002:19) states that Encarnation & Wells (1986) found that between 25 to 45 percent of 50 projects studied reduced national income; again the main cause was high protection.

Intellectual property right protection can be central in attracting FDI in sectors that depend extensively on patent protection, helping to tilt the heart of investment projects toward manufacturing and away from distribution. Trade and competition policy instruments that serve to offset the market power granted to holders must complement the protection of intellectual property rights.

2.10 Summary

It is widely held that failure to participate in the global economy assures a country of declining economic influence and its citizens of a decrease in their standard of living. Countries and firms that successfully sell internationally enjoy an improved quality of life, a better society, and a more peaceful world. It can therefore be argued that one of the primary aims of any country's macroeconomic policy, and specifically its trade and industry policy, is to create and maintain a sustainable internationally competitive manufacturing sector. This will contribute to achieving socio-economic goals such as job creation, higher income generation, and higher economic growth rates.

A host of studies agree that, over the long run, the most successful economies are essentially open and geared for international competition rather than seeking to shelter inefficiency and being inward looking from world realities.

In this highly interdependent world, outward oriented policies are an imperative; however, the difficulty is that there is no unique way of conducting such policies, since these policies have an impact not only on trade, but also on the exchange rate policy, fiscal goals, labour and competition policies, as well as foreign direct investment and intellectual property protection.

There are quite a few economists arguing that trade liberalisation holds some great advantages in store. These advantages include a positive impact on growth, general efficiency gains, poverty alleviation, and financial assistance as well as reduced risk. However, not all economists are in favor of trade liberalisation. Some of the arguments against trade liberalisation include the diffuse nature of trade liberalisation, implying that although trade liberalisation will benefit the poor, it will often be defied. Other arguments against trade liberalisation includes the fact that traditional trade policy rest on the assumption of perfect competition, no externalities, homogenous products and so forth. However, there has been a mounting accord in the literature that these factors are not only significant realities to be considered, but are often determinants in trade flows.

In this chapter, the theory of trade liberalisation was reviewed and it was stated that the most practical way of stimulating international trade is through liberal trade regimes.

The next chapter documents the various trade policy instruments that are available to policy makers in order to liberalise a country's economy, including tariff and non-tariff barriers.

Chapter 3

TRADE POLICY AND TRADE POLICY INSTRUMENTS

3.1 Introduction

Virtually all countries impose some limitations on the free flow of international trade. Since these limitations and regulations deal with a country's trade or commerce, they are commonly known as trade or commercial policies. While trade restrictions are customarily rationalised in terms of national welfare, in reality they are usually advocated by those special groups in the country that stand to benefit from such restrictions (Salvatore, 1995:219).

This chapter focuses on trade policy and the various instruments that policy makers can implement in order to influence trade. These are structured as follows. Trade policy is defined in section 3.2, where after the classification of trade policy is set out in section 3.3. Section 3.4 provides an overview of the different trade policy instruments. Section 3.5 contains a summary.

3.2 Definition of trade policy

Husted & Melvin (1990:152) defines trade policy as all the actions taken by a government to influence the volume and composition of trade flows, both into and out of a country. According to Kreinin (2002:2) trade policies are governmental measures intended to control the country's international transactions.

Policy makers have a mixture of options in conducting trade policy for the purpose of controlling international trade. The restrictions that policy makers can use upon international transactions cannot be imposed on domestic transactions. These options include tariffs, which are taxes on imports and/or exports; quotas, which are government imposed restrictions on the value or volume of imports and exports; subsidies, which are payments by government to industry to promote exports or discourage imports; and non-tariff barriers, which include a variety of government policies or regulations such as health and safety standards, exchange control, voluntary export restraint or government procurement policies that affect trade flows, for example exchange control (Husted & Melvin, 1990:15; Kreinen, 2002:2).

3.3 Classification of trade policy

Trade policy can, in a constricted sense, be classified into two main categories: those policies that directly (or indirectly) have some bearing on the quantities (price) of imports and exports, such as quotas and exchange controls, and those that directly (or indirectly) influence prices (quantities) such as tariffs and subsidies. Distinction can also be made between those measures that are apparent and those that are hidden. Hidden measures may have unintended effects on the prices and quantities of tradeable goods, but import-licensing procedures are often intentionally complex and slow in order to control imports and not merely to satisfy other stated objectives of the procedures (Milner, 1988:56).

In order to fully understand the impact of trade policy instruments, it is necessary to differentiate between the various trade policy instruments. The following section will focus and describe the most common trade policy instruments.

3.4 Trade policy instruments

Trade policy instruments have been used for all kinds of reasons: for protecting infant industries in the process of catching up; for protecting established industries in the process of being caught up; as a strategic instrument for promoting (protecting) capital intensive or technology intensive industries; as a sectoral tool for addressing regional concerns resulting from spatial concentration of particular industries; as a measure to smooth or hasten industrial restructuring; as an instrument of competition policy to correct internal product market imperfections, and as means of fostering competitiveness in otherwise inactive industries (Mohan, 1998:16).

The first step in designing a strategy to use trade policy for growth is to understand how the trade regime works. According to Hoekman *et al.* (2001:6), this necessitates learning the importance of trade policy in order to answer the following questions:

- What is the importance of non-tariff barriers, including who gets the licenses and permits?
- What is the structure of the tariff, including its dispersion, exemptions and rebates?
- How much revenue comes from tariffs?
- What policies are in place that may tax or subsidise exports?
- Are trade-related institutions, such as standards organisations, export finance, and marketing facilities, adequate to support an expansion of exports?

The conventional instruments used in the implementation of trade policy have largely been import and export tariffs and different kinds of QRs whereby imports or exports are constrained regardless of cost or price. The use of these conventional instruments has become increasingly prohibited under various international agreements on a multilateral, regional and bilateral basis. Examples of such agreements include the WTO, various economic union agreements and agreements between many different pairs of countries (Mohan, 1998:17).

The armoury of trade policy instruments used by various countries has seen considerable improvement in the last twenty years. The following section will define the most important trade policy instruments available to trade policy makers around the world.

3.4.1 Tariffs

A tariff, as the term is used in international trade, is a tax on importing a good or service into a country, usually collected by customs officials at the border.

Such taxes are extremely familiar throughout the world and also have a long history. Practically every country of the world imposes tariffs on at least some products (Husted & Melvin, 1990:154; Lindert & Pugel, 1996:117).

Nominal tariffs, the effective rate of protection, and the relationship between these two will be described subsequently. Thereafter the advantages of a uniform tariff regime will be described.

3.4.1.1 Nominal tariffs

Nominal tariffs are calculated using an array of formulas. Nominal tariffs can be *ad valorem*, specific, or compound. The *ad valorem* tariff is defined as a fixed percentage of the anticipated market value of the product when they reach the importing country. The specific tariff is calculated as a money amount per physical unit of import, such as Rands per ton of steel bars, or Rands per eight-cylinder two-door sports car, i.e. it is a fixed sum per physical unit of the product. Finally, a compounded tariff is a combination of an *ad valorem* and a specific tariff (Salvatore, 1995:220; Lindert & Pugel, 1996:117).

By taxing only the foreign product, a tariff brings advantage for domestic producers who face import competition. The more it costs consumers to buy the foreign product, the more they will turn to domestic suppliers, who get the advantage of extra sales and higher prices due to the tariff (Lindert & Pugel, 1996:121).

The impact of nominal tariffs on South Africa's automotive and textile industries will be analysed in chapter five of the study.

3.4.1.2 Effective rate of protection

The effective rate of protection of an individual industry is defined as the percentage by which the whole set of a nation's trade barriers augments the industry's value added per unit of output. The effective rate of protection for the industry can be quite different from the percentage tariff paid by consumers on its output (Lindert & Pugel, 1996:123; Du Plessis *et al.*, 1998:121-124).

According to Salvatore (1995:228), the rate of effective protection is calculated by the following formula:

$$g=(t-a_i t_i)/1-a_i$$

where g = the rate of effective protection to producers of the final commodity

t = the nominal tariff rate on consumers of the final commodity

a_i= the ratio of the cost of the imported input to the price of the final commodity in the absence of tariffs

t_i= the nominal tariff rate on the imported input

Du Plessis *et al.* (1998:122), use the following formula for determining the effective rate of protection:

$$e_j=(V'_j-V_j)/V_j$$

where e_j = the effective rate of protection for commodity j

v'_j = the value added per unit of commodity j under protection

v_j = the value added per unit of commodity j under free trade.

A particular industry's incomes, or value added, will be influenced by trade barriers on its output, and the effective rate of protection will be larger than the nominal rate when the industry's output is sheltered by a higher duty than the tariff duties on it inputs (Lindert & Pugel, 1996:123).

3.4.1.3 Relationship between nominal tariffs and the effective rate of protection

Very often, a country imports a raw material duty free or imposes a lower tariff rate on the importation of the input than on the importation of the final product produced with the imported input. The country usually does this in order to promote domestic processing and employment. For example, a country may import wool duty free but impose a tariff on the importation of cloth in order to encourage the domestic production of cloth as well as employment within the local industry (Salvatore, 1995:226).

In many cases the effective rate would be higher than the nominal rate due to the fact that tariffs on outputs are higher than tariffs on inputs (Kenen, 2000:186).

Evidently, the nominal tariff rate can be very unrepresentative and does not give even a rough idea of the degree of protection actually provided to domestic producers of the import-competing product. Furthermore, most industrial countries have a "cascading" tariff structure with very low or zero nominal tariffs on raw materials and higher and higher rates the greater the degree of processing. This makes the rate of effective protection on a final product with imported inputs much larger than the nominal tariff rate would indicate (Salvatore, 1995:229).

Table 3.1 indicates the difference that can exist between the nominal tariff rate and the effective tariff rate.

Table 3.1: Nominal and effective tariff rates for selected industries after the Tokyo Round of trade negotiations.

	United States		European Community		Japan	
Product Group	**Nominal**	**Effective**	**Nominal**	**Effective**	**Nominal**	**Effective**
Food, Beverages, and tobacco	4.7	10.2	10.2	17.8	25.4	50.3
Textiles	9.2	18.0	7.2	8.8	3.3	-2.4
Apparel	22.7	43.3	13.4	19.3	13.8	42.2
Leather products	4.2	5.0	2.0	-2.2	3.0	-14.8
Footwear	8.8	15.4	11.6	20.7	15.7	50.0
Wood products	1.7	1.7	2.5	1.7	0.3	-30.6
Furniture and fixtures	4.1	5.5	5.6	11.3	5.1	10.3
Paper and paper products	0.2	-0.9	5.4	8.3	2.1	1.8
Chemicals	2.4	3.7	8.0	11.7	4.8	6.4
Rubber products	2.5	2.0	3.5	2.3	1.1	-5.0
Iron and steel	3.6	6.2	4.7	11.6	2.8	4.3
Nonferrous metals	0.7	0.5	2.1	8.3	1.1	1.7
Metal products	4.8	7.9	5.5	7.1	5.2	9.2
Electrical machinery	4.4	6.3	7.9	10.8	4.3	6.7
Transport equipment	2.5	1.9	8.0	12.3	1.5	0.0

Source: Kenen, 2000:188

A tariff on imported inputs is a tax on domestic producers that increases their costs of production, reduces the rate of effective protection provided by a given nominal tariff on the final product, and consequently discourages domestic production. In some cases, even with a positive nominal tariff on the final product, less of the product is produced locally than would be under free trade (Salvatore, 1995:229).

Domestic value added equals the price of the final product minus the cost of the imported inputs going into the production of the product. While the nominal tariff rate is significant to consumers, the effective tariff rate is important to producers because it specifies how much protection is really provided to the domestic processing of the import-competing product (Salvatore, 1995:226).

3.4.1.4 Uniform tariff regime

A uniform tariff conveys a number of advantages, the most significant of which is that if the tariff is uniform, the benefits to industry lobbying are much smaller, creating a kind of free-rider problem for the lobbying industry and radically reducing the motivation to lobby for protection (Panagariya & Rodrik, 1991:22).

A uniform tariff really simplifies customs operations, eradicates a number of ways used to avoid paying the tariff, and should help reduce corruption and save on limited administrative resources. There will also be a direct saving of resources from reduced lobbying for higher protection, and an associated gain from encouraging scarce entrepreneurial talent to be employed more productively in the creation of improved and cheaper products. Overall, the level of protection is likely to be lower as the enticement to lobby for higher tariffs is attenuated (Hoekman *et al.*, 2001:7).

Uniformity does not mean that there can be no exemptions for products that are deemed to be of great social importance such as necessary medicines or mosquito nets (Bannister & Thugge, 2001:6). However, care should be taken that such exceptions target only products that are vital to attain social and public health objectives.

Even though tariffs have traditionally been the most important form of trade restriction, there are many other types of trade barriers. The following section describes the various non-tariffs barriers available to policy makers around the world.

3.4.2 *Non-tariff barriers*

Non-tariff barriers take on many forms – import quotas, quality standards, domestic content requirement, state monopolies on foreign trade, buy-at-home rules for government purchases, administrative red tape to harass foreign sellers, complicated exchange controls, and so forth (Salvatore, 1995:257; Lindert & Pugel, 1996:135).

A distinction is often made between non-tariff barriers that are intended to control the amount of goods imported or exported, such as quotas, voluntary export restraints, etc. and those effectively designed to have an effect on the price of traded goods, for example subsidies and anti-dumping measures (ITRISA, 2002:55).

In recent years, these non-tariff trade barriers, or the new protectionism, have become more important than tariffs as barriers to the flow of international trade and now represent a major threat to the world trading system that has evolved since the end of World War II (Salvatore, 1995:260).

3.4.2.1 *Import quotas*

The best-known non-tariff barrier is the import quota. It is a direct quantitative restriction on the amount of a product permitted to be imported or exported (Salvatore, 1995:258). For example, a government may choose to limit imports of a product to no more than 1 million tonnes in a particular year, or it may decree that no more than ten million Rands worth of another product will be allowed into the country (Husted & Melvin, 1990:189).

There are two major types of import quotas that can be distinguished, namely the absolute quota, which limits the quantity of imports to a specified level during a certain period of time, and the tariff rate quota, which enables a specified quantity of goods to be imported at a preferential tariff during the quota period. In addition, import quotas may be global, i.e. applied to all imports of a certain product regardless of its source, or bilateral, i.e. limited to imports from a specific destination (ITRISA, 2002:55).

One way or another, the government hands out a limited number of licenses to import products legally and bans importing without a license. As long as the quantity of licensed imports is less than the quantity that people would want to import without the quota, the quota not only reduces the quantity imported but also drives the domestic price of the product up above the world price at which the license holders buy the product abroad. In this respect, it is like the import tariff (Lindert & Pugel, 1996:136).

Quotas that completely eliminate trade in a certain product are known as embargoes. Embargoes are occasionally established as a form of economic sanctions against the policies or practices of another nation. Embargoes are relatively rare and quotas are usually set at levels greater than zero so that some, though limited trade, occurs (Husted & Melvin, 1990:189).

There are a number of reasons why governments have often chosen to use quotas rather than tariffs as a way of restraining imports. The first is as insurance against further increases in import competition and import spending. Quotas help ensure that the quantity of imports is strictly limited. If increasing foreign competitiveness lessens the world price of imports, that action will simply accelerate the reduction in the total amount spent on imports. A tariff, by contrast, allows later foreign price cuts to raise both import quantities and import values, thus complicating any official forecasts of the balance of payments (Lindert & Pugel, 1996:136).

Quotas are also, in part, chosen because they give government administrators greater flexibility and authority in dealing with local firms. For their part, protectionist interests also see a quota system as a chance to lobby for special license privileges, whereas a tariff is a source of government revenue to which they do not have any easy access (Lindert & Pugel, 1996:136).

Perhaps as a result of this approach, quotas on imports of manufactured products have been forbidden by the international GATT agreement international agreement. However, import quotas can be used to protect a domestic industry, to protect domestic agriculture, and/or for balance of payments reasons. For this reason quotas are not unusual. Moreover, countries have found ways of imposing quotas indirectly by attaining agreements from exporting countries to "voluntarily" limit exports (Husted & Melvin, 1990:189; Salvatore, 1995:258).

3.4.2.2 Voluntary Export Restraints (VERs)

A quota can harm the country more than a tariff by giving monopoly control to foreign exporters. This anomalous result has occurred in the case of the voluntary export restraints (VERs) (Lindert & Pugel, 1996:140).

A VER arises from an agreement between two countries, in terms of which one country limits or reduces its exports of a particular product or commodity to the other country if such exports threaten the importing country's domestic industry. In other words, VERs refer to the case where an importing nation encourages another nation to ease its exports of a commodity "volantarily", under the threat of higher all-round trade restrictions (ITRISA, 2002:57; Salvatore, 1995:260; Du Plessis *et al.*, 1998:130).

VERs are used by large, influential countries as a rearguard action to protect their industries that are having difficulty competing against a rising tide of imports (Lindert & Pugel, 1996:140). The three sectors in which VERs have been most widely used are automobiles, steel and consumer electronics (ITRISA, 2002:55).

When VERs are successful, they have all the economic results of equivalent import quotas, except that they are administered by the exporting nation, and so the revenue effect or monopoly profits are obtained by foreigner exporters (Salvatore, 1995:262).

However, VERs are likely to be less effective in limiting imports than import quotas because the exporting countries agree only half-heartedly to limit their exports. Foreign exporters are also likely to fill their quota with higher quality and higher priced units of the product over time (Salvatore, 1995:262).

3.4.2.3 Export taxes

An export tax is levied only on domestically produced products that are destined for export and not for domestic consumption. The tax can be specific or *ad valorem*. Like an import tax or tariff, an export tax diminishes the volume of international trade (Appleyard & Field, 2001:243).

In view of the fact that exports are hypothetically good for a country because they improve the balance of trade, provides jobs, and so forth, why would a country want to impose an export tax? A very significant reason for the use of export taxes is to generate government revenue, because it is more complicated to implement other forms of taxation such as income or property taxes. An additional reason to impose export taxes is to combat domestic inflationary pressures. Since the price of the product on the domestic market falls, this could diminish the rise in the domestic price level. Further, export taxes can be used to redistribute domestic income. If the exported product is an agricultural product grown by large-scale and wealthy landowners and consumed by low-income urban dwellers, then the lowering of the domestic price by means of the export tax can modify the income distribution towards greater equality. In addition, of course, if an export tax is imposed and import prices do not change, the country's terms of trade will improve (Appleyard & Field, 2001:271).

Developing countries frequently impose export taxes on exports of primary products. In some cases these are impose as an alternative to royalties for the extraction of minerals; in other cases they are used in an attempt to exercise market power or to support local processing industries (Hoekman *et al.*, 2001:9).

3.4.2.4 Export subsidies

Exports are subsidized more often than they are taxed. Patrick Low has estimated that, in 1998, subsidies to producers of exported goods amounted to 0,6 percent of GDP in the United States, 0,9 percent in Japan, and 2,5 percent in the European Communities (Lindert & Pugel, 1996:178).

This is curious and controversial. It is curious for at least two reasons. First, why would a country want to show prejudice in favour of selling exports instead of giving just as good a bargain to its own citizens? That is, why should a government want its domestic consumers to pay more than foreign buyers? Second, it is curious that some export-subsidising nations restrict their imports, without seeming to notice that subsidising exports implicitly subsidises imports (Lindert & Pugel, 1996:179).

Export subsidies may be direct payments or the granting of tax relief and subsidised loans to the country's exporters or potential exporters, and/or low-interest loans to foreign buyers in order to encourage the country's exports. This payment is usually related to the level of exports, and thereby enables exporters to charge a price that is lower than would otherwise be charged. With lower prices, exporters are then able to obtain a larger share of the world market (Husted & Melvin, 1990:202; Salvatore, 1995:266).

The export subsidy, by giving the nation more foreign exchange earnings and appreciating the exchange rate value of the local currency, makes it easier for others in the home country to buy foreign products that compete against local products (Lindert & Pugel, 1996:179).

Export subsidies can be viewed as a form of dumping. Although the GATT forbids export subsidies, many countries provide them in disguised and not-so-disguised forms (Salvatore, 1995:266; Husted & Melvin, 1990:202).

Export subsidies take on many forms in the real world. These include tax rebates, subsidised loans to foreign purchasers, insurance guarantees, government funding for research and development, guarantees against losses, and direct grants or subsidised loans (Husted & Melvin, 1990:202). They use taxpayers' money to give low-interest loans to either exporters or foreign customers. Governments also engage in direct promotional expenditures on behalf of exporters, advertising their products globally and supplying cheap information on export market possibilities (Lindert & Pugel, 1996:179). Another method used for export subsidies is through the use of tied aid for projects in developing countries. To the extent that the price of equipment sold by firms belonging to the donor country is higher than world prices, that amount is really an export subsidy to domestic firms rather than aid to the recipient (Mohan, 1998:19).

The official means for dealing with export subsidies is to inflict a tariff on the subsidised exports, known as a countervailing duty, in order to counteract the subsidy and increase the price of the product to the pre-subsidy price (Husted & Melvin, 1990:202).

The key problem with export subsidies is their use by high-income countries for agricultural produce. This has a destabilising effect on world prices and is harmful to producers in developing countries of the products involve (Hoekman *et al.*, 2001:9).

Developing country WTO members have become more controlled in the use of export subsidies, but least developed countries and countries with per capita incomes below $1 000 are allowed to use them. This presents legal cover to follow policies that aim to offset informational asymmetries and related market failures. To be successful and not distort incentives, such policies should be 'horizontal' in nature, not sector-specific (Hoekman *et al.*, 2001:9).

Using subsidies to counteract the negative outcome of other policies on exports is wrong. Such situations call for the removal of protection and the implementation of instruments such as duty drawbacks or EPZs.

3.4.2.5 Export processing zones

EPZs are free trade co-operatives within a protected economy. They are fenced and controlled industrial parks that fall outside the domestic customs area and are usually situated near a harbour or airport (Du Plessis *et al.*, 1998:173).

Producers establish an EPZ to manufacture exclusively for export purposes, making use of imported inputs, which are obtained duty free of all customs and other trade related restrictions (Du Plessis *et al.*, 1998:173). Export processing zones (EPZs) are "enclaves" for non-traditional exports that are often used in circumstances where economy-wide trade liberalisation is implemented or infrastructure and regulatory requirements cannot be met on a countrywide basis (Hoekman *et al.*, 2001:11).

Experience has shown that the development of EPZs, together with the provision of infrastructure and management, should be privately handled. Publicly developed and managed EPZs have usually been unsuccessful.

Attracting investment into EPZs is a function of many factors, including some that are national – such as political stability and sound macroeconomic management. An overvalued exchange rate will put a damper on exporting from EPZs just as much as from the rest of the economy (Hoekman *et al.*, 2001:11).

Research has shown that, due to the costly incentives that are put into place in order to attract foreign investors, EPZs might not generate the desired net benefits in terms of direct and indirect employment, income creation and foreign exchange earnings (Du Plessis *et al.*, 1998:173).

In general, the conditions that make EPZs successful involve the same complementary policies that are required to make trade liberalisation successful. As a result, EPZs are best regarded as transitional mechanisms in the quest of an overall liberal trade regime (Hoekman *et al.*, 2001:11).

All non-tariff barriers do not create revenue for the country concerned, but are used in the name of health, safety and content requirements. These non-tariff barriers include quality standards, domestic content requirements and other technical and administrative regulations.

3.4.2.6 Quality standards

There is panoply of restraining laws concerning product quality. These include those that are imposed in the name of health, sanitation, safety, and the environment. If a government is determined to shield local producers, it can always write rules that can be met only by local producers (Lindert & Pugel, 1996:144).

Quality standards do not elicit tariff or tax revenues for the importing country's government. On the contrary, enforcing these rules with border inspections uses up government resources. From the viewpoint of the world as a whole, the quality standards bring a gain to the degree that they really protect health and safety (Lindert & Pugel, 1996:145).

3.4.2.7 *Domestic content requirements*

Domestic content requirements specify that the importer must purchase a certain percentage of the final manufactured good locally. Like quality standards, domestic content requirements do not create any tariff or tax revenue for the government. The protected home-country sellers of the product obtain the benefits on the implicit price mark-ups. The world as a whole bears the usual deadweight loss because the home product is either less preferred or more costly to produce (Lindert & Pugel, 1996:146).

A domestic content requirement offers protection to domestic factors of production and to the domestic producer and raises the price of inputs to the producer of the final product (Kreinin, 2002:137).

For example, to sell vehicles in Brazil or any other country, a foreign manufacturer must set up local assembly operations and guarantee that a specified minimum portion of the value of the final product is made locally.

Worldwide, domestic content requirements have received most attention in the automobile industry. Developing countries have often used domestic content requirements to foster domestic automobile production, as shown in Table 3.2.

Table 3.2: Minimum content requirements applied to automobile

Country	Minimum content requirements applied to automobiles in selected countries
Argentina	76
Brazil	60
Malaysia	60
South Africa	55
Thailand	54
Chinese Taipei	50
Venezuela	41
China	40
Pakistan	40

Source: U.S. Department of Commerce, 2002: 166, as cited in Carbaugh, 2002:166

3.4.2.8 Technical, administrative and other regulations

International trade is also hindered by several technical, administrative, and other regulations. These include safety regulations for automobile and electrical equipment, health regulations for the hygienic production and packaging of imported food products, and labeling requirements showing origin and contents. While many of these regulations serve legal purposes, some are only finely veiled disguises for the restriction of imports (Salvatore, 1995:263).

Much awareness has also been given in recent years to border taxes. Border taxes are rebates for internal indirect taxes given to exporters of a commodity and imposed on importers of a commodity. Examples of indirect taxes are excise and sales taxes (Salvatore, 1995:264).

Trade barriers are not only used to minimise imports or to stimulate exports, but are sometimes used as a measure to control dumping. The various forms of dumping and use of instruments to penalise dumping, will now be defined.

3.4.2.9 *Anti-dumping measures*

Dumping is international price discrimination in which an exporting firm sells at a lower price in a foreign market than it charges in domestic markets. This definition is the one used most often in national laws and by the GATT (Lindert & Pugel, 1996:174).

Dumping is categorized into persistent, predatory, and sporadic dumping. Persistent dumping, or international price discrimination, is the continuous propensity of domestic monopolists to maximise total profits by selling the product at a higher price in the domestic market than globally (Salvatore, 1995:265).

Predatory dumping is the temporary sale of a product at below cost or at a lower price in a foreign country in order to force foreign producers out of business, after which prices are raised to take advantage of the newly acquired monopoly power abroad. Sporadic dumping is the sporadic sale of a product at below cost or at a lower price in a foreign country than domestically in order to unload an unexpected and temporary surplus of the product without having to cut domestic prices (Salvatore, 1995:265).

Trade limitations to neutralize predatory dumping are acceptable and allowed to protect domestic industries from unfair competition abroad. These limitations generally take the form of anti-dumping duties to offset price differentials, or the threat to impose such duties. However, it is often difficult to verify the type of dumping, and domestic producers consistently demand protection against any form of dumping. By so doing, they put a damper on imports and increase their own production and profits (Salvatore, 1995:265).

3.5 Summary

Almost all countries impose some kind of limitation on free trade in order to protect the domestic economy. In order to fully understand the impact of trade policy on the domestic economy, it is necessary to understand the workings of the various trade policy instruments available to policy makers. This chapter highlighted the various instruments that policy makers can use in the composition of a country's trade policy.

The armory of trade policy instruments used by policy makers in the design of a trade policy has seen considerable improvement in recent years. The traditional instruments of export and import tariffs and various other QRs have been increasingly prohibited under various international agreements, for example the WTO. These prohibitions have been put into place due to the liberalisation of the global economy. Non-tariff barriers such as export taxes, voluntary export restraints and export subsidies have largely replaced the use of these traditional instruments.

Chapter four will give a historic overview of South Africa's trade policy and the road towards a fully liberalised South African economy.

Chapter 4

OVERVIEW OF SOUTH AFRICA'S TRADE POLICY

4.1 Introduction

South Africa, not unlike many other middle-income developing countries, has at various times traveled the paths of both import-substituting industrialisation (ISI) and export-oriented industrialisation (EOI), as documented in a number of studies. Notable among these are Strydom (1995), Jenkins and Siwisa (1997) and Cassim *et al.* (2001), which chronologically identify the stages of the country's industrialisation.

Table 4.1 illustrates the various policies and stages that the South African government has implemented in the process of trade liberalisation.

Table 4.1: Timeline of policy changes, implementations and relevant events

Years(s)	Policy change, important commissions, relevant events
1925-72	***The period of import-substitution industrialisation (ISI)***
1925	Adoption of ISI with the Customs Tariff and Excise Duty Amendment Act
1948	Introduction of QRs
1958	Viljoen Commission recommends continued ISI, but using tariffs rather than QRs or subsidies
1969	SA government announces its intention to lift QRs under pressure from the GATT and the IMF, but does nothing
1972-83	***The first liberalisation episode***
1972	Reynders Commission recommends export promotion
1972	Export incentive measures are introduced
1972-76	Some relaxation of QRs
1975-79	The Rand is devalued
1978	Further assistance to exporters introduced in line with the Van Huyssteen Committee's proposals
1979-80	Rand appreciates sharply
1983-91	***The second liberalisation episode***
1983	Kleu Study Group recommends a move away from ISI
1983-85	The reduction of QRs is resumed
1983	The dual exchange rate system is abolished
1983-85	The external value of the Rand falls significantly
1985	Government white paper recommends a dual approach to industrial policy: ISI and export promotion
1985	Debt crisis; dual exchange rate system re-introduced
1985	Substantial import surcharges introduced
1987	BTI begins to move away proactively towards trade policy reform
1989	QR removal continues
1989	'Structural adjustment' export incentives introduced for clothing, textiles, automotives and automotive components
1990	General Export Incentive Scheme (GEIS) is introduced
1990	The phasing out of the import surcharge begins; not completed
1991	An accelerated depreciation tax scheme is introduced
Current	***The third trade liberalisation episode***
1994	The conversion of QRs to tariffs is completed
1995	Import surcharges are eliminated
1995	Tariff reduction in line with GATT requirements begin
1995	The financial Rand is abolished
1995	Negotiations with the European Union over trade preferences commence
1996	The SADC free trade protocol is signed
1997	Further exchange control liberalisation is announced
1997	EMIA was updated

Source: Jenkins & Siwisa, 1997:50

South Africa has always relied heavily on international trade. During the years prior to 1925, South Africa's economic growth rate was almost entirely determined by the exports of gold, diamonds and agricultural products (Blatch *et al.*, 1995:207-208).

Bell (1992) identified two trade liberalisation periods in South Africa. The first period began in 1972 with the report of the Reynders Commission of Inquiry into the export trade of South Africa. The second period started in 1983 with the programme to replace QRs with equivalent tariffs. During the second period vigorous export promotion was pursued. With the lowering of tariffs under an agreement with the GATT, South Africa has entered a third liberalisation period. The trade liberalisation process in South Africa has survived the changes in government, which reduces the possibilities of a reversal of the process (Jenkins & Siwisa, 1997:2).

In sections 4.2, 4.3, 4.4 and 4.5 the various liberalisation episodes from import substitution, through the first and second liberalisation episodes as well as the third and current liberalisation episode will be described.

4.2 Import substitution (1925 to 1972)

South Africa was one of the first middle-income countries of the world to openly adopt a policy of ISI according to Levy (1992:4-5).

In the years leading up to World War II, South Africa followed a policy of import-substitution. This policy stance of ISI was motivated by the following (Cassim *et al.*, 2001:6; Botha, 1973:334; Lumby, 1990:63).

- It was seen as a vehicle for industrialisation,
- It was seen as a manner to create employment for white people within the manufacturing sector,
- It was a seen as a mechanism to reduce South Africa's reliance on the exports of agricultural produce and gold and,
- It was seen as a means to reduce South Africa's dependence on the UK.

The Customs Tariff and Excise Duty Amendment Act of 1925 initiated a protectionist tariff policy rather than a revenue-orientated tariff policy where protection extended considerably and affected a large number of industries that had not previously been affected (Kleu Report, 1983). This act enabled the Board of Trade and Industries (BTI), now the Board of Tariffs and Trade (BTT), to recommend tariffs for specific activities and made provision for judicious and selective tariff protection. Its recommendations were invariably accepted and with only some exceptions continued into the 1990s (Jenkins & Siwisa, 1997:2).

Further interventions followed, such as the establishment of parastatal enterprises and development institutions together with the introduction of QRs on imports in 1948. In fact the main instrument of industrial protection after 1948 was import controls rather than import tariffs (Lachman, 1974:25-31).

Support for this new strategy was not undisputed as seen by the fact that The Economic and Wage Commission, which was appointed by the government only weeks after the passing of the 1925 Act, provided a jaundiced criticism of protection. Furthermore, the Customs Tariff Commission, which was appointed in 1934 with the intention of reviewing the effects and application of this policy, came to the conclusion that protection was having a negative impact on initiative, risk taking and competitiveness although there has been substantial gains in employment and industrial expansion, and thus argued that this strategy was not unequivocally advantageous. At this point many industries as well as companies were dependent on protection for their survival and the maintenance of protection became a political issue. Justification for the continued use of this policy was found in the fact that an increasing number of other countries pursued similar policies. The 1958 Viljoen Commission recommended that a policy of ISI be continued but that QRs and subsidies should be replaced by the use of tariffs. Despite this fact, QRs remained an important element of protection. The threat of economic isolation form 1960 added to the strategic need for continuing ISI behind tariff and non-tariff barriers, especially of strategically important commodities (Jenkins & Siwisa, 1997:2).

During the period after Word War II, South Africa's current account of the balance of payments began to show a continued deficit. During this period South Africa relied on the inflow of foreign investment in order to preserve the equilibrium in the overall balance of payments. The deficit on the country's current account increased to such an extent towards the end of the 1960s, that import controls and a devaluation of the Rand became crucial to correct the deficit. It also became evident that the main sources of foreign exchange, namely the exports of gold and agricultural products, could no longer be relied on to the degree that they had been in the past. In addition, South Africa's ore reserves were reducing and agricultural products were affected by poor weather conditions and unstable international supply and demand patterns. All of the above led to the notion that more importance should be given to developing the export potential of the South African manufacturing industry and thus the first liberalisation episode was started in 1972 (Blatch *et al.*, 1995:207-208).

4.3 First liberalisation episode (1972 to 1977)

The first trade liberalisation episode was heralded by the 1972 report of the Reynders Commission of Inquiry into South Africa's export trade. The Reynders Commission was authorised with the identification and removal of barriers hindering free trade as well as indicating ways of strengthening South Africa's export competitiveness (Cassim *et al.*, 2001:7).

The Commission recommended the positive promotion of exports, with specific focus placed on the manufacturing sector, as the long-term solution to future foreign exchange needs. They suggested that the following export incentives are offered to domestic producers (Cassim *et al.*, 2001:7):

- Direct cash grants,
- Tax concessions on export turnover and export profits,
- Rail freight concessions,
- Tax concessions on the use of tariff laden inputs and
- Rebates on import duties paid on imported inputs.

According to Jenkins & Siwisa (1997:2), *the Report of the Commission of Inquiry into the export trade of the Republic of South Africa*, introduced these incentives in order to counteract the effect that the distance from markets and transport cost has on prices, together with the existence of subsidised exports from other countries.

The report further encouraged the replacement of QRs with tariffs lower than those implicit in the QRs, together with a real devaluation of the Rand (Cassim *et al.*, 2001:7).

From June 1972, direct controls on imports were partially relaxed but this ceased to be the case in 1976 as manufacturers increased pressure for protection in the light of the recession of the mid to late 1970s. The 1978 Van Huyssteen Committee's proposals lead to further assistance being offered to exporters and at this time the incentives offered to exporters were consistent (Jenkins & Siwisa, 1997:2).

Bell (1992) stipulates that first episode of trade liberalisation was quite mild due to the fact that its consequences were being mainly eradicated by a substantial real appreciation of the Rand. This appreciation in the Rand led to a weakening of the international competitiveness of South Africa's manufacturers, and consequently increased calls for protection. The prevailing world recession in the early 1980s, gave credibility to the belief that exchange rate management and the level of demand were more important determinants of export levels than the export incentives offered in the early 1970s. However, this conclusion differs from the results of a study done by Holden and Gouws (1997:29), which established that not all manufacturing exports were influenced by the exchange rate, given that some industrial sectors have the benefit of greater productivity as the proportion of exported output grew.

The Commission was criticized for promoting exports in the presence of a largely unchanged protective tariff and import control structure (Ratcliffe, 1975:76). However, the 1980s were typified less by import liberalisation than by trying to improve conditions for exporters. These improvements included the introduction of custom duty drawbacks and duty exemptions. In other words, some trade liberalisation came about in the midst of high levels of anti-export bias (Cassim & Onyango, 2001:2-4).

4.4 Second liberalisation episode (1983 to 1990)

Bell (1992) identifies 1983 as the beginning of a more intensified period of trade liberalisation. This period was characterised by:

- A decline in the pace of economic development, which can be attributed to the collapse of the gold price,
- A sharp decline in general exports,
- Rapidly increasing foreign debt and
- Heightened political instability.

During the period between the end of the first period of trade liberalisation and the beginning of the second period, notable developments included the establishment of the Van Huyssteen Committee (Cassim *et al.*, 2001:8).

4.4.1 Van Huyssteen Commission

The Van Huyssteen Commission's tasks of revising the South Africa's system of export incentives culminated in the introduction of a more powerful system of export incentives. These incentives were introduced with the aim of easing the pressure on exporters that existed due to the comparatively higher cost of local production and the high costs of delivering to international markets. These incentives included, *inter alia,* duty drawbacks and duty exemptions that were granted to exporters. Bell (1992) dismisses this system of duty drawbacks and duty exemptions as unwieldy, since these incentives were not used to obtain free access to more competitive inputs. However, the massive real depreciation of the Rand together with a global recession, which led to a sharp decline in South Africa's exports, had a negative impact on this incentive system (Cassim *et al.*, 2001:8).

4.4.2 Kleu Report

A change in South Africa's protectionist policy became evident during the 1980s (Blatch *et al.*, 1995:207-208). During the 1980s attempts were made by government commissions to favour higher value-added manufactured exports through a more effective system of export incentives. The Kleu Study Group, which was set up in 1977, released an important report concerning the formulation of a new industrial strategy. This report recommended a move away from import substitution, and criticised existing export incentives for neither favouring domestic intermediate inputs, nor for creating incentives for technological innovation. It also looked at the issue of standardised versus selective export assistance, pointing out that if the need of exporters for assistance were taken into account, selective assistance would be more appropriate, but that this might discriminate against more competitive exporters. If, on the other hand, standardised assistance was provided, then some exporters would receive help when they did not need it, or when help would not lead to increased exports (Jenkins & Siwisa, 1997:10).

The Kleu Report criticised the existing export incentives at that time because it did not favour domestic intervention nor did it create incentives for technical innovation. The Kleu Report furthermore queried the merits of uniform export assistance versus selective export assistance, since uniform assistance would benefit all exporters, even those exporters who did not need it (Cassim *et al.*, 2001:8).

It was clear by the end of the 1980s that South African exporters had not changed fundamentally since primary products, particularly minerals, was still dominating the export basket. One of the most important problems was the fact that, for most companies, the anti-export bias nonetheless remained strong. This meant that there were still no real incentive to export. During the early 1990s there were some growth in manufactured exports with the introduction of the General Export Incentive Scheme (GEIS), but this growth was at great cost to the national treasury (Cassim & Onyango, 2001:2-4).

4.4.3 Debt crisis

During 1985, the move towards trade liberalisation gained momentum when a national debt crisis arose. This debt crisis had been the result of a large reduction in foreign direct investment and short-term capital inflows. These reductions led to a large and sustained deficit on the country's balance of payments (Cassim *et al.*, 2001:8).

The 1985 debt crisis necessitated a further shift in trade policy. A large and sustained deficit on the capital account of the balance of payments was created through the outflows of both long- and short-term capital from 1985 together with the near standstill on inflows of both direct investments and loans. This required action by the monetary authorities to turn the historical current-account deficit into a substantial surplus in order to service foreign debt (Jenkins & Siwisa, 1997:11).

This led to the re-introduction of the dual exchange rate system together with a considerable real depreciation of the Rand as well as the introduction of a 10 percent import surcharge (Cassim *et al.*, 2001:8).

The introduction of a 10 percent surcharge led to an increase in the weighted average of the effective protection rate from 30 percent to 70 percent (in 1987 estimates). Effective protection rates varied from a low of 1,0 percent (for non-electrical machinery) to a high of 348 percent for synthetic resins, as compared to a range of 1,0 percent to 143 percent for the same commodities in the previous period (Jenkins & Siwisa, 1997; Cassim *et al.*, 2001:8).

Also in 1985 the positive list of permitted imports was replaced with a negative list of imported items requiring approval, with unrestricted entry of all unlisted items (Jenkins & Siwisa, 1997:9). Bell (1992) identifies this action as a big step towards trade liberalisation.

4.4.4 Board on Tariffs and Trade

South Africa's dedication towards the process of trade liberalisation became more obvious towards the end of the 1980s, when the BTT, which had succeeded the BTI, hardened its attitude towards private sector requests for protection. In 1989, only 20 percent of such requests were supported, as opposed to 38 percent in 1988 and 65 percent in 1987. During 1989 there was an increase in export promotion due to the introduction of sectoral "structural adjustment programmes" (Cassim *et al.*, 2001:8).

The aim of these structural adjustment programmes was to make a profit. The first programmes were implemented in 1989 and applied to the motor vehicle, textiles and clothing industries. Local producers in these industries were allowed to import duty-free inputs or finished goods as long as they exported a sufficient part of their output (Jenkins & Siwisa, 1997:11).

This approach to redress the anti-export bias has been controversial and was criticised by government officials within the DTI for creating increased administrative requirements, and by observers both within and outside the industries concerned for providing incentives for fraud in the form of fictitious exports (Jenkins & Siwisa, 1997:11).

Shortly after the first structural adjustment programmes were introduced, the DTI indicated that these programmes would be phased out over a period in favour of a more uniform incentive programme (Jenkins & Siwisa, 1997:11).

4.4.5 General Export Incentive Scheme (GEIS)

The process towards trade liberalisation continued in the beginning of the 1990s with the introduction of GEIS in April 1990. GEIS was introduced in order to replace the export incentives of the 1980s. GEIS was designed as an economy-wide package, based on value added and local content, and offered considerable incentive to export (Cassim & Onyango, 2001:2-4).

These incentives were put into practice through a selective system of liberal tax-free grants. These grants increased through four phases of higher value-added and domestic content, with industries characterised by both high value-added and high local content qualifying for a nominal subsidy of 19,5 percent of export turnover, while those firms with low value-added and low domestic turnover qualified for only 2 percent. Fluctuations in the value of the Rand compared to a basket of major international currencies were also taken into account. Imported materials benefiting from the duty drawback system were, however, not entitled to any compensation under the GEIS scheme (Cassim *et al.*, 2001:9).

The South African government successfully negotiated with GATT in 1993 for the continued maintenance of GEIS and its extension to exporters of non-factor services for a period of five years, arguing that it would assist with the post-apartheid reconstruction. This agreement was observed when South Africa signed an agreement with the WTO, which included a commitment to a three-year phase-out beginning April 1995. GEIS was to be replaced by a newly refined drawback scheme for exporters (Jenkins & Siwisa, 1997:12).

Although GEIS did not differ very much from schemes in the 1980s insofar as it motivated exports via the output side of the equation, rather than on the input side, it was certainly more comprehensive than anything available during the 1980s (Cassim & Onyango, 2001:2-4).

4.4.6 Concluding remarks

Other developments in trade policy included the tax incentive under the 37E programme, which was introduced in 1991 with the aim of further encouraging beneficiated exports and then abolished in September 1993, and the availability of 9 percent loans form the Industrial Development Corporation (IDC) for exporters (the prime overdraft rate in 1991 was 20,25 percent) (Jenkins & Siwisa, 1997:12).

4.5 Current policy/third liberalisation episode (1991 onwards)

4.5.1 International Development Corporation (IDC)

During June 1990, shortly after the introduction of GEIS, the IDC published a study entitled *The Modification of the Application of Protection Policy* (IDC, 1990). This report argued that the scope for further ISI was limited and that a shift towards EOI was necessary in order to further liberalise trade (Cassim *et al.*, 2001:9).

This report supported a much more uniform and lower tariff structure, stating that the existing system was substandard because of the cost-raising implications of a relatively high protective structure, as well as the resource misallocation occuring from sectoral variations in protection levels. This report was in strong contrast to the structural adjustment programmes of the BTT (Cassim *et al.*, 2001:9).

This report identified, *inter alia,* (Cassim *et al.*, 2001:9):

- The absence of frequent tariff reviews,
- Limited further opportunities for ISI,
- Lack of highly skilled personnel to administer selectivity in an effective manner,
- Excessive use of cost-raising formula duties, as warranting a process of

structural adjustment towards EOI.

This report also included the lowering of protection by way of replacing formula duties with more specific anti-dumping measures, and supported the gradual downward adjustment of tariffs to pre-determined levels within a 4 to 5 year timeframe. The only exceptions to this downward adjustments of tariffs would be pertaining to those industries that still qualified for protection at parallel levels to those prevailing in more established industries (Cassim *et al.*, 2001:9).

There were concerns that the new government, which has close associations with the trade and labour unions, would be under pressure to undo the reforms and opt for a more protectionist policy, since protection favoured labour. However, as stated in Jenkins and Siwisa (1997:15) both the Industrial Strategy Project (ISP), commissioned by the largest trade union body (ISP, 1993) and the framework for macroeconomic policy commissioned by the African National Congress (MERG, 1993) acknowledged the need for South Africa to become globally more competitive. Both of these programmes recommended a more neutral trade regime with a straightforward and transparent tariff structure, tariff reductions in line with GATT requirements, and guaranteed export incentives for a period of five years after the change of government. All of the above recommendations have since been implemented.

4.5.2 General Agreement on Tariffs and Trade/World Trade Organisation (GATT/WTO)

South Africa's benefits from being a member of GATT include the following (Blatch *et al.*, 1995:207-208):

- South Africa benefits from tariff concessions made by any GATT member through the most-favoured-nation or non-discrimination principle. This means that South African exports enter GATT member countries at tariffs lower than would be the case were South Africa not a GATT member. These tariff reductions embody great advantages for South African exporters, such as extended markets and considerable increases in foreign exchange earnings. Tariff concessions also smooth the progress of marketing South African products abroad.

- South Africa benefits from the flexibility of many of the GATT rules. This means, for example, that although one of the articles of the Agreement prohibits the use of quantitative restrictions between member countries, another article states that countries that are experiencing balance of payments difficulties may impose import quotas in order to prevent a serious decline in such a country's foreign reserves. South Africa has, on occasion, made use of this concession.
- South Africa forms part of a secure international organisation that determines future trading relationships.

South Africa's membership to GATT has from time to time been questioned on the following two counts (Blatch *et al.*, 1995:207-208):

- It has been reasoned that South Africa, which is a founder member of GATT, is prohibited through its membership from providing sufficient protection to local industry.
- It has also been argued that membership to the GATT would only be beneficial to South Africa if the GATT regarded South Africa as a developing country.

The view of the South African Government concerning South Africa's position in the GATT is that South Africa's membership advantages outweigh the disadvantages. Furthermore, the South African government is of the opinion that non-membership would introduce severe risks for South Africa, given the volume and nature of South Africa's trade and South Africa's status as an important trading nation (Blatch *et al.*, 1995:207-208).

It is during the 1990s that a more significant and continuous process of trade liberalisation began, despite some trade liberalisation during the 1980s (Cassim *et al.*, 2001:9). South Africa was under pressure from the US and Europe to revise its first GATT offer. These countries objected to the high protection that was given to the clothing, textiles and motor industries (Jenkins & Siwisa, 1997:15).

This shift in South Africa's trade policy has, to some extent, been driven by the increasing pressure on South Africa to conform to GATT requirements – particularly from the early 1990s when sanctions against South Africa began to subside (Blatch *et al.*, 1995:207-208).

South Africa's offer to the WTO on conclusion of the Uruguay Round of trade negotiations consisted of a five-year tariff reduction and rationalisation programme and South Africa has undertaken to (Cassim & Onyango, 2001:2-4):

- Increase the proportion of bound tariffs from less than 20 percent to just over 50 percent,
- Increase the percentage of bound zero-rated tariff lines to just over 25 percent,
- Reduce the simple average tariff for industrial tariffs by one third in a phased reduction programme.

The tariff on clothing was reduced to 45 percent, compared to the 60 percent offered, the tariff on motor vehicles was reduced from 150 to 100 percent, while the 45 percent tariff on textiles was preserved (Jenkins & Siwisa, 1997:15).

These programmes involved reducing the number of categories from over a 100 to just 6. These were to be at zero, five, ten, fifteen, twenty and thirty percent. The only exceptions to the five-year tariff liberalisation programme were the clothing, textiles and automotive sectors, which were each granted eight years to achieve the levels made in the WTO offer (Cassim *et al.*, 2001:9).

The offer also included a reduction in average weighted import duties from 34 to 17 percent for consumption goods, 8 to 4 percent for intermediate goods, and 11 to 5 percent for capital goods. South Africa's dedication to the opening up of these sectors to international competition was implicit, since the GATT/WTO requisites for these categories were 26 percent, 4 percent and 15 percent respectively (Cassim *et al.*, 2001:10).

The tariff phase–down schedule under the WTO is shown in Table 4.2 and it can be seen that South Africa's average tariff declined from 11,7 percent in 1994 to 4,9 percent in 2004 (Cassim & Onyango, 2001:2-4).

Table 4.2: South Africa's average tariff rates

New ISIC	Description	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
3	Textiles	30.1	33.8	31.8	24.9	23.4	21.9	20.3	18.7	17.3	17.3	17.3
4	Clothing, excl. footwear	73.7	73.6	68.2	54.6	50.5	46.4	42.4	37.7	33.2	33.2	33.2
5	Leather and leather products	14.9	14.8	14.1	16.5	15.7	14.8	14.8	14.8	14.8	14.8	14.8
6	Footwear	37.5	41.6	39.1	36.8	34.2	29.1	29.1	29.1	29.1	29.1	29.1
7	Wood and wood products	13.9	3.6	3.4	3.5	3.3	3.1	3.1	3.1	3.1	3.1	3.1
8	Paper and paper products	9.6	9.3	9.1	8.8	8.7	8.5	7.9	7.3	6.8	6.2	5.6
9	Printing and publishing	8.1	1.3	1.2	1.1	1.0	1.0	1.0	1.0	1.0	1.0	1.0
10	Petroleum and petroleum products	1.6	-	-	-	-	-	-	-	-	-	-
11	Industrial chemicals	9.3	7.5	7.5	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
12	Other chemical products	9.0	3.8	3.7	2.7	2.6	2.5	2.5	2.5	2.5	2.5	2.5
13	Rubber products	30.5	14.5	14.1	15.8	15.4	14.9	14.6	14.4	14.0	14.0	14.0
14	Plastic products	19.8	14.7	13.7	13.2	12.6	12.0	12.0	12.0	12.0	12.0	12.0
15	Glass and glass products	11.8	9.5	9.0	8.3	7.9	7.6	7.6	7.6	7.6	7.6	7.6
16	Non-metallic mineral products etc	10.6	8.7	8.1	8.4	8.0	7.7	7.7	7.7	7.7	7.7	7.7
17	Basic iron and steel products	7.6	4.4	4.2	4.2	4.1	3.9	3.9	3.9	3.9	3.9	3.9
18	Non-ferrous metal products	2.3	2.3	2.3	2.3	2.2	2.0	2.0	2.0	1.9	1.7	1.7
19	Metal products, excl. machinery	13.1	8.2	7.8	7.8	7.6	7.4	7.4	7.4	7.4	7.4	7.4
20	Non-electrical machinery	6.5	1.4	1.3	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
21	Electrical machinery	11.0	6.1	6.0	5.8	5.8	5.7	5.7	5.7	5.7	5.7	5.7

22	Radio, television and communication apparatus	12.1	5.1	3.7	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3
23	Professional equipment etc.	7.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
24	Motor vehicles, parts and accessories	55.4	33.5	31.7	29.3	27.9	26.1	24.8	23.2	22.1	22.1	22.1
25	Other transport equipment	1.4	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
26	Furniture	28.1	21.4	20.8	20.2	19.6	18.9	18.9	18.9	18.9	18.9	18.9
27	Other manufacturing	2.9	1.0	1.0	5.2	5.1	5.0	4.9	4.9	4.9	4.9	4.9
82	Mining	2.7	0.6	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Total		11.7	7.2	6.8	6.1	5.8	5.5	5.3	5.1	4.9	4.9	4.9

Source: IDC, as cited in Cassim *et al.*, 2001:10

Predictions were that the GATT offer would cause great difficulties for the textile and motor industries; yet it did not prevent Ford US form purchasing a 45 percent stake in South Africa's fourth largest vehicle maker in November 1994. The offer to GATT did not prevent the announcement in September 1994 from the then Minister of Trade and Industry that these industries, in other words the textile and automobile industries, should expect tariffs to be reduced to below those levels agreed to with the GATT. In March 1995 the Minister of Trade and Industry retracted an earlier commitment to provide R4,5 billion in subsidies to textile producers, and announced that tariff protection for the local textile industry would be lowered even faster than required by the GATT (Jenkins & Siwisa, 1997:16).

In the offer to the WTO the South African government has reserved the right to use import controls under special circumstances. However, these import controls, should the decision be made to apply them, will only be applicable for a limited period. Import controls may be used in order to temporary protect infant industries or to temporary protect an industry against alleged dumping from counties that are not member countries of the WTO, as was the case in the footwear industry during March 1997. Progress has been made on restructuring anti-dumping and countervailing legislation in order to make the system more transparent and 'equitable'. Stronger legislation in respect of anti-dumping and countervailing will allow for the phasing out of formula duties (Jenkins & Siwisa, 1997:16).

This phase-down in tariffs will give rise to an estimated R600 million loss in tariff revenue over a period of five years. However, there may be some savings as the GEIS, which cost the government R2 billion annually, was eliminated in July 1997 and replaced with a new system of export incentives (Jenkins & Siwisa, 1997:16).

4.5.3 Supplementary measures

Supplementary measures are extending the process of trade liberalisation, for example the introduction of the privatisation programme in 1996 and the abolition of nearly all agricultural marketing boards by the end of 1997. These marketing boards had all the power over the imports, exports and prices of most agricultural products and their closing down was in line with WTO requirements. However, among the objectives of closing down the marketing boards was to break the monopolistic stranglehold over agricultural markets and to opening up the agricultural sector (Jenkins & Siwisa, 1997:17).

The DTI has developed a strategy of integrated trade and industrial policy measures in order to promote production within the manufacturing industry. This was done with aim of increasing the exports of manufactured products. A deliberate shift in policy occurred when the use of demand-side interventions, such as subsidies, were terminated. Such subsidies have been known to lower the risks of manufacturing. A variety of supply-side measures, such as a new pre-shipment export guarantee programme for small- and medium-scale enterprises, support for industrial innovation, human resource development, and investment promotion schemes, have been introduced in addition to the use of rebates and drawbacks (Jenkins & Siwisa, 1997:17).

The Export Marketing Assistance scheme (EMIA) was updated in April 1997 in order to reinforce the export drive. EMIA was designed to assist potential and existing exporters with (Jenkins & Siwisa, 1997:16):

- Primary export market research,
- Trade missions and exhibitions ,
- Investigations into both inward and outward investment opportunities.

The phased liberalisation of exchange controls in South Africa has taken place at the same time as the opening up of trade. During March 1995 the financial Rand, along with capital controls applicable for non-residents, was abolished. However, this did not generate the anticipated outflows of capital and expected depreciation of Rand. In July 1997 there were further relaxations in the exchange controls applicable on South African residents (Jenkins & Siwisa, 1997:17).

A number of other measures were also proposed with the intention of increasing exports. These included (Cassim *et al.*, 2001:9):

- The lowering of corporate taxes,
- Encouragement of higher domestic savings,
- Realistic exchange rate policies,
- An improvement in the supply of skilled labour.

4.6 Summary

In this chapter an overview was presented of South Africa's trade policy. South Africa is not unlike many other developing countries and has at various times traveled the path between ISI and EOI.

Traditionally, South Africa followed a policy of import substitution until 1972, when the first liberalisation episode began. This period of trade liberalisation was characterised by the Reynders Commission and the introduction of export incentives. This period was followed by another period of trade reform from 1983 to 1991, when a move away from ISI was recommended. After this period of reform, the country embarked on its third episode of trade liberalisation, which entailed the phase-down of tariffs in accordance with WTO rules.

South Africa's trade reform has been far more intensive than required by the WTO. The question can now be asked about the impact of this drastic and rather fast reform on the South African economy.

In chapter five an analysis will be given on the impact that trade liberalisation in South Africa had on its automotive and textile industries.

Chapter 5

THE IMPACT OF TRADE LIBERALISATION ON THE SOUTH AFRICAN AUTOMOTIVE AND TEXTILE INDUSTRIES

5.1 Introduction

According to the former Minister of Trade and Industry, Mr. Alec Erwin, South Africa's approach to become a globally competitive economy has focused on lowering tariffs and becoming and export-oriented economy (DTI, 2003:6).

South Africa has embarked on an extensive trade liberalisation programme, agreed to under the GATT in 1994. This program built on the trade liberalisations in the early 1990s. The steepest cutbacks have been in those sectors that were previously the most profoundly protected. During this period of reform, quantitative and formula duties have been converted to *ad valorem* tariffs. Simultaneously, other trade-related measures that contravene the WTO rules, such as local content requirements and some export incentives, have also been eradicated. The tariff liberalisation programme, however, goes further than terms obligated by the GATT agreement, and has been justified by the South African government's macroeconomic strategy (GEAR) as being indispensable to the generation of export-led growth (Roberts & Thoburn, 2002:4).

In this chapter, an analysis will be done on the impact that trade liberalisation in South Africa has had on the South African automobile and textile industries. As was the case in many other developing countries, the South African automotive industry has, in the past, been protected by a mixture of high tariff barriers on imported vehicles as well as by local content requirements (Black, 2001:14). Concomitantly, the textile sector had the highest tariff rate in 1990 (Roberts & Thoburn, 2002:5). Over the past ten years, these two industries have been increasingly exposed to international competition as a result of falling protection and this chapter analyses the impact of these developments on the exports, imports, production and employment within each industry. Section 1 is a short introduction, where after section 2 and 3 will discuss the effect that trade liberalisation has had on the South African automotive and textile industries respectively, the protection that is in place, the phase-down of the relevant protection, the impact of liberalisation on exports and imports as well as employment within the relevant industry. Conclusions will be drawn in section 4.

5.2 The automotive industry

5.2.1 Introduction

During the past five decades the South African automotive industry has re-engineered itself from being one of the world's most protected and inefficient industries to being an outstanding global competitor and a progressively more self-sufficient industry (NAAMSA, 2003:18).

The South African automotive industry consists of sophisticated vehicle assemblies, component manufacturing and R&D facilities (Viviers, Saayman & Muller, 2003:4) and can be described in terms of three sub-sectors: OEMs (Original Equipment Manufacturers, in this case the car assemblers), T1 (Tier 1 suppliers, supplying to the OEMs), and T2 suppliers (tier 2 suppliers, supplying to the T1 suppliers) (Barnes, 1999:3).

The automotive components industry in South Africa developed out of the first automobile assembly plants established in South Africa during the 1920s (DTI, 2002:39). The industry's increasingly fairly low costs and the accessibility of raw materials make it a key supplier of components, including exhaust catalysts, automotive leather products, and wheels (Viviers *et al.*, 2003:4).

Even as this picture did not transform much over the next twenty years, the low intensity of value added within the South African automotive industry led the South African government to target the sector after World War II. This was due to the fact that the automotive sector accounted for 15 percent of total imports in 1960 and because it was seen to have both growth potential and externalities to other sectors of the South African economy (Barnes, 1999:3).

The South African automotive industry has become one of the fastest growing international suppliers for assembled vehicles – including BMW, Mercedes-Benz, VW and Toyota – to markets including Asia, Europe and North America (Viviers *et al.*, 2003:4). Nearly every major international vehicle brand sells into the South African market and uses the country as its gateway into sub-Saharan Africa (Viviers *et al.*, 2003:4).

The South African vehicle assembly industry, in close proximity to its suppliers, is situated in three of South Africa's nine provinces. Gauteng is home to BMW South Africa, Nissan South Africa, including the assembly of Fiat, as well as Ford Motor Company of Southern Africa integrating the assembly of Mazda, Volvo and Land Rover. KwaZulu Natal is home to Toyota South Africa, while the Eastern Cape hosts Volkswagen of South Africa, DaimlerChrysler South Africa and the Delta Motor Corporation.

The vehicle assemblers in South Africa are similar to other assemblers across the world in that they hold a solid position within the global automotive industry. This strength has, in the past, often led to confrontational associations with retailers and component suppliers. The liberalisation of the international automotive industry had the effect that the interactions between role players in the supply chain have changed. Partnerships have started to develop merely because all role players recognised that this is the only way onwards (Williams, 2004a:1).

The following statistics draw attention to the past growth performance in new vehicle sales (NAAMSA reported sales).

Table 5.1: Growth performance in new vehicle sales

Year	New Car Sales	New Commercial Vehicle Sales	Total New Vehicle Sales
1950	36 758	7 676	44 434
1960	98 779	20 385	119 164
1970	201 854	95 719	297 573
1980	277 058	127 708	404 766
1981	301 528	152 013	453 541
1990	209 608	125 171	334 779
2000	224 122	116 960	341 082
2001	239 060	127 839	366 899
2002	231 602	118 452	350 054

Source: NAAMSA, 2003:18

Local OEMs are part of a universal system, as are some of the component suppliers (Williams, 2004a:1).

The following section discusses the impact of the South African automotive industry on the domestic economy concerning production, trade and employment.

5.2.2 Impact of the automobile industry on the South African economy

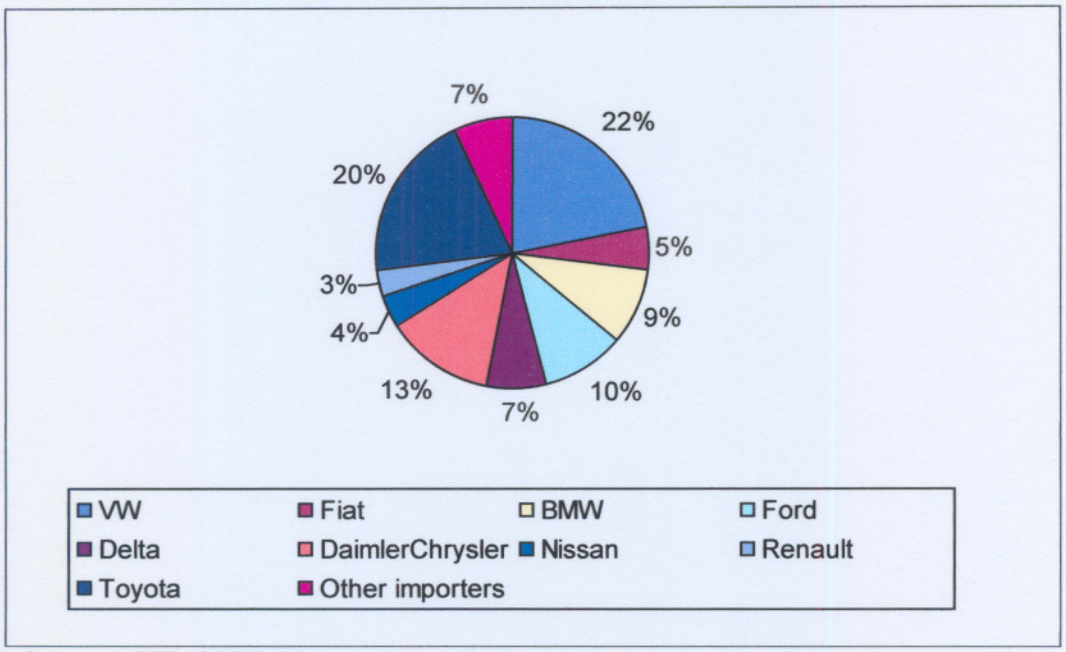
5.2.2.1 Production

The South African automotive industry contributed approximately 6,4 percent to South Africa's gross domestic product of R1 098,7 billion in 2002. The broader South African automotive industry presented the largest manufacturing sector in the South African economy and accounted for just under 30 percent of the country's manufacturing output during 2002 (NAAMSA, 2003:6).

South Africa is ranked eighteenth in terms of worldwide vehicle production and increased its segment from 0,6 percent in 2000 to 0,69 percent in 2002 (DTI, 2002:39; NAAMSA, 2003:22). This increase was mainly the result of an increase in domestic vehicle sales and rapid export development. The domestic component market was estimated at approximately R30 billion in

2002. This represents 3 percent of the global automotive parts industry of US$ 1 trillion in 2002 (DTI, 2003:28). The following graph gives an indication of the domestic market share of passenger cars[1]

Figure 5.1: Domestic market share of passenger cars



Source: DTI, 2003:14

The vehicle assembly industry consists of twelve assembly plants and seventeen marques (DTI, 2003:26).

Table 5.2 summarises the domestic production of new vehicles from 1995 to 2002.

[1] Percentages are rounded to the nearest 1%. Other importers include the smaller independent importers such as Peugeot, Citroen, Daewoo, Honda, Hyundai, Kia, SAAB, Sabura, Lada and Daihutsu.

Table 5.2: Domestic production of new vehicles from 1995 to 2002

Period	Total domestic production[2]	Percentage growth
1995	389 476	-
1996	386 311	-0.82
1997	362 104	-6.69
1998	312 055	-16.04
1999	326 065	4.30
2000	357 364	8.76
2001	406 149	12.01
2002	404 441	-0.42

Source: NAAMSA, 2003:3 and own calculations

Table 5.2 indicates that South Africa's automotive production declined over the period 1995 to 1998, whereafter production increased from 312 055 in 1998 to 406 149 in 2001. There was a slight decrease of 0,42 percent in production from 2001 to 2002.

5.2.2.2 Trade

5.2.2.2.1 Exports

5.2.2.2.1.1 New vehicle exports

As stated earlier, the export sector of the South African economy is seen as the engine of South Africa's growth into the international economy, and in this regard, the automotive industry is a contributor par excellence (Black, 2002:5). In 2002, the automotive sector contributed 12,8 percent to South Africa's total exports, up from a mere 4 percent in 1995 (DTI, 2003:8).

Figure 5.2 indicates the growth in the exports of new vehicles from 1995 to 2003.

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[2] Domestically produced vehicles include cars, light, medium and heavy commercials. The South African vehicle manufacturing industry does not report production data, only retail and export sales. NAAMSA uses sales of domestically produced vehicles and export sales as a proxy for South African vehicle production.

Exporters of components tend to focus on high-value, domestically beneficial components that take up as little transport and space as possible. Table 5.3 clearly indicates the strong growth in the exports of components. Components exports have increased from R7 895 million in 1998 to R22 883 million in 2002, which represents an increase of 189 percent. Although catalytic converter remained the main component exported under the Motor

Industry Development Programme (MIDP), this category's share of total exports declined from 48,4 percent in 2001 to 40,2 percent in 2002 (DTI, 2003:27).

Table 5.3: Major component exports from 1998 to 2002 in R million

Component Category	1998	1999	2000	2001	2002	% of total (2002)
Catalytic converters	1 520	2 569	4 683	8 989	9 204	40,2%
Stitched leather components	1854	1888	1926	2391	3184	13,9%
Tyres	498	639	682	781	1379	6,0%
Road wheels and parts	446	518	551	725	955	4,2%
Engine parts	390	383	409	520	771	3,4%
Engines	334	54	76	88	623	2,7%
Wiring harnesses	207	304	319	391	457	2,0%
Automotive tooling	256	264	362	441	363	1,6%
Silencers/exhaust pipes	493	598	377	282	340	1,5%
Automotive glass	112	147	171	241	328	1,4%
Transmission shafts/cranks	62	85	127	149	236	1,0%
Ignition/starting equipment	47	94	128	195	231	1,0%
Brake parts	76	79	95	118	215	0,9%
Radiators	108	111	72	70	199	0,9%
Filters	72	85	118	114	184	0,8%
Car radio's	47	73	89	115	171	0,7%
Batteries	79	68	100	116	150	0,7%
Body parts/panels	30	75	84	107	140	0,6%
Axles	7	13	63	81	129	0,6%
Gauges/instruments/parts	30	59	64	77	119	0,5%
Clutches/shaft couplings	51	54	59	92	110	0,5%
Other components	1 176	1 514	2 085	2 503	3 395	14,9%
Total	7 895	9 674	12 640	18 586	22 883	100%

Source: DTI, 2003:27

The growth in exports is also illustrated by the following export revenues of South African produced automotive components and vehicles (NAAMSA, 2003:4).

Table 5.4: Export revenues for component exports and vehicle export from 1990 to 2002

Year	Value of Components Exports (R Millions)	Value of Built-up Vehicle Exports (R Millions)	Total (R Millions)
1990	287	381	668
1991	523	392	915
1992	832	419	1 251
1993	1 307	581	1 888
1994	1 550	695	2 245
1995	3 318	900	4 216
1996	4 051	750	4 801
1997	5 115	1 600	6 715
1998	7 895	2 100	9 995
1999	9 600	5 100	14 700
2000	12 640	7 400	20 040
2001	18 585	11 400	29 985
2002	22 883	17 220	40 103

Source: NAAMSA, 2003:4

5.2.2.2.2 Imports

The imports on new vehicles, used vehicles and components and parts will be subsequently described.

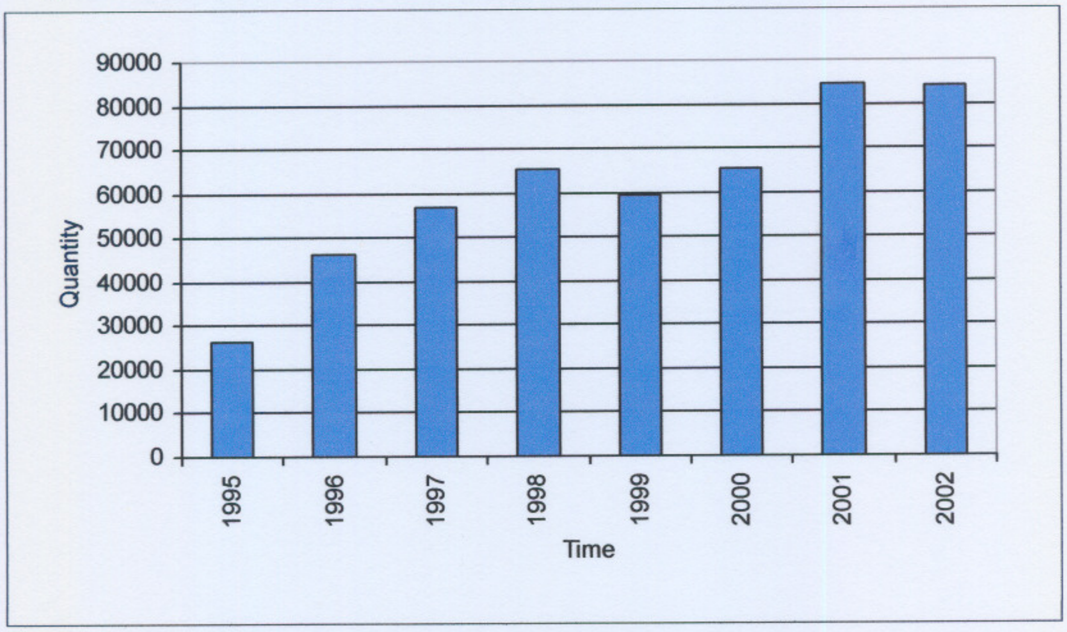
5.2.2.2.2.1 New vehicles

Until the early 1990s, prohibitive tariff levels resulted in negligible imports of vehicles into South Africa. Domestic vehicle prices were consistently above international price levels (Black, 2001:15).

The value of the imports of passenger car amounted to R10,3 billion in 2002. Of this amount, 45 percent originated from Germany, South Africa's main automotive trading partner, 12 percent from Japan, 11,9 percent from the United States of America and 9 percent from France (DTI, 2003:19).

Figure 5.3 indicates the quantity of new vehicle imports from 1995 to 2002.

Figure 5.3: Importation of new vehicles from 1995 to 2002



Source: NAAMSA, 2003:3

It is evident from figure 5.3 that there was an increase in the number of new vehicles being imported from 1995 to 1998, whereafter there was a slight decline from 1998 to 1999. However, since 1999 the number of new vehicles imported has continued to increase to levels a level of 84 049 in 2002, which represents an increase of 41 percent from 1999 to 2002.

5.2.2.2.2.2 Used vehicle imports

Strict control measures ensure that only a limited number of import permits are issued for the import of used vehicles into South Africa. In terms of existing legislation, used vehicles that meet the requirements for an import permit include (DTI, 2003:22):

- Vehicles for returning residents and immigrants,
- Vintage cars,
- Racing cars,
- Donated vehicles for welfare organisations,
- Adapted vehicles for persons with physical disabilities.

Table 5.5 stipulates the number of import permits that were granted for used vehicles.

Table 5.5: Number of import permits granted from 1998 to 2002

Year	Number of import permits granted
1998	490
1999	674
2000	731
2001	713
2002	510

Source: DTI, 2003:22

5.2.2.2.2.3 Component and parts

Aftermarket parts are imported from South Africa's main trading partners and reveal the presence of European, Japanese, American and Asian OEMs in the local market. South Africa's vehicle park is growing and ageing, which requires the replacement of parts for passenger cars and trucks. The aftermarket, however, is more and more coming under pressure as accessories such as alloy wheels, air conditioning, audio systems and others, are included by OEMs as standard equipment in new models (DTI, 2002:12).

Table 5.6 gives an indication of component and parts being imported (in R millions) for the period 2001 to 2002.

Table 5.6: Imports of component and parts

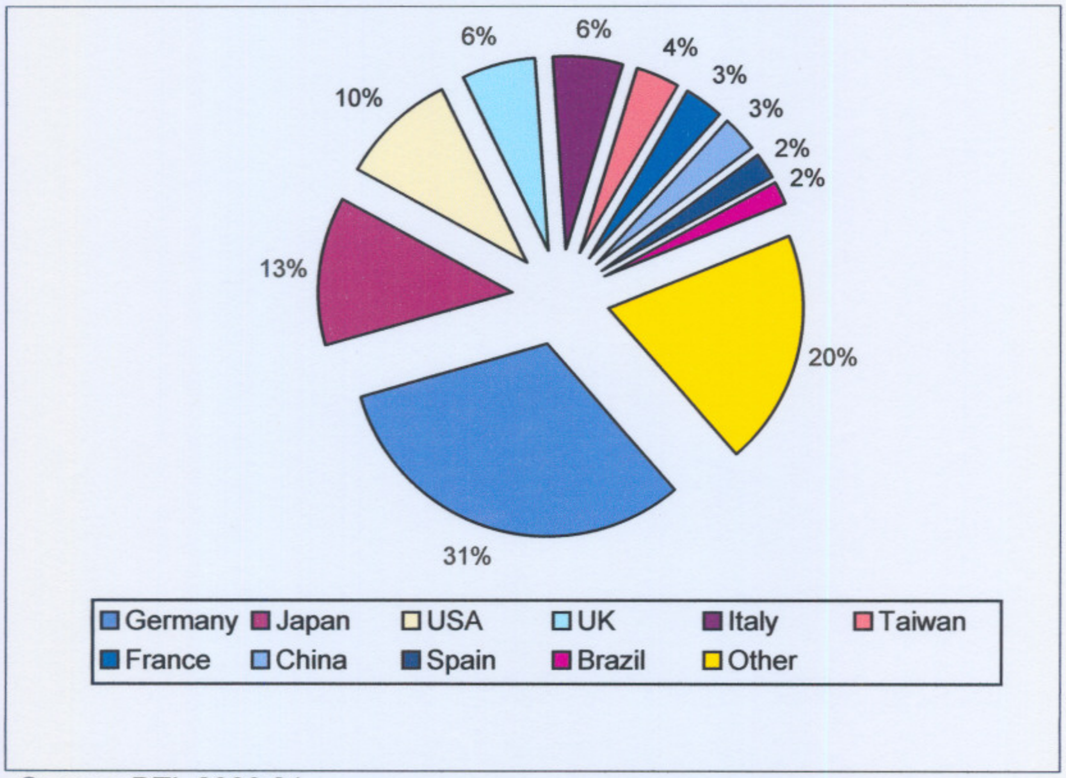
Category	2001	2002
Automotive tooling	1 289	1 547
Engine parts	1 054	1 545
Tyres	558	814
Stitched leather seat components	451	805
Gauges/instrument parts	429	572
Brake parts	297	467
Transmission shafts	283	356
Catalytic converters	259	332
Lighting equipment	188	257
Axles	144	238
Other	5 562	7 203
Total	**10 514**	**14 136**

Source: DTI, 2003:21

From table 5.6 it is clear that component imports increased from 2001 to 2002. However, this was in line with the aim of the MIDP to encourage local companies to specialise in the manufacture of high-volume products. This results in obtaining economies of scale benefits to export competitively, which then enables the local companies to import low-volume ranges (DTI, 2003:20).

Top ten countries of origin for parts and components imported are illustrated in figure 5.4.

Figure 5.4: Top ten countries for the importation of parts and components



Source: DTI, 2003:21

5.2.2.2.3 *Trade balance*

The South African automotive industry is a major role player in the South

African economy, despite the fact that the industry has a negative trade balance (Barnes, Kaplinsky & Morris, 2003:7). The industry's trade balance is shown in the table 5.7 and it can be seen that although the industry has a negative trade balance, there was a decrease in the deficit from 1996 to 2001, whereafter there was again a slight increase of R2,1 million.

Table 5.7: South African automotive industry's trade balance from 1995 to 2002

Year	Exports (Rand billions)	Imports (Rand billions)	Trade balance (Rand billions)
1995	4,2	16,4	-12,20
1996	5,1	19,2	-14,10
1997	6,6	17,2	-10.60
1998	10,1	19,9	-9,80
1999	14,8	22,8	-8,00
2000	20,0	29,7	-9,70
2001	30,0	38,0	-8,00
2002	40,1	50,2	-10,1

Source: DTI, 2003:31

5.2.2.3 *Employment*

Black (2001:16) and the DTI (2002:32) state that employment within the South African automotive industry is very cyclical and closely linked to economic growth and export levels.

Average monthly employment levels by major sector over the period 1997 to 2002 may be shown as follows:

Table 5.8: Average monthly employment by major sector

	1997	1998	1999	2000	2001	2002
Vehicle Manufacturing Industry	37 100	33 700	32 000	32 300	32 700	31 700[3]
Automotive Components	78 000	70 000	67 200	69 900	70 700	75 000
Tyre Industry	9 500	9 100	6 670	6 575	6 300	6 000
Motor Trade, Distribution & Servicing	180 000	170 000	175 000	180 000	182 000	191 000
Total	**304 600**	**282 800**	**280 870**	**288 775**	**291 700**	**303 700**

Source: DTI, 2002:19; NAAMSA, 2003:5

In economic terms, the South African automotive industry's gearing effect in creating work opportunities can be tracked down to numerous kinds of basic manufacturing activities, including steel production, paint and rubber, textiles, plastics, petrochemical industries and component fabrication. In addition, because the automotive industry provides employment by proxy in many other areas (civil servants in licensing departments; Customs and Excise personnel; tax official; staff in local authorities that provide supportive services to the industry), the impact that the automotive industry has on a large part of employed South Africans is substantial (NAAMSA, 2003:18).

5.2.3 Trade policy with regard to the South African automotive industry

5.2.3.1 History

The policy environment with regard to the automotive industry stretches back to 1961, with the introduction of a series of six local content programmes. These local content programmes were designed with the aim of conserving foreign exchange reserves, rather than to rationalise production. This had

[3] The leather division of BMW South Africa Pty (Ltd) – South Africa Trim – was sold effective 1st July 2002 and, as a result, the employment numbers involving over 1 000 employees are no longer reflected in terms of vehicle manufacturing industries member and, from said date, fall under automotive components

the effect that, over the next thirty years, there was a sharp increase in assembly plants (seven), assembling 34 different platforms by 1993. Additionally, the first five programmes that lasted until 1989, defined local content by weight rather than value (Barnes *et al.*, 2003:5).

By the mid 1980s South Africa had developed a reasonably large and diversified automotive industry, despite decades of protection. During this policy stance, there was a prohibition on the rates of protection on assembled vehicles, while the domestic component sector was supported by requirements that specified that 60 percent of the mass of the vehicle had to be locally produced. This resulted in a highly, inward-oriented industry that comprised a large number of product lines that were produced in low volume and at a relatively high cost. The first major change to the traditional policy of protection came with the introduction of Phase VI of the local content programme. Phase VI of the local content programme allowed firms to include exports as part of their local content requirements (Black, 2001:14-15; Black, 2002:2).

Phase VI of the local content programme was the first shot to deal with the problems of an inward-oriented fragmented industry with low production volume and subsequent high unit costs. Most important, however, was the fact that local content was to be measured not just by the value of locally produced components fitted to locally assembled vehicles, but on the basis of net foreign exchange usage. This meant that exports by an assembler counted as local content and enabled the assembler to reduce actual local content, to a minimum of 50 percent, in locally produced vehicles. This resulted in the rapid growth of exports, especially of components. This growth in exports gave assemblers greater flexibility with regard to their sourcing arrangements (Black, 2002:2).

One of the problems of the previous versions of the local content programme was uneconomic volumes, with the resultant high production cost. It was anticipated that the first five local content programmes would encourage both local content and specialisation. However, they did not deal with the proliferation of makes and models in the local market. The effective rate of protection for assembly increased sharply under Phase VI of the local content programme due to an increase in the elasticity of component sourcing, with a resultant reduction in the protection of components, together with maintaining high nominal protection levels on built-up vehicles. This increase in the effective rate of protection for assembly led to greater certainty with regard to an increase in the variety of models and makes being assembled domestically (Black, 2002:2).

Phase VI of the local content programme was heavily criticised, with numerous changes adding to the atmosphere of uncertainty. During 1992 the Motor Industry Task Group was chosen with the task to re-examine the local content programme and to advise government as to the future development of the industry. The eventual outcome of the Motor Industry Task Group was the introduction in 1995 of the Motor Industry Development Programme (MIDP) (Black, 2002:2).

5.2.3.2 Motor Industry Development Programme

The automotive industry is inclined to be well regulated and assisted by governments worldwide. In South Africa, the rules that currently regulate the South African automotive industry are set out in a government document that is located at the back of the Customs Act and is called MIDP. The MIDP was published in September 1995 with the intention of making the local automotive industry globally competitive over a realistic period of time. The DTI administers the MIDP, with the help of customs officials.

The objectives of the MIDP were to (Barnes *et al.*, 2003:5-6):

- Improve the global competitiveness of firms within the South African automotive industry,
- Enhance the industry's growth via exporting,
- Improve the affordability of vehicles,
- Improve the industry's highly distorted trade balance,
- Stabilise employment levels.

The measures taken to promote competitiveness were to slowly reduce the import duties relevant at the time, from levels of over 100 percent, down to levels accepted by the GATT. The level that was accepted by the GATT was important as the GATT was, at that time, about to become the WTO and the South African Government had every intention of being compliant with the WTO's rules and regulations (Williams, 2004b:1).

The MIDP has been reviewed twice since its inception, first in 1999 and for the second time in 2002, in order to perfect it. The MIDP was extended with the second review in 2002 to 2012 (Barnes *et al.*, 2003:6). This extension was given in order to give a longer planning horizon to participants and to deal with some of the trivial imbalances that had crept in. All participants in the South African automotive industry, including the component manufactures, vehicle assemblers, retailers and labour had input into the review and the MIDP is strongly backed by the participants as being a impartial system that is reasonable, but tough (Williams, 2004b:1).

For all intents and purposes, the MIDP puts down a timetable for reducing import tariffs for completely built-up (CBU) vehicles and completely knocked down (CKD) components for motor vehicles and light commercial vehicles. Passenger vehicles and light commercial vehicles are subjected to the following tariff phase-down under the MIDP:

Table 5.9: Tariff phase-down under the MIDP

Year	CBU (percent)	CKD (percent)
2003	38	29
2004	36	28
2005	34	27
2006	32	26
2007	30	25
2008	29	24
2009	28	23
2010	27	22
2011	26	21
2012	25	20

Source: Williams, 2004b:1-2

CBU medium and heavy vehicles (above 3,5 tonnes) may be imported at a duty of 20 percent and components for these vehicles may be imported duty free, except for tyres, which attract a duty of 6 percent from the European Union (EU), or 10 percent from elsewhere. Semi-knocked down (SKD) vehicles may be imported at the CBU rate, but the importing of second hand vehicles are not permitted (Williams, 2004b:1).

Role players registered within the MIDP may cut the duty payable through one of the following three mechanisms:

(i) The Duty Free Allowance (DFA),

(ii) An import/export complementation scheme,

(iii) The Productive Asset Allowance (PAA).

All of these mechanisms will subsequently be described.

5.2.3.2.1 The Duty Free Allowance

The DFA is a straightforward calculation where 27 percent of the wholesale price of the vehicle may be imported duty free (Barnes *et al.*, 2003:6; Williams, 2004b:2).

5.2.3.2.2 Import/Export complementation schemes

The import/export complementation scheme agrees to reductions of import duties on motor vehicles and light commercial vehicles consistent with values exported. For every Rand of CBU exported, a percentage settled on by the Value of Export Performance (VEP) of CBUs may be imported duty free. For every Rand of components exported, a percentage determined by the VEP of components may be imported free of duty, or 0,6 percent times the price of CBU may be imported free of duty (Williams, 2004b:2).

The VEP started at 94 percent in 2003 and reduces by 4 percent each year to 70 percent by 2009, whereafter it will stay fixed at 70 percent (Williams, 2004b:2).

There is a final cutback in the value that may be imported that pertains to the platinum group metal (PGM) content of catalytic converters, where only 40 percent of the precious metal content may be incorporated in the calculation (Williams, 2004b:2).

The import/export complementation scheme is regulated by the issue of Import Rebate Credit Certificates (IRCCs) to registered exporters, as soon as the foreign funds have been repatriated. These IRCCs may be conveyed once and can be sold by the exporter to a registered importer (Williams, 2004b:2).

The final duty payable is the fiscal duty. This fiscal duty is calculated on a descending scale in relation to the vehicle retail price. At R50 000, the duty is just under 0,5 percent and at R180 000, the duty is over 2,5 percent. The value of the fiscal duty purposes may be diminished using the IRCC system (Williams, 2004b:2).

5.2.3.2.3 Productive Asset Allowance

With the broadcast of the midterm review of the MIDP in 1999, the South African government also presented the PAA. This is a scheme whereby investors in new plant and equipment can be eligible for a duty credit certificate up to 20 percent of the value of their investment over a five-year period. This scheme gives investors a boost; while it is further an indication of what course the MIDP will take after 2012 (Williams: 2004b:1-4).

The main purpose of the PAA is to support model rationalisation: the vehicle assemblers are motivated to produce fewer models at increased volumes and import low volume models instead by using the duty credit certificates that they may receive based on the value of productive assets they invest in (DTI, 2004b:1).

The MIDP is quite simple in theory, but the consequences on company strategy can be quite immense. There is an ongoing debate between the various automotive participants about how satisfactory objectives are being met and the effects of the different limitations of the programme (Williams, 2004b:1-4).

5.2.4 The impact of trade liberalisation on the automotive industry

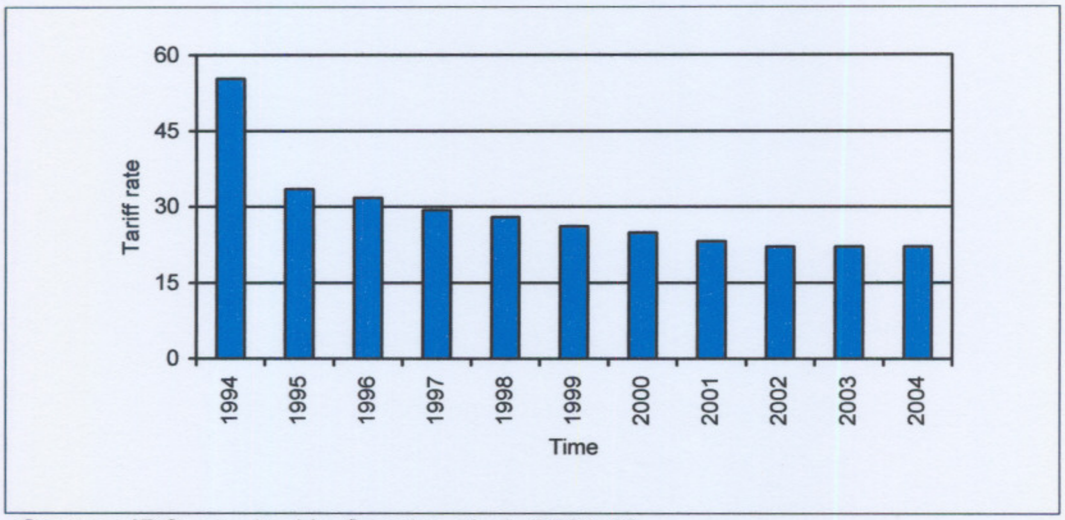
In the previous sections, an introduction was given to the South African automotive industry concerning its history and the applicable policies as well as the industry's production, trade and employment. The question can be asked as to how the tariff liberalisation within the South African automobile industry has affected the industry's production, trade balance and employment statistics.

In the following sub-section an analysis will be given on the impact of tariff liberalisation on the South African automotive industry's performance relating to production, trade and employment.

5.2.4.1 Tariff phase-down

Figure 5.5 illustrates the phase-down in tariffs that was applicable to the South African automotive industry.

Figure 5.5: Tariff phase-down for the automotive industry from 1994 to 2004



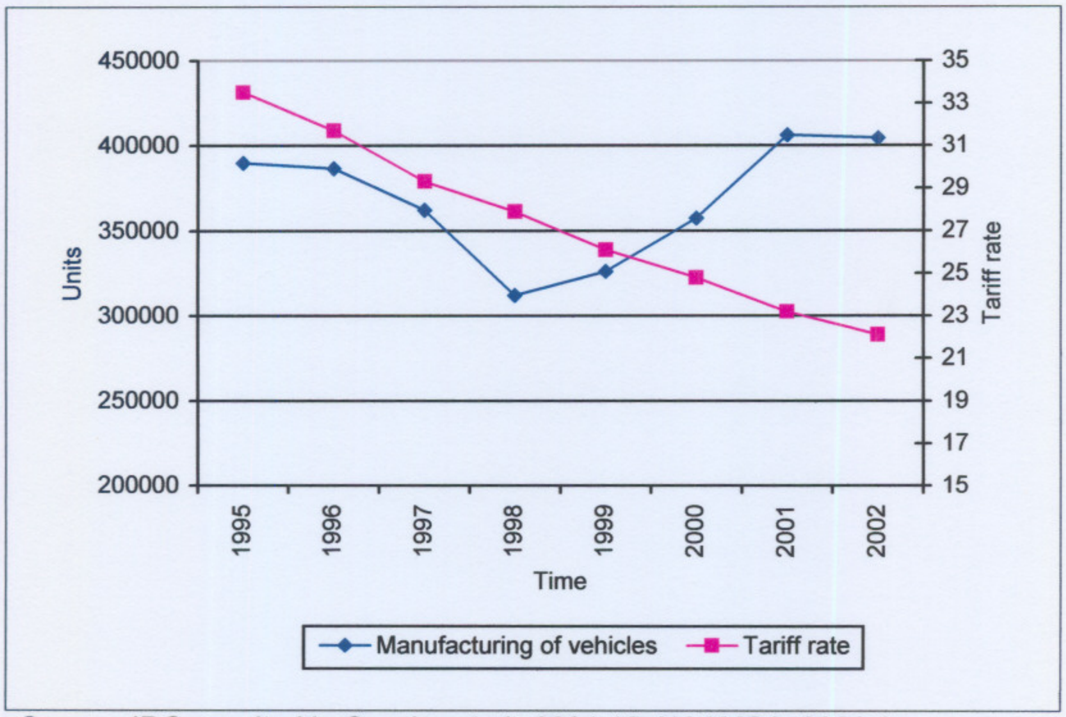
Source: IDC, as cited in Cassim *et al.*, 2001:10

From figure 5.5 it is clear that there was a dramatic phase-down in the applicable tariff, especially from 1994 to 1995 when the tariff decreased from 55,4 to 33,5 percent. There was a constant phase-down in the applicable tariff rate from 1994 to 2002, whereafter the tariff stabilised at 22,1 percent.

5.2.4.2 Production

The impact of trade liberalisation with regard to domestic vehicle manufacturing is illustrated in figure 5.6.

Figure 5.6: Tariff phase-down and the vehicle manufacturing



Source: IDC, as cited in Cassim *et al.*, 2001:10; NAAMSA, 2003:3

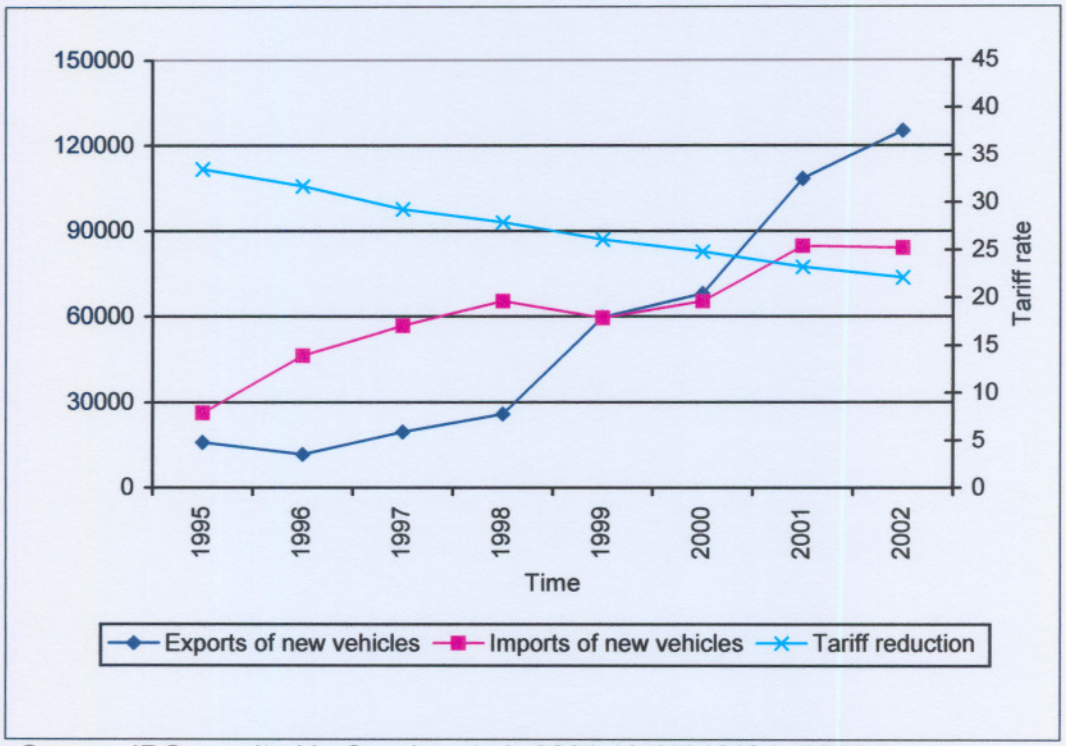
From figure 5.6 it is clear that there was a decline in the production of new vehicles from 1995 to 1998, coinciding with the initial reductions in the tariff rate. However, production increased from 1998 to 2001, despite further reduction in the tariff rate. There was a slight decrease in production from 2001 to 2002. This reduction can be ascribed to higher financing costs, above-average new vehicle price increases and an increasing pressure on personal disposable income (DTI, 2003:12).

Although there was an increase in domestic production, it does not necessarily imply that there was an increase in units exported and imported. The following section analyses the impact that the tariff phase-down had on the industry's trade.

5.2.4.3 Trade

Figure 5.7 indicates the impact that the tariff phase-down had on the exports and imports of the South African automotive industry.

Figure 5.7: Tariff phase-down and exports and imports of automotive industry



Source: IDC, as cited in Cassim *et al.*, 2001:10; NAAMSA, 2003:3

The initial impact of tariff reductions affected the export of vehicles negatively, with a decrease of 4 211 units from 1995 to 1996. However, since 1996 the exports of vehicles showed growth. Imports increased from 1995 to 1999. Despite the reductions in tariffs, there was a slight decrease in imports of nearly 10 percent from 1999 to 2000.

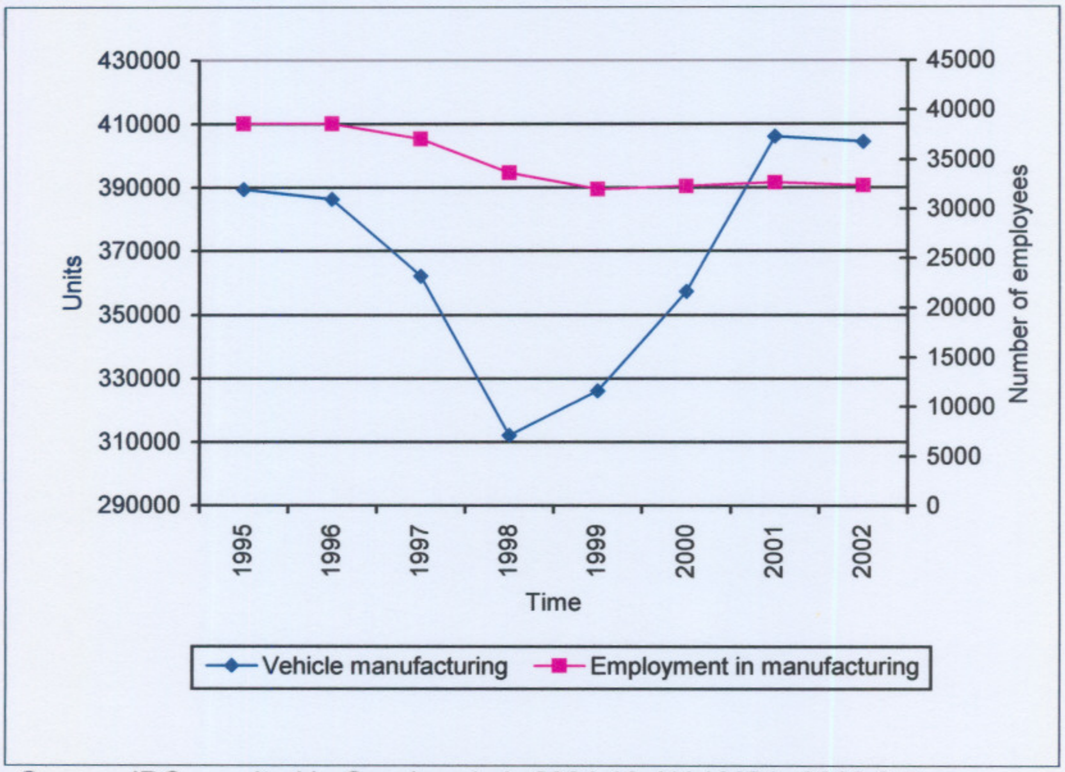
From the above graph it is clear that there was modest growth in vehicle exports until 1999, when exports increased from 25 896 in 1998 to 59 716 units in 1999. From 1995 to 1999 imports of vehicles exceeded the exports of vehicles, but this trend was reversed in 1995 when exports were almost equal to imports, whereafter the gap started to widen.

The MIDP motivates OEMs to import low-volume models and focus on the production of high-volume models (DTI, 2002:11). As a result of this, as well as the progressive lowering of import tariffs, the percentage of total new vehicle imports in relation to the domestic market increased from 6,5 percent in 1995 to 23,1 percent in 2002 (NAAMSA, 2003:3).

5.2.4.4 Employment

Figure 5.8 indicates the impact of trade liberalisation of the South African automotive industry on vehicle manufacturing and employment within the vehicle manufacturing sector.

Figure 5.8: Tariff phase-down and employment levels



Source: IDC, as cited in Cassim *et al.*, 2001:10; NAAMSA, 2003:3-5

The South African automotive industry is extremely cyclical and this shows up in the general employment levels (Black, 2001:16). Despite a sharp increase in the manufacture of new vehicles from 1998 to 2001, there was a decline in the average employment level. This can be indicative of more capital intensive production methods.

In the sections above the automotive industry was described in terms of its background, the impact it has on the economy and the policies and programmes that were put in place in order to liberalise the sector. As mentioned earlier, the automotive and textile industries were formerly the most protected industries and the question can now be asked as to the impact that liberalisation had on the textile sector.

5.3 The textile industry[4]

5.3.1 Introduction

The textile production chain is made up of separate levels of processing in which raw material is made into yarn, which in turn is made into fabric (either knitted, woven or non-woven) from which an assortment of articles are made, including clothing. There is also a series of 'other textiles' activities concerning the manufacture of diverse finished products, many for industrial use (Roberts & Thoburn, 2002:2).

The South African textile industry is divided into seven sub-sectors namely: spinning & weaving; manufacturers of man-made (synthetic) textiles; garments and hosiery knitting mills; other knitting mills; manufacturers of carpets and rugs; cordage, rope and twine industries; and other textiles not classified (Machaka, 2002:6; Roberts & Thoburn, 2002:3).

These sub-sectors are quite different from each other. The large textile categories, such as spinning, weaving and finishing, cover a number of production stages and conflicting grades and types of products. The South African textile industry's largest sub-sector is spinning & weaving, followed by made-up textile, knitting mills, and other knitting mills, while carpets and rugs are the smallest sector (Machaka, 2002:6).

5.3.1.1 Wool

[4] In this dissertation the term textiles is used in the narrow sense; that is to exclude clothing. This is also the normal usage in South Africa.

Wool is produced under different conditions in most parts of South Africa. In South Africa the purebred Merino is the sheep breed with the highest wool production per head. South Africa produces environmentally friendly and high quality wool, which is predominantly a Merino clip. The wool's micron range ranges between 18 and 27, with more than 80 percent of the clip finer than 24 microns. Firm precautionary measures to safeguard against the contamination of wool during growing, shearing and packing have been introduced as a fundamental part of the marketing process (Textile Federation, 2004:6-7).

More than 90 percent of the wool clip is sold through the auction system, which has been centralised in Port Elizabeth, and then sold in the international markets. Although the wool clip is mainly sold in Port Elizabeth, it is stored in all four of South Africa's major ports: Port Elizabeth, East London, Cape Town and Durban (Textile Federation, 2004:6-7).

The price of wool is influenced by the supply and demand in the free market and is strongly linked to the international prices for apparel wool. The Australian market, as the biggest wool producing country and market, is the main driving force that influences the international price for apparel wool (Textile Federation, 2004:6-7).

South Africa has about 21 million sheep with a 1999/2000 production of 49,8 million kg of wool and an average yield of 60,3 percent. The 1999/2000 domestic sales value of the wool clip was R512,8 million while the local consumption of wool fibres during 2000 was in the region of 11 million kg (Textile Federation, 2004:6-7).

5.3.1.2 Mohair

South Africa's Eastern Cape is the global leader in the production of mohair. Mohair represents less than one per cent of all globally produced natural fibres, with South Africa generating more than 60 percent of the world's mohair production. The advanced breeding and farming techniques used in

South Africa guarantee the consistent availability and fibre quality of mohair (Textile Federation, 2004:6-7).

5.3.1.3 *Cotton*

South Africa's main cotton producing areas are the Springblok Flats, the Limpopo Valley, the lower Orange River, North West Province, Mpumalanga and KwaZulu-Natal. Cotton is produced under both dry land and irrigation conditions. South Africa produces only about 40 percent of its domestic cotton fibre requirements, with the other 60 percent being imported. This imported cotton is mostly produced on dry land. The yield of cotton in respect of irrigated land is approximately 1136 kg/hectare (Textile Federation, 2004:6-7).

The South African cotton crop for 2001/2002 was 39 million kg, while it is estimated to be in the order of 21 million kg for the 2002/2003 season. Approximately 78 percent of South Africa's 2002 cotton fibre imports are of Zimbabwean and Zambian origin (Textile Federation, 2004:6-7).

5.3.1.4 *Sisal*

South Africa's existing sisal areas are situated in a "horse-shoe" configuration, beginning in Hluhluwe in KwaZulu-Natal and then moving northwards toward Mkuze, Pongola, Barberton and Tzaneen whereafter it moves southwards towards Gillead and ends up at Zebediela in the Limpopo (Textile Federation, 2004:6-7).

The inclination has been to grow sisal in the drier, hotter climate of Mpumalanga's Lowveld areas, where other agricultural crops have proved not to be economically feasible (Textile Federation, 2004:6-7).

South African grown sisal is graded according to International Sisal Grading Regulations, which are accepted across the world. The indigenous sisal fibre is well received on world markets due to its high quality. Domestic production has decreased with about 1 000 tonnes per annum in recent years in view of the fact that there were huge labour uncertainty (Textile Federation, 2004:6-7).

Sisal production can be classified into two main lines, namely line fibre, that is used for the production of ropes and twines and tow fibre that is used as padding material in mattresses and for the reinforcing of concrete products (Textile Federation, 2004:6-7).

5.3.1.5 Man-made fibres

South Africa is a large producer of man-made fibres such as polyester and polyamide (nylon). South Africa's consumption of man-made fibres during 2000, was approximately 67 percent of South Africa's total fibre usage (Textile Federation, 2004:6-7).

Sasol Fibres, until recently operating in Durban, KwaZulu-Natal, was Africa's only acrylic fibre producer that used to specialise in the production of custom-built, producer-dyed acrylic fibres. Sasol Fibres closed its doors in 2002 because of fierce competition from imported fibres (Textile Federation, 2004:6-7).

SANS Fibres, which is situated in Cape Town, is South Africa's most important producer and exporter of filament and monofilament nylon and polyester yarns (Textile Federation, 2004:6-7).

Hosaf Fibres (previously Hoechst Fibres) is the main producer of polyester staple fibres, while SAPY, situated in Hammersdale, KwaZulu-Natal, is the chief producer and exporter of multifilament polypropylene yarns (Textile Federation, 2004:6-7).

The history of the South African textile industry is relatively short, dating back to before the World War II, when the primary activity concerned the manufacture of blankets, rugs and sheeting. At the beginning of the war, the

South African textile industry provided approximately 3 500 jobs and it satisfied roughly 90 percent of South Africa's requirements of the aforesaid items by 1944. In the period directly after the war, the South African textile industry expanded noticeably, even though the main expansion took place between 1950 and 1960 (Textile Federation, 2004:2-5).

By 1960, nineteen enterprises produced knitted fabrics (excluding knitted garments and hosiery) and 46 mills produced cotton-based yarns and woven fabrics. These 46 mills supplied the local South African market with more or less 90 percent of its cotton and cotton-blend yarns, 42 percent of its cotton fabrics and 16 percent of its cotton-blend fabrics (Textile Federation, 2004:2-5).

The first synthetic fibre plant was commissioned in 1964 with a capacity of 2 500 tonnes per year, with total synthetic fibre capacity currently at 140 000 tonnes per year. In the wool worsted sector, four of the seven mills were entirely integrated (spinning and weaving) and three of these seven mills were merely yarn producers (Textile Federation, 2004:2-5).

During the same period, the worsted weavers fulfilled 95 percent of plain worsted fabric demand and 60 percent of fancy fabrics. In the following three decades, the South African textile industry grew in size and in the variety and sophistication of its products – and it also faced grave problems. The growth in size of the domestic market, mainly during the 1960s and into the first half of the 1970s, was only reasonably continued in the 1980s (Textile Federation, 2004:2-5).

The expected result of these circumstances was that the domestic industry had to meet the requirements of diversity at volume levels that tended to thrust production costs higher than those of its foreign competitors. The insistent and often price-disruptive strategies of the major exporting countries in the East aggravated the problem. This was a problem that had to be met, given that the South African textile industry plays a vital role to the overall economy, not least of all through import substitution and the significant provision of employment (Textile Federation, 2004:2-5).

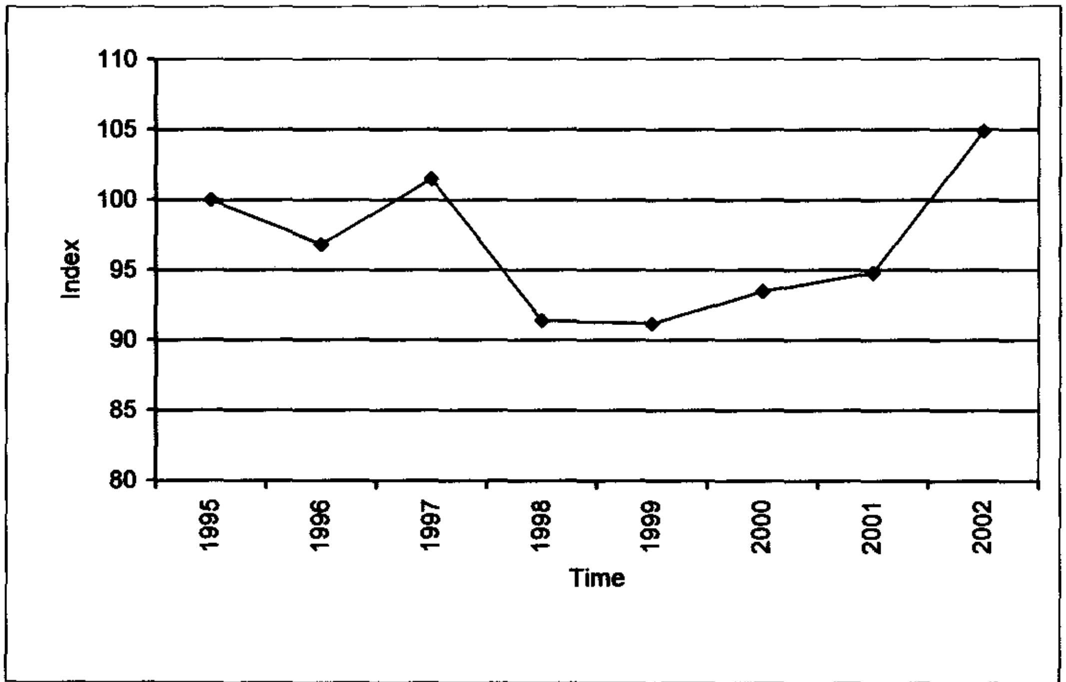
5.3.2 The impact of the South African textile industry on the South African economy

5.3.2.1 Production

The domestic textile industry contributes approximately 1,2 percent to the country's GDP in 2002 of R1 098,7 billion. The South African textile industry's production is more or less equivalent to that of the South African plastics industry, and parallel to a third of South Africa's agricultural production. After the mines, the South African textile industry is the second largest consumer of electricity from Eskom and the second largest payer of rates and taxes in towns and cities around South Africa in which it is located (Textile Federation, 2004:6-7).

Figure 5.9 illustrates an index of the physical volume of production of total textiles with constant prices (1995=100).

Figure 5.9: Index of the physical volume of textile production



Source: Textile Federation, 1996, 2001 & 2004

From figure 5.9 it is clear that there was a decrease in production from 1995 to 1996, whereafter there was a slight increase from 1996 to 1997. However, what can clearly be seen is the sharp decline in production from 1997 to 1999, when production declined from an index number of 101,5 to 91,2. After 1999, there was a constant increase in total textile production from an index number of 91,2 in 1999 to 104,9 in 2002.

This sharp decrease from 1997 to 1999, and the increase thereafter can be ascribed to the characteristic of the new South African textile market. In this new South African textile market, the demand for diversity was not very different to that of the classy 'first world'. The level of consumption overall, however, continued to be relatively low, totaling less than a third of the developed countries in the West (Textile Federation, 2004:2-5).

Even at the present time, the domestic per capita consumption of all textile fibres represented by all end usage, is still less than 7 kg. The apparel fabric requirements, which stand for about 40 percent of the output of the South African textile industry, are consequently highly fragmented and detached from the "drill, twill and sateen" production range of the South African textile industry's early growth period (Textile Federation, 2004:2-5).

The improvement of both fashion and variety in the formerly dull world of domestic and household textiles, compromising another 40 percent of production (inclusive of blankets and carpeting), offered the same problem of relatively low volumes and high variety (Textile Federation, 2004:2-5).

This led to the inevitable result that the domestic textile industry had to meet the requirements of variety at low volume levels. However, this tended to push production costs higher than those of its international competitors. In order to achieve variety at higher volume levels, the South African textile industry drew up plans appealing for investments of more than R3 billion over a period of five years. Since 1995, large capital investments have already been made and the improving financial performance of some of the industry's main companies provides solid evidence of the South African textile industry's willpower to succeed. Over the last few years there were some important changes in the ownership of textile companies within South Africa and the South African textile industry finds itself in the hands of a few large corporations (Textile Federation, 2004:2-5).

5.3.2.2 Trade

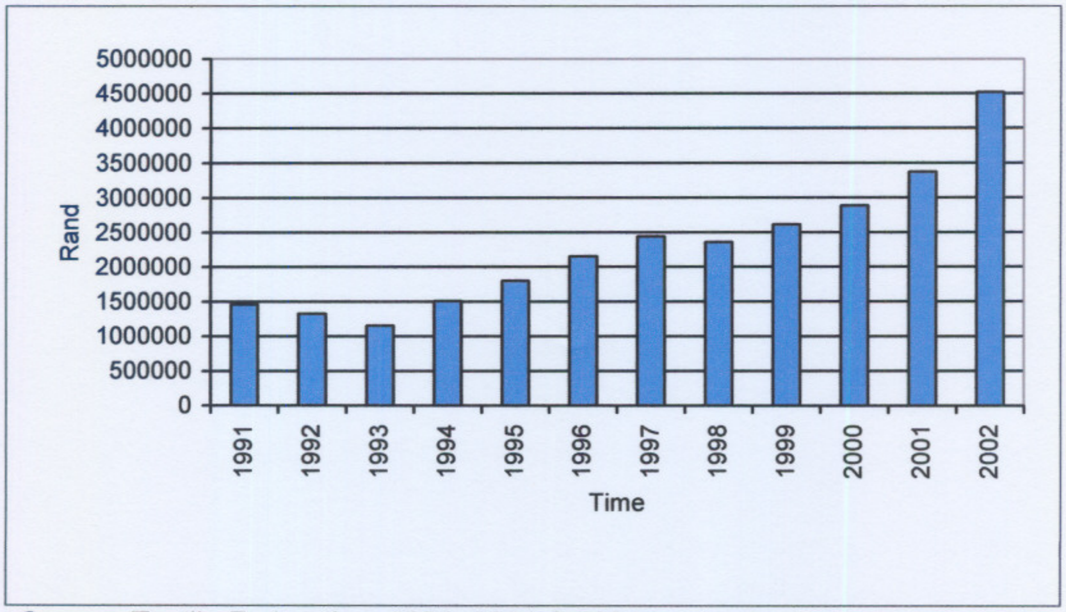
5.3.2.2.1 Exports

In 2002, the South African textile sector contributed R4,5 billion to total exports, which represents an increase of 55 percent from the R2,9 billion in 2000 (Textile Federation, 2001:5; Textile Federation, 2004:6). The South African textile industry is South Africa's eleventh largest exporter of manufactured goods (Textile Federation, 2004:6).

The bulk of South African textile exports are destined for European countries especially the United Kingdom. However, the levels of South African exports to European countries have decreased from 56 percent in 1999 to 41 percent in 2001 (Machaka, 2002:13).

Figure 5.10 illustrates South Africa's textile industry's exports from 1991 to 2002 in Rand Million. It can be seen that was a constant increase in the exports of textiles from 1998 onwards, with exports increasing by approximately 92 percent from 1998 to 2002.

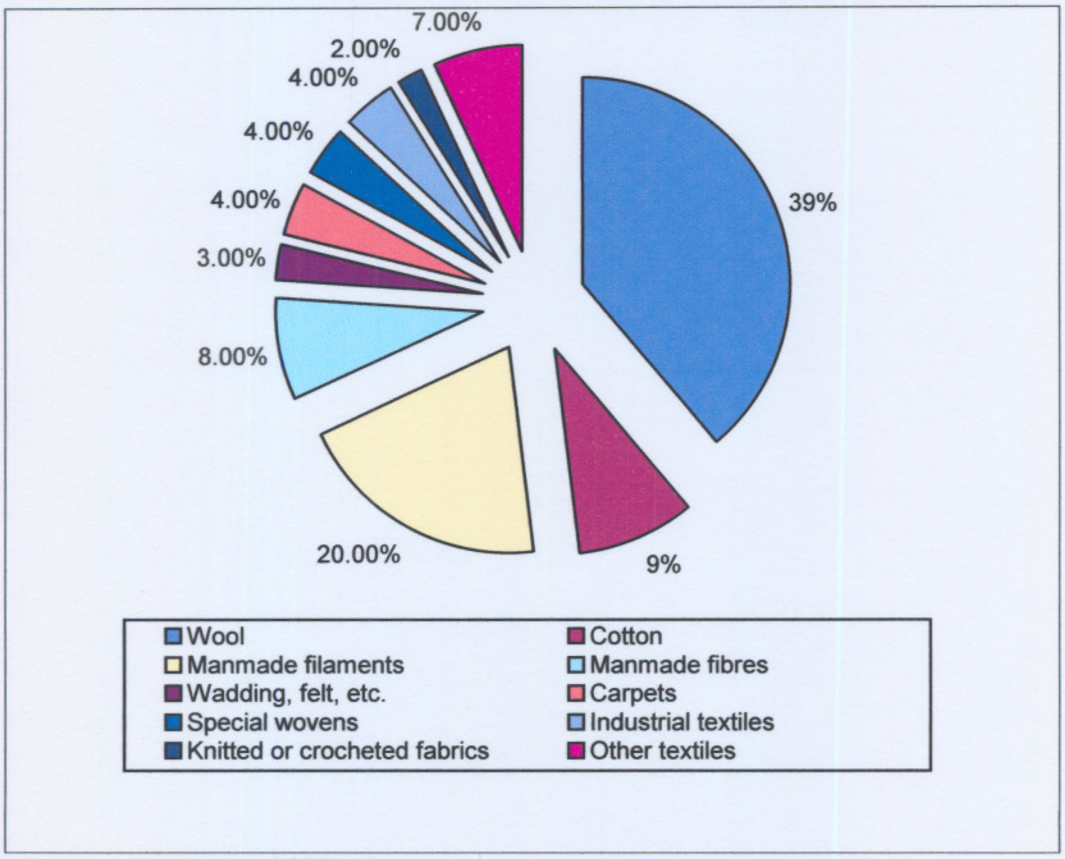
Figure 5.10: South Africa's textile sector's exports from 1991 to 2002



Source: Textile Federation, 1996, 2001 & 2004

The bulk of exports are wool, contributing approximately 39 percent to total exports in 2001, with knitted and crocheted fabrics the smallest contributor, contributing only 2 percent. Figure 5.11 gives an illustration of the share of the various textile exports, while table 5.10 gives a detailed description of exports at the various sub-sector levels.

Figure 5.11: Percentage of exports, 2001.



Source: Machaka, 2002:14

Table 5.10: Sub-sectoral export data for the textile industry

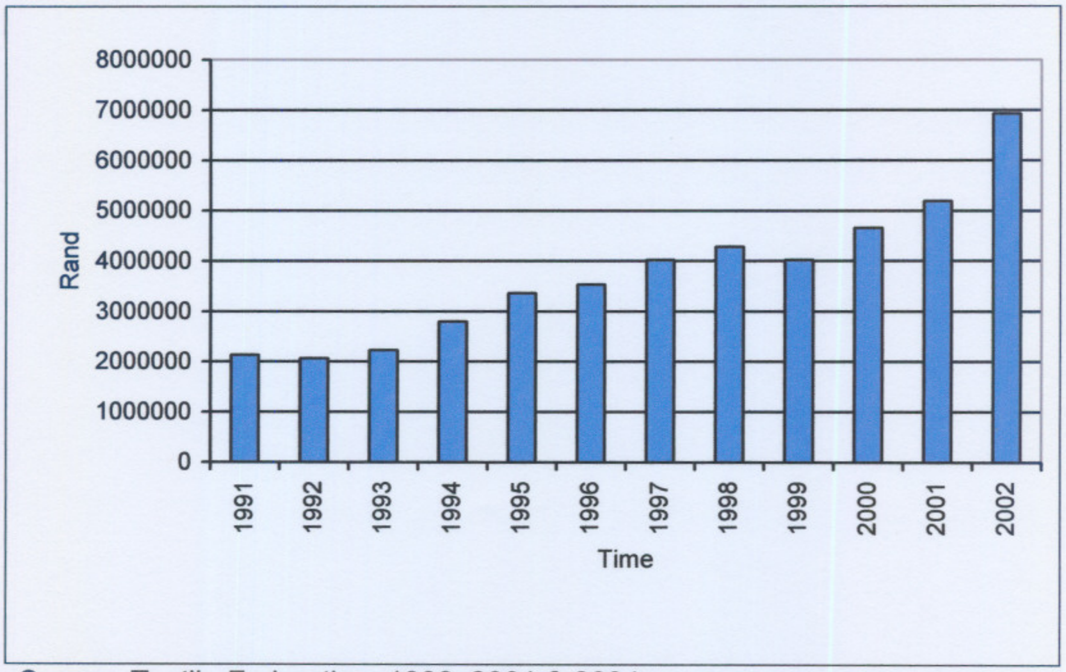
Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Wool	365644	357318	280687	193637	242249	249076	234361	214504	175922	167279	155475	145550
Cotton	37635	37604	39546	24160	19297	28360	27132	34287	37681	39878	32979	34337
Man-made filaments	20958	19968	33299	31452	35477	64541	38380	73016	72058	65567	5607	74598
Man-made fibres	26224	26951	25888	18274	31294	44626	43113	59519	36259	34484	27217	29739
Wadding, felt, etc	4241	4950	7328	8669	5331	6720	11463	7994	8374	10363	8359	11601
Carpets	12503	13111	13887	8254	22500	17681	17989	19200	18300	20071	14963	15655
Special wovens	5533	4618	7953	8482	9271	11803	13283	14656	14991	16926	21030	15051
Industrial textiles	6458	5419	7344	6016	6280	9035	9536	10197	9497	10433	11064	13994
Knitted fabrics	13758	26942	13625	11072	13872	10993	10107	10907	9408	8178	6937	5915
Other textiles	10660	10076	15514	13265	14882	18518	22881	40879	20174	23367	23975	24934
Total	**503614**	**506957**	**445071**	**323281**	**400453**	**461353**	**428245**	**485159**	**402664**	**396546**	**358096**	**371374**

Source: Machaka, 2002:24

5.3.2.2.2 Imports

In contrast to exports, the largest proportion of imports has originated from the Asian countries with a share of 53 percent in 2001, followed by Europe with 27 percent, Africa at 11 percent and the America's at 8 percent (Machaka, 2002:14).

Figure 5.12: South Africa's textile sector's imports from 1991 to 2002

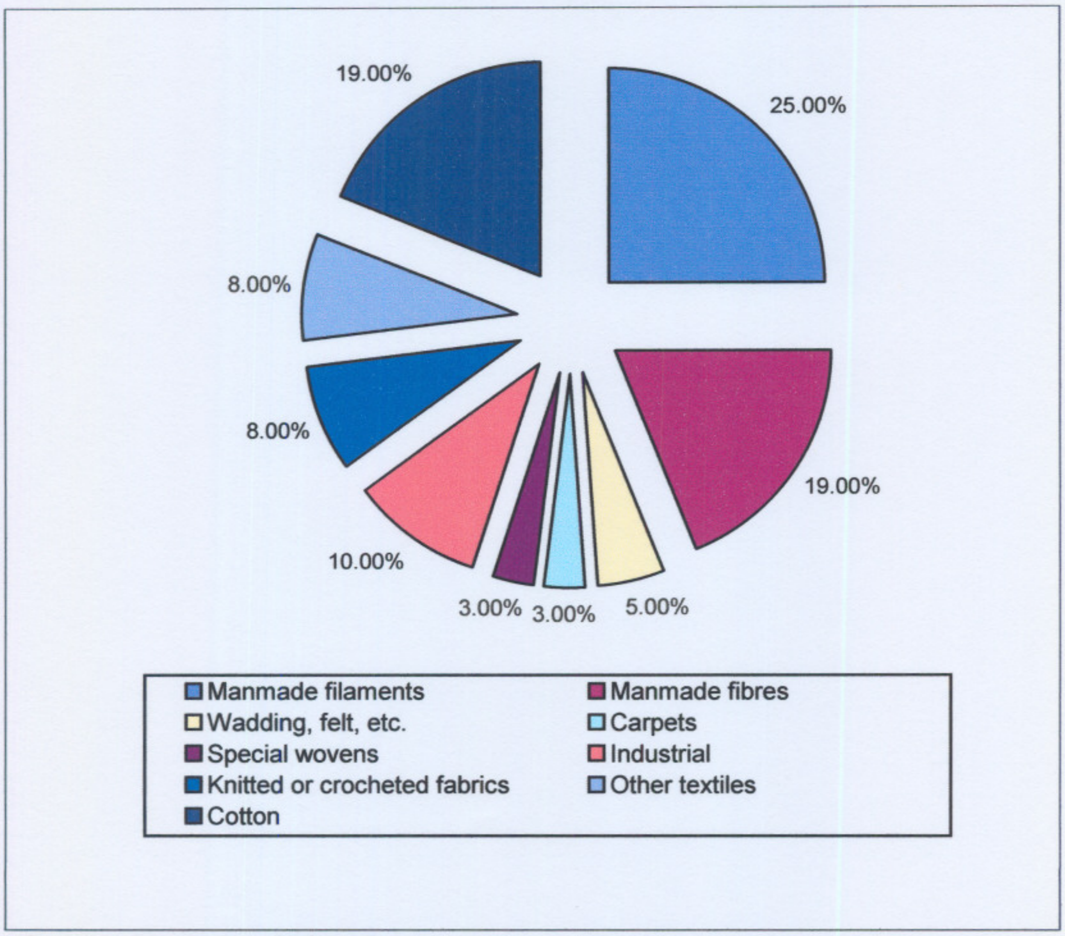


Source: Textile Federation, 1996, 2001 & 2004

Figure 5.12 indicates that over the long term there was an increase in the value of textiles imported. However, from 1998 to 1999, there was a decrease in imports. This decrease can probably partly be ascribed to the fact that the biggest share of South Africa's imports originate from the Asian countries and that it was during this period that the Asian countries experienced the Asian crisis.

Table 5.11 gives detailed information regarding the importation at the various sub-sectoral levels, while figure 5.13 indicates the share of imports. From table 5.11 and figure 5.13 it can be stated that man-made filaments are the biggest item being imported, followed by man-made fibres.

Figure 5.13: Percentage of imports, 2001



Source: Machaka, 2002:15

Table 5.11: Sub-sectoral import data for the textile industry

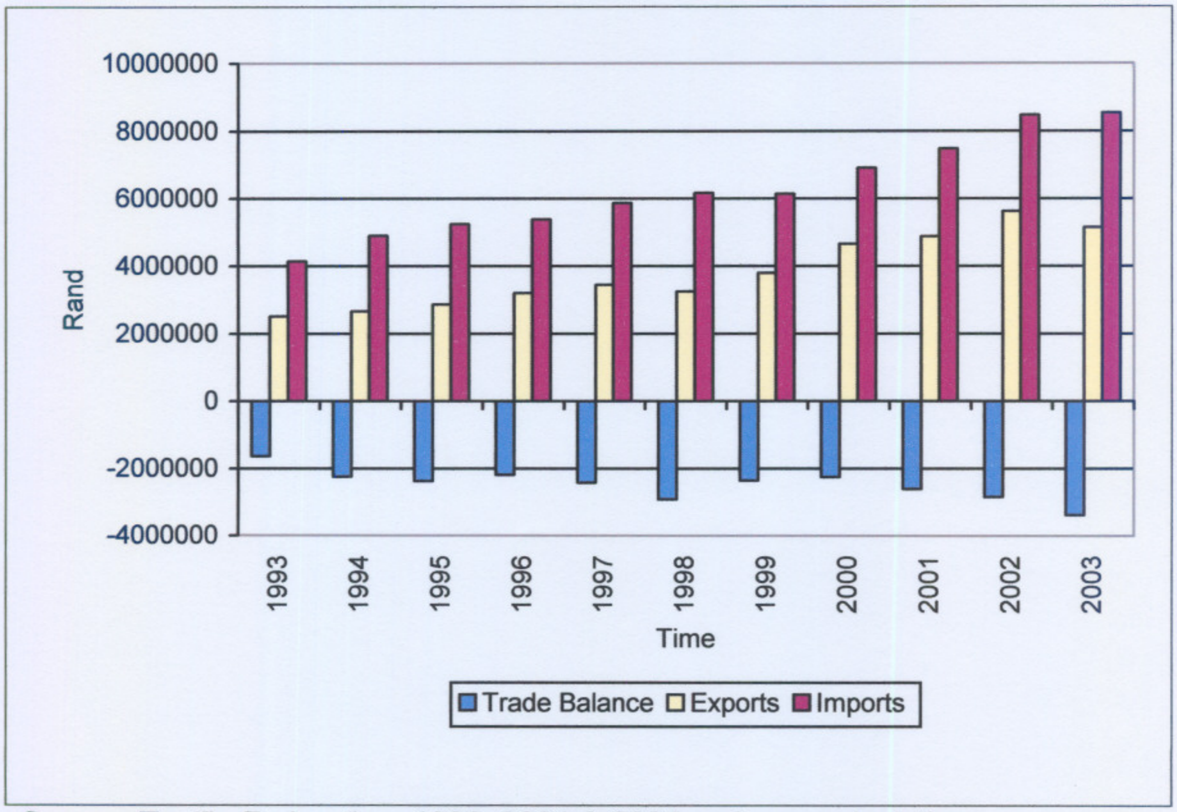
Year	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001
Wool	15614	14247	16278	13392	17189	26667	21721	28600	15933	19599	19182	14503
Cotton	86357	95625	120891	110924	135859	158910	132750	140110	143050	97907	90300	117095
Man-made filaments	150939	166740	144252	159492	163889	159802	138148	160467	175026	177303	183506	154145
Man-made fibres	230377	271868	233206	191404	185856	237144	169103	179049	166767	115447	133056	111188
Wadding, felt, etc	22113	21569	23059	26455	29406	37720	34902	30882	30086	29757	31432	27589
Carpets	14912	15484	16781	15747	16786	17338	19958	21107	17732	15676	20556	17844
Special wovens	20257	26770	23629	29606	41726	57949	44613	46000	33764	23097	24246	18840
Industrial textiles	56764	59817	65506	64651	65666	76507	81306	83087	69932	63359	67953	58965
Knitted fabrics	38493	41372	35456	32995	43179	55613	49987	57894	53270	50559	49968	45320
Other textiles	47219	67111	62918	54986	104839	114084	102129	96226	76134	66063	53583	45612
Total	**683045**	**780603**	**741976**	**699652**	**804395**	**941734**	**794617**	**843422**	**781694**	**658767**	**673782**	**611101**

Source: Machaka, 2002:24

5.3.2.2.3 Trade Balance

Although the textile industry has a negative trade balance, it still contributes approximately R13 billion per annum to the country's balance of payments (given an average duty of 10,5 percent) (Textile Federation, 2004:6-7).

Figure 5.14: Textile industry's trade balance from 1993 to 2003



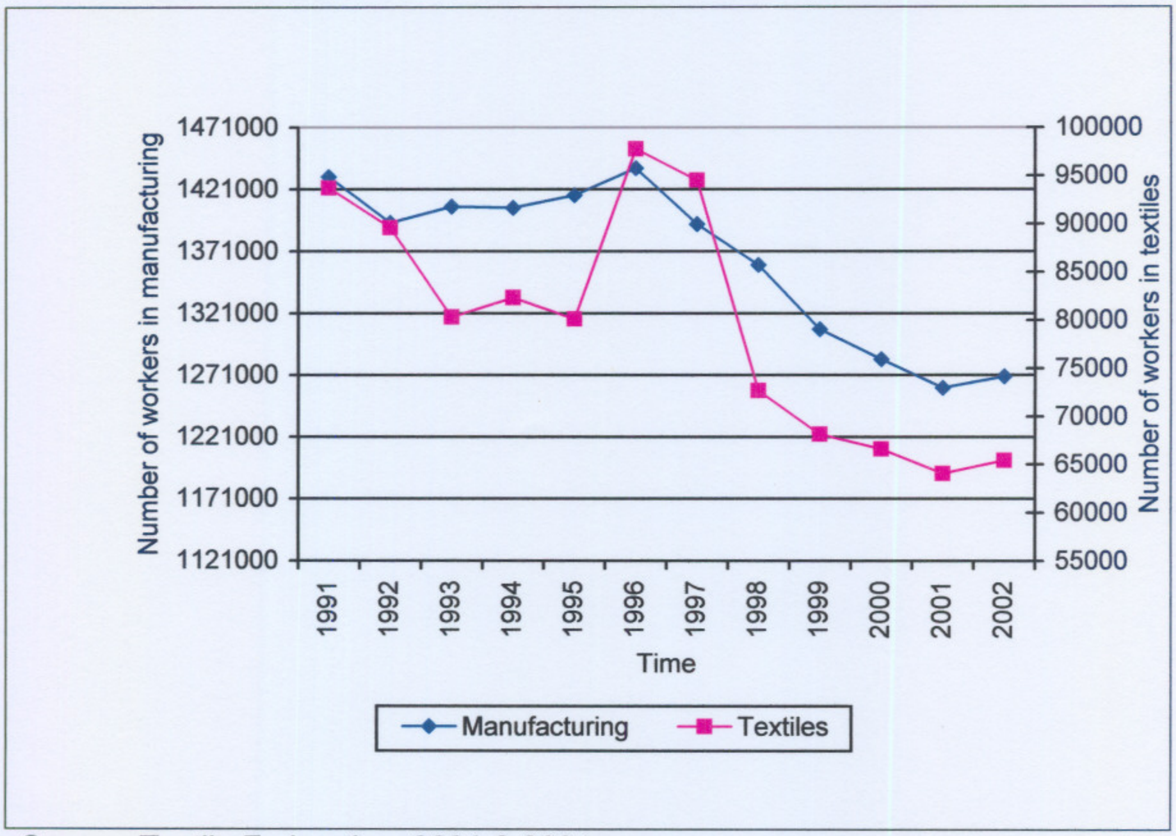
Source: Textile Federation, 1996, 2001 & 2004 and own calculations

From figure 5.14 it is evident that there was an increase in the negative trade balance from 1996 to 1998, whereafter the deficit reduced from 1998 to 2001. However, since 1991 the negative trade balance has been increasing yearly.

5.3.2.3 Employment

The South African textile industry is the sixth largest employer within the South African manufacturing sector. The South African textile industry presently employs roughly 54 500 workers in the textile sector and 11 100 in the knitting sector, while another 200 000 workers are indirectly employed in other industries that are depended on the textile industry, such as transport and packaging. According the Textile Federation (2004:6-7) the IDC calculated that for every worker in the textile industry, 2,5 jobs are generated in connected industries. This, however, does not take into account the 80 000 workers that are employed on the cotton farms. In total about 300 000 jobs depend on the South African textile industry (Textile Federation, 2004:6-7).

Figure 5.15: Employment statistics for the textile sector from 1996 to 2002



Source: Textile Federation, 2001 & 2004

From figure 5.15 it is evident that there were a sharp drop in employment levels from 1996 to 2001, when manufacturing employment levels dropped from 1 438 000 workers in 1996 to 1 270 000 workers in 2002. This represents a decrease of 11,68 percent. The same pattern can be observed for employment within textiles where employment levels dropped by 34 percent.

Table 5.12 gives an indication of the remuneration that is annually paid to workers within the textile industry.

Table 5.12: Remuneration within the textile industry

Year	Manufacturing (Rand million)	Textiles, excl. knitting (Rand 000)	Knitting (Rand 000)
1996	54 743	2 055	327
1997	57 296	2 194	373
1998	65 358	2 357	364
1999	67 798	2 265	380
2000	70 867	2 290	311
2001	76 031	2 305	365
2002	84 435	2 472	374

Source: Textile Federation, 1996 & 2004

5.3.3 Trade policy with regard to the South African textile industry

Since most textile products can readily be exported at each step of the chain, the textile industry is extremely responsive to a producing country's trade policy and, for this reason, to trade liberalisation (Roberts & Thoburn, 2002:3).

During the past decade, the South African textile industry has undergone significant trade liberalisation, as was the case for all manufacturing activities in South Africa. The following section will give an overview of the various policies and programmes that were initiated in order to liberalise the textile sector.

5.3.3.1 Background

As stated earlier, the textile industry struggled to meet the requirements of variety at low volume levels, since this tended to push production costs higher than those of its international competitors.

The call for the extended degree of protection to the textile industry was acknowledge and the then BTI, now BTT, embarked on various inquiries that led to realistic levels op protection (Textile Federation, 2004:2-5).

A system was formulated that comprised a customs tariff structure that offered fair protection against 'normal' competition, together with an increasing rate against 'disruptive' imports, itself reliant for its usefulness on the degree of the specific level of disruption (Textile Federation, 2004:2-5).

Combined with the above-mentioned system, additional protection was given by using quantitative import control measures that was primarily designed to protect the country's balance of payments. This quantitative import control was not stringently applied (Textile Federation, 2004:2-5).

The inconsistency in this instance was the fact that the increasing cost of 'disruptive' imports (in Rand terms) reallocated such imports into the moderate level of percentage-based duties, and away form the supposedly more effective monetary formula duties (Textile Federation, 2004:2-5).

The joint effects of tariffs and quantitative controls led to a 150 percent growth in the demand for woven fabrics between 1949 and 1981. In 1981, 80 percent of the domestic demand for both woven and knitted fabrics was met by local production. This was supported by the local production of cotton and wool, as well as by the local manufacturing of polyester and polyamide fibres and filament yarns (Textile Federation, 2004:2-5).

However, import penetration did increased from 1988 onwards, and, in respect of fabrics, is presently at around 40 percent of domestic consumption. Import control measures were abolished in mid-1989 with the level op protection being reduced in the case of the *ad valorem* percentage levels (Textile Federation, 2004:2-5).

Table 5.13 gives an indication of the nominal and effective rates of protection in South Africa during 1989.

Table 5.13: Nominal and effective rates of protection in South Africa, 1989

	Nominal (%)	**Effective (%)**
Wool & cotton processing	9	-26
Spinning & weaving	40	94
Made-up textile goods	22	45
Garment & hosiery knitting	87	99
Other knitting mills	58	235
Carpets & rugs	30	161
Cordage, ropes and twines	25	15
Other textiles	20	18
Clothing	75	239

Source: IDC, as cited in Machaka, 2002:12

5.3.3.2 *Structural Adjustment Programme (SAP)*

The SAP, which, for five years, allowed for duty-free imports based on export volumes, was initiated in 1989 (Textile Federation, 2004:2-5).

The objective of the SAP was to provide support to targeted industrial sectors with the intent of making them competitive through an increased level of exporting. The SAP presented tradeable duty-free import permits on the basis of export success as a means of reducing manufacturing input costs (Machaka, 2002:16).

However, the SAP scheme was disapproved of on the basis that it led to an increase in the importing of finished textiles and clothing goods and ultimately the destruction of certain sectors within the textile and clothing industries (i.e. jerseys). These imports of finished textiles and clothing goods had a harmful impact on sensitive products to which the highest tariffs applied (Machaka, 2002:16). The situation was worsened by extreme dumping of textile products from the East into South Africa, as well as fallacious tariff declarations, value added tax fraud and poor Customs control (Textile Federation, 2004:2-5).

5.3.3.3 *General Export Incentive Scheme (GEIS)*

Before the launch of the Duty Credit Certificate Scheme (DCCS), the most important support to the South African textile and clothing industries was the GEIS, which, in essence, served to subsidise exports (Machaka, 2002:16).

The objective of GEIS was to offer textile manufacturers an export incentive based on their export value (Textile Federation, 2004:2-5).

Even though GEIS was open to maltreatment by exporters, the decision to bring it to an end was due to the fact that the scheme was in breach of international trade protocols and that it was the taxpayers that were paying the price (Machaka, 2002:16).

During 1996 the South African government declared that GEIS would be phased out, with the final abolition on 11 July 1997 (Textile Federation, 2004:2-5).

5.3.3.4 *Duty Credit Certificate Scheme (DCCS)*

The DTI's principal instrument for restructuring the South African clothing and textile industry is the Duty Credit Certificate Scheme (Machaka, 2002:16). The SAP was replaced in 1994 with a DCCS (Textile Federation, 2004:2-5). The scheme presents duty credit certificates (equivalent to 35 percent of the value of their exports) to qualifying exporters that can be used to gain access to imported inputs (Machaka, 2002:16).

The intention of the scheme is to provide an incentive for exporters by giving them rebates to exports or duty credits (Machaka, 2002:16) and to influence and motivate textile and clothing manufactures to compete globally, free of government subsidies (Textile Federation, 2004:2-5).

Partaking in the DCCS is related to a Performance Audit that measures the participant's performance in terms of productivity and training. Participants are also expected to demonstrate a growth in exports (Textile Federation, 2004:2-5). The beneficiaries of the DCCS are subjected to other requirements as well. These additional requirements include spending a minimum of 4 percent of the salaries they pay on human resource development initiatives and to demonstrate operational efficiency over a specific period of time (Machaka, 2002:16).

The fact that this scheme was designed through a process of collaborations that incorporated affected industry associations and trade unions from both the clothing and textile sectors, sets it apart from any other preceding programmes that was intended to reform and restructure the South African textile and clothing industries (Machaka, 2002:16).

The implementation and functioning of the scheme has been acceptable and pleasing to date, with exports increasing in the latter part of the decade. On the negative side, it has been found that only about a hundred firms benefited from the scheme, yet the South African clothing and textile industries include a large number of companies. The scheme also failed to affect small and medium size firms, which was one of the scheme's principles objectives (Machaka, 2002:16).

At the beginning of 1997 the South African Government and the IDC initiated a list of supply-side measures. One of these measures was the duty credit certificate scheme and it was decided to extent the DCCS for another five years on the 23 March 2001 up to March 2005 (Textile Federation, 2004:2-5).

5.3.3.5 Long term strategy

The longed-for publication of the Long Term Strategy for the textile pipeline was finally published on 12 June 1995 (Textile Federation, 2004:2-5).

Fundamentally, the plan requires the phase-down of tariffs over an eight-year period to the following *ad valorem* levels in the year 2002:

Table 5.14: South Africa's tariff liberalisation programme (Average MFN tariff rates, percentages)

Year	Synthetic fibres	Yarn	Fabric	Made-up household textiles	Clothing
1993	25	35	50	60	100
1994	25	32	45	54	90
1995	23	30	42	52	84
1996	21	28	39	49	78
1997	19	26	36	46	72
1998	17	24	33	43	66
1999	15	22	30	40	60
2000	13	20	27	37	54
2001	11	18	24	34	47
2002	7,5	15	22	30	40
WTO-2000	22	31	44	53	87

Source: DTI, as cited in Roberts & Thoburn, 2002:5

The scaling down of protection and the move away from quantitative measures and formula duties thus represents a much greater change than indicated in the average tariff rates. It suggests, furthermore, that the effects of trade liberalisation will be quite differentiated. The reduction in tariffs on textile products, which are produced at different levels of processing, at different rates means that alterations in the effective rates of protection also vary greatly across the various textile products. However, the nominal and effective rates of protection on textiles continue to be high, both absolutely and relative to other activities (Roberts & Thoburn, 2002:5).

The South African textile industry embraced the main beliefs and values of the then GATT – now the WTO – and the beliefs of trade liberalisation. Regardless of difficulties being encountered with the postponement in the announcement of the new dispensation for the textile pipeline, the South African textile industry accepted the contest to remodel itself and become more competitive (Textile Federation, 2004:2-5).

The following section will give an analysis on how the South African textile industry adjusted to the tariff phase-down.

5.3.4 The impact of trade liberalisation on the textile industry

The South African textile industry has encountered major reductions in protection compared to the high levels for 1989 as indicated in table 5.15 below. Besides the tariff phase-down schedule, the formerly huge variation in tariffs, which had resulted from lobbying, has been diminished and quantitative restrictions have been transformed into *ad valorem* tariffs. The South African textile industry has also been circuitously affected by illegal imports and misrecorded clothing (Machaka, 2002:6). The question can now be asked as to the impact of these reductions on the sector's production, trade and employment levels.

Table 5.15: Textile & clothing duty phase-down

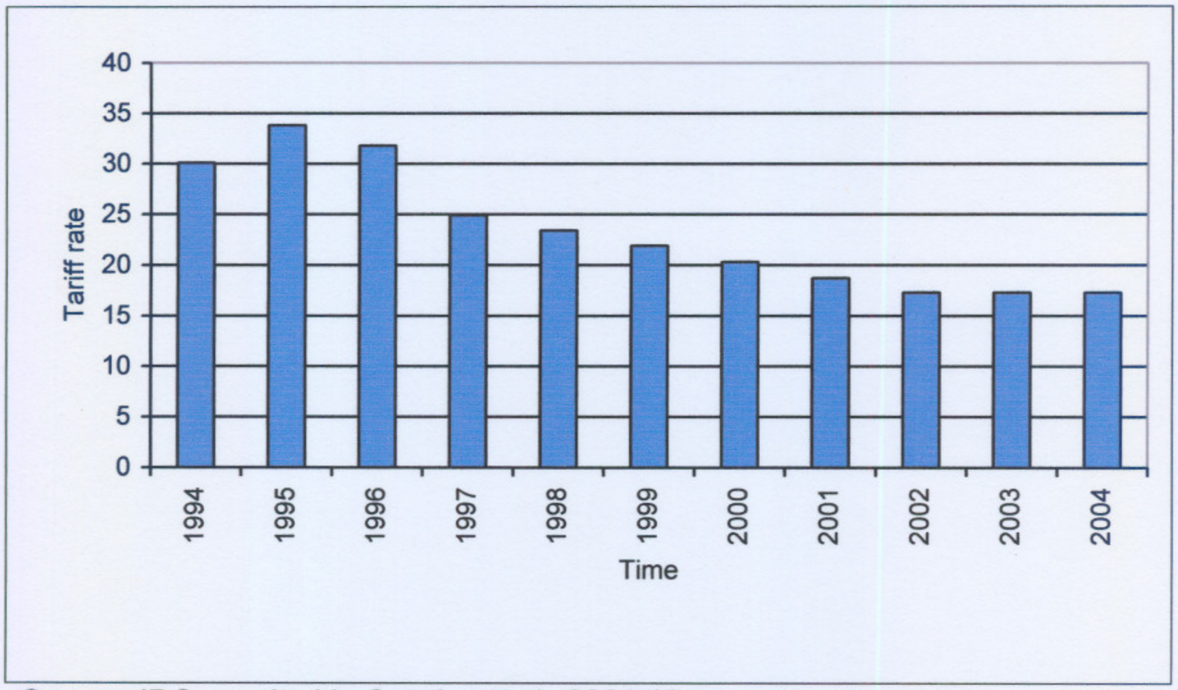
Year	'92	'93	'94	'95	'96	'97	'98	'99	'00	'01	'02
***Ad valorem* percent**											
Polyester Fibre	15	25	25	23	21	19	17	15	13	11	7,5
Filament Yarn	32	32	15	15	15	15	15	15	15	15	15
Spun Yarn	35	32	32	30	28	26	24	22	20	18	15
Woven Fabric	50	45	45	42	39	36	33	30	27	24	22
Knitted Fabric	50	45	45	42	39	36	33	30	27	24	22
Domestic Textiles	60	55	55	52	49	46	43	40	37	34	30
Clothing	100	90	90	84	78	72	66	60	54	48	40
Specific Duties C/kg											
Minimum											
Spun Yarn/Woven Fabric	1	.85	.85	.765	.688	.619	.557				
Knitted Fabric	1	1	1	.9	.81	.729	.656				
Domestic Textiles/Clothing	1	.9	.9	.81	.729	.656	.590				
Maximum	1	1	1	1	1	1	1				
3RD Schedule Rebates											
Yarn	Full	Full	Full	Full	Full less 2%	Full less 4%	Full less 6%	Full less 8%	Full less 10%	Full less 12%	
Fabric	Full	Full	Full	Full	Full	Full	Full	Full less 5.5%	Full less 11%	Full less 16.5%	

Source: Textile Federation, 1996, 2001 & 2004

5.3.4.1 Tariff phase-down

Figure 5.16 illustrates the phase-down in tariffs that was applicable to the South African textile industry as a whole.

Figure 5.16: Tariff phase-down for the textile industry from 1994 to 2004



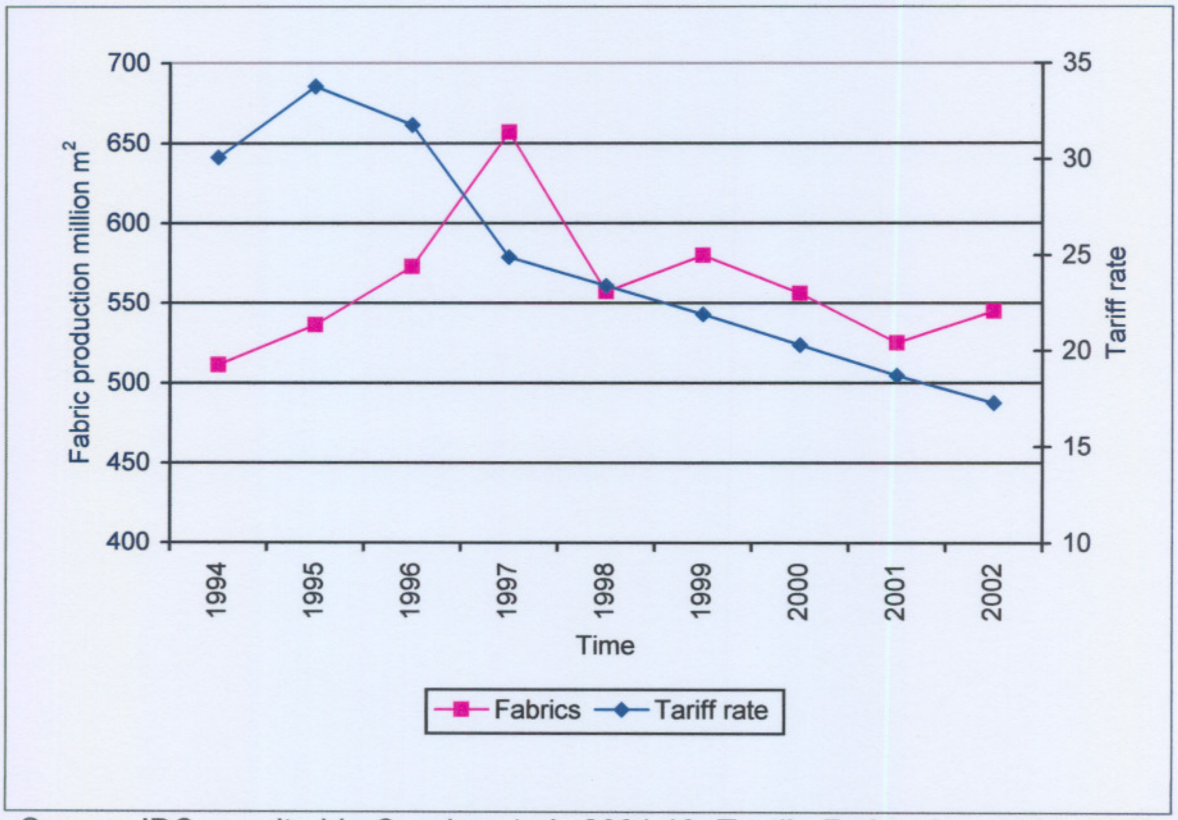
Source: IDC, as cited in Cassim *et al.*, 2001:10

From figure 5.16 it is clear that there was an initial increase in tariffs from 1994 to 1995, whereafter tariffs decreased from 33,8 percent in 1995 to 24,9 percent in 1997. There was a constant decrease in the applicable tariff rate from 1995 through to 2002, whereafter tariffs stabilised at 17,3 percent.

5.3.4.2 Production

The impact of trade liberalisation with regard to domestic fabric production is illustrated in figure 5.17

Figure 5.17: Tariff phase-down and fabric manufacturing [5]



Source: IDC, as cited in Cassim *et al.*, 2001:10; Textile Federation, 1996, 2000 & 2004

From figure 5.17 it is clear that while the applicable tariff rate increased from 1994 to 1995, so did the production of fabrics. However, from 1995 onwards there was a continuous decline in the applicable tariff rate, but it is evident that fabric production increased from 1995 to 1997. From 1997 to 1998 a sharp decline in fabric production occurs, even though the applicable tariff only changed from 24,9 to 23,4 percent. During 1998 there was again an increase in production even though the tariff rate was moving down. This increase in production might be the consequence of a decrease in Asian production. From 1999 to 2001 there was a decrease in both fabric production and the tariff rate, whereafter production expanded in 2002.

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[5] Fabric production refers to cotton fabrics, spun synthetic fabrics, cont. filament fabrics, worsted fabrics and knitted fabrics

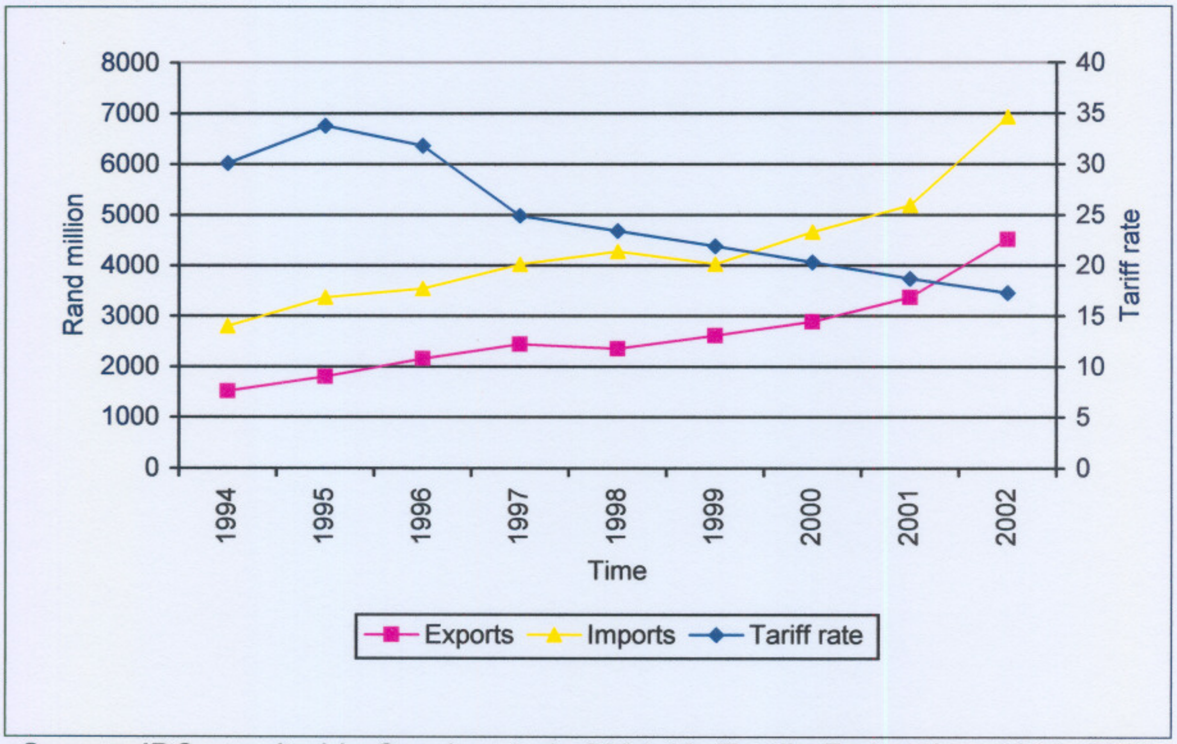
From figure 5.17 it is clear that there was a long-term decline in the production of fabrics. This decline is mainly the result of low domestic demand during the 1990s.

Even though there was a decline in the production in fabrics, it does not necessarily imply that there would have been a decline in imports and exports. In contrast, there was a huge increase in the amount of textiles exported. The following section analyses the impact that the tariff reductions had on the textile industry's trade performance.

5.3.4.3 Trade

Figure 5.18 indicates the impact of the tariff phase-down on the exports and imports of the South African textile industry.

Figure 5.18 Tariff phase-down and exports and imports of the textile industry



Source: IDC, as cited in Cassim *et al.*, 2001:10; Textile Federation, 1996, 2000 & 2004

The initial impact of the reduction in the tariff rate from 1995 to 1996 had no real impact on the exports of textiles. It is evident from figure 5.18 that exports increased from 1995 to 1997, whereafter there was a slight decline in exports. However, as stated earlier, this could be ascribed to the Asian crises. Since 1998 there were steep increases in the value of textiles being exported.

From figure 5.18 it is evident that there was a constant increase in textile imports from 1994 to 1998. However, there was a slight decline in imports from 1998 to 1999 that, according to Machaka (2002:13), can be ascribed to lower domestic demand and a considerable depreciation of the currency during the mid 1990s. It is furthermore due to the effect of clothing on the demand for textiles[6].

5.3.4.4 Employment

Figure 5.19 indicates the impact of trade liberalisation of the South African textile industry on employment within textiles.

[6] It should be kept in mind that a major impact on the textiles sector comes from increased imports of clothing. This reduces the demand for textiles from domestic clothing manufacturers. Similarly, the exportation of clothing generates an indirect export demand for fabrics (Roberts & Thoburn, 2002:8)

Figure 5.19: Tariff phase-down and textile employment levels

Source: IDC, as cited in Cassim *et al.*, 2001:10; Textile Federation, 1996, 2000 & 2004

From 1996 to 2001 there was a constant decline in the textile industry's employment levels as is evident from figure 5.19, despite a huge increase in the value of textiles exported. However, these reductions can be the result of the decrease in fabric production as illustrated in figure 5.9.

5.4 Summary

The South African automotive and textile industries have entered into an episode of rapid change, brought about by the globalisation and intercontinental trend alignment of what were formerly highly protected local industries. The question was raised as to how these two sectors adapted to this period of change brought about by liberalisation.

It is clear from the discussion in section 4.2 that, even although the automotive industry experienced a rough and sometimes difficult time to adapt to the liberalisation process, it has completed the process of adaptation and is focused on being an international role player. This is evident from the fact that the South African automotive industry experienced a continuous increase in its levels of production from 1998 to 2001, even though it was subjected to a constant decrease in the applicable tariffs. This had the effect that there was a continuous increase in the value of exports, while imports seemed to stabilise from 2001 onwards. Although employment levels were initially negatively affected by the tariff phase-down, employment levels show a continuous increase from 1998 to 2001 and seems to have stabilised.

The automotive industry was severely affected by the liberalisation process but it has stabilised and has a positive outlook with regards to production, trade and employment levels.

However, this is not the case for the textile industry. The South African textile industry has been under great pressure during the past ten years, especially from 1997 onwards. This is evident from the fact that the sector experienced a decline in the levels of production from 1997 to 2001. During this period of liberalization, the textile industry experienced a continuous increase in both exports and imports. Although the increase in exports is positive, the continuous increase in imports is worrisome. This indicates that the South African textile industry has not yet adapted to the process of liberalisation. However, the increase in imports might be motivated by the decrease in the level of the production. This decrease in production has also led to a continuous decrease in the employment levels.

The conclusion can be made that trade liberalissation had some success in the automobile industry, but the textile industry is struggling without protection.

Some conclusions and recommendations are made in the next chapter.

Chapter 6

SUMMARY AND RECOMMONDATIONS

6.1 Summary

Openness to trade has long been seen as an important element of good economic policy, and trade liberalisation as a necessary step for achieving it. As mentioned in chapter 4, tariff liberalisation was one of the main policy instruments underpinning South Africa's trade policy during the 1990s.

The primary objective of the trade liberalisation programme was to increase the competitiveness of the manufacturing sector. This was necessary due to the fact that South Africa contributed only 0,48 percent to total world exports in 2002 and was ranked 49^{th} out of 60 countries in 2004 with regard to overall competitiveness.

This study attempted to analyse the impact of trade liberalisation in South Africa on two of the sub-sectors of manufacturing, namely the textile and automotive industries. These two industries were chosen because they were formerly the most protected industries, with the textile industry having the highest tariff in 1990 and the automotive industry being protected by a mixture of high tariffs and local content requirements.

In chapter 2 an in-depth discussion was given on trade liberalisation. The point of departure in this chapter was that the most practical way of stimulating trade and consequently improving competitiveness was through a process of trade liberalisation.

It was found that there are many arguments in favour of and against trade liberalisation. The arguments in favour of trade liberalisation are an increase in economic growth, enhanced allocative efficiency and thus eradicated deadweight losses, increased efficiency by domestic manufacturers, discovery of new markets, increased dispersal of knowledge and technology, poverty alleviation and reduced risk.

However, even if trade liberalisation will lead to the above, it will often be defied since the sectors with the utmost protection know they receive concentrated benefits from protection. Another argument against trade liberalisation is the fact that employment and income benefits from trade liberalisation are likely to be diffuse. Additionally, the move towards trade liberalisation rest on traditional trade theory and its assumptions of perfect competition, constant or decreasing returns of scale, no externalities, homogenous products and the country being 'small'. However, there has been a mounting accord in the literature that these assumptions are not only significant realities to be considered, but are often determinants of trade.

The conclusion was drawn that no matter the costs, the most practical way of stimulating trade and opening up to global trade is through trade liberalisation.

Policy makers have a mixture of options in conducting trade policy and these include: tariffs, quotas, subsidies, exchange controls, health and safety standards, voluntary export restraints, etc.

The conventional instruments used have largely been export and import tariffs and different kinds of quantitative restrictions. The use of these conventional instruments has become increasingly prohibitive under various international agreements, such as the WTO.

In chapter four, an overview was given of South Africa's historic and current trade policy. South Africa has at various times traveled the paths of both import-substituting industrialisation and export-oriented industrialisation. From 1925 to 1972 South Africa followed a policy of import-substituting industrialisation. The first liberalisation episode began in 1972 with the Reynders Commission's recommendation of export promotion. This was followed by the recommendations from the Kleu Study Group to move away from import-substituting industrialisation. The third and current liberalisation episode began in 1994, with the main focus being tariff reductions in line with GATT requirements.

The question arises as to how the liberalisation process affected the South African automotive and textile industries. From chapter five it is evident that the automotive sector had far better success than the textile sector.

Although the automotive industry experienced a rough and sometimes difficult time to adapt to the liberalisation process, it has completed the process of adaptation and is focused on being an international role player. This is evident from the fact that the South African automotive industry experienced a continuous increase in its levels of production from 1998 to 2001, even though it was subjected to a constant decrease in the applicable tariffs. This had the effect that there was a continuous increase in the value of exports, while imports seemed to stabilise from 2001 onwards. Although employment levels were initially negatively affected by the tariff phase-down, employment levels show a continuous increase from 1998 to 2001 and seems to have stabilised.

On the other hand, the textile industry is experiencing difficulties in adapting to the process of liberalisation and a more open economy. This is evident from the fact that the industry experienced a decline in the levels of production from 1997 to 2001. During this period of liberalisation the textile industry experienced a continuous increase in both exports and imports. Although the increase in exports is positive, the continuous increase in imports is worrisome. This indicates that the South African textile industry has not yet adapted to the process of liberalisation. However, the increase in imports might be motivated by the decrease in the level of the production. This decrease in production has also led to a continuous decrease in the employment levels.

The conclusion can be drawn that trade liberalisation had some success in the automobile industry, but the textile industry is struggling without protection.

6.2 Recommondations

It is clear that there is still a long road to travel before a definite conclusion can be drawn on the advantages and disadvantages of trade liberalisation from a South African viewpoint.

It is recommended that further studies be undertaken after the process of liberalisation has been completed in order to determine its success. Alternatively, separate studies should be undertaken on the textile and clothing industry in order to determine whether the negative impact of trade liberalisation on the South African textile sector is not the result of negative performances within the clothing sector.

In order to fully determine the impact of trade liberalisation on the South African economy it is necessary to study not only the automobile and textiles industries, but also all sub-sectors within manufacturing.

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