

SOUTH AFRICA-US INTRA-INDUSTRY TRADE IN SERVICES

By

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SUMMARY

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The steady growth of services sector's contribution to national output (GDP) and employment is a characteristic feature of most modern economies. The increase in the contribution of services is attributed to revolution in information communication technology (ICT) and liberalisation under the General Agreement on Trade in Services (GATS) since 1994. Despite its dominance in economic growth and job creation, services account for less than a quarter of total trade in South Africa and the US due to its limited tradability and unrecorded transactions.

The enhanced internationalisation of services has two opposite economic welfare implications for South Africa. On one hand, the increase generates standard comparative advantage gains (specialisation and exchange) and non-comparative advantage gains (pro-competitive, exploitation of economies of scale, increased variety and lower factor market adjustment costs). Additionally, proper phasing in of liberalisation of trade for services could be consistent and complementary to sustainable development in the context of the Doha Development Agenda (DDA). On the other hand, the increased tradability may lead to higher factor market adjustment costs along the lines of Stolper-Samuelson theorem or vertical differentiation model of Flam and Helpman (1987). The negative effects of internationalisation of services are the causes of the anti-globalisation

sentiments in the world (Bhagwati, 2004, Salvatore, 2004a and 2004b) and South Africa (mainly by the confederation of South African trade unions, COSATU).

However, to understand the benefits and costs of South Africa's trade in services with the US (South Africa's leading exports destination of services in the OECD countries) calls for a need to disentangle inter-industry and intra-industry trade (IIT) flows since they have different causes and consequences. This is, however, frustrated by lack of appropriate data.

It is against this background that the study addresses two key issues about South Africa-US IIT in services. Firstly, what are the determinants of South Africa-US IIT in selected services during the period 1994-2002? Secondly, when trade expands/contracts, is factor adjustment lower in an environment characterised by IIT (Smooth Adjustment Hypothesis)? In answering these questions, other complementary issues are dealt with: the structure and trends of South Africa-US trade in selected services as well as nonparametric measures of barriers to trade in services for South Africa and the US.

Utilising both descriptive and bootstrapped panel data econometric analysis, a number of conclusions emerge from the study. Firstly, using the GATS commitment schedules in 1994, 1995, 1997 and 1998 and WTO trade policy reviews, South Africa has higher trade barriers in most services especially telecommunications and banking than the US. This is typical of low and middle-income economies.

Secondly, the study shows that South Africa-US IIT in selected services is determined by factors similar (except economic distance) to those identified in other "North-South" IIT studies. Specifically, it is determined by economic distance proxied by differences in per capita income, differences in market size, FDI by American companies in South Africa, service and time-specific effects. Additionally the study remotely suggests horizontal intra-industry trade (HIIT). This finding is inconsistent with the other "North-South" IIT on goods studies, which show vertical (quality) differentiated intra-industry trade (VIIT) as the dominant form of trade.

Thirdly, the study shows that marginal intra-industry trade (MIIT) is low for most services. Given the consistency of the results with the CHO model of HIIT, the low MIIT implies potentially high trade-induced labour market adjustment costs.

There are a number of policy implications that emerge from the study. Firstly, there is an urgent need for Statistics South Africa (STATSSA) and South African Reserve Bank (SARB) to adopt the current manual on statistics of international trade in Services (MSITS) with a view to providing a comprehensive database for trade analysis as well as form a basis for identifying priority areas and strategies in future services trade negotiations.

Secondly, the fact that there is a significant negative relationship between IIT and per capita income difference (economic distance) means that South Africa-US IIT in services is inimical to intra-industry specialisation and trade in homogenous and horizontally differentiated services. South Africa should therefore view the services component of the SACU-US FTA with caution and use trade and industrial policy strategically to fashion the location of production in Southern Africa in the hope of deriving future scale advantages in services.

Thirdly, the study shows that there is a positive relationship between FDI and IIT implying that US multinationals in South Africa play a complementary rather than a supplementary role. Thus there is need for an intensification of initiatives to promote investment from the US e.g. the American Chamber of Commerce in South Africa (AMCHAM).

Finally, the low MIIT calls for the need for the government to cushion the adverse effects of South Africa-US trade in services. These include, among others, programs that assist on guidance in job searching and retraining of retrenched employees. Additionally, South Africa's trade negotiators could treat the MIIT indices as guesstimates of the extent of trade disruption in the services sector and use them in negotiating for market access and national treatment concessions from the US during future services trade negotiations.

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LIST OF ACRONYMS

Acronym	Meaning
AU	African Union
BEA	United States of America Bureau for Economic Analysis
BMP5	IMF Balance of Payment Manual, fifth edition (1993)
Cell C	Cell C (Pty) Ltd, South Africa, licensed on 25 th June 2001
COSATU	Confederation of South African Trade Unions
CPC	The United Nations Central Product Classification
DDA	Doha Development Agenda, signed in 2001
DGP	Data generating process
DTI	Department of Trade and Industry, South Africa
EDF	Empirical Distribution Function
E-commerce	Electronic commerce
Email	Electronic mail
et al.	et alii, which means and others
EU	European Union
FDI	Foreign direct investments
FCC	The Federal Communications Commission, US
FBSEA	Foreign Bank Supervision Enhancement Act of 1991, US
FPE	Factor price equalisation
FRB	Federal Reserve Board, US
FTA	Free Trade Agreement
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GL	Grubel and Lloyd (1975) intra-industry trade index
GLM	General linear model
HCCME	Heteroscedasticity consistent covariance matrix estimator
HIIT	Horizontally differentiated intra-industry trade (trade in Varieties)

HK	Hamilton and Kniest (1991) marginal intra-industry trade index
HOS	Heckscher-Ohlin-Samuelson model
HOV	Heckscher-Ohlin-Vanek model
HS	Harmonised Commodity Description and Coding System
ICASA	Independent Communications Authority of South Africa
ICT	Information communication technology
IE	Integrated equilibrium
IIT	Intra-industry trade
IMF	International Monetary Fund
ISIC	International standard industrial classification
LSDV	Least squares dummy variable estimation
MA	Market access
MIIT	Marginal intra-industry trade
MFN	Most favoured nation principle of the WTO
Mode 1	Supply of services through cross-border trade
Mode 2	Supply of services through consumption abroad
Mode 3	Supply of services through commercial presence (FDI)
Mode 4	Supply of services through presence of natural persons
MSITS	Manual on Statistics of International Trade in Services, 2002
MTN	Mobile Telephone Networks (Pty) Ltd, South Africa
NEPAD	New Partnership for Africa's Development
NT	National treatment
OECD	Organisation for Economic Co-operation and Development
OLS	Ordinary Least Squares
PDF	Population Distribution Function
R & D	Research and Development
SA	South Africa
SAA	South African Airways
SACU	Southern African Customs Union
SAH	Smooth Adjustment Hypothesis

SARB	South African Reserve Bank
SEC	Securities Exchange Commission, US
SNA	System of National Accounts, 1993
STATSSA	Statistics South Africa
SITC	Standard international trade classification
TPR	Trade Policy Review by the WTO
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
US	United States of America
VANS	Value-Added-Network Service
VIIT	Vertically differentiated intra-industry trade (trade in quality)
VodaCom	VodaCom (Pty) Ltd, South Africa
WITHIN	Panel model using demeaned variables
WTO	World Trade Organisation