

## CHAPTER NINE

### SUMMARY AND POLICY RECOMMENDATIONS

#### 9.1 Summary

As mentioned in chapter one, tariff liberalisation was one of the main policy instruments underpinning South African trade policy during the 1990s. The primary objective of the tariff liberalisation programme was to increase the competitiveness of the manufacturing sector. This study attempted to ascertain if this objective was met. This was done by testing the hypothesis that South Africa's tariff liberalisation policy in the 1990s has contributed to improved competitiveness of the manufacturing sector.

In chapter two, an analysis of trade theory and its implications for competitiveness was undertaken. The point of departure in this chapter was that competitiveness is dependent on production being in conformity with a country's comparative advantage situation. Within this context, traditional trade theory based on conditions of perfect competition make two fundamental claims. Firstly, comparative advantage is based on factor endowments. Secondly, "free trade" or "*laissez-faire*" policies are needed to secure production according to a country's factor endowments. The policy implications for competitiveness are firstly, optimal policy involves minimal government intervention. Secondly, production that is not in line with a country's factor endowments is an outcome of trade distorting government policies. This implies that improved competitiveness is dependent on a move towards "*market friendly*" policies. However, new trade theory based on conditions of imperfect competition has shown that comparative advantage is not solely based on factor endowments. This in essence means that in certain circumstances, and more particularly for developing countries, there may be an important role for government policy to influence the comparative advantage pattern of a country.

Against this background, chapter three analysed the role of protection in industrial policy. More specifically, in keeping with the objective of this study,

the chapter appraised the relationship between trade liberalisation and economic growth. It was shown that this relationship is ambiguous both from a theoretical and empirical standpoint. The empirical evidence on the tariff-growth relationship was found to yield similar results. The lack of a robust relationship between tariff liberalisation and economic growth means that trade policy effects are "country" and "industry" specific. This provides some justification for this study, which attempts to analyse a particular aspect of the tariff-growth relationship, namely, the impact of tariff liberalisation on the price competitiveness of the manufacturing sector.

It has been acknowledged in the empirical work that South Africa's tariff liberalisation during the 1990s was extensive. This conclusion, has in the main, been based on a descriptive analysis of South Africa's WTO offer in the mid-1990s. However recently, effective rate of protection (ERP) calculations have been used to contest the extent of tariff liberalisation during the 1990s (Feddereke and Vaze, 2001). Employing a similar methodology, chapter four shows that the 1990s was indeed characterised by extensive tariff liberalisation.

Much of the empirical work on South Africa's trade policy has been undertaken within a two-sector (exportables and importables) model. Within this model, any trade incentive for one sector (importables) is at the expense of the other sector (exportables); this is captured in the conventional anti-export bias measure of protection. However, within a three-sector (exportable, importable and non-tradable) model the conventional measure of anti-export bias is called into question. In chapter five, it was shown that the empirical work to date has exaggerated the extent of anti-export bias during the 1990s.

One of the traditional measures of competitiveness is the real exchange rate (RER). Chapter six used a variant of the conventional RER measure (which differentiates the tradable sector into both exportables and importables), to show that tariff liberalisation had a limited impact on the competitiveness of the manufacturing sector.

In chapter seven, a more thorough econometric analysis was used to appraise the results obtained in chapter six. Tariff liberalisation was expected to increase competitive pressures on domestic industry. It was found that tariff liberalisation led to reduced imported input costs. However, as far as final goods imports are concerned, it was found that while tariff liberalisation led to reduced import prices at the border, it did not exert any significant influence on the price of import substitutes. This, in effect, meant that tariff liberalisation had a limited impact on improved competitiveness of the manufacturing sector. These results complemented those reached in chapter six.

Reduced price is one dimension of competitiveness. Chapter eight considered other indicators of competitiveness, namely, output and export growth, the nature of products produced and exported, and productivity gains. An analysis of these indicators reveals that there are very little positive differences between the liberalising and non-liberalising sectors. This once again casts some doubt over the impact of tariff liberalisation on improved competitiveness.

The main conclusion of this study is that the tariff liberalisation policy of the 1990s had a limited impact on improving competitiveness within the manufacturing sector. The next section considers some policy implications of this conclusion.

## **9.2 Policy implications**

The government's commitment to its liberalisation programme cannot be doubted. This is evident by the pace of tariff liberalisation, which in some cases, went beyond the requirements specified in South Africa's WTO offer (Bell, 1997). Thus, the limited impact of tariff liberalisation on the competitiveness of the manufacturing sector cannot be blamed on the extent of the tariff liberalisation undertaken during the 1990s. Recently, government released a policy document entitled *"Accelerating growth and development: The contribution of an integrated manufacturing strategy"* (hereafter referred to as IDS) (DTI, 2002). The policy document outlines government initiatives pertaining to the development of the manufacturing sector. The

recommendations mentioned hereafter are done with reference to the IDS policy document.

It should be categorically pointed out that while this study has shown that tariff liberalisation did not have the expected impact on the competitiveness of the manufacturing sector, it does not mean that increased protection would secure better results. In fact, there are strong theoretical justifications (as was pointed out in chapter three) for tariff reductions on economic efficiency grounds. The benefits from tariff liberalisation are dependent on prevailing market conditions. Under conditions of perfect competition it is not unreasonable to assume that tariff liberalisation would promote competitiveness. On the other hand, under conditions of imperfect competition, the results are ambiguous. The results in chapter seven of this study has shown that while tariff liberalisation had an impact on the price of imports at the border, it did not have any significant influence on the domestic price of import substitutes. These results are in line with those obtained in other recent studies (Fedderke and Schaling, 2000; Fedderke, 2001: 28) which show that pricing power has adversely affected competitive pressures in output markets. This suggest that there is room for improving the role of competition policy in creating the environment conducive for improved competitiveness.

There are indications that concentration in South African manufacturing is not only high but also on the increase (Fourie, 1996).<sup>1</sup> The fundamental objective should be to ensure that where market dominance may be necessary (e.g. to ensure economies of scale in production) it should not result in abuse of economic power. In order to improve competitiveness, competition policy and trade policy should be better co-ordinated. According to Fourie and Smith (1993: 131) *"...there are sufficient empirical grounds for suspecting a significant interaction between concentration and import protection in the determination of industrial profitability"*. The results presented in chapter

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<sup>1</sup> Although he argues that the concentration ratios are not increasing at an "alarmist" rate.

seven of this study suggest that this aspect warrants further research, particularly at the disaggregate sectoral level.<sup>2</sup>

Given that increased entry does not necessarily lead to better performance (Nickell, 1996; World Bank, 2002; Aw, et al, 2002) it is imperative that competition policy goes beyond just the mere facilitation of increased entry. While competition policy should address the overall developmental concerns of the country (Singh, 2002), it should also be sufficiently flexible to cater for the specific needs of individual sectors. The proposed measures specified in the IDS pertaining to the regulatory business environment for the manufacturing sector is an important first step in improving competitiveness trends in the future.<sup>3</sup> In addition, industrial competitiveness depends not only on improved efficiency but also on improved capabilities (Lall, 1990). The former requires increased competition while the latter may require some protection. Competition policy should be sensitive to prevailing conditions confronted by the different industries.<sup>4</sup> The East Asian experience, for example, has shown that successful industrial policy depends on the exploitation of economies of scale in production and linkages between sectors. Competition policy should be of such a nature that it facilitates this process.

The recent IDS recognises the importance of linkages between sectors. It emphasizes the importance of "integrated value matrices" for the establishment of competitive manufacturing capabilities (DTI, 2002). Viewing production as a value chain process implies that the end producer, together with all the other producers involved with the inputs used in the final product, also contribute to the competitiveness of the product. Viewed in this way, the

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<sup>2</sup> A disaggregate analysis would allow for the development of appropriate policies that could address the needs or problems at the industry or sub-industry level.

<sup>3</sup> The IDS proposes a reform of the regulatory environment which would entail "... corporate law reform, formulation of modern consumer protection legislation, improved international trade administration, promotion of good corporate governance, establishment of standards-quality assurance-and-trade metrology institutional framework and the development and implementation of appropriate policies for regulated industries and related public interest issues" (DTI, 2002: 46).

<sup>4</sup> see Stewart et al, 1992 for a discussion of the relevant issues within a developing country context

issue of governance over the chain becomes one of the key issues affecting competitiveness since governance determines, "...the division of rents from the operation of the chain as a whole, as well as, the dynamic evolution of the chain through new product development" (Roberts, 2002: 15). The role of government is to facilitate an appropriate economic environment that promotes industrial competitiveness. In practice this entails ensuring that the incentives, factor markets and institutions all work together to promote competitiveness (UNIDO, 2003: 93).

It is widely accepted that institutions play an important role in economic development (North, 1990; Acemoglu, et al, 2001). Their influence stem primarily from their ability to "...create incentives for desirable economic behaviour" (Rodrik and Subramanian, 2003: 31). In the case of South Africa, there are a variety of institutions having an influence on industrial performance. These include, *inter alia*, the Industrial Development Corporation, National Empowerment Fund, Khula Enterprise Finance, Competition Commission, Competition Tribunal, South African Bureau of Standards, South African National Accreditation System, Ntsika Enterprise Promotion Agency, Council for Scientific and Industrial Research, National Co-ordinating office for manufacturing Advisory Centres and Sector Co-ordinating and Training authorities (SETAs). Industrial success depends on the co-ordination of the priorities and activities of these institutions. While sectorial or industrial policies may be in line with the country's overall objectives, industrial success depends on the accessibility and effect that policy has on individual firms. The manufacturing advisory centres (MACs), for example, have been established "...to contribute significantly to the economic transformation of South Africa by supplying high-quality information and advisory services to SMMEs so as to ensure a quantum improvement in their growth and competitiveness" (DTI, 2003: 3). However, the results to date indicate that while the programme has laudable intentions, its success has been somewhat limited, since other factors (e.g. access to finance, technological know-how, etc.) that have a direct impact on industrial competitiveness, have not been adequately addressed. There is an urgent

need to co-ordinate the initiatives of all the above mentioned institutions if programmes like the MACs are to produce the desired results.

In terms of the new institutional arrangements specified in the IDS, South African trade policy is to be co-ordinated by the Commission for International Trade Administration (CITA). CITA would be responsible for the administration of trade policy for the South African Customs Union (SACU). This in effect, requires that the national interests of South Africa would have to be balanced with those of the SACU countries. While agreement has been reached on the sharing of the tariff revenue, CITA will have to ensure that the customs procedures and institutional arrangements in the different countries are streamlined and synchronised so that industrial policy is not compromised across the SACU countries.

Industrial competitiveness is a multi-faceted construct, which goes beyond merely ensuring that production is efficient. Other factors like non-tariff barriers (e.g. labelling requirements, customs procedures and documents, etc.) to trade have a direct impact on a country's international trade performance. This issue is of particular relevance in the 21<sup>st</sup> century, which is being characterised by increasing levels of globalisation. South Africa has, in some respects, embraced globalisation with a view to benefiting from increased and improved international economic relations. Broadly speaking, the South African approach started off being multilateral (as in the GATT offer in 1994) and has since become more bilateral in nature. The bilateral agreements have taken the form of free trade agreements (FTAs) - some of which have already been concluded (e.g. with the SADC and the EU) and others that are in discussion (e.g. with the US, the Mercosur countries in Latin America, India and China). The FTA is a useful means of improving the competitiveness of South African products by securing privileged access to foreign markets, as well as, access to foreign investment and technology transfer initiatives that may not be easily available within a multilateral context; for example, in the case of the EU-SA FTA, a specific science and technology agreement was also signed to allow for co-operation on technological issues). While the FTA approach as a means of stimulating exports should be

welcome, it is imperative that government ensures that the perceived benefits from the FTAs actually do materialize. The experience to date shows that government resources have been mainly directed at the negotiations of these agreements, while not much attention is given to ensuring that the perceived benefits are realized after the agreement has been signed.<sup>5</sup>

As far as factor markets are concerned, competitiveness is highly dependent on improved industrial capabilities. According to Lall (1990), industrial capabilities include physical investment, the provision of human capital and technological effort. The importance of all these factors has been recognized in the recent IDS policy document (see DTI, 2002: 27-29). However, concrete programmes still have to be developed to explicitly address these issues.

Finally, there is little disagreement with government's recent assertion that there is a need to "*...accelerate the current trajectory of our economy...Old ways of thinking and working are no longer appropriate. A concerted effort is therefore required by government and all other economic actors to address these constraints and place the economy on a path that can achieve high growth, employment and equity*" (DTI, 2002: 1-2).

The results in this study have shown that tariff liberalisation on its own has not, and cannot be relied upon in the future to secure improved competitiveness. A competitive environment characterizes the globalised world of the 21<sup>st</sup> century. The WTO is increasingly placing limitations on the use of conventional policy instruments to support industrialization. This, in effect, means that developing countries need to adopt a wider interpretation of industrial policy and the instruments to be used in supporting industrial development (Singh, 1996). In general, government policies should be directed at issues relating to efficiency in production, distortions in factor

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<sup>5</sup> The results from the EU-SA FTA indicate that policymakers did not give sufficient attention to marketing the benefits of the agreement, as well as, setting up the necessary institutional arrangements (e.g. customs procedures and institutions to deal with rules of origin requirements) to ensure the realisation of the benefits (Rangasamy, 2001).



markets and institutional development.<sup>6</sup> It should be remembered that both theory and empirical evidence suggest that where deficient markets give distorted signals, intervention may be necessary to restore efficiency. The desired or appropriate level of openness may not entail completely free markets for trade and investment. In the light of market and institutional failures facing the acquisition of new technologies (UNIDO, 2003: 142), the role of government in promoting the appropriate trade and industrial policy should not be underestimated.<sup>7</sup>

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<sup>6</sup> See Bora, et. al (1999) for a discussion on the impact of WTO rules on industrial policy within a developing country context.

<sup>7</sup> The optimal level of trade openness and trade liberalisation remains a matter of debate (see Rodrik, 2001; Lall, 2001b).