

Logic of an Australia-South Africa FTA

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Australia, previously a strong supporter of multilateral trade liberalisation, recently began negotiating a series of free trade agreements with countries in the Asia-Pacific region. This paper explores, at a conceptual level, the question of whether there is an argument for expanding the geographical scope of these negotiations to include a link to our neighbouring southern continent of Africa. The argument involves a development of the 'hub-and-spoke' framework to indicate that a 'hub-to-hub' agreement between Australia and South Africa would bring benefits both in terms of increased bilateral trade, and provide strategic advantages through enhanced investment and intra-industry trade.

Free Trade Agreements (FTAs) between two countries are a 'second best' approach to achieving gains from liberalisation of trading arrangements compared with multilateral reductions in tariffs and other trade barriers. However, this approach has proliferated in recent years due to difficulties in achieving further multilateral reductions after the failure of the Cancun negotiations, and particularly in response to the growth in Regional Trading Agreements (RTAs) throughout the world. RTAs have emerged strongly in Europe and the Americas. Asian region countries have been late in entering such arrangements but recently there has been an upsurge in activity in this region (Lloyd and MacLaren, 2004).

There is a possibility that, as they proliferate, FTAs will coalesce into a tripolar system of trading blocs based on Europe, North America and Asia (Lloyd and McLaren, 2004). The economic theory of preferential trading systems or trade blocs essentially concerns changes to world economic welfare arising from a move to discriminatory trading arrangements. Welfare change is the net effect of trade creation (positive welfare) and trade diversion (negative welfare). Trade creation occurs between members of the bloc as cheaper imports from one member replace higher cost local production, such that net welfare of members of the bloc increases as all countries benefit from production and allocation efficiencies. Trade diversion occurs when lower cost imports from a non-member are replaced with higher cost imports from a member, who differentially benefits from the reduction in protection, such that net welfare of members and non-members falls.

It is further assumed that as the number of blocs falls and each bloc becomes larger, they can use their market power to raise, or lower more slowly, relative tariffs against non-members thus accentuating both negative trade diversion and positive trade creation effects. Consequently, as FTAs coalesce into RTAs, the net welfare effect is ambiguous as the number of trading blocs decreases and the market power of each bloc increases. Further, it is argued that the welfare

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minimising number of blocs is three. This negative welfare effect however is likely to be less if the blocs form with 'natural' partners, defined as trading partners with low transaction (transportation and communication) costs, that is continental FTAs. The high tariffs against non-members' imports will not result in significant trade diversion in such cases as this trade would not occur anyway due to these high transaction costs (Krugman, 1993).

Faced with this prediction, countries outside natural trading blocs would be at a considerable disadvantage and may suffer significant trade diversion welfare losses. Oceania, Africa and Latin America are in this category. Even though theoretically non-discriminatory tariff reductions would be a better policy for such countries (Jones, 1993; Lloyd, 2002; Schiff and Winter, 2003), they will seek to counter this effect with bilateral agreements based on mutual interests. An Australian-South African agreement is a possible response to this situation. This paper explores whether it is a feasible option, and discusses the possible sources of gains from trade from such a FTA.

The arguments in favour of an Australian-South African FTA fall into two categories, which are evaluated in the following sections. First, there is statistical evidence of a rapid growth in trade values between the two countries. The rate of growth in this trade is higher than that of any of the other countries with which Australia has or is considering FTAs, except China. It can also be shown that trade between the two countries is largely complementary. Australia exports predominantly mineral products to South Africa and South African exports to Australia are predominantly manufactures. This complementarity creates a common interest and highlights the likely market protection role of a FTA.

Second, it has considerable strategic advantages. A 'hub-to-hub' agreement would connect Africa and Asia. If the 'rules of origin' conditions were ever to be relaxed, it positions both countries to act as gateways for trade between these two continents in the future. Conversely, while the current situation regarding these rules persists, it makes both countries attractive sites for foreign direct investment from each other. A further strategic advantage arises from its potential to stimulate intra-industry trade within the passenger motor vehicle (PMV) industry. Both countries have relatively high tariff protection for this industry at the moment, and both have plans to reduce this in the near future. The PMV varieties produced in these countries are complementary, such that a FTA would help each industry to expand their exports, thus gaining economies of scale before having to face increased international competition in the future.

These topics are explored within the hub-and-spoke framework developed below. A statistical analysis of existing trade, focusing on the potential trade creating and trade diversion effects likely to arise from such a FTA is provided, and the strategic considerations through intra-industry trade and enhanced investment are analysed. While it is not possible here to develop a full statistical modelling of the net welfare benefits related to an Australian-South African FTA, the case is made that, at least conceptually, there is a logic to such an agreement and that it should be explored further as a policy option.

Framework for an Australian-South African FTA

Economic analysis of FTAs emphasises evaluation of net welfare benefits likely to arise from such an agreement, where the net benefits are the value of the trade creating effects minus any trade diversion effects. The natural trading partners theory postulates that the negative trade diversion effect will be less if trading agreements form between geographically close partners. Baier and Bergstrand (2004) argue that logical or ‘natural’ partners in FTAs are determined by a combination of comparative advantage and geographical features. A comparison of the economic features of Australia and South Africa are shown in Table 1.

Table 1: Economic Comparison: Australia and South Africa, 2003

	<i>Australia</i>	<i>South Africa</i>
GDP (\$US) Billions	518.4	159.9
GDP per capita (\$US)	29,000	3,503
Population (millions)	19.9	45.3
GDP growth (10 year av.)	3.8%	2.7%
Population growth (10 yr av.)	1.2% p.a.	1.7% p.a.
Population density per sq. km.	2.5	35.1
Unemployment rate	6%	31%
Capital – Labour ratio* (\$US)	9,246	1,472
Ranking in Economic Remoteness**	2	3

* Calculated as consumption of fixed capital divided by labour force.

** Australia and South Africa are ranked second and third most remote countries in the sample of countries considered by Ewing and Battersby (2005). Remoteness is measured as the percentage of world GDP occurring within an increasing kilometre distance from a country.

Sources: World Book (2004); CIA World Factbook (2004); International Monetary Fund (2004).

It could be argued that Australia and South Africa are not natural trading partners. They are over 11,000 Km apart, although not an abnormally different separation than for several other countries negotiating FTAs with Australia. Both are only medium-sized economies and hence bilateral trade flows are not likely to be large. However, both are relatively remote from the major world economic centres and hence could be excluded from emerging trading blocs, suggesting that they should look for alternative means of enhancing their future trade growth. Further, they have different factor endowments with South Africa being relatively labour intensive and Australia relatively capital intensive. This indicates that bilateral trade would be consistent with national comparative advantages.

Empirical studies do not support the ‘natural partners’ hypothesis. Neither size of existing trade flows or geographic proximity is necessarily associated with welfare effects (Schiff and Winter, 2003). As Bhagwati (1999:14-15) points out, trade creation/diversion effects depend not only on the size of trade flows but also on the elasticity of substitution between domestic goods and non-member imports.

With high substitution, trade diversion will be significant regardless of existing trade levels while low substitution rates enhance welfare benefits from trade creation even if existing trade is low. Further, agreements between geographically close partners will not generate increased welfare if the countries have had past hostilities, while agreements between distant countries with shared interests can promote trade. Each proposition needs to be analysed on a case-by-case basis.

In recent years, both Australia and South Africa, despite a general preference for multilateral trade liberalisation, have been interested in bilateral agreements. Much of this activity has been a response to the proliferation of agreements throughout the world involving their major trading partners, and a fear of being excluded from the merging blocs because of their size and remoteness (Bailey and Perry, 1993). In addition, in a time of coalescing trading blocs, each country has needed to act to safeguard its existing markets against any potential future closure inherent in a tripolar bloc world trading system (Mansfield, 1998). This idea gained currency in the early 1990s, after the US abandoned its strong adherence to non-discriminatory trade policy and began negotiating bilateral trade agreements.

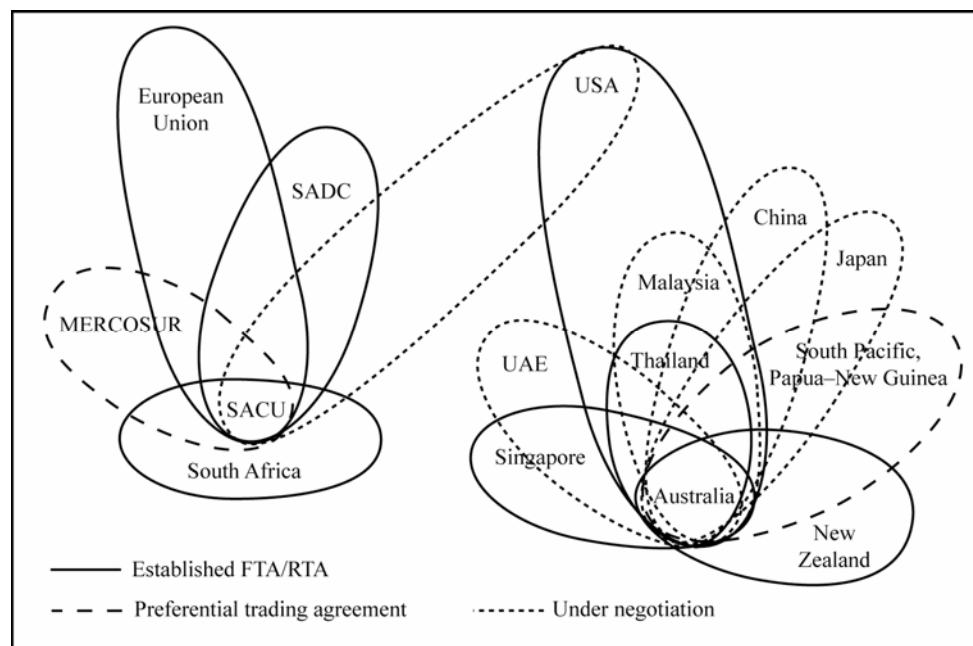
South Africa plays a key role in the African Union and on a regional level in the Southern African Development Community (SADC) which includes 13 other African countries mainly located in the southern and eastern regions. It took a leading role in establishing the New Partnership for African Development (NEPAD) which aims to unite all African countries and promote the economic renewal of the continent. It is thus envisaged that over the long run the whole of Africa would be united, enhancing the potential of pro-active action. South Africa is also a member of the Southern African Customs Union (SACU), along with Botswana, Lesotho, Namibia and Swaziland. SACU has a FTA with the European Union and since December 2004, has engaged in a preferential trading agreement with MERCOSUR (Argentina, Brazil, Paraguay, Uruguay, Chile and Bolivia) and is presently negotiating a FTA with the United States (Schiff and Winters, 2003).

Australia has preferred multilateral trade negotiations and remains committed to APEC's goal of free and open trade and investment in the Asia Pacific region. However, it is also willing to consider FTAs with other significant individual economies or regional groupings likely to deliver faster and deeper liberalisation. It has a comprehensive Closer Economic Relations Trade Agreement with New Zealand and allows preferential access to goods from the South Pacific Islands and from Papua New Guinea. Australia has developed a number of FTAs in recent years with Thailand, Singapore and the US. According to the Department of Foreign Affairs and Trade (DFAT, 2005), Australia is currently negotiating agreements with China, Japan, Malaysia and UAE.

Figure 1 maps the growing involvement of Australia and South Africa in bilateral and regional trading agreements. As discussed below, the Australia-South Africa FTA should offer trade creation benefits arising from both inter-industry and intra-industry trade. The higher growth rates and per capita incomes in Australia provide an opportunity for South African firms to expand their markets and provide badly needed employment opportunities to local people. Even if the Asian and African 'hub-and-spoke' arrangements were to coalesce into

regional blocs incorporating Australia and South Africa respectively, there would be logic in pursuing an agreement for strategic purposes. An agreement linking these two blocs would enhance the importance of each partner as trading ‘hubs’, making them attractive locations for investment, and giving them ‘first mover’ advantages in becoming gateways for regional trade flows between the two blocs.

Figure 1: Australian and South African Trading Agreements



Notes: SACU = Southern African Customs Union: South Africa, Botswana, Lesotho, Namibia, Swaziland.

SADC = Southern African Development Community: South Africa, Angola, Botswana, Dem. Rep. of Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, Swaziland, Tanzania, Zambia and Zimbabwe.

MERCOSUR = Argentina, Brazil, Paraguay, Uruguay, Chile, Bolivia.

UAE = United Arab Emirates.

Source: Adapted from Schiff and Winters (2003:76), and Lloyd and MacLaren (2004).

Bilateral Trade

South Africa is currently Australia’s largest and most dynamic trading partner on the African continent. Bilateral relations already exist and both countries have a history of productive cooperation across a wide range of issues. These include the Commonwealth, World Trade Organisation, Cairns Group, Commission for the Conservation of Antarctic Marine Living Resources, the New World Wine Producers Group, the Kimberley Process on conflict diamonds, fisheries protection, customs cooperation, human rights, migration and people smuggling,

law enforcement, and defence relations. Another forum for economic and trade cooperation between Australia and South Africa is the Indian Ocean Rim Association for Regional Cooperation (DFAT, 2005). Thus the two countries have a commonality of interest and open communication channels that would facilitate development of a FTA.

Table 2: Australia's Merchandise Trade with South Africa (\$A'000)

<i>Year</i>	<i>Total exports</i>	<i>% change</i>	<i>Total imports</i>	<i>% change</i>	<i>Balance of trade</i>	<i>% change</i>
90/91	178,099		99,285		78,813	
91/92	226,144	26.97	113,525	14.34	112,618	42.89
92/93	334,242	47.80	191,632	68.80	142,610	26.63
1994	431,877	29.21	288,280	50.43	143,597	0.69
1995	658,874	52.56	365,424	26.76	293,451	104.36
1996	945,922	43.57	453,299	24.05	492,624	67.87
1997	1,020,735	7.91	472,638	4.27	548,097	11.26
1998	1,064,495	4.29	561,292	18.75	503,203	-8.19
1999	912,603	-14.27	640,307	14.08	272,296	-45.89
2000	1,262,260	38.31	852,116	33.08	410,143	50.62
2001	1,298,206	2.85	858,711	0.77	439,496	7.16
2002	1,295,620	-0.19	965,887	12.48	329,734	-24.97
2003	1,324,813	2.25	1,135,252	17.53	189,561	-42.51
2004	1,589,100	19.90	1,249,964	10.10	339,136	78.91

Source: DFAT (2004; 2005)

Over the past five years, total trade between these two countries grew by approximately 10 per cent per year and, in 2004, it was valued at \$A2.8 billion (see Table 2). In addition, bilateral exports of services from Australia and South Africa were \$A267million and A\$275million respectively in 2004 (DFAT, 2005). Taking a long term perspective, the average quarterly rate of growth of trade between the two countries since 1980 was 2.4 per cent. This growth rate is the same as that of Australian trade with Malaysia, and higher than that of trade with Thailand (1.5 per cent), UAE (1.7 per cent) and Singapore (2.04 per cent), all of which are involved in preferential trade negotiations with Australia.

This growth was partly due to the lifting of sanctions but South Africa is also purposely moving away from commodity-based products to more diversified exports including manufactured products. Current exports such as passenger motor vehicles (PMV) were not exported before the sanctions and this trade is thus not merely the result of re-opening old markets. South Africa's trade is still under its full potential and new trading relationships could contribute to filling this gap.

South Africa is Australia's 16th most important export destination and its 24th most important source of imports. The composition of trade largely reflects each country's comparative advantages. Australian main exports to South Africa are

confidential items and special transactions (particularly alumina), coal, crude petroleum, nickel and meat, with some manufactured items such as PMV, machinery and equipment, aircraft and parts. Australia's imports from South Africa were mainly manufactures such as PMVs (mostly BMW series 3 vehicles), furniture, pig iron, televisions and specialised machinery. In 2004, South Africa was the fourth largest exporter of PMVs into Australia. It was also the fifth largest source of arms and ammunition (DFAT, 2005). Increasing trade volumes indicate a potential for renegotiating the trading relationship between the two countries, with the implication that trade creating welfare benefits will increase in future. Many of the items imported into each country are also produced locally. Thus a FTA would have trade creating effects in most of the major traded products, where imports could replace any remaining inefficient local production.

The extent to which these positive welfare effects may be offset by negative trade diversion effects depends on the relative tariff position of these two countries against the rest of the world (ROW). Both countries have been involved in programs of multilateral tariff reductions from relatively high post-war protection regimes. South Africa now has zero tariffs on most products imported from Australia, and thus little trade diversion would result from a FTA in these sectors. Both countries still have tariffs averaging just under five per cent on manufactured products, but with higher levels on PMV, textiles, clothing, footwear and leather, wood and paper products, and furniture. Thus, a FTA may result in a small trade diversion effect in these sectors, which predominantly would occur in Australia if growing South African manufactures displaced similar products from other countries. The impacts on PMV trade are discussed in the next section. Countries also need to consider any negative impacts that could arise from the loss of customs revenue if they rely on it as a source of government income (de Melo *et al.*, 1993). This is not an issue for Australia, where it is only 2.4 per cent of total government revenue (Commonwealth Government Budget Paper No. 1, 2005-2006) or South Africa where customs duty was only 3.6 per cent of total tax revenue (Schiff and Winter, 2003:95).

Overall, an initial evaluation of a FTA between Australia and South Africa would indicate that it would result in a positive net welfare effect. This effect may be small as trade volumes, except for the two major export items, and existing tariffs are relatively low. However, this initial assessment does not include effects that may arise from strategic issues associated with intra-industry trade and investment considerations, as discussed below.

Strategic Considerations

Intra-industry Trade

The general findings outlined above are modified if trade involves imperfectly competitive goods. In a situation where there are many import-competing goods produced with economies of scale, several effects can arise from a FTA. Production of some goods will expand as the partner's market is taken over and

firms obtain cost reductions with scale, consequently consumer prices fall. The competing firms in that market cease production as they become non-competitive. These two effects generate trade creation welfare benefits from reduced prices for consumers in both partner countries arising from the elimination of protection and reduced production costs. Profits, however, move from the less successful firms to those in the more competitive country. Imports from the rest of the world (ROW) may be reduced if they are displaced by the FTA partner's lower cost production, due to trade diversion in the first country and trade displacement by domestic production in the successful country. The extent to which these negative welfare effects arise depends on how significantly the relative tariff between the FTA partners and the ROW rises, thus suppressing the benefits from the economies of scale cost reductions. This depends on the elasticity of substitution between domestic production and ROW imports (Corden, 1999:196-197).

For a FTA to be viable, each country must have firms that can benefit from these economies of scale and can expand into each other's markets, such that both countries achieve some increase in production, employment and profits (Baldwin and Venables, 1995, Krugman, 1995). The likelihood of this increases with trading of differentiated products. Consumers in each country buy a number of varieties, due to differences in tastes. Trade thus reflects specialisation advantages from decreasing returns to scale rather than differences in the factor endowments of each country. Of the models based on imperfect competition, horizontal differentiation is relevant in this scenario. There are two main approaches to horizontal product differentiation, namely the 'love of variety' approach (Krugman, 1979, Helpman, 1981) and the 'ideal-variety' approach (Lancaster, 1966; 1980). The first assumes that consumers value variety and prefer a larger variety of goods. Under the second, a certain specification of a product rather than the availability of a range of goods is preferred by consumers. Each consumer has a most preferred or ideal product. Thus, even if similar products are manufactured locally, some consumers will prefer imported models. In the 'love-of-variety' approach goods enter the utility function symmetrically and an increase in available varieties increases the welfare of all consumers. In the 'ideal-variety' approach, goods enter the utility function asymmetrically and an increase in variety does not benefit those previously consuming their ideal variety. Thus, for PMV, imports and exports will occur simultaneously in the same market segment making some consumers better off while others may not gain (Sichei, 2005).

The Department of Trade and Industry (DTI) in South Africa developed an Integrated Manufacturing Strategy in 2002 because manufacturing was regarded as a catalyst for accelerated growth, increased exports and employment. South Africa's competitive advantage in PMV is based on its ability to operate with short or low-volume runs, competitive tooling costs and a high degree of manufacturing flexibility. As a right-hand-drive (RHD) country, it has a further cost advantage when exporting to similar countries such as the UK, Australia and New Zealand (DTI, 2002). The main PMV producers are Ford, Volkswagen, Toyota and BMW. Ford (S.A.) is about to commence exports of the Focus model to Australia and New Zealand. It also manufactures the Ranger (or Courier) and Drifter for those

markets. Volkswagen (S.A.) produces the Golf model and has been positioned as its sole supplier to the Asia-Pacific region. The Focus and the Golf compete in the medium size market segment. South Africa currently predominantly exports BMW series 3 vehicles to Australia, US, Japan, New Zealand, Singapore, Hong Kong, and Taiwan. In 2003, it exported 21,254 units into the Australian prestige market segment. Toyota exported 8,000 Corollas to Australia in 2003 and a substantial increase is expected in 2004 and 2005 (Anon, 2003). Australia received 15 per cent of the South African PMV exports in 2003 (DTI, 2004).

The Australian PMV industry now largely produces for the large car market segment. Ford produces the Falcon and Territory, both of which are exported to South Africa. Holden produces the Commodore and Lexcon, while Mitsubishi produces the Magna. Neither firm currently exports to South Africa. Toyota produces the Avalon and Camry 6 in the large car segment and the Camry 4—the only medium car now produced in Australia. Both versions of the Camry have substantial exports. Australia also produces small volumes of the Ford Fairlane, LTD, Holden Statesman and Caprice, and the Holden Monaro since 2001 in the prestige market segment, but none of these are currently exported (DITR, 2005).

Analysis of PMV production and trade has to consider global strategies of car companies in addition to comparative costs. Australian and South African PMV producers are subsidiaries of global corporations and are affected by their parent's global positioning. Firms, faced with large economies of scale, high R&D costs, and steep learning curves tend to adopt a strategic trade position, involving demands for both access to export markets and protection of their home markets (Milner and Joffie, 1989), which helps to explain the relatively high tariffs in these sectors. Their support for FTAs is mixed. A FTA is opposed if it is likely to result in direct competition to local production but supported if it is likely to open up new markets for locally developed and differentiated models (Hoy, 2003).

Further, regional production rationalisation by global motor corporations is likely to influence their attitudes to trading agreements. For example, under Toyota's previous (prior to 1999) multinational strategy, both its Australian and South African subsidiaries produced Corollas. As a result of regional rationalisation Australia now imports Corollas from Japan and, since 2003, from South Africa. It exports Camrys and Avalons to New Zealand, the Middle East, South Africa, South East Asia and Oceania (Toyota Global website, 2006). Thus an Australian-South African FTA would be consistent with this strategy.

Small cars represent the largest segment of the Australian market with over 265,000 units in 2004 (DITR, 2005) imported mainly from Japan, Republic of Korea, Thailand, Malaysia and other Asian countries. Increased imports from South Africa would normally have a trade diversion effect against these countries. However, because Australia has, or is currently negotiating FTAs with many of these countries, a FTA with South Africa would prevent trade discrimination against its exports, rather than create trade diversion in its favour in most cases—under the circumstances, significant trade diversion might occur only against small cars from the Republic of Korea.

Two other South African PMV producers, Ford and Volkswagen, are planning to export to Australia. These models would compete against locally produced Camry 4 series cars and should produce some small trade creation welfare effects. Given that Toyota is the only remaining Australian producer of medium-size cars, it could be assumed that Australia is relatively inefficient in this segment. However, since 2001, over 60 per cent of Australian production has been exported (DITR, 2005) suggesting otherwise. Thus increased competition in the medium car market should have trade creating welfare benefits with distribution of profits being determined by the relative strengths of each producer.

Australia also has competitive advantages in the large car segment. Since 2001, almost 20 per cent of production has been exported. South Africa does not produce in this segment. Toyota and Ford are currently the main exporters to South Africa, although a FTA may encourage Holden and Mitsubishi to also commence exports. An expansion of production would create welfare benefits for Australia if prices fall with economies of scale. Australian manufacturers have a cost advantage in being RHD producers and the transport cost effect would be minimised as the alternative producers in Europe, Japan and the US have to cover similar distances. Thus trade diversion should not be significant. In South Africa this market segment is probably small because low average income levels suggest only a small proportion of the population can afford large and prestige cars.

South Africa exports of PMV into Australia are currently predominantly the BMW series 3 vehicles in the prestige segment. Australian imports almost 90 per cent of this segment and has no exports. There may be a small trade creating welfare effect against local prestige car production, but the main effect would be trade diversion against other prestige car imports, which are currently coming particularly from Germany and the US. Due to BMW's global production strategy (BMW website, 2006), the South African BMWs would not compete against German production of this brand, but would of course compete against models from other German and European manufacturers. Trade diversion effects would be reduced by RHD cost savings and by lower transport costs from South Africa to Australia. South Africa would also benefit from trade creation from economies of scale and cost savings from expanded production leading to price reductions. The welfare gains and losses discussed above are summarised in Table 3.

Table 3: Possible Welfare Effects of an Australia-South Africa FTA from PMV trade.

<i>Segment</i>	<i>Production with Trade Creation Benefits</i>		<i>Diversion Possibilities</i>	
	<i>South Africa</i>	<i>Australia</i>	<i>South Africa</i>	<i>Australia</i>
Small	Corolla			Some
Medium	Golf, Focus	Camry 4	Some	Minor
Large		Camry 6, Territory	Minor	
Prestige	BMW			Minor

Investment

If both countries already have low tariffs on most traded goods, a FTA can deliver benefits from improvements in regulations on things such as investment, trade in services (banking, financial services, transport), protection of intellectual property, non-tariff measures, the settlement of disputes, health and safety, and product standards. Reducing and harmonising regulations will generate a range of benefits likely to stimulate investment flows between the partners leading to opportunities, not only for FDI, but also co-production, joint marketing and the transfer of technology (Weintraub, 1993, Wonnacott, 2001).

These benefits are heightened if the two partners in a FTA are also 'hubs' within their own regional trading areas. The strategic benefits will vary depending on the rules of origin conditions contained in each hub's arrangements with its other FTA spoke partners (Atkins, 1993). If these do not allow the trading of goods originating in one spoke through the hub to its other spokes, then the 'hub-to-hub' arrangements will stimulate FDI and joint ventures located in the partner hub. Thus, for example, should South African firms wish to access the US and Asian markets already involved in FTAs with Australia, they will need to invest in production facilities in Australia. The reduction in regulation and harmonisation of standards negotiated within the Australia-South Africa FTA will assist this flow of investment and would generate economic benefit to Australia. Conversely, the FTA would facilitate an inflow of investment to South Africa from Australian firms seeking to access the wider African and EU markets.

Investment in the two countries might also realign, reflecting their different factor endowments. Labour intensive manufacturers could move to South Africa and export back into Australia, as an alternative to the current movement into Asian countries. This trend could increase over time as Asian labour costs rise. Conversely, African processors of raw materials may find Australia a more attractive location, contributing to the current exports of minerals and metals. Such changes would be efficiency enhancing.

Should the conditions affecting the existing FTAs already entered into by each hub country allow the re-export of products through the partner country into its 'spoke' markets, then this FTA would have the added advantage of converting Australia into a gateway for African exports into Asia, and make South Africa a gateway for Asian exports into Africa. Achieving this type of change to the rules of origin conditions is problematic, and thus the initial strategic benefits will largely be through FDI as discussed above. Some analyses of export-led growth indicate that much of the benefit arises through the nexus between trade and investment rather than exports in themselves (Greenaway and Sapsford, 1994).

Conclusion

Both Australia and South Africa are currently involved in developing a series of regional FTA/RTAs and are developing into hubs within their own regions. It is argued that a FTA joining these two hubs would have strategic advantages in

addition to the usual net welfare trade creation benefits by linking Asia and Africa. In part, the regional gateway role is an opportunistic advantage from being the first pairing between the two regions based on common geopolitical interests. This gateway role will initially be manifest in an increase in investment facilitated by improved regulatory environments negotiated in the FTA. It also positions both countries to take advantage of any future liberalisation of trading rules relating to the re-export of products within FTAs.

While the initial trade creating benefits may not be large, the rapid growth in bilateral trade indicates that these should increase in the future. Furthermore, a FTA would have some interesting impacts on both countries' PMV industries. Both industries currently comprise subsidiaries of global motor companies that are attempting to establish their own positions within the world market. Each has specialised in a different market segment, providing an opportunity to expand into each others market and thus gain economies of scale. This provides the PMV manufacturers in both countries with an opportunity to expand their export markets without any substantial threat to existing production and employment.

The actual value of the welfare effects associated with an Australia-South Africa FTA can only be measured through a complex modelling exercise. Prior to any modelling, a conceptual analysis is required to set its parameters, which has been attempted here. Computerised general equilibrium (CGE) models as widely used to evaluate trading agreements predominantly incorporate perfect competition and constant returns to scale. To capture the effects highlighted in this paper, modifications to include imperfect competition and decreasing returns to scale within the PMV industry would be required. If it is considered that the conceptual argument mounted here warrants placing a FTA between Australia and South Africa on the policy agenda, such a modelling exercise would be the next step in developing this proposition.

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