

CHAPTER 1

INTRODUCTION

1.1 Background

South African agricultural policy underwent drastic and far-reaching changes since the early nineties, moving from a fully regulated marketing environment towards an open system, where market forces determine price levels. These changes in agricultural markets and the liberalization of international trade through the abolition of quantitative import restrictions and the introduction of import tariffs have propelled South Africa into the group of countries that emphasize the need for market liberalization (Swart, 1997). Furthermore, the government's commitment towards trade liberalization is demonstrated in the Growth, Employment and Redistribution (GEAR) strategy, where one of its key elements incorporates a drive to facilitate higher investment and the restructuring of international trade. It thus seems that trade could play a key role in restructuring the South African agricultural sector and providing it with the opportunity for growth by means of exports.

The European Union (EU) was South Africa's most important trading partner throughout the apartheid era, and after the political change in 1994, as South Africa once again became an acceptable trading partner, the EU could afford to further strengthen its ties with Pretoria. For a couple of years South Africa attempted to become a member of the Lomé group of countries, which would have entailed lucrative trading opportunities for South African agriculture products. This was however met with strong resistance both from countries within the EU and from existing Lomé countries, wary of South African competitors.

In 1995 therefore a new approach was taken towards South Africa. The EU suggested the creation of a Free Trade Agreement (FTA) with South Africa, which would take more than 12 years to fully implement. EU bureaucracy and politicizing proved to be a formidable obstacle, apart from

resistance from some EU member countries. A deal could have been reached much earlier, had it not been for opposition, especially from Spain and Portugal, fearing South African competition in products such as fruits, juices and wine. Finally a deal known as the South African and European Union Trade, Development and Cooperation Agreement (SA/EU TDC) was concluded. On the 24th March 1999 the EU approved a free trade deal with South Africa. Significantly, this was the first free trade deal between the EU and a developing country and also the first to include agricultural goods. The deal was signed into force in January 2000 and encompasses 90% of the annual bilateral trade between South Africa and the EU. It is assumed that the agreement will have spillover benefit effects for the 14-nation Southern African Development Community (SADC) and the five-nation Southern African Customs Union (SACU).

This agreement is the central theme of this study, which is concerned with the economic benefits and welfare effects of the agreement on South African agriculture. At first sight it appears that South Africa could be disadvantaged by the liberalization on domestic markets, which has progressed much further than in most of the country's trading partners' markets. This could pose a threat to local producers, especially for some agricultural industries, which might not survive on the unequal playing field created by massive support to European farmers under the Common Agricultural Policy (CAP).

It is therefore of critical importance to quantify the impact of freer trade between the EU and South Africa. The EU is a highly developed economic power, whereas South Africa is still battling with third world development issues on the one hand, whilst attempting to uphold a modern agricultural system on the other. It is widely accepted that trade between developed and developing countries should be treated with circumspection, and that goodwill towards the developed country is essential.

1.2 Problem Statement and Motivation

Since South Africa's emergence from the apartheid era, policymakers have pursued a path of speedy integration into the world economy. Recent developments include negotiations about the creation of a free trade area (FTA) with the EU. Critics have, however, pointed out that not much is to be gained from such an arrangement. Furthermore it has been argued that South Africa could benefit more from forging regional trade alliances, and that the country should not neglect its regional responsibilities, South Africa being the major economy of the region. Any trade agreement encompassing South Africa is therefore bound to have substantial effects on the welfare of the region. The government of South Africa however seems to be convinced that the reduction of trade barriers between South Africa and the EU will be beneficial to South African exports and will stimulate the economy, leading to job creation and economic development.

The goal of this study is to quantify the effects of an FTA between South Africa and the EU against the backdrop of potentially closer regional cooperation. Although there have been a few studies attempting to estimate the effects of a trade agreement between the EU and South Africa (OECD, 1995; Maasdorp, 1998; Davies 1998), none of them has really evaluated the trade deal, or calculated the actual welfare numbers and trade flows. One reason might be that the trade agreement was only recently concluded, and that all the relevant information had not been made public prior to the signing of the deal. It is therefore somewhat unclear on what basis the negotiators and their critics base their arguments. Critics within South Africa are nonetheless concerned with the seemingly lopsided market access structure of the agreement in the agricultural sector. While South African markets will open to about 95% of EU agricultural exports over the next ten years, only 60% of South Africa's vital agricultural exports will enjoy duty-free access to the EU. Cheap, subsidized EU agricultural exports, critics fear, will flow onto the South African and SACU markets, which could seriously threaten small and unsubsidized farmers in South Africa and the region as a whole.

This study is significant, because the agreement is a rare example of cooperation between developed and developing countries, and because South Africa's regional obligations could be compromised by the agreement unless compensatory steps are taken. Furthermore, South Africa

may sign other such agreements in the future (with Mercosur or the Pacific Rim), and needs to know as much about the trade effects as possible.

1.3 Objectives

The objective of this study is therefore to analyze the effects on South Africa of the concluded deal, with special emphasis on the agricultural sector. Trade flows will be closely scrutinized together with the resulting welfare effects. Important issues such as unemployment and trade diversion will also be highlighted. This leads to a regional analysis, and other hypothetical trade arrangements will be drawn up.

According to international trade theory, all the parties to an FTA will benefit from reduced barriers to trade, although it is suspected that the effects will be rather small in the case of South Africa. Trading partners excluded from the arrangement will experience welfare losses, because of trade diversion effects. The greater the liberalization, the greater will be the benefits. The study will attempt to illustrate and quantify these generally accepted trade theorems.

1.4 Methodology

The main aim of this study is to quantify trade benefits for South Africa, in terms of income distribution and job creation within the agricultural sector, using a general equilibrium model as laid down by the GTAP model, which will be discussed in later chapters. Subsequently various scenarios will be sketched, which could assist policy makers in their decisions about the timeframe and degree of preferential concessions.

The GTAP model is based on general equilibrium foundations and employs a wealth of theoretical structures and assumptions to make calculations possible. The initial equilibrium of the model is shocked in this study by a change in import tariffs and the resulting effects are analyzed. More than 2,000 equations are solved simultaneously through the GEMPACK solver employed by the model, and in the results the emphasis is placed on welfare effects and trade flows. The model will be discussed in more detail in Chapter 4. Note however, that because of its complexity and size, only the relevant aspects of the methodology will be highlighted.

The GTAP model was used, because of its ease of use and its readily available databases. Furthermore, GTAP modeling has been well accepted by the trade-modeling community and its use is spreading. Finally the GTAP model is based on a sound and comprehensive economic modeling framework, which generates a wealth of information.

1.5 Outline and Delineation of the Study

This study is organized into seven chapters, progressing from a description of the development of international trade and the formation of trade blocs, into a more focused discussion on South Africa and the Southern African region (Chapter 2). Chapter 3 then elaborates on the relationship between South Africa and the EU, and the existing trade agreements. It also reveals the details of the trade deal, which forms the central theme of this study.

Chapter 4 provides a brief look at the GTAP model, and discusses general equilibrium modeling in general. The actual analysis of the trade deal is conducted in Chapter 5. The GTAP model provides a wealth of information, and it is therefore often difficult to keep the discussion within a manageable length. Therefore an effort is made to highlight only the core aspects without wandering off into too much detail. Chapter 6 is dedicated to South Africa's neighbors and the effects of the trade deal on their economies. Trade diversion effects are key during this discussion.

In conclusion a final note is presented in Chapter 7. Some political aspects are discussed as well as the projected outcome of the deal. It will be fascinating to re-evaluate the deal a few years down the road, and to compare the results with the findings in this study.