Trade Liberalisation in Sub-Saharan Africa: Case Study of South Africa

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ABSTRACT: A striking feature of South Africa's trade liberalisation is that, until 1995, it did not involve any import liberalisation. The focus of earlier liberalisation was the reduction of the anti-export bias, and, on the import side, the replacement of QRs with equivalent tariffs and other duties. This distinguishes the process in South Africa from that which has happened in other African liberalisations. A second distinction (and the two are in all likelihood connected) is that South Africa was not pressured into making changes as part of conditions attached to a loan; trade policy has evolved in response to the perceived needs and problems of the economy, and has had the commitment of government and the support of the business community, virtually eliminating the credibility problem. A third noteworthy difference is that South Africa was the first African country with a GATT offer, signifying its new commitment to a more outward-oriented growth strategy. The reintegration of South Africa into Southern Africa poses a dilemma. South African manufacturing firms are felt by other regional manufacturers to be a threat. All countries in the region are afraid of being swamped by South African trade and investment, or of losing foreign investment to South Africa. On the other hand, South Africa is both a large market for regionally produced goods (including manufactures) and a reliable (though not necessarily cheaper) source of imports which is closer than Europe and North America. Access to the South African market provides both competition, which should improve efficiency in production, and opportunities to gain from economies of scale. South African penetration of the region is likely to increase further in the medium term.
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1. Introduction

By the standards of most of the rest of sub-Saharan Africa, South Africa is a large and developed country. Throughout the twentieth century gold has been the most important export commodity, and in the last two decades fluctuations in the gold price have been a significant influence on the whole macroeconomic environment. The international political isolation of the country in the apartheid era had wide-ranging effects, encouraging self-sufficiency as an aim of economic policy and a protectionist trade regime designed to promote employment and incomes amongst the relatively skilled and educated white minority (South Africa's comparative advantage almost certainly lies in products which are intensive in less skilled labour).

A strategy of import-substituting industrialisation has been in place since the first half of the twentieth century, but since 1970 the limitations of the policy have been increasingly recognised within South Africa. On the import side (as we show below), this has not been reflected in any significant reduction in the effective rate of protection, but protection has become more transparent, with a shift from import permits and quantitative restrictions to tariff protection. On the export side, export subsidies were first introduced in the 1970s, and the system has been gradually refined and developed. These subsidies were a deliberate attempt to offset the anti-export bias of import protection. Nevertheless the manufacturing sector remains very much oriented to the domestic market, and exports represent only a minor component of sales. Since the domestic market is relatively concentrated, South African manufacturing firms do not experience a very high degree of competitive pressure, and this is a handicap in an increasingly competitive world market.

Since 1980 macroeconomic performance has been dismal. Growth, which had been rapid before 1970, decelerated virtually to nothing, and total factor productivity was declining in the last years of apartheid according to most estimates. Unemployment is very high, and inflation has been in the 10–20% range since the early 1970s (although it did dip below 10% temporarily in 1993–4). This weak economic performance parallels that of other middle-income countries (notably in Latin America) that have pursued an import-substitution strategy over a long period.

This chapter describes and assesses the process of trade liberalisation in South Africa. It is divided into several sections. In the next section we provide an extended account of the development of South African trade policy. In Section 3 we analyse the impact of trade liberalisation on relative prices in the economy. In Section 4 we discuss the credibility of trade liberalisation, both in the past and as announced by the new government. In Section 5 we consider the regional dimension.
2. Historical Overview of Trade Policy

2.0 Introduction

A study by Bell [1993] identifies two trade liberalisation episodes in South Africa: the first beginning in 1972 with the report of the Reynenders Commission of Inquiry into South Africa's export trade, and the second beginning in 1983 with the programme to replace QRs with equivalent tariffs. During this second phase, more vigorous export promotion policies were also implemented. It is possible that South Africa has now entered a 'third liberalisation episode', with the lowering of tariffs under an agreement with the GATT. The process of trade liberalisation has survived the change in government, which reduces the possibilities of a reversal of the process.

A striking feature of South Africa's trade liberalisation is that, until 1995, it did not involve any import liberalisation. The focus of earlier liberalisation was the reduction of the anti-export bias, and, on the import side, the replacement of QRs with equivalent tariffs and other duties. This distinguishes the process in South Africa from that which has happened in other African liberalisations. A second distinction (and the two are in all likelihood connected) is that South Africa was not pressured into making changes as part of conditions attached to a loan; trade policy has evolved in response to the perceived needs and problems of the economy, and has had the commitment of government and the support of the business community, virtually eliminating the credibility problem. A third noteworthy difference is that South Africa was the first African country with a GATT offer. This signified a new commitment to a more outward-oriented growth strategy.

What follows identifies three phases of active industrialisation policy; beginning briefly with the adoption of a strategy of import replacement, and following with the shift in emphasis from the need to expand the manufacturing sector to the need to generate a current account surplus. Because the succession of policy initiatives has been complex, a summary table in Appendix 1 lists the developments chronologically. The account of policy changes is followed by a brief discussion on the nature of South Africa's liberalisation episode.

2.1 Import-Substituting Industrialisation from 1925

2.1.1 Objectives

South Africa was one of the first of the world's current middle-income countries to explicitly adopt a policy of import-substituting industrialisation (ISI) [Levy, 1992:9]. The 1925 Customs Tariff and Excise Duty Amendment Act initiated protectionist rather than revenue-oriented tariff policy; it 'extended protection considerably and affected a large number of industries that had previously not been affected' [Kleu Report, 1983:13]. The Act provided for 'moderate and selective' tariff protection, and empowered the Board of Trade and Industries (now the Board of Tariffs and Trade) to recommend tariffs for specific activities. Its

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1 Of course, revenue duties imposed previously must have had a protective effect, and some limited protective duties had existed in the former states prior to Union in 1910 [Botha, 1973:327–31].

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recommendations were invariably accepted. With some exceptions, these powers continue into the 1990s.

ISI was expected to assist with developing greater economic independence from Britain and with creating employment for whites in manufacturing [Botha, 1973:334; Lumby, 1990:63]. Further interventions followed, like the establishment of parastatal enterprises (for example, iron and steel in 1928) and development institutions (for example, the Industrial Development Corporation in 1940), and the introduction of quantitative restrictions (QRs) on imports in 1948. In fact, after 1948 import controls rather than tariffs were the main instrument of industrial protection [Lachman, 1974:25-31].

Support for the new strategy was not undisputed. The Economic and Wage Commission appointed by the government within weeks of the passing of the 1925 Act (and which reported in January 1926) provided a jaundiced criticism of protection. The Customs Tariff Commission, appointed in 1934 to review the application and effects of the policy, argued that the strategy was not unequivocally beneficial; it found that there had been substantial gains in employment and industrial expansion, but that protection was having a weakening effect on initiative and risk-taking, and on competitiveness (wages, particularly of skilled workers, were higher than those for similar occupations in the UK, Australia, New Zealand and elsewhere, which raised domestic prices). By that stage, however, many industries were reliant on protection for survival, and its maintenance had become a political issue. Justification for continuing was found in the increasing number of other countries pursuing similar policies. The 1958 Viljoen Commission (into the protection of industry) recommended that ISI be continued, but through the use of tariffs, rather than through QRs or subsidies. Nevertheless, QRs remained an increasingly important component of the protection programme [Hirsch, 1993:2]. The threat of economic isolation from 1960 added to the strategic need for continuing ISI behind tariff and non-tariff barriers, especially of strategically important commodities.

2.1.2 Effects
Studies which have examined the levels of protection provided by South Africa’s tariff structure prior to the 1970s conclude that tariff protection was indeed moderate [BTI, 1931:137; Holden and Holden, 1975:378; Lachman, 1974:25 n.] (although Holden and Holden

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2 The system of import controls was initiated as a response to a serious balance-of-payments crisis in 1948, because of the restrictions on tariff policy which had followed the entry of South Africa into the GATT negotiations in 1947. The system of import licensing was extended and formalised in 1949, and maintained until the early 1980s. In contrast to the active policy of import licensing, South Africa adopted a relatively passive policy with respect to exchange rate changes and tariff adjustments through the 1950s and 1960s [Lachman, 1975:25].

3 This was increasingly the case during the 1950s and 1960s as many developing countries adopted strategies of import substitution. The prevailing wisdom was based on post-War arguments supporting export pessimism, especially with respect to primary commodities [Prebisch, 1959 and Nurske, 1959], and the expected future benefits of protecting infant industries.
found that effective tariff protection increased over the period 1956/57 to 1963/64 [p. 378].

What these studies do not consider, however, is the importance of import controls for the protection of domestic manufacturing. Estimates of the share of imports subject to import controls range from 50–90% [Levy, 1992:9]. However, no study measuring the protective effects of import controls has been done for this period.

As a consequence of the protection of domestic industry, considerable diversification of the economy occurred, although the manufacturing sector which developed was highly concentrated [Meth, 1990:299]. In a large measure the rules for protection encouraged this, usually being granted if a producer could supply at least 60% of the domestic market [Holden, 1992b:254]. A significant proportion of investment was the creation or expansion of parastatals, some of which were unprofitable, but, like Mossgas and Sasol, were deemed necessary to maintain independence from the rest of the world. Private-sector investment ‘became too accustomed to being protected from price-cutting from abroad in times of international stringency’ [AH/SAFCD/SEIFSA, 1977:24], and was enabled to sustain high profit levels, even in periods of declining productivity, by raising the prices of manufactures at a rate faster than that at which input prices were rising [Du Plooy, 1988:89], a practice which reduces competitiveness.

ISI also served to increase the country’s dependence on foreign trade because of the need of the manufacturing sector to import capital and intermediate goods, necessitating greater export earnings to finance this. Between 1950 and 1970 the composition of imports changed, with capital goods as a proportion of imports rising from about 32% to 41.5%; a further 10% of imports was made up of industrial raw materials. Controlled nominal interest rates and an overvalued currency (which appreciated in the post-War boom) favoured imported capital and intermediate goods in production, while at the same time reducing the profitability of producing for export. The strength of primary exports, particularly gold, and the ability of the country to attract foreign investment in the 1950s and 1960s made an inappropriate exchange rate policy appear sustainable. Manufacturing growth, however, began to slow at the end of the 1960s.

In summary, the effects of the ISI strategy from 1925 were (i) initially rapid industrial growth and diversification, which slowed at the end of the 1960s; (ii) industrial concentration; (iii) further industrial expansion increasingly dependent on the continuing ability to import capital; (iv) a marked anti-export bias in manufacturing.

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4 A later [1978] study by Merle and Paul Holden estimated average rates of effective protection in 1964 as 15% on consumer goods, 6% on intermediate goods and 2% on capital goods. This study, however, excluded the protective effect of QRs.

5 Although there has been a secular decline in overall import penetration, the level of import penetration in the crucial sectors of capital and transport equipment has remained extremely high, and has not declined over time, despite high levels of protection of these industrial sectors [see Kahn, 1987:238].
2.2 Initiatives to Reduce the Anti-Export Bias from 1972

2.2.1 Objectives
The failure to expand exports, together with the recognition that ISI was no longer driving growth,\(^6\) initiated a second major policy shift in the early 1970s with the appointment (1971) and reporting (1972) of the Reynders Commission of Inquiry into the country’s export trade. The Commission was required to make recommendations designed to improve the country’s competitive export position and to identify for removal obstacles to export trade [Reynders, 1975:126]. There was concern that South Africa was too dependent on a single commodity, gold (at that stage subject to a fixed price). In any event, imports were rising too rapidly for the trade deficit to be financed by gold exports and capital inflows. In addition, the export pessimism of the 1950s and 1960s had given way in the face of the achievements of the newly industrialised countries of South East Asia, which had achieved rapid economic growth through export promotion (or at least without biasing their economies towards import substitution).

The Commission recommended the positive promotion of exports, especially of the manufacturing sector, as the long-term solution to future foreign-exchange needs. It proposed that export incentives be offered to domestic producers to counteract the effects of distance from markets and the existence of subsidised exports from other countries [RSA, 1972].

Although the Commission was criticised for ignoring what some saw as a contradiction of encouraging exports in the presence of a largely unchanged protective tariff and import-control structure [Ratcliffe, 1975:76], it initiated a more outward-looking trade strategy on the part of the government. A range of incentives to exporters was implemented by the government within a year of the publishing of the Commission’s report. These included direct cash grants to exporters, tax concessions on export turnover and export profits, rail freight concessions, tax concessions on the disadvantage of using tariff-laden inputs, and rebates of import duties on imported inputs. In addition, direct controls on imports were partially relaxed from June 1972,\(^7\) although this ceased in 1976 as manufacturers increased pressure for protection during the recession of the mid- to late 1970s. Further assistance to exporters was given from 1978 in line with the Van Huyssteen Committee’s proposals. The principle of uniformity of incentives to exporters was established at this time [Holden, 1990:265]. The strategy was reinforced by the real devaluation of the rand in the mid-1970s, which went some way to correcting the overvaluation of the currency. This was not maintained when the gold price rose at the end of the decade, and the rand appreciated.

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\(^6\) Empirical estimates of the contribution to growth show that import substitution was an important source of growth up to the mid-1950s during the ‘easy’ stages of ISI; thereafter, given the size of the domestic market, further import substitution in capital goods did not drive growth [Scheepers, 1969].

\(^7\) Under pressure from the GATT and the IMF, the government had announced its intention to lift QRs in 1969. When the GATT made provision for unbinding tariffs, QRs were gradually, although only partially, relaxed between 1972 and 1976 [Hirsch, 1993:3]. This process was resumed in 1983.
2.2.2 Effects

The Reynders Report initiated what has been called 'South Africa's first liberalisation episode' [Bell, 1992:6]. Export incentives made the trade regime more neutral, and the commencement of the dismantling of QRs, and the devaluation of the rand in 1975, deepened the episode. Despite incentives to exporters, the policy pursued cannot be considered a full-blown strategy of export promotion. Protection of the domestic market continued, with import substitution proceeding in the production of intermediate goods [Holden, 1992a:27]. The incentives were an attempt to redress some of the bias which existed against exports. Certainly in the years which followed the shift in policy, exports grew in volume terms more rapidly than imports: from 1974 to 1984 the volume of merchandise exports, including gold, increased some 28% (although this reflects a period of rapid expansion in the late 1970s, with a fall 1980–83, and recovery in 1984), while the volume of merchandise imports fell by about 20%.

However, these effects could be attributed to a real depreciation of the rand against the currencies of most of South Africa's major trading partners from 1974–79 and a precipitous slide in 1984. Furthermore, the growth in exports came mainly from an expansion in mining exports (from 57% to 62% of the value of total exports) and from beneficiated mining exports (in the category 'basic metals'), which recorded impressive growth from around 5% of total exports (15% of manufactured exports) to 17.5% of the total (52% of manufactured exports) from 1974 to 1985. With few exceptions, production of most other categories of manufactures was sold mainly in the domestic market (see table ??). There is no empirical evidence to suggest that basic metals received greater incentives to export than did other sectors, and yet, apart from basic metals, the export performance of most other sectors in the economy failed to respond to the improved system of incentives [see table; Holden, 1990:267].

In summary, the measures introduced during this period to reduce the anti-export bias were limited in scope, and less effective in promoting exports than a more appropriately valued exchange rate. The import regime remained protectionist, not only through the 1970s, but through the 1980s as well. This is covered in more detail later. Between 1979 and 1983 there were, in fact, pressures for increased protection.

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1 The rand did rise sharply in value during the gold boom of 1979-1980. This, and the combined effect of world recession in the early 1980s and the boom in South Africa in 1979-81, contrived to reduce exports, lending weight to the view that the exchange rate, and the level of demand, were more important in determining the level of exports than the export incentives offered in the 1970s.