South Africa will expose them to subsidised exports: incentives under the GEIS are payable on exports to all countries except the SACU partners.

| Table 5.2 Nominal and effective protection of selected South African industries, 1990 |
|---------------------------------|-----------------|-----------------|
| Nominal protection              | Effective protection |
| Pottery, china, earthenware     | 38              | 421             |
| Clothing, excl. footwear        | 75              | 239             |
| Knitwear: other                 | 58              | 235             |
| Carpets and rugs                 | 30              | 161             |
| Bakery products                 | 25              | 139             |
| Knitwear: clothing              | 87              | 99              |
| Textiles                        | 40              | 94              |
| Footwear                        | 35              | 87              |
| Tobacco products                | 40              | 56              |
| Furniture                       | 25              | 44              |
| Wood and wood products          | 20              | 37              |
| Non-alcoholic beverages         | 18              | 32              |

Sources: IDC, annex C (1990:58); McCarthy (1992:13)

These problems are now, in the main, temporary. South Africa has signed an agreement under the GATT, which virtually eliminates QRs, reduces tariffs and phases out the GEIS. South Africa’s offer in the Uruguay Round was the raising of the proportion of tariffs bound by the GATT from less than 20% to just over 50%, and an increase in the percentage of duty-free lines to over one-quarter [GATT, 1993:5]. The tariff reduction programme began in January 1995. Despite talk of accelerated and reciprocal tariff reduction within regional structures, preferential arrangements through the SADC are very unlikely. In order to secure guaranteed access under predictable rules to the South African market, neighbouring countries should look to securing comprehensive bilateral agreements with South Africa (Zimbabwe has already begun negotiations for the extension of the current outdated bilateral agreement with South Africa).

The trend of increasing South African penetration of the region does pose a threat to South Africa’s competitors in Southern Africa, particularly Zimbabwe. Although Zimbabwe is a major supplier to the SADC countries, its trade with them did not grow much during the 1980s, while South Africa’s trade in the region did. South Africa is now aggressively seeking markets in Africa, and is tapping into donor-funded projects, and regional competitors will have to better South African producers in terms of price, quality and reliability in order to win markets which may have been easier to gain during the 1980s. Zimbabwean firms say that it is difficult for them to compete in and with South Africa on quality. This is the result of a tightly closed economy for 30 years, which slowed technological advancement and capital replacement, and, in many cases, eliminated cheaper, better-quality imports.\(^\text{20}\)

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\(^\text{20}\) Although there are considerable inefficiencies in South African manufacturing (and agriculture) after decades of protection, South Africa’s response to the debt crisis in particular and trade sanctions more generally was to begin to reduce its anti-export bias and to attempt to become internationally more competitive.
It does not follow that South Africa will swamp regional markets. Regional competitors have some cost advantages over South Africa: cheaper labour; lower transport costs to countries to the north; and a better knowledge of local conditions, which reduces information costs. Obviously South African competition will most affect uncompetitive, inefficient or backward sectors, but some exporters in Botswana and Zimbabwe are already competing effectively in SACU countries, where South Africa holds the advantage of proximity and an integrated goods market. Moreover, strong post-sanctions demand for South African exports, together with increased domestic demand as the economy begins to show signs of growth, means that South Africa is hitting capacity constraints. There are therefore limits to the expansion of South African exports in the short to medium term.

The asymmetry of the trade relationship between South Africa and its neighbours does not mean that the region is of no significance to South Africa. It is particularly important as a market for manufactured exports, which may be less competitive in European, American or Asian markets, but which can compete in Africa because of proximity, which reduces delivery times, and better access to parts and servicing technicians. The range of South Africa's exports to Africa is virtually as wide as the range of South African products, the most important being invisibles (services), food, steel, domestic appliances, building materials and paper products. In fact, almost two-thirds of South Africa's manufactured exports are sold to other African countries. For this reason, South African exporters are interested in the maintenance of trade links with the region, and South African policy makers are anxious not to alienate neighbouring countries.

There is an additional reason why South Africa is treading cautiously and diplomatically within the region. There is a strong group in the government which is keen for South Africa to be seen as an African nation, rather than as an aspirant member of the so-called Western group of nations. This school of thought sees future relations with Africa as important, and is willing, for example, to deal with Europe within African structures. This will be particularly important if Europe scraps Lomé, and chooses to negotiate with regional structures.

There are numerous factors which will influence future trade between South Africa and the rest of Southern Africa. Firstly, many of the regional countries are pursuing programmes of trade liberalisation, usually with World Bank support. Although not under pressure from the World Bank, South Africa has eliminated the possibility of reversing its liberalisation by signing an agreement under the GATT. The effects of unilateral liberalisation taking place in several countries in the region will be to increase trade flows between them (as well as with the rest of the world).

Secondly, peace is now restored in Mozambique, which not only has implications for the region's transport routes, but will also increase trade as Mozambique begins the process of reconstruction, funded by bilateral and multilateral aid donors. The restoration of peace in

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21 South Africa is planning a large road corridor from Johannesburg to Maputo, and there is talk of eventually extending this to Gaborone.
Angola, a potentially rich country, will also provide landlocked countries with closer access to a port, and will increase the volume of intra-regional trade.

Thirdly, South Africa's political transformation will improve that country's ability to receive and send trade delegations from and to the neighbouring countries, and makes it possible for South Africa to tender for aid-financed projects in the region. This implies that South Africa's trade within Southern Africa may not yet have reached its potential, despite its being very large.

Fourthly, once South Africa's relationship with the European Union is resolved, it may provide an opportunity for South African inputs to qualify for Lomé cumulation rules, even if South Africa is not granted full Lomé status - in other words, inputs of South African goods would count as 'local content' in the production of exports to Europe from neighbouring countries under the Lomé Convention.

The cumulative result of these factors means that South Africa's penetration of the region is likely to increase in the short to medium term. These factors are likely to be of far more importance than South Africa's joining SADC. Apart from the SACU, African attempts at regional integration are notoriously unsuccessful at promoting regional trade. At any rate, the regional arrangements are a muddle (see Appendix 2). Their resolution is important as a tidying-up exercise, but will have little effect on promoting trade.

The factors which might offset the tendency to increased regional trade with South Africa are the lack of investment in South Africa which means that South Africa is reaching capacity constraints, and the possibility of political resentment at bilateral trade imbalances by the governments of smaller countries.

5.3 Regional Investment
South Africa's large trade surplus with the region will need to be offset by some flows in the opposite direction. In itself a continuing trade deficit with South Africa is not a problem if the smaller economies are running trade surpluses with other partners (or receiving aid that allows them to purchase from South Africa). However, the deficit with South Africa is growing, and, for political reasons if not economic ones, there will need to be reverse flows. The freer movement of labour is one solution, but, as stated above, is not an option for the South African government. Alternatively, capital will need to flow from South Africa to its neighbours, either in the form of direct investment by South African firms (or multinational corporations based in South Africa), or in the form of finance. The latter will imply an extension of the South African financial system to its neighbours, developing de facto a monetary zone centring around the rand.

Currently, what little intra-regional investment there is occurs exclusively from South Africa outwards. Even during the period of tight capital controls, it was possible for South African investment to occur in the region. Historically, this was dominated by mining investment, although more recently it has also occurred in other sectors, notably financial services, beer brewing and construction. Construction companies are particularly interested in positioning themselves to take advantage of their eligibility to tender for projects funded by multilateral
donor organisations. In other sectors the primary objective of South African investment in Africa has been to obtain lucrative contracts, rather than to establish manufacturing concerns; South Africans are as nervous about investing in the rest of Africa as they are about domestic investment. An exception is Mozambique, where access to complementary agricultural raw materials has prompted large investments, usually in joint ventures with local entrepreneurs.

No exchange controls exist between SACU members, and members co-operate in exchange control procedures with outside parties. The rules for outward investments in Southern African countries tend to be more leniently applied than elsewhere, although any project which is demonstrated to contribute to SACU (South African) exports, or to substitute for strategic imports, has usually received approval. All profits generated offshore must be repatriated.

Flows of investment within the region are likely to be influenced by several factors. Firstly, if South Africa signs an agreement with the European Union which allows its products to quality as inputs to regional exports under the Lomé Convention, this will increase the incentive for South African firms to invest in other countries in the region in last-stage manufacturing, using South African inputs.

Secondly, South African firms wishing to produce in countries with which they currently trade may take the opportunity to purchase enterprises currently being sold off by the public sector under World Bank-sponsored privatisation programmes. One of the attractions of this option lies in many public enterprises currently being monopolies.

Thirdly, direct investment from outside the region, to the extent that it is made in Southern Africa, is likely to be made in South Africa rather than the smaller countries.

The cumulative effect of these factors is that cross-border investment is more likely to be South African than to come from anywhere else. The flows are therefore unlikely to be significant in relation to the trade imbalances. Ironically, if these flows did become large, they would cause political resentment at the increased foreign ownership of domestic assets, a contributing factor to the nationalisations of the 1960s and 1970s.

Both trade and investment are hindered by exchange-rate instability, and would therefore probably grow faster if more formal arrangements could be established to reduce the uncertainty associated with fluctuating exchange rates [Harvey and Hudson, 1993].

5.4 South Africa’s Exchange Rate Policy and its Implications for Neighbouring Countries
South Africa adopted a more flexible and market-determined exchange-rate regime in 1983. During the period 1981–83 to 1988–90, the value of the rand fell in real terms between 25% and 45% against the currencies of the major industrialised economies; and between 11% and 35% against the currencies of some East Asian countries. In sharp contrast to the real devaluations achieved against the industrialised countries, the rand was remarkably stable in real terms against the currencies of South Africa’s main regional trading partners in the 1980s, generally appreciating modestly (9.1% against the Botswana pula; 13.7% against the Zimbabwe
dollar over the period 1981–3 to 1988–90). The reason for this is that regional currencies *de facto* track the rand, because of the importance of South Africa for trade. However, the fluctuations of the rand have consequently carried costs for the neighbours by causing their currencies to fluctuate against those of other trading partners, especially in Europe and America *and Africa*, making other trade and investment more expensive.

Devaluations under structural adjustment programmes have exacerbated bilateral exchange-rate instability between other regional trading partners. For example, when the Zimbabwe dollar was devalued in 1990/91, it virtually destroyed Botswana’s textile sector (which has now recovered somewhat, but the costs were high).

In summary, then, the regional exchange-rate arrangements are marked by long-term *real* stability of the rand against other currencies, with stable nominal rates within the Common Monetary Area and unstable nominal rates outside the CMA (except for Botswana).

Because of the asymmetry in their mutual relative importance as trading partners, it is unlikely that South Africa will ever achieve a competitive advantage in the region, other than very temporarily, through nominal devaluation [Harvey and Jenkins, 1992:15], while neighbouring countries may be able to devalue against the rand without fear of retaliation from South Africa.²² For example, when Zimbabwe devalued in 1990 and again in 1991 as part of the structural adjustment programme, South Africa did not retaliate, because its exports to Zimbabwe were then less than 2% of total exports. Increased competitiveness is at least partly responsible for the steady increase in Zimbabwe’s manufactured exports to South Africa since 1991. Of course, as mentioned previously, no regional country trades exclusively with South Africa, and further falls in the value of the rand complicate the question of choosing the external value for regional currencies. Following a falling rand adds to inflationary pressures, which, if not contained, erode any real exchange-rate advantage achieved by devaluation.

There appears to be a compelling case for greater exchange-rate co-operation in Southern Africa. The range of options extends from regular consultation (as at Basle for Western European countries) to full monetary integration. The best route would be to begin with regular consultation in order to increase mutual awareness of the effects of domestic policy on neighbouring economies. This also defuses speculation about devaluations when central bank governors meet, if they do it regularly. Furthermore, there is a greater role for the international financial institutions in taking account of the external effects of measures imposed as part of conditionality. An opportunity to co-ordinate policy in Africa has been missed.

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²² In Botswana, maintaining a stable real exchange rate against the rand has been a matter of deliberate policy: despite having large budget and balance of payments surpluses at the time, Botswana has devalued on a number of occasions in order to prevent a worsening of its competitive position [Harvey and Lewis, 1990:221–2].
6. Conclusions

South Africa has experienced not so much a trade liberalisation episode as a gradual shift of trade policy in a more liberal direction, which may now accelerate with the advent of majority rule and the removal of international sanctions. Historically, South Africa has had a high level of import protection for many decades, and this remains the case. Import protection is highly differentiated and, under apartheid, was used as an instrument for controlling import dependence. The complex structure of import protection also means that the system is open to lobbying by sectional interests: an industry which feels itself to be under serious threat from import competition would expect a sympathetic hearing from the government. Export subsidies have been the principal instrument of trade liberalisation in terms of reducing anti-export bias, and it is possible that they have contributed to the fall in the relative price of non-gold exports, which has been greater than can be attributed to other identifiable factors. Trade volumes, however, have remained remarkably close to what would have been predicted on past trends (after taking price and income effects into account).

The present situation could be summarised in the statement that, until now, South Africa has taken no more than the preliminary steps towards a more fundamental trade liberalisation. Announced plans include a phased reduction of import tariffs and the phased elimination of export subsidies, which will be replaced by a system of import duty drawbacks. All remaining quantitative restrictions on imports were abolished in December 1994. These measures would still leave effective protection in the manufacturing sector at a level which is relatively high by OECD standards, although moderate compared to most developing countries. Rather more important is that dispersion of protection across sectors will not be greatly reduced, since six different tariff levels are envisaged, and sensitive sectors are being allowed to phase in the new tariffs over longer than the standard five-year period.

This suggests that the South African government is hesitating to take the risk of a move to a much more uniform structure of import tariffs. Current plans effectively continue the cautious approach of the apartheid regime, and show signs of an acceleration of trade liberalisation, but not of a radical break with the past such as has occurred in some other middle-income countries with a history of import-substituting strategy, like Mexico, Chile, Poland and the former Czechoslovakia, in opting for a much less discriminatory import regime and accepting the transitional costs in the expectation of making long-term efficiency gains. At present the government’s energy is concentrated on overcoming the legacy of apartheid, and trade liberalisation may become an increasingly attractive policy option because of its positive impact on the demand for unskilled labour and the anticipation that it will generate faster growth.