TIPS South African Service Trade Project
Sector Research Programme

1. INTRODUCTION

The economic importance of services in the South African economy has grown considerably. Not only has it become a major generator of employment but is playing an increasing role in trade in two specific ways. Firstly, it plays an important role as an input to manufacturing and can critically influence the competitiveness of this sector. Secondly, parts of the service sector are highly tradable and South Africa is increasingly becoming a significantly more important exporter of services. At the same time South Africa will be preparing its negotiating mandate at the WTO in the year 2000.

This has several consequences most important of which are the likely costs and benefits of becoming part of a particular international services agreement. What kind of barriers are potential exporters of services facing and what kind of concessions would South Africa need to make in return for better market access? These are the questions which calls for a systematic and co-ordinated research programme involving the Department of Trade and Industry, other related government departments as well as the private sector.

TIPS initiated a research programme on South African trade in services in order to help the DTI prepare for the next round of WTO negotiations starting in January 2000. The first part of the programme involved producing an overview paper in order to gain a better understanding of the contribution of services to the South African economy and the extent of existing service trade. It also tried to identify the role of the DTI in service sector issues which primarily fall under other departments. A summary of that paper appears as an attachment. TIPS then underwent a consultative process with representatives of the DTI and other departments in order to define the role of TIPS in this research field and come up with a research agenda for specific service sectors.

It was agreed that the DTI had a role to play in jointly developing a trade policy around services, considering its mandate to undertake trade negotiations on behalf of South Africa. It was also agreed that TIPS, as its representative research organisation, should undertake research on these issues. This should preferably be in collaboration with the departments who themselves often had limited capacity to undertake the research.

2. CHALLENGES FROM A DEPARTMENT OF TRADE AND INDUSTRY PERSPECTIVE

Kobus Du Plooy

Background

Services were first brought into the multilateral trading system, when the Uruguay Round was launched. The GATS was negotiated in the Uruguay Round. It also has a built-in agenda to further liberalise trade in services in the future.

The GATS agreement resembles GATT but there are some differences since GATS is concerned with trade in services. The GATS covers all tradable services except government services which are not provided on a commercial basis.

Broadly speaking the GATS resembles the rules for goods as set out in the GATT. The key principles are:

MFN treatment
Transparency
Market Access
National Treatment
Disciplines regarding Domestic Regulation

The last three items are conditional upon specific commitments by individual countries.

The GATS consists basically of two parts:

A framework of rules which applies to all services and to all countries (general obligations)

Specific commitments by individual countries to liberalise its service sectors on a sector by sector basis (specific obligations)

The following services are covered by the GATS:

Business (including professional and computer) services
Communication services
Construction and engineering services
Distribution services
Educational services
Environmental services
Financial services
Health services
Tourism and travel services
Recreational, cultural and sporting services
Transport services
Other services

Current work in the services field

Work in the services field is continuing in the WTO context. The GATS Council has set up Working Parties to look at some unfinished areas of the Uruguay Round GATS negotiations. Two such areas, trade in telecommunications services and financial services, have since been completed and trade in maritime services have been abandoned and will be continued in the next round. Work is currently underway in professional services and in this working party guidelines for the accountancy profession has been finalised.

Currently, as part of the General Council's deliberations on a new negotiating round that will start in January 2000, attention is also being given to the new negotiations that will take place in the area of services. As stated in the beginning, the GATS has a built-in agenda which specifies that in January 2000 negotiations on trade in services will resume with a view to further liberalise trade in services.

Challenges in the Sector for the DTI

The big challenge for the Department of Trade and Industry is to further liberalise the services sector. In the previous round of negotiations South Africa committed itself to the status quo as it was then in the various services industries, which has been relatively easy. During the negotiations a number of services had partly been liberalised but in the next round countries will be expected to make more far reaching offers. Countries will be expected to liberalise further on the undertakings that were given in the Uruguay Round as well as bringing further service sectors into its specific commitments offers. The next round of negotiations will resume in January 2000. A starting point for the South African government is to look at the services industry and decide on whether such sectors could be further liberalised.

An important priority for South Africa is to determine not only where we can further offer to liberalise, but also identify which services we have a strong comparative advantage in or potential comparative advantage. This will help the DTI negotiators in Geneva to gain concessions from other countries in return for further liberalisation of South African services.

In order for the DTI to go into these negotiations we will need the assistance of the private sector service providers - both to give us an indication of how far a sector can be liberalised as well as an indication of impediments to the exporting of their services that they experience in other countries.

This may seem to be a simple request, but it is certainly going to be more involved than it would at first appear. In the case of goods, liberalisation entails only the reduction of import tariffs. In the case of services it is slightly more complicated as the equivalent of tariffs in the case of services are regulations - often these regulations are made in terms of enabling legislation, but often these regulations would specifically be put in place by legislation e.g.

as in the case of acts regulating various financial services. In order for our negotiators to undertake any commitments in liberalising these types of regulations, consultations (or even negotiations) would have to be held with the various regulatory authorities before any offer could be made. Quite often also the interests of the service providers and those of the regulatory authorities might not be identical and solutions would have to be found also to such problems.

Helping small industries to export needs the assistance of the private sector, these small industries should indicate which services they can export and those that they would potentially like to export, the countries they would like to export to and the barriers they are faced with. This will be different from the exports of goods where you only have to reduce tariffs in goods to liberalise, services are liberalised by way of altering regulations and acts governed by different departments and different regulators. In this case, this will involve not only the government and private sector but also regulators.

3. DEVELOPING A TRADE AND INDUSTRY POLICY AGENDA FOR SERVICES SECTORS IN SOUTH AFRICA

James Hodge

The purpose of this paper is both to motivate a case for more active involvement of the Department of Trade and Industry (DTI) in the service sectors of South Africa, and to present an overview of the role of services in the national economy which may help identify areas of priority involvement.

It argues that more active involvement of the DTI is necessary for three reasons:

First, services are becoming more tradable and there exists pressure to liberalise through GATS. Trade policy remains a mandate and area of competency of the DTI.

Second, services are a crucial intermediate input into manufacturing which affect its competitiveness. The DTI has a mandate to enhance manufacturing competitiveness.

Third, the DTI has numerous other mandates such as SME development and job creation which they can look to fulfil not just in manufacturing but also in the service sector.

The Contribution of Services to the South African Economy

The service sector makes up 65% of GDP, 63% of employment and 74% of capital formation in South Africa and has been the main source of growth for the economy in the 1990s. The largest sectors are community/social services (18.6%), distribution services (14.5%), business services (11.2%), financial services (6.1%) and transport services (5.3%). The domination of services is more pronounced in the informal sector where petty trade, domestic work and minibus taxi driving are the most common sources of income.

The intermediate role of services can be measured in terms of its cost contribution to final output. Service requirements are around 12.5 cents per rand of final output in agriculture, mining and manufacturing. The requirements for service industries themselves are 27.5 cents per rand of final output. The most important are utilities, construction, internal trade, transport, communications, financial and business services. In addition to the cost contribution, many of these services offer the main source of competitiveness or productivity growth to various sectors in the economy. For instance, information technology is a critical source of competitiveness and productivity in finance and manufacturing.

The multiplier effects of autonomous increases in services represent another benefit to the economy. The domestic service multiplier in South Africa is

1.87, which is slightly higher than mining but considerably less than manufacturing or agriculture. However, exceptions do exist. Catering and accommodation has the largest multiplier of all sectors of the economy and this is concentrated in manufacturing and agriculture demands. Construction also has large multiplier effects in manufacturing and other services. The poorest performers are business and communications with few domestic multiplier effects at all.

When employment intensity of production is added, then it is possible to determine the employment multiplier effects of autonomous increases in the output of services. On average, a R1 million increase in service sector production in South Africa creates 34 jobs. Of these 34, 19 are created directly, 15 indirectly, 20% are high skilled, 55% go to African workers and 30% go to female workers. The total number of jobs created is far less than manufacturing (43 jobs) and agriculture (89 jobs). The highest performer is catering and accommodation with 74 jobs, of which 31 are indirect, 46 are low skilled, 42 go to African workers and 26 go to female workers. Other good employment creators are construction (65 jobs) and social services (42 jobs). The worst performers were business services (12 jobs created for a R1m increase) and utilities (18 jobs).

GATS- An Opportunity for Reform

The GATS process may provide a perfect research opportunity to look at inefficiencies in the services sector in South Africa. Preliminary evidence does seem to suggest that there exists opportunities for improving the efficiency of South African service sectors and therefore their contribution to the national economy.

Amongst intermediate producer services there seems to be mostly competitive market structures. In business services and construction there is a competitive environment though a number of large firms have emerged. In financial services, a few large firms dominate retail banking and insurance, while corporate banking and brokerage are characterised by many competing firms. In utilities, the state electricity firm, Eskom, generates 95% of electricity and controls wholesale distribution to municipalities.

Intermediate distributive services have been the main area of state monopolies. In communications, monopolies exist in fixed line telephony and international services while few firms dominate in mobile telephony (competitive duopoly) and television broadcasting. In transport, rail transport as well as ports and airports are monopolies, while air transport has 4 firms competing on domestic routes and numerous on international routes. Social services remain a conventional area of state provision funded by taxation but numerous private healthcare and education facilities exist.

Changes in the efficiency of South African services should also impact positively on their growth through the demand effects of lower prices. In addition, removing state monopolies should allow for some pent-up demand to be satisfied and enhance product innovation, both of which will contribute to growth. Finally, export promotion will provide another outlet for growth in South African services.

Trade in Investment in Services

Measuring trade flows in services remains problematic because of the poor data on cross-border flows and sales of multinationals. An estimate of South African trade in services, which accounts for profit remittances of multinationals only and not actual sales, puts imports and exports at around $6 billion p.a. each. This represents 17.8% of total imports and 16.8% of total exports. A small trade surplus exists suggesting no comparative disadvantage in service production for South Africa. Exports have also been growing twice as fast as imports through the 1990s.

The largest trading sectors are trade facilitation services (transport, finance, communication, business services) and tourism. Tourism is South Africa's largest service export totalling $2.3 billion in 1996 and has a trade surplus of over $650 million. Transport services are exported to the tune of $2 billion yet imports outweighed this at $2.6 billion. The dominant form of trade is freight services which South Africa appears to have a strong comparative disadvantage. An area of seemingly strong comparative advantage is financial services though exchange controls may be the reason behind this. Total trade in financial services is $1 billion, in communication is $500 million, and in business services is $700 million. In contrast, total trade in utilities, construction and social services together is only $250 million. This reflects their less tradable nature.

A closer look at FDI as a source of service trade reveals that services constitute about 50% of total FDI stock in South Africa. This investment is almost exclusively in tourism, financial and business services with the privatising of telecommunications attracting some of the more recent investment. What is unusual about South Africa is that the outgoing FDI is larger than the incoming FDI. The outgoing FDI is mainly mineral companies taking up concessions around the world as exchange controls are loosened. However, service firms are joining them with financial and information technology firms leading the way.

The trade and FDI data for South Africa reflects our position in the global economy. Being the dominant economy in the region and geographically close means that South Africa is the main supplier of advanced producer services to the region but imports resource or labour intensive services from the region. South Africa's less developed stature in the world market means we are likely to import producer services from industrial nations but sell them tourism.

4. FUTURE RESEARCH -TERMS OF REFERENCE

On the basis of both work done and consultation with other stakeholder this sections presents a detailed terms of reference for the further research that will ultimately assists South African negotiators at the WTO.

Sector Study Outline

A complete study outline (or terms of reference) for each sector chosen could comprise of three parts as follows:

1. Understanding the Service Sector

The purpose of this initial component is to understand the composition and operation of the sector in general as a basis for the analysis of the South African scenario that follows. It can examine the following aspects:

- What are the main sub-sectors included in the sector
- What is the nature of production
- What are the main determinants of competitiveness in each sub-sector
- What are the potential forms of trade and their relative importance
- What is the cost and strategic intermediate role of the sector in the broader economy

2. The Domestic Service Market

The purpose of this component is to map the current South African service market and the regulatory structure before analysing how different interventions shape the structure and performance of the sector and how changes to the regulatory structure may impact on key performance and import variables.

2.1 Mapping the domestic service market

- What are the output and employment dimensions of each sub-sector?
- What is the market structure and who are the main players in each sub-sector?
- What is the significance of imports by each mode of supply?
- What is the cost and quality competitiveness of supply (local and foreign) in comparison to other countries?
- What are the strengths and weaknesses of the local providers?

2.2 Regulation and other interventions in the domestic market

- Documentation of all significant regulation in the sector.
- Documentation of all other significant intervention in the sector (subsidies, procurement policies, etc).
- Which regulation acts as a barrier to trade and how does it operate?
- What other barriers to trade exist?
- What other regulation has an impact on the shape and performance of the sector?

2.3 Impact analysis of removal of barriers to trade

What are the static and dynamic effects of removing key regulation or other trade barriers on the following:

- the domestic sector performance i.t.o efficiency, employment, output, price, quality, product range
- the rate of imports by different modes of supply
- the performance of other sectors in the S.A. economy

3. Exports Activity

The purpose of this component is map current export activity, understand the various barriers to exports and seek the importance of various instruments in promoting exports. The study should focus on sub-Saharan Africa because a) most of the South African exporting activity is likely to be there, and b) South African efforts at opening markets are likely to focused there because that is the focus of exports and industrial countries are likely to open each other.

3.1 Mapping current export activity

- What services are being exported, to which markets and through which modes of supply?
- What is their cost and quality competitiveness in comparison to world and regional markets?
- What are the reasons for current exports?
- In which sub-sectors does the country's comparative advantage seem to lie?
- What are the benefits of exports to the firm and to South Africa?

3.2 Barriers to exports

- What is the incentive structure for South African firm's to export?
- What barriers to trade are being encountered by exporting firms in current and potential markets?
- What domestic regulation is hindering exports?

3.3 Promoting exports

- What impact will removing trade barriers in other countries have on export performance?
- What other domestic policies may be required to support exporting and what impact will they have on export activity?

C. Choice of Sectors

It is impractical to develop studies of all service sectors considering that they make up two-thirds of the economy. Therefore, there needs to be some criteria for selecting which sectors to study. The first cut in the selection process was to eliminate social services from the list. These remain the role of any government and are not a serious concern in WTO talks. The criteria used to select from the remaining sectors were:

1. Which sectors is there likely to be pressure on South Africa to liberalise?

   It is likely that the most pressure will come from industrial countries, not developing ones. If this is the case then the pressure on South Africa will be in sectors which are easily tradable over distance because industrial markets are not close to S.A. This would narrow the list down to financial, communication (excl. post, courier services) and transport (excl. road, rail and airports/ports) services. Business, distribution and tourism services are all relatively open and utilities have a definite regional limit to competition. From the list one can probably eliminate financial services because the sector is relatively liberal barring prudential requirements and exchange controls – with the latter unlikely to be affected by this study.

2. Which sectors have uncompetitive market structures and whose inefficiencies affect manufacturing?

   The list of intermediate services of concern to manufacturing are business, financial (excl. retail banking and personal insurance), construction, utilities, communications (excl. broadcasting), transport and distribution services. Those in which there are uncompetitive market structures and perceived inefficiencies are communications (fixed line telephony, international services) and transport (air, rail, maritime, ports, airports). Although utilities are monopolistic, the prices remain one of the world's cheapest.

3. Which sectors does South Africa have a potential advantage but where trade barriers are potentially limiting exports?

   In the SADC regional context one could probably add all the intermediate services to the list of sectors where a potential comparative advantage exists. In a broader world market one could add tourism to this list but there are no real trade barriers in the sector.

The selection procedure suggests that while all sectors will benefit from an analysis of export activity, only a few will benefit from an analysis of the domestic market. Therefore there will be two types of studies done - those that include all sections of the study outline and those that just involve sections 1 and 3. The choice of sectors and sub-sectors for the full study outline should be:

- Transport – all sub-sectors with the exception of road transport.
- Communications – telecommunications and broadcasting only.

The choice of sectors and sub-sectors for the analysis of parts 1 and 3 only should be:

- Financial – all sub-sectors
- Construction – civil contracting and engineering services only
- Business services – a selection of the most important sub-sectors
- Distribution services – all sub-sectors
- Utilities – all sub-sectors

Financial limitations mean that distribution services and utilities will be left to a later date.

D. Timeframe and Approach

The timeframe for the project is as follows:

Nov.-Dec. 1998: Select researchers and define terms of reference
Jan-June 1999: Complete studies

The approach will be to have a lead researcher who is responsible for each study. They will establish contact with a representative of the relevant supervisory government department to facilitate the exchange of information and establish some buy-in to the research.

It is important that the research informs the South African approach to WTO negotiations and that it is widely distributed. It will be the responsibility of TIPS to arrange publicity for the work.