

GLOBAL INTEGRATION AND THE NEW TRADE AGENDA:

A WORLD BANK INSTITUTE COURSE HOSTED BY TIPS

Cape Town

28 February – 4 March 2000

REPORT COMPILED BY:

**Dr. Martin Botha of TGI, P O Box 13021, N1 City, Cape Town, 7463, South Africa.
Tel: +27 82 377 3349**

March 2000

TABLE OF CONTENTS

Background	1
Part One: Commercial Policy	2
Analytical Framework: Trade and industrial performance	2
Trade and industrial performance in South Africa	16
New challenges in the WTO	32
Future WTO challenges for Southern Africa	40
WTO and services in South Africa	42
General discussion on WTO issues	47
Southern African regional integration issues	51
Part Two: Practical tools for commercial policy analysis	60
SOURCES	61

BACKGROUND

A Summer School on global integration and the new trade agenda was held at the Victoria and Alfred Waterfront, Cape Town, from 27 February to 4 March 2000. This World Bank Institute course was hosted by the Trade and Industrial Policy Secretariat (TIPS).

The aim of the course was to assist participants in improving their skills to formulate, analyse and implement sound trade and investment policies and to participate in the development of multilateral rules. The course included papers on relevant theory, policy options and cross-national experience used to evaluate trade and investment policy options.

The course was divided into two distinct modules:

- Second generation issues in trade policy
- Practical tools for trade policy analysis

The aim with this report is to **summarise the essential aspects of** the contents of the papers and discussions on second generation issues in trade policy.

PART ONE: COMMERCIAL POLICY: SECOND GENERATION ISSUES

ANALYTICAL FRAMEWORK: TRADE AND INDUSTRIAL PERFORMANCE

On the first day of the course, in both the morning and afternoon sessions, Prof. James Tybout from Pennsylvania State University provided a comprehensive overview of openness and industrial sector performance, as well as manufactured exports in developing countries.

Tybout started by presenting an overview of the possible effects of trade policy. Channels through which trade policy affects industrial sector performance are:

- traditional relative price effects,
- the degree of domestic competition,
- the size of the market, and
- access to foreign technologies.

Tybout identified the following factors that condition industrial sector responses:

- Threshold costs and scale
- Product differentiation
- Knowledge spillovers.

He classified the dimensions of industrial sector responses as follows:

- Traditional comparative advantage effects
- Pricing and output decisions
- Dispersion in technical efficiency
- Technological catch-up, and
- Changes in the rate of productivity growth.

Tybout proceed to characterise less developed countries' (LDC) manufacturers in terms of these features. This was done in order to focus the discussion of the effects of trade policy on the models, which are most relevant. These features are scale economies and start-up costs, product differentiation and market power, and learning and spillovers (see Tybout 2000, for a comprehensive overview of plant and firm-level studies regarding the manufacturing sectors of developing countries.)

After an extensive discussion of these features Tybout linked trade policy to pricing and scale efficiency. By presenting an equation Tybout argued that the more elastic demand is, the lower is the mark-up of output prices over marginal costs. So whenever placing firms in global markets increases the elasticity of demand that they face (smaller fraction of the market, closer substitutes available), the pricing condition implies that they will move toward marginal cost pricing, thus generating efficiency gains. The effects of trade

liberalization on scale economy exploitation depend on whether there are significant entry/exit costs, and whether liberalization expands the market size (as with export-oriented industries) or contracts it (as with import-competing industries).

Furthermore, if the elasticity of demand is constant, then changing the size of the market has no effect on production levels at the representative firm. The elasticity determines the profit-maximizing mark-up, and the number of firms adjusts when market size changes until profits are zero.

On the other hand, if putting the domestic firms in competition with more varieties increases the demand elasticity they face, liberalization will force mark-ups down, and induce an expansion in output, even among import-competing firms in shrinking markets.

Tybout stated that most studies found that heightened import competition is associated with reduced price-cost margins. For example, in the 1980s, Mexico underwent dramatic trade liberation. Between 1985 and 1990 effective protection rates went from a weighted average of 31 percent to 9 percent for manufacturing, and license coverage ratios went from 92 percent to 11 percent.

With regard to trade policy and scale economy exploitation Tybout suggested that the theory indicates that firms may expand or contract with trade

liberalization. Empirical evidence, however, suggests that contraction typically occurs in the import-competing sectors. That is, the market size effect appears to dominate the elasticity effect. This finding is especially strong in sectors where sunk entry/exit costs are high (i.e., in sectors with low turnover). Nonetheless, although plant sizes tend to shrink when import competition is increased, the effects on scale efficiency are quite modest. The reason is that most of the adjustment in total domestic output comes from large firms that are operating in the flat portion of their average cost curves.

Tybout then discussed trade policy within the context of productivity and import competition. The theory suggests that when sunk cost matter, and/or when inimitable product differentiation is significant, domestic firms that are not at maximum efficiency may nonetheless earn profits and survive. Foreign competition introduces a new source of competitive pressure, and may (or may not) force inefficient domestic firms to shape up. When the protection is removed, profits at the least productive firms may be driven so low that they exist. When protection is removed, the return to investing in technologies that reduce MC may go down because share of the market is smaller. On the other hand, the return to managerial efforts may go down, and if managers are on the backward-bending portion of their labour supply schedule, they may work harder. By means of regression studies on Chilean data Tybout demonstrated that productivity dispersion falls when protection is dismantled.

Tybout also linked trade policy to productivity growth. According to him, if technological mastery of an industry takes practice, the producers or countries with experience are likely to be the most efficient. Latecomers may not be able to compete with them. This logic is often invoked to defend infant industry protection.

On the other hand, if technology can be easily acquired through conscious imitation, or if it diffuses through other channels, late-comers may be able to exploit the fruits of others' learning without bearing comparable costs. This puts them at a potential advantage, and opens the possibility that they will be able to close a technology gap.

Tybout then discussed and presented models of growth-enhancing infant industry protection, as well as models where openness facilitates growth. With regard to the latter he stated that trade liberalization can make economies grow faster (or slower) by affecting relative prices faced by the R&D sector; the knowledge stock that domestic innovators have access to; and access of domestic agents to goods developed abroad.

The morning session was concluded with a discussion on Foreign Direct Investment (FDI). Tybout suggested that there are essentially three ways through which firms can exploit their technological advantage internationally, namely through exports, licensing of the technology to foreign firms or horizontal FDI. Licensing is problematic when the value of the rights to the

technology is hard to judge, as will be the case when expanding into a new market. Further, once shared, it becomes more difficult to protect proprietary information. Exports, on the other hand, can be unattractive when shipping is costly, when there are advantages to being close to one's clients, or when there are trade barriers in the host country. Further, if labour is cheap in the host country, there may be extra advantages to producing there.

Multinationals may even wish to make the host country an export base when labour is cheap. FDI may look the most attractive of the three options.

FDI transmit technology gains in the following ways:

- A large fraction of the R&D and innovation in the world comes from multinationals, but multinationals generally try to protect their technological advantage rather than let it diffuse,
- Some of the expertise embodied in the multinational is likely to spill over to the domestic market as employees turn over, and brings skills learned at the subsidiary with them to domestic firms,
- Another channel for diffusion is through the use of domestic suppliers, who are given specialized orders and subject to the quality control and supervision of subsidiary management,
- Just the presence of the subsidiary, producing and selling a new good, demonstrates the viability of the new technology and management techniques in the domestic market. By demonstrating the viability of their products and technologies, multinational

subsidiaries resolve uncertainty. They may thereby induce copycat behaviour among domestic firms, for example, through reverse engineering, and

- Multinationals are concentrated in industries characterised by high capital intensity, product differentiation, and other start-up costs. These are the very sectors that are likely to behave less than competitively, especially when the market is small. Hence, having a multinational come in can increase the degree of competition, and may force domestic rivals to catch up technologically.

Given these potential gains, some developing countries have aggressively promoted FDI. Tybout argued that some policies are sensible in their own right. Stable sustainable macro policies hopefully translate into steady growth, with few crises. When they do succeed, the country is relatively attractive. An effective legal system and protection of property rights are also important from the multinational's perspective. Informational, marketing efforts are vital to educate potential investors.

Some countries go well beyond these measures and establish trade barriers to encourage domestic production. Tax breaks, exclusive rights to the domestic market and complementary services are also established.

Countries have also tried to ensure that spillovers take place, once the subsidiary is there. Local content requirements, for example, ensure upstream

suppliers are part of the action. Furthermore, local R&D requirements are an effort to prevent multinationals from simply outsourcing the low skill, labour intensive stages of production rather than bringing sophisticated processes to the host country. There are also local hiring requirements for managerial and skilled personnel, in order to develop an indigenous stock of expertise.

According to Tybout regression analyses have indicated that many of the above-mentioned policies do induce FDI, but when captive markets are created for multinationals, the effect can actually be to reduce the value of GDP at world prices. When FDI reduces national income, its not because the multinationals are losing money – it is because there are large discrepancies between domestic and world prices. This often traces to protectionist trade policies and other interventions. The subsidiaries do often bring newer technologies in, and they typically pay above-market wages to their employees. The magnitude of these spillover effects, however, is debatable. Tybout referred to case studies, which certainly identify instances when they are present, but he stated that the econometric evidence on their pervasiveness and quantitative significance is mixed.

Tybout proceeded after lunch with an elaborated lecture on manufactured exports in developing countries. Successful development is often tied to successful exporting (Roberts & Tybout 1996). The encouragement of export could enable countries to absorb capital inflow reductions. It will also enable a country to reap the gains from trade. When anti-export bias is removed, the

increased volume of foreign capital goods and intermediate goods can improve domestic efficiency and productivity growth.

One also notes a heightened competition among tradeable goods producers. Exports should also be encouraged in order to absorb foreign technologies. When local goods are exported the foreign purchasing agents may suggest ways to improve the manufacturing process. Participation in the export markets brings firms in contact with international best practice and fosters learning and productivity growth. The knowledge exporters acquire may spill over to other producers through shared input suppliers, labour turnover, demonstration effects, and changes in competitive pressures.

Tybout identified three dimensions of export responses namely

- Volume adjustments by incumbent exporters
- Entry into and exit from the export market by existing firms
- The creation of new exporting firms and dissolution of existing exporting firms.

A distinct set of factors affects each margin of response, but all types of responses are influenced by the profit stream firms expect to earn in foreign markets. A study by Roberts and Tybout (1996) regarding the micro foundations of export booms in Colombia, Morocco and Mexico addresses many of these factors.

According to Tybout the decision to export by existing firms depends on various factors. As marginal costs fall or the foreign marginal revenue function shifts outward, profits from exporting eventually become positive. Another factor is the extent of heterogeneity across plants. Entry costs are a third factor. If sunk entry costs are significant, they discourage firms from repeatedly entering or exiting the export market. Similarly, when the returns to exporting in the future are uncertain, firms may take a “wait and see” approach to exporting. Changes in export supply may also be irreversible, so similar policies may not lead to similar outcomes.

Tybout then focused on entry by firms born to export. When changes in the incentive structure increase the expected combined profit stream from domestic and foreign sales sufficiently, new firms will be created. He stated that non-multinational firms are not usually born to export. They initially have high operating costs, and they undergo a shakedown period. For most exporting firms, exports are a small share of total revenue, so changes in the exchange rate are not usually the deciding factor in whether to found a firm. Exceptions occur in industries with low entry costs, and where cheap labour makes the country an attractive export platform.

Tybout identified the main sources of start-up costs:

- Market research: Among exporters and non-exporters alike, the types of market research considered to be most important for entry were buyer identification and contact, foreign prices, market selection, and standards/testing requirements.
- Product development: Among firms that had already broken into export markets, only one-tenth developed a new product to do so. Two-thirds sold products that they already produced for domestic consumption, and another quarter adapted such products for export. In short, product development is by no means a necessary pre-condition for exporting.
- Distribution: For firms that sell directly to foreign buyers, the problem of establishing distribution channels may be substantial, both domestically and internationally. But for a fee, firms can engage third parties to handle distribution and contain this type of start-up cost.
- Significant problems: In terms of the start-up process factors such as customs clearance, the country's international reputation (e.g. crime-vested South Africa) and documentation problems may have an effect.

Roberts and Tybout (1996) analysed export booms in Mexico, Colombia and Morocco, and Tybout presented some of these findings in his lecture.

Colombia (1984-1991) manufactured exports in the sample industries grew 184 percent, and 103 percent of this was due to net entry into export markets.

Morocco (1984-1990) exports grew 137 percent, and 73 percent of this growth was due to turnover effects. Although the incentives to export changed dramatically enough to induce rapid entry into foreign markets, they did not induce incumbent exporters to rapidly expand their sales abroad. Mexico (1986-1990) data also indicated that net entry and turnover contributed to growth, but to a much lesser degree. Tybout reasoned that small producers are not in the sampler, so the researchers miss turnover due to newly created firms that export, as well as turnover due to small exports that shut down. Mexican export growth is also concentrated in several assembly industries – electrical machinery, transportation equipment, and other machinery. Looking industry by industry, Tybout argued that one finds considerable variation in the relative magnitudes of the different sources of export growth (see Roberts & Tybout 1996).

Tybout summarised his findings. Although there are some industry-specific expectations, it appears that export booms are typically accomplished by inducing large numbers of non-exporters to re-orient their output toward foreign markets. To some extent, the new exporters are replacing producers who are ceasing to export, but even this tends to increase aggregate export volume because, on average, firms just beginning to export tend to do so on a larger scale than firms exiting foreign markets. This is not surprising, since exiting producers have just decided that they cannot profitably sustain foreign sales. Accordingly, Tybout reasoned that it appears worthwhile to get away

from thinking in terms of representative plant analysis, and adjustment on a single margin.

Tybout discussed a formal model of export response (see Das, M., Roberts, M. & Tybout, J. *Micro foundations of export dynamics*, processed during 1999). After presenting the structural model to the delegates he proceeded to discuss data from Colombian Chemicals producers.

He then focused on whether exports encouraged efficiency gains by referring to case study data, econometric evidence from cross-sectional studies, and panel-based evidence. With regard to case study evidence he concluded that a good deal of the information needed to augment basic capabilities has come from the buyers of exports who freely provided product designs and offered technical assistance to improve process technology in the context of their sourcing activities. Some part of the efficiency of export-led development must therefore be attributed to externalities derived from exporting. Buyers want low-cost, better-quality products from major suppliers. To obtain this, they transmit tacit and occasionally proprietary knowledge from their other, often OECD-economy, suppliers. The important thing about foreign buyers is that they do much more than buy and specify. They come in with models and patterns for engineers to follow, and they even go out to the production line to teach workers how to do things.

With regard to econometric evidence from cross-sectional studies it was found that exporting plants are more efficient than their domestically oriented counterparts. Panel-based evidence from various countries including Mexico, United States, China, Ghana, Cameroon, Taiwan and Korea, however, found little evidence of improved performance after entry into the export market.

Tybout attributed these results to the following explanations:

- The graphs don't deal with the endogeneity of export market participation,
- Learning lags can be long and variable: effects may be cumulative,
- Firms might be inspired to improve their efficiency in order to become exporters, and
- These longitudinal studies tell us nothing about the presence of externalities; only that sometimes firms seem to get more efficient after becoming exporters.

Tybout concluded the afternoon session by discussing policy implications. He rather came up with more questions than answers, but an important theoretical foundation was established for the papers of the following two days of the conference.

TRADE AND INDUSTRIAL PERFORMANCE IN SOUTH AFRICA

The second day of the conference was divided into two sessions, a discussion on trade and industrial performance in South Africa during the morning, and an overview of the World Trade Organisation (WTO) and issues concerning trade in services during the afternoon session (see the next section on New challenges in the WTO).

Three speakers participated in the morning session:

- Anthony Black from the School of Economics at the University of Cape Town presented a paper on the South African automotive industry in a globalising world (see Black 1999).
- Eric Wood discussed South African manufacturing in transition by focusing on internal dynamics of learning.
- Jeff Lewis shared some thoughts on trade liberalization with the delegates.

Anthony Black

The South African automotive industry like the industries in many other emerging markets faces major challenges as protection is reduced and it seeks to establish a sustainable basis for expansion in the 21st century (Black 1999:3). The domestic vehicle market is limited and has been growing only

slowly. In 1960 the country produced more vehicles than any other developing country, but following a long period of economic stagnation and political isolation, the automotive industry now ranks behind several emerging market producers in Asia and Latin America.

The other countries of the southern African region are characterised by low income levels and correspondingly low levels of vehicle ownership. Because of these reasons, South Africa does not easily fall into the IMVP's locational typology of a Big Emerging Market (BEM) or the Periphery of a Large Existing Market Area (PLEMA) (Black 1999:3). Currently South Africa's domestic market and regional location poses clear disadvantages in terms of attracting international investment in vehicle production and first tier components and raises difficult questions for both firms and policy makers with regard to appropriate strategy.

Globalization in the automotive industry is not a new development. In spite of these pressures and the constraints imposed by the WTO nation states still have a significant level of choice with regard to the extent to which they wish to expose the industry to the forces of globalization (Black 1999:3). South Africa has adopted a policy of phased liberalisation, meaning protection is being phased down below the limits set by the WTO but remains significant. It also operates a system of import-export complementation, which has a profound impact on shaping the strategies of international and local players.

Trade liberalisation tends to reduce the prices of liberalised products relative both to other goods in the domestic market and to similar commodities internationally (Black 1999). Both standard trade theory and the general equilibrium models used to analyse the sectoral impact of tariff reductions predict a fall in output for the affected sector with the benefits accruing to the rest of the economy in the form of lower prices and a more efficient allocation of resources.

But, according to Black (1999:3) reality at the sectoral level is more complex and there are a number of important dynamic effects, which affect the outcome in the industry in question. While the change in relative prices would at face value, be to the detriment of the sector, these changes are refracted through the prism of variables such as

- domestic demand (influenced by lower prices),
- structural change (which may reduce production costs),
- growing international integration (which will impact on investment and trade in the sector), and
- productivity initiatives (spurred by growing competition).

Black argued that these effects could be of particular importance in the automotive industry where economies of scale are important and where a handful of multinational vehicle producers dominate global production and

also exercise considerable influence over the location of new investments by first tier component suppliers.

In this environment, Black stated, comparative advantage is much less a function of existing endowments but quite clearly created by the interplay of the locational behaviour of the multinational corporations, host country policy and domestic market conditions. So the impact of liberalisation is a function of a range of factors and outcomes vary. In Black's (1999) paper he vividly illustrated the interplay between domestic economic conditions (the domestic market and the overall business environment) and the incentive structure (specifically changes to the regime of protection and export assistance) on the one hand; and firm behaviour (in the form of the supply response of local producers and strategic decisions of major international firms) on the other. The focus of his paper is on changes in the organisation of firms.

By means of statistics on the automotive industry Black indicated that the South African market grew very rapidly from 1950 to the early 1980s and has since been through a period of "volatile stagnation" as the economy entered a period of very slow growth. During this latter phase, growth was constrained by political instability and increasing international isolation during the 1980s as well as a decline in revenues from gold, the major export commodity. The positive impact of economic reforms introduced by the ANC-led government since 1994 has been delayed by the repercussions of the Asian economic crisis of 1997-1999.

During 1998 the eight producers of light vehicles in South Africa assembled 302 000 units of which 8,3 percent were exported. Heavy protection has resulted in proliferation to the extent that most manufacturers build a variety of models and in some cases more than one make in a single assembly plant. All assemblers are now wholly or partly owned by the parent company in Japan, the United States or Europe. There are eleven producers of medium and heavy commercial vehicles which produced 10 400 units during 1998 (Black 1999:6).

The component industry consists of approximately 350 firms and produces a full range of components for the domestic and export market. Of the nineteen firms with over 500 employees, approximately half are foreign controlled.

With regard to policy South Africa initially followed a programme of import substitution similar to that adopted in other developing countries especially in Latin America. Later policy concerns were manifested in efforts to reduce the trade deficit in the sector first by extending protection to components and then by promoting exports. More recently the issue of rationalisation of the industry has come to the fore (Black 1999:7).

Phase VI of the local content programme, introduced in 1989, was the first attempt to address the problems of an inwardly oriented, overly fragmented industry with low volume output and associated high unit costs. Local content

was to be measured by value rather than mass. Most importantly local content was to be measured not just by the value of domestically produced components fitted to locally assembled vehicles but on a net foreign exchange usage basis. Exports especially of components grew extremely rapidly with firms citing the increased availability of incentives and the desire to increase the scale of production and improve product quality as the major factors motivating exports. Rapidly rising exports gave assemblers greater flexibility in their sourcing arrangements (Black 1999:8). Black, however, criticised the programme – one of the problems of Phase VI was the fact that it did not address the major factor impacting on the scale of production in the component sector, namely proliferation of makes and models in the domestic market. In fact the impact was rather the reverse: By increasing the flexibility of the component sourcing but at the same time maintaining high nominal protection levels on Completely Built Up Units (CBUs), the effective rate of protection on CBUs increased sharply. This led predictably to an increase in the variety of models and makes being assembled locally in spite of the stagnant market.

Phase VI came in for heavy criticism with frequent changes adding to the atmosphere of uncertainty. In late 1992 the Motor Industry Task Group was appointed to re-examine the programme and advise government as to the future development of the industry. The eventual outcome was the Motor Industry Development Programme (MIDP), which was introduced in 1995 and runs until 2002. It continued the direction taken by Phase VI and entrenched

the principle of export complementation. It took a step further by abolishing local content requirements and introducing a tariff phase down at a steeper rate than the terms of South Africa's offer to the GATT (Black 1999:8).

The main elements of the MIDP are the following:

- The excise duty based local content system has been changed to a tariff driven programme,
- There is no minimum local content requirement,
- Tariffs on light vehicles are being phased down to 40 percent for light vehicles and 30 percent for components by 2002,
- Manufacturers of light vehicles are entitled to a duty free allowance for the importation of original equipment components,
- Import duty on components and vehicles may be offset by import rebate credits derived from the export of vehicles and components, and
- Provision is made for a Small Vehicle Incentive (SVI) in the form of a higher duty free allowance for low cost vehicles.

While nominal duties on imported vehicles will remain high even until the year 2002, the ability to rebate import duties by exporting enables importers to bring in vehicles at lower actual rates of duty. Import/export complementation also enables assemblers to use import credits to source components at close to international prices. Thus declining nominal protection on vehicles has to

some extent been offset by reduced protection for components. This means that there is still a significant incentive to assemble locally as evidenced by the recent introduction of low volume new models, which are being locally assembled (Black 1999:9).

Black stated that international competition in the South African market is increasing as a result of falling protection and the changing strategies of domestic and international firms. A survey of component firms undertaken in 1995 just before the introduction of the MIDP indicated that:

- Firms were well aware of the changes that would have to be made in response to the new programme,
- The respondents proved to be accurate in forecasting the impact of the MIDP,
- Firms anticipated a massive increase in exports, moderate increases in investment and roughly stable employment, and
- Two types of firms were emerging – those who were linked into export markets and expected to increase employment and another group of more traditional component suppliers who expected employment to decline.

As protection is reduced, imports will gain a larger share of the domestic market and very rapid import expansion can threaten the viability of local

producers not only by eroding their domestic market share but also by limiting their capacity to take advantage of new export opportunities (Black 1999:12).

The reduction of anti-export bias is the major objective of South Africa's programme of trade liberalisation. Exports from the previously highly protected manufacturing sector have grown rapidly especially since the early 1990s.

Automotive exports have also grown quickly due to the following factors:

- The import-export complementation arrangements of Phase VI and the MIDP,
- Falling protection and limited domestic market growth possibilities forced firms into the export market, and
- Domestic firms, in many cases, have been required to acquire a foreign technology partner, which has eased access to foreign markets.

From the perspective of a national automotive strategy, the nature of export expansion is extremely important (Black 1999:14). Given that exports are assisted by declining complementation arrangements, there are, however, concerns regarding the sustainability of export expansion and the degree to which it improves overall competitiveness by increasing the level of industry integration. In the mid 1990s these concerns appeared to be borne out by the relatively slow growth of vehicle exports, which could have indicated that vehicle manufacturers were embarking on strategies to generate import

credits by exporting components. By failing to increase volumes through exports and a degree of specialisation, Black argued they could be left vulnerable as the tariff reduction process progressed.

Black, however, stated that vehicle exports are now growing rapidly with at least three manufacturers putting in place significant long-term vehicle export programmes. Statistics from the Department of Trade and Industry indicated that light vehicle exports have increased from 11 400 units in 1992 to 25 150 units in 1998 following a sharp decline in 1996 with the ending of the VW's China contract. Statistics also indicated that component exports have expanded dramatically. The prime objective of the export complementation scheme is to assist component suppliers to generate high volumes which would make them more efficient, and able to compete in the domestic market against imports (Black 1999:15).

In terms of productivity and employment Black stated that automotive industry productivity is low in South Africa but is improving rapidly. Collected data showed that the average South African assembly plant compared very poorly with assembly plants in other countries. The main reasons for this can be ascribed to relatively low levels of automation and the complexity of most assembly plants, which produce a range of models in relatively low volumes.

According to Black (1999:19) the automotive industry is exceptionally cyclical and this shows up in employment levels. Disaggregating the effect of trade

liberalisation from the impact of market conditions is complicated by the impact on market growth resulting from the reduced price of vehicles in real terms, which in turn is partly the result of liberalisation. The export sector has now also become a major source of employment.

In terms of rationalisation the picture is not very bright! The scale of production is one of the central policy issues facing the South African automotive industry. South Africa's eight light vehicle plants produced an average of ONLY 37 600 vehicles in 1998 and a total of as many as 38 different basic models. Resulting average volumes per model are way below the world norm and significantly lower even than in relatively low volume producers such as Brazil and Australia (Black 1999:20). Statistics by the National Association of Automotive Manufacturers of South Africa show this has changed little in recent years in spite of the new competitive pressures introduced by the MIDP. The cost premium incurred by component makers for producing a wide range of products at low volume is considerable.

Black concluded by stating that the prognosis for the South African industry did not appear good in the face of the pressures of globalisation. He however felt that to date the costs of liberalisation have been quite low. The share of imports has grown and profit margins have been eroded. The fall in employment that has occurred is mainly attributable to weak domestic sales, although rising imports have certainly played a role.

Black also argued that in the South African context, the pressures of trade liberalisation are compounded by difficult economic conditions. Current sales are still below the levels achieved in the early 1980s. The domestic market grew by nearly 25 percent in 1995, the year that the MIDP was introduced, but have since stagnated (Black 1999:29). It is also clear that South Africa does not easily fall into the categories of a Big Emerging Market (BEM) because its market has been growing only slowly; or of the Periphery of a Large Existing Market Area (PLEMA) because there is no neighbouring large market. Black, however, felt that it has attracted moderate but growing levels of international investment.

Eric Wood

In his lecture Eric Wood gave an excellent overview of the internal dynamics of learning by presenting case studies of two South African companies.

The first case concerns *uCheckers*, which Wood classified as a reluctant learner. The company manufactured HDPE Carrybags, employed 250 staff and was/is based in Cape Town. It enjoyed its heyday from 1970 to 1990 with

- 100 percent local sales
- A 75 percent market share
- Tariff and low import penetration
- Strong growth during the 1970s, but
- Slower growth in the 1980s.

The false security still existed from 1990 to 1994 in the form of full 25 percent GEIS subsidy. There was a controversy over the export decision, because of small, uncertain export margins. By 1995/96 harsh reality crept in: Its market share fell from 70 to 50 percent and GEIS was withdrawn. The Board considered closure. The company experienced underlying problems: The General Manager ruled by decree, the management was patriarchal, stewards threatened strike action in 1996 and the company was internally characterised by distrust, sabotage and shrinkage. Prospects look better during 1996 with an early retirement of the General Manager and cost reductions by the new one. During a “bosberaad” “burning issues” were discussed: The Trade Union pushed for growth and resisted job cuts. Export orders thirty percent below cost were accepted, but new initiatives nearly fell apart two hours from the end. The Board gave the company three months to break even.

The company reorganised its leadership by including trade union representation at all management meetings. Stewards formed part of the steering committee. The company thus moved from autocracy to consultation: No decisions were made without consultation and responsibility, ownership and trust were established internally. A workable foundation was based on

- Effective teambuilding
- Staff ownership
- Coordinated problem solving

- Systematic performance measurement, and
- 5s on all machines (1,5 years).

The company reached a break-even after the deadline and experienced a 30 percent export growth annually. Twenty new jobs were created, but falling prices and the loss of money forced the Board to send a second warning concerning closure. It was back to the drawing board: Unprofitable lines were addressed, there was a focus on VTC, as well as a change in machinery and teams. When the shift system was changed, further disruptions took place. The staff resisted the trade union leadership, morale plummeted and production fell. Because of a borderline financial position, the company moved out of exports.

Wood then painted a learning profile of this company – initially it accepted responsibility to change and proceed on a sustainable improvement path, but deeper learning was troublesome. No investment was made in equipment upgrading and the company lacked innovation capability. It also faced a positioning dilemma in terms of the Europeans' technology advance. Furthermore, wages in Indonesia were 25 percent lower than in South Africa and South African plants had only a narrow quality lead over the Indonesians. Because of its sheltered existence the company learned not to learn.

On the other hand considered Wood the second case, BigBrand, to be a deep learner. The company was involved in outdoor durable media, in fact the

largest South African producer of billboards since 1993. Until recently it has been privately owned and employed 240 people.

Learning here concerned resource utilisation, which began late during the 1980s. The drivers experienced come-backs and high wastage. The company shifted to an inclusive management style and strong participation in the problem solving process was the order of the day. Productivity was raised, as well as an increase in quality and profitability occurred.

Learning, however, went deeper – processes were upgraded and technology improved. In terms of learning there was a shift to deep, high risk learning.

Jeff Lewis

In contrast with the papers by James Tybout, Anthony Black and Eric Wood, Jeff Lewis' thoughts on trade liberalization in South Africa were more sceptical, even provocative. In fact, Lewis was playing devil's advocate.

He agreed that trade reform has made real progress – from 1990 onwards there was a movement towards outward-orientation and the WTO offer laid out a clear liberalization path. From 1990 to 1996, for example, the average economy-wide tariff fell from 28 percent to 9 percent; the average manufacturing tariff fell from 30 percent to 16 percent, and the maximum tariff was cut to 61 percent. The number of tariff lines fell from 12 500 to 8 250.

Lewis, however, asked how “reformed” is the tariff structure. Low international averages are driven by large zero rates. Many “high rate” economies have effective rebate or drawback schemes to achieve world prices. A strong cascading structure remains. Effective protection remains highly dispersed. Anti-export bias actually rose, as the fall in tariffs was not enough to offset elimination of export subsidy. More than 2000 tariff lines changed at least once during 1996.

Lewis then discussed the impact of liberalization on imports. He suggested that the evidence of “de-industrialization” is weak: Manufacturing is not shrinking, the largest employment losses occurred in sectors in decline before trade liberalization, and there was a favourable impact on import prices. But then Lewis stated that the current situation concerning trade liberalization “could be described as hasn’t done much, hasn’t hurt much”...

He concluded by stating that liberalization works easier in a dynamic, growing economy, in an environment that promotes resource movement out of low, inefficient uses, and if liberalization is linked with competition policy (see also Lewis’ paper on trade liberalization within the SADC region).

NEW CHALLENGES IN THE WTO

Bernard Hoekman divided his lecture in two parts: The first part consisted of an overview of WTO disciplines, while the second part focused on regulation, the WTO and the new trade agenda. He also discussed the GATS and services.

Hoekman highlighted three dimensions of the WTO namely

- Codes of conduct
- Negotiating rounds – a “market” for liberalization, and
- Enforcement mechanisms.

Four principles are underlying the WTO:

- Non-discrimination
- Reciprocity
- Enforceable market access commitments
- “Fair” competition, exceptions and safety valves.

He then referred briefly to the codes of conduct within the WTO by highlighting three types of agreements, namely

- Multilateral Trade Agreements (MTA)
- Sector- or issue specific agreements (under a MTA), and
- Plurilateral agreements.

The Multilateral Trade Agreements include

- The General Agreement on Tariffs and Trade (GATT)
- The General Agreement on Trade in Services (GATS), and
- Trade-Related Intellectual Property Rights (TRIPs).

Sector- or Issue Specific Agreements include under the GATT the following issues:

- Textiles
- Agriculture
- Standards
- Import licensing
- Antidumping
- Safeguards
- Subsidies and countervailing duties
- Customs valuation
- Pre-shipment inspection
- Trade-related investment measures (TRIMs), and
- Rules of origin.

Under GATS financial services and basis telecommunications are included (see Cowhey & Klimenko 1999; Mattoo 1998). With regard to plurilateral agreements Hoekman referred to civil aircraft and government procurement (see Evenett & Hoekman 1999).

Hoekman proceeded to discuss so-called “horizontal” principals regarding the WTO codes of conduct. He highlighted the following issues:

- Nondiscrimination
- Price-based instruments, not quotas
- Transparency and procedural disciplines
- Exceptions and safety valves. These include national security, health, safety, the environment, emergency protection, renegotiation of concessions, antidumping and countervailing duties, the balance of payment problems, as well as preferential trade agreements.

Furthermore, Hoekman accentuated the role of the WTO as a market for exchange of policy commitments. It serves as a negotiating round, which include market access commitments involving the GATT and GATS. The WTO has various enforcement mechanisms in place.

After this general overview of the WTO Hoekman continued with a discussion on regulation, the WTO and the so-called “New” Trade Agenda. As classic trade barriers and export disincentives fall (tariffs, quotas and prohibitions), the direct and indirect impacts of domestic regulatory regimes on international trade and investment flows are becoming the focus of policy attention.

Hoekman cited the following examples of domestic “regulatory” policies:

- Competition antitrust policy: Regulations concerning the conduct of enterprises and the structure of national markets. Rationale: efficiency and equity.
- Industrial policy: Measures to support certain activities (e.g., R&D) or types of firms (e.g., SMEs) through the use of subsidies, tax concessions, directed credit or matching grant schemes. Rationale: externalities.
- Health, safety, prudential, social and environmental regulation: Measures that seek to impose performance standards for producers, production and/or consumption. Rationale: asymmetric information and spillovers.

According to Hoekman the “trade policy” agenda is becoming increasingly complex for the following reasons:

- Institutions enter into the picture,
- Welfare assessment and political economy dimensions are less straightforward,
- The international repercussions of domestic regulatory must be considered,
- The scope for international cooperation must be assessed, and
- Existing international constraints on domestic actions must be taken into account.

The “New” Trade agenda in its positive context revolves around lowering real trade costs, and enhancing the contestability of markets, subject to attaining regulatory objectives. Real trade costs include formalities at the border, non-recognition of standards and test results or certification. Contestability could be a function of many factors, including business strategies, technologies and public policies that define the conditions of competitions applying to a market. These policies include trade, industrial, antitrust, immigration, tax and macro-economic issues.

With regard to the negative side of the “New” Trade Agenda Hoekman argued it could be a vehicle to impose regulatory norms and preferences on other countries. He stated that there is substantial scope for “bootlegger-Baptist” outcomes.

Hoekman highlighted issues regarding the WTO and services during the afternoon session. One often needs movement of the consumer or provider for international transactions to occur. Thus trade liberalization in terms of services involves allowing investment and the movement of people. Services are often regulated – governments often have good reasons to continue to intervene in some sectors even if foreign firms are permitted to provide services. Many governments, however, have been pursuing programmes of privatisation and de-regulation of service sectors.

Hoekman then discussed the gains from the liberalization of services. Restrictions on services trade and investment can be very costly. United States prohibitions on sabotage by foreign shippers, for example, increased prices by 100 to 300 percent above the average world price. He also referred to another example: Flag discrimination and cargo preference policies maintained by Chile imposed both higher costs on shippers and severely constrained the export potential. The liberalization of maritime transport, however, supported the substantial diversification and growth of Chilean exports in fruit and fish. In Argentina foreign ownership in telecommunications companies led to more and better service. The number of lines installed grew five-fold, and waiting times and incomplete calls fell dramatically (see Cowhey & Klimenko 1999).

An efficient service sector is important since many services are crucial inputs into the production process and international trade. One thinks of services such as transport, communications and finance.

Rapid technological change also facilitates cross-border delivery of services, allowing the unbundling of production and consumption of information-intensive service activities, as well as fostering the introduction of new products such as financial derivatives, computer reservation systems for airlines, telemedicine and distance education. Hoekman emphasised that incorrect policy could drag down the entire economy and a weak service sector increases production costs and reduces output.

Hoekman presented an economy-wide perspective on services and trade liberalization. He argued that it is not enough to focus on merchandise trade barriers. Distortions will continue to persist if services are protected. For example, welfare gains associated with Uruguay Round cuts in industrial tariffs may have been three times higher if services barriers had been cut by only 25 percent. He also stated that effective rates of protection illustrate how inefficient services impose a tax on manufacturing.

He reasoned that by providing crucial transport and communication functions, services allow the coordination of separate production processes (e.g., via “just-in-time” inventory-management practices). Deregulation and liberalization will help improve the ability of firms to compete internationally. By reducing the costs of intermediate service inputs, small and medium sized firms that would otherwise be marginal will be able to expand their export activities, and larger firms will be able to specialize and rely more on third-party suppliers.

Hoekman concluded his discussion with a focus on the GATS. He referred to the four basic disciplines of the agreement, which include a most-favoured-nation treatment for four modes of supply: cross-border, commercial presence (investment), temporary presence (consulting) and movement of recipient. He discussed the specific commitments of the GATS, as well as its weaknesses. One of the weaknesses is the various options for small countries to “opt out” of agreements under the GATS. This was illustrated by presenting a graph on

developing countries' pre-commitments to liberalize in basic telecommunications. Some countries such as the Cote D'Ivoire, Mauritius and Tunisia made commitments to end monopolies in telecommunications at a given deadline, while South Africa and Senegal stated that they will "review" their policies and "consider the feasibility of more licenses".

With regard to foreign market access barriers Hoekman stated that no comprehensive information exists due to the nature of services and regulation. The GATS gives a very incomplete picture. In terms of data only the United States has good disaggregated data on bilateral flows of cross-border trade and FATS. In terms of sectoral openness mostly telecommunications and financial services, in part reflecting recent GATS negotiations (see Cowhey & Klimenko 1999; Mattoo 1998).

Hoekman concluded by discussing ways in improving the GATS and its rules (see also his presentation on industrial policy.)

FUTURE WTO CHALLENGES FOR SOUTHERN AFRICA

During this morning session on the third day of the conference Stephen Yeo and Kennedy Mbekeani basically introduced a research project, still in its infancy, to the delegates. The objective of the project is to facilitate the cooperation of Southern African countries in the WTO activities. The speakers called the research project the Southern Africa Trade Research Network. By means of this project Yeo and Mbekeani hope to help policy makers in the Southern Africa region, especially from the smaller countries, to participate in WTO processes. The emphasis is on assistance to these countries with regard to research expertise and trade negotiations within the WTO. A similar initiative has been established in Latin America.

The discussion consisted with an introduction by Yeo, a lengthy discussion around issues of importance for the Southern Africa region, which needs consideration in the research study, and lastly, an exchange of information between the delegates and Yeo on possible researchers, who could be involved in the study.

Yeo, also in a very early planning phase, discussed the methodology. The study will be structured on a thematic basis, rather than by country. The researchers want to organise the project in broad themes and then study these issues on a country-by-country basis.

Three focus areas are of importance:

- Policy analysis: Analysis of existing data as well as the collection of new data.
- Capacity building: To make the best possible use of the research capacity in the region. In future more researchers will be involved.
- Training of government negotiators/officials.

Yeo proposed a study leader and coordinator for the thematic studies with involvement of researchers from various Southern African countries. An advisory committee should guide the project as a whole. The members of this committee should come from the different countries.

It is a long-term project, which could run up to five years.

The rest of the discussion focused on a huge variety of issues – at WTO level and on the regional level – which should be addressed by the research study.

WTO AND SERVICES IN SOUTH AFRICA

In many ways James Hodge's discussion on the WTO and services in South Africa complemented the general overview by Bernard Hoekman regarding trade liberalization, the WTO and services. In terms of the WTO all services in South Africa are covered but the focus is on producer services such as telecommunications, utilities, finance, transport, business, construction and distribution. The current agreement, however, excludes government procurement. Four modes of supply were identified, namely cross-border, consumption abroad, commercial presence and presence of natural persons. Hodge stated that trade data in South Africa is difficult to source, unreliable and lacking disaggregation.

Liberalization of a sector requires making commitments on market access and national treatment for all four modes of supply. There is scope for excluding trade in some modes of supply to manipulate the costs and gains from trade or to phase in a liberal regime.

Hodge considered liberalization as essentially a regulatory process that requires the introduction of pro-competitive, non-discriminatory regulation in place of monopolies and license-restricted oligopoly markets. The political economy of service trade reform is difficult as it involves numerous government departments and public enterprises. It also often involves adjustment costs for the industry while the benefits accrue to the users. The

South African experience is that the sector reform of other departments dictates the trade reform and they tend to have a political economy rather than a general economy perspective.

Regulatory reform also takes considerable public capacity to both develop a new regulatory framework and to undertake good competition and conduct regulation afterwards. Gains from regulatory reform also depend on how they are shared, which depends on the effectiveness of regulation and competition. Ineffective regulation could result in gains going to producers and not the consumers, and in some cases foreign producers. Furthermore, the gains from trade may not be realised if other factors in the country environment do not support such trade.

Adjustment costs, according to Hodge, are an important issue in services as many of the reforms are irreversible and involve key sectors. In the financial sector the most sensitive and best practice dictates that liberalisation is preceded by macro stabilisation and supported by prudential measures. Labour is likely to be a source of high adjustment costs as easy productivity gains can be made from staff retrenchment. Hodge, however, added that it is important to see this in a context of potential job creation elsewhere in the economy. On the flip side, there is also the potential for skilled labour shortages in the period of adjustment as pent-up investment is realised.

Hodge proceeded to discuss patterns of trade and the gains from trade. Trade allows reallocation of resources to where they are most productive, and producer services tend to be intensive in their use of physical and human capital, as well as technology.

Intra-industry trade offers improved productivity through the exploitation of scale economies by allowing specialisation and differentiation. Producer services have scale economies in knowledge, organisation and technology. One can thus expect greater volumes of two-way trade amongst more developed economies while trade patterns of poor countries will reflect one-way trade as per comparative advantage. This does not imply that services are not important to developing countries and can often be considerable export and import items such as in the case of Egypt.

Hodge also reasoned that trade widens the downstream market, allowing greater specialisation and productivity gains upstream. These results in benefits accrue to users of intermediates who get better variety, quality and lower costs. Producer services are all crucial intermediates. One can expect countries with larger markets or open to service trade to have better quality and lower cost services. This may be reflected in better performance of trade in goods. Yet if cross-border trade is limited and economies of scale are at the plant level, then poor countries may not benefit, as narrow markets will limit gains.

Services can act as trade facilitators. Many of the producer services facilitate trade and so changes in volumes of goods trade alter directly the volumes of service trade. One can expect a strong correlation between trade volumes in goods and certain cross-border services, yet whether these are reflected as imports or exports depends on comparative advantage. In terms of services as trade facilitators one observes a trend towards global production networks operated by retailers or final goods assemblers. Participation in these international supply chains requires a minimum standard of finance, communication and transport services. Trade in services may assist in enabling inclusion. The service infrastructure also facilitates trade in other services or in other modes of supply such as tourism.

Hodge argued that services could also serve as FDI facilitators. Multinational firms decide on a location based on matching their own competitive advantages with the assets and inputs that a particular location can provide. Improvements in producer services from trade in services alter the production and logistical costs of operating in a country and so altering the quantity of FDI. FDI could serve as a form of trade, but as FDI is a preferred form of trade in services it often limits some of the potential adjustment costs from trade. Trade liberalization will often create new investment and jobs in the developing country. It will enhance the transfer of technology and skills, and will provide market growth to stimulate downstream markets.

Hodge then focused on distortions of regulations. The level of distortions in trade and production from regulations is large making the analysis of the potential outcomes from trade liberalization difficult.

He concluded by saying that after trade services liberalization poor countries are likely to see widening trade deficit and one-way trade based on comparative advantage. However, this may also provide an opportunity to reduce the deficit or widen the surplus in good trade. Developing countries could become more industrialised by liberalising services trade if markets for goods opens up too. Middle-income countries are likely to experience two-way trade based on product differentiation. There is considerable scope for exports, which needs to be encouraged. According to Hodge countries need to focus on sector regulation, competition and creating an environment for FDI to get the most from trade liberalization.

GENERAL DISCUSSION ON WTO ISSUES

Bernard Hoekman confined his last lecture at the conference to a general discussion of industrial policy and the WTO. He addressed two issues in his presentation:

- What is industrial policy?
- Which disciplines in the WTO deal with these policies and how do WTO regulations constrain governments with regard to industrial policies?

Hoekman defined industrial policy as an attempt to change the structure of production. Industrial policy aims at enhancing productivity and growth.

Why is it important to have industrial policies? Hoekman provided three reasons:

- A given government wants to support a certain sector,
- Industrial policy could enable firms to compete internationally, and
- Industrial policy addresses a market failure.

Hoekman identified two types of industrial policies:

- General industrial policy – it is not targeting a specific firm, but the general market, for example, the labour market. It can also target an activity like export, and
- Specific industrial policy – it targets a specific industry, for example, the automotive industry (see Black 1999).

Two instruments could be used to pursue industrial policy:

- Tax base: One can put specific incentive in place, and/or
- Quantitatively-based measures, for example, restrictions on the number of firms.

Hoekman argued that from a WTO point of view one is uncertain where to draw the line when countries pursue measures such as incentives and subsidies to boost their industries. The question is: “What is allowed, what is not under WTO agreements”? For the WTO the focus is the following:

- Does the policy effectively discriminate against imports?
- Does the policy lead to the increase of exports?

Hoekman argued where do you draw the line for what is permitted and what not. Furthermore, to what extent constrain WTO agreements those countries pursuing certain industrial policies? Many industrial policies tend to discriminate against imports. These have the effect of essentially changing the

playing field by providing incentives to local firms, which could violate international industrial agreements. Under the GATT there are also various weak disciplines on subsidies. The key binding disciplines in the GATT, however, are the export subsidies, which initially did not apply to developing countries. Another problem within the GATT has been the absence of disciplines on intellectual property rights. This changed with the adoption of the TRIPs agreement. In terms of intellectual property rights, reverse engineering has become more difficult since the establishment of TRIPs.

Hoekman then discussed the debate between the United States and developing countries regarding policy on local content.

The following subsidies are subjected to WTO rules:

- Export subsidies are not allowed, for both developed and developing countries.
- Production subsidies are dealt with less severely, but if production subsidies are used by a country, an importing country could place a levy on those production goods.
- Needle subsidy: Anyone can use it and usually it doesn't lead to disputes. This subsidy has an economic support theme, e.g. subsidy for R&D support. When a country has social problems to address such as income disparities between members of that

country, needle subsidy could be applied. Countries, thus, should be able to use subsidies in certain cases, like here.

What is WTO regulation with regard to export promotion? According to Hoekman these measures are dependent on lateral agreements with the trading partners. There must be a very good rationale for such measures. Some of these measures could violate regulations set by the WTO.

Does the WTO constrains the use of policies in developing countries that actually make sense? One should, according to Hoekman, use other, more efficient measures than these policies to achieve the desirable results. Usually experts in the economy ask where is the market failure, which these instruments are supposed to address. The WTO agreements force governments to think more clearly why they would pursue these policies, for example, export subsidies.

The TRIPs agreement is a more controversial one. It does not always make economic sense for countries, which are very poor, for example, intellectual property right issues.

Hoekman concluded by discussing Anthony Black's case study on the South African automotive industry within the context of the WTO and industrial policy. He pointed out how policy within this industry in the past and present has complied with WTO agreements.

SOUTHERN AFRICAN REGIONAL ISSUES

In his presentation Jeff Lewis basically summarised and discussed two research studies: One documented by Tsikata (1999); the other one reported by Lewis, Robinson and Thierfelder in their 1999-document entitled *After the negotiations: Assessing the impact of free trade agreements in South Africa*. Lewis took the title of the second paper as the theme of his presentation. He divided his lecture into three parts:

- Painting a context in which globalization, the WTO and WTO 2000 negotiations were discussed.
- A focus on Tsikata's paper on trade and liberalization within the SADC region. Issues such as tariff harmonization, as well as Free Trade Area (FTA) vs. customs union were covered.
- By means of General Equilibrium (GE) Spreadsheet Models the fiscal implications of free trade areas were investigated within the SADC and EU-SADC regions.

Lewis first focus on developing countries in the GATT system. Some developing countries were members of GATT. Very few least developed countries (LDCs) were members. The OECD countries set the agenda and ran the various rounds of GATT negotiations. The interests of the developing countries thus tended to be considered only after the major countries reached agreement on their issues.

The United Nations Conference on Trade and Development (UNCTAD) became the institution that dealt with trade issues concerning developing countries. It provided a forum for the group of 77 to articulate their interests in international trade. UNCTAD, however, did not (and can't) provide an institutional framework for a bargaining bloc. It supported preferential arrangements such as the Lome convention and aid flows, but had little or no influence on bargaining on the trading rules, which took place in the GATT.

The developing countries were integrated into the WTO. In February 1999 the WTO had 134 members. Some 70 percent are developing countries, although there is no formal definition of a "developing country" used by the WTO.

The United Nations classifies 48 countries as "least developed". Of these are 29 members of the WTO, six have applied for membership and another three are "observers". Knowledge of the economic consequences of different WTO agreements is crucial if developing countries are to represent their interests in the WTO negotiation process. Detailed knowledge of international law is also crucial if developing countries are not to be "shortchanged". The negotiators must understand the political economy of their own country and of other countries in the WTO if they want to negotiate effectively.

Jeff Lewis accentuated the importance of negotiating blocs in the WTO. Developing countries should create alliances with respect to their main export and import commodities and the markets they approach for their exports. It is

in the interest of the OECD countries to encourage such negotiating blocks since they would concentrate the interests of several countries. OECD countries would then deal with a single negotiating position rather than with numerous separate countries and the negotiations would be much more efficient. Developing countries can learn from these existing negotiating blocks.

Requirements to be effective members in the next WTO round include:

- The capacity to analyze the economic consequences of different WTO scenarios,
- Technical knowledge of international trade law,
- The understanding of the political economy of the involved trading partners, and
- Diplomatic and negotiating skills to put together a negotiating strategy.

When one studies Tskikata's (1999) paper on trade liberalization within the SADC region and the implications for a free trade area, the overlapping agreements between African and SADC countries are clearly visible. A Southern Africa Tariff Database was established with detailed transactions-level data (exports and imports) from customs offices. Full disaggregated tariff schedules were also obtained. The database includes information on origin/destination, exemptions, duties and taxes, as well as transport mode,

and covers the various years from 1994 to 1997. For SADC it includes SACU, Malawi, Mauritius, Tanzania, Zimbabwe, Zambia and Mozambique.

When studying the basic economic indicators for SADC one notes the dominance of South Africa in the region, as well as the large variation in size, range of GDP/capita and variability of growth between the member countries. One also notes the direction of trade – The intra-regional trade is small (7,4 percent in 1992) but growing (12,6 percent in 1996). South Africa accounts for 81 percent of intra-regional exports and Zimbabwe for 16 percent (based on customs data).

When comparing tariff structures SADC members diverge widely in design, coverage and the effectiveness of tariff systems. In 1996, for example, Zambia had 8 bands, while SACU had fifty! The pattern of “cascading” also differs across economies. Collection ratios (reflecting exemptions) differ. Conformity with standard classifications varies between the countries.

These issues raise multiple questions when one wants to address aspects of Regional Trade Agreements. In terms of internal harmonization, should one have FTA or low tariffs among members? Other questions concern the handling of “sensitive” industries and the sharing of the differential fiscal burden. With regard to external harmonization one is faced by other set of questions. Should one retain external national tariffs? This requires complex definitions and the regulation of rules of origin. Should one, alternatively,

adopt common external tariffs? This requires tariff negotiations or decisions over pattern to use.

When one studies the SADC Tariff Revenue structures, the following observations could be made:

- Dependence on tariff revenues from intra-SADC trade flows varies from 2,5 percent in South Africa to almost fifty percent in Malawi, Zambia and Zimbabwe,
- The “yield” of different tariff bands varies,
- Efficiency of tariff collection ranges from 44 to 87 percent, and
- The importance of tariff revenue in total fiscal revenues varies enormously, from 3,5 percent in South Africa to more than 25 percent in Tanzania and Mauritius.

Lewis studied various indicative RTA fiscal scenarios by using partial equilibrium trade projection models that capture direct and indirect revenue effects. Three different scenarios were investigated:

- SADC FTA: Zero percent tariffs on intra-SADC trade and national external tariffs retained,
- Modified SADC FTA: Maximum ten percent rate on intra-SADC flows, while other rates remain unchanged, and

- The “Zambia” scenario because of its simplicity: All RTA countries adopt Zambia’s tariff regime for both external and intra-SADC flows.

Lewis presented the results and emphasised the loss in revenue for many SADC countries within these scenarios. He stated that policy issues regarding free trade should address:

- Compensatory mechanisms
- Fiscal shifting and response
- Special treatment for sensitive industries
- Overlapping RTA memberships
- Compatibility with bilateral deals
- Rules of origin, and
- Harmonizing commodity classifications.

Lewis spent the rest of the lecture discussing a Southern Africa CGE Model.

The dataset is called the Global Trade and Analysis Project. This 1995 database contains information on bilateral trade flows and sectoral tariff rates for 45 countries/regions within 50 sectors.

The Southern Africa CGE Model’s input consist of data on:

- Eight countries/regions namely South Africa, the rest of Southern Africa, other sub-Saharan Africa, EU, NAFTA, high-income Asia, low income Asia, and ROW,
- Seventeen sectors – six primary, six industry and five services.

Another step would be to disaggregate the data on “the rest of Southern Africa into major SADC economies – Zambia, Zimbabwe, Malawi, etc.

The model structure used by Lewis is in fact eight individual CGE models, with links through trade (sectoral export supply, import demand functions). The analyses consist of comparative static simulations, meaning that selected parameters are varied, while others are held constant. The models are not dynamic – there are no time periods. They basically provide a simulation laboratory for examining the relative magnitude of different alternatives, and are not used for predictions or forecasts. Similar models were used for NAFTA, ASEAN/APEC and Mercosur.

The following questions are addressed in the modeling processes:

- What is the impact of the EU-South Africa free trade agreement on trade welfare, and the economic structure in South Africa and the rest of Southern Africa?
- What are the gains to the rest of Southern Africa in joining the EU-South Africa FTA and on what terms?

- Can South Africa serve as a growth pole for the region?
- How does a FTA with the EU, South Africa and the rest of Southern Africa compare to the gains from global tariff reduction?

Lewis used key indicators such as trade creation vs. trade diversion; GDP and absorption changes, and the impact on labour demand in the modeling process.

He presented the following data:

Export shares:

EU exports:

- 1,5 percent to South Africa
- 2,0 percent to the rest of Southern Africa

South African exports:

- 32,3 percent to the EU
- 8,3 percent to the rest of Southern Africa

Rest of Southern African exports:

- 40 percent to the EU
- 3,5 percent to South Africa

Average weighted tariffs:

- EU against South Africa: 4,7 %
- EU against the rest of Southern Africa: 19,2 %
- South Africa against the EU: 4,4 %

- South Africa against the rest of Southern Africa: 9,0 %
- Rest of Southern Africa against the EU: 7 %
- Rest of Southern Africa against South Africa: 5,8 %

With regard to the results Lewis made the following conclusions:

- Trade creation dominates trade diversion for the region under all FTA arrangements,
- The rest of Southern Africa benefits from an FTA between the EU and South Africa – the recently signed bilateral agreement is not a “beggar thy neighbour” policy,
- The rest of Southern Africa gains more from zero-tariff access to EU markets than from a partial (fifty percent) reduction in global tariffs,
- South Africa is not large enough to serve as a growth pole for the region. Access to EU markets provides substantially bigger gains for the rest of Southern Africa than does access to South Africa,
- Southern Africa should work hard to get access to EU markets, as this appears potentially more important than global liberalization,
- Certain sectors will benefit more from global tariff reductions than from the trilateral FTA between the EU, South Africa and the rest of Southern Africa, and lastly
- Differential gains to agriculture and industry between trilateral FTA and global liberalization in the rest of Southern Africa may lead to tensions.

PART TWO: PRACTICAL TOOLS FOR COMMERCIAL POLICY ANALYSIS

During the second part of the conference the delegates were exposed to the following modeling modules:

- Partial Equilibrium Spreadsheet Models: The geometry, algebra and practical implementation of basic partial equilibrium models with homogeneous products, as well Armington product differentiation and market power under homogeneous products.
- Simple General Equilibrium Spreadsheet Models: A GE extension of the Armington spreadsheet model and the structure, comparative statistics and implementation of a simple 123 CGE model.
- Large General Equilibrium Models: Social accounting matrices, multi-region issues and an introduction to the GTAP and GAMS GE model. Using GTAP to model imperfect competition, scale economies and capital accumulation.
- CGE Modelling in South Africa.

SOURCES

Black, A. 1999. *The South African automotive industry in a globalizing world*. Paper read at the International Motor Vehicle Program Conference, Cambridge, Massachusetts.

Cowhey, P. & Klimenko, M.M. 1999. *The WTO Agreement and telecommunication policy reforms*. Report for the World Bank.

Evenett, S. & Hoekman, B. 1999. *Government procurement: How does discrimination matter?* (Unpublished paper)

Hodge, J. & Nordas, H.K. (date unknown) *Liberalization of trade in services – the impact on developing countries*. (Unpublished paper)

Mattoo, A. 1998. *Financial services and the WTO: Liberalization in the developing and transition economies*. (Unpublished paper)

Roberts, M.J. & Tybout, J.R. 1996. *What makes exports boom?* (Unpublished paper).

Tsikata, Y.M. 1999. *Southern Africa: Trade, liberalization and implications for a free trade area*. Paper read at an annual forum of TIPS held at Muldersdrift, South Africa.

Tybout, J. 2000. Manufacturing firms in developing countries: How well do they do, and why? *The Journal of Economic Literature* (forthcoming).