Trade and the path to durable growth and development

Trade and Uneven Development: Opportunities and Challenges is the theme of TIPS’ ninth Annual Forum, jointly organised in 2005 with the Development Policy Research Unit at the University of Cape Town (UCT), in association with the World Institute for Development Economic Research of the United Nations University (UNU-WIDER).

The Forum on 30 November will examine a range of effects that trade liberalisation has had on economic growth in South Africa (SA), including the impact on sectors’ growth performance and potential.

In this Monitor’s Special Focus article, Lawrence Edwards and Tijl van de Winkel of the School of Economics, UCT, analyse the impact of trade liberalisation on the pricing behaviour of SA industries. They estimate the extent to which SA industries mark up prices over marginal costs, and investigate the disciplining effects of trade liberalisation and import penetration on manufacturing industries’ pricing behaviour.

They find that average mark-ups in manufacturing equal 42%, falling to 12.5% when intermediate inputs are included. Very high mark-ups are found in mining and services. However, little correlation exists in the sectoral structure of mark-ups between SA and international countries, which may reflect the impact of domestic factors – competition policy, openness, concentration and the number of domestic firms.

They also find strong evidence for the market disciplining effects of trade liberalisation. During 1995-2002, a 1% reduction in tariffs is estimated to have reduced average mark-ups in manufacturing by about two percentage points. Import penetration also reduces mark-ups, with imports from developed economies having the strongest market disciplining effects.

The authors have drawn some useful policy conclusions from their results. First, substantial scope exists to lower prices and raise the welfare of consumers through stronger anti-trust policies and tariff liberalisation. Second, an accelerated liberalisation programme and more competition-enhancing policies will enable the Reserve Bank to pursue a less restrictive monetary policy.

Further, reduced mark-ups through competition will enhance export profitability through lower input costs and so stimulate export growth.

Competition-enhancing policies will also facilitate new industries’ (particularly small businesses’) entry into the economy.

In Focus on Data we examine current bilateral trade patterns between SA and China, and the question of which goods SA should target in the event of Free Trade Area negotiations. The report finds that SA exports relatively low-value, capital-intensive products to China that face fairly low tariff barriers, and imports relatively highly protected, higher-value, labour-intensive products. However, a trade analysis which identifies commodities with high export potential in China’s markets finds positive exporting prospects for SA. The challenge is to maximise the potential gains from and reduce the costs of trade through perhaps a preferential trade agreement.

Looking to the continent, our next article further examines the link between trade and growth, and the relationship between trade and poverty via growth. Africa’s share of world trade has slumped and Africa has fallen behind its competitors. The continent faces huge challenges if it is to reverse this and catch up. In March 2005, the Commission for Africa issued a study assessing these challenges and outlining a series of steps to further development and progress.

The feature More and Fairer Trade for Africa is an excerpt from this report, which recommends action in three key areas: African countries and the international community, working together, should support African-owned strategies for building trade capacity, dismantling the rich world’s trade barriers through the Doha Round of world trade negotiations, and providing transitional support to help Africa adjust to new trading regimes. Further, the poorest people must be helped to take advantage of new opportunities and cope with the impacts of a more open world trade system.

Potential barriers to trade for developing countries are also reviewed in our article on the case for special and differential (S&D) treatment within the WTO Agreement on Agriculture (AoA). Alan Matthews of the Institute of International Integration Studies, Trinity College, Dublin, highlights a number of major shortcomings revealed by the AoA implementation.

These include a huge imbalance in the amount of trade-distorting support provided to developed country farmers, which leaves many developing countries fearful that further liberalisation of their agricultural policies will leave their farmers exposed to unfair competition. Many developing countries are concerned that poor farmers are less capable of dealing with the consequences of world market price volatility and deserve some special protection; others that their ability to pursue growth-promoting agricultural policies is limited by the low ceiling limits for domestic support.

However, Matthews cautions against developing countries putting too much of their negotiating effort into gaining S&D treatment, as less attention will be paid to gaining significant reductions in market access barriers and tighter controls on domestic support policies in developed country markets.
The market disciplining effects of trade liberalisation and regional import penetration on SA manufacturing

The increased openness of the SA economy, both in terms of tariff reductions and increased trade flows, has forced domestic producers and retailers to respond to new international competitors and lower international prices. This article by Lawrence Edwards and Tijl van de Winkel estimates the impact of increased openness on the internal competitiveness and pricing behaviour of SA manufacturing industries between 1988 and 2002.

Introduction

Since the mid-1990s, SA has made considerable progress in reintegrating itself into the international economy. Protective barriers such as quotas, tariffs and surcharges have been reduced or eliminated. Average tariff protection (inclusive of surcharges) in manufacturing fell from over 20% in 1990 to around 10% in 2002. Trade flows have also increased. Export orientation within manufacturing rose from 12% in 1990 to 23% in 2000. Imports as a share of domestic expenditure on manufactures rose from 17% to 28% during this period.

The effects of trade liberalisation on an economy have been extensively debated. In classical international trade theory, markets are competitive and the efficiency gains from free trade arise from the reallocation of scarce resources from inefficient import-competing sectors towards competitive export-oriented sectors. If markets are imperfectly competitive, further efficiency gains can be achieved through trade liberalisation. In domestic markets dominated by monopolists or oligopolists, trade liberalisation enforces international competition, which reduces their ability to raise prices above marginal costs. Consumers benefit in the form of lower prices.

Besides these gains, trade liberalisation may also create dynamic gains. These arise from productivity improvements induced by greater competition, better access to higher quality, and varied imported intermediate inputs and technology flows, both direct and imbedded in imported inputs. In addition, expanded market size may enable firms to take advantage of economies of scale and scope.

In this article, we analyse one aspect of the impact of trade liberalisation on the economy; the impact on the pricing behaviour of SA industries. There are two components to this study. First, we estimate the extent to which SA industries mark up prices over marginal costs. Secondly, we investigate the disciplining effects of trade liberalisation and import penetration on the pricing behaviour of SA manufacturing industries.

Average mark-ups

In the international literature, two methods are used to estimate industry profits. The first method uses accounting data and measures the price-cost margin as (revenue-variable costs)/revenues. This approach, however, suffers from problems associated with the measurement of the variable cost of capital, and is in essence a measure of price over average cost, not marginal cost. An alternative method is to estimate the mark-up using econometric techniques and the approach introduced by Hall (1988) and extended by Roeger (1995). In this approach, the Solow residual is expressed as a function of the mark-up and the labour/capital ratio. This is the approach followed in this study, as well as in a similar study on SA by Fedderke et al. (2003).

We estimate average mark-ups in SA industries from 1970 to 2002. These averages are presented for manufacturing, mining and services in Figure 1. Two estimates are presented, one based on gross output in which intermediate inputs are accounted for and one based on value added where intermediate goods are excluded. The averages exclude the agriculture sector, the government sector, other producer services and other social services.

As shown in Figure 1, the estimated mark-up is strongly influenced by the inclusion or exclusion of intermediate inputs. As found in most empirical research, the inclusion of

![Figure 1: Average mark-ups according to broad sector classification, 1970-2002](image-url)

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1 This is an abbreviated version of a longer paper prepared for TIPS, which forms part of its Working Paper Series 2005. The full paper is available at [http://www.tips.org.za/research/item.asp?id=753&WebType=Papers](http://www.tips.org.za/research/item.asp?id=753&WebType=Papers).
2 School of Economics, University of Cape Town.
3 The measurement of tariff protection in SA is very sensitive to the selection of tariff measure (collection duties or surcharges) and the estimation of ad valorem equivalents of non-ad valorem tariffs. The difficulty in measuring ad valorem tariffs. The pricing response and welfare changes from free trade can be sensitive to the theoretical structure of the model used in the analysis. For a thorough review of strategic trade policy, see Brander (1995).
4 A fuller discussion of this methodology can be found in the extended version of this paper.
5 These sectors are excluded as they are...
intermediate inputs reduces the estimated mark-up. The average mark-up between 1970 and 2002 for the entire economy equals 49% when intermediate inputs are excluded and 17% when intermediates are included. Looking at the results including intermediate inputs, the mining sector has the highest average mark-up (44%), followed by the services sector (17%) and the manufacturing sector (13%). When intermediate inputs are excluded, the average mark-up for these broad economic sectors rises to 103%, 42% and 50% respectively.

Our estimated average mark-ups for SA manufacturing differ from those estimated by Fedderke et al. (2003). They find that average mark-ups in SA manufacturing lie in the range of 72% to 79% (compared to 42% for this study) when intermediate inputs are excluded, and 6% to 9% (compared to 13%) when intermediate inputs are included. The differences in results reflect the use of different estimators, the longer time period of this study (1970-2002 as opposed to 1970-1997), and different estimates of the return to capital used in the calculation of the variables.

To assess the trend in mark-ups, we estimate the average mark-up for each broad grouping for each decade. These results are presented in Table 1.

Looking at the trends, average mark-ups are lower in the 1980s than in the 1970s in almost all cases. Average mark-ups, however, are significantly higher in the early 1990s. This increase in mark-ups corresponds with high surcharges imposed during this period and is therefore consistent with the view that mark-ups rise under protection. Mark-ups then appear to decline or remain constant during the period of liberalisation from 1994-2002. Average mark-ups in mining and manufacturing fall if intermediate inputs are excluded in the estimation, but are constant if intermediate inputs are included. Mark-ups in the services sector rise if intermediate inputs are excluded, but are constant if intermediate inputs are included.

Turning to a sector level analysis of mark-ups, Table 2 presents estimates of the mark-ups at the sector level for various time periods. We only present the results in which we account for intermediate inputs, as the trend in mark-ups when excluding intermediate inputs is qualitatively similar, although the level of mark-ups are higher.

As shown in Table 2, there is considerable variation in the average level of mark-ups across sectors. Relatively high mark-ups in excess of 50% are found in agriculture, gold & uranium mining, other mining, electricity & water, wholesale & retail trade, transport & storage and business services. Some caution in interpreting these values is required, as the accuracy of the estimations is dependent on the quality of the capital stock data. The highest mark-ups in manufacturing (in excess of 18%) are found in glass products, non-metallic minerals, coke & petroleum products, beverages and professional & scientific equipment.

Comparisons of estimated mark-ups across countries, as differences in estimators, time periods and sector aggregation, as well as the possible omission of important variables, such as concentration and competition policy, can affect the estimates.

Average mark-ups for the set of comparator countries range between 13% and 25%. Average mark-ups in SA manufacturing appear to fall at the lower end of this range and are also characterised by relatively low variation across sectors. When intermediate inputs are excluded, mark-ups in SA manufacturing are equal to the median mark-up of 41 countries studied by Hoekman et al. (2001), but are higher than some estimates for the US (Roeger, 1995). Thus mark-ups in SA manufacturing fall within the range of mark-ups estimated for other countries, but the comparison is sensitive to the inclusion of intermediate inputs, the selection of time period and country-specific factors, such as competition policy, openness and the number of domestic firms. More cross-country comparisons using similar methodologies are thus required to establish the relative mark-up in SA industries firmly.

Trade as market discipline

We also assess the impact of trade liberalisation and increased openness on SA mark-ups. To test the robustness of the relationship to the choice of tariff data, we measure protection using nominal and effective protection rates calculated from collection duties and scheduled tariff rates, both including and excluding surcharges. The analysis is confined to the period 1988-2002 for which tariff data are available.

The impact of nominal tariff protection on mark-ups is presented in Table 3. The tariff coefficients measure the impact of a 1% decline in tariff protection on the level of the mark-up. The variable ‘Tariff 95-02’ captures the additional impact of tariffs on mark-ups during the period 1995-2002.

The results in Table 3 provide evidence of the market disciplining effects of trade liberalisation, but these effects are concentrated in the second period, 1995-2002. The estimates suggest that a 1% reduction in tariffs during the second period reduced average mark-ups in manufacturing by approximately two percentage points. This relationship is robust to the choice of protection measure (scheduled tariffs, collection rates and effective rates of protection). Consistent results are also found in our estimates excluding intermediate inputs. These results suggest that tariff liberalisation during the 1990s, and from 1995 in particular, lowered average mark-ups in SA manufacturing industries.

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Table 1: Average mark-up by broad economic sector and decade

<table>
<thead>
<tr>
<th>Decade</th>
<th>Manufacturing</th>
<th>Mining</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-2002</td>
<td>0.424**</td>
<td>0.432</td>
<td>0.504**</td>
</tr>
<tr>
<td>1970</td>
<td>0.424**</td>
<td>2.501**</td>
<td>0.424**</td>
</tr>
<tr>
<td>1980</td>
<td>0.611**</td>
<td>0.519</td>
<td>0.360**</td>
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<tr>
<td>1990-94</td>
<td>0.421**</td>
<td>0.547</td>
<td>0.784**</td>
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<tr>
<td>1995-2002</td>
<td>0.504**</td>
<td>0.183</td>
<td>0.923**</td>
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</tbody>
</table>

(Excluding intermediate inputs)

<table>
<thead>
<tr>
<th>Decade</th>
<th>Manufacturing</th>
<th>Mining</th>
<th>Services</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-2002</td>
<td>0.281</td>
<td>0.270</td>
<td>0.148</td>
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<tr>
<td>1970</td>
<td>0.097</td>
<td>0.076</td>
<td>0.311</td>
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<tr>
<td>1980</td>
<td>0.125</td>
<td>0.210</td>
<td>0.281</td>
</tr>
<tr>
<td>1990-94</td>
<td>0.173</td>
<td>0.210</td>
<td>0.185</td>
</tr>
<tr>
<td>1995-2002</td>
<td>0.173</td>
<td>0.210</td>
<td>0.185</td>
</tr>
</tbody>
</table>

(Including intermediate inputs)

(Note: Mark-ups are estimated separately for each sector and sub-sector. Fixed effects are included for each sector. * and ** represent significance at the 10% and 5% level respectively.)

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3 This partly explains the difference in estimated mark-ups from those of Fedderke et al (2003), who analyse mark-ups over the period 1970-97.
(continued from page 3)

Table 2: Average mark-up by sector and decade, including intermediates

<table>
<thead>
<tr>
<th></th>
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</thead>
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<td></td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
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<td>0.94 *</td>
<td>0.75 **</td>
<td>0.61 **</td>
<td>0.58 *</td>
<td>0.63 *</td>
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<td>Coal mining</td>
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<td>0.29 **</td>
<td>0.07</td>
<td>0.37 **</td>
<td>0.28 **</td>
<td>0.50 **</td>
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<td>Gold &amp; uranium mining</td>
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<td>0.89 **</td>
<td>0.32</td>
<td>0.33 **</td>
<td>0.48 *</td>
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<tr>
<td>Other mining</td>
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<td>0.48 **</td>
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<td>0.41 *</td>
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<td>0.09 **</td>
<td>0.06 **</td>
<td>0.13 **</td>
<td>0.10 **</td>
<td>0.17 **</td>
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<td>Beverages</td>
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<td>0.10</td>
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<td>Textiles</td>
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<td>0.13 **</td>
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<td>0.18 **</td>
<td>0.20 **</td>
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<td>Wearing apparel</td>
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<td>0.07 **</td>
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<td>0.09 **</td>
<td>0.07</td>
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<td>0.02 **</td>
<td>0.12</td>
<td>-0.06</td>
<td>0.17</td>
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<td>Footwear</td>
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<td>0.05 **</td>
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<td>0.04 **</td>
<td>0.21 **</td>
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<td>0.25 **</td>
<td>0.22 **</td>
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<td>Paper products</td>
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<td>0.24 **</td>
<td>0.14 **</td>
<td>0.31 **</td>
</tr>
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<td>Printing &amp; publishing</td>
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<td>0.13 **</td>
<td>0.10</td>
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<td>0.02</td>
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<td>Coke &amp; petroleum</td>
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<td>0.11</td>
<td>0.29 **</td>
<td>0.38 **</td>
<td>0.15 **</td>
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<td>Basic chemicals</td>
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<td>0.11 **</td>
<td>0.09 **</td>
<td>0.18 **</td>
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<td>Other chemicals</td>
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<td>0.22 **</td>
<td>0.21 **</td>
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<td>Basic iron &amp; steel</td>
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<td>Machinery &amp; equipment</td>
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<td>0.10</td>
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<td>0.18 **</td>
<td>0.17 **</td>
<td>0.19 *</td>
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<td>0.14 *</td>
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<td>0.04 **</td>
<td>0.04 **</td>
<td>0.05</td>
<td>0.06 **</td>
<td>0.03</td>
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<td>0.23 **</td>
<td>0.22</td>
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<td>0.04 *</td>
<td>0.06 *</td>
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<td>0.08 **</td>
<td>0.06</td>
<td>0.09 **</td>
<td>0.04</td>
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<tr>
<td>Other manufacturing</td>
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<td>0.00</td>
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<td>-0.01</td>
<td>0.05 **</td>
<td>0.04</td>
<td>0.06 **</td>
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<td>Wholesale &amp; retail trade</td>
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<td>0.58 *</td>
<td>0.59 **</td>
<td>0.74 **</td>
<td>0.70 **</td>
<td>0.85 **</td>
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<td>Catering &amp; accommodation</td>
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<td>-0.13</td>
<td>0.09</td>
<td>0.04</td>
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<td>Transport &amp; storage</td>
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<td>0.56 **</td>
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<td>Medical, dental &amp; veterinary</td>
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<td>0.42 **</td>
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<tr>
<td>Excl. medical, dental &amp; veterinary services</td>
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<td>-0.28 *</td>
<td>0.30</td>
<td>0.28 **</td>
<td>0.25 **</td>
<td>0.34 **</td>
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<tr>
<td>Other producers</td>
<td>-0.06</td>
<td>-0.10 *</td>
<td>-0.14</td>
<td>0.04</td>
<td>0.03</td>
<td>-0.07</td>
</tr>
</tbody>
</table>

[Note: * and ** represent significance at the 10% and 5% level respectively]
An alternative approach to estimating the impact of import competition on mark-ups is to use import penetration values instead of tariffs. Higher import penetration reflects increased international competition and is hence expected to reduce domestic market power and mark-ups. Table 4 presents the impact of total import penetration and regional import penetration on mark-ups (allowing for intermediate inputs) during the period 1988-2002. The coefficient on the variable ‘Imports’ reflects the percentage point change in mark-ups arising from a 1% increase in import penetration.

The results show that import penetration has a strong disciplining effect on the mark-up pricing behaviour of domestic firms in SA. Similar results are found by Fedderke et al. (2003). Looking at the results, a 1% rise in total import penetration is estimated to reduce average mark-ups in manufacturing by five percentage points.

Table 3: Impact of tariff liberalisation on mark-ups in manufacturing, 1988-2002

<table>
<thead>
<tr>
<th></th>
<th>Collection duties</th>
<th>Collection duties incl. surcharges</th>
<th>Tariffs</th>
<th>Tariff incl. surcharges</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
<td>Coefficient</td>
</tr>
<tr>
<td>Incl. intermediates inputs</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mark-up</td>
<td>0.175 **</td>
<td>0.176 **</td>
<td>0.150 **</td>
<td>0.147 **</td>
</tr>
<tr>
<td>Tariff</td>
<td>-0.005</td>
<td>-0.005</td>
<td>0.008</td>
<td>0.009</td>
</tr>
<tr>
<td>Tariff 95-02</td>
<td>0.026 **</td>
<td>0.025 **</td>
<td>0.018</td>
<td>0.019</td>
</tr>
<tr>
<td>N</td>
<td>392</td>
<td>392</td>
<td>420</td>
<td>420</td>
</tr>
<tr>
<td>F</td>
<td>110.7 **</td>
<td>110.8 **</td>
<td>87.3 **</td>
<td>87.4 **</td>
</tr>
</tbody>
</table>

[Note: * and ** represent significance at the 10% and 5% level respectively. The estimations using collection data are for the period 1988-2001.]

Table 4: Impact of import penetration on mark-ups in manufacturing, 1988-2002

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Africa</th>
<th>China &amp; India</th>
<th>Rest of Asia</th>
<th>South America</th>
<th>Developed</th>
<th>Eastern Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Incl. intermediates inputs</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mark-up</td>
<td>0.10 **</td>
<td>0.02</td>
<td>0.10 **</td>
<td>0.05</td>
<td>0.17 **</td>
<td>0.09 **</td>
<td>0.08 **</td>
</tr>
<tr>
<td>Imports</td>
<td>-0.05 **</td>
<td>-0.03 **</td>
<td>-0.02 **</td>
<td>-0.03 **</td>
<td>0.00</td>
<td>-0.05 **</td>
<td>-0.01 **</td>
</tr>
<tr>
<td>N</td>
<td>420</td>
<td>420</td>
<td>417</td>
<td>420</td>
<td>413</td>
<td>420</td>
<td>412</td>
</tr>
<tr>
<td>F</td>
<td>140 **</td>
<td>134 **</td>
<td>132 **</td>
<td>145 **</td>
<td>128 **</td>
<td>144 **</td>
<td>133 **</td>
</tr>
</tbody>
</table>

[Note: * and ** represent significance at the 10% and 5% level respectively.]

We also find that the market disciplining effects of import penetration differ, according to the origin of these imports. The coefficient on the import variable is negative and significant for all regions, except for South America. Imports from developed economies appear to have the strongest market disciplining effects (-0.05), followed by Rest of Asia (-0.03) and Africa (-0.03). The coefficient on imports from China & India (-0.01) is significant, but is relatively low. This partly reflects the large share of imports from this region accounted for by textiles and clothing, for which mark-ups are relatively low (see Table 2).

Conclusion

Average mark-ups in manufacturing are equal to 42% when excluding intermediate inputs, but fall to 12.5% when intermediate inputs are accounted for. Very high mark-ups are found in mining (44% including intermediate inputs) and services (17%). The mark-ups for SA manufacturing generally fall within the range of mark-ups estimated in international studies. However, there is little correlation in the sectoral structure of mark-ups between SA and a range of international countries. Sectoral differences in mark-ups may reflect the impact of domestic factors, such as competition policy, openness, concentration and the number of domestic firms, which are excluded from our analysis.

We find strong evidence for the market disciplining effects of trade liberalisation. This effect is particularly strong during the period 1995-2002 when a 1% reduction in tariffs is estimated to reduce average mark-ups in manufacturing by approximately two percentage points. We also find that import penetration reduces mark-ups, but the impact differs according to the source of imports. Imports from developed economies have the strongest market disciplining effects, followed by the Rest of Asia and Africa.

Some useful policy conclusions emerge from the results. First, there is still substantial scope to lower prices and raise the welfare of consumers through stronger anti-trust policies and tariff liberalisation. Second, an accelerated programme of liberalisation (from its current trend) and more competition-enhancing policies will enable the Reserve Bank to pursue a less restrictive monetary policy, at least in the short run. These policies may have additional benefits for the economy. A reduction in mark-ups through competition will enhance export profitability through lower input costs and will thus stimulate the growth of exports. As shown by Alves and Kaplan (2004), SA export performance has been mediocre compared to other developing economies and has not generated an export-led growth boom similar to those of East Asian and a few other...
dynamic emerging economies. Competition-enhancing policies will also facilitate the entry of new industries, particularly SMMEs*, into the economy.

**References**


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**ANNUAL FORUM 2005:**

**TRADE AND UNEVEN DEVELOPMENT: OPPORTUNITIES AND CHALLENGES**

**30 November 2005**

Glenburn Lodge, Johannesburg

The Forum is an annual event bringing together members of the research, academic and policy communities to discuss economic policy issues of SA and regional interest. The 2005 event promises to continue developing these links and, indeed, to further strengthen the flow of relevant research into policy-making. Forum 2005 is jointly organised by TIPS and the DPRU at the University of Cape Town, in association with the World Institute for Development Economic Research of the United Nations University (UNU-WIDER).

**CALL FOR PAPERS**

SA has experienced just over a decade of tariff-associated trade liberalisation through its WTO offer and Free Trade Area agreements with the EU and SADC. During this time, the macroeconomy has been stabilised and moderate growth has returned after a significant period of recession and decades of erratic growth.

However, the growth rate over the last decade has averaged only about 3%. This rate of growth does little to reduce widespread poverty in SA, and compares poorly with the growth rates of other middle-income developing countries.

Moreover, the widely expected positive link between trade and growth – and the perhaps more contentious inference of a positive relationship between trade and poverty via growth – have not been rigorously evaluated, although a significant body of empirical evidence has been accumulated internationally.

Forum 2005’s focus is therefore on growth, particularly through the lenses of sector strategies and trade policy.

Some of the pressing research questions that Forum 2005 would like to interrogate are:

- How has the industrial landscape changed in recent years?
- What effect, if any, has trade policy had on sectors’ growth performance?
- What are SA’s current comparative and competitive advantages?
- What likely impact will the recent appreciation of the rand have on sectors’ growth potential and SA’s long-term growth trajectory?
- What effect has trade integration had on economic growth?
- What implications do the pre-existing levels of development and structure of production have for the trade and poverty nexus?
- What influences (positively or negatively) the trade and poverty nexus?
  - Institutions, geography, macroeconomic stability, exchange rates, competitive factor or product markets, competition policy and skill levels, amongst others.
- What are the transmission mechanisms of trade liberalisation to households?
  - Openness and competition, and their relevance for households.
  - Openness and distribution and retailer markets, and their relevance for household welfare
- Is trade liberalisation gender neutral or is it contributing to gender inequality?
- Adjustment processes unfold at the coal-face of industry: what does the available evidence say about the impact of trade policy on poverty in a skills-constrained economy?

The conference organisers welcome abstracts from interested researchers along these themes.

**Closing date for proposals/abstracts:**
Monday 25 July 2005

**Closing date for final papers:**
Monday 10 October 2005

**For abstracts & enquiries about papers:**
papers2005@tips.org.za

**For general enquiries:**
forum2005@tips.org.za

**For further information, visit our websites:**
http://www.tips.org.za
http://www.commerce.uct.ac.za/dpru/

*Small, medium and micro enterprises*
More trade and fairer trade for Africa

This article\(^1\) is an excerpt from Our Common Interest: Report of the Commission for Africa\(^2\) released in March 2005, which presented a number of recommendations as an agenda for progress concerning debt, aid, trade and HIV/AIDS in Africa. In terms of trade, the Commission recommends that Africa must improve its transport infrastructure to make goods cheaper to move, and also reduce and simplify the tariff systems between African countries. But the Commission also observed that rich nations must dismantle the barriers they have erected against African goods, particularly in agriculture. In addition, careful attention should be given to ensure that the poorest people are helped to take advantage of the new opportunities and to cope with the impacts of a more open system of world trade.

Trade, debt and aid

Three sometimes contradictory dynamics – trade, debt and aid – dominate the relationship between Africa and the industrialised nations.

In the last few decades, Africa has seen its share of world trade fall from 6% in 1980 to less than 2% in 2002 (see Figure 1). The industrialised world has been unhelpful here. Indeed it has been a wilful obstacle. The EU, Japan, the US and many other rich countries all heavily subsidise their agriculture, which depressives world prices in the subsidised commodities. Local farmers then find that they cannot produce crops at prices which compete with products so heavily funded by taxpayers in G8 nations. Poor countries have complained to the WTO about this and had their complaints upheld.

But reform of the EU’s Common Agricultural Policy and US farm policy is painfully slow. Indeed, the amount the developed world spent just subsidising its agriculture – much of which goes to big agri-business – was in 2002 the equivalent of the income of all the people in sub-Saharan Africa put together.

That is far from the only problem with trade. Developed nations place taxes on goods exported to them. Agricultural produce imported into Europe, for example, must pay an average tariff of 22%. There is a whole variety of such barriers on products of interest to Africa, for instance, tariffs on peanuts coming into the US are 132%.

Some of these barriers have been reduced over the years but new barriers have been introduced. These indefensible trade barriers must go, though these are not the only impediment to trade for Africa. Finally, African economic policy relating to trade, such as moves to liberalise sectors of the economy, is too often a condition of receiving aid from donors. If they are to be accountable to their own citizens, African governments have to be allowed the space to make their own decisions.

The second problematic area in the relationship between Africa and the developed world is that of debt. There is strong resentment in many parts of Africa over these debt obligations, in part because much of the debt was incurred by unelected leaders supported by the very countries now receiving money to cover the payments of those debts – and who, many Africans feel, are now using debt as a lever to dictate policy to the continent. There is a widespread feeling that the debts are unreasonable and that what was owed has in practice already been paid many times over.

Over the years, Africa has had difficulty in paying off the interest – let alone the capital – on these debts. Even after various rounds of debt reduction, sub-Saharan Africa still pays out more on debt service than it spends on health (around 3% of its annual income). For every US$2 Africa currently receives in aid, it pays back nearly US$1 in debt payments.

The third key area in the relationship of Africa with the rich world is that of aid. In some quarters there is much scepticism about aid, as it is seen as ineffective, stolen or wasted. There is no doubt that this has been the case in the past. There is also no doubt that some countries have not had the capacity to handle aid effectively. But the evidence on the effectiveness of aid, which has been examined very carefully, shows that it is simply untrue that aid to Africa has been wasted in more recent years.

Strong lessons have been learned and Africa is changing. But there are areas in which African governments must accelerate that change before extra aid can yield its full potential. In addition, international donors must seriously improve the way aid is delivered. This report

\(^{\text{Source: WTO, 2004}}\)

\(^{\text{1} \text{The full report is available online at http://www.commissionforafrica.org/english/report.html or http://www.eldis.org/cf/rdr/rdr.cfm?doc=DOC18024.}}\)

\(^{\text{2} \text{The objectives of the Commission are to generate new ideas and action for a strong and prosperous Africa, using the 2005 British Presidencies of the G8 and the European Union as a platform; to support the best of existing work on Africa, in particular the New Partnership for Africa’s Development (Nepad) and the African Union; and to help to ensure this work achieves its goals. Moreover, the Commission aims to help to deliver implementation of existing international commitment towards Africa, and to offer a fresh and positive perspective for Africa which challenges unfair perceptions and helps to fulfill African aspirations for the future by listening to Africans.}}\)
improving transport infrastructure

Africa needs a functioning transport and communications system to get its goods to market. This is one key area in which rich nations can help. At present the costs and difficulty of moving goods in Africa can be far higher than in richer countries — in many cases double. For landlocked countries, transport costs can be three-quarters of the value of exports; transport costs impose the equivalent of an 80% tax on clothing exports from Uganda. These kinds of costs make it extremely difficult to get goods to market at a competitive price. And the problem is not just with land transport. It costs about the same to clear a 20-foot container through the port of Dakar as it does to ship the same container from Dakar to a north European port. This is why transport is such an important element in the infrastructure package recommended.

clearing away the roadblocks

Historically, the African domestic market has been fragmented by high internal and external barriers. In 1991, the Abuja Treaty was adopted, establishing a timetable towards the creation of a pan-African Economic Community by the year 2025. The existing Regional Economic Communities were to be the foundation. This is an ambitious objective, but the first building block must be the creation of free trade areas that can be the foundation for wider economic integration at the regional and continental level. Figure 2 shows the potential of intra-regional trade in more integrated regions, such as in East Asia and the Pacific.

Africa has many internal barriers to trade, which damage its ability to grow its way out of poverty. These include excessive bureaucracy, cumbersome customs procedures and corruption by public servants using bribes to supplement their meagre wages. The African roadblock stands as symbol of many of these. Checkpoints, official and unofficial, are characterized found on any major African road. The journey from Lagos to Abidjan encounters one every 14 km. In Côte d’Ivoire, to get a single lorry from one side of the country to the other typically adds US$400 to the journey in official payments and bribes.

The African domestic market has been fragmented by high internal and external barriers. Many African governments fear that removing these barriers will cut their income, as customs revenues provide up to a quarter of government revenue in Africa. But experience shows that it is possible to reduce tariffs and still maintain revenue. "

The clean-up of the Mozambique customs service, and the rapid transformation of the Tanzanian port of Dar es Salaam to world standards of efficiency, show what is possible. In Mozambique, goods are cleared 40 times faster than before reforms took place, and customs revenue in the first two years increased by 38%. African governments should make reforms in this area an extremely high priority. Donors should fund African governments’ moves to reduce internal tariffs and regulations barriers. They should support reform of customs and port administration, sharing expertise in areas such as automating customs systems. This will not require very substantial donor assistance, but will have major economic pay-offs.

To grow, trade must have the same climate as does the rest of the economy. But there are three other areas in which Africa, with support from the rich world, must make changes: improving transport infrastructure, reducing Africa’s internal barriers to trade, and diversifying African economies away from current levels of dependency on primary commodities.

Africa must increase efforts to achieve greater economic efficiency through integration and increased co-operation within African regions. Some of these steps will be relatively easy and low cost. The continent should also do more to improve the economic environment for farmers and firms, backed up by major investments of aid from international donors to ensure Africa can produce and trade competitively. Funding for infrastructure should, in part, be spent on improving African transport and communications to bring down costs.

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More trade

Trade has been a key driver of economic growth over the last 50 years, first in the Western world and Japan, and then more recently in China and India. Developing countries, particularly in Asia, have used trade to break into new markets and change the face of their economies: two decades ago 70% of their trade was in raw materials, today 80% is in manufactured goods.

Alas, not in Africa. The last three decades, by contrast, have seen stagnation in African countries and a collapse in their share of world trade. This has been caused, in part, by the fact that the composition of Africa’s exports has remained essentially unchanged. As more dynamic and competitive regions have made major shifts into manufacturing, Africa has been left behind. The task of catching up gets harder every day.

Many people think that Africa’s problems in trade come primarily from the trade barriers imposed by rich nations. It is true that these barriers are absolutely unacceptable. They are politically antiquated, economically illiterate, environmentally destructive and ethically indefensible. But contrary to what is often supposed, there is also another cause: Africa simply does not produce enough goods to trade, at least not of the right kind or quality, or at the right price. Addressing these issues, as well as the trade barriers Africa faces, are key if Africa is to prosper.

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Reducing primary commodity dependency

The biggest single action that Africa could take to reduce its dependency on raw materials is to help large firms and family farms break into new products and activities. Strong support from G8 and EU countries in infrastructure is key to building this capacity to trade, but they should also help Africa to develop the capacity to process agricultural products and improve the productivity and quality of raw materials. They should fund the development of organisations to help small farmers to market their produce.

Supermarkets could also do more to make it easier for household farmers to become suppliers.

Fairer trade

‘First do no harm’ is a popular summary of the Hippocratic oath taken by doctors through the ages. This maxim should also be applied to the responsibility that the rich world has towards Africa. The trading relationship between the developed and developing worlds has long been one dominated by a complex web of rules, taxes, tariffs and quotas, which massively bias the entire business of international trade in favour of the rich. As well as helping to improve Africa’s capacity to trade competitively, G8 and EU countries must compete more fairly.

There are three key areas where developed countries can do more:

• They should do a deal at the Doha Round of WTO talks that genuinely helps development.
• They should make their existing ‘trade preferences’ work better.
• They should provide cash to help African countries to adjust to new trading opportunities.

Figure 2: Intra-regional trade as a share of GDP (%), 2002

![Graph showing intra-regional trade as a share of GDP (%) for different regions.](Source: UN COMTRADE)

Agriculture is the activity from which the vast majority of the poorest Africans make their living. By contrast, agriculture is not of great economic importance to most developed countries, accounting for a few per cent of national incomes, or less. Yet the agricultural sectors of many G8 and EU countries are the most heavily subsidised and protected in the economies of the industrialised world. Rich countries spend around US$350-billion a year on agricultural protection and subsidies – 16 times their aid to Africa. The EU is responsible for 35% of this, the US for 27% and Japan for 22% (see Figure 3).

These policies have a harmful effect in both the poor and rich worlds. Tax-payers and consumers pay heavily to support their farmers – though, ironically, it is not small farmers in the EU and US who benefit. They get only 4% of the subsidy, with more than 70% going to the 25% richest farmers, land-owners and agri-

Figure 3: OECD producer support estimates for agriculture, 2003

![Graph showing OECD producer support estimates for agriculture.](Source: UN COMTRADE)

business companies. The result is that the EU subsidises sugar beet at such high levels that it is grown in places where it is economically irrational and inefficient to do so. And in the US, subsidies to just 25,000 farmers who are paid twice the world market price for cotton threaten the livelihoods of more than 10-million people in West Africa who produce the crop for a third of the price.

Reform of the EU Common Agricultural Policy is essential, as is further reform of protection and subsidies to American and Japanese agriculture. There are many other ways for rich countries to exercise their right to support their rural areas, such as direct income support to farmers, and investments in rural development and in the environment. Using farm protection to ruin the livelihoods of millions of poor Africans is morally inexcusable.

Taking out the tariffs

Developing countries face disgraceful barriers in the markets of the developed world. Agriculture is the most important export sector, by far, for the poor people of Africa. Yet, knowing that, Europe puts taxes on agricultural produce which are three to four times higher than its tariffs on manufactured goods, and even higher in products of interest to Africa. It is essential that rich countries stop
discriminating against the few goods in which Africa has a comparative advantage. G8 and EU countries should accelerate the process of dismantling their trade barriers to give Africa a chance to expand exports – by progressively reducing all tariffs to zero by 2015. This should be a top priority at the WTO’s Doha Round negotiations.

There are new barriers too, such as health and safety standards, where help is needed. If the EU used international standards on pesticides on bananas, instead of its own, African exports would grow by US$410-million. Although Africa wants to meet developed country product standards, it is struggling to meet the costs of doing so. Rich countries should apply a ’development test’, including an impact assessment, when designing and setting standards to minimise the barriers they may create and avoid doing major development damage for minimal gains. Rich countries should fund Africa to meet these new standards.

Scraping the subsidies
Rich countries must also stop subsidising their own farmers to over-produce, undermining world prices, and then dump their surpluses on African markets. When trade ministers meet in Hong Kong in December this year, G8 and EU countries should bind themselves to end all export subsidies and trade distorting support by 2010. As a down-payment, trade distorting support to cotton and sugar should be scrapped immediately. By doing this, by cutting tariffs they will create massive wasteful spending, and provide huge benefits to their own public, and to Africa and other developing countries. These reforms could be win-win for everyone. The money saved could be shifted to rural development and environmental needs in the rich world, and aid could be increased to Africa.

Preferences do not work as effectively as they should and are often temporary, unnecessarily complex, or deliberately obstructive.

Trade liberalisation must not be forced on Africa as a condition of trade or aid negotiations. Individual African countries must be allowed to sequence their trade reforms in line with their poverty reduction and development plans, and not forced to open up their markets to imports on terms which damage their infant industries.

Assisting with change
Preferences cannot be a permanent system. Eventually Africa must adjust to open competition with the rest of the world. Making those adjustments is a gradual business – which is what negotiations at the WTO are about. But such changes involve costs. The rich world must help to fund this change and smooth the adjustment. This means:

- Helping poor people to benefit from the new opportunities created, and assisting those whose incomes may reduce;
- Supporting governments to meet losses in trade revenue;
- Countering the impact of higher food prices for some importing countries; and
- Assisting countries to adjust to losses as the value of preferences erode when rich country trade barriers come down.

Development at Doha
Perhaps most importantly, what Africa needs is an ambitious agreement at the Doha Round of world trade talks by no later than the end of 2006. That cannot happen unless rich countries agree to major reductions in their subsidies of their agriculture. It cannot happen without the rich world’s trade barriers coming down. It cannot happen without dropping the idea that poor nations must make reciprocal concessions in return for those of rich countries – this is not a level playing field.

And developed countries must provide the increased aid necessary to help Africa to adjust to more open markets.

Any deal at Doha must allow reforms to proceed at a pace agreed by Africa, not forced upon it. The discussion must adopt a more transparent and inclusive style of decision-making than is often the norm at WTO negotiations. And it must ensure that poorly staffed African governments can get a fair deal when involved in highly complex rules-based trade negotiations in which rich countries have large teams of highly paid lawyers.

And while Doha is a multilateral process, bilateral measures – such as free trade agreements negotiated between the US or EU and Africa – can cause harm by forcing additional demands. The EU must ensure that the Economic Partnership Agreements it is currently negotiating with Africa are designed primarily for development, guided by the same principles that we call for in the Doha Round – and providing African products with full access to the EU market, with the EU not

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demanding concessions from Africa in return, and providing the aid necessary to increase Africa’s capacity to trade. Such negotiations must pay adequate attention to the impact on poverty.

All of these policies – increasing opportunities for trade and lifting restraints on trade – must be pursued together. We realise this is an ambitious agenda but we believe it to be a realistic one. Anything less will not offer Africa the opportunities it needs to increase trade, in both traditional products and new ones. And it should not be separated from the other recommendations of the Commission. Africa will never break out of its interlocking vicious circles with piecemeal solutions and policy incoherence.

In WTO negotiations, rich countries should seek only minimal concessions from poor countries in return for making major concessions themselves. The reciprocity traditional in trade negotiations will not help Africa overcome the huge obstacles it faces. Nor should poor countries be blackmailed into accepting a plethora of complex arrangements as the price for admission to the WTO. Declarations to this effect should be made by rich country ministers at the next WTO meeting.

Conclusion
Increased trade is vital to increased growth. Africa’s share of world trade has slumped and Africa has fallen behind its competitors. The continent faces a huge challenge if it is to reverse this and catch up. African governments must drive this process and be allowed to develop their own trade policies.

Action in three key areas by African countries and the international community, working together, could make this happen, by supporting African-owned strategies for building the capacity to trade, dismantling the rich world’s trade barriers through the Doha Round of world trade negotiations, and providing transitional support to help Africa adjust to new trading regimes.

References

TIPS Training on TradeMap and ProductMap
TIPS will be running several training course on using the Geneva-based International Trade Centre’s (ITC’s) Market Analysis Tools, TradeMap and ProductMap, throughout 2005.

The courses will focus on the use of ITC’s tools for market analysis in the development of international trade strategies, both from a business and policy perspective.

About ITC Market Analysis Tools
TradeMap SA operates in a web-based interactive environment and covers the trade flows of all products between 180 countries and territories. It allows SA exporters, for example, to analyse present export markets, pre-select priority markets and review opportunities of market, product and supplier diversification, as well as to identify existing and potential bilateral trade with partner countries. TradeMap also provides important information on tariff and non-tariff barriers.

Complementary to TradeMap SA, an additional online tool, ProductMap, is now available in SA. ProductMap offers extensive market and business information on 72 industry platforms.

These services have helped countries such as Vietnam, the United Arab Emirates, Chile and now SA to design new trade strategies, promote regional trade, diversify exports, target investments and assess trade performance.

Thanks to financial support from TIPS and the Dutch and Swiss governments, TradeMap and ProductMap are available to all interested users in SA.

To attend these courses or for further information, please contact Matthew de Gale:

Tel: (012) 431 7900 or E-mail: matthew@tips.org.za
Special and differential treatment in the WTO agricultural negotiations

This article by Alan Matthews examines the case for special and differential (S&D) treatment for developing countries within the WTO Agreement on Agriculture (AoA) and the particular instruments or exemptions it should contain. It highlights a number of shortcomings that have become evident with the implementation of the AoA, such as the huge imbalance in the amount of trade-distorting support provided to developed country farmers, which have left many developing countries fearful that further liberalisation of their agricultural policies will leave their farmers exposed to unfair competition. The article also highlights where changes in the treatment of developing countries in the AoA would be desirable in the areas of tariffs, safeguards and domestic supports.

Introduction
The Fourth WTO Ministerial Declaration launched the so-called Doha Development Round of multilateral trade negotiations in 2001. It reaffirmed that “special and differential treatment for developing countries shall be an integral part of all elements of the negotiations on agriculture”. S&D treatment for developing countries has been a principle of the General Agreement on Tariffs and Trade (GATT) since the 1960s and to date has taken two main forms: the granting of preferential access to developed country markets and exemption from disciplines applying to the protection of domestic industries under particular conditions.

Preferential market access was justified as a means to encourage export diversification by developing countries to escape the ongoing decline in their terms of trade. Exemptions from the disciplines on the use of protective measures were justified by arguments that the trade policies appropriate to developing countries are different to those required in developed countries, that the developed countries themselves used selective protection in earlier periods, and thus that the policy disciplines which apply to the latter should not apply to the former.

The meaning of S&D treatment changed during the Uruguay Round. Developing countries (apart from the least developed countries) were expected to assume the general obligations of membership. Instead, the focus shifted to one of responding to the special adjustment difficulties in developing countries which might stem from their implementation of WTO decisions (Whalley, 1999). This included a lower level of obligations and longer implementation periods, as well as technical assistance for capacity-building.

When disciplines on trade-distorting agricultural policies were included in the Uruguay Round AoA, the principle of S&D treatment also applied to the treatment of developing countries under that Agreement. However, developing countries have argued that the Agreement represents a very unbalanced and skewed set of obligations. They argue that changes to WTO rules are necessary if they are to have the flexibility to implement specific policies to address their food security, rural development and poverty alleviation concerns. The exemptions and rule changes to the AoA sought by a number of developing countries have become known as the Development Box.

This article examines the case for a Development Box within the AoA and the particular instruments or exemptions it should contain.

Special and differential treatment provisions in the AoA
S&D treatment is provided for developing countries in three main ways under the AoA. First, there are lower reduction percentages and longer implementation periods for the main commitments entered into. Second, there is greater flexibility in the use of certain policy instruments such as investment subsidies and export subsidies. Third, special commitments were entered into for net food-importing developing countries and least developed countries, known as the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries. However, while this Decision contained many exhortatory and ‘best endeavour’ commitments, no real action has followed from it to date.

Tariffs
A major achievement of the AoA was tariff binding. Developed and developing country WTO members bound almost 100% of all agricultural tariff lines. Most developing countries opted to use ceiling bindings rather than tariffication, and bound rates were set at high levels, though not for all countries. Egypt, Sri Lanka and several Latin American countries are countries with relatively low bound rates. Newly-acceding countries to the WTO (which are nearly all developing countries) are also required to offer low bound rates.

Applied tariffs are much lower than bound rates. For 32 developing countries, a simple average of the applied rates is 20% versus the bound rate of 84% (Sharma, 2002). Matthews (2003) found almost identical numbers for an overlapping sample of 23 developing countries (18% against 84%). Gibson et al. (2001) reach the same conclusion. Examining a sample of 12 Latin American countries with good data availability, they found that the average bound tariff level was 45%, while the average applied tariff in 1998 was 13%, or less than one-third the bound level. They noted that applied tariff data were more difficult to source for other developing countries, but for a small sample of seven other developing countries, they found applied rates averaged from one-quarter to about three-quarters of the bound rates.

This evidence suggests that developing countries, on average, have not been making use of the flexibility they already have to raise tariffs on imported foods where they think this is appropriate. One reason may be that countries have been forced to lower applied rates as part of structural adjustment programmes. However, case study evidence suggests that low applied rates often reflect autonomous choices (Matthews, 2003). In many countries, applied rates are low as part of a strategy to keep food prices down for low-income consumers. In other cases, applied rates are low or have been lowered as part of a regional integration strategy with neighbouring countries.

However, flexibility on average does not rule out the possibility that, for particular commodities, bound tariffs may constrain applied tariff levels. If so, this will apply a fortiori if bound tariffs are further reduced in...
the Doha Round. It is therefore probable that a larger number of countries would find that the tariff overhang will be reduced for a larger number of products and even that they may be required to reduce applied rates below those currently in force.

Sharma (2002) argues that the cases where countries have difficulties living within their bound tariffs are often basic foods, where tariffs are often higher than the average rate and in many instances are supplemented by additional measures such as surcharges and variants of price band policies.

The case study evidence from 23 developing countries suggests that applied rates are often close to bound rates for a wider range of products, including dairy products, poultry meat and alcoholic beverages. This is an area where quantitative evidence for disaggregated commodities is as yet limited.

### Special safeguards

One reason why a margin between bound and applied tariffs may be important to developing countries is that it gives them flexibility to adjust border protection to stabilise domestic prices in response to low world prices or import surges.

Case study evidence has been presented of particular problems with specific commodities in particular countries. Oxfam quotes a number of examples where it claims small farmers have lost their livelihoods as a result of rapid liberalisation and the growth of imports (Oxfam International, 2002). Its examples include cheap maize imports from the US into Mexico as a result of the North America Free Trade Agreement (Nafta), rapid growth of imports of subsidised rice from the US into Haiti and of subsidised milk powder from the EU into Jamaica. Import surges do not have to be caused by subsidised imports; another Oxfam example is imports of cheaper Thai rice into Senegal, which caused severe distress to that country’s domestic rice sector.

There are general provisions to deal with import surges under the WTO safeguards provisions. However, the existing safeguards provisions are difficult and time-consuming to implement.

### There are general provisions to deal with import surges under the WTO safeguards provisions. However, the existing safeguards provisions are difficult and time-consuming to implement.

Limited capacity to adjust to a sudden upsurge in agricultural or food imports. The problem may become more acute if margins between applied and bound tariffs shrink as part of the overall liberalisation of a new Round. The issue is therefore whether developing countries should be given access to a new safeguard instrument designed to allow them to protect themselves against import surges or periods of undue low world prices.

### Minimum access commitments

Those countries that undertook tariffication were required to offer minimum access commitments in the AoA. Only 14 developing countries made these commitments, including Brazil, Indonesia, Korea, Malaysia, Mexico, Morocco, the Philippines and Thailand.

Minimum access commitments do not appear to have caused problems for domestic market management in developing countries to date. Tariff rate quotas (TRQs) were generally established for two categories of agricultural commodities: non-tradables and politically sensitive staples. TRQs are frequently reported for meat, dairy products, sugar, cereals and oilseeds. In the case of cereals and oilseeds, TRQs may have substituted for state-trading enterprises as a way of controlling imports. TRQ in-quota rates are only specified for two countries, but this is consistent with other evidence from the remaining countries that TRQs as originally envisaged are rarely being implemented. In over half the cases in which TRQs are reportedly being used, applied tariffs are being used. Applied tariffs are often low, and in many cases below the commitments for in-quota tariffs. Fill rates are low, but this does not seem to be due to institutional or licensing arrangements that might maintain protection.

Despite existing provisions, many developing countries argue that there is a need for greater flexibility and additional exemptions.

TRQs have become an important way of managing imports in many cases, but they are not resort to this option, because the import surges did not lead to negative effects (which is one of the conditions to trigger the safeguard), or, most likely, because the complexity of the emergency safeguard process made it too difficult for countries to use.

The problems arising from an import surge can be serious for vulnerable agriculture. Developing countries and poor farmers have a limited capacity to adjust to a sudden upsurge in agricultural or food imports. The problem may become more acute if margins between applied and bound tariffs shrink as part of the overall liberalisation of a new Round. The issue is therefore whether developing countries should be given access to a new safeguard instrument designed to allow them to protect themselves against import surges or periods of undue low world prices.

### Market access

The Framework envisages a tiered formula under a single approach under which deeper cuts will be made in higher tariffs, but with flexibilities for sensitive products. There will be no general increase in tariff rate quotas, but the reduction or possible elimination of in-quota tariffs and improved quota administration have been agreed as ways to increase the fill rates of existing tariff quotas. Increased TRQ access

In many of the cases where low fill rates are observed, imports are on or above trend after 1994.

### Export subsidies

Very few developing countries provide direct or indirect subsidies on agricultural exports, so there is limited implementation experience on which to draw. There is some reported use by developing countries of the S&D treatment, especially for high-value, low-weight products like cut flowers, fresh fruit and vegetables (Matthews, 2003).

### Domestic subsidies

Commitments on domestic support (Total Aggregate Measurement of Support, or Total AMS) in the AoA were made overwhelmingly by developed countries. 96 of the 118 developing countries did not report AMS subsidies in their schedules and thus have no reduction commitments (their support measures fall, by default, under one or more of the exempted categories). There are just 13 developing countries with Total AMS reduction commitments.

Existing commitments on domestic subsidies have not been a constraint on developing country policies until now. Developing countries generally do not have the budgetary means to provide significant support to their farmers.

### Development Box

Despite the existing provisions, many developing countries argue that there is a need for greater flexibility and additional exemptions. In a June 2000 submission to the WTO Committee on Agriculture, 11 countries – including Cuba, Kenya, Pakistan, Uganda and Zimbabwe – suggested creating a Development Box to allow developing countries the flexibility to tackle food security.

The extent to which these countries have succeeded in having their concerns recognised can be evaluated by examining the scope of S&D treatment proposed in the August 2004 Framework Agreement.

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2 Abbott and Morse, 1999

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15
Potential provisions in a Development Box

General

Exempt certain products from AoA commitments, using either a negative or positive list approach. Under the negative list approach, all products would be exempt except those listed by developing country members. This approach is used in negotiations on industrial tariffs and services. Countries may have the flexibility to designate an appropriate number of products as Special Products, based on criteria of food security, livelihood security and rural development needs, which will be eligible for more flexible treatment. Finally, the Framework envisages the creation of a Special Safeguard Mechanism for use by developing country members.

Domestic support

The Framework states that S&D treatment remains an integral component of domestic support. It is agreed that the modalities to be developed will include longer implementation periods and reduced reduction coefficients for developing countries for all types of trade-distorting domestic support. Reductions in de minimis support are foreseen, but developing countries that allocate nearly all of their de minimis programmes to subsistence and resource-poor farmers will be exempt.

Export subsidies

Developing country members will benefit from longer implementation periods for the phasing out of all forms of export subsidies. Following the deadline for the phasing out of export subsidies in general, a time limit, to be agreed, will be placed on their continued access to the provisions of Article 9.4, permitting developing countries to provide limited types of export subsidies even where no such subsidies had been provided before.

Assessment of S&D treatment proposals

The Agreement on Agriculture negotiated in the Uruguay Round allows developing countries considerable flexibility to address issues of food security, rural development and poverty alleviation. Developing countries were able to opt for ceiling tariff bindings from which to implement their tariff reduction commitments. Reduction commitments were set at two-thirds of those of developed countries, and least developed countries were exempted from reduction commitments altogether.

With respect to domestic support, specific measures to promote agricultural production in developing countries are exempt from reduction commitments and they have higher de minimis thresholds for trade-distorting support.

Nevertheless, experience to date with the implementation of the AoA has revealed a number of major shortcomings. The huge imbalance in the amount of trade-distorting support provided to developed country farmers compared to that available to developing country farmers, despite and indeed because of the “built-in” provisions within the AoA, leaves many developing countries fearful that further liberalisation of their agricultural policies will leave their farmers exposed to unfair competition. There is a general concern across many developing countries that poor farmers in these countries are much less capable of dealing with the consequences of world market price volatility and deserve some special protection against this volatility. Some countries which believe that food self-sufficiency is an important element in their food security strategy and those which have bound their tariffs on food staples at relatively low levels are concerned that developing countries may not be able to meet their food security of further tariff reductions.

Other countries are concerned that their ability to pursue growth-promoting agricultural policies may be limited because they will come up against the low ceiling limits for domestic support.

In the case of tariffs, a lower rate of tariff reduction for a limited number of food security products, with a minimum threshold below which countries would not be required to go – at least until there had been a much more significant dismantling of agricultural protection in developed countries – would be justified. Countries whose bound tariffs were already below this minimum threshold have the right under existing WTO rules to raise these tariffs.

[Source: Drawn from Roberts et al., 2002; Ruffer et al., 2002]
although with the payment of compensation in terms of additional market access elsewhere to those import suppliers adversely affected. Developed countries might agree to exercise restraint in seeking compensation in the case of food security crops.

A special agricultural safeguard measure on a permanent basis for developing countries is justified, particularly in the case of food security products. Technical discussions will be needed on the design of this mechanism with respect to trigger levels, duration and the level of additional duties which would be permitted.

On domestic support, the exemptions under Article 6.2 should be maintained and, if necessary, broadened. With a sufficiently generous interpretation of permitted support measures, the current de minimis percentages for developing countries should be maintained, but not increased. The justification for maintaining the higher percentages is in recognition of the much higher levels of trade-distorting support permitted to developed countries under the current rules. But seeking an increase in these percentages is not likely to result in a commercially valuable concession, given the difficult budgetary situation in most developing countries.

Finally, there is the question of which countries would be eligible for S&D treatment. Here, the approach proposed by the International Food and Agricultural Trade Policy Council (IPC) to adapt a per capita income based distinction but to allow countries which feel they have particular vulnerabilities (for example, a high proportion of people undernourished or a great dependence on a single or narrow range of commodity exports) to petition for more favourable treatment, is a promising one to pursue.

Comparing these recommendations with the text agreed in the Framework for the modalities shows a high degree of overlap. The Framework recognises a category of Special Products based on criteria of food security, livelihood security and rural development needs which will be eligible for more flexible treatment. The concept of a minimum threshold below which further tariff reductions would not be required does not appear explicitly, but could be incorporated into the treatment agreed for Special Products. The Framework text also commits to the establishment of a Special Safeguard Mechanism for use by developing countries, but is silent on the scope and mechanics of such a mechanism.

On domestic support, the August 2004 Framework calls for reductions in de minimis, taking into account the principle of S&D treatment. This is interpreted in the next sentence as meaning that developing countries that allocate almost all de minimis programmes for subsistence and resource-poor farmers will be exempt (from these reduction commitments). It proposes to maintain access to Article 6.2 provisions but not to extend them. It also proposes to allow access to other S&D treatment provisions for export subsidies for a time-limited period after all other export subsidies have been phased out.

Thus, the potential exists in the Framework Agreement to take a significant step towards “operationally effective and meaningful provisions” for S&D treatment. While noting this positive outcome, the important objective for developing countries of gaining a reduction in the trade-distorting support and protection by developed countries should not be forgotten.

The danger for developing countries is that if too much of their negotiating effort is put into gaining special and differential treatment, less attention will be paid to gaining significant reductions in market access barriers and tighter controls on domestic support policies in developed country markets. This is a particularly important issue for those middle-income developing countries who may be asked to forego some of the benefits of the new S&D regime as the price of reaching an agreement. If the market opening commitments are sufficiently attractive, it would be important not to lose the opportunity of taking advantage of these simply to make a point about S&D treatment.

Experience to date with the implementation of the AoA has revealed a number of major shortcomings. For example, some countries are concerned that their ability to pursue growth-promoting agricultural policies may be limited because they will come up against the low ceiling limits for domestic support.

References


FOCUS ON DATA

Trade between SA and China: future potential

This article by TIPS economist Owen Willcox examines current bilateral trade patterns between SA and China and finds that SA exports relatively low-value, capital-intensive products to China that face relatively low tariff barriers, and imports higher-value, labour-intensive products which are relatively highly protected. However, from a trade analysis which identifies commodities with high export potential in China’s markets, he also finds very positive prospects for exporting to China. The challenge is therefore to maximise the potential gains from and reduce the costs of trade, perhaps through a preferential trade agreement.

Aggregate trade flows between SA and China

From Table 1 portraying the aggregate flows of trade between SA and China, it is apparent that trade between the two countries is increasing in both directions at about 30% per annum in nominal rand terms.

SA’s imports from China are growing slightly faster than exports but both trade flows are growing more than twice as fast as trade with the rest of the world. Consequently, imports from China made up 6% of total imports in 2003, up from 2% in 1993.

Similarly, exports to China increased their share from about 1% in 1993 to about 3% in 2003. Most of the growth in exports has occurred since 1999. In fact, between 1998 and 2003, exports grew by a massive 45% per annum compared to the 33% growth rate registered by imports.

The most extraordinary feature of the performance of Chinese imports into SA is that the value of the rand fell by 124% between 1993 and 2002. Although the rand appreciated by 28% in 2003 to stage a recovery, exports to China still increased by 40%.

Given these growth rates for imports and exports respectively, it is no surprise that SA’s trade with China is increasing faster than total trade. The China trade makes up 4.5% of total trade now, with every prospect of becoming more important over the next few years. Trade with China grew faster than total trade every year in the sample except for the first – 1994.

Table 2 reports the data for total trade between SA and China where total trade is the sum of exports and imports. As is to be expected, given the performance of Chinese exports to SA, the trade balance with China is in China’s favour and has become steadily more so. This is in contrast with SA’s total trade balance, which has vacillated between deficit and surplus over the years.

Between 1980 and 2001, China achieved economic growth of, on average, 10% per annum. This led to a seven-fold increase in income. Growth has slowed slightly since then and will probably average around 8% for the foreseeable future (Srinivasan, 2004). In an attempt to secure continued market access and raw materials to feed this expansion, China wants to negotiate an FTA with SA. This report examines the question of which goods SA should target in the event of FTA negotiations.

Structure of SA’s trade with China

Figure 1 moves away from this aggregate analysis to describe the structure of SA’s trade with China, and especially look at the structure

This is an abridged version of the original paper prepared by TIPS in 2004. Due to data constraints, this article cannot analyse trade in services and thus only refers to trade in goods. All data is in nominal prices. The analysis makes use of trade data from SA’s Customs and Excise and UNComTrade, as well as tariff data from the dti and the United Trains database.
of merchandise trade. We have aggregated HS2 data into very broad classifications based on the level of sophistication needed to produce the goods. The data is presented for 1993 and 2003 to examine changes in the structure of trade.

Imports from China are dominated by the industrial classifications – basic processing and advanced manufacturing. During our sample period, advanced manufacturing has taken over from basic processing as the largest classification. The importance of agriculture and mining declined as well, also to the benefit of advanced manufactured goods.

In terms of exports, the largest decline occurred in advanced manufacturing, which lost the majority of its share to basic processing. Mining’s share of trade declined but it took over from advanced manufacturing as the second-largest classification. Agriculture and forestry tripled its share, but still remains at less than 2% of exports.

Figure 2 shows how many HS6 commodity groups were involved in trade with China between 1993 and 2003. The data for imports should be read off the left axis and that for exports off the right. A far larger number of HS6 goods are imported than exported, but the number of export goods is growing faster.

The number of import commodities grew from 1,597 in 1993 to 3,360 categories in 2003, more than doubling the number of goods imported. In contrast, the number of exporting goods nearly quintupled. Export commodities grew from 146 in 1993 to 706 categories in 2003.

Potential trade analysis

Current bilateral trade patterns suggest that SA exports relatively low-value, capital-intensive products to China that face relatively low tariff barriers, and imports higher-value, labour-intensive products which are relatively highly protected. Ignoring consumer surplus and real household income arguments, this suggests that a free trade agreement (FTA) with China is not particularly beneficial to SA. Nevertheless, anecdotal evidence suggests that the rapid development of the Chinese economy requires imports of a wide range of products, some of which are currently exported by SA to the rest of the world but not to China, suggesting that potential trade in these products may be high.

The challenge is to find markets for SA exports that defy the typical Heckscher-Ohlin outcomes, otherwise the notion of South-South trade may well undermine the good intentions of the Cancún group of 20. Its sheer enormity and the fact that China is conducting FTA negotiations of one sort or another with many partners may well mean that SA exporters are essentially competing with the rest of the world in this market.

Building on methodologies employed by the International Trade Centre (ITC) in 2001 and those developed earlier by TIPS for bilateral trade studies on the European Free Trade Association (EFTA) and the US, we proceed with the identification of commodities with high export potential in China’s markets. The objective is to find evidence of potential exports that is relatively high value added and labour intensive.

In order to identify export goods with potential, weighted average annual growth rates are calculated for SA exports to China and to the world and Chinese imports from the world for the period 1998-2003 for each HS6 commodity group. Each good is then classified according to these growth rates. The categories are described in what we think is an appropriate ranking for policy-makers.

This analysis was carried out at the HS6 level. Goods that are identified as category 5 have growing SA exports to the world and a growing Chinese market, yet SA exports to China are either zero or declining. HS6 commodity groups were identified as having high potential for further exports in the Chinese markets.
Table 3: High export potential codes and descriptions

<table>
<thead>
<tr>
<th>Potential exports code</th>
<th>Growth in SA exports to China</th>
<th>Growth in SA total exports</th>
<th>Growth in China total imports</th>
<th>Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td>5</td>
<td>0 or -</td>
<td>+</td>
<td>+</td>
<td>High potential in China but not realised by SA exports in that market, although significant SA exports occur elsewhere.</td>
</tr>
<tr>
<td>4</td>
<td>+</td>
<td>+</td>
<td>+</td>
<td>High potential in China, realised by SA exports in that market, with significant SA exports elsewhere.</td>
</tr>
<tr>
<td>3</td>
<td>+</td>
<td>0 or -</td>
<td>+</td>
<td>High potential in China, realised by SA exports in that market, but with export supply constraints elsewhere.</td>
</tr>
<tr>
<td>2</td>
<td>0 or -</td>
<td>0 or -</td>
<td>+</td>
<td>High potential in China, not realised by SA exports in that market and with export supply constraints elsewhere.</td>
</tr>
<tr>
<td>1</td>
<td>+</td>
<td>0 or -</td>
<td>0 or -</td>
<td>Low potential in China, realised by SA exports in that market, with significant SA exports elsewhere.</td>
</tr>
<tr>
<td>0</td>
<td>0 or -</td>
<td>+</td>
<td>0 or -</td>
<td>Low potential in China but not realised by SA exports in that market, although significant SA exports occur elsewhere.</td>
</tr>
<tr>
<td>-1</td>
<td>0 or -</td>
<td>0 or -</td>
<td>0 or -</td>
<td>Low potential in China but not realised by SA exports in that market, with export constraints elsewhere.</td>
</tr>
</tbody>
</table>

Table 4: High potential exports with a comparative advantage for SA (1998-2003, US$'000)

<table>
<thead>
<tr>
<th>21 Chapter Code</th>
<th>Description</th>
<th>No. of HS6 groups</th>
<th>% of Total</th>
<th>SA exports to China</th>
<th>SA exports to the World</th>
<th>Chinese imports from the World</th>
<th>Indicative trade potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>6</td>
<td>Chemicals</td>
<td>46</td>
<td>30.1</td>
<td>24,743</td>
<td>447,069</td>
<td>1,302,412</td>
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<tr>
<td>2</td>
<td>15</td>
<td>Base Metals</td>
<td>31</td>
<td>20.3</td>
<td>53,641</td>
<td>277,097</td>
<td>3,482,238</td>
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<tr>
<td>3</td>
<td>16</td>
<td>Machinery</td>
<td>13</td>
<td>8.5</td>
<td>20,744</td>
<td>958,039</td>
<td>1,045,354</td>
</tr>
<tr>
<td>4</td>
<td>11</td>
<td>Textiles</td>
<td>10</td>
<td>6.5</td>
<td>9,038</td>
<td>115,329</td>
<td>1,045,752</td>
</tr>
<tr>
<td>5</td>
<td>17</td>
<td>Vehicles</td>
<td>8</td>
<td>5.2</td>
<td>1,248</td>
<td>49,037</td>
<td>59,567</td>
</tr>
<tr>
<td>6</td>
<td>4</td>
<td>Prepared foods &amp; tobacco</td>
<td>7</td>
<td>4.6</td>
<td>3,481</td>
<td>33,757</td>
<td>535,211</td>
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<tr>
<td>7</td>
<td>1</td>
<td>Live Animals</td>
<td>6</td>
<td>3.9</td>
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<td>59,567</td>
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<td>8</td>
<td>2</td>
<td>Vegetables</td>
<td>6</td>
<td>3.9</td>
<td>2,259</td>
<td>276,951</td>
<td>169,732</td>
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<td>5</td>
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<td>5</td>
<td>3.3</td>
<td>443,499</td>
<td>593,478</td>
<td>30,111</td>
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<tr>
<td>10</td>
<td>8</td>
<td>Leather</td>
<td>5</td>
<td>3.3</td>
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<td>57,178</td>
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<td>13</td>
<td>Stone &amp; Glass</td>
<td>5</td>
<td>3.3</td>
<td>34,077</td>
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<td>30,186</td>
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<tr>
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<td>7</td>
<td>Plastics</td>
<td>4</td>
<td>2.6</td>
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<td>35,502</td>
<td>130,856</td>
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<tr>
<td>13</td>
<td>3</td>
<td>Animal or Vegetable Fats</td>
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<td>1.3</td>
<td>-</td>
<td>6,305</td>
<td>6,654</td>
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<tr>
<td>14</td>
<td>20</td>
<td>Misc. Manufactures</td>
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<td>1.3</td>
<td>-</td>
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<td>217,698</td>
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<td>9</td>
<td>Wood Products</td>
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<td>3,287</td>
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<td>10</td>
<td>Wood Pulp &amp; Paper</td>
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<td>0.7</td>
<td>-</td>
<td>172</td>
<td>3,668</td>
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<tr>
<td>17</td>
<td>14</td>
<td>Precious Metals</td>
<td>1</td>
<td>0.7</td>
<td>3</td>
<td>17,791</td>
<td>3,050</td>
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</tbody>
</table>

(Source: UNComTrade and own calculations)

In order to determine which goods should be the top priority for trade negotiators, we have taken all the goods classified as category 5 and calculated revealed comparative advantage (RCA) indices for these goods from the SA and the Chinese perspective. We then calculated the difference between the RCA index for SA and China. If a good has an RCA for SA greater than China’s and SA’s RCA index is greater than 1, we classify these goods as very high potential. 153 goods achieved this higher potential. On the other hand some goods have an RCA index less than 1, we classify these goods as low potential. As a result we have 153 goods that have high potentialities with high RCA index greater than China’s and SA’s RCA index is greater than 1. We also have 68 goods that have low potentialities with RCA index less than China’s and SA’s RCA index is less than 1.

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