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Trade Policies Review: Experiences and Impacts

This edition of the Trade & Industry Monitor considers various aspects of trade policy and its influence on development and growth. The first article by Cosatu's Tanya van Meelis and Neva Makgetla looks at the impact of trade on economic structure, and is a response to Xavier Carim of the dti's article, "South Africa's Trade Policy – Ten Years On", which was published in the September 2004 Monitor edition.

The article points out that simply growing trade in its current form might assist in maintaining macroeconomic stability, but will not do much to create employment or support increased equality. It suggests that, if trade is to assist in alleviating the country's overwhelming unemployment problem, a much more differentiated approach is required, and points towards the need to link trade strategies with consistent support for labour-intensive sectors, such as light industry and services. It also suggests the need to work harder at improving trade relations within southern Africa.

Better integration of regional concerns and expectations is also a theme of our second article by Bilal and Laporte, which documents SA's experience in conducting negotiations on a free trade agreement (FTA) with the EU. They find that SA's preparations for and approach to the negotiations meant that, despite numerous constraints and drawbacks, it was possible to successfully devise and pursue a development-oriented trade strategy, even with a partner that is economically and politically more powerful.

Using the SA experience, the article provides insights and possible lessons on how developing countries can mobilise its limited capacity to effectively prepare for and conduct trade negotiations. Foremost is that a comprehensive strategic framework should be in place before embarking on trade negotiations.

However, one of the lessons learnt from the negotiation process is to address regional trade concerns more effectively. Southern African Customs Union (SACU) member states have observed that insufficient consulting with them around the trade negotiations have had major effects on their economic development.

Also in this Monitor, TIPS economist Mmatlou Kalaba reports on the key issues discussed at The Third Annual Southern African Trade Research Network (SATRN) symposium "Policy Space and Implementation of World Trade Organisation Agreements", which was held in Namibia in November 2004. The main objective of the symposium was to identify the type of policy space required by SADC countries to achieve their development objectives within the WTO disciplines – improving special and differential treatment (SDT) in the WTO, implementing WTO Agreements, rules of origin and the erosion of trade preferences – in an attempt to drive economic development and further integrate developing countries into the global trading system.

A number of options were suggested that could be considered to preserve the future of trade preferences, including liberalising rules of origin and simplifying the process of certifying compliance; compensating for erosion of preferences margin – although this may prove highly complex – defining preferential tariffs relative to MFN tariffs rather than in absolute terms; and shifting more towards 'aid for trade'.

In November 2004, the Small Business Project (SBP) published a ground-breaking new report on regulatory compliance cost in SA. The SBP study – "Counting the Cost of Red Tape for Business in SA" – is the first comprehensive survey of its kind in SA, and covers regulatory compliance costs from large corporations through SMEs to the informal sector.

This edition of the Monitor carries the key findings of the report, which estimates that, based on a costing of the time spent and professional fees paid to meet regulatory requirements, compliance costs are about R79bn a year across the economy. This is equivalent to 6.5% of GDP – a high ratio when compared to that in developed countries. The study also found that compliance costs also disproportionately affect small business: in firms with sales of less than R1-million, compliance cost 8.3% of turnover, while in firms with sales of R1-billion or more, it cost 0.2% of turnover.

Most importantly, the SBP report shows that the socio-political costs of reforming the regulatory environment need not be high, while the rewards could be very large indeed. Obviously, this is an opportunity to accelerate growth and development that SA cannot afford to miss.

SPECIAL FOCUS

EDITORIAL

FEATURES

TIPS Executive Director: Stephen Hanival
Editor: Lucille Gavera

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The Impact of Trade on Economic Structure

This article by **Tanya van Meelis** and **Neva Makgetla**[1] responds to Xavier Carim's "South Africa's Trade Policy – Ten Years On" published in the September 2004 edition of the Trade & Industry Monitor.

Analysis of South Africa's (SA's) trade indicates that if trade is to assist in alleviating the country's overwhelming unemployment problem, a much more differentiated approach is required. Simply growing trade in its current form may assist in maintaining macroeconomic stability, but will not do much to create employment or support increased equality.

This conclusion arises from analysing the structure of SA's trade. Specifically:

- SA's exports remain geared primarily toward relatively capital-intensive sectors, notably minerals, heavy chemicals and the automotive sector. Expansion in these sectors can do little to contribute to employment creation or more equitable ownership and control. Meanwhile, given relatively slow economic growth, increased imports of labour-intensive goods and services will tend to displace domestic employment.
- Substantial regional differences emerge in the structure of trade. SADC[2] accounts for a disproportionate share of labour-intensive exports, while Europe still makes up the lion's share of SA trade, with the US also providing important markets for light industry. Capital-intensive industries predominate in exports to China, which is a growing source of labour-intensive imports.

This analysis points, in the first place, to the need to link trade strategies with consistent support for labour-intensive sectors, such as light industry and services. Secondly, it suggests the need to work harder at improving trade relations within southern Africa. Finally, it suggests that stronger ties with China, while desirable in themselves, should not take the form of a free trade agreement (FTA).

SA's growth path

The main economic challenge today, as 10 years ago, remains high unemployment and massive inequalities. Unemployment is now around 40%, if we include people who want paid work but are too discouraged to seek it actively. According to the World Bank's Development Indicators (*World Bank, 2003*), the average unemployment rate for other middle-income countries is around 5%.

Cosatu has consistently argued that SA's extraordinarily high unemployment results from two factors:

- The structure of the formal sector historically centred on minerals and, more recently, heavy chemicals and autos. These sectors are relatively capital intensive and cannot create employment on a large scale, even when expanding. Moreover, this kind of capital-intensive industry generally fosters highly concentrated ownership.
- *Apartheid* deprived the majority of the population of productive assets, including land, as well as education, training and access to formal-sector facilities such as the banking sector and retail marketing. As a result, most people have little scope for earning a living outside of paid jobs in the formal sector.

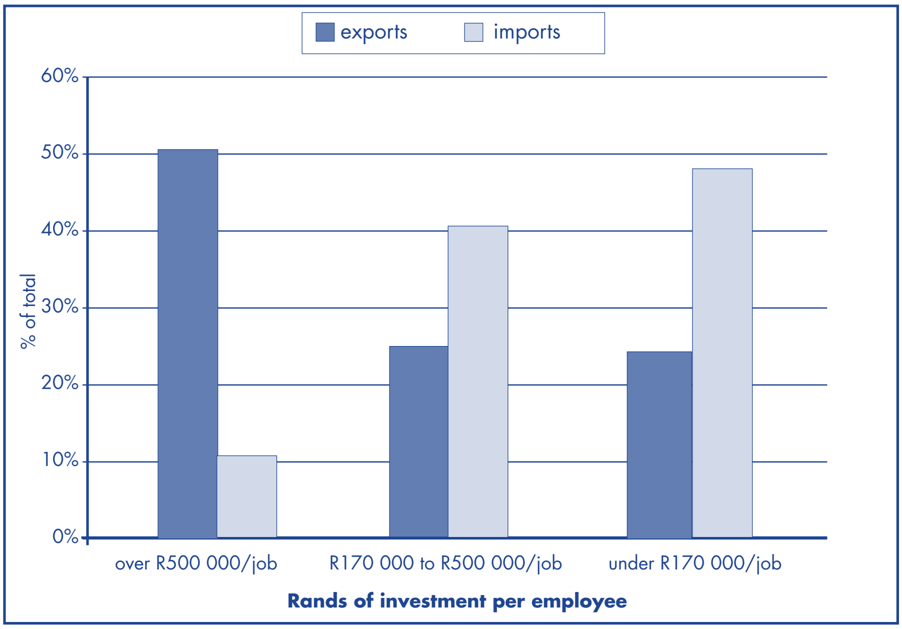
Shifts in economic structure since 1994 have done little to remedy these problems. Specifically, we have seen:

- In the minerals sector, a shift from gold to platinum mining, plus growth in aluminium and steel refining;
- In manufacturing, faster growth in heavy chemicals and autos, with relative stagnation in light industry;
- In services, rapid expansion in the relatively capital-intensive sectors of finance and communications, with stagnation in other private services and a decline in the public sector;
- A decline in construction; and
- Rising capital intensity in commercial farming.

All of these trends are associated with a shift toward rising capital intensity, so that increases in output and exports have not created employment on the necessary scale. Since 1998, formal employment has only grown about 1% a year, or about half as fast as the population.

Various indicators show the shift toward a more capital-intensive economy. To start with, as Table 1 indicates, the fastest growth in output occurred in the most capital-intensive sectors, led by telecommunications and basic non-ferrous metals. Light industry showed relatively little expansion.

Figure 1: Share of imports and exports by fixed capital per employee, 2003



[Note: Capital intensity was estimated using a weighted average of the capital intensity per sector of exports and imports, and is therefore only indicative.

Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

[1] Respectively Trade and Industry Co-ordinator, and Fiscal, Monetary and Public Sector Co-ordinator for the Congress of SA Trade Unions (Cosatu).

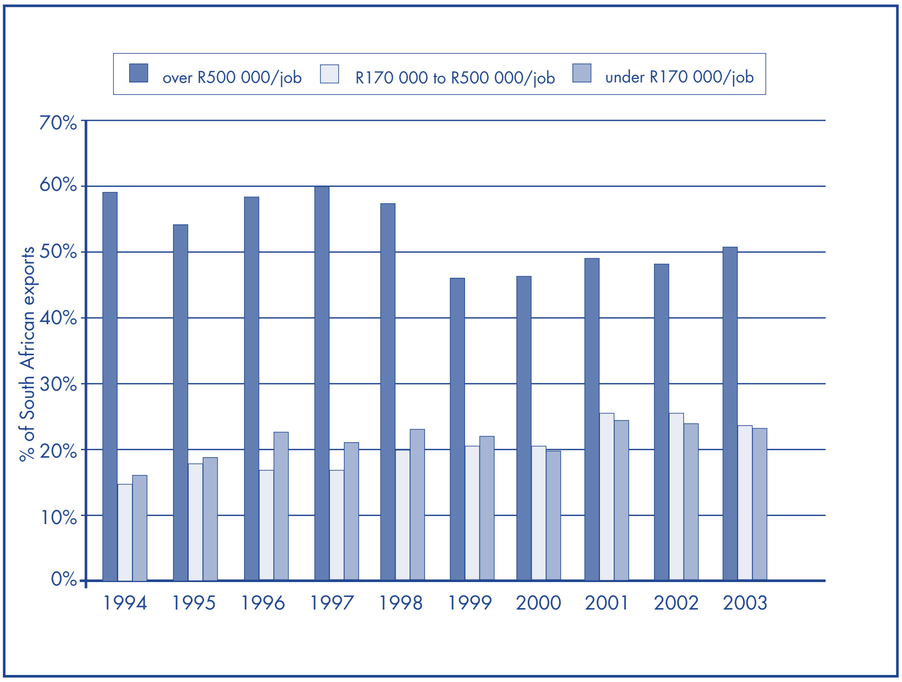
[2] Southern African Development Community

Table 1: Growth rates and capital intensity, 1994-2002

Average annual growth rate, 1994-2002	Capital-labour ratio, 2002 (Rand)
Communications & basic non-ferrous metals at 15%	2,215,00
Sectors growing over 5%	539,000
Sectors growing over 3% to 5%	345,000
Sectors growing under 3%	129,000

[Source: Calculated from TIPS EasyData, downloaded from www.tips.org.za, March 2004]

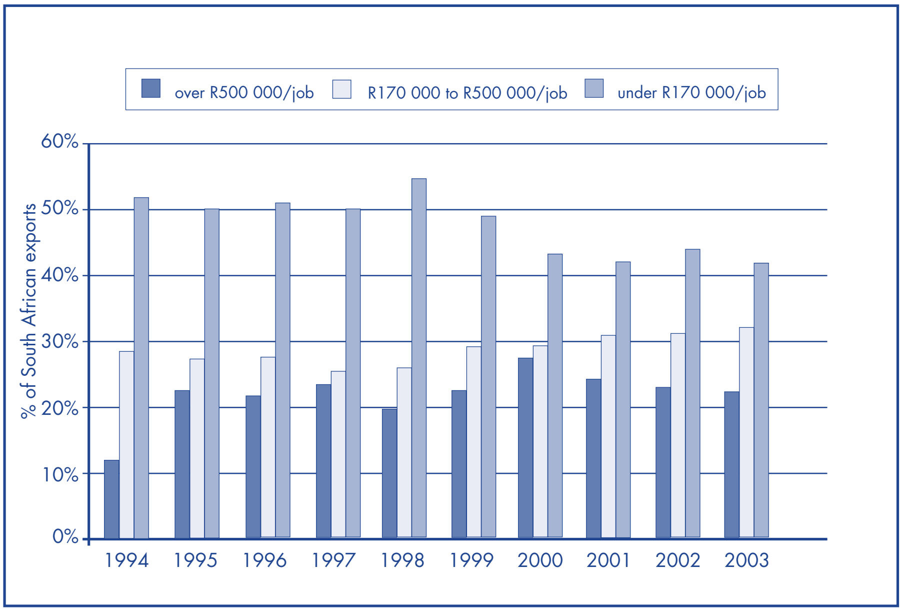
Figure 2: Exports by level of capital intensity, 1994 to 2003



[Note: Capital intensity was estimated by using a weighted average of the average capital intensity per sector of exports in 2003, and should therefore be seen as indicative.

Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

Figure 3: Imports by level of capital intensity, 1994 to 2003



[Note: Capital intensity was estimated by using a weighted average of the average capital intensity per sector of imports in 2003, and should therefore be seen as indicative.

Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

As might be expected, the result of this growth pattern has been a shift in production structure toward heavy and away from light industry. The share of agriculture, gold mining, light manufacturing, public and most private services has declined. The winners have been steel, platinum and aluminium refining; heavy chemicals; autos; communications; and finance – all of which are relatively capital intensive.

The impact of trade on labour-intensive sectors

SA exports continue to be dominated by minerals, heavy chemicals and autos, while imports consist principally of machinery and appliances, as well as fuel. But very strong regional differences emerge. SADC and the European Union (EU) form key markets for SA exports of labour-intensive products, while heavy industry dominates sales to China. Moreover, China is becoming the dominant source of labour-intensive imports by SA.

As Figure 1 shows, SA's exports are considerably more capital intensive than its imports. Half of exports were relatively capital intensive, with R500,000 in capital for each employee. Just under half of imports were relatively labour intensive, with under R170,000 in investment per job. This pattern suggests that increased exports would do little to create employment directly, while rising imports could displace jobs on a larger scale.

As Figure 2 shows, the dominance of capital-intensive exports declined in the late 1990s, but regained ground from 2000. The average capital intensity of SA exports in 2003 was virtually the same in real terms in 2003 as it was in 1994.

In contrast (*see Figure 3*), the bulk of SA imports are relatively labour intensive, although the share of highly labour-intensive imports has declined over the past decade.
The average capital intensity of imports, excluding petroleum, rose by just over a quarter between 1994 and 2003.

Exports were capital intensive because they were dominated by minerals, autos and heavy chemicals – which in turn were largely derived from coal mining. The only shift in the past 10 years was the increase in autos exports and the decline in mining and minerals.

Almost half of all imports were machinery and equipment, autos and appliances of various kinds. Import of transport equipment rose almost as fast as exports by the autos industry.

In short, the overall pattern of trade remained characterised by exports of resource-based goods, with the exception of the autos industry. Consumer and capital equipment dominated imports, which were generally much more

(continued on page 4)

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diverse. This pattern clearly limited the potential for job creation. Moreover, it left SA vulnerable to shifts in world commodity markets, with little sign of the broader economic diversification needed for stable growth.

Underlying the overall trends in imports and exports were substantial differences between the main regions for SA trade. These have significant implications for current bilateral negotiations, as well as broader trade policy. In particular, the EU and SADC have been the main markets for relatively labour-intensive goods. China, India and Brazil bought mostly minerals and heavy chemicals from SA, but exported mainly light industrial goods.

The bars in Figure 4 reflect the share of trade by sectors at different levels of capital intensity. The line shows the share of the region in SA's total trade.

The chart shows that:

- SA exports to the EU and SADC are relatively labour intensive. While SADC absorbs only 10% of SA's total exports, the figure rises to 20% for industries that require under R170,000 in capital per employee.
- SA exports to China and Hong Kong, and to a lesser extent India and Brazil, tend to be capital intensive. Almost 70% of SA exports to China come from industries that require over R500,000 in capital for each job.

These patterns are largely reversed when it comes to imports by SA. Again, in Figure 5, the bars show the share of trade by level of capital intensity, while the line shows the region's share in total trade.

The chart shows that:

- Imports from SADC were more likely to be capital intensive, mostly because SA buys minerals from neighbouring countries. SADC is the only trade region with which SA maintains a strong trade surplus.
- Imports from all regions were dominated by light industry. China, however, was far more likely to provide labour-intensive goods, with almost 80% of its exports to SA falling into the most labour-intensive categories.

These trade patterns reflect substantial differences in the commodities traded.

- For the EU, minerals comprised 42% of SA's exports, the automotive sector 9% and agricultural goods 7%. SA's imports from the EU were mostly transport equipment and autos inputs (30% of the total), machinery (20%) and appliances (15%).
- SADC imports from SA were much more diversified, and included a far higher share of manufactures – over three-quarters of the total. Chemicals comprised 15%, machinery and equipment 12% and food 10%. SADC's exports to SA were dominated by mining and agricultural products, at around 25% each.
- Some 60% of Chinese imports from SA were mineral products, with heavy chemicals at 8%. Meanwhile, China's exports to SA were predominantly light industrial goods – 25% clothing, textiles and shoes, 20% appliances, and 22% machinery and equipment.

The trends in trade structure also vary by region. (Figures are given in dollars, which are closer to real terms.) The most notable trend has been the extraordinary growth in imports from developing countries, especially China. While overall imports rose by just under 60% in dollar terms between 1994 and 2003, imports from China, Brazil and India tripled. SA exports to China doubled and to Brazil remained virtually unchanged. Only in the case of India did exports grow almost as fast as imports.

As a result of these trends, although China remains a relatively minor trading partner, its labour-intensive goods have displaced competitors. In 1994, China accounted for 4% of SA imports and 5% of labour-intensive imports. In 2003, imports from China accounted for 7% of the total, and 13% of labour-intensive goods. In clothing and footwear alone, China provided 40% in 1994, and some 70% in 2003. Meanwhile, China absorbed only 1% of SA exports in both 1994 and 2003.

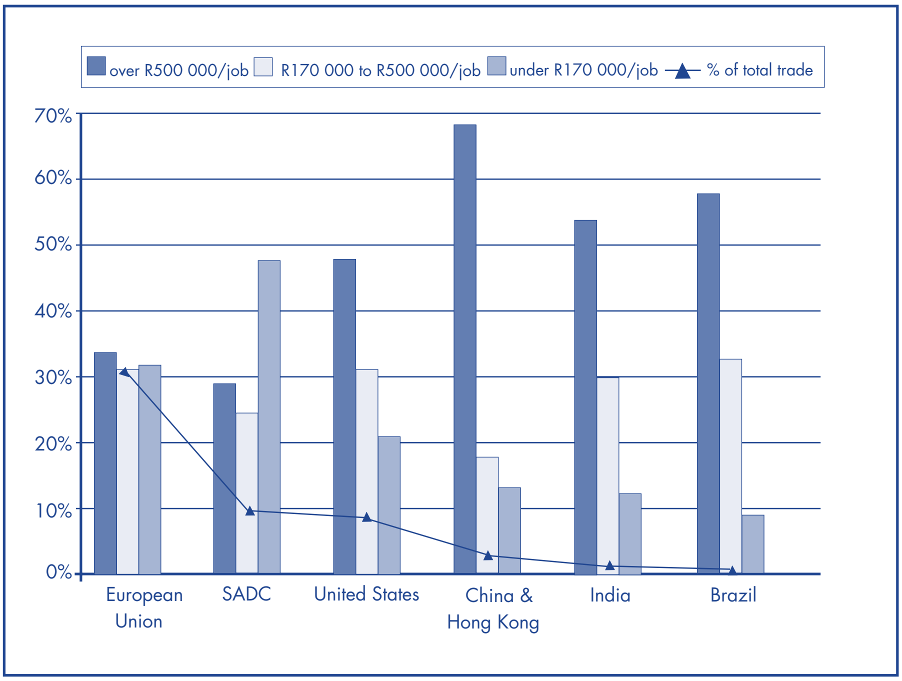
The trends with regard to the EU and the US have been almost the opposite, at least until the rand appreciated dramatically in 2002. While

Table 2: Major exports and imports, 2003

	1994 (%)	2003 (%)
Imports		
Machinery and equipment	22	18
Transport equipment	15	22
Appliances	14	12
Other	49	48
Exports		
Mining and minerals	57	47
Autos	2	10
Heavy chemicals	8	9
Other	33	35

[Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

Figure 4: Export by capital intensity and region, 2003



[Note: Capital intensity was estimated by using a weighted average of the average capital intensity per sector of exports. Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

SA's total exports rose 37% between 1994 and 2003, exports to the EU increased by 82% and to the US by 66%. Labour-intensive exports to the EU and US increased relatively rapidly, especially between 1999 and 2003. But growth in labour-intensive exports slowed substantially with the strengthening of the rand in 2002.

Labour-intensive imports from the EU and the US rose by only 14% between 1994 and 2003, far slower than the average. Moreover, total imports from the EU and the US rose slower than total imports, at 42% for the EU and 30% for the US.

Finally, trade with SADC has largely stagnated. Overall, exports rose 66% between 1994 and 2003. But imports from SADC increased by only 25% – or half as fast as the world total.

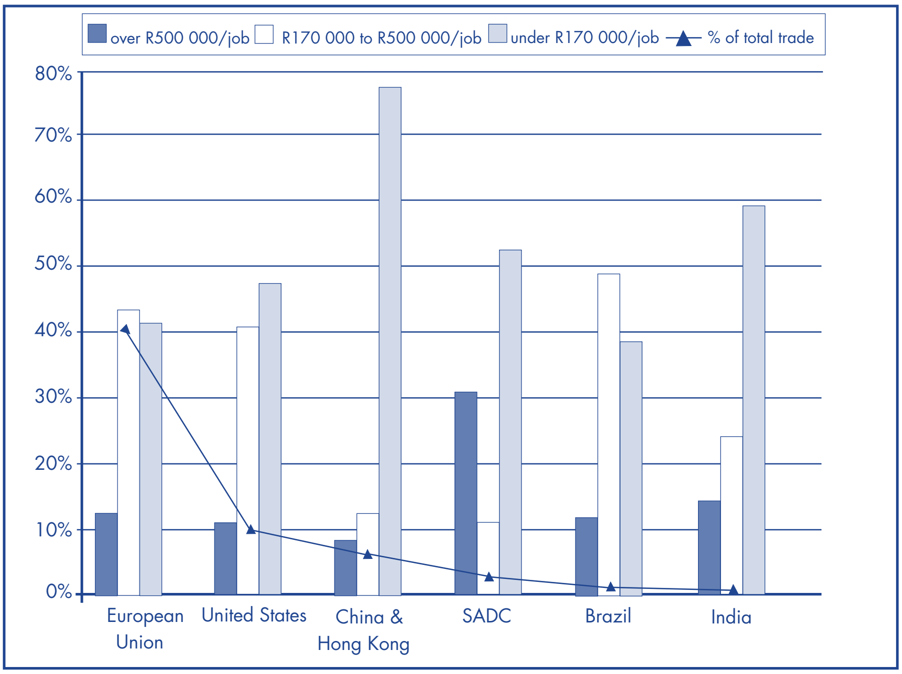
Conclusions

Analysis of SA's trade suggests that simply relying on opening up markets will not do much to improve the employment crisis. Rather, trade policy should be linked to a consistent strategy of supporting relatively labour-intensive industries that can provide employment on a large scale. In particular:

- Increased trade with Europe and the US supported relatively labour-intensive activities as long as the rand was at a reasonable rate. The question is whether these trends will continue with the deeper tariff cuts coming in the next few years.
- Trade with developing countries in general, and China in particular, is more likely to displace domestic light industry and employment, while the benefits are felt only in capital-intensive, resource-based sectors that provide few gains for the majority of the population.
- Trade with SADC remains neglected, although it is an important market for key manufacturing industries.

These findings also point to the need to develop a more sophisticated approach to solidarity with other nations of the South. Free trade agreements will not necessarily increase economic ties in desirable ways. Rather, efforts at co-operation must involve broader areas of engagement, including skills transfer, structured investment agreements and other developmental programmes. Efforts to free up trade should rely on fixed-preference agreements, which target areas of benefit to all parties. In this context, much stronger efforts are needed to ensure development throughout southern Africa.

Figure 5: Trade by capital intensity and region, 2003



[Note: Capital intensity was calculated by using a weighted average of the average capital intensity per sector of imports. Source: Calculated from TIPS EasyData, downloaded November 2004 from www.tips.org.za]

Putting Development Back into the Doha Agenda: Poverty Impacts of a WTO Agreement

06 April 2005, 10h00 - 16h00, Pretoria.

TIPS and the School of Economics and Business Sciences are pleased to offer, on behalf of the World Bank, a seminar on the poverty impacts of the Doha Development Agenda.

This seminar reports on the findings from a forthcoming book based on a major international research project investigating the poverty impacts of a potential Doha Development Agenda (DDA). It combines in a novel way the results from several strands of research. First, it draws on an intensive analysis of the DDA Framework Agreement, with particularly close attention paid to potential reforms in agriculture.

The scenarios are built up using newly available data tariff line data and their implications for world markets are established using a global modeling framework. These world trade impacts, in turn, form the basis for 13 country case studies of the national poverty impacts of these DDA scenarios. The focus countries include: Bangladesh, Brazil, Cameroon, China, Indonesia, Mexico, Mozambique, Philippines, Russia, Vietnam and Zambia.

For further information and registration, contact Amanada Ryland at amanda@tips.org.za or see http://www.tips.org.za/events/povertyimpacts2005.asp

How Did David Prepare to Talk to Goliath? SA's experience of trade negotiations with the EU[1]

The spread of globalisation and the rise of North-South trading arrangements have led many developing countries to wonder whether they are capable of negotiating new trade regimes that will foster their development. Their lack of experience, combined with insufficient capacity and generally weak bargaining power, could prevent them from effectively defending their interests, particularly in harsh trade negotiations with highly developed countries and regions.

Yet SA negotiated a trade agreement with its key strategic and economic partner, the EU. This article documents SA's experience in devising and pursuing its development-oriented trade strategy, in organising itself and in mobilising its limited capacity to conduct negotiations on FTA with the EU. Beyond SA, the case provides insights and possible lessons on how developing countries can effectively prepare and conduct trade negotiations.

From international isolation to credible partner

After decades of international isolation, SA held its first democratic elections in April 1994. After an era of economic and diplomatic sanctions, the new government faced the task of reintegrating the country into the world community by redefining SA's international relations.

Within these relations, the EU is a key strategic partner. Besides the historical ties between SA and some prominent EU member states, the EU has played an active role in promoting and supporting the democratisation process and providing development assistance. Moreover, the EU has been SA's most important trade partner and the country's prime source of foreign direct investment (FDI).

Consequently, the EU was the first major trading partner with which SA sought to establish preferential trade after 1994. Intensive and difficult negotiations took place between SA and the EU from 1995 to 1999, which culminated in both trade and development assistance relations being laid out in the Trade Development and Co-operation Agreement (TDCA), which provisionally entered into force in January 2000.

The TDCA sought to establish a free trade area between the parties, covering 90% of the products traded between the two partners. It also contains specific provisions on development co-operation. The agreement's trade coverage is asymmetric. The EU, being the more developed partner, was to liberalise 95% of its imports from SA, while the latter was to free only 86% of imports from the EU

Figure 1: SA's main trading partners (1995 and 2001)

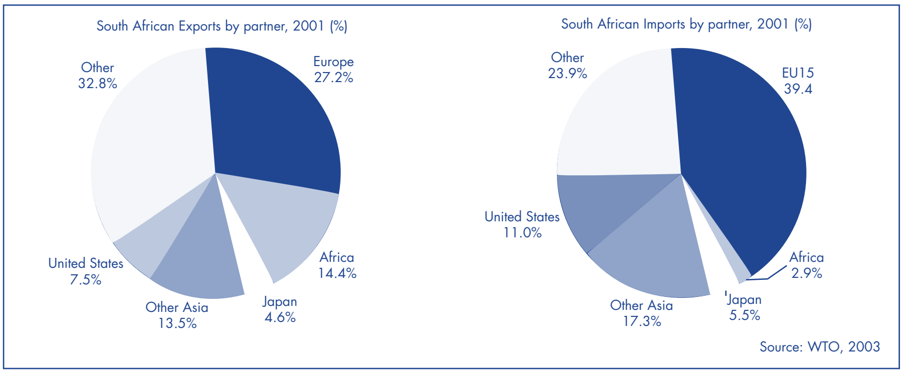
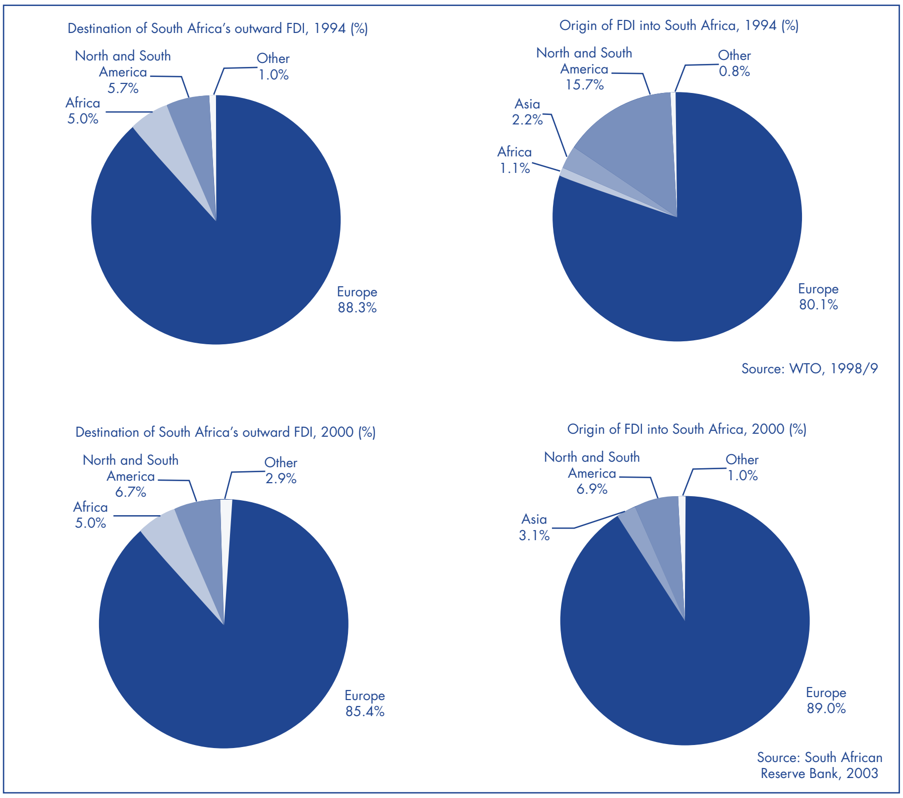


Figure 2: SA's main investment partners (1994 and 2000)



[1] This article is an abbreviated version of the paper by S. Bilal and G. Laporte, published by the European Centre for Development Policy Management (ECDPM) in 2004. For the full paper, refer to the Eldis Trade Policy Resource Guide at http://www.eldis.org/cf/search/disp/docdisplay.cfm/doc=DOC15547&resource=f1trade. The ECDPM aims to improve international co-operation between Europe and countries in Africa, the Caribbean and the Pacific (ACP) through capacity-building for policy management, the promotion of policy dialogue between ACP countries and Europe, and the provision of information and facilities for knowledge exchange.

from customs restrictions. A 12-year transition period was foreseen to allow for gradual trade liberalisation before the TDCA is fully implemented.[2]

The road to the TDCA was travelled in different stages. Initially, SA sought access to the trade provisions of the fourth Lomé Convention. The EU rejected this request, arguing that SA's economic structure did not match those of the ACP countries and its membership could jeopardise the future of the Lomé Convention. Instead, the EU offered SA 'qualified' membership of the Lomé Convention.

Though an FTA was not SA's first preference, the government accepted the offer in September 1995 and both parties started preparations for bilateral trade negotiations. Detailed negotiations began in October 1997, and a first stalemate was reached after an EU proposal in January 1998. The proposal failed to take into account the regional implications of an eventual agreement for SA's partners in the Southern African Customs Union (SACU).

In the talks on agriculture, the EU was accused of 'turning the asymmetry principle on its head' by restricting and back-loading SA's access to EU markets, while front-loading access for its own products. Ongoing disagreement over a parallel agreement for wine and spirits further delayed the conclusion of the TDCA.

The purpose of this article is not to describe the content of the TDCA negotiations or its outcome, but rather the process of conducting the trade negotiations, as experienced by SA with the EU.

SA: A model for trade negotiations?

A conducive governance context

Trade negotiations are a complex process that requires a number of basic governance conditions to ensure the necessary coherence of views across the highest political levels, the various technical ministries involved and the large variety of actors and stakeholders inside and outside of government. Trade negotiations with the EU started while SA was in full transition. The new ANC political leadership had to show leadership, responsibility, a sense of compromise and the ability to ensure strong coherence in negotiating policies and strategies. At the same time, it had to mobilise the best capacities the country could muster, both human and financial, to ensure a positive outcome.

Four crucial elements played a role in the way SA conducted the trade negotiations:

High-level government leadership: Former-president Nelson Mandela was the personification of a worldwide respected and strong visionary, providing charismatic leadership. Internally, this was crucial in bringing all of SA's key players onto the same wavelength. Externally, strong visionary leadership helped to create goodwill on the EU side. Mandela took a personal interest in the negotiations and was strongly committed to conclude the negotiations successfully before the end of his term.

A working democracy with respect for strong social partners and opposition: There was strong commitment amongst the highest political levels (particularly within the SA Department of Trade and Industry, or **the dti**) to negotiate the TDCA in an inclusive and participatory manner. Information was transmitted, dialogue was organised and views were shared.

Match between old and new political generations: A Transitional Executive Council (TEC) – composed of politicians and officials from the De Klerk administration, members of the ANC political intelligentsia and key economic actors – was established prior to the 1994 elections to manage and facilitate the delicate transition from the old regime to the new one. Many TEC members occupied key positions in the post-*apartheid* regime and became involved in the SA-EU negotiations. Though there were different views and perspectives on SA's relationship with the EU and how to manage it, participants worked together towards SA's integration into the world community.

Lead role by the dti: Throughout the negotiating process, SA benefited from the leadership of competent and well-respected ministers with strong personalities at the head of **the dti**. Minister Trevor Manuel – in charge of **the dti** until April 1996 – provided the initial impetus for the new SA economic development and trade strategy, including the negotiations with the EU. For the second, more technical stage of the negotiations, Minister Alec Erwin took up the lead, providing leadership for the co-ordination mechanism established within the government and with key non-governmental actors. Erwin appointed some of the best SA senior trade negotiators to his team. Between 1996 and 1999, under his leadership, **the dti** became a model department with particularly strong offices for multilateral and industrial policies, which led to quick agreement that **the dti** should be the chief negotiating body.

A strategic approach to trade negotiations

The strategic approach adopted by SA in its trade negotiations with the EU has to be put in its historical context. Since 1994, SA has been faced with the challenge of correcting the inequities resulting from the *apartheid* regime. To do this, a programme to transform the SA economy was required to stimulate economic growth and promote social development (see also Bertelsmann-Scott et al., 2000b; Hirsh, 1997; Ismail, 1997).

SA was guided by the principles of integration into the global system and development of stable and predictable relationships with strategic partners. Its first priority was to deepen its ties with African countries, principally by negotiating regional trade agreements with its neighbours (with SACU and the SADC). At the same time, SA's strategic objective was and remains to anchor its economy in the world economic system, and to deepen and enhance the predictability of its relations with major economic powers. To stimulate its economic growth and development, SA considered it imperative to lock in its relations with the EU, which had traditionally been its main economic partner (e.g. Davis, 2000). As such, not only would the largest market in the world be open to SA exports, but increased stability in economic relations would stimulate the flow of investment and the transfer of technology towards SA (see also Graumans, 1998; Hirsch, 1997; Ismail et al., 2002).

As mentioned earlier, SA initially sought only preferential treatment from the EU, in line with that received by the ACP countries under the Lomé Convention. But the EU offered only extremely restricted conditions (SA was excluded from the trade and aid dimensions of the ACP-EU partnership). Instead, the EU proposed negotiating a co-operation and (reciprocal) free trade agreement with SA (see also Bertelsmann-Scott et al., 2000a; Davis, 2000; Houghton, 1997; Perry, 2000).

The EU proposal for a preferential trade relationship with SA based on reciprocity forced the SA government to adjust its strategy and pay more attention to analysing the costs and benefits that an FTA would bring. More broadly, it compelled the government to consider its policy prospects for trade and economic development (see also Smalberger, 2000). A new trade strategy was widely debated, both within the government and across SA society, particularly regarding the appropriate level of trade liberalisation (and thus the extent of asymmetrical liberalisation within an FTA). The formulation of trade policy was thus well integrated with SA's development strategy.

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[2] Though an overall assessment of the impact of the TDCA remains to be done (for instance as part of the official review of the TDCA due by 2005), trade flows between the EU and SA increased sharply in the first two years after the agreement came into force. SA's exports to the EU rose by 35% and 22% respectively in 2000 and 2001. In the same years, imports to SA from the EU increased by 20% and 6% respectively. From 1999, SA's trade surplus with the EU nearly tripled to 3.6bn in 2001.

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SA's key players in the negotiations

Having established the strategy and policy rationale behind its trade negotiations with the EU, the SA government turned to conducting the negotiations. In this it faced several handicaps:

- It had no experience in negotiating preferential bilateral agreements. In contrast, the EU was experienced in international trade negotiations, mainly within the context of the General Agreement on Tariffs and Trade (GATT), and with European countries and neighbours.
- SA was in the midst of a momentous transition, restructuring its economy, social arrangements and institutions. This was not the most conducive and stable environment in which to conduct major trade negotiations.
- The end of *apartheid* meant a cultural shift towards a more equitable society, based on genuine democracy. As a consequence, consultation amongst a range of societal actors – from government officials, politicians and parliamentarians to businesses, farmers, trade unions and civil society – became a key element of the development approach.

Intra-governmental relations

The decision to start trade negotiations with the EU was first and foremost a strategic choice by the SA government in the context of its development objectives. Political leadership came from the highest level (from Mandela and President Thabo Mbeki), which gave the government an overall sense of priority and direction.

Negotiations were prepared and conducted under the close political guidance of the *Cabinet Committee,* which grouped the ministers of trade and industry, foreign affairs, finance, agriculture and environment (in charge of fisheries). All these departments were, to various degrees, directly concerned with the negotiations.

Leadership throughout the negotiation process came from *the dti*, as mandated by the Cabinet Committee. Combined with the department's strong technical expertise, it proved crucial in ensuring the general coherence of the SA stance throughout the negotiations.

The Department of Foreign Affairs co-ordinated the international negotiations, which required linking with SA's embassies within the EU and with the SA mission to the EU in Brussels. Though the department did not intervene directly in technical trade issues, it provided political and diplomatic oversight for the negotiations.

The SA mission to the EU also liaised with the ACP Secretariat and with individual members of the ACP group, particularly with the SADC group ambassadors. It also regularly met European parliamentarians in Brussels and Strasbourg to lobby support for the SA positions in the negotiations.

Other departments were given responsibility for the trade chapters that fell directly under their competence. The National Treasury provided technical input to the negotiations and was in charge of the development dimension, especially the chapter on development co-operation. The Department of Agriculture took charge of the agricultural chapters. To supplement its limited internal capacity and provide for a consultative process, a group called the Agricultural Trade Forum was established. Negotiations on fisheries were prepared by the Department of Environmental Affairs and Tourism.

The technical preparations for the negotiations were in the hands of a *technical working group* composed of representatives of the departments concerned and the Reconstruction and Development Programme (RDP) office, while *the dti* co-ordinated this work.

The negotiating team: SA's ambassador to the EU, based in Brussels, assumed the overarching co-ordination role and as such officiated as the public figure of the negotiations. However, the effective lead negotiators came from **the dti**, first Faizel Ismail and then Bahle Sibise, two highly skilled and respected officials who were supported by technical experts from within **the dti** and other relevant departments and were in constant contact with the political leadership.

> *The decision to start trade negotiations with the EU was first and foremost a strategic choice by the SA government in the context of its development objectives.*

Parliament

As part of SA's democratic revival, the revamping of institutional arrangements and the drive for a more equitable society – to be enshrined in a new constitution, consultative processes and, in particular, in democratic representation of the people – played a central part in the trade negotiations. The SA parliament was assigned a key role in the development of the country, including trade matters. It was thus closely involved in the TDCA negotiating process.

The government was required to report progress in the negotiations to both houses of parliament. Nonetheless, parliament had no means of forcing amendments to the negotiated agreement; it was empowered only to ratify the agreement.

Economic and social actors

SA has a longstanding tradition of strong intermediary bodies amongst social and economic actors. A key challenge of the negotiations was to integrate the views of these actors into the process. In addition to its powerful trade unions, SA's well-organised corporations and strong agricultural lobbies played a major role in the TDCA negotiations.

SA's ***private sector*** has many faces – large corporations, exporting industries, non-trading sectors, medium-sized entities and small business. Various, sometimes competing, intermediary bodies represent this range of interests.

The large SA industrial and financial groups (for example, the steel and automotive industries) have long-held business interests in the EU. They were therefore eager for SA to reintegrate into the world community and used both formal and informal mechanisms to influence government policy in this direction.

A key concern of SA exporting businesses was to improve market access for their products. With the EU being a major world market, negotiating an FTA with the EU became a priority. Most of these companies possessed enough in-house expertise and capacity to defend their interests effectively and to articulate specific technical positions for the negotiations. The agricultural sector, in particular, seems to have been able to garner influential support from well-organised European importers' associations. This support proved helpful in monitoring proposals on legislation and tariffs.

Less active during the TDCA negotiations were the non-trading sectors (for example, livestock and cereals). In general, these sectors possess less expertise and are less organised. Protectionist interests expressed themselves more in principles and generic terms than through specific technical inputs aimed to influence the negotiating process. The trade unions tended to support the concerns of import-competing industries regarding trade liberalisation.

With regard to medium-sized private sector bodies and small business, entities such as the SA Chamber of Business (Sacob) and the National African Federated Chamber of Commerce (Nafcoc) seem to have had limited impact on the negotiating process. Some observers felt that these organisations had a 'narrow understanding' of trade issues, which was not always helpful in keeping a global perspective on SA's interests in the trade negotiations.

SA has a long tradition of strong, well-organised trade unions. Umbrella organisations such as the Congress of SA Trade Unions (Cosatu), the National Council of Trade Unions (Nactu) and the Federation of Unions in SA (Fedusa) participated in the negotiating process at two levels:

- Via a cross-sector tripartite consultative forum, including government, business and labour and organised under the auspices of the National Economic, Development and Labour Advisory Council (Nedlac);
- Via *ad hoc* sectoral consultations outside the Nedlac framework.

Public opinion and civil society

Trade negotiations usually hinge on technical aspects that render the process inaccessible to non-experts. More importantly, trade policy generally attracts little attention until its direct effects become known or felt. Those directly involved in the negotiations on the SA side therefore had to exert significant effort during the process to raise awareness among the public at large on the issues at stake. In this regard, civil society organisations were instrumental in steering the trade policy debate and facilitating dialogue between trade specialists and a larger audience.

> *Trade negotiations usually hinge on technical aspects that render the process inaccessible to non-experts.*

Institutionalised mechanisms of public-private dialogue

In its trade negotiations with the EU, SA reserved a pivotal place for consultation between government, the private sector and trade unions. This took place largely through Nedlac and the Agricultural Trade Forum.

Building on earlier successes around public-private consultation, the new ANC government created *Nedlac*, a statutory quadripartite consultative body comprising government, labour, the private sector (employers) and civil society, which became SA's primary institution for social dialogue on issues of economic and social policy. It is subdivided in chambers, including one on trade and industry. Under this chamber, the Technical Sectoral Liaison Committee was created to follow the trade negotiations and make recommendations on general principles and technical details.
In the trade negotiations with the EU, SA's government leadership used Nedlac in three main capacities – as a channel for information exchange, as a critical advisory body and as an instrument for 'interest mediation'.
To supplement the capacities of the Agriculture Department and to improve consultation, the government established the **Agricultural Trade Forum** in 1997, which provided technical inputs, a platform for the exchange of views on agricultural issues in the negotiations and an opportunity for the agricultural sector to express and defend its interests. Nonetheless, non-exporting sectors, such as livestock and cereals, were less active, and therefore tended to be excluded from the consultation process.

Key components of the negotiating process

Clear identification of strategic interests

The move to integrate the new SA into the world economy and anchor its economic ties with key strategic partners was inspired by a core group of ANC political leaders and intellectuals assigned to various ministries and institutions, as well as prominent positions in trade unions, associations and research institutions. This ensured that the strategic objectives being pursued via trade policy were promulgated in a coherent manner by various actors throughout society. The combination of these forces proved instrumental in the effective pursuit of SA's strategic objectives, including those related to its relations with the EU.

Broad consensus on the potential benefits of trade for SA's development did not pre-empt a lively debate on desirable trade orientations for the country, including within the ANC. Gaining preferential access to the EU market under the Lomé Convention would have stirred little controversy. However, the spectre of reciprocity in opening trade, in particular, reciprocity with a world economic power, did generate serious concern. Protectionist tendencies were in play throughout the negotiations. But strong commitment prevailed – to rejoin the world community, to build solid economic ties with the EU, to stimulate the competitiveness of SA industry and to attract FDI to support development – under strong and sustained political leadership.

After identifying the main principles to be pursued during the negotiations, the government concentrated most of its efforts on identifying the country's specific interests (see also Sudworth and Van Hove, 1998). The process adopted for negotiating the FTA can be summarised as follows:

- General impact assessment of an EU-SA FTA;
- Identification of SA's strategic interests in terms of exports to the EU market and opening the domestic market to imports from the EU;
- Detailed sectoral analysis, in co-operation with the private sector and social actors;
- Co-ordination and consensus-building exercises within the government and with economic and social partners;
- Negotiations with the EU and (formal and informal) lobbying; and
- Ratification and implementation of the agreement.

Technical preparations

Trade negotiations are, first and foremost, a technical process; negotiation positions are won or lost mainly on the basis of the technical arguments put forward. This meant that the sympathy the new SA regime enjoyed in Europe did little to shape the specific positions taken by the European Commission and the EU member states during the negotiations, though it did contribute to create an atmosphere of goodwill. Solid technical arguments, based on hard facts, specific economic interests and compatibility with World Trade Organisation (WTO) policy and legal principles, generally prevailed over good intentions and generic (unspecified) development concerns.

Preparations for negotiations therefore start with solid research and analysis on all potential components of an agreement. In this regard, a research 'value chain' for trade negotiations can be devised, centred on four elements:

A strategic competitive analysis to identify the core reasons for undertaking the negotiations and their specific objectives, which depend on the strategic political and economic objectives of a country. Based on these objectives, an overall assessment can be made of the potential impacts of an eventual trade agreement. In general, too much emphasis is often placed on macroeconomic impact studies at this stage (based on partial or general equilibrium models). The results of such studies rely heavily on crude assumptions about the state of an economy and possible negotiation scenarios. Besides, negotiations are driven primarily by political decisions, as in the case of the TDCA, not by generic macro-impact studies. Such studies may, however, serve a political purpose and may also assist in raising the profile of issues around the negotiations.

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SA TRADE AT A GLANCE

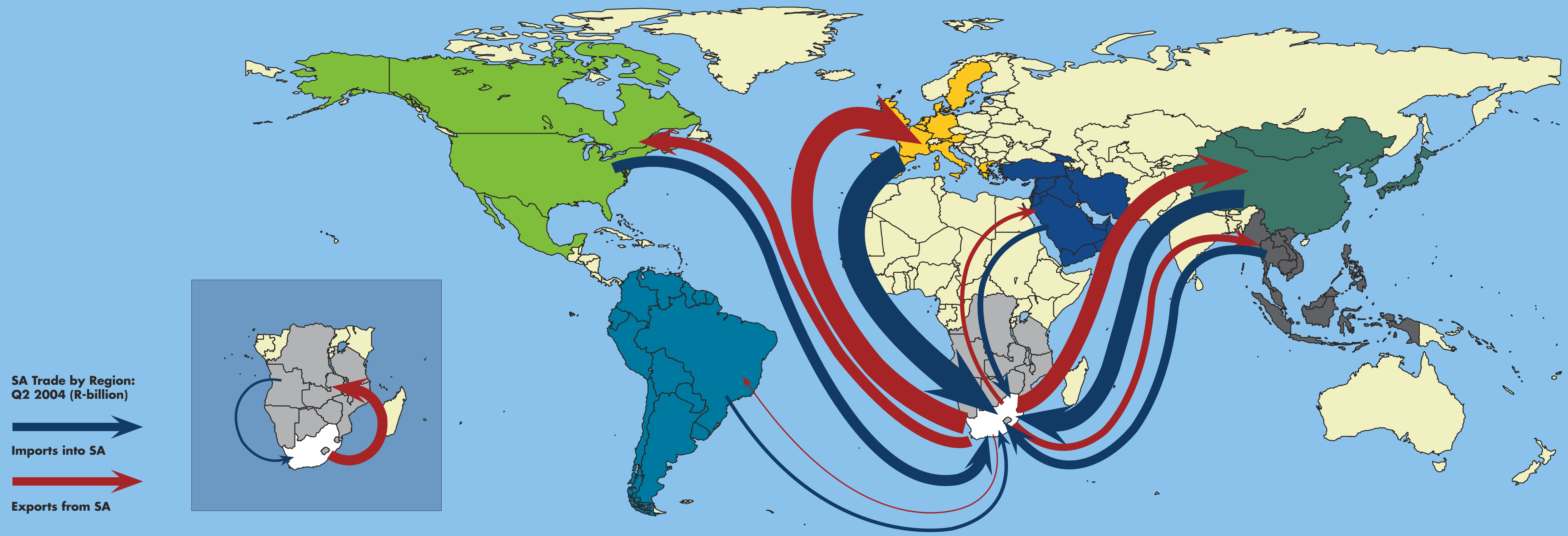
SA Trade Flows to the World

	Q3 2003		Q3 2004		Q2 2004		Q3 2004	
	Rbn	US$bn	Rbn	US$bn	Rbn	US$bn	Rbn	US$bn
Total Exports	66.01	8.90	72.85	11.43	72.32	10.98	72.85	11.43
Total Imports	66.25	8.93	78.69	12.34	79.05	12.01	78.69	12.34
Trade Balance	-0.23	-0.03	-5.84	-0.91	-6.73	-1.03	-5.84	-0.91

SA Trade with the World: Percentage Growth Rate

	Q3 2003 – Q3 2004 (%)	Q2 2004 – Q3 2004 (%)
Total Exports	10.35	0.73
Total Imports	18.78	-0.46

Note: Growth rates have been calculated on the Rand values



Top Three Non-Mineral Exports from and Imports to SA from Regions (HS4, Q2 2004)

Region	Exports			Imports		
	Products	Value (Rbn)	% Share	Products	Value (Rbn)	% Share
EU	Ferro-alloys	2.17	9.10	Original equipment	3.86	13.25
	Centrifuges	1.74	7.32	Motor vehicles	2.35	8.06
	Motor vehicles	1.67	7.02	Radio and TV transmitters	1.25	4.28
East Asia	Platinum	2.73	22.97	Original equipment	2.20	14.76
	Motor vehicles	2.31	19.37	Motor vehicles	0.91	6.08
	Ferro-alloys	1.34	11.23	Computers	0.65	4.37
NAFTA	Platinum	1.63	22.07	Motor vehicles	0.38	5.62
	Ferro-alloys	0.70	9.53	Aircraft	0.29	4.31
	Motor vehicles	0.52	7.05	Gas turbine engines	0.23	3.32
SADC	Motor vehicles (goods transport)	0.20	3.27	Cotton	0.23	13.16
	Solid cane or beet sugar	0.17	2.67	Precious/semi-precious stones	0.05	3.12
	Fertilizer	0.14	2.19	Refined copper	0.04	2.30
Middle East	Hot-rolled products, iron/steel	0.24	9.45	Mineral or chemical fertilisers	0.22	3.29
	Citrus fruit	0.17	6.64	Polymers of ethylene	0.12	1.76
	Centrifuges	0.07	2.79	Motor vehicles	0.07	1.05
South-East Asia	Rolled stainless steel sheet	0.29	14.56	Original equipment	0.41	10.88
	Hot-rolled products, iron/steel	0.10	4.79	Rice	0.33	8.88
	Motor vehicles	0.08	4.01	Computers	0.28	7.51
South America	Ferro-alloys	0.10	14.52	Original equipment	0.52	19.28
	Hot-rolled bar iron/steel	0.07	9.38	Soybean oil-cake residue	0.25	9.29
	Aluminium plates	0.04	5.01	wheat	0.16	5.86

Note: Share refers to the proportion of total exports/imports from the specified trade partner.

EU
East Asia
NAFTA
SADC
Middle East
South-East Asia
South America

Top 10 Export Markets and Import Sources (Q3 2004), all products

Exports			Imports		
Country	Value (Rbn)	Share (%)	Country	Value (Rbn)	Share (%)
UK	7.44	10.2	Germany	11.78	15.0
Japan	7.09	9.7	US	6.23	7.9
US	6.64	9.1	China	6.08	7.7
Germany	4.87	6.7	UK	5.88	7.5
Netherlands	2.99	4.1	Japan	5.26	6.7
Switzerland	2.66	3.7	Saudi Arabia	5.09	6.5
Spain	2.07	2.8	Iran	4.17	5.3
Belgium	1.98	2.7	France	3.08	3.9
Italy	1.92	2.6	Italy	2.41	3.1
Australia	1.78	2.4	Brazil	1.80	2.3
Total	39.45	54.2	Total	51.76	65.1

Note: Share refers to the proportion of total exports/imports

SA Trade with the World: Top 10 Products (HS2; Q3 2004)

Products	Total Exports (Rbn)	% of Total Exports	Products	Total Imports (Rbn)	% of Total Imports
Pearls, precious stones	19.87	27.27	Mineral and fuel oils	12.5	15.94
Iron and steel	9.44	12.95	Machinery and boilers	12.1	15.43
Vechicles other than railway	7.29	10.01	Electrical, electronic equipment	8.2	10.45
Mineral and fuels oils	6.44	8.84	Special classifications provision	7.3	9.31
Machinery and boilers	4.45	6.11	Vehicles other than railway	6.4	8.31
Edible fruit, nuts	2.48	3.41	Optical, medical apparatus	2.6	3.25
Aluminium	2.48	3.41	Plastics	2.0	2.51
Ores, slag and ash	2.02	2.78	Aircraft	1.8	2.26
Electric, electronic equipment	1.50	2.06	Pearls, precious stones	1.6	2.06
Beverages	1.21	1.66	Organic chemicals	1.5	1.88
Total	57.18	78.5	Total	56.04	71.2

SA Trade by Region (Rbn)

	Q3 2003		Q3 2004		Q2 2004		Q3 2004	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
EU	20.90	26.11	23.81	29.14	22.92	29.67	23.81	29.14
East Asia	10.14	11.86	11.90	14.91	12.01	13.80	11.90	14.91
NAFTA	6.78	6.80	7.39	6.81	9.40	7.64	7.39	6.81
SADC	6.60	1.48	6.19	1.73	6.25	2.35	6.19	1.73
Middle East	2.36	5.78	2.51	6.75	2.43	6.13	2.51	6.75
South-East Asia	1.87	2.99	2.00	3.72	1.87	3.39	2.00	3.72
South America	0.66	2.18	0.70	2.68	0.77	2.44	0.70	2.68
Rest of Africa	2.94	1.26	3.03	2.07	3.07	2.57	3.03	2.07
Rest of the World	13.76	7.79	15.30	10.87	13.60	11.06	15.30	10.87

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Government departments often already possess detailed information on official trade flows, domestic tariff lines and structure, and domestic regulations. However, practical information on trade, such as impediments and opportunities for exports and imports, transaction costs and competitive effects at the sectoral level, mainly rest with the private sector. Detailed *sector- and industry-specific* analyses conducted in close co-operation with the private sector can unearth such details.

To manage the negotiation process successfully, it is important to know who the key players are in the negotiations, how they are organised and what resource providers and political forces are in play. In the case of the TDCA negotiations, to acquire *in-depth knowledge for negotiation management*, study tours to Brussels were organised, as well as dedicated workshops on European matters for the SA negotiation team. These experiences gave them insight into the institutional functioning of the EU and its main policy and decision-making mechanisms. **the dti** further developed its own internal capacity, creating an economic research and analysis unit and setting up institutions such as TIPS to conduct impact studies, tariff simulations and other analyses, as well as using institutions like the Industrial Development Corporation (IDC) for trade and tariff analyses.

Detailed negotiation inputs such as technical analyses must be fed into the process throughout the negotiations to provide continuous support to the negotiators and help them to assess promptly any proposals tabled by the negotiating partner. Speed is often of the essence – sufficient analytical capacity must be in place to respond in a rigorous and timely manner.

Several primary factors affect a government's level of preparation and responsiveness at the negotiating table:

- Its internal structure for policy analysis;
- Its degree of co-ordination with sources of information and analysis outside of the government and abroad (including embassies); and
- The priority given to technical analysis by policy-makers and negotiators.

A key component of this is the relationship between available academic research and policy-orientated analysis. In particular, it is important for **the dti** to have sufficient internal capacity to render academic insights useful for policy purposes.

Broad-based consultation

The consultation mechanism with non-state actors was a key feature of the EU-SA negotiations. It contributed to keeping all partners informed and provided opportunities for general and specific inputs to be provided to the negotiations, especially technical inputs. However, some issues arose in this arena.

Public-private dialogue: does it make a difference? In a well-functioning public-private dialogue, a 'healthy' tension exists between government, the private sector and non-state actors in general. Effective consultation, however, requires that all actors' views be considered in the policy-making process and, where feasible, integrated into negotiation positions. Some key non-state actors openly complained about their lack of impact on the final results (see also Cosatu, 1999).

The priority given to technical analysis by policy-makers and negotiators affects a government's level of preparation and responsiveness during negotiations. A key component of this is the relationship between available academic research and policy-orientated analysis.

Predominance of informal channels over formal mechanisms? Despite Nedlac being a strong institutional multi-partite platform for dialogue, a lot of informal dialogue outside the Nedlac framework influenced the outcome of the negotiations. Several direct channels of communication existed between large private sector interests and technical staff within the various departments. Gradually, this contributed to a de facto erosion of the role of Nedlac.

Nedlac: too large to be effective? Many actors considered having only a single forum through which the trade negotiations could be discussed to be a handicap. Nedlac was perceived as too large, representing too many sectors (exporting, import-competing and non-trade sectors, industries of different size, etc.) and too many actors (government, private businesses, trade unions) with divergent interests, thus limiting its effectiveness.

Post-negotiation: Nedlac co-opted by government? According to some, Nedlac gradually became a political instrument and is now too heavily influenced by the government. Moreover, its relationship with the government has become increasingly based on informal contacts. Loss of transparency is seen as a major challenge; some in the business community and in trade unions no longer perceive Nedlac as a key participatory platform for preparing negotiation positions.

Despite these critical comments, a mechanism such as Nedlac can be valuable in promoting democratic decision-making, ownership and cohesion of views on negotiating stances, as the SA experience exemplifies.

Lobbying and negotiating strategy

Influencing the position of the negotiating partner remains a key component of successful negotiation, and SA made dedicated efforts in this respect. Its lobbying and negotiating strategy targeted key players that were crucial to the eventual outcome of the negotiations.

Targeting within the European Commission: From the start of negotiations, SA made a clear choice to deal mainly with DG Development (officially in charge of the TDCA negotiations) and DG Trade within the European Commission.

Selective attention to EU member states: Overall, SA made little attempt to systematically lobby the EU member states. A notable exception was the UK, which, because of its special relationship with and sympathy for SA, was the object of dedicated lobbying efforts by SA officials, politicians and other actors.

Informal contacts: The SA negotiators established generally good informal personal relations with their EU negotiating partners – at ministerial level, between the SA Minister of Trade and Industry and the EU commissioners for trade and development, and at the level of the chief negotiators. These informal contacts helped to create a better understanding of the respective positions.

Support within the European Parliament: SA succeeded in mobilising sympathy and support within the European Parliament, which is known to have a strong development orientation.

European public opinion: SA was able to build sympathy and support among the European public. The moral weight of President Nelson Mandela in Europe created goodwill and sympathy amongst civil society organisations, the private sector, NGOs and politicians dealing with SA.

It is important to note that while this political and public sympathy benefited SA in its negotiations, it was not automatically transferred to the technical, interest-rigged negotiation table. While ministers can provide strategic and moral leadership, the day-to-day management of the negotiations must be carried out by a competent negotiating team with the support of technical specialists from the departments concerned.

Domestic lobbying and the use of media: The government's institutional consultation process, active involvement by SA's parliament and participation of domestic interests (mainly the private sector and civil society) served to raise awareness and gather domestic support for the trade negotiations. In this respect, the media played a role in informing the wider public and promoting the public debate. The government's strategy stimulated a virtuous cycle of strong public-private interaction, communication strategy, media coverage and public debate.

Lessons learned and a general framework for other developing countries

Negotiations are won on a solid foundation of visionary leadership, high-calibre arguments and analyses, thorough understanding of national interests and strong co-ordination mechanisms within government and with a multitude of actors and stakeholders. This case study suggests that SA did quite well in most of these respects during its negotiations with the EU. However, with hindsight, key actors in the process on the SA side recognise that, in some areas, things could have been done differently.

Lesson 1: Better anticipation of the European decision-making process SA negotiators were not always prepared for the complexity of European decision-making related to the negotiating process. In particular, the EU's solid co-ordinated agenda and its strong institutional memory proved formidable elements of the EU strategy. First, while the European decision-making machinery needed time to get into gear, once a decision had been taken, it was very difficult to change. Secondly, the EU's institutional memory proved a strong asset throughout the negotiations. The EU side made extensive use of modern communication systems and digital data storage and retrieval, as well as statistical and technical data, to back up its positions. SA had no such system to call upon.

SACU member states have expressed criticism that they were hardly consulted throughout the TDCA negotiating process on issues that have major effects on their economic development.

Lesson 2: Proactively influencing the European negotiating mandate Once a mandate on trade negotiations is approved by EU member states – after a laborious and time-consuming process through various levels of the European machinery – there is little room for the Commission to move beyond that mandate. This meant that the EU mandate predetermined to a large degree the whole negotiating process with SA. However, it sometimes also served as a pragmatic negotiating tactic to limit the number of concessions the EU would have to grant to its negotiating partner. In this context, it would have been useful for SA to have invested more in lobbying the EU member states at the early stages of the discussion on the draft EU mandate, certainly *before* its finalisation and approval.

Lesson 3: Better integration of regional concerns and expectations SACU member states have expressed criticism that they were hardly consulted throughout the TDCA negotiating process on issues that have major effects on their economic development.

Lesson 4: Stronger focus on lobbying EU member states Except for the UK, and to a lesser extent Ireland and the Nordic countries, SA invested little effort in lobbying individual EU member states. At first, this seemed to be a wise decision to keep the process manageable. However, as the negotiations progressed, and certainly in the final stages, member states began to defend their own specific protectionist interests. For instance, Italy and Greece defended their wine and spirits industry. SA embassies could have played a role in lobbying individual EU member states in their capitals.

Lesson 5: Dealing with European negotiating 'power plays' The EU's discourse towards SA strongly emphasised equity concerns and a commitment to support post-*apartheid* development in the country. However, at the negotiating table, the EU proved a tough negotiator, strongly driven to defend its own economic interests using the whole range of negotiating tactics to exercise pressure on SA. The relatively young SA negotiating team was unused to such hard negotiating practices. With hindsight, it could have made a more effective use of the new democratic development process under way to obtain concessions.

Lesson 6: Readiness for the final stages of negotiations The final stages of negotiations require extreme prudence and vigilance to guarantee the best possible outcome. Some SA negotiators felt "it went too fast at the end" and that at that stage too quick concessions were made to the European side.

Lesson 7: Retaining capacity beyond the negotiations Trade negotiating capacity is very vulnerable. Though the process of building capacities can be a long haul, capacities can be lost quickly. This is precisely what seems to have happened in SA, with key officials moving to different functions within the government or simply leaving the public sector.

A framework for the preparation of the negotiation process

Using the SA experiences as a model for other developing countries, a number of points can be made. Foremost is that a comprehensive strategic framework should be in place before embarking on trade negotiations. A number of basic questions can help to guide the creation of this framework, preparing negotiators for the process at hand.

What? What issues should be covered and which should be left out? What are the implications for the economy, for the social development of the country, for domestic strategy and for international relations and commitments with other countries, regions and the multilateral systems? What are desirable outcomes for the negotiations?

These questions should be asked not only in preparing for the negotiations but also throughout the negotiation process. Answers must be updated constantly to ensure that the approach adopted is coherent.

How? How should the issues identified for negotiation be addressed and how can potential negative effects be mitigated? Responding to the 'how' question implies development of a negotiation strategy and tactics in accordance with key national objectives. These will have to be constantly adjusted during the negotiations, as strategy and tactics are not static concepts. Lessons must be learnt and approaches adapted. Possible supporters for the domestically agreed positions will also need to be identified, both within the region and internationally.

Who? Who should participate in the negotiations and, in particular, which domestic institutions should belong to the core group preparing and conducting the talks? Relevant institutions may include a co-ordinating body, ministries, and representatives from the business community, agricultural interests, trade unions and social actors such as civil society, think-tanks and research institutions.

With whom? To conduct successful negotiations, it is important to know the negotiating partner: their agenda, institutional arrangements, negotiating mandate and political, economic and social conditions. Understanding the strengths and weaknesses of the partner and the partner's room for manoeuvre can be invaluable at the negotiating table.

Where? Where refers not only to the physical place where the negotiations take place but

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also to where regular updates and experience-sharing exercises will be held at the national level. Monthly meetings can be organised with the main protagonists in the negotiations to keep all concerned up to date on each stage of the negotiations. Such consultation and sharing of information may enable negotiating parties to uncover possible trade-offs, usually within sectors, but also across issues at times.

When? The timeframe of the negotiations constitutes a key ingredient for success. Clear understanding must be reached with the partner as to when the negotiations will start. Internal milestones must be identified to allow adequate preparation at each stage. Negotiators must understand the time constraints and pressures faced by the partner and adjust the negotiating strategy accordingly.

Conclusion

No preparation for international trade negotiations can ever be entirely satisfactory. In fact, improvement and adaptation of any strategy should always be sought. Nonetheless, SA's experience illustrates that, despite numerous constraints and drawbacks, it is possible to prepare adequately for trade negotiations, even with a partner that is economically and politically more powerful.

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(Sudworth is already in - in fact, it's the last ref currently for that article - so this just shows the order of the references.)

TIPS SEMINAR SERIES

Trade and Poverty Roundtable

The SA Institute for International Affairs (SAIIA) and Nedlac, in partnership with TIPS, are hosting a bi-monthly **Trade and Poverty Roundtable Series** in 2005 as part of a broader SA Trade and Poverty Programme (SATPP) initiative funded by the Department for International Development (DFID). The object is to promote informed dialogue on trade policy formulation processes by providing a platform where government, business, labour and broader social interest groups can exchange views on issues related to trade policy.
The first seminar, with a focus on trade policy and poverty reduction in SA, took place on 27 January at Nedlac. Discussions were based on the DFID *Trade and Poverty Handbook*, and was led by Matthew Stern, director of USAID's Support for Economic Growth and Analysis Project.
For details on the next seminar, discussion points and potential presenters and participants, please visit www.tips.org.za/events/.

The future of trade preferences

The Third Annual Southern African Trade Research Network (SATRN) symposium[1] "Policy Space and Implementation of World Trade Organisation Agreements" was held in Windhoek, Namibia, from 17 to 19 November 2004. The main objective of the symposium was to identify the type of policy space required by SADC countries to achieve their development objectives within the WTO disciplines. TIPS economist **Mmatlou Kalaba** reports on the key issues discussed – improving special and differential treatment (SDT) in the WTO, implementing WTO Agreements, rules of origin and the erosion of trade preferences – in an attempt to drive economic development and further integrate developing countries into the global trading system.

The nature of preferential trade arrangements

The subject of trade preferences (where developed countries offer developing countries preferential market access through lower duties) is particularly relevant since it coincides with debates around the Economic Partnership Agreements (EPAs) between seven SADC members and the EU. However, although trade preferences for developing countries have been a feature for nearly four decades, with overall trade liberalisation, preferences are gradually losing importance.

The US offers preferences to developing countries under the Generalised System of Preferences (GSP) and the African Growth and Opportunity Act (AGOA). The GSP – instituted in 1976 and designed to promote economic growth in the developing world by preferential duty-free entry for more than 4,650 products from 144 designated beneficiary countries and territories – was extended to the 70 ACP countries. AGOA was introduced in 2000, and since then 48 sub-Saharan African countries have been granted preferences to the US market. Furthermore, AGOA grants duty-free preferences to clothing products, although specific rules govern the granting of preferences for clothing. It has been extended till 2015.

The EU offers preferences under the GSP and the Cotonou agreement. In 2001, the EU introduced the Everything But Arms (EBA) initiative, which grants duty-free access to imports of all products from Least Developed Countries (LDCs) with the exception of arms and munitions. Japan offers trade preferences under the GSP for to 164 developing countries.

[1] Participants included senior policy-makers from SADC member states; the SADC Secretariat; the Common Markets of East and Southern Africa (Comesa) Secretariat; SADC delegates based in Geneva and Brussels; researchers from SADC countries; and international trade experts from the World Bank, the Food and Agricultural Organisation (FAO), the United Nations Development Programme (UNDP) and the United Nations Conference on Trade and Development (Unctad).

Why are preferences depreciating?

For most of SADC and other developing countries, preferences have not been a major success as a development tool. A major problem is that preferences decline in value over time. Other reasons why gains are not realised include:

- Most Favoured Nation (MFN) duties are already low for most products from developing countries and therefore preference margins are zero or low.
- For SADC countries, the erosion of trade preferences is aggravated by the extension of the number of beneficiaries to other states, such as those of the former USSR.
- Rules of origin reduce the value of the preferences because of their complex nature and thus increase compliance costs.
- Preferences are not legally binding, which means developed countries can withdraw them unilaterally.
- In cases where there are significant benefits, they are concentrated in a handful of products and countries.
- Trade preferences have done little to stimulate export diversification.

Limited benefits

However, trade preferences can have some benefits for the exporting countries concerned. Potentially they can help developing countries to support economic development if they enabled industries to adjust and compete effectively in global markets. Furthermore, preferences can play an important role in low-income and small countries that are unlikely to benefit significantly from global liberalisation. Preferences are also potentially valuable in cases where MFN tariffs are still high, although this is more relevant in the short to medium term since MFN tariffs are in the process of being reduced. In essence, trade preferences should not be seen as a solution, but rather as part of a strategy for export-led growth.

What needs to be done?

There are a number of options to be considered to preserve the future of trade preferences. Some of them are to:

- Liberalise rules of origin and simplify the process of certifying compliance.
- Compensate for the erosion of the preferences margin, although this may prove highly complex.
- Define preferential tariffs relative to MFN tariffs rather than in absolute terms.
- Shift more towards 'aid for trade'.

Trade preferences and EPAs

For SADC and Comesa countries taking part in EPAs, it is important that they assess the impact of preferences on their economies. EPAs can be used to preserve preferences, protect funding from the EU and simplify rules of origin. However, unlike preferences, EPAs have reciprocity elements and are therefore associated with tariff revenue losses from EU imports, increased competition for domestic sectors and possible trade diversion. Furthermore, countries need to consider what they can achieve through EPA negotiations against MFN liberalisation.

Symposium outcomes

The symposium enhanced participants' understanding of special products and special safeguard mechanisms, preference erosion and rules of origin by pointing out:

- The complexity associated with and threats arising from applying special and differential treatment to developing countries at various levels of development
- The need to go beyond general product categories to tariff line-specific level when analysing preference erosion, impact of rules of origin, tariff reduction, etc.
- The importance of weighing negotiating approaches (multilateral or bilateral) on special and differential treatment.
- The importance of taking into account the interests of preference-giving countries, preference-receiving countries and non-preference beneficiary countries prior to analysing the impact of preference erosion.
- The possibility of using the common customs area definition to apply special and differential treatment in regions within a country.

Counting the cost of red tape for business in SA[1]

In November 2004, the **Small Business Project** (SBP) published a ground-breaking new report on regulatory compliance cost in SA. The SBP study – the first comprehensive survey of its kind in SA – covers regulatory compliance costs from large corporations through SMEs to the informal sector. Based on a costing of the time spent and professional fees paid to meet regulatory requirements, SBP estimated that compliance costs across the economy were about R79bn a year – equivalent to 6.5% of GDP – a high ratio when compared to that in developed countries. The study found that compliance costs also disproportionately affect small business. SBP says that in firms with sales of less than R1m, compliance cost 8.3% of turnover. In firms with sales of R1bn or more, it cost 0.2% of turnover.

Introduction

Organised business and the SA government agree that it is necessary to create an enabling environment which spurs economic growth and job creation. The SBP study provides strong research-based evidence with which to take forward the discussion about how to achieve a regulatory environment that will be most conducive to the private sector's optimal performance, particularly for small and medium-sized businesses (SMEs). The study is also a valuable point of reference in the growing debate around the institutionalisation and use of regulatory impact analysis in SA.

The rewards of an improved regulatory environment are large. A 2002 study of 10 developing countries, including SA, by SBP and Bannock Consulting concluded that an appropriate regulatory environment was the single most important element in an economic growth strategy. A 2004 World Bank study has found that many developing countries could improve their annual growth rates by as much as 1.4% if they created a world-class regulatory environment for business. Though SA has a better regulatory system than many developing countries, improving the regulatory environment could have a significant impact on its economic prospects too.

A 2002 study of 10 developing countries, including SA, by SBP and Bannock Consulting concluded that an appropriate regulatory environment was the single most important element in an economic growth strategy.

Improving the regulatory environment will take hard work, and excellent information. However, unlike improvements in education or health, results can be seen relatively quickly. Moreover, the socio-political costs of much regulatory reform are low. Well-informed, well-designed regulatory reform presents an opportunity to accelerate growth and development that SA cannot afford to miss.

Efficiency costs and compliance costs

Between February and June 2004, a total of 1,794 businesses throughout the country were interviewed in depth, making this the largest survey of its kind undertaken anywhere in the world. Respondents ranged from corporations on the top 200 list to enterprises in the informal sector. The survey covered all the sectors of the economy, including manufacturing, mining, construction, trade, agri-business and services.

Regulations are vital to the fair and sustainable working of market economies, but even the most socially necessary regulations create costs as well as benefits, and some of these costs may be unnecessarily high. It is very important to distinguish between a regulation and the costs created by complying with it. For instance, health and safety regulations are unarguably essential. This does not mean, however, that we should accept the current level of associated regulatory costs as fixed. It may well be possible to reduce the costs of complying with regulations without reducing their benefits. Reducing regulatory costs can be very beneficial – studies by the World Bank covering 145 countries have demonstrated that countries with higher regulatory costs have larger informal sectors, more unemployment, and slower growth.[2]
SBP's survey looked in detail at two kinds of regulatory costs faced by the private sector: efficiency costs and compliance costs.[3]

Efficiency costs arise because regulation may distort market outcomes. If employment is discouraged by inappropriate labour market regulation, for example, the costs of the resulting unemployment in terms of lost output and incomes are an efficiency cost. Other examples of the efficiency costs of regulation would be a business's decision to restrict output to keep sales below the Value-Added Tax (VAT) threshold, or an inability to compete in an export market because the costs of complying with regulations have made a product too expensive.

The efficiency costs of regulation are usually by-products of contested political processes. Often, difficult political choices have to be made if they are to be reduced.

Compliance costs are pure red tape costs: that is, they are the incremental costs incurred by business in the course of complying with regulations. They include the value of time spent by business managers and staff on understanding the rules and applying them; interacting with the authorities to clarify matters arising; and the payments made for the expertise of professional advisers, such as consultants, lawyers, and accountants. For instance, the costs of tax paperwork are compliance costs, while the tax payments themselves are not. Capital costs of compliance, such as those for effluent or smokestack equipment, were excluded from our study.

For informal sector enterprises only, questions were also asked about the costs arising from harassment by police and others, and of bribes. These we term the costs of non-compliance.

In contrast to efficiency costs, compliance costs are usually not the result of conscious political choices. This means that reducing some of the compliance costs of regulation can be a relatively quick, easy and uncontroversial process.

[1] This headline report was prepared by a team led by Chris Darroll, and comprising Graham Bannock, Lawrence Schlemmer, Luqman Ahmad, Simon Dagut, Kerri Hampton and Douglas Irvine. The survey was conceptualised by SBP, which commissioned MarkData (Pty) Ltd to devise the sampling and carry out the field work and computer analysis. For the full report, including an appendix setting out the survey method, please contact SBP at tel: +27 11 486 0797 or via e-mail: info@sbp.org.za, or visit their website: www.sbp.org.za.

[2] World Bank, Doing Business in 2005: Removing Obstacles to Growth, Washington, 2004.

[3] Regulation also results in costs for government both as it applies to government's own activities (as in the case of employment law) and in the costs of staff engaged in administering the regulations themselves. Costs to the public sector have not been measured in this study. Evidence from the UK suggests that the cost of administering regulations is equivalent to around 20% of the cost of complying with them.

This study provides a great deal of significant information about the ways in which SA businesses experience the efficiency costs of regulation. These are important results, but they are not unique. Though this study is distinguished by its scale, depth, representivity and specific focus on regulations, there have been several other surveys which have covered similar ground in asking questions about how business owners and managers perceive the investment climate and the regulatory environment.

What makes SBP's regulatory cost study uniquely valuable is that it provides hard data on compliance costs. For the first time in SA, we have quantitative information about how much red tape actually costs businesses. We now also have a much clearer picture of the precise incidence of regulatory compliance costs.

It might be thought that business people would be tempted to exaggerate the costs of regulation. This is certainly possible, partly because smaller and more vulnerable businesses might overstate the extent to which they actually comply with regulations in an interview.

Some large businesses with many subsidiaries might, in the absence of detailed information at headquarters, also overstate their regulatory costs. Equally, however, the bias could go the other way. For example, our researchers found that respondents overlooked whole areas of minor (but cumulatively significant) regulatory costs because each small cost appeared trivial in comparison with more conspicuous regulatory requirements. Moreover, any bias in estimation will have been more than compensated for by our adoption of conservative assumptions in grossing up from the sample to business as a whole, and by our exclusion of the capital costs associated with regulatory compliance. We consider, therefore, that our results are under- rather than overstated.

It is important to note that we have not attempted to measure the benefits of regulation. Our estimates of compliance costs are gross of the benefits accruing to individual firms or to society in general. Clearly, the benefits of regulation are often substantial, but these are usually far better understood than their costs. It is therefore appropriate to focus research effort, at least in the first instance, on regulatory costs.

Business perceptions of constraints on growth and regulatory costs

At the outset, our survey sought to elicit open-ended responses about the business environment. The objective was to let respondents put regulatory issues in a broader context before asking detailed questions about regulatory costs. Respondents were aware that regulatory issues were the main focus of the survey, but by probing for second and third responses, the interviewers neutralised any possible overemphasis of regulations. The answers were unprompted, and respondents were expected to state which three issues were uppermost in their minds.

The first question was: What factors of any kind prevent or discourage a business like yours from expanding its operations? The results are presented in Figure 1.

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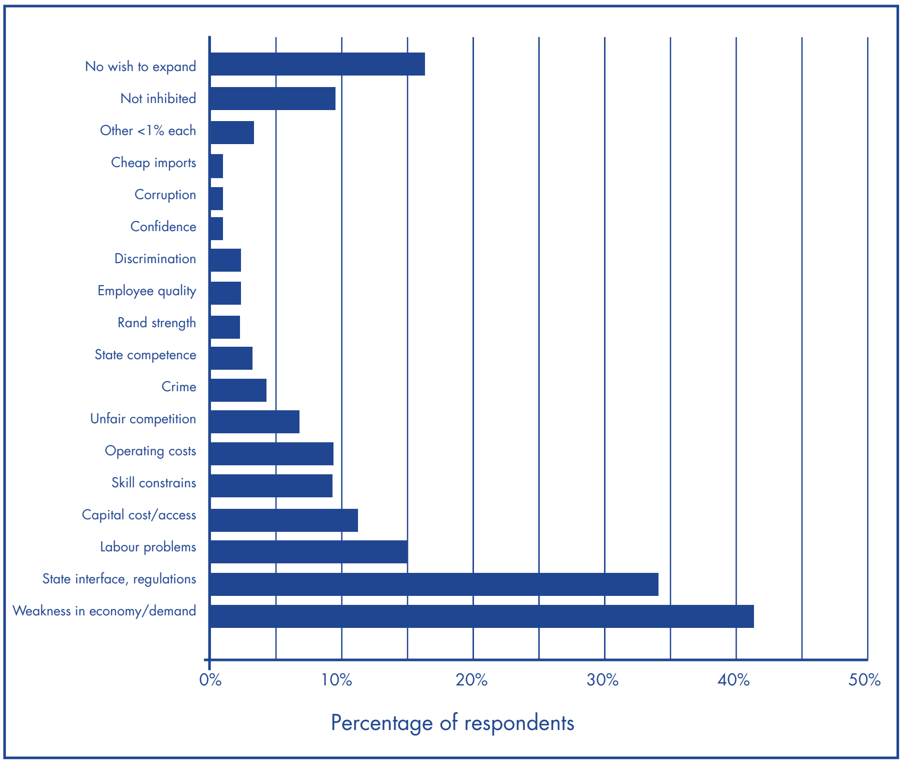
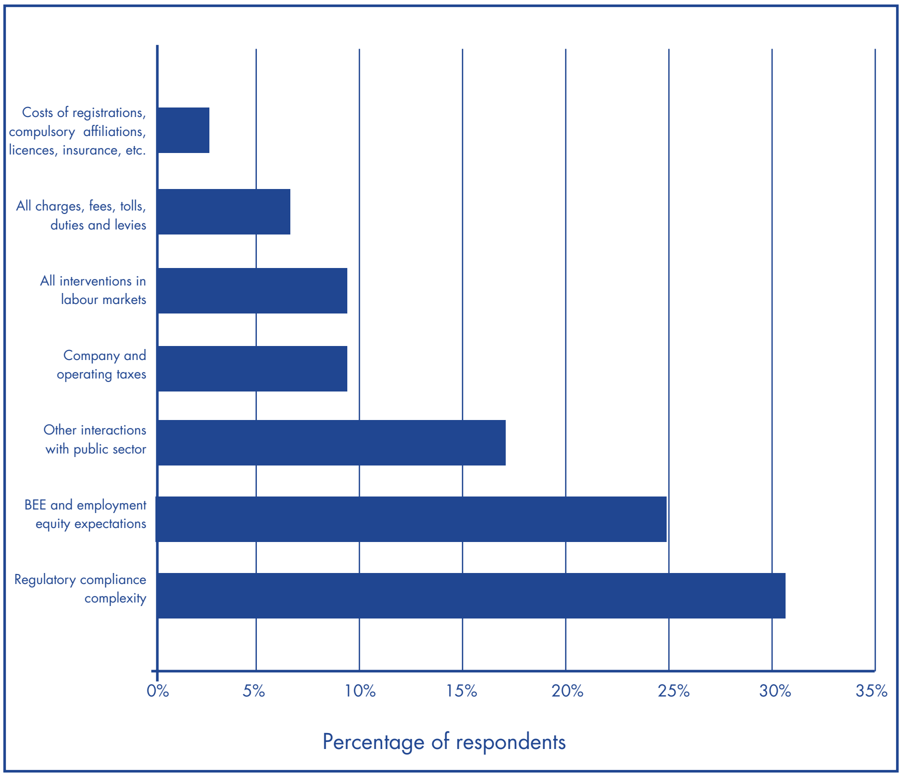
Figure 1: Factors inhibiting business growth



[Note: Percentage exceeds 100 because many respondents gave more than one response. The results in figures 1 to 7 are based on the main integrated sample. See technical appendix for details.]

Figure 2: State interface – constrains on growth



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A wide range of factors is perceived to limit growth. Of the constraints mentioned, two stand out: weakness in the economy, or a lack of demand; and a range of factors resulting from the state's interface with business. These two factors are ahead by some way of the third and fourth: labour problems and affordable access to capital.

Figure 2 breaks down the growth-inhibiting factors that arise at the state interface. It can be seen that respondents perceive these as entailing efficiency costs, except for the single largest category, which is the pure red tape of regulatory compliance. Regulatory compliance costs are followed by black economic empowerment (BEE) issues (which have yet to make their full effect felt). Labour and taxation issues are also significant.

A detailed analysis of the responses by sector shows that relatively speaking, the impact of state-induced constraints is greatest in transport, services, and tourism (the last-named arguably the single most important growth sector), and least in retailing and wholesaling.

Manufacturing, also a key growth sector, emerges as slightly above average in terms of constraints originating at the state interface. These constraints are, in the perception of respondents, greatest for the largest enterprises, and least significant for micro enterprises.

Figure 3 summarises the pattern of responses on constraints on increased employment. Again, a lack of confidence or demand in the economy attracted the most mentions, followed by labour laws, and government regulations in general. Some of the other factors, such as hiring and firing difficulties, employment equity, and various employment-related costs, are heavily influenced by government actions. The responses generally give the impression that regulatory costs – of both the efficiency and compliance varieties – are an important reason why SA businesses are reluctant to hire more staff.

Further evidence about the efficiency costs of regulation comes from responses to one of the last questions in the survey: Thinking of other businesses like yours in general, what things are done to avoid the costs of regulation?[4] The responses are summarised in Figure 4.

A large minority of 35% did not think it possible to avoid regulation. The majority did think it possible, and believed that reducing employment or curtailing business growth would be the most common way to avoid complying with regulations. Both are very significant efficiency costs.

[4] The question was phrased in this way to avoid putting pressure on respondents to admit to avoidance in their own business.

The regulatory framework

There is no comprehensive database of regulations in SA. Although regulatory powers and responsibilities are conferred by legislation, the detailed interpretation of these powers into specific rules and requirements takes the form of ministerial orders, departmental guidance notes and other instruments issued by central, provincial and local governments and their agencies.

These are nowhere brought together. Right from the beginning, a new enterprise with a turnover of more than the VAT threshold (R300,000) will have to comply with nine separate registration requirements, involving contact with five different central government offices. Thereafter, the business will face a large number of other requirements. These cross-cutting measures affect businesses of every kind. In addition, almost every sector of the economy has regulations specific to its

Figure 3: Constraints on increased employment

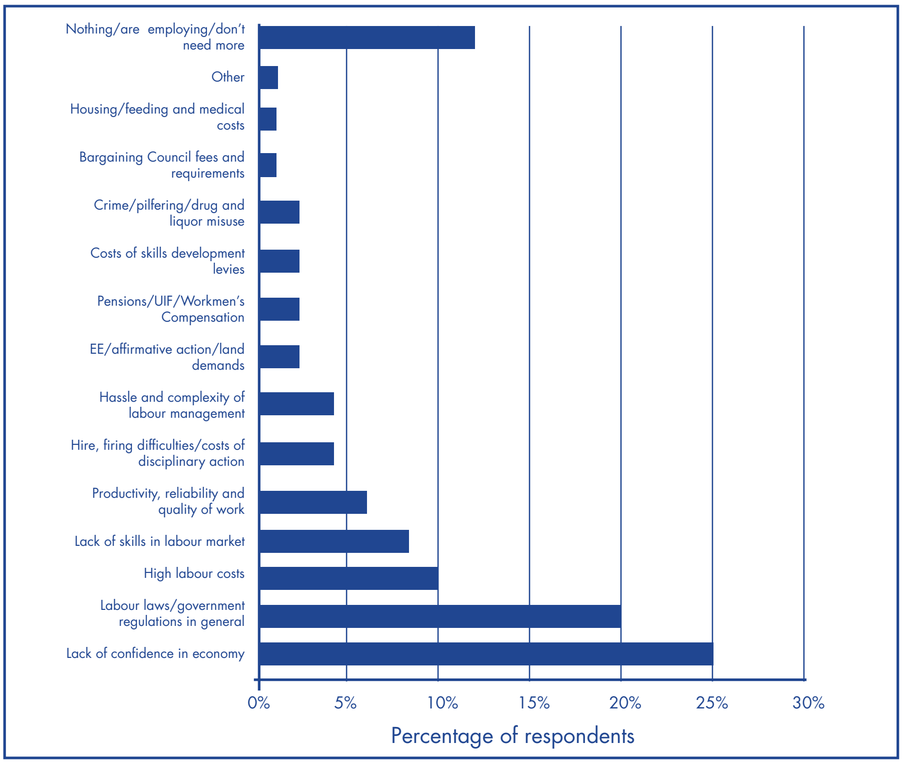
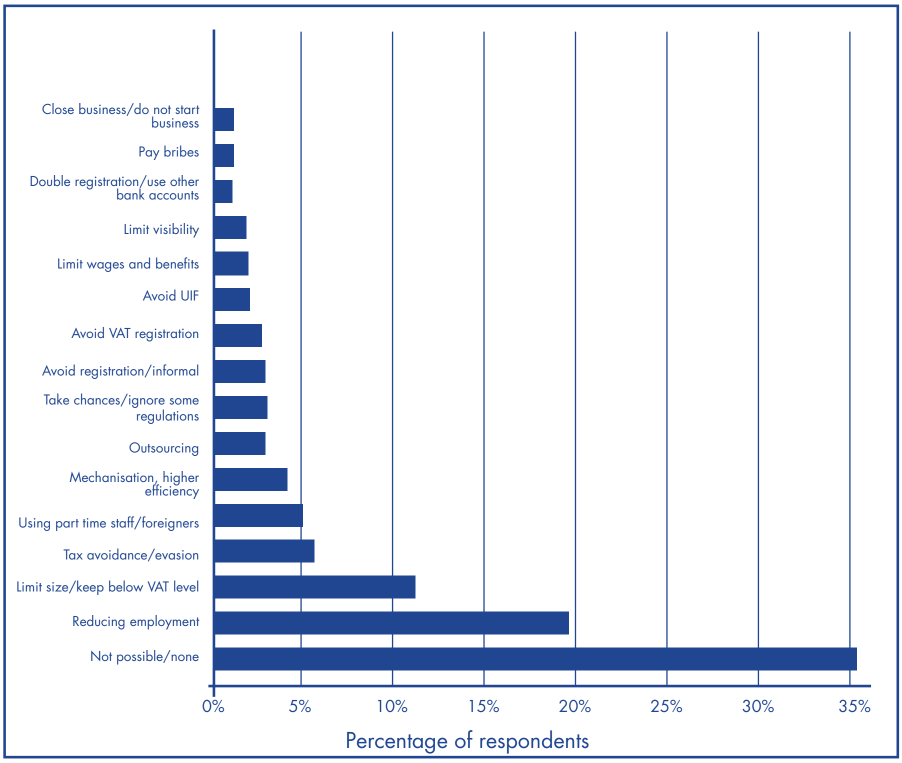


Figure 4: Ways of avoiding regulatory compliance



type of operations. Examples include labelling requirements for foods and pharmaceuticals, construction and use regulations affecting motor vehicles, and prudential regulations for banks and other financial institutions. Businesses may also be required to comply with provincial and municipal regulations affecting, for example, zoning, signage, licensing, and local rates and taxes.

Businesses have to spend time learning which regulations apply to them, complying with them, and keeping up to date with changes. Larger firms in particular need to comment on proposed and current legislation and regulations as part of the process of consultation with government. Many businesses are also obliged to spend time collecting information, often highly detailed, to respond to compulsory questionnaires from Statistics SA.

Respondents were asked to name the three regulations found to be most time-consuming, costly, and troublesome. Figure 5 gives the rank order as a percentage of all responses. VAT was cited in 19% of responses, and this, with other tax-related issues (PAYE and SARS together totalling 20% emerged as the most problematic regulations. Labour laws were mentioned in 12% of the responses, and SETA Secter Education and Training Authority and RSC Regional Service Council levies in 11%. No other issue attracted a mention in more than 5% of the responses.

It is interesting that socially important issues, such as health and safety (3%) and empowerment (2.5%), were not prominent, and environmental issues did not figure at all.

Respondents were asked whether the real costs (that is allowing for inflation) of complying with official regulations had decreased, increased, or remained constant. Overall, 76% of respondents thought regulatory costs had increased over the past two years, and 80% thought they had increased over the past 10 years. Asked about the future, no less than 83% expected costs to increase. These views were remarkably similar between sectors: only in agriculture did less than 74% of respondents perceive an increase over the past two years. For the past 10 years, again excepting agriculture, 80% or more of respondents in all sectors perceived an increase. The pattern of responses was somewhat more variable by firm size band, with 64% of the smallest firms and 95% of the largest firms indicating an increase over the past two years.

The compliance costs of regulation

Respondents were asked to estimate the value of time spent and outsourced costs incurred in complying with regulation over a year. These questions were asked for each of the eight categories of regulation as listed in Table 1.

Figure 5: Most time-consuming and troublesome regulations

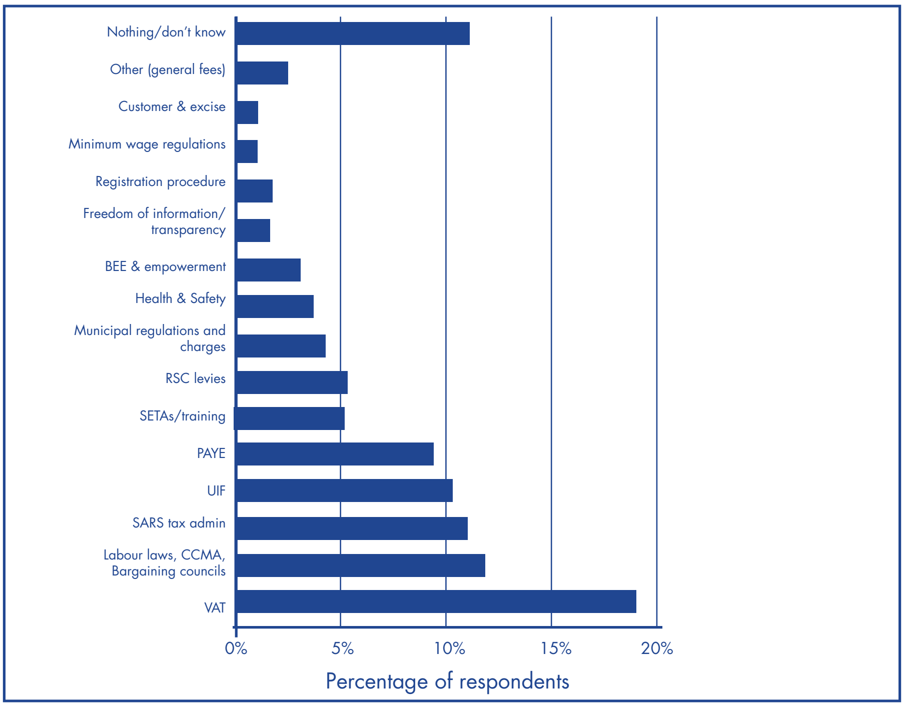


Table 1: Average estimated annual administrative, manpower, supervisory and professional costs of regulatory compliance: means for the range of applicable state regulations

Type of regulation	Mean costs
Company registration (initial)	R9 371
Professional fees	R6 107
TOTAL	R15 478
Company registration (annual)	R6 262
Professional fees	R3 388
TOTAL	R9 650
Tax compliance	R15 709
Professional fees	R11 589
TOTAL	R27 298
Labour and employment	R11 735
Professional fees	R6 557
TOTAL	R18 292
Employment equity/empowerment	R5 525
Professional fees	R6 835
TOTAL	R12 360
Additional regulations	R18 866
Professional fees	R3 241
TOTAL	R22 107
Government information	R6 389
Professional fees	R2 283
TOTAL	R8 672
Local government regulations	R5 542
Professional fees	R1 253
TOTAL	R6 795
Overall mean costs of compliance per firm	R120 652
Mean recurring costs (Initial registration excluded)	R105 174

Note: Some respondents were unable to break down costs between all the categories. These costs, amounting to 4.6% of the total, were allocated to categories in line with the average for other respondents.

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Figure 6: Breakdown of recurring compliance costs

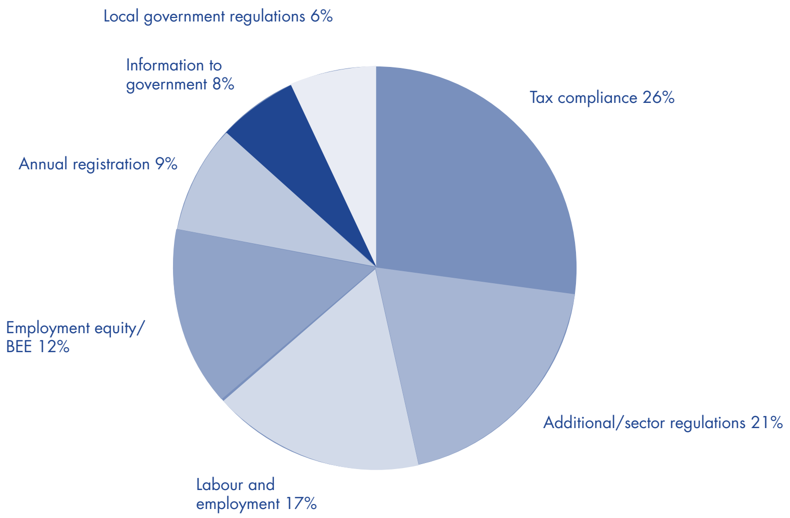


Table 2: Recurring regulatory compliance costs by type of regulation and enterprise turnover band

Type of regulations distributions of recurring costs	<R1m	R1m-<R5m	R5m-<R10m	R10m-<R25m	R25m-<R100m	R100m-<R500m	R500m-<R1bn	>R1bn
Ongoing registration	16.1%	11.9%	7.9%	12.1%	5.5%	9.8%	1.2%	6.7%
Tax compliance	34.7%	45.6%	34.9%	32.8%	31.6%	12.1%	22.8%	11.5%
Labour/personnel	14.7%	9.1%	15.2%	23.7%	14.1%	24.3%	16.2%	19.5%
Employment equity/ empowerment	7.1%	7.4%	12.6%	10.3%	22.1%	14.9%	9.7%	14.6%
Additional regulations	6.1%	6.5%	9.1%	5.8%	11.0%	22.4%	10.8%	38.2%
Statistical returns	9.2%	9.7%	8.5%	11.4%	9.5%	12.2%	17.2%	6.6%
Local government requirements	12.0%	9.8%	11.8%	3.9%	6.3%	4.3%	22.2%	2.9%
Recurring costs	R32 482	R54 766	R66 311	R159 913	R286 109	R675 286	R891 854	R2 314 727

Figure 7: Annual regulatory compliance costs as a percentage of turnover

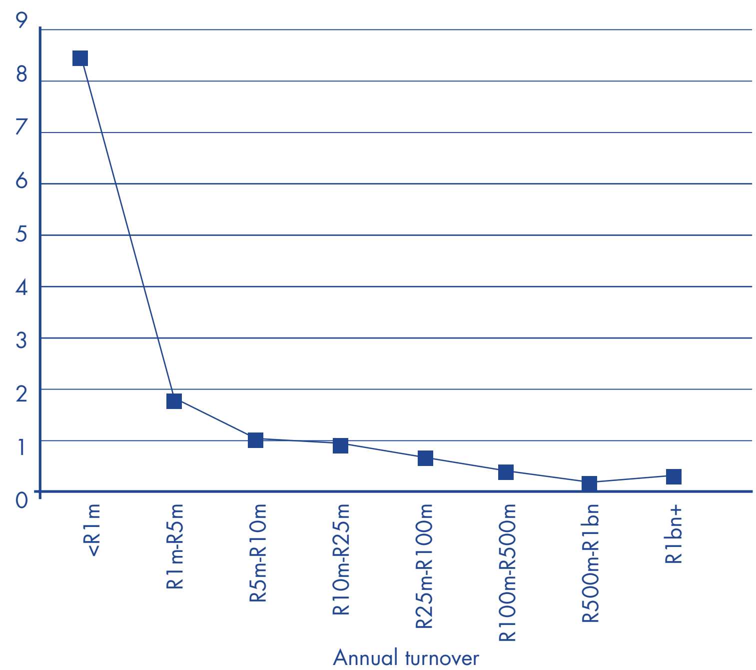


Table 1 shows the mean (average) costs for all respondents – a cross-section comprising 1,140 firms – in eight categories of regulation. Average total recurring compliance costs per firm, excluding initial registration, were R105,174 for all sizes and sectors.

Figure 6 shows that the largest element in this total of R105,174 is tax compliance, followed by additional (other) regulations, including elements specific to certain kinds of business. These two categories are followed by labour-related compliance costs and by initial registration requirements (a non-recurring cost), with annual registration costs being considerably lower. Employment equity/ empowerment is fifth, followed by government information (for example, responding to statistical inquiries), and last, local government requirements.

Viewed sector by sector, the data show that the tourism, manufacturing, mining, power and water sectors bear the heaviest mean burden of compliance costs, followed fairly closely by transport. It should be noted that these variations are affected by the different average size of operations. Taking average firm size per sector into account, tourism and manufacturing; mining, power and water; and the service sector are still relatively heavily regulated. It is difficult to generalise about differences in the percentage breakdowns of average costs, but additional regulations (largely sector-specific) contribute above-average proportions to the total in manufacturing, mining, power and water, and especially in tourism. Labour and empowerment issues, taken together, assume relatively large proportions in transport, manufacturing, mining, power and finance. Local government requirements are a small proportion of the total in all sectors. They are, however, relatively high in trade and services.

The relative importance of different types of regulation to total compliance costs varies with firm size. Table 2, which includes recurring costs only, gives total costs and their breakdown by regulatory category for each enterprise size band. Tax compliance costs are much larger proportions of the total for the smallest firms: 34.7% for those with compliance costs of less than R1m, compared to 11.5% for those with compliance costs of more than R1bn. By contrast, labour regulations are somewhat less important for smaller firms: 14.7% of the total, compared to 19.5% for larger firms.

The incidence of compliance costs is sensitive to firm size in another very important way: while big firms have the largest costs absolutely, in relation to their size small firms bear the heaviest burden. For example, the 20 firms in our sample with a turnover of more than R1bn incurred costs of R23m each on average. However, when set against the massive scale of their operations, a different picture emerges.

Figure 7 shows compliance costs as a percentage of turnover for each turnover size band. The ratio of compliance costs to turnover drops fairly smoothly as firm size increases, from 8.3% for the smallest size band to 0.2% in the largest. This pattern reflects the fact that there are economies of scale in regulatory compliance. Certain basic costs, such as those for licensing or registration, are fixed and borne by all firms, but are spread over more turnover for the bigger firms. In addition, large firms are better placed to absorb these costs, given their higher turnover. Large firms manage compliance costs by employing in-house specialists.

Regulatory costs clearly impact disproportionately on small firms. Average compliance costs per person employed for firms with fewer than five employees are 10 times higher than for a firm with 200 to 499 employees.

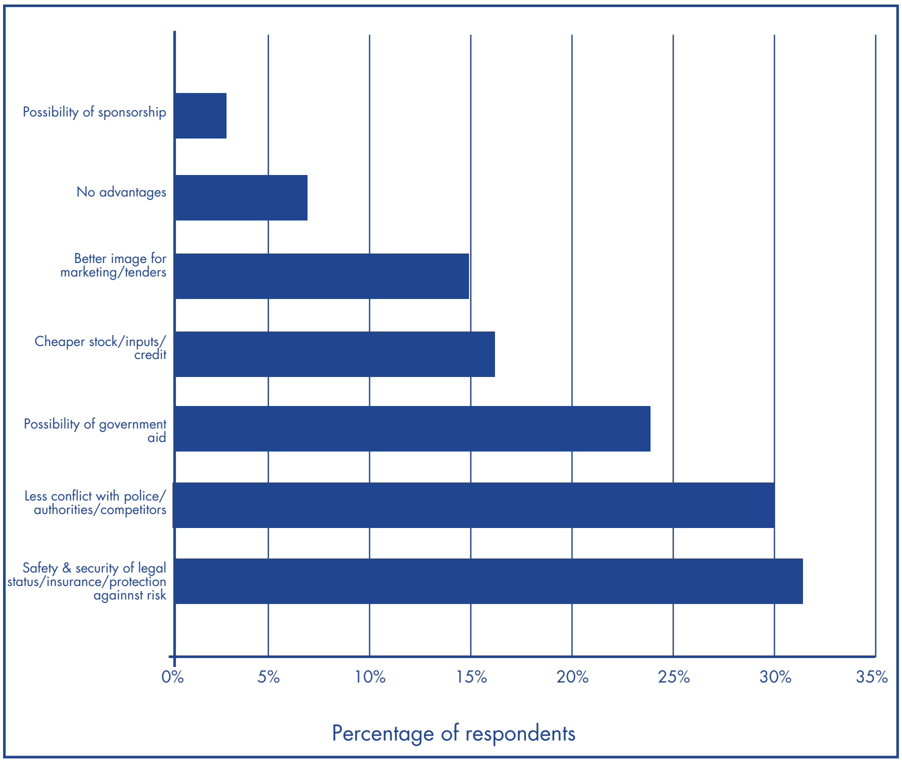
The informal economy

The results considered so far have not included the informal sector in SA. This sector employs about two million people, so it is essential to rectify this omission as far as possible despite the obvious difficulties in gathering comprehensive and reliable data on the informal economy.

The conventional wisdom that the informal sector is dominated by survivalists is questionable. Although most informal businesses are indeed tiny, the sector is very diverse and includes some fairly substantial operations. Furthermore, 57% of the informal sector operators in our sample said that they would prefer to run their own business rather than take a job. This sector is a reservoir of entrepreneurial energy and experience that could be harnessed for the further development of the economy and the alleviation of poverty.

By definition, the informal sector is excluded from most of the regulatory system. But this does not mean that it is unaffected by it. First, informal enterprises are often subject to harassment, and some are forced to pay bribes to be able to stay in business. These are the costs of non-compliance as distinct from the compliance costs borne in the formal sector. Secondly, formal status is necessary for fuller access to credit, supplies, markets, secure premises and so on. The high compliance costs and tax regime in the formal sector act as an insurmountable barrier for most informals seeking to grow. Our special survey of informal businesses provides evidence on both these points, and reveals some surprising facts about the sector.

Figure 8: Advantages of registration



Many of the 150 informal enterprises in our countrywide sample were young and still vulnerable to failure. The median average age of the enterprises was about 3.5 years.[5] About half the informal businesses consisted of the entrepreneur on his or her own, the rest having between one and five employees. About three-quarters of the firms were in retail and personal services (catering, fruit stalls, hairdressing) while a quarter were in repairs, small manufacturing, transport, and other activities. The firms were mostly very small, with a median sales turnover of only R8,482, although 8% had annual sales of R50,000 or more, and 3% sales of R100,000 or more.

Firms outside retailing and personal services had twice the sales, and a larger proportion said their business was expanding. Some firms did have permits and licences to operate at a particular place, and for these the average costs were R225 a year (2.6% of their sales turnover in terms of medians).

Respondents were asked whether or not officials had interfered with their operations in any way, and some 28% indicated that this had occurred. Among that 28%, 62% had had stock confiscated or destroyed, 19% had been prosecuted and fined, and 17% had been ordered to close or move on. 10% had been asked to pay bribes. The median bribe payment was R225 per bribe, small but significant in relation to a median turnover of R700 a month.

Respondents were well aware of the advantages of formalisation. As Figure 8 shows, these were identified as: less harassment (30%); cheaper stock/inputs and credit (17%); the possibility of government aid (24%); and a better image for marketing and tenders. Almost half of the sample (45%) was considering registration, but clearly the disadvantages weighed heavily against it. Among the perceived disadvantages were: taxes (38%), costs in relation to rewards (22%), and red tape (7%), though 24% thought that their present compliance was sufficient, or saw no disadvantages in informal status.

Conclusions

Efficiency costs in the formal sector

It is clear from our survey results that regulation creates very significant efficiency costs in the SA economy. There is strong evidence, echoed by many other studies, to show that features of the regulatory environment discourage business growth and job creation in the formal economy.

Regulatory obstacles to the informal sector

Our research has also shown that, even though regulations may not be enforced in the informal sector, the regulatory environment acts as a barrier to development by keeping a large, energetic, and entrepreneurial group of black South Africans out of the formal economy. From the perspective of informal operators, the regulatory environment is a cliff – they stand at the base, very aware of the advantages of reaching the higher ground, but equally aware that the cliff is too steep to be climbed.

(continued on page 22)

[5] The median is the value at the midpoint of a sample of values ordered by size. We make extensive use of medians rather than arithmetic averages in analysing the informal sample because they are far less influenced by extreme values.

(continued from page 21)

Table 3: Estimated regulatory compliance costs in some developed countries as a percentage of GDP

Australia	3.0
Austria	3.8
Belgium	1.8
Finland	1.0
Iceland	1.3
New Zealand	2.8
Norway	2.8
Portugal	5.0
Spain	5.6
Sweden	2.2

Regulatory compliance costs

The unique contribution of SBP's survey has been to show that regulatory compliance costs are substantial, and to specify with some precision what these costs are in SA.

Based on the average recurring compliance cost per firm of R105,174 and our conservative estimate of 750,000 as the number of firms affected, we estimate that aggregate recurring compliance costs for the formal sector amounted to R78.9bn in 2004 – an amount equivalent to 6.52% of GDP.
It is clear is that the aggregate of resources spent by formal business in SA on regulatory compliance is very large. These costs represent real resources, which have alternative uses. Businesses could employ the resources now used in complying with regulation for innovation and expansion, or improving their local and international competitiveness.

The government could use some of the cost savings (and some of the income generated by the private sector in the rounds of spending and production stimulated by these savings) to improve public services or to reduce taxation. Moreover, countries that reduce their regulatory compliance costs increase their attractiveness to FDI.

It is worth reiterating that reducing the compliance costs of regulation does not pose the same kinds of political challenges or require the socio-political trade-offs as would reducing their efficiency costs. Simplifying procedures, making forms available online, and rationalising multiple requests for information or for proof of tax compliance could all make a significant difference to compliance costs without raising the hackles of any important interest group.

Compliance cost studies: international comparisons

It is not possible, based on existing data, to make systematic comparisons of compliance costs across countries. While there have been a number of studies, their coverage and methods differ so much that to compare the results too closely would be misleading. Nevertheless, it is interesting to look at SA's 6.52% of GDP in the context of the available international comparisons.

During 1998 to 1999, the OECD[6] carried out a postal questionnaire compliance cost survey of between 300 and 1,200 businesses with fewer than 500 employees in eight European countries, Australia and New Zealand. The basic approach was similar to that used in our survey, though only tax, employment, and environmental regulations were covered. The study also excluded businesses in agriculture and mining, as well as those without employees.[7] The key results in terms of compliance costs as a percentage of GDP are shown in Table 3.

Compliance cost surveys for developing and transition countries still seem to be quite rare. A very small-scale survey in Bulgaria among 20 firms with fewer than 100 employees suggested that compliance costs were of the order of 5% of GDP. A similar exercise in Jamaica put compliance costs for firms with fewer than 10 employees at 3% of GDP. Another, in Uganda, put them much higher – as much as 11% of GDP for all firms.

Towards regulatory impact analysis

Many regulations are obviously necessary. But even among necessary regulations, there are probably many which are unnecessarily expensive to comply with. There are likely to be many other regulations where the costs exceed the benefits, and some which have no benefits at all. The cumulative impact of the regulatory environment is an important factor in determining a country's overall economic prospects.

Regulatory cost surveys are an important tool for deciding which regulations should be simplified, which should be scrapped, which are appropriate in their current form, and even which should be made stronger.

International experience suggests that the next steps could be:

- The creation of Regulatory Impact Analysis capacity in government that will advise lawmakers and regulators about the costs and benefits of proposed new regulation; and
- A systematic review of the existing regulatory environment.

As this report has shown, the socio-political costs of reforming the regulatory environment need not be high, while the rewards could be very large indeed. This is an opportunity to accelerate growth and development that SA cannot afford to miss.

[6] Organisation for Economic Co-operation and Development
[7] CDE, Labour-intensive public works: towards providing employment for all South Africans willing to work, April 2003.

TIPS COURSE:

Introduction to Economy-Wide Policy Impact Analysis

11-15 April 2005, Johannesburg or Pretoria

Rationale:

Input-output analysis, complemented by means of social accounting matrices is often used as a tool to conduct meso-level economic enquiry. Researchers frequently use these tools to analyse the impact on production, the environment, prices, employment and income effects of policy-related changes in international trade, taxes, fiscal policy and investment. Economic modelling techniques that capture economy-wide impacts of policy changes are increasingly being used in SA academic, consulting and research circles. To cater for this increased demand, the School of Economics at the University of Cape Town, in conjunction with TIPS, is offering its fourth one-week introductory course in economy-wide policy impact analysis.

Design:

The course programme is revised each year to take into account new issues and the interests of participants. The course is designed and presented by academics and experts in the field of economy-wide policy modelling. Lectures are used to introduce the theory and provide insight into the scope of research possible using the particular modelling technique. More importantly, each lecture is followed by a hands-on exercise where the theory or model is applied using economic data from SA and other Southern African countries where appropriate.

Outcomes:

Each participant will present a brief project using the modelling tools learnt during the course. An afternoon slot will be reserved for guest lectures on live applications, highlighting the usefulness and shortcoming of these techniques. By the end of the course, participants will be equipped with sufficient theoretical and practical skills to engage in impact analysis within their research, consulting or academic environments. The course also provides a solid grounding for those who wish to enter into the field of computable general equilibrium (CGE) modelling.

Registration closing date: 28 February 2005

Contact:

If you wish to be considered for admission to this course, please send your CV to Dirk Ernst van Seventer (dirk@tips.org.za; www.tips.org.za). A degree in economics is the minimum requirement for admission.

Further information on registration, accommodation and required preparation can be obtained from the course conveners:

Dirk Ernst van Seventer
or
Lawrence Edwards (ledwards@commerce.uct.ac.za; www.commerce.uct.ac.za/tarpog)

Fees: (includes teas and lunches)

SA-based researchers: R4,500 **Non-SA based researchers:** R6,000

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Contact TIPS:
Ground Floor, Broll Place
Sunnyside Drive, Sunnyside Park
Parktown, Johannesburg

P O Box 87643
Houghton, 2041

Tel: +27 (0)11 645 6404
Fax: +27 (0)11 484 4115
Web: www.tips.org.za

To be placed on the mailing list for the TIPS
Trade and Industry Monitor, please contact
Matthew de Gale at matthew@tips.org.za

For information about and contributions to this
publication, please contact
Lucille Gavera lucille@tips.org.za

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