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Trade and Competition Policy, and the Relationship to Industrial Development

Economists generally see industrial policy as a very broad concept incorporating a range of other mainly but not exclusively, economic policies as part of the industrial policy toolbox.

Trade and competition policy are at least at a theoretical level firmly part of this. However in practice, in the cut and thrust of trade negotiations, and the legalese of merger filings this is often forgotten.

In this edition of the Monitor we feature a number of articles which remind us of the often profound implications which trade and competition policy can have for industrial development.

In the article by Xavier Carim we are reminded of the underlying logic behind South Africa's (SA's) trade policy approach and its implications for industrial policy.

The article by Raphie Kaplinsky takes these issues further and notes the significant changes in the terms of trade for various categories of products. The article suggests that the historical relationship between the prices of commodities and manufactures may be changing, partly because of the price pressure arising from China's capacity to export significant quantities of cheap manufactured goods.

The implications of this are not negative *per se* for all developing countries but it certainly does imply that trade policy needs to be approached with even more care.

In the articles by Ryan Hawthorne and Kim Kampel, the links between competition policy and industrial policy are explored as they pertain to two important elements of industrial policy – employment retention and small enterprise development.

The two key rulings of the Competition Tribunal they discuss may profoundly shape the industrial landscape in SA and give tangible effect to the public interest considerations in the Competition Act.

In the final article, by Ben Cousins, we continue our focus on the small enterprise sector and the 'second economy' with an analysis of the contribution land and agrarian reform could make to reducing inequality and poverty.

Revisiting the Revisited Terms of Trade: Will China Make a Difference?

A focus on the terms of trade can be traced back to the prescient analyses of Singer and Prebisch in the early 1950s. In challenging the conventional wisdom at the time, they posited a number of explanations for declining terms of trade, including both country- and product-specific factors. Until the early 1990s, analyses of the terms of trade focused on the product-determined commodities/manufactures price relationship. However during the 1990s, stimulated by Singer's revisiting of his earlier work, there was growing recognition that within manufacturing there were terms of trade effects, with the prices of low-income economy manufactures falling relative to those of high-income economies. This renewed a focus on the country determinants of trade. Over the past decade, we have begun to witness a simultaneous process of differentiation within commodities and within manufacturing. **Raphie Kaplinsky**[1] argues that these price changes may reverse the decline in the terms of trade of commodity producers. He also points out that China's entry into the global market has played an important role here, augmenting the demand for many 'hard commodities' and undermining the prices of many manufactures.

Early thinking on the terms of trade[2]

A focus on the particular problems confronting developing countries was a byproduct of post World War II reconstruction. Until then, low-income economies had not been seen as a special case. This neglect resulted in part because of the challenges posed by the Great Depression of the1930s, and subsequently due to the years of disruption during the war. But with reconstruction came the demand for raw materials – food and commodities – and hence the developing world was seen as a source of supply. But at what prices?

The prevailing wisdom at the end of WWII was that developing country barter terms of trade would increase due to the relatively rapid technological progress in industry, which would push down the relative prices of manufactures exported by the high-income economies. Prebisch and Singer contested this in the early 1950s, arguing that developing country terms of trade would rather decline.

Their first reason was that many of their (exported) products were inputs into the production of (imported) manufactures. Hence a drop in the price of a primary commodity, which is an input into a manufacturing product, would have different implications for the producer of the commodity and the purchaser of the manufacture.[3]

Second, they argued that the income-elasticity of demand for products produced by low-income economies would rise less than that for products embodying higher technology – the so-called Engels Law.

A third and related explanation concerned the price elasticity of demand for the primary products exported by developing economies. The demand for these lower-technology and more basic products would be much less price-sensitive. So an increase in demand for the output of low-income country exports would only come from a large and disproportionate fall in prices.

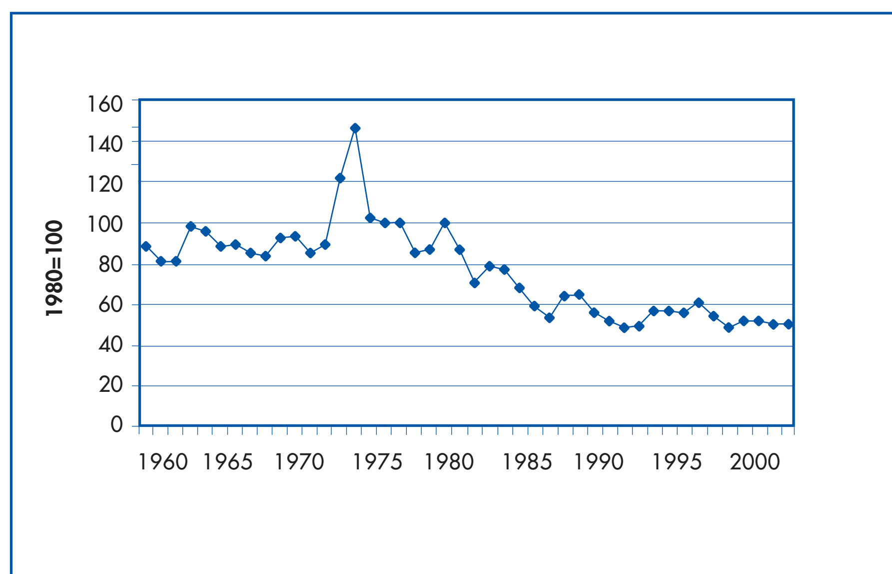
Fourth, many of the commodities exported by low-income countries were subject to synthetic substitution, and hence to declining demand.

Also, the output of low-income economies were generally products with low barriers to entry. Thus they would be subject to a greater squeeze on prices and margins than products that were more difficult to produce and had greater technological content.

But they also offered a sixth explanation, which has largely been ignored in the literature. This is that the tightness of labour markets in the high-income economies and the strength of trade unions in these economies contrasted with the labour surpluses in developing economies. Prebisch and Singer worked within a framework elaborated in 1954 by W. Arthur Lewis of a traditional sector acting as a "reserve army of labour" in developing countries, which kept the price of developing country labour low.

Consequently, products emanating from high-income countries were more likely to be priced

Figure 1: Commodities/Manufactures Terms of Trade



[Source: Drawn from Unctad database]

[1] Development economist Raphael Kaplinsky specialises in the areas of industry, trade and globalisation, and has led advisory groups on industry and trade policy in a number of countries, including SA, where he has an active research and policy advisory role. In 1991, Kaplinsky initiated and co-directed the *Industrial Strategy Programme for a Post-Apartheid South Africa* (with the ANC, Cosatu and the University of Cape Town). With Avril Joffe, David Kaplan and David Lewis, he co-authored *Improving Manufacturing Performance: The Report of the Industrial Strategy Project* in 1995. Kaplinsky holds a BA degree from UCT, SA, an MA in Development Economics and a DPhil, both from the University of Sussex, UK. Currently, Kaplinsky is Professorial Fellow at the Institute of Development Studies, University of Sussex, and Professor and Principal Research Fellow at the Centre for Research in Innovation Management, University of Brighton.

[2] This paper is wholly focused on the barter, rather than the income and factor, terms of trade.

[3] For example, if the copper inputs into a telephone system comprised 10% of the final product costs, a halving of the copper price (their export) would only lead to a 5% fall in the price of the final telephone (their import).

on a cost-plus basis, reflecting the growth of wages and incomes in these economies. In developing economies, wages and incomes were kept low due to the size of the "reserve army of labour".

Prebisch and Singer would have liked to compare the trends in the relative prices of products emanating from these two different types of economies, but this was not possible, given data limitations. Therefore they chose to measure the differential trends in unit prices of manufactures and commodities *as a surrogate for the output of high-income and developing economies.*

This focus on the commodities-manufactures terms of trade has been the subject of extensive debate. There has been disputation on both methodology, and perhaps more importantly on the significance of the choice of base- and concluding-year in the analysis[4]. Nevertheless, it is now widely accepted that for much of the 20th century[5], the barter terms of trade did indeed run against commodities, and in favour of manufactures.

Figure 1, for example, drawn from Unctad[6] data, plots the aggregate terms of trade between a weighted basket of manufactures and commodities[7], and shows a declining trend, except for the latter half of the 1970s.

The terms of trade revisited

In 1971, Singer reworked his ideas about the gains from international trade to raise the possibility that the determinants of price formation may reflect the degree of innovation intensity. This revisited the earlier discussion of the 1950s in three important respects.

First, it re-emphasised the initial focus on the role played by barriers to entry in income determination. In this sense Singer was reflecting the growing importance of neo-Schumpeterian perspectives on the role played by innovation as a determinant of income growth (Freeman, 1976). But, secondly, it reopened the country (as opposed to product) determinants of price trends, since Singer observed that systematic innovation was centred in the high-income economies. Third, and perhaps most importantly, it opened the possibility that not all manufactures would necessarily experience rising terms of trade.

However, it was not until the early 1990s that this third contention was explored. Together with Sarkar, Singer explicitly addressed the possibility that the terms of trade of developing countries within manufacturing might be declining. New data enabled a better measure of price trends, to "provide some support to the hypothesis of terms of trade deterioration extended to the field of trade in manufactures between the periphery and the centre, as in the country (rather than the commodity) version [of Singer's initial terms of trade work]" (Sarkar and Singer, 1991: 334).

Sarkar and Singer computed a fall in prices of developing country exports of manufactures relative to those of developed countries of 1% per annum, providing a cumulative decline of 20% between 1970 and 1987 (Sarkar and Singer, 1991).[8] These results were challenged by Athukorala (1991), who raised methodological objections to Sarkar-Singer and found no decline in the net barter terms of trade when the primary commodity-based SITC[9]68 category (non-processed non-ferrous products) was excluded (Athukorala, 1991).

In 1997, in a widely cited paper, Wood compared the price of a basket of developed country manufactured exports and services with a basket of developing country manufactured exports (Wood, 1997). He concluded from this that within manufactures, between 1985 and 1995, developing countries had experienced a 20% decline in their terms of trade when compared with the manufactures (and some services) exported by high-income economies. But this was a relatively crude estimate of falling terms of trade in manufactures.

Maizels has undertaken a series of more detailed analyses of developing country terms of trade in manufactures with each of the Triad economies – the US, the EU and Japan. In the case of the EU for 1979-1994, developing countries witnessed a sharp deterioration in their relative barter terms of trade (Maizels *et al*, 1999). This was despite an increase in overall unit prices of imports into the EU of 2% per annum (outweighed by an increase in EU unit export prices of 4.2% per annum). With regard to the US, he analysed 1981-1997 and observed a fall in the relative barter terms of trade of developing countries during the first half of the 1980s. Thereafter, no trends emerged (Maizels, 1998). Finally, with regard to Japan, for1981-2000, there was once again a disparity between the more rapidly falling barter terms of trade of developing country exporters compared to developed country exporters to Japan (Maizels, 2003).[10] In each case, the terms of trade of the East Asian newly industrialised economies (NIEs) fell more slowly than those of other developing countries. Maizels observes that this latter result "provides support for Singer's [1971] thesis… that the degree of terms of trade deterioration for developing countries in their exchange of manufactures with developed countries reflects the level of technology embodied in their manufactured exports" (Maizels, 2003: 8).

Revisiting the terms of trade revisited

The issue explored in this article is whether the terms of trade trends within manufactures presage a change in the terms of trade between manufactures and commodities. To this end, two sets of developments are considered – the decommodification of many primary products and the impact of China's increasing presence in the global economy.

The decommodification of some primary products

Loosely used, 'a commodity' refers to the characteristics of final products and their material composition. Hence we distinguish between the 'soft' agricultural commodities (tea, coffee, etc.) and the 'hard' mineral commodities (iron ore, copper, etc.). But this is not an analytically helpful way of determining the commodity nature of products.

A more useful way into this problem is to see commodities as products where there are low barriers to entry. In these circumstances, intense competition forces down income streams, and leads to an association between commodity production and low standards of living. In this framework, even unskilled labour can be seen as a commodity, as for example in the simple assembly of manufactures in export processing zones (Kaplinsky, 1993). It is in this latter sense of products exhibiting low barriers to entry that we use the term commodities, hence 'decommodification' reflects a process whereby products benefit from raising barriers to entry.

Explanations of post-war industrial history distinguish between the era of mass production (sometimes referred to as 'fordism') and mass customisation (so-called 'post-fordism' or flexible specialisation).[11] The period before the 1970s, said to be the heyday of mass production, reflected a world of post-war reconstruction and shortages. Producers thrived in markets which reflected Henry Ford's observation that

(continued on page 4)

[4] Balassa (1989), Evans (1987), Lewes (1989) Hadass and Williamson (2003), Spraos (1980) and the various contributions in Sapsford and Chen (1998).

[5] However, see Balassa (1989) for a dissenting view.

[6] United Nations Conference on Trade and Development.

[7] The commodities index was calculated on the basis of individual price indices for the 'principle commodity exports' of developing countries, notably, all food, agricultural raw materials and minerals, ores and metals.

[8] However, this fall in the barter terms of trade was outweighed by a massive expansion of developing country exports, such that the income terms of trade in the same period rose at 10% per annum.

[9] Standard International Trade Classification

[10] In each of these three cases, rapidly growing imports from developing countries meant that the falling barter terms of trade were outweighed by rising income terms of trade.

[11] Piore and Sabel, 1984; Lipietz, 1987; Pine, 1993.

(continued from page 3)

his customers "can have a Model T Ford in any colour they like as long as it is black". But as production capability and incomes grew in the post-war period, consumers were no longer happy with black Model T Fords. Companies such as BMW and Mercedes Benz carved out profitable market niches by emphasising individuality and variety. This capability to individualise products rapidly spread across the spectrum of manufactures, with the growth of numerous designer labels. There is an extensive literature on the role which this differentiation plays in the determination of relative income streams.[12]

But it is only recently that we have come to recognise the opportunities for the decommodification of a variety of 'soft commodities' (Jaffee and Gordon, 1993; Jaffee, 2003; Kaplinsky, 2003). Two of the most widely cited cases are horticultural products and coffee.

In the case of horticulture, producers who are able to tailor their output to the needs of very dynamic markets earn relatively high incomes (Dolan and Humphrey, 2004). For example, Kenyan horticultural producers fly their salads out to UK supermarkets – ready-packed and labelled for individual stores – every night. Demand for salads is highly variable depending on the weather (for example, during warm weather, the demand for salads for barbeques mushrooms). The Kenyan producers are so sophisticated in their logistics that they allow their UK supermarket customers to vary their orders for pre-packed salads right up to the day of dispatch.

In the case of coffee, customers are beginning to appreciate the enormous variety of tastes – in the words of a Nestlé senior executive, "there are as many varieties of coffee, with a greater variation in taste, than there are of wines" (Kaplinsky and Fitter, 2004). Producers who are able to target these niche markets have been able to insulate themselves from the devastating fall in global prices in the early 2000s. For example, Jamaican Blue Mountain coffee is a premium product, with Japanese consumers prepared to pay up to US$20 per cup. Its growers have been able to escape the severe price pressures which have characterised the industry, particularly in recent years. As the CEO of the Jamaican Coffee Board observed: "Blue Mountain coffee prices are not subject to the factors of supply and demand that affects other commodities. The price is fixed. This is useful in these times when coffee prices are low because of over-supply".[13] In early 2002, Blue Mountain coffee sold at $68,000/tonne compared to the London market price for arabicas of around $1,200/tonne. Similar trends are found in many 'soft commodities', including wood products with Forestry Stewardship Council (FSC) accreditation and even wool.

A key characteristic of these niche markets is that they are very demanding at the level of process, particularly with respect to certification. For example, FSC wood products have to be accompanied by a chain-of-custody which follows the product from forestry to the retail store. This sets standards in logging (no cutting for a number of days after it has rained, not undermining biodiversity, and respecting the needs and culture of local peoples, etc.). But it also requires specific environmental standards in manufacture, transport and retail.

In the auto and the electronics sectors, buyers set basic standards concerning defective parts (increasingly being targeted at zero parts per million) and delivery, as well as prices. In horticulture, traceability is required at a very detailed level, which allows retailers and producers to identify individual growers and plots of land in case there should be problems with pesticide residue at the point-of-sale.

It is in this extensive and demanding process of certification that barriers to entry are constructed and primary products are decommodified. This has become an increasingly important characteristic in the markets for many 'soft commodities', and suggests that falling prices are not an inevitable outcome in these product markets based on primary products. The impetus for the increase in the prices of niche-based 'soft commodities' lies in the growth of *per capita* incomes in the high-income economies.

This is a form of Engels Law reversal, reflected in the fact that the most accurate predictor of the per capita incomes of shoppers in UK supermarkets lies in the proportion of fresh fruit and vegetables in their shopping trolleys; increasingly these fresh fruits and vegetable are sourced from developing economies.

The impact of China's increasing presence in the global economy

There is a second set of factors which might have an impact on relative prices of traded products – the growing and significant presence of China since it entered global markets in the mid-1980s. As we can see from Table 1, China's growth rate over the past two decades has been significantly higher than any of the various groupings of countries by income (and similarly by region, although we have chosen to use income groupings as the comparator). Using PPP[14] constant prices, per capita incomes in China grew at an average rate of more than 8% during the 1980s and more than 9% during the 1990s.

This growth was increasingly outward oriented. Before China's commitment to entering the global economy in the early 1980s, its trade-GDP[15] ratio was less than 10%, compared to a global average of almost 30%. By 2002 its trade-GDP ratio had risen to 55%, exceeding the global average of 47% (*see Figure 2*).

Whilst the growth rate of China's exports has been no greater than that of the previous generation of Asian outward-oriented economies (Korea, Taiwan, Hong Kong and Singapore) (Rumbaugh and Blancher, 2004), it is the sheer size of China's economy which threatens to disequilibrate past patterns of price formation. This is reflected in China's growing share of manufactured imports in the US, EU and Japan (*see Table 2*). Between 1980 and 2002, its share of total manufactured imports (including many products which China does not produce or export in significant numbers) rose from virtually nothing to 14% in the US.

In the buyer-driven consumer products sectors which have not been subject to major import quotas, its share of total imports has grown dramatically. In footwear and toys and games where its presence has not been hindered by import quotas, it now accounts for more than two-thirds of all imports into both the US and Japan. It also accounts for two-thirds of imports of travel goods into the US. Import quotas that hitherto constrained the pace of China's growing presence in the clothing and textile sectors were removed in January 2005.

Table 1: Relative growth rates - GDP per capita, 1985 PPP, US$

	1980s	1990s	1997-2002
Low income	2.4	2.3	2.7
Lower middle income	2.5	2.3	4.3
Middle income	1.8	2.2	3.5
Upper middle income	-0.8	1.7	0.1
High income	2.4	1.8	1.7
World	1.6	1.5	2.0
China	8.3	9.3	6.7

[Source: World Development Indicators 2004, World Bank]

[12] For example, see the burgeoning value chain literature which relates this literature to developing countries, at www..ids.ac.uk/globalvaluechains.
[13] *Financial Times*, 18 October 2001.
[14] Purchasing power parity
[15] Gross domestic product

Another indication of China's impact on global markets can be seen in the evolution of shipping freight rates (*see Figure 3*). China's demand for imports and growth in exports have been so great as to lead to a shortage in global shipping capacity in 2001. For both iron ore and grain, freight rates reached levels which were more than double the previous highs in 1973 and 1995 respectively (although these rates are not price-deflated). The cause? As a major ship-chandler observed, "Chinese iron ore, steel and soybean demand was unquestionably the main reason ocean freight rates for dry bulk commodities hit all-time highs earlier this year".[16]

The very rapid growth of China, and its size, are beginning to have a significant impact on prices in global product markets. In some cases, it has been associated with (and almost certainly caused) a decline in prices. In other cases, demand from China has been associated with (and almost certainly led to) an increase in global product prices. We now consider these two separate effects.

The link to declining prices of manufactures

Much of the second half of the 20th century was a period of inflation in the global economy. Prices of most commodities rose, although (*as we have seen in Figure 1*) the price rise was faster for manufactures than for primary products. By the 1990s, most economies had begun to get on top of high rates of inflation, and for the OECD[17] economies as a whole the inflation rate at the turn of the millennium was less than 3%. What followed was a period of price deflation in manufactures, beginning with a slowdown in the inflation rate in the late 1980s, and after 1998, in absolute nominal prices (*see Figure 4*).

What role does China play in this pattern of falling prices of manufactures? The terms of trade literature reviewed above is almost entirely based on aggregated data, mostly using SITC3- and very occasionally SITC4-digit classifications. This is not adequate for a detailed examination of prices. The HS[18] trade classification system introduced in the late 1980s has a much finer degree of disaggregation and provides greater scope for the detailed tracking of product prices. At the 8-digit level there are 10,000 different HS product categories. An analysis of these product categories tracked the extent to which prices of EU imports fell in the period 1988 to 2001 (Kaplinsky, 2005; Kaplinsky and Santos-Paulino, 2005). The EU provides a unique dataset on international trade, which is large enough to use as a surrogate for the behaviour of global product prices.

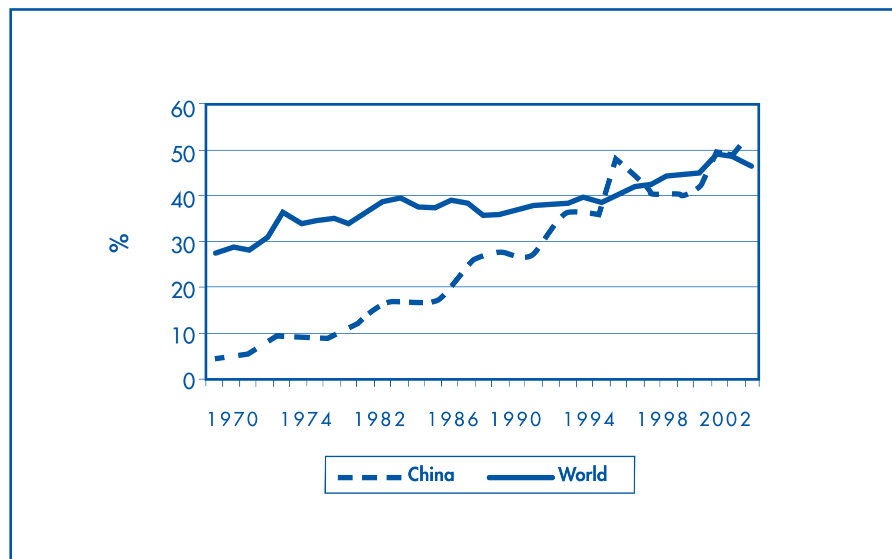
[16] Tom Cutler, Clarksons, personal communication
[17] Organisation for Economic Co-operation and Development
[18] Harmonised System

Table 2: Share of imports from China: EU, Japan and US, 1995 and 2002

	EU		Japan		US	
	1995	2002	1995	2002	1995	2002
All manufactures	2.2	4.0	5.3	6.8	7.6	13.8
Textiles	2.5	4.6	31.3	47.5	11.6	15.8
Clothing	7.9	11.5	56.6	78.1	14.9	15.1
Other consumer products	6.4	9.5	19.7	31.6	25.5	36.5
Footwear	6.7	9.7	47.3	67.4	52.3	68.2
Travel goods	40.4	45.1	32.9	45.2	47.4	64.2
Toys and games	26.0	35.8	26.4	63.5	48.4	66.6
Furniture	7.0	6.2			11.2	34

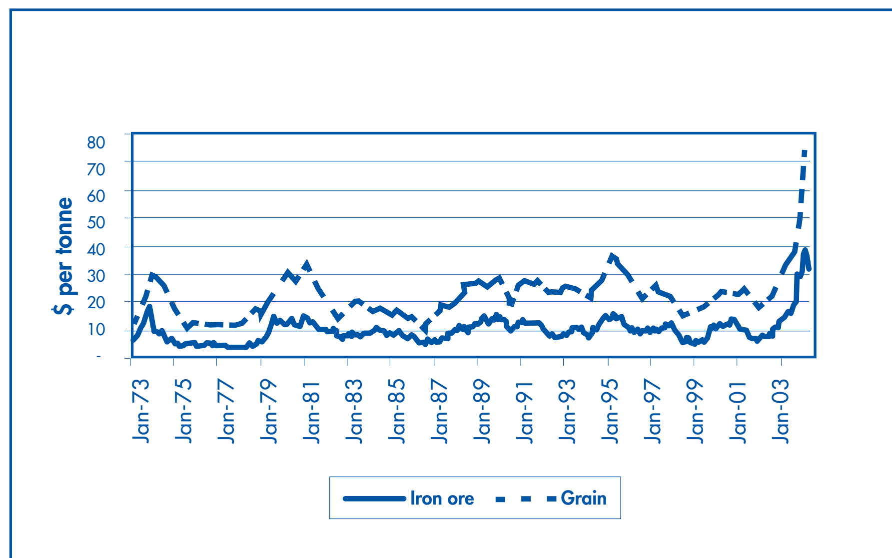
[Source: Kaplinsky 2005]

Figure 2: Trade as a proportion of GDP (%) 1970-2002



[Source: Kaplinsky 2005]

Figure 3: Shipping freight rates, 1973-2003



[Source: Kaplinsky, 2005]

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Figure 5 presents the results of this analysis. It focuses on the major product groupings (classified at the 8-digit level) imported into the EU where developing country exporters were prominent. It reports the proportion of the sectors for which the unit price of imports from different income groups (and China) fell between 1988 and 2001. In almost one-third of these sectors, the price of Chinese-origin products fell. In the case of products emanating from low-income economies, the proportion of product groups in which unit prices fell was around one-quarter. As a general rule, the higher the *per capita* income group of the exporter, the less likely unit prices were to fall. Thus, within a significant number of product groups, the prices of products exported into the EU by China and low-income economies were more likely to decline than the prices of the same products groupings sourced from other high-income economies.

We draw two conclusions from this price analysis. First, the greater China's participation in global product markets, the more likely prices will fall. Second, this seems to have a disproportionate impact on the low-income country group which faces intense competition from Chinese producers.

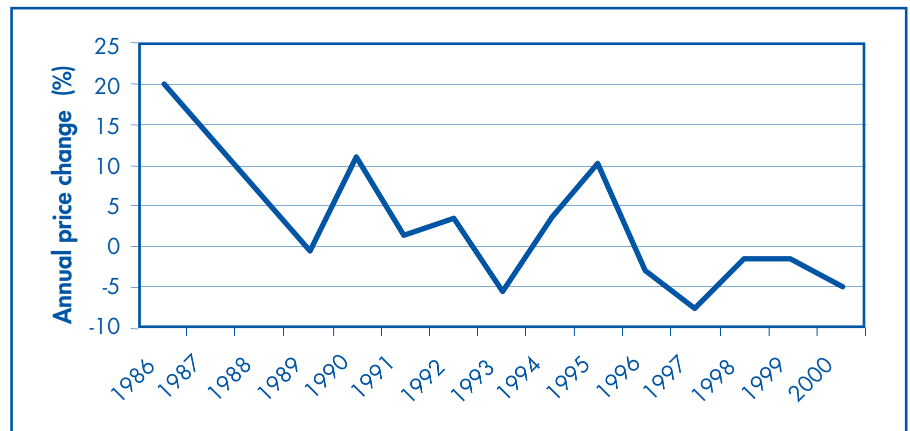
The link to rising prices of 'hard commodities'

By definition, manufactures involve the transformation of inputs into outputs. In the case of automobiles, for example, more than 5,000 components are involved, and each of these in turn requires the input of a variety of raw- and semi-processed materials. The advance of global value chains over the last two decades of the 20th century resulted in a significant increase in global trade in components, and hence in a growth of import intensity in export production in almost every country.

For example, in the case of China, the proportion of export revenue which reflected direct imports into production processes rose from 8% to 12% between 1980 and 1998, and in the case of direct and indirect imports (that is, taking account of the imports going into the production of domestically sourced inputs), it rose from 15% to 23% in the same period (Martin and Manole, 2003).

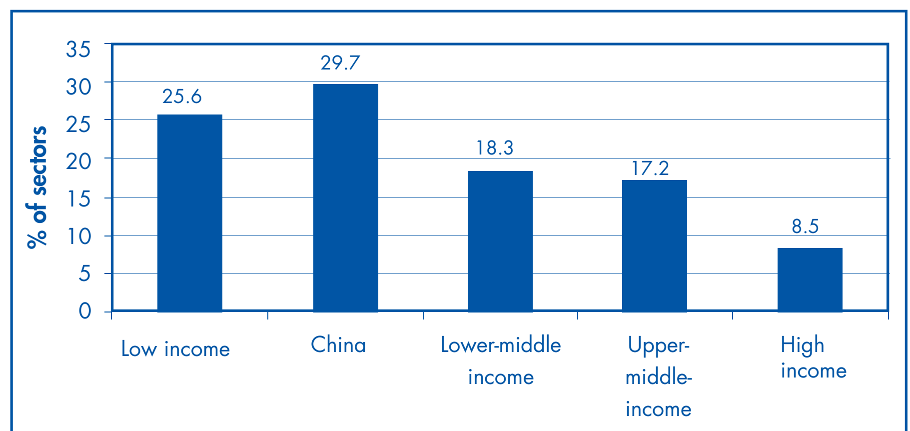
Consequently, with rapidly growing production destined for both the domestic and export market, it is not surprising that China has become a very large market for the exports of other countries. In many cases it has imported manufactured products, particularly capital goods from Japan. In addition, Chinese exports of products such as consumer electronics have involved the assembly of components sourced from the East Asian region.[19] However, from the perspective of developing economies, it is China's sourcing of 'hard' and semi-processed

Figure 4: World manufacturing export price, 1996-2000



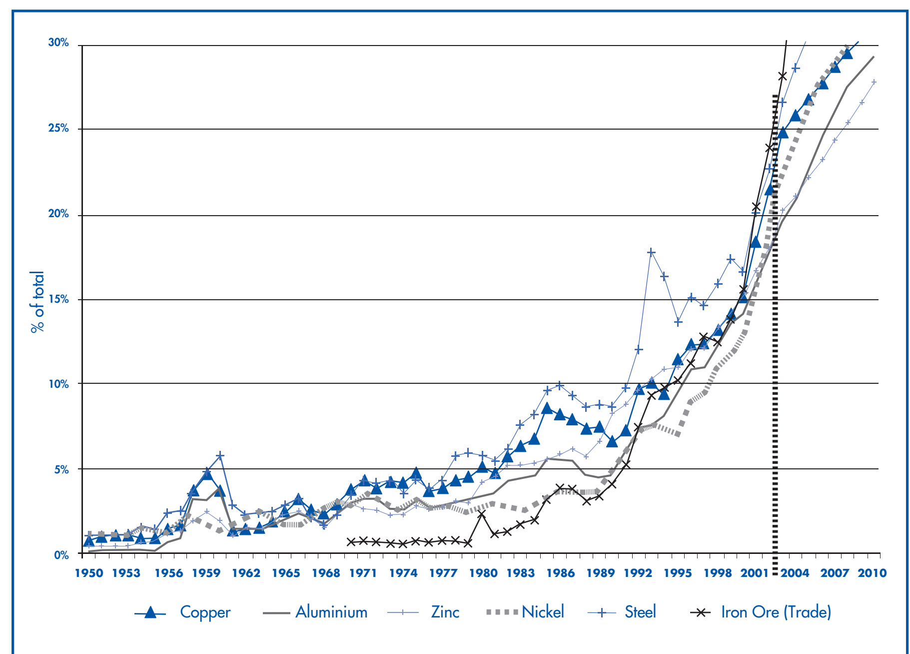
[Source: IMF, World Economics Outlook Database, September 2003]

Figure 5: Percentage of sectors with negative price trends, 1988/89-2000/01 by country groupings



[Source: Kaplinsky, 2005]

Figure 6: Actual and projected global share of China's consumption of base metals, 1950-2010



[Source: Macquarie Research Metals and Mining, personal communication, 2004]

[19] China's trade deficit with East Asia grew from US$4bn in 1990 to US$40bn in 2002, and the region's share of China's merchandise imports grew from 55% to 62% in the same period (Lall and Abaladejo, 2004).

commodities which represents a particularly significant impact on prices in the global economy.

Focusing on basic metals as an example, China's demand for imports has been fuelled by three factors. The first has been the rapid growth of domestic demand for household consumer goods and autos (where production has grown at a dramatic pace). Secondly, there has been very substantial investment in infrastructure, both in the public and private sector, and this has been particularly basic-metal intensive. And, thirdly, many of China's exports have been of metal-based products.

Consequently, China's share of global demand for the main base metals (aluminium, copper, iron ore, nickel, steel and zinc) grew from 7%-10% of global demand in 1993 to 20%-25% in 2003. In the case of steel, its share has grown from less than 10% in 1990 to more than 25% in 2003, equivalent to three times that of Japan, and more than that of either the EU or the US (around 20% each). Between 2000 and 2003, China's share of the increase in global demand for aluminium, steel, nickel and copper was 76%, 95%, 99% and 100% respectively. As Figure 6 shows, its projected utilisation of these basic metals is likely to grow even further in the future, in part because of its relatively low *per capita* consumption of these materials (*see Table 3*). (Bear in mind that China accounts for more than 20% of the global population, and it is inevitable that as incomes grow and the minerals-intensity of consumption grows, as they have in other countries, this will continue to lead to rising demand for imported materials.)

This thirst for mineral imports is also reflected in the food sector, where declining land availability (because of rising industrialisation) and stagnant agricultural productivity have led to rising food imports. In the first half of 2004, China had a trade deficit on foodstuffs of US$3.7bn, including imports of 4.1-million tonnes of food grains. It is predicted that this deficit will soar in future – for food grains to around 40-million tonnes by 2007[20].

Table 3: The scope for China's increased consumption of basic metals, 1955-2003

	Kg/capita			GDP per capita (US$, 1995)
	Aluminium	Copper	Steel	
Japan				
1955	0.6	1.2	80	5,559
1975	10.5	7.4	599	21,869
Korea				
1975	1.0	1.3	84	2,891
1995	15.0	8.1	827	10,841
China				
1990	0.7	0.6	59	342
1999	2.3	1.2	108	756
2002	3.3	2.0	160	933
2003	4.0	2.4	200	1,103

[Source: Macquarie Metals and Mining, personal communication (2004)]

Table 4: Employment in formal sector manufacturing, 1995-2002

	Employment ('1000)				Index of employment (1995=100)			
	OECD 14*	China	India	Brazil	OECD 14*	China	India	Brazil
1995	85,623	98,030	6,500	9,438	100	100	100	100
1996	84,508	97,360	6,800	8,739	99	99	105	93
1997	83,003	96,120	6,900	8,381	97	98	106	89
1998	81,728	83,190	6,800	7,882	95	85	105	84
1999	81,266	81,090	6,700	7,420	95	83	103	79
2000	81,486	80,430	6,600	7,478	95	82	102	79
2001	80,535	80,830	6,400	7,565	94	82	98	80
2002	78,761	83,080	6,500	7,556	92	85	100	80

** US, Canada, Germany, UK, Japan, Russia, Italy, France, Taiwan, Korea, Spain, Netherlands, Austria, Sweden.*

[Source: Calculated from Carson, 2003]

Implications for the terms of trade

The preceding discussion has identified three trends which are likely to have an impact on the trend in the terms of trade. First, it is not inevitable that the prices of all primary 'soft commodities' will fall. There are opportunities for value accretion which reflect the same processes of Schumpeterian rents which Singer and Prebisch identified as being unique to manufactures in the 1950s. Barriers to entry – an important antidote to falling prices – are becoming an intrinsic feature of many of these primary product value chains.

A second conclusion is to challenge the assertion in the early Prebisch-Singer thesis – questioned in Singer's revisiting of the terms of trade debate in the early 1970s and early 1990s – that manufactured prices would continue to rise. There is a significant category of manufactures – particularly those in which China participates – in which prices appear to be falling. Figure 5 shows the results of a detailed enquiry at the 8-digit level, but there is anecdotal evidence available to virtually every reader of the sometimes astonishing fall in product prices. This author recently purchased an electronic watch (having the identical electronic movements as a US$100 watch) plus 10 videotapes – all made in China – for a retail price of around US$12.

Third, the price of many of the 'hard commodities' which have previously been in long-term decline appears to have risen in the early 2000s. In many sectors there are supply constraints, and the gestation period for new investments to come in stream often exceeds five years. Each of these three developments reflects a set of price trends which run counter to the long-term secular decline in the commodities/manufactures terms of trade. If they are sustained, the issue will not be commodities versus manufactures, but which commodities versus which manufactures. The key question is whether they will be sustained, and if so, for how long.

Here we can distinguish between the demand and the supply sides of these changing conditions affecting global prices. On the demand side there is no reason to doubt that the scope for niche-based consumption will continue to grow. Indeed, as global incomes rise – including in consumption-conscious China – the search for positional goods is likely to strengthen the demand for differentiated products, including for differentiated 'soft commodities'. Similarly, although there are many who doubt whether China can sustain an annual growth rate of more than 9% for many decades into the future, there is widespread agreement that it will continue to grow rapidly, and at a faster rate than the global economy as a whole. Given that China accounts for

[20] *Financial Times*, 23 August 2004.

(continued on page 8)

(continued from page 7)

almost one-fifth of the global population, this suggests a world of robust demand. Moreover, lurking around the corner is the spectre of India – likely to have a population larger than China by 2030, and also growing at more than 6% a year since the late 1990s.

If demand is likely to be robust, what about supply? Will China begin to experience capacity constraints which will diminish its potential for forcing global product prices in manufactures down? One sign that this might be the case is the shortage of labour in the coastal region and in Beijing in the summer of 2004. However, this labour shortage was an aberration, associated with the concentration of manufacturing production in the eastern coastal regions and the high cost of living encountered by migrant labour. China has, and continues to have, a very large reserve army of labour in the interior, and firms locating away from the coast pay much lower wages. The Japanese managing director of a Chinese subsidiary observed: "If we run out of people we just go deeper into China" (Roberts and Kynge, 2003).

Table 4 shows that in the largest 14 OECD economies – the economies with high wages threatened by imports from low-wage economies – employment in formal sector manufacturing fell by 8% between 1995 and 2002. But what is perhaps even more surprising is that, contrary to expectations, there was an even more significant fall in employment in China (15%), and a 20% drop in the third-largest developing country manufacturing sector (Brazil). The overall picture for these 17 largest manufacturing economies was a decline in total employment in formal sector manufacturing from 200-million to 176-million, a drop of 12% in seven years.

The picture for China is particularly surprising since, as we saw in Table 1, it has been such a successfully growing economy. It is also a particularly important economy due to its size, with a formal sector-employed labour force larger than that in the combined 14 largest OECD economies. However, the rapid growth in employment during the first half of the 1970s gave way to a process of employment displacement during the 1990s, particularly in state-owned enterprises (SOEs) and township and village enterprises (TVEs). As China entered the global economy after the early 1980s, this labour displacement was particularly acute in manufacturing. But it is also evident in mining (Rawski 2003). Even these numbers underestimate the extent of real labour displacement in China, since many people in the SOEs and TVEs remain on the books but are effectively unemployed. There remains a residue of enterprises which continues to keep workers on their payroll (so that they can get access to social security services) even though there is no sense in which they are actually working productively (Gu, 2003).

A variety of observers concur that there are something like 100-million to 150-million people in China currently working at very low levels of productivity and who are waiting to be absorbed into the global economy. This surplus labour force is equivalent to more than one-quarter of the total labour force in all high-income economies. Yet this labour surplus does not show up in Chinese labour statistics:

"The officially released low (formal) unemployment figures, however, do not reflect the severity of the actual high unemployment… [which]… takes place in urban China, not in the form of open unemployment, but rather in the form of lay-offs. Laid-off workers, according to an official definition, are those who lose their jobs as their employing units encounter economic difficulties, while still maintaining their nominal employment relationship with their employees" (Gu, 2003: 2).

Rawski concludes that "[e]xpansion of formal employment during the 1990s is entirely attributable to increases in rural jobs... [and] employment prospects deteriorated dramatically after 1995, with large numbers pushed out of the formal sector" (2003: 4-5). One of the consequences of this opening up to the global economy, argues Rawski, is that the barriers to domestic migration have dropped sharply, so that up to 100-million people moved their place of residence during the 1990s.

The upshot of this is that wages are unlikely to grow in China in the medium run, at least in the export-oriented manufacturing industries which have the capacity to move into the interior and be serviced by the mass of rural unemployed and underemployed.[21] And, if and when they do, India sits on a labour force of 470-million (compared to the 770-million in China), and there is a plentiful supply of labour in Indonesia and other populated Asian economies. The medium-term prognosis for manufacturing prices – or at least for those manufactures which can be produced by low-income economies such as China and India (and this includes a growing number of higher-technology sectors) – is of continuing price pressures.

Conclusions: understanding terms of trade dynamics

In 1971 Singer 'revisited' the terms of trade, in theory, and with Sarkar, in 1991, through an empirical exploration.[22] This revisiting echoed his contention, with Prebisch, in the early 1950s that the key determinants of relative price-performance might be country-, rather than product-specific. It began a process of enquiry, picked up by Wood, Maizels and his collaborators, and Kaplinsky and Santos-Paulino, which has shown that manufactures are not immune to falling relative prices.

For some categories of manufactures, relative prices have fallen, and these are predominantly manufactures in which China has become a significant exporter. We argued in this article that the explanation for this price performance within manufactures is indeed found, as Singer and Prebisch asserted in the early 1950s, in the composition of the labour force. China and other low-income economies are characterised by a large reserve army of labour – including increasingly of educated and skilled people (Kaplinsky, 2005) – which explains the evolving pattern of price performance within manufactures.

Our 'revisiting' of this 'revisited' discussion of the relative prices of traded products is to move the discussion beyond intra-manufacturing terms of trade, and back to the commodities-manufactures terms of trade. We have suggested that a confluence of factors might lead to a reversal in the historic relationship between the prices of commodities and manufactures. The rising prices of some 'soft' and some 'hard' commodities occur at the same time as falling prices of a significant number of manufactures. In this case, the real terms of trade is not so much between commodities and manufactures, but rather between innovation-intensive and non-innovation-intens-ive products.

In general this proximates to high-income and low-income economy products rather than to commodities and manufactures.[23] But there are a number of cases in which low-income economies, or rather parts of them, are able to benefit from these Schumpeterian innovation-rents. Examples include the growing number of science-intensive products being produced by indigenous firms in China, India's expertise in some areas of software, SA's role as a provider of high-tech medical services, and Costa Rica's presence in eco-tourism. But in both respects – the country determinants of declining prices and the innovation deter-

[21] This is not inconsistent with rising wages in the coastal regions associated with the production of higher-technology products. China possesses such a large expanse and working-age population that it is able to work with a segmented labour market. High-tech industries with high wages, competing with products from high-income economies, will be located on the coastal region; low-tech industries competing with low-wage economies will be located in the interior.

[22] The phrase 'revisited' belongs to Maisels *et al* (1998).

[23] A big gap in this discussion is the price performance of services, of which an increasing number are being traded with the global diffusion of information and communication technologies. Aside from Wood's admittedly crude use of a UK service price index in his 1997 paper, there remains a large gap in the role which services play in inter-country and inter-product price performance.

minants of rising prices – the parents of terms of trade analysis were remarkably prescient. Only our crudeness over the past five decades has led us to characterise these relative price trends as resulting from product attributes in general and commodities/manufactures in particular.

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The Trade Dimensions of Industrial Policy

the dti is responsible for developing and implementing SA's industrial policy. In doing so, it is important to consider the international trade dimensions of industrial policy. This article by **Xavier Carim**[1] sets out the broad contours of SA's trade policy and draws the links to industrial policy. He notes that establishing the conceptual links between trade and industrial policy is only a first step, and that it will be necessary to build and strengthen an institutional framework so that the relevant divisions in **the dti** are able to deepen co-ordination and ensure greater operational effectiveness in an ongoing manner.

Introduction

SA has a relatively well-developed and diverse industrial base. SA is also a trading economy. Over 50% of GDP is related to trade, and trade policy has a significant contribution to make to economic development. Several dimensions of trade policy are pertinent to formulating industrial policy.

First, exports encourage domestic industrial production. A key consideration in the design of policy interventions would be to align industrial capabilities to take advantage of dynamic, high growth, high value-added products and markets that reinforce industrial development and deepening. Negotiating enhanced market access agreements should be informed by these considerations, and should aim to reduce or eliminate tariff and non-tariff measures for targeted products and markets. Second, imports satisfy local demand where there is no domestic production, and competitive imports reduce input costs, improve competitiveness and enhance consumer welfare. However, as competitive imports may threaten import-competing industries with possible negative implications for domestic production and employment, it is important to design tariff offers in negotiations with care in the tariff policy framework. Third, rules and disciplines at the multilateral level impose some constraints on the formulation of industrial policy and need to be taken into account.

This article elaborates these points and sets out the main trade dimensions of the industrial policy by outlining:

- SA's trade policy framework;
- Key considerations regarding tariffs and related rules;
- Multilateral disciplines that impose constraints on trade, investment and industrial policy;
- SA's trade negotiating agenda; and
- Trade in services.

Available evidence offers no demonstration of clear links between trade reform, employment and growth. What is clear is that the impact of trade reform is limited in either direction – shedding or creating employment.

The trade policy framework

SA's isolation under *apartheid* meant a continual deterioration in economic prospects that was underpinned by an inward-looking, high cost-uncompetitive manufacturing sector. As in traditional colonial relationships, primary products dominated exports. The Government has since 1994 sought to reverse this along two trade policy dimensions. First, through a phased tariff reduction process coupled with a range of supply-side measures, Government encouraged structural economic reform to enhance the capacity of economic operators to compete in higher value-added production and export, in the context of an increasingly integrated and competitive global economy.

The second dimension of Government's trade policy focused on negotiations at multilateral, regional and bilateral levels. Multilateral negotiations offer opportunities to enhance the security of access to global markets and ensure that rules preserve 'space' for economic and industrial development policy. Agreements negotiated at regional and bilateral levels provide preferential market access that improves the competitive position of SA exports in those markets and, as such, encourages investment to take advantage of the new market access opportunities. A key consideration for export promotion activities is to identify and communicate export opportunities arising from trade agreements clearly.

SA's trade policy is framed in a broad development strategy and seeks alignment with other policies, addressing, amongst others, the macro-economy, industrial development and the regulatory framework. Two examples illustrate this point. First, the trade reform process produces 'winners' and 'losers', and hence a sustainable trade reform process and the structural adjustment it entails may require transitional measures to cushion the costs of adjustment, including retraining of workers. Second, trade policy is linked to an industrial policy that aims to shift dependence on primary exports to high value manufactures.

Tariff reform has thus been accompanied by supply side measures to promote industrial restructuring, technology upgrading, investment and export promotion, SMMEs[2] and BEE[3]. Industrial policy has a sectoral focus aimed encouraging the exports of – and attracting investment and technology to – sectors that will drive industrial development. The industrial policy also stresses the importance for producers to increase the knowledge intensity of their production. Trade should support these efforts.

Trade policy is conducted in the context of democratic governance and, to be sustainable, requires an institutional framework that ensures constituencies bear adjustment costs to participate in its evolution. The National Economic Development and Labour Council (Nedlac) is the forum for these consultations. Business, labour and government in Nedlac together have defined both the framework and the details of requests and offers for the negotiations, which include consensus on the pace, sequencing of and exclusions from tariff reductions.

Trade considerations

While trade can promote structural reform, export growth stimulates domestic production and assists in achieving scale economies, competitiveness and job creation. Since resources are reallocated among sectors as the economy opens to international competition, trade reform is seen as key to efficient resource allocation and may be more important in its distributional effects than in its effect on growth. The impact of trade liberalisation on the economy is nevertheless contentious, due to the difficulty in disentangling the impact of tariff liberalisation from other factors, such as exchange rate movements and growth rates in importer and exporter countries.

Since 1994, exports have made a consistently positive contribution to GDP. Export growth between 1993 and 2003 has averaged 13.7% annually, and the share of manufactured to total exports has grown by almost 10% since 1995 to around 61.4% in 2004. SA's target markets are also increasingly diversified. Detailed export strategies should be able to build on this by targeting growing markets and high value products that match domestic industrial capabilities. Further, industrial policy interventions should be designed to shift domestic capabilities to compete in such markets and product groups.

[1] Chief Director: Multilateral Trade Negotiations at the International Trade and Economic Development Division of **the dti**
[2] Small, medium and micro-sized enterprises
[3] Black economic empowerment

Imports should pose no difficulties where local demand is not met by domestic production and, in general, competitive imports increase consumer welfare and reduce input costs that enhance competitiveness. However, imports can impose pressure on import-competing producers, with possible negative spill-over effects on production and employment. For industrial policy, the development of detailed sector strategies should also consider the need to offer tariff protection to particular products in the sectoral value chain at the HS8-digit level. Such consideration should result in defensive tariff offers for negotiations and also identify offensive interests.

With respect to employment, available evidence offers no demonstration of clear links between trade reform, employment and growth. What is clear from analysis is that the impact of trade reform is limited in either direction – shedding or creating employment. Employment is dependent on other factors, such as investment, foreign and local demand, the nature of the labour market, skills bias and technology change. While there has been an increase in import penetration in almost every manufacturing sector, these sectors have also shown export growth.

Tariff reductions have in general slowed since 2000 and the effective rate of protection remains relatively high in textiles, leather, footwear, clothing, motor vehicles and parts, food processing, and to some degree, chemicals and other rubber products. These industries are considered 'sensitive', and even their relatively higher levels of tariff protection may not provide long-term solutions to their vulnerability that is more structural-based. There is also the matter of the cost to maintain protection where national prices are above the world price. These include foregone consumer surplus, the increase in the cost of real wages, and the trade-off between consumer welfare gains, producer welfare and employment loss.

Tariff framework

Access to global markets encourages domestic production and creates the basis for sustainable employment. Contractual preferential agreements, moreover, may improve policy certainty and signal investors to take advantage of preferential access opportunities. Nevertheless, negotiations involve reciprocity and in seeking enhanced access to markets, SA is obliged to offer trade concessions. Concessions are undertaken in an established tariff regime at bound and applied levels.

SA's tariff regime is set at levels agreed in the Uruguay Round of multilateral trade negotiations that took place under the auspices of the GATT[4] and resulted in the establishment of the World Trade Organisation (WTO) in 1995. These upper-bound rate levels are likely to be reduced with the outcome of the current round of WTO negotiations. SA's Uruguay Round offer consisted of a five-year tariff reduction programme (until 2000). The exceptions were clothing and textiles which were granted 12 years; paper 10 years; and autos, footwear, rubber products and certain chemicals which were granted eight years.

While overlapping membership in regional organisations and the viability of concurrently establishing customs unions pose serious challenges, the variety of trade-related protocols in SADC under negotiation, along with a diverse set of programmes, suggest an unwieldy trade agenda. The perception is that, without effective engagement, SADC integration agenda will unravel, particularly with respect to forging a regional industrial base.

Other aspects of the WTO offer included:

- Increasing bindings from 17% to 96%;
- Increasing the percentage of bound zero-rated tariff lines to 25%; and;
- Reducing the simple average tariff for industrial tariffs by one-third by 2000.

In general, average bound rates of customs duty are set at 30% *ad valorem* on manufactured consumer products, 20% *ad valorem* on intermediate products and 10% *ad valorem* on primary products. Tariff subheadings covering products that are not manufactured in the Customs Union are, as far as possible, duty-free. While SA's average WTO binding is 17.5%, current most favoured nation (MFN) applied rates are set at, but more frequently, lower levels than WTO bindings (the so-called tariff overhang). Of course, average rates disguise considerable variations in tariff rates at an HS8 level. It should be noted that 25% of tariff lines bound are currently bound at zero, so there are no tariff-industrial policy options.

The SA-EU TDCA[5] and the SADC[6] Trade Protocol have added additional parameters to our trade regime. While SA's trade with the EU accounts for 40% of our total external trade, the terms of the TDCA imply that by the end of the transitional period in 2012, based on average annual trade flows (1994-1996), 94.9% of SA's exports to the EC, and 86.3% of the EC's exports to SA will be duty free. SA's tariff offer to the EU excluded fish and marine products, most of the petroleum sector, caustic soda, soda ash, some vegetable textile fibre, second-hand clothes, fully built-up cars and original equipment components for the automotive sector. The SADC Trade Protocol entered into force in 2000. By 2005, 99% of tariff lines, consisting of 97% of SA imports from SADC, will qualify for duty-free access to SA.

In preparations for regional and bilateral negotiations, the TDCA is employed as the basic framework for considering further trade concessions. Since the EU is SA's single most important trading partner, the rationale is that concessions already offered under the TDCA may, with some possible adjustment, be extended to other trading partners. In areas where additional domestic competition is considered detrimental to import-competing firms, this is reflected in negotiating offers through concepts of asymmetry and exclusions that determine the pace and sequencing of tariff reduction.

Related rules

There is a range of other 'rules' that may be considered in designing industrial policy. Rules of origin (RoO) apply under preferential trade arrangements and aim to ensure that only goods defined as originating in a Member of the arrangement qualify for the tariff preference. RoO define minimum conditions for a product to be considered as originating. Although the criteria differ amongst products, they tend to reflect the trade partners' state of industrial capacity.

Since the level of industrial capacity and competitiveness in a particular sector may differ, the less competitive party in a particular sector would tend to seek higher protection through stricter RoO (higher local content levels). The debate in RoO is focused on liberal versus strict rules. Nationally, major tension exists between the producers of primary and intermediary products on the one hand, and the producers of final products on the other. Generally, the former favour strict rules (high levels of local content) for the end-products of the value chain, whilst the latter tend to oppose being forced into a particular supply chain.

Product standards, technical regulations and conformity assessment procedures also have a bearing on industrial production and export. Technical specifications based on product requirements in terms of performance, health and safety and environmental standards and labelling requirements, as well as the testing of conformity may impose certain additional costs to production. Meeting these, increasingly along with labour standards, are required to access international markets, particularly developed country markets.

Contingency measures (trade remedies such as safeguards, anti-dumping and countervailing measures) provide, under specified conditions, relief from import competition when imports surge, are dumped or subsidised, and either cause or threaten injury. These are ordinarily not considered industrial policy instruments but maybe temporarily be used as such.

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[4] General Agreement on Tariffs and Trade
[5] Trade and Development Co-operation Agreement
[6] Southern African Development Community

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Multilateral disciplines

WTO Agreements incorporate multilateral disciplines on subsidies, government measures to promote local content and/or trade balancing, and intellectual property protection. The WTO Subsidies and Countervailing Measures (SCM) Agreement sets out the definition of a subsidy as a direct government grant, government revenue foregone (duty credits other than duty drawbacks), provision of goods and services other than for general infrastructure, and income or price support.

The agreement prohibits export subsidies (benefit for export performance) and measures that require local content to receive a benefit. All other subsidies are permissible if they do not have an "adverse effect" on trading partners. Allowable subsidies that are not seen to cause adverse effect include those to achieve legitimate development goals, sub-regional growth, technology research and development funding, production diversification, and the development and implementation of environmentally sound production methods.

Duty drawbacks are allowed where the duty on imported inputs for production that is exported is not in excess of the duty actually paid. Drawback can only be used on inputs imported for export (seen as goods in transit). Duty is payable on goods for domestic consumption.

The WTO Agreement on Trade Related Investment Measures (TRIMs) prohibits government measures that require purchase or use of domestic inputs (local content) or purchase and use of imported products limited to value of exports (trade balancing). There are no WTO disciplines covering performance requirements such as minimum levels of local equity, joint ventures, local hiring, technology transfer, nationality requirement for senior management, achieving a given level of investment, sales, employment, or research and development.

The WTO Agreement on the Trade Related Aspects of Intellectual Property Rights (TRIPs) sets minimum international standards for the protection of intellectual property (IP). It is observed that many late industrialising countries in East Asia used lax IP protection to build local technology capabilities that drove their industrial development. TRIPs has foreclosed some of these options. SA's IP legislation is TRIPs compliant. To the extent that industrial policy interventions consider measures relating to technological development, so long as they are consistent with national legislation, the TRIPS agreement has no immediate bearing, except in areas where negotiations are underway – geographic indications, the relationship between the Convention on Biodiversity (CBD) and TRIPS, and the relationship between TRIPS and Public Health.

SA's trade negotiating agenda

Multilateral negotiations

SA has developed an extensive trade negotiating agenda at multilateral, regional and bilateral levels. Multilateralism is seen as an appropriate institutional and inter-governmental response to managing both globalisation and the deepening interdependence of national economies. A key challenge remains to forge coherent multilateral policy-making to establish mutually supportive systems governing international trade, monetary and financial relations. Interdependence itself extends beyond the mutual dependence of economies to include an integrated consideration of policies. Policies for trade in goods and services interact with policies on investment, competition, intellectual property and the environment, amongst others. This partly explains the fact that new-generation trade-related issues are now firmly on the international trade agenda.

SA's support for the launch of negotiations at Doha was based on the assessment that negotiations open up the possibility of ensuring that issues of development are addressed. To achieve sustained global economic growth, developing countries must pursue industrialisation in sectors where they possess comparative advantage, and industrial countries need to undergo structural adjustment in sectors where they have lost advantage. This conception has informed our detailed positions in each of the areas under negotiations. SA's negotiating objectives in the WTO aim to:

- Enhance market access for products of export interests to developing countries;
- Eliminate industrial country subsidies and support to inefficient producers, particularly in agriculture;
- Re-negotiate rules that perpetuate imbalances in the international trade regime; and
- Ensure appropriate policy space for developing countries to pursue developmental objectives through meaningful implementation of the principle of special and differential treatment.

A positive outcome from the current negotiations should define new rules to promote development and offer new access to global markets. The sixth WTO Ministerial Conference in December 2005 is expected to give greater shape and detail to negotiations and establish the basis for reaching a final agreement in 2006. The current focus is on the scope of and ambition for global tariff reductions on industrial and agricultural goods. Negotiations are focused on methods to reduce or eliminate the trade-distorting agricultural subsidies of industrial countries.

New-generation issues tend to be advanced by industrial countries. Aside from underscoring the lack of policy integration in SACU in these areas, industrial countries' approach to such issues tend to limit SACU's development and regional integration policy options. Obligations in these areas could impose inappropriate standards for developing countries and the burden of substantive policy and regulatory adjustment would fall entirely on SACU.

Regional and bilateral negotiations

An important feature of the global environment is the proliferation of regional trading arrangements (RTAs). In 2005, up to 300 may be in force around the world, while trade under RTAs already accounts for over 60% of global trade. Tensions exist between RTAs and the multilateral trading system. While the economic benefits of RTAs remain a subject of dispute, countries may be compelled to pursue them if only to retain a competitive position in external markets. More positively, by promoting competitiveness at a regional level, RTAs can be stepping-stones for national firms to compete globally.

SA's regional negotiations have unfolded in three directions: Southern Africa, key economies in the 'South', and the 'North'. In Southern Africa, the Southern African Customs Union (SACU) Agreement has opened an extensive trade-related work pro-gramme. Aside from requiring that future trade negotiations be pursued by SACU as a block, the Agreement envisions deeper economic integration in SACU through the establishment of SACU institutions and the development of common policies for industry, agriculture, investment, competition and intellectual property, amongst others.

Following the leadership provided by SA in concluding the SADC Trade Protocol in 2000, the SADC trade agenda now confronts certain challenges. While overlapping membership in regional organisations and the viability of concurrently establishing customs unions pose serious challenges, the wide variety of trade-related protocols in SADC under negotiation, along with a diverse set of programmes, suggest an unwieldy trade agenda. A widespread perception is that without effective engagement the SADC integration agenda will unravel, particularly with respect to forging a regional industrial base.

The initiation of negotiations between the EU and SADC for an Economic Partnership Agreement (EPA) has raised additional challenges. That only seven Members are committed to negotiate under the SADC banner demonstrates the weakness. SA's TDCA with the EU also complicates the picture. The SADC-EU EPA negotiations, together with the current mid-term Review of the TDCA, offer an

opportunity to begin a process of harmonising Southern Africa's trade relations with the EU. SA has to define its interests and role in the process.

SACU has undertaken to consider integration initiatives beyond Southern Africa and to identify an appropriate negotiating partner in Africa. Still on a South-South axis, SACU concluded a Preferential Trade Agreement (PTA) with Mercosur in December 2004. The PTA establishes an institutional basis for further integration and co-operation.

In short, trade with Mercosur will be the subject of ongoing negotiations. SACU will begin negotiations for a similar arrangement with India in the second half of 2005. The limited scope of the negotiation suggests this may be concluded in one year. While there is a commitment to negotiate a trade arrangement with China, the challenges posed suggest that more analysis and consultations with industry are required before formal negotiations commence.

Deepening links with key economies in the North is imperative to lock in markets and supplies of capital, technology and finance. This consideration informed the TDCA between SA and the EU and underpins the rationale for negotiations with the European Free Trade Association (EFTA) and the US. Negotiations with EFTA were also seen as an opportunity to harmonise SACU trade arrangements with Europe as a whole. The SACU-EFTA negotiations were set to conclude in August 2005. Engagement with the US has raised serious difficulties, and the negotiations have stalled, with substantive negotiating differences on all issues.

SACU believes the objective of locking in current access in goods is of strategic importance and could be achieved. The serious difficulties relate to new-generation issues – services, investment, procurement, IP, environment and labour. New-generation issues tend to be advanced by industrial countries. Aside from the US, EFTA initially proposed these and the EU has placed them on the agenda in EPA negotiations and as part of the TDCA Review.

Aside from underscoring the lack of policy integration in SACU in these areas, industrial countries' approach to such issues would tend to limit development and regional integration policy options in SACU. Obligations in these areas could also impose standards that are inappropriate for developing countries and the burden of substantive policy, legislative and regulatory adjustment would fall entirely on SACU. Demands in these areas go far beyond obligations agreed in the WTO, and introduces into the bilateral context issues that contributed to failures at the multilateral level (investment, government procurement and labour). Moreover, by negotiating these issues bilaterally, SACU would be complicit in bypassing WTO negotiations or prejudging its negotiating positions in the Doha round in areas of IPR protection, environment and e-commerce where multilateral negotiations are ongoing.

Trade in services

The principles underlying trade in services are similar to those for trade in goods. Open markets are expected to encourage quality improvement, and product and process innovation; reduce the scope for wasteful resource use and rent seeking; constrain the power of individual economic operators; and ensure users of continued product availability at reasonable conditions. The fact that services have long been ignored in international trade negotiations is due to the traditional perception of services being non-tradeable, for legal and institutional reasons (public monopolies in core sectors such as telecommunications and transport) as well as economic and technical constraints (need for simultaneous presence of producers and users, unavailability of transmission technologies). However, dramatic changes – technical innovations and regulatory reform – have occurred over the past two decades.

Services account for about 74% of output and 72% of formal employment in SA. The expansion of the sector should be considered central to government's endeavours to promote growth and employment. As important is the need to enhance the competitiveness of services sectors that comprise intermediate inputs into agriculture, mining and manufacturing.

Countries throughout the world have recognised that there are economic benefits to be derived from reforms in sectors such as financial services, telecommunications and transport that may be viewed as the infrastructural backbones of any economy.

These sectors have a significant impact on growth and efficiency across a wide range of user industries, and by implication, overall economic performance. Technical breakthroughs in information, communication and transport technologies have added to the importance of these sectors, enhancing the gains from innovation and amplifying the risks of technical and/or institutional inertia.

Services account for about 74% of output and 72% of formal employment in SA. The expansion of the services sector, including the export of services, should be considered central to government's endeavours to promote growth and employment. Of equal importance is the need to enhance the competitiveness of services sectors that comprise intermediate inputs into agriculture, mining and manufacturing. It is this link between services and manufacturing and the impact on economy-wide competitiveness that will require appropriate consideration in the development of industrial policy.

An approach to promoting the development of the services sector may begin with a well-considered research agenda that identifies the trade and export potential for key sectors. It should provide economic analysis of identified services sectors and how this interacts with existing and/or envisioned regulations.

It should also recommend precise government interventions, including proposals for regulatory reform, incentives to promote specific domestic sectors, exportable services, and setting negotiating priorities. The research will need to establish a consistent methodology and an accurate database.

The outcome of the research with recommendations will inform trade negotiations by identifying offensive interests (regulatory barriers in foreign markets) and defensive offers. Priority sectors may include energy, transport, telecommunications, tourism, finance, business services, construction, environmental, wholesale and retail, and personal services. The first three sectors, with minor exceptions, are still monopolies and much policy and regulatory work remains. However, the latter seven sectors are either substantially or fully liberalised.

The principles, structure and scope of the WTO General Agreement on Trade in Services (GATS) set out a framework for negotiating trade in services. Commitments are set out in a positive list; that is, commitments need to be specified explicitly. There are no obligations in sectors not so specified. Governments decide whether or not to make commitments on the basis of national policy and development strategy. There is no obligation in the GATS to allow the foreign supply of any service, and governments retain the right to decide on the services opened to foreign-service suppliers.

Moreover, where such commitments are made, the government may still limit the degree of market access and/or national treatment. Further, the GATS' safeguard provisions allow governments policy discretion to ensure the negotiations do not jeopardise access to vital public services. The right to regulate is a basic

(continued on page 14)

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premise and the aim of the negotiations is not to deregulate services, many of which are closely regulated for legitimate public policy reasons.

Public services that are not provided on a commercial or competitive basis are not subject to the GATS and are thus not included in negotiations. In other words, the scope of negotiations exclude services provided by governments in sectors such as education and health, or other essential public utilities. For those services provided on a commercial or competitive basis, the Agreement does not require that they be privatised or liberalised. There are no disciplines or restrictions on providing subsidies to the service sector, although negotiations to do so are underway. The danger is that having no disciplines benefits those economies with a stronger fiscal base.

Assessment and challenges

It may be fair to argue that trade policy as set out is an appropriate response to the challenges of the global environment. It is clear that the negotiating agenda is extensive, intensive and set to expand further. Meeting our objectives will require strengthening the trade policy and negotiating infrastructure along several dimensions.

First, it requires strengthening the trade negotiating machinery in **the dti** on an ongoing basis.

Second, it requires building a stronger institutional and consultative framework within **the dti** and government to ensure greater policy alignment and integration. Further, as the scope of the negotiating agenda now includes a range of trade related issues (services, competition, IP, labour, environment, etc.), closer co-ordination across government departments is required. Such co-ordination needs to be underpinned with strengthened human and technical capacity across government on trade matters.

Third, the consultative process in Nedlac must be strengthened. The question of representivity arises and has been highlighted in consultations to determine private sector interests in services negotiations.

In the fourth place, a great deal of analytical capacity in institutes and universities can be mobilised to support and inform the negotiating process. This requires resources to actively engage such institutions, both to raise awareness of the negotiating issues and to give direction to research activities.

In sum, we need to continually build the requisite technical, human and institutional capacity to pursue SA's trade policy and negotiating agenda.

WTO WATCH

Tracking CAFTA's Potential Consequences

In this article, TIPS Trade Programme Manager ***Owen Willcox*** discusses a number of the provisions of CAFTA, the newly signed free trade agreement entered into by five Central American countries and the Dominican Republic with the US. He also looks at the CAFTA's implications for progress towards freer trade, as well as its potential effects on African economies.

Introduction

The newly signed Central American Free Trade Agreement (CAFTA, or more correctly DR-CAFTA[1]) could provide important clues to the future of American trade policy.

CAFTA only passed the House of Representatives after much arm-twisting by the Republican leadership. President Bush went to bed thinking the vote was lost, only to be woken up to lobby a few more wayward Representatives from his own party. The final vote was eventually held in the small hours of the morning after parliamentary House rules were broken to hold the vote open for over an hour instead of the usual 15 minutes. The eventual total was 217 to 215.

The political mood in the US seems to have swung against free trade, especially in the light of debates over outsourcing. The worry is that US jobs are being transferred to other countries but that the usual reciprocal gain in jobs is not occurring. US economists seem unsure about where US comparative advantage lies.

So CAFTA seems to be the trade agreement that will test America's commitment to free trade. The economic benefits for the US would be quite small, given that the partner countries are small economies, especially compared to the US. The partners are mostly poor with low wages, a real threat to American jobs. Despite this, the agreement was signed, which seems to show strong dedication to free trade by the political leadership. The agreement was strongly opposed by labour and environmental groups.

As usual with US trade treaties, the agreement embraced a lot more than trade. The final agreement consists of 22 chapters, 3 annexes, 14 notes and appendices on tariff schedules, 30 side letters and three understandings. The accord covers a number of issues besides trade in goods, such as trade in services, environmental standards, investment, labour standards, rules of origin and dispute settlement.

Non-tariff barriers to trade, such as sanitary and phyto-sanitary measures, and technical barriers to trade are covered. Telecommunications and financial services each have their own chapter in the agreement, as does electronic commerce. Trade facilitation is also addressed.

Making progress towards freer trade?

CAFTA does represent progress towards freer trade, even if this progress is small. The signing countries will get preferential access to the US market but the level of preference is limited by the fact that they already have duty-free access to 80% of US tariff lines through the Caribbean Basin Trade Partnership Agreement and the Generalised System of Preferences.

Trade in agriculture will also not be totally free. For example, the US has expanded but not done away with quota tariffs for certain sensitive agricultural goods. The rate of expansion of the quotas is slow and occurs at a fixed rate every year, so that the growth rate declines over time.

On other goods, imports to the US will be tariff free by 2015 but most of the reduction is backloaded to 2010. The first year of the treaty only sees tariffs reduced by 2% from the preferential rates that apply to the Caribbean Basin Trade Partnership Agreement.

Because US tariffs are highest for the clothing and textile sectors, tariff cuts will be highest in these industries. This, however, is of little use to the CAFTA countries because China and India have such strong comparative advantages in these goods. Tariffs in the other CAFTA countries will be reduced to zero, in periods ranging from 15 to 20 years. The agreement is thus asymmetric in that the US will reduce its tariffs more quickly than its partner countries.

[1] The DR-CAFTA has been signed by Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic with the US, and aims to increase trade and investment, boosting economic growth and poverty reduction in Central America.

CAFTA and IPRs

Many economists have argued that CAFTA is more about the extension of intellectual property rights (IPRs) than about trade. The majority of these rights are for the pharmaceutical industry. CAFTA prevents trade in, and manufacture of, generic drugs. In addition to the normal patent restrictions, brand name drugs are allowed an extended five-year period of exclusivity, as they currently enjoy in the US.

Drug regulation agencies in the signing countries will have to protect regulatory data on medicines. This means that after a patent has expired, the manufacturers of competitor drugs will have to conduct their own costly, time-consuming trials, even though these studies will replicate the studies performed by the original patent holder. The net effect of these regulations will be a de facto extension of the patent by about a decade.

There is an exception for public health emergencies built into the treaty that would allow countries to waive these restrictions in the interest of responding to a medical emergency, based on a similar provision in TRIPS[2].

Although the TRIPS provision allows the issuing of compulsory licences, only Brazil has done this so far. Other countries have come under enormous pressure from pharmaceutical companies not to use this provision. This is particularly worrying given that some of the CAFTA countries are facing an Aids pandemic, though not on the same scale as in Africa.

This is indicative of America's trade policy as a whole. Where negotiators have not been able to obtain concessions in the more difficult World Trade Organisation (WTO) process, FTAs were pursued that have been far more advantageous to the US, for example, with Australia. The US demands have been labelled as TRIPS plus, as they extend the provisions of the TRIPS agreement.

It is important to realise that this undermines the WTO process. If the US knows that it can achieve its aims in bilateral treaties, then the energy and commitment directed towards the WTO will be less, reducing the likelihood of further liberalisation as even the US has capacity constraints.

Trade negotiators blamed the lack of progress at the July General Council meeting of the WTO on the fact that American attention was diverted towards CAFTA, thus no pressure could be brought to bear on the EU, as they could easily claim that any lack of progress was due to the US.

Investor protection provisions

The other area of major concern in the CAFTA treaty is the investor protection provisions. These provisions are modelled on similar provisions in the NAFTA[3] which were designed to protect US and Canadian firms from the risk of nationalisation of their assets by the Mexican government.

Chapter 11 of NAFTA sets up tribunals to hear charges laid by exporting firms. Firms are allowed to file suit whenever their property is expropriated. The danger is that suits are also allowed where regulation results in the expropriation of profits or future profits. This has produced some perverse results.

For example, the Canadian government had to lift a ban on a dangerous ethanol-based petrol additive because a tribunal found that the ban hurt the sales of an American company. Another tribunal ordered Mexico to pay an American chemicals firm US$16.7m after Mexico did not allow the firm to build a toxic chemicals plant. The tribunal found that this was tantamount to expropriation. There is no appeals process.

CAFTA and Africa

The effect of CAFTA on African economies will probably be quite small. The major effect would be through the erosion of preferences conferred by AGOA[4], but the best part of this advantage will have been reduced by the Caribbean Basin Trade Partnership Agreement already.

It is doubtful to what extent African producers can compete with Asian competitors in the US textile and clothing markets anyway, even with preferences. SA's motor industry makes the most use of AGOA concessions for this country, but as an industry it should not really be affected by CAFTA. Besides, any short-term negative effect could be reduced by negotiating a favourable SACU-US FTA. However, SA's generic drug industry would be devastated by the patent provisions of CAFTA.

Conclusion

The political dynamics in the US were such that a rejection of the treaty would have set free trade back a number of years, with an especially severe impact on the WTO process, even though this agreement represents a very small move towards free trade. This led Tyler Cowan, a professor of economics at George Mason University, to proclaim that the US should sign CAFTA but it should not feel proud of it. This is probably a fitting conclusion, given the number of worrying provisions contained in the treaty.

[2] Trade-Related Aspects of Intellectual Property Rights
[3] North American Free Trade Agreement
[4] African Growth and Opportunity Act

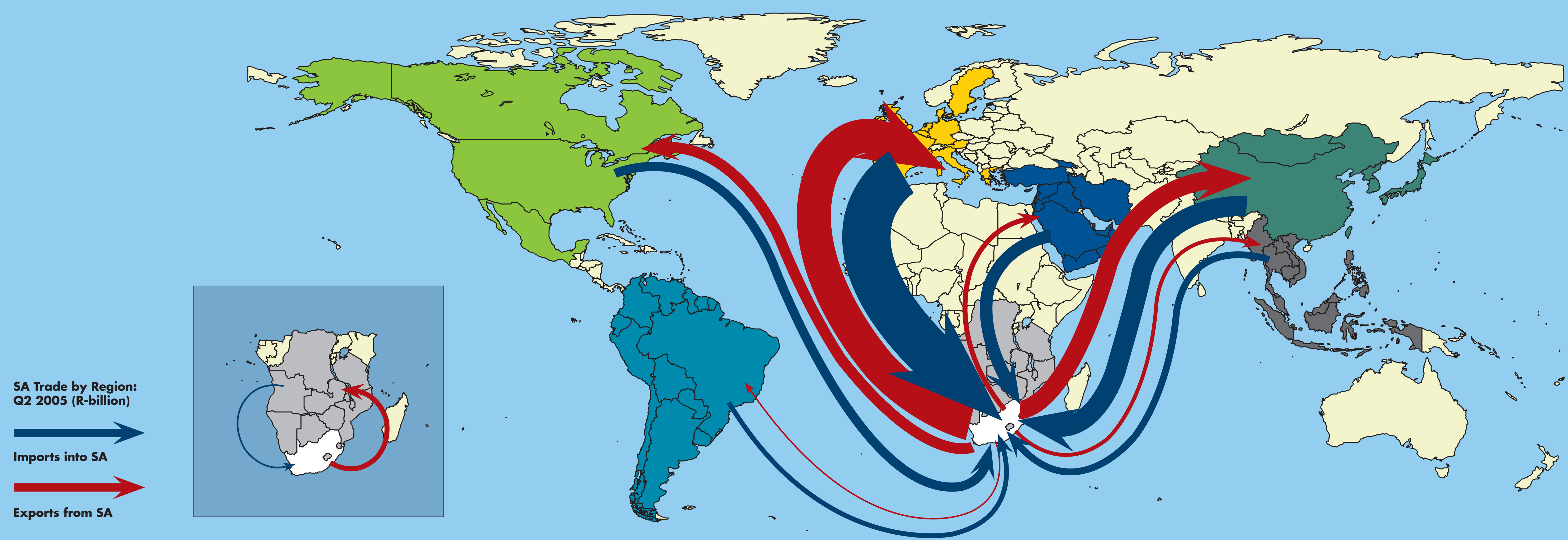
SA Trade Flows to the World

	Q2 2004		Q2 2005		Q1 2004		Q2 2005	
	Rbn	US$bn	Rbn	US$bn	Rbn	US$bn	Rbn	US$bn
Total Exports	72.32	10.98	83.34	12.99	69.15	11.53	83.34	12.99
Total Imports	79.05	12.01	89.01	13.9	75.5	12.58	89.01	13.9
Trade Balance	-6.73	-1.03	-5.67	-0.91	-6.35	-1.05	-5.67	-0.91

SA Trade with the World: Percentage Growth Rate

	Q2 2004 – Q2 2005 (%)	Q1 2005 – Q2 2005 (%)
Total Exports	15.24	20.52
Total Imports	12.60	17.89

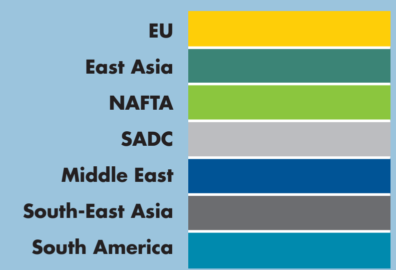
Note: Growth rates have been calculated on the *Rand* values



Top Three Non-Mineral Exports from and Imports to SA from Regions (HS4, Q2 2005)

Region	Exports			Imports		
	Products	Value (Rbn)	% Share	Products	Value (Rbn)	% Share
EU	Liquid and gas centrifuges	2.49	9.11	Motor vehicle parts	3.91	10.98
	Ferro-alloys	1.80	6.58	Motor vehicles	3.75	10.53
	Motor vehicles	0.86	3.15	Aircraft	2.32	6.51
East Asia	Ferro-alloys	2.19	13.79	Motor vehicle parts	2.35	13.69
	Motor vehicles	1.96	12.32	Motor vehicles	1.39	8.11
	Wood and charcoal	0.49	3.11	Radio and TV transmitters	1.06	6.18
NAFTA	Ferro-alloys	0.74	8.71	Aircraft	0.51	6.81
	Titanium oxides	0.31	3.60	Motor vehicles	0.31	4.15
	Liquid and gas centrifuges	0.27	3.20	Motor vehicle parts	0.28	3.77
SADC	Cereals	0.62	8.45	Copper wire	0.08	3.73
	Motor vehicles	0.23	3.11	Cotton	0.06	2.74
	Maize (corn)	0.22	3.05	Refined copper	0.06	2.58
Middle East	Hot-rolled iron and steel products	0.24	8.27	Motor vehicles	0.11	1.49
	Citrus fruit	0.13	4.29	Acyclic hydrocarbons	0.09	1.20
	Flat-rolled iron/steel	0.10	3.45	Acyclic alcohols & their derivatives	0.08	1.11
South-East Asia	Rolled stainless steel sheet	0.28	12.14	Motor vehicle parts	0.68	16.75
	Chemical wood pulp	0.16	6.81	Computers	0.28	6.97
	Semi-finished iron products	0.12	5.28	Rice	0.24	5.96
South America	Ferro-alloys	0.11	12.71	Motor vehicle parts	0.60	20.52
	Aluminium plates	0.03	3.42	Soya-bean oil	0.22	7.55
	Insecticides, fungicides & herbicides	0.03	3.31	Meat (poultry)	0.22	7.39

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



Top 10 Export Markets and Import Sources (Q1 2005), all products

Exports			Imports		
Country	Value (Rbn)	Share (%)	Country	Value (Rbn)	Share (%)
Japan	9.14	11.0	Germany	12.59	14.1
US	7.54	9.0	China	6.91	7.8
UK	7.54	9.0	US	6.64	7.5
Germany	5.43	6.5	Japan	5.93	6.7
Netherlands	3.99	4.8	UK	5.19	5.8
China	2.72	3.3	Saudi Arabia	5.18	5.8
Australia	2.47	3.0	France	4.91	5.5
Spain	2.41	2.9	Iran	4.29	4.8
Belgium	2.30	2.8	Italy	2.84	3.2
Zimbabwe	2.12	2.5	Korea	2.38	2.7
Total	45.66	54.8	Total	56.87	63.9

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

SA Trade with the World: Top 10 Products (HS2; Q2 2005)

Products	Total Exports (Rbn)	% of Total Exports	Products	Total Imports (Rbn)	% of Total Imports
Precious metals	18.76	22.5	Machinery and boilers	14.05	15.8
Iron and steel	11.20	13.4	Mineral and fuels oils	13.53	15.2
Mineral and fuel oils	8.20	9.8	Vehicles other than railway	8.93	10.0
Vehicles	6.15	7.4	Electrical machinery	8.93	10.0
Machinery and boilers	5.75	6.9	Aircraft	3.52	4.0
Ores, slag and ash	4.49	5.4	Medical & surgical equipment	2.68	3.0
Aluminium	2.77	3.3	Plastic	2.18	2.5
Citrus fruit	2.59	3.1	Pharmaceutical products	1.97	2.2
Inorganic chemicals	1.88	2.3	Organic chemicals	1.67	1.9
Organic chemicals	1.47	1.8	Precious metals	1.41	1.6
Total	63.27	75.9	Total	57.46	64.6

SA Trade by Region (Rbn)

	Q2 2004		Q2 2005		Q1 2005		Q2 2005	
	Exports	Imports	Exports	Imports	Exports	Imports	Exports	Imports
EU	23.4	31.5	27.4	35.6	24.0	31.6	27.4	35.6
East Asia	12.0	13.8	15.9	17.1	10.7	14.9	15.9	17.1
NAFTA	9.4	7.6	8.5	7.5	7.2	6.5	8.5	7.5
SADC	6.2	2.3	7.3	2.2	6.0	2.8	7.3	2.2
Middle East	2.4	6.1	3.0	7.5	2.5	5.3	3.0	7.5
South-East Asia	1.9	3.4	2.3	4.1	2.0	3.4	2.3	4.1
South America	0.8	2.4	0.9	2.9	0.7	2.6	0.9	2.9
Rest of Africa	3.07	2.57	3.80	1.87	2.87	0.74	3.80	1.87
Rest of the World	13.18	9.21	14.39	10.14	13.15	7.73	14.39	10.14

Under Which Conditions do Employment Concerns Meet the Public Interest Test for Opposing a Merger?

In May 2005, the SA Competition Tribunal approved Harmony Gold's proposed merger with Gold Fields, subject to the condition that for a period of 24 months, no retrenchments of employees below the level of management and supervisory positions will take place as a result of the merger, and no more than 1,000 retrenchments of employees at or above this level. **Ryan Hawthorne**[1] analyses the ruling, and finds that mergers in a declining industry such as gold mining could be a useful means of restructuring, since better business models introduce a means of preserving employment. He also finds that the concerns around employment are most relevant in terms of the retrenchment of semi- and unskilled workers, because they may lead to long-term unemployment consequences, and thus were addressed appropriately in the Harmony/Gold Fields case where the condition for retrenchments would affect categories of employees best equipped to secure alternative employment.

Public interest concern

The Harmony/Gold Fields merger provides a useful test for the interpretation of the public interest clause of the Competition Act 89 of 1998 as it applies to employment. There were no competition concerns for consumers of gold arising from the merger, as gold prices are set independently of producers. Other issues were raised, such as the impact on suppliers, but the merger substantively turned on the interpretation of the public interest provision[2].

It was accepted that there have been massive reductions in employment in the gold mining industry in the past 10 years and that retrenchments of mine workers have had a major impact on their communities. As such, employment in gold mining is related to poverty[3].

The key issue for merger evaluation is whether the specific merger under consideration would increase retrenchments by more than would otherwise be the case. In this regard it is important to remember that the overall decline of the gold mining industry in SA is a primary reason for the dramatic reduction in employment over time. Part of the restructuring of the industry due to lower gold production has been mergers between major firms. Indeed, the growth of Harmony has been largely a result of its acquisition of mines other firms no longer wanted to operate.

The concerns of employment as expressed in the Act are most relevant in the case of unskilled workers, as skilled workers are likely to find alternative employment with relative ease. Therefore the main issue contested was the impact of the merger on unskilled employment levels.

The merger's effect on employment

In addressing this question, two competing perspectives were put forward, based on alternative economic theories. The first theory relates to the breach of implicit contracts as a result of the merger. The crux of this theory, as it applies to the case, is that firms retain employees for longer than would otherwise be optimal because implicit contracts exist.

The second theory is that the merger was an example of the active working of the 'market for corporate control'. Under this framework, a firm with a different business model more suited to current industry conditions targets firms with weaker management for takeover. By applying their management techniques they believe that they will be able to realise returns that the incumbent management have been unable to achieve. In this specific case, Harmony claimed that their much leaner management structure enables them to lower costs and mine more marginal ore bodies, so increasing the life of mines and sustaining employment at the unskilled levels, although retrenching a large proportion of management.

According to the implicit contract theory, first expounded by Andrei Shleifer and Lawrence Summers[4], many companies encourage their stakeholders, such as employees and suppliers, to make specific investments. These investments can be in the form of human capital by employees or sunk costs incurred by suppliers, for example, by investing in machinery specific to the customer firm's needs. Specific investments are encouraged by remunerating suppliers and employees at levels above marginal cost in terms of an 'implicit contract'[5].

Where a company has developed such 'implicit contracts' and becomes the target of a hostile takeover, value to shareholders is created by expropriating specific investments by suppliers and employees by forcing prices down to marginal costs. Proponents of this theory argue that this is harmful, as such takeovers will discourage specific investments, which is a less efficient outcome.

The 'implicit contract' theory was employed in the Harmony / Gold Fields merger by arguing that even though the gold mining industry is in decline, Harmony will retrench workers more quickly than Gold Fields otherwise would have, with the concomitant impact on poverty in affected gold mining communities. This suggests that a significant amount of the efficiencies that Harmony claimed it would be able to achieve will be realised through the breach of 'implicit contracts', as it does not take into account any expansion in output (or a slower pace of reduction in output) through better management practices. Previous mergers in the gold mining industry have been analysed in econometric models to test whether these mergers are correlated with job losses to prove that the breach of implicit contracts is indeed the reason for many mergers in this industry, and therefore the reason for the Harmony/ Gold Fields merger.

The line of causation, under this theory, effectively ran as follows: gold mining firms need to adjust but have entered into implicit

[1] The author is chairman of Johannesburg Economics and helped to prepare expert reports for Harmony in the merger proceedings.

[2] See the Competition Tribunal's decision in case number 93/LM/NOV04.

[3] This analysis was presented to the Tribunal by Prof. Haroon Bhorat of UCT.

[4] Shleifer, A, and Summers, L, 1987, Breach of trust in hostile takeovers, NBER working paper number 2342, www.nber.org/papers/2342

[5] The implicit contracts literature has been significantly expanded upon in the following articles: Schnitzer, M, 1995, 'Breach of trust in takeovers and the optimal corporate charter', The Journal of Industrial Economics, Vol. 43, No. 3; Gugler, K, Yurtoglu, B, 2004, 'The effects of mergers on company employment in the USA and Europe', International Journal of Industrial Organisation, No. 22; Conyon, M, Girmya, S, Thompson, S, Wright, P, 2000, 'The impact of mergers and acquisitions on company employment in the United Kingdom', European Economic Review, no. 46.

contracts with workers and suppliers, which means that they are unable to make employees redundant or seek lower prices from suppliers; mergers are the only means of breaching these contracts and thus allowing firms to adjust. Such adjustment should be blocked as this reduces suppliers' and employees' incentives to make specific investments.

There is no *a priori* reason to expect an expropriation motive for mergers, and this needs to be tested empirically on a case by case basis[6]. There are a number of reasons why the implicit contract theory should not have been applied in the Harmony/Gold Fields merger. For instance, mergers in the SA gold mining industry in the 1980s and 1990s were largely friendly, though the implicit contract theory relates mainly to hostile takeovers. A friendly takeover does not have the same conditions for managers to 'breach trust', as incumbent managers would be unlikely to break the bonds with stakeholders for the same reasons they would presumably not do so absent a merger. Also, many mergers in the gold mining industry were caused by the need to restructure, and the job losses that arose would have been occurred anyway were the merger not approved.

The implicit contract model is not applicable in the case being reviewed for a number of other reasons. For instance, specific investments are unlikely to be made by unskilled workers, which are the employees that cause the most concern in the merger being analysed. Additionally, there is no need for implicit contracts for unskilled workers, as explicit contracts would normally suffice. Employment in the gold mining industry declined from 392,000 in 1994 to 167,000 in 2003. It seems unlikely that employees of gold mining firms, in the context of the loss of jobs on this scale, would make specific investments in the industry. In addition, Gencor and GFSA (Gold Fields' former incarnation) merged in 1998. It seems somewhat unlikely, if we accept that mergers in this industry lead to rupturing of implicit contracts, that employees would have made new specific investments post this merger that could be expropriated by Harmony's management.

Additionally, Harmony argued that the efficiencies it intended to achieve would in fact arise because of its 'lean' management philosophy and track record in extending the life of marginal mines, rather than any breach of implicit contracts. It argued that any reductions in employment would take place at the managerial and supervisory level, where the impact on poverty would be least felt, given that managerial and supervisory skills provide more mobility to workers than the skills acquired at the rock face. Harmony went so far as to undertake not to make redundant more than 1,500 people at the managerial and supervisory levels. Harmony effectively argued that rather than rupturing implicit contracts with low-skilled workers, it would extend the lives of mines and prolong the viability of their jobs. It is generally accepted that Harmony has a strong record in prolonging the lives of marginal mines. So the theory employed to block the merger is not applicable to the facts of the case, and the analysis should have taken into account the fact that mergers can be employment enhancing, through better management and a resulting expansion in output.

Ignore for the moment the facts that do not support the 'implicit contract' model in the Harmony/Gold Fields merger. Further, assume that all of the efficiencies Harmony proposed will result in the expropriation of specific investments from labour and suppliers, and that the merger should therefore be blocked.

The implication of this is an alleviation of the discipline on managers to run companies efficiently, wherever specific investments are at risk of being expropriated. Discipline on managers emanates from a 'market for corporate control' that exists in any economy where firms are free to acquire other firms. According to this theory, weak managers are replaced by good managers through the takeovers of weak firms by strong firms.

A large literature has developed around the need for a 'market for corporate control'. The main proponent of this theory is Michael Jensen[7]. Much of the literature on 'breach of trust' and the 'market for corporate control' developed during the 1980s in the US, when 'corporate raiders' and hostile takeovers were the order of the day. There was much controversy over the alleged value of such transactions, and the costs to stakeholders appeared to be high.

Effectively, the 'market for corporate control' to some extent alleviates the 'principal agent' problem. 'Principal agent' theory suggests that managers of corporate entities will pursue their own interests at the expense of shareholders. For instance, they will attempt to grow firms beyond their optimal size or make unprofitable investments (in corporate art, for example) to gain prestige. Shareholders attempt to alleviate 'principal agent' problems by various means, such as offering incentives if share prices rise or sales targets are met. However, such incentives are inevitably imperfect, as management performance to some extent relies upon factors beyond the control of managers. The 'market for corporate control' provides additional incentives for managers to pursue the interests of shareholders; where managers are doing a bad job in the estimation of shareholders, they can be replaced by other managers of acquiring firms. Allowing the 'market for corporate control' to work allows the best models to be chosen, and ultimately output and employment to be maximised.

Restructuring of gold mining

The Harmony/Gold Fields merger takes place in the context of a substantial restructuring of the gold mining industry. Mergers in a declining industry are a useful means of restructuring, as economies of scale are maintained as output is reduced. Arguing that a merger should be blocked because it speeds up restructuring (as is the case here) is effectively arguing for a 'public works' type test for merger evaluation, which could lead to destructive ways of industry restructuring.

For instance, if reorganisation does not occur, firms may fail. There are also examples of real savings from rationalisation of management, including the transformation of Saldanha Steel by Mittal Steel. There are also many examples of strategies replacing the dominant industry approach, for example, Toyota's innovations that were eventually adopted by far more established auto firms. Industries go through major changes in systems and strategy where the industry has been insulated from developments outside, as has been the case in the SA gold mining industry. Ultimately, it is for shareholders to decide on the optimal approach.

The basic point is that the 'implicit contract' theory could be applicable, depending on the facts of the case. More generally, however, it is less likely to apply in the case of less skilled labour. It is employment of these categories of workers which is of greatest concern. Additionally, it is widely acknowledged that different business models exist and that part of competition is the testing of such models in practice. The implementation of better business models, to the extent that they allow for increases in output (or maintenance of output in the case of a declining industry), is the best means of preserving employment.

[6] Gokhale, Groshen and Neumark, for instance, find little evidence of an expropriation motive in mergers (although they find that extra-marginal wage payments to more tenured workers appear to be appropriated) – Gokhale, J, Groshen, E, Neumark, D, 1993, 'Do hostile takeovers reduce extra-marginal wage payments?', NBER Working Paper No. 4346, www.nber.org/papers/4346. Additionally, Kleinert and Klodt find evidence that retrenchment is not the factor that results in greater profitability in the restructuring that follows a merger – Kleinert, J & Klodt, H, 2002, 'Causes and consequences of merger waves', Kiel Working Paper No. 1092.

[7] See, for instance, Jensen, M & Ruback, R, 1983, 'The market for corporate control – the scientific evidence', *Journal of Financial Economics*, 11; Jensen, M, 1984, Takeovers: Folklore and science, http://papers.ssrn.com/ABSTRACT_ID=350425; Jensen, 1986, 'Agency costs of free cash flow, corporate finance, and takeovers', *American Economic Review*, Vol. 76 No. 2; Jensen, M, 1986, 'The takeover controversy: analysis and evidence', *Midland Corporate Finance Journal*, Vol. 4 No.2, http://papers.ssrn.com/ABSTRACT=173452; Jensen, M, 1988, 'Takeovers: their causes and consequences', *Journal of Economic Perspectives*, Vol. 2, No. 1.

Competition Law and SMEs: Exploring the Competitor/Competition Debate in a Developing Democracy

In the June 2005 edition of the Trade & Industry Monitor, TIPS reported extensively on the Competition Tribunal's ruling that the small enterprise Nationwide Poles had been a victim of prohibited price discrimination at the hands of petrochemical giant Sasol Oil. **Kim Kampel**[1] takes this debate, as well as the public interest concerns of the Competition Act as introduced in our article on page 18 of this edition further, to focus on those objectives in the Act that aim to protect SMEs.

Introduction

SA's new competition law has been in business for five years. Its competition legislation, the Competition Act 89 of 1998, has been praised by many as one of the most sophisticated on the African continent. Throughout the Act's formulation and the brief reign of the new competition authorities, they have had to grapple with numerous debates about the merits of incorporating various public interest objectives into the Act. The particular objectives addressed in this article are those that aim to protect SMEs.[2]

In a previous paper by the same author, the dearth of SME-related complaints that are enforced before the competition authorities was highlighted[3]. How-ever, in recent weeks a small business case was successfully brought when the Tribunal ruled in favour of a small business owner who alleged price discrimination by its main supplier, Sasol.

In Nationwide Poles v Sasol Oil (Pty) Ltd, the complainant, a small vineyard pole producer in the Eastern Cape, charged Sasol Oil, its main supplier of a vital chemical-treatment input in the pole manufacturing process, with discriminating against it in favour of its larger customers in terms of price. Sasol was giving its larger customers a discount based on the volumes of the chemical they purchased. It alleged that Sasol was charging Nationwide Poles more for the chemical input than it was charging other larger competitors, without any economic justification for this discrepancy. The conduct meant that the complainant's input costs were much higher than its larger rivals, resulting in his inability to compete equitably by selling on its own treated poles to its downstream competitors. The Tribunal upheld many of the complainant's assertions, holding that the purpose of section 9 of the Act's provision prohibiting price discrimination was to express the legislature's desire to maintain accessible, competitively structured markets, which accommodate new entrants and which enable them to compete effectively against larger and well-established incumbents.

The case is undoubtedly a landmark in the competition authorities' history. It is the first time a small business owner has laid a complaint direct at the Tribunal's doors, the first time the Competition Act's controversial price discrimination provision has been tested, and the first time a small business has represented itself in Tribunal proceedings and succeeded. Dubbed by the press as a case of David against Goliath, the lone business, tenaciously represented by its sole proprietor, successfully pitted itself against an army of Sasol Oil's lawyers to come up trumps. The case emphasises the policy aspirations of the legislature with respect to small business, the first case in the history of the competition authorities' regime to do so.

What are the implications for the policy approach competition authorities should adopt when SME creation and small business promotion is a key item on the government's agenda? Can competition law and policy play a role in ameliorating the plight of SMEs in the context of a highly concentrated market structure?

SA's political and economic context

It is no secret that until the early 1990s, SA was an isolated and protected economy. Over the *apartheid* years, government subsidies, strict market controls, high tariffs, low levels of foreign direct investment and high levels of government ownership engendered a highly concentrated economy[4]. In a relatively small, developing market such as SA, the legacy of economic concentration, state ownership and state protection has had the effect of preventing smaller competitors from getting into and competing within the market. Dominant firms in these markets may not have achieved their market positions through high levels of efficiency, innovation or strategic vision, but precisely because they have never had to compete, due to a legislative and economic history of discriminatory laws and protectionist government policies.

What then, are the implications for the policy approach the competition authorities should adopt when SME creation and small business promotion is a key item on the government of the day's agenda?

Challenges facing SMEs

Being large and dominating a particular market *per se* is not an offence under the SA competition statute. How-ever, it has been recognised that large firms in SA, having been used to the easy life attained through market dominance, have a tendency to resort to anti-competitive behaviour to protect their positions of market dominance. Exclusionary and anti-competitive conduct to entrench market share is not uncommon and for competitors, particularly small firms, these practices hurt them where they are most vulnerable – either by denying them access to customers or suppliers or by squeezing their cash flow. The upshot of these harsh 'rules of play' imposed by big business is that the new entrant must pay a higher price, face an increased cost base and be forced to trade on thin margins, restraining its ability to

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[1] Case Manager, Competition Tribunal. The author writes in her personal capacity and her views should in no way be attributed to those of the Competition Tribunal.

[2] This article is a modified extract from a presentation in Cape Town in September 2004, "Pro-Poor Regulation and Policy", and submitted as a Centre for Regulation and Competition working paper. 'SMEs' refers to small and medium-sized enterprises, whilst 'SMMEs' incorporates micro enterprises. This paper is concerned with the former.

[3] See paper entitled "The Role of South African Competition Law in supporting SMEs" focused on enforcement problems in respect of SME complaints being prosecuted before the authorities. K. Kampel, 2004.

[4] Kampel *op cit.*

grow and flourish. Since there are no alternate suppliers, consumers are denied the quality of products or services that the smaller firm could have provided, and since there are no efficiency savings to pass on, prices to consumers are not lowered.

As far back as 1998 when the Competition Bill was being negotiated, the effect of high concentration and monopolisation by big business on smaller firms and potential new entrants was recognised and acknowledged by most political constituencies. The Competition Act's attention to small business interests was therefore born out of a need to protect small (especially black-owned) businesses by facilitating access to markets hitherto controlled by white-held monopolists.

In SA five years on it is apparent that many markets remain highly concentrated, notwithstanding the valiant attempts by the competition authorities to forestall monopolies through merger control and by closely monitoring anti-competitive conduct in various markets. Despite the high level of activity by the competition authorities in the merger control arena, there has not been a similar scale of intervention in respect of restrictive practices, and an authoritative belief lingers that markets remain highly concentrated and hostile to new entrants.

Accessing and growing within markets remains a crucial challenge facing SMEs. A recent review commissioned by the dti and conducted by TIPS found, in highlighting the unequal growth rates between informal and formal SMEs, that attention needed to be focussed on lowering barriers to entry for SMEs into the formal sector of the economy. The review highlights competition policy as an area for intervention to support the "upgrading and establishment of SMMEs."

Can competition law and policy in fact play a role in ameliorating the plight of SMEs in the context of a highly concentrated market structure?

The role of competition policy

There is broad international consensus that the 'core' goals of competition law and policy of promoting and protecting the competitive process for the benefit of economic efficiency and consumer welfare should be incorporated into most competition regimes. This is achieved by competition authorities striving to apply the competition law so as to encourage firms to reduce prices and create greater choice of goods or services.

In exercising their functions, most competition authorities tend to focus on the detrimental effects encountered at consumer level when there are high levels of market concentration, since typically this takes the form of raised prices or limited output by dominant or monopolistic firms. The authorities do not generally strive to protect individual competitors against anti-competitive harm if larger incumbent firms' conduct will bring down prices for and otherwise benefit consumers. However, notwithstanding the effects on consumers, when a few large firms dominate the competitive landscape, monopolistic conduct can affect smaller competitors by restricting their ability to enter into or compete within markets, or by precluding them from challenging the entrenched positions of their larger rivals.

In this way, the *contestability* of markets is reduced. In practice, seeking to give effect to competitor concerns inevitably brings competition authorities into conflict with their core goal, which is to protect the consumer welfare at large. SMEs, by virtue of sheer lack of economies of scale, will be unlikely to guarantee lower prices or greater choice. The fundamental tension between pure competition goals and other public policy goals typically creates a dilemma of which class of rights to protect at the expense of the other.

To what extent should the manner in which a large firm exerts its market power to the detriment of competitors, as opposed to the detriment of consumer welfare at large (or competition), be a concern of competition authorities? It is a fine distinction, indeed, because by protecting competition and the competitive process, we are in fact protecting competitors, who make up the fabric of competitive markets. If there are no competitors, there is no competitive process to protect.

This dilemma of anti-trust policy has been confronted by competition authorities the world over, and takes on even greater proportions in the context of an Act which seeks to level the playing fields for SMEs.

Other jurisdictions

US policy approach

Tracing the evolution of anti-trust policy in the US, it appears that it has travelled full circle. In the 1960s and 1970s, there was a concerted effort to favour the protection of smaller competitors against larger competitors, even at the expense of efficiency. This changed in the 1980s when economic efficiency became the overriding goal of anti-trust policy, under the auspices of enhancing consumer welfare (Fox, 2003). Under this doctrine, competition law should only intervene where conduct reduces output or raises price, in other words, where market conduct produces 'inefficient' outcomes. No other socio-political considerations are relevant. This is rationalised on the basis that to protect competitors would penalise large efficient firms and discriminate between market participants.

The US today is a sophisticated and developed economy which is characterised by open, highly competitive markets. Under current US anti-trust policy, productive efficiency is the overriding concern (Areeda, 1999). Accordingly, efficiency arguments by large dominant firms would, understandably, be likely to prevail against allegations of harm to competitors. Put simply, competition in the US is already fully entrenched as part of the US citizen's everyday culture, and commercial reality and barriers to market entry are relatively low.

EU policy approach

In the EU, competition policy has focussed on the over-arching goal of integrating the common market, but protection of competitors and viability of smaller businesses have also been of central concern to the European Commission, along with economic efficiency considerations (Janow, 2003).

Therefore, under the restrictions on abuse of dominance under Article 82 of the Treaty of Rome, any conduct which detracts from the openness of markets is condemned by the European Courts. SMEs are therefore protected under "fair competition" principles which endorse open and accessible markets and uphold the competitive process (Jenny, 2002: 320). Current EU policy therefore favours a more interventionist role by competition agencies than does the US.

Similarly, some member states have afforded a special status to SME constituencies under their applicable competition statutes. In Germany, the amendments to the Act against Restraints on Competition (ARC) post 1973, reinforces the legislature's instruction to use competition law to protect small and medium-sized businesses against aggressive competition by larger firms. This attention to SME interests reflects Germany's post-war social market approach whereby companies are held accountable to shareholders, stakeholders, employees, customers and suppliers.

Accordingly, it is apparent that the successful adoption and application of a particular competition policy is more a question of context-specific economic conditions, which must be dynamically shaped to reflect a particular country's prevailing market characteristics at any one point in time, if the policy is to be credible, effective and legitimate.

Competition policy in South Africa and its application

Like most pieces of competition legislation, the SA Competition Act commits itself to the protection of consumers by providing them with "competitive prices and product choices". However, the Act goes further than most and

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incorporates other policy goals, including promoting a greater spread of ownership, particularly amongst previously disadvantaged individuals, and ensuring that small and medium-sized enterprises have an equitable opportunity to participate in the economy".

Though SME interests are explicitly catered for under the merger provisions, there is no explicit reference to small business interests, or indeed, any of the public interest goals under Chapter 2, dealing with the prohibited practice provisions of the Act. This means that up until the Nationwide Poles case, no decisions had specifically interpreted how small business interests could be given effect under the prohibited practice provisions of the Act, nor how to enact the Act's stated purpose to level the playing field for SMEs .

There have been few full-blown prohibited practice cases prosecuted before the competition authorities. Though prohibited practice complaints may be lodged, they either die a quiet death at the doors of the investigator (Competition Commission) when they are non-referred, or alternatively do not garner sufficient resources to take to the adjudicative (Tribunal) stage.

It is not uncommon to see a track record of poor enforcement of prohibited practice cases in developing countries, especially in the competition regime's infancy, and SA is no exception. Large interest groups or firms have the resources, expertise and infrastructure to interpret, apply and shape the country's competition law. This naturally works against firms that do not have the same resources but nevertheless are the victims of anti-competitive conduct.

Furthermore, the lack of enforcement of complaints before the competition authorities may well be attributable to an inability of the complainant to prove anti-competitive effect or to show "substantial" competition harm.

What is anti-competitive effect?

Many of the prohibited practice sections of the Act stipulate that in order to succeed in proving anti-competitive conduct, the complainant must prove anti-competitive effect. What determines anti-competitive effect? Some sections require evidence of "a substantial prevention or lessening of competition" in a particular market in order to ground harm to competition. The term "substantial" implies that there must be a systemic degradation of the competitive process sufficient for the authorities to intervene, and not merely the exit of one competitor. Other sections require proof of exclusionary conduct to establish anti-competitive effect.

Exactly what is required to prove anti-competitive effect under these sections is still somewhat of a grey area, since jurisprudence is still evolving. Exclusionary acts are a species of abuse of dominance, which admits of a different type of competitive harm, namely that the act "impedes a firm entering into, or expanding within, a market". Harm flowing from an exclusionary act has been given a fairly liberal interpretation in some cases – where no exclusionary effect was required to be proven (Patensie Sitrus) and a more conservative one in other cases, requiring establishment of the 'anti-competitive effect' of the practice, which, in one case, required the applicant to show that market power was created or extended in consequence of the alleged act (York Timbers).

An SME complainant seeking to enforce its rights at the competition authorities will always confront the question: *What is harm to competition?* It is here where the competitor versus competition debate comes to the fore.

The difficulty of small businesses proving anti-competitive effect lies in such entities being met with the response that their troubles have little, if any, effect on competition in the market as a whole.

In the absence of any specific evidence of firms exiting a particular market, it is assumed that there is no anti-competitive effect, nor has any harm to the competitive fabric of the market been occasioned. However, what is more significant as far as SMEs and other potential new entrants are concerned, is that they may be discouraged from engaging in any form of innovation where perceived barriers to entry and raised costs make capital investments non-viable. These growth-restraining effects are an unknown factor. As a consequence, the incidental loss to consumer welfare as a whole can never be entirely quantified, but that does not mean that it is not there.

It is significant that at the Commission investigation stage, 8% of the total number of cases investigated in 2003 to 2004 was referred and 63% were not referred to the Tribunal for prosecution. Of those non-referred, the Commission cites 29% as being non-referred *due to a failure to prove* a substantial prevention or lessening of competition. Interestingly, Nationwide Poles was one of those cases in respect of which a Notice of Non-Referral was issued by the Commission.

The difficulty of small businesses proving anti-competitive effect was acknowledged by the tribunal in Nationwide Poles. In this regard the Tribunal remarked that: "Foot points out that on a consumer welfare test small business will always fail, precisely because it is not able to correlate harm that is inflicted upon it to harm that is inflicted on the broader market. A small firm will always be met with the response that its troubles are, in relation to the market as a whole, de minimus, that is, that they have little, if any, effect on competition in the market as a whole."

The SME-friendly policy aspirations ventilated in the Nationwide Poles case allowed the Competition Tribunal to apply a lower threshold test for interpreting "likely to substantially prevent or lessen competition" in evaluating this concept in its decision. It acknowledged that since the legislature could not have intended small firms to be non-suited in proving anti-competitive effect under section 9, all the complainant had to establish was that the complaint was *relevant* to competition, as opposed to a mere narrow claim to protect its own commercial interests.

The case makes clear that the policy goals to protect small business and level the playing fields are very much a part of the Act and can be applied to prohibited practice cases. However, in the application of the Act, are the authorities taking enough cognisance of small firms that are effectively barred entry to or hampered from growing within markets? Could the application of a pure consumer welfare standard in all cases be raising the bar too high in a context where SMEs face a distorted market context, where there is a certain reticence about pursuing anti-competitive infringements under the Act?

Unique SA context

In SA, the perceived risk of reprisal or of being boycotted and lack of representivity ensures that SME complainants are too terrified to even lay a complaint at the competition authorities which would allow proper investigation into harm to the competitive process. Furthermore, a culture of dominance prevails such that SMEs are not sure whether they indeed have the right to take on big business. There is therefore a quiet acceptance of the *status quo* directly related to the hostile market structure SA SMEs face. Monopolistic conduct may therefore remain pervasive and entrenched.

The ramifications for ultimate competition are severe. SMEs will simply refrain from entering certain markets or be coerced not to enter markets where they compete head-on with larger rivals. In this way, the contestability of markets is reduced, damaging the competitive process which will harm consumer welfare in the long term. The reality is that no matter what interventions have been made to break up monopolies, exclusionary practices by dominant firms may well be accepted as

'business as usual' in the SA context. This would further explain the low level of enforcement activity.

What the Nationwide Poles case succeeds in exposing is the phenomenon whereby dominant firms in SA are able to maintain their entrenched positions by keeping their larger customers or suppliers happy, despite the absence of efficiency gains to the benefit of consumer welfare. In doing so, large firms are able to maintain the *status quo* by keeping smaller, potentially obtrusive firms out and enforcing un-level playing fields.

The rationale of a US-based, Chicago School pure efficiency approach is to protect the innovation and technology gains of a particular firm from rivals who wish to 'free ride' on such innovations. However, it is rare, in a developing, small economy context, to find ruthless smaller competitors banging down the doors of big companies and piggy-backing on their inventions or copying their innovations. In fact, they have frequently had to learn to be more innovative, more efficient and more differentiated just to stay in the market or indeed, operate on the fringes thereof.

Similarly, the perceived risk of stifling competition by 'protecting a competitor' at the expense of the integrity of the market mechanism does not seem to be justified in the SA context. The competition authorities have, in other cases, been eager to denounce opportunistic attempts by competitors, large or small, to abuse the competition mechanisms to further their own commercially motivated claims. Far from seeking preferential advantage, small players merely request a level playing field on which to compete. While it is not suggested that pure competition goals should be abandoned, the market mechanism cannot function when large firms alone dictate the rules of play.

What is even more distinct in the SA context, is the absence historically of alternative effective policy mechanisms to support the enhancement of SMEs. Government SME policies are being revisited, but it is widely accepted that up to now, they have failed to deliver.

While it is not suggested that competition policy should replace industrial policy in this regard, competition policy should nevertheless not disregard the position of SMEs in a very unique market context in which large firms have the resources to use their size and privileged positions to deter firm growth and new entry. Furthermore, what is quite apparent in SA is the marked absence in the past of sophisticated consumer protection legislation. This, together with a lack of active consumer lobby groups and networks, has created a culture of consumer apathy, reducing the likelihood of any serious challenges to large firm behaviour, entrenching reticence and acceptance of the status quo.

Approach in transition economies

There is support for the view that in transition economies where there is a history of state protection that has shielded various monopolies from competition, some sort of 'middle-road' approach, focussed on the competitive *process* and on preserving the openness of markets, short of protecting competitors, should be adopted in favour of new entrants:

"Further, numerous fledgling antitrust economies have among their many tasks the job to create and root competition. Often they are operating in an environment of state-owned or recently privatised enterprises, state-granted privileges, and weak capital markets. They must keep a watchful eye on entry conditions and contestability of markets. Preserving incentives of firms without power to enter markets, expand and innovate, is of great importance to the success of their project to support a market economy." (Fox, 2003)

The generally accepted acknowledgement of the peculiar economic and political circumstances facing developing economies should make competition authorities in such countries wary of borrowing wholesale competition prescriptions from more developed market contexts where the same socioeconomic conditions do not necessarily exist.

There is accordingly a generally accepted acknowledgement of the peculiar economic and political circumstances facing developing economies as they strive toward economic maturity. There is a recognition that competition authorities in developing countries should therefore be wary about borrowing wholesale competition prescriptions from other more developed market contexts, where the same socioeconomic conditions do not necessarily exist.

The future in the wake of Nationwide Poles

The Nationwide Poles case is the first time the Tribunal has pronounced in one of its decisions on the legislature's intent in levelling the playing fields for business, as well as recognising definitely where the focus of competition enforcement should lie for the benefit of the SA economy:

"In our view the relevant, that is, the SA legal and political economy context favours competition enforcement that is concerned to protect the market mechanism from conduct that has the effect of undermining it."

The case is ground-breaking in that it acknowledges structural imbalances in the SA economy and recognises the difficulty of a small competitor to establish anti-competitive effect as required by a consumer welfare standard.

With its SME-friendly tone, the upshot of the Nationwide Poles decision might well be the creation of a perception amongst SMEs that the competition authorities are not merely an instrument of big business. It could give SMEs impetus and confidence to expose the anti-competitive conduct of their larger counterparts by engendering an awareness of the competition authorities' sensitivity to SME concerns in the market place.

It could also alleviate the reticence and reluctance amongst smaller players to lodge complaints before the competition authorities in the first place. It might well lead to a frenzied rush of complaints being brought before the competition authorities However, the tenor of the tribunal's decision cautions against us assuming that smaller competitors will be willy nilly protected.

Though the tribunal clarifies in Nationwide Poles that under section 9, smaller players are given the luxury of a lower threshold test, we are still left with the question of what sort of harm competitive effect envisages, particularly under sections 8 (c), 4(1)(a) and 5(1). Certain suggestions in the decision suggest that it is likely that complaints will still be evaluated very much through the lens of harm to consumer welfare, and again, SME complainants may run aground in seeking to prove anti-competitive effect.

While the consumer welfare standard is an essential standard to distinguish anti-competitive from pro-competitive conduct, where does it leave smaller, under-resourced competitors, and is it always apposite in our context? The government's 10-year audit's revelation of persistently high concentration levels serves as an opportunity to rethink and re-examine whether the correct approach is being applied in accordance with the legislature's policy goals.

Conclusions

the dti's new policy initiatives signal that all areas of government intervention are being mobilised to support and enhance the plight of small and medium-sized businesses, and not surprisingly, the Competition Act is also coming under scrutiny. Competition authorities

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need to be seen to be *creating* competition and attending to the needs of its smaller stakeholders, not just those of big business. This would assist to lower the perceived risks of entry into markets by small and medium-sized players.

It must be recognised that unlike the developed markets of the US or even the EU, it is difficult for SMEs in SA to enter into and expand within many markets in the first place because of the distorted market structure. An approach which loudly proclaims the virtues of efficiencies of large monopolistic firms over smaller players, or that lays down as a precursor to establishing competitive harm an onerous showing of market exit or a negative consumer welfare effect, disincentivises vital potential new entrants from challenging the *status quo*, thereby inhibiting much-needed growth in many market sectors.

The ultimate policy aim of competition law should always be to protect the consumer welfare. The question that the competition authorities will continue to face is what is required to *show* anti-competitive effect – must the complainant in all circumstances establish harm to the consumer in the form of raised prices or limited output?

The authorities should bear in mind that on a strict consumer welfare test, it is very difficult for competitors, SMEs in particular, to enforce a prohibited practice complaint and they will very rarely succeed under this standard. It is submitted that proof that the competitive process has been *unfairly* interfered with, distorted or manipulated in favour of a larger, well-resourced firm, to the exclusion of (smaller) competitors, should be enough to invoke the penalties under the Act. In enforcing this approach, protecting the competitive process ultimately benefits consumers.

It is still early days in the SA competition regime's life, and a culture of being free to compete without interference still needs to be cultivated. This can only be achieved by the competition authorities taking a nuanced and holistic view of barriers to access to and expansion within markets, and by taking proactive and decisive steps towards punishing large firms which cross this line. Within the prescribed framework of the Act, there is sufficient flexibility and interventionist potential by the authorities to empower the competition authorities to rigorously scrutinise abuse of dominance claims brought at the behest of SMEs, evaluating these claims in the unique SA context. In this regard, the approach in Nationwide Poles is heartening.

Without abandoning the core adherence to preserving the integrity of competition in the market, the Competition Commission can, as the gatekeeper and advocate of the public interest, afford to adopt a somewhat 'activist' approach to SME and other public interest complaints.

The competition authorities should give some thought to affording some anti-victimisation protection to SME complainants wanting to give evidence or to actively participate in merger or enforcement proceedings, free of threat and intimidation.

Previously, the importance of sector trade associations as possible vehicles to bring complaints on behalf of particular small business sectors was highlighted and the authorities can play a role in encouraging these sorts of interventions. The bringing of complaints by networks of SME organisations would fortify allegations of harm to the competitive process and enable SMEs to access and galvanize the requisite legal skills and financial resources they are currently lacking. This would entail vigorous lobbying and advocacy work by the Commission to these groupings.

In fairness, the competition authorities can only act within the confines of the Competition Act. Consideration of an amendment to provide a catch-all provision that envisages harm to smaller competitors, along the lines of those provisions contained in competition statutes of other countries, might be useful. Further, perhaps the adoption of an alternative threshold test for certain types of anti-competitive conduct vis-à-vis SMEs is mandated.

SA, as a relatively new democracy, is still very much a country in transition. Accordingly, the focus of competition policies and institutions should be geared towards developing competitive market structures and creating an enabling environment for fair competition and market forces to 'take root'. In the meantime, the focus should be on creating developing country rules and standards which pays homage to context-specific conditions and barriers to market entry. A consistent balance will have to continue to be struck between application of the purely economic, efficiency-based competition theory of foreign, particularly US, competition jurisdictions and our model, which incorporates public interest considerations, in order to create a uniquely SA jurisprudence.

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Agrarian Reform and the 'Two Economies': Transforming SA's Countryside

This article by ***Ben Cousins***[1] focuses on the rural dimensions of the 'two economies' debate, and in particular on the question of what contribution land and agrarian reform can make to reducing inequality and addressing the structural nature of rural poverty in post-apartheid SA. It suggests that the problem needs to be conceptualised in terms of an 'agrarian question of the dispossessed' that can only be resolved through a wide-ranging agrarian reform. This must include the redistribution of land and the securing of land rights, but go beyond land questions and aim to restructure rural economic space, property regimes and socio-political relations. This approach is premised on the potential for 'accumulation from below' in both agricultural and non-agricultural forms of petty commodity production, and expanded opportunities for multiple livelihood strategies.

Introduction

SA' new democracy has made tremendous strides in its first decade, as a host of 10-year reviews have pointed out. But continuing poverty and inequality undermine these gains. We continue to live in one of the most unequal societies on earth, albeit one in which inequality does not coincide with race as closely as it did in the past. The continuing coexistence of economic growth and structural poverty poses challenges to how we understand the problem, and even greater challenges to policy-makers charged with constructing a developmental path that results in rising incomes for all.

President Thabo Mbeki has recently characterised the developmental challenge in terms of connecting and integrating the 'two economies' of the modern industrial, mining, agricultural, financial and services sector, on the one hand, and the 'third world economy' found in those urban and rural areas where the majority of poor people live (Mbeki, 2004: 10-11). He suggests that the two economies are 'structurally disconnected', which means that economic growth in the 'first economy' does not automatically benefit those in the 'second economy', and that integration will require 'sustained government intervention', including resource transfers and the infusion of capital (ibid: 11).

Agrarian reform and the integrated rural development programme are included in the list of government strategies to 'meet the growth and development challenges of the Second Economy' (ibid: 11).

But are there really two economies, and is the challenge to integrate the two? Some analysts suggest that poverty is caused by structures of inequality within one economy that is already integrated, but in ways that disadvantage the majority (Makgetla 2004; Terreblanche 2002). In other words, it may be that the apparently successful policies pursued within the 'first economy' are the same policies that create structural disadvantage in the 'second', and thus need to be questioned.

As Andries du Toit (2004: 11) puts it:

… powerful and suggestive as the metaphor of a separate 'third world economy' is, it is not a helpful way to understand the very complex actual relationships that persist between the highly developed 'core' of the SA economy and its underdeveloped and impoverished periphery. Shack dwellers in Khayelitsha, seasonal farm workers in Ceres and villagers in Mt Frere cannot be meaningfully described as being 'excluded' from the SA economy; their impoverishment, on the contrary, is directly linked to the dynamics of 150 or more years of forcible incorporation into the economy and racialised capitalism. Indeed, it may well be that many of the obstacles to accumulation from below among poor people are linked very closely to the depth of corporate penetration of the economy as a whole…

Agrarian reform and the integrated rural development programme are included in the list of government strategies to meet the growth and development challenges of the 'second economy'.

This paper focuses on the rural dimensions of the 'two economies' debate, and in particular on the question of what contribution land and agrarian reform can make to reducing inequality and the structural nature of rural poverty in post-apartheid SA.

It suggests that the problem of rural poverty needs to be conceptualised in terms of an agrarian question of the dispossessed that can only be resolved through a wide-ranging agrarian reform that must include the redistribution of land and the securing of land rights, but must go beyond land questions and restructure the agrarian political economy as a whole. A further implication is that such restructuring is unlikely to succeed if restricted to the rural sector. It will only be feasible if it forms part of a broader shift in national policies and programmes aimed at addressing the structural causes of poverty.

The context: poverty and inequality in SA

Since 1994, inflation has stabilised and moderate economic growth (1% to 3% per year) has occurred. There have been substantial improvements in the provision of infrastructure and social services, such as clean water for eight million people, electricity for 1.5-million households, and free medical services to all pregnant women and children under the age of seven (De Swardt, 2003). The provision of grants (for example, old-age pensions and child support) has risen steadily, and more people would be below the poverty line without them.

Despite these achievements, there is compelling evidence that structural poverty is worsening. Unemployment has risen rapidly, from 16% in 1995 to 29% in 2002, but if those who are too discouraged to continue to actively seek work are included, the figure rises to over 40%.

Employers have increasingly chosen capital- rather than labour-intensive techniques to improve competitiveness, and there has been a dramatic decrease of employment in the semi-skilled mining and commercial farming sectors. Between 45% and 55% of all South Africans presently live in poverty. Rural poverty is a major problem, as over 70% of all poor people reside in rural areas and nearly half of these are chronically poor (Aliber, 2003).

(continued on page 26)

[1] Director: Programme for Land and Agrarian Studies (PLAAS), School of Government, University of the Western Cape. This article is an abridged version of a draft chapter for a forthcoming book on "The Land Question in SA: the challenge of transformation and redistribution", edited by Ruth Hall and Lungisile Ntsebeza (2005). The full chapter is available from www.eldis.org/cf/search/disp/docdisplay.cfm?doc=DOC18810&resource=f1trade

(continued from page 25)

Seekings and Nattrass (2002) suggest that class divisions are becoming more important than race in the dynamics of poverty. The emerging class structure consists of an increasingly multi-racial upper class (corporate elites plus professional and managerial groups), a 'middle' group of mostly urban, employed workers and a marginalised group of farm and domestic workers plus the unemployed with little income from assets or entrepreneurial activities (the 'underclass').

The upper class comprise 12% of the population but earn 45% of all income, the middle group comprise 48% of the population and earn 45% of income, and the marginalised comprise 40% of the total but earn only 10% of income. The 'underclass' makes up 28% of the total population. Contemporary inequality is no longer primarily inter-racial, but intra-racial, 'driven by two income gaps – between an increasingly multi-racial middle class and the rest, and between the African urban industrial working class and the African unemployed and marginalised poor' (ibid: 25).

To reduce inequality while ensuring growth in income, Seekings and Nattrass recommend a 'social democratic policy agenda', aimed at sustained job creation (including low-wage, labour-intensive employment), improvements in education, 'democracy deepening asset redistribution' (worker ownership of firms plus land reform), and welfare reform.

Others also argue for a large-scale redistribution of productive assets, in concert with a range of other policies such as skills development and infrastructure development (De Swardt, 2003:18; Terreblanche, 2002: 466; Makgetla and Van Meelis, 2003: 103). For May et al (2004: 20), a 'fundamental rethinking of economic strategy may be required', involving stronger linkages between macroeconomic and microeconomic reforms, the latter including 'measures that improve the access of the poor to productive assets such as land reform, infrastructure and financial services'.

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The problems surrounding SA's land reform programme would not be resolved even were it better funded and the relvant agencies adequately staffed, since many of the fundamentals of the policy framework are ill-suited to the goal of poverty reduction.

SA land reform since 1994 – progress and problems

Economic policy analysts are beginning to suggest that land reform could form a central thrust of government's anti-poverty strategy, and recent government rhetoric implies that it should be seen in this light. Policy statements now portray land and agrarian reform, as well as the black economic empowerment charter for the agricultural sector (Agri-BEE) as part of a strategy to integrate the second economy into the first.

However, land reform policies as presently conceived are unlikely to achieve their current targets, or reduce rural poverty. One reason why land reform is barely impacting on poverty is because it is chronically under-funded (Hall and Lahiff, 2004). Between 1994 and 2004, the Department of Land Affairs (DLA) received no more than 0.5% of the national budget, and only in 2005 did this increase to around 1.0%. By August 2004 it had transferred a total of only 4.2% of commercial agricultural land, through all three sub-programmes taken together – restitution, redistribution and tenure reform (PLAAS, 2004). This compares to a target of 30% of agricultural land, originally by 1999, and now by 2014.

A major weakness in both land redistribution and restitution programmes is in relation to post-transfer support for beneficiaries. Inadequate resources have thus far been devoted to such support; the recent announcement of a Comprehensive Agricultural Support Programme is encouraging, but its budget allocation is still small (R200m in the first year) and the thrust and content of the programme still unclear. In addition, land reform projects are poorly integrated into the development plans of local government bodies (Hall et al, 2005).

The tenure reform component has been particularly slow to produce real change in the lives of rural people. Government is now preparing to implement the Communal Land Rights Act of 2004, amid continuing controversy over the increased powers of traditional leaders in land administration, the wide discretionary powers accorded the Minister, the inadequacy of measures to enable gender equity, and whether or not the Act gives expression to the constitutional requirement for tenure security. Tenure legislation to protect the rights of farm workers, labour tenants and farm dwellers has been on the books since 1996/1997, but has had only limited success in preventing evictions from farms, and even less in assisting people in these highly vulnerable groupings to acquire land in their own right (Hall, 2003b).

Capacity constraints are common in land reform programmes (Adams 2000; Adams and Howell, 2001), and SA has been no exception. The DLA employs few professionals relative to the magnitude of the task, has suffered from exceptionally high rates of staff turnover, and has struggled to provide its staff with appropriate skills. These problems have been exacerbated by the fact that the three main sub-programmes of land reform are poorly integrated, and the potential for synergies between them have rarely been exploited.

The problems surrounding SA's land reform programme would not be resolved even were it better funded and the relevant agencies adequately staffed, since many of the fundamentals of the policy framework are ill-suited to the goal of poverty reduction. As characterised by Hall *et al* (2003: 32-33), defining features of policy to date have been 'a gradual and modest redistribution of land through consensual, market-based methods'; a 'clear shift away from a programme aimed at the rural poor and landless to one aimed at the

creation of a new class of commercial farmers'; non-interference with existing property rights (most evident in the 'willing seller-willing buyer' approach to land acquisition); and the failure to integrate land reform into a broader programme of rural development, together with a general neglect of post-transfer support.

A key issue, however, is how committed the ANC government is to land and agrarian reform, and thus the political feasibility of a more radical approach.

SA's agrarian question revisited

This article suggests that the most appropriate analytical framework for understanding the ongoing production of poverty in SA's 'integrated but unequal economy' is one drawn from materialist political economy, and in relation to the rural areas, from an analysis of the 'agrarian question of the dispossessed'.

Agrarian questions of capital and of the dispossessed

The classical agrarian question was concerned with the transition to capitalism, both within agriculture and in the mechanisms through which agricultural development contributes to industrialisation. The agrarian question of capital is resolved when transitions to capitalist agriculture and industry are complete (Bernstein 1996; Byres 1991). But there is not just one pathway through this transition – both its character and the outcomes are shaped by class relations and struggles, depending on the strength of contending interests of landed property and agrarian capital, agricultural labour in a variety of forms, and emerging industrial capital. State policies and interventions also influence agrarian transformation.

Byres (1991), following Lenin, describes two broad alternative pathways: (a) '*accumulation from above*', the Prussian or Junker path, in which pre-capitalist land owners are transformed into agrarian capitalists. This occurred in parts of Latin America, northern India and SA, as well as in 19th century Germany; (b) '*accumulation from below*', or the American path, where conditions for petty commodity production are establi-shed and a fully capitalist agriculture emerges through class differentiation of peasants and other kinds of small producers.

In relation to SA, Bernstein (1996) suggests that the agrarian question is both 'extreme and exceptional'. He argues that in the past, the central place within the social and political order of white commercial farmer interests resulted in policies that promoted cheap agricultural labour, provided extensive subsidies and installed a bureaucratic regime to regulate production, distribution and trade in the interests of agricultural capital. The concentration, scale and productive capacity of capitalist agriculture in SA is clear evidence that the agrarian question *of capital* has by now been resolved, via 'accumulation from above'. Market liberalisation in the 1980s eroded these 'Prussian' features to a certain extent (for example, casualisation and outsourcing of labour supplies, and private forms of regulation within globalising agro-food regimes), but did not fundamentally alter the distribution of power and resources within the sector.

The agrarian question of capital, however, is only one side of the coin; on the other, the agrarian question *of the dispossessed* (or of labour) has not yet been resolved. Structural unemployment, poverty, food insecurity, land hunger and continued rule by chiefs mean that the struggle for democracy, and against oppression and exploitation, continues. The agenda of the incomplete agrarian question is to contest the monopolistic privileges of white/corporate farming, and of chiefly/bureaucratic elites in former 'homelands', and create the conditions for more diverse forms of commodity production 'accumulation from below' – always recognising that this will involve processes of class differentiation.

Stereotypes of small-scale agriculture

The radical restructuring of agrarian relations does not appear to be on SA's policy agenda just yet. This is partly the result of lobbying and advocacy by the most effective arm of 'organised agriculture', Agri-SA, which has developed a close relationship with the highest echelons of government. Conservative policy stances are also influenced by somewhat stereotyped understandings of agricultural development, promoted by both the commercial farming lobby and by agricultural economists, and embraced by many ANC policy-makers.

A deep sceptisism prevails in relation to the contribution of rural areas and agriculture in general, and of smallholder production in particular, to national economic development.

This view can be summarised as follows:

- Only commercial agriculture is *real* agriculture, and thus successful small-scale farming must be a scaled-down version of the market-oriented, technologically sophisticated and profit-maximising commercial farmers.

- 'Subsistence farmers' survive as relics of the era of deliberate under-development, have been deprived of scientific knowledge, are inefficient and unproductive, and use farming methods which degrade the environment.

- In the former reserves (now 'communal areas'), even farming households have access to only small plots; many people are no longer farmers or even aspire to be such.

- Communal tenure systems contribute to low levels of productivity because they provide inadequate security of tenure and prevent the use of land as collateral for bank loans.

- Economic development inevitably involves a decline in the rural population, urbanisation and a shift from agriculture to industry.

- Rural poverty in Africa will only be addressed when large numbers of rural people relocate to urban areas to engage in either formal-sector wage employment or informal sector self-employment.

- Land reform programmes that redistribute commercial farm land to inefficient subsistence producers, or to people not really interested in farming, have at best a welfare function, and transfer a scarce resource to those least able to make productive use of it.

- Appropriate land reform in Southern Africa should focus on de-racialising commercial agriculture, and lowering entry barriers to small-scale producers who are fully market-oriented.

Against this perspective a number of counter-arguments, with extensive supporting evidence, can be mounted, asserting:

(a) The social inefficiency of large-scale commercial farming, in terms of land use in particular (Moyo, 1995; Weiner, 1988; Levin and Weiner, 1997); and

(b) The under-acknowledged productivity of communal area farming systems (McAllister, 2000; Shackleton *et al*, 2000; 2001).

At present, however, a deep scepticism prevails in relation to the contribution of rural areas and agriculture in general, and of smallholder production in particular, to national economic development.

It is tempting to dismiss SA scepticism in relation to smallholder production as stereotyped, over-simplistic and unhelpful. We should however, take note of analysts such as Bryceson (2000) who point to profound transformations in livelihood systems in Africa over the past two decades. Many were set in motion by Structural Adjustment Programmes (SAPs), the removal

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of agricultural subsidies and the dismantling of parastatal marketing boards. The terms of trade for many agricultural export crops have declined, and many small-scale producers have shifted out of commercial crops (Raikes and Gibbon, 2000). SAPs have also resulted in a rise in cash needs as subsidies have been removed from education and health. In response, many households have shifted to non-agricultural income sources, and diversified their livelihood strategies. Individualisation of economic activity has begun to dissolve household ties and internal divisions of labour.

Globalisation of the agro-food sector in Africa has led to increasing levels of class differentiation as small farmers sell or rent their land to successful larger farmers able to link into the new commodity chains (see also Bernstein 2004). Byceson refers to these transformations as 'de-peasantisation', but notes that "African rural dwellers… deeply value the pursuit of farming activities. Food self-provisioning is gaining in importance against a backdrop of food price inflation and proliferating cash needs" (*ibid:* 5).

In SA, of course, 'de-peasantisation' was deliberately engineered, a key component of segregationist and *apartheid* policies pursued by the state and capital from the early 20th century, and has resulted in a structural disadvantage with deep historical roots. Both in SA and more widely in Africa, therefore, 'rural scepticism' is the result of more than simply bias and a misreading of needs and opportunities.

It arises in part from real changes that have been wrought in the character of rural livelihoods, and are still in process. This means that arguments for broad-based land reform and agricultural development 'from below' must take account of these larger realities and processes, and show how they can be challenged. These alternative realities should be the real focus of debate, given the fact that poverty continues to deepen, that the bulk of the rural population, in SA as elsewhere, is becoming 'increasingly redundant' (Bryceson, 2000: 187), and that without real change the likely future of many rural areas is to become 'reserves of poor migrant labour pools' (Kydd *et al*, 2000: 2).

Agriculture and land-based livelihoods in the contemporary agrarian question

How important is agriculture in te livelihoods of rural South Africans today? In most discussions of the agrarian question there is a primary emphasis on *farming*, which has obscured to a certain extent the reality of increasing reliance on non-agricultural livelihoods, including natural resource harvesting and processing. These need to be integrated more centrally into both analysis and proposals for agrarian reform. In SA the diversity of livelihood strategies has arisen in part as a response to dispossession, overcrowding and landlessness in the former 'homelands'. Although 70% of the population in these areas have access to land, for more than 50% of this group, land size is less than one hectare (Statistics SA, 1998).

In these circumstances, reliance on farming alone is not an option for most rural people at present.Research reveals that the rural population is not homogeneous, but socially and economically differentiated, and different strata within rural communities assemble different bundles of livelihood strategies (May, 2000; Levin *et al*, 1997). Many depend on *multiple* livelihood sources, including agriculture at different scales, formal employment, remittances, welfare transfers such as pensions, and micro-enterprises.

As Weiner *et al* (1997: 51) emphasise, dependence on pensions is often over-stated, and 'the dominance of wages and pensions… must not be used to understate (or ignore) the importance of alternative income earning strategies such as selling (crafts, fruits and vegetables), brick building, construction and trading'. In addition, harvesting of natural resources such as medicinal plants, fuel wood or wild foods (mostly from communal rangelands), and their consumption, sale or further processing, have been underestimated or ignored in the past, but play a key role in the livelihoods of many rural households (Shackleton *et al*, 2000; Kepe,1997).

Small plot agriculture remains important for most rural households, mostly for domestic consumption, and is often located in large 'gardens' adjacent to homesteads rather than in more distant fields (Andrew and Fox, 2004; Ardington and Lund, 1996; McAllister, 2000; May, 2000; Shackleton et al, 2000; Weiner et al, 1997). Around 70% of households in the former reserves are engaged in some form of crop production. Participation in this form of production is highly gendered, with women taking major responsibility for it as one aspect of domestic reproduction.

At the other end of the spectrum, there is also a small but important class of emergent capitalist and petty commodity producers in black rural areas (Bernstein 1996; May 2000; Murray 1996). They formed the National African Farmer's Union in the early 1990s and have been pressing government for land reform policies that will enable them to acquire land, credit and support services. However, their primary economic activity is often not farming, but a small business enterprise such as a transport company, a trading store or a butchery (Murray, 1996). Small-scale agriculture in SA is thus highly differentiated in terms of the class identity of producers (Levin et al, 1997).

Reformulating the agrarian question in SAA

reconsideration of the agrarian question in post-*apartheid* SA requires us to frame it in terms of contemporary realities of structural poverty. The linkages between rural and land-based livelihoods and formal and informal jobs in small towns and urban areas are still important, but massive job shedding from the core economy means that contradictory trends are evident.

On the one hand, the functional articulation of wage income and rural production is reduced, and people look to farming or natural resource harvesting as sources of livelihood. On the other hand, cash is still needed for the purchase of agricultural inputs and assets such as livestock, and when asked why they do not plant more crops, rural people often reply – 'because we have no money from a job'.

Many rural people are now neither 'workers' nor 'peasants' nor a hybrid of the two, but an under-class with an uncertain future, or what Breman (1996) terms 'footloose labour' (cited in Bernstein, 2004: 205).

The agrarian question of the dispossessed thus revolves around the constituting of a class of emergent petty commodity producers from within the ranks of the desperately poor. It cannot be constituted on the basis of production in agriculture alone, given the density of settlement and population-resource ratios in the countryside, as well as the difficulties faced by the agricultural sector as a whole.

'Multiple livelihood' forms of petty commodity production, articulated with wage labour in many instances, will have to be created, both within and beyond the borders of the former homelands, and in urban and semi-urban zones as well as in deep rural areas. The close connections between the urban and rural sites in which households constitute and reconstitute themselves mean that these livelihoods and forms of production will have a hybrid character, combining the 'urban in the rural' and the 'rural in the urban' (Mamdani, 1996).

Research reveals that the rural population is not homogeneous, but socially and economically differentiated, and different strata within rural communities assemble different bundles of livelihood strategies. Many depend on multiple livelihood sources, including agriculture at different scales, formal employment, remittances, welfare transfers such as pensions, and micro-enterprises.

Towards agrarian reform

Land reform must be clearly distinguished from agrarian reform. The former is concerned with rights in land, and their character, strength and distribution, while the latter focuses not only on these but also a broader set of issues: the class character of the relations of production and distribution in farming and related enterprises, and how these connect to the wider class structure. It is thus concerned with economic and political power and the connections between them; its central focus is the political economy of land, agriculture and natural resources.

Although distinct, and presenting different challenges, land reform and agrarian reform are inseparable. Building on the conceptualisation of 'the agrarian question of the dispossessed' presented here, an agrarian reform programme could be guided by the following five core propositions.

A wide-ranging programme of land reform is a necessary but not sufficient condition for the resolution of the agrarian question of the dispossessed

Overcrowding and high population-resource ratios in the former reserves, where a third of the population still lives, together with poorly defined and insecure rights to those resources, are major constraints on rural livelihoods. Land reform is required, therefore, to create equitable access to land and natural resources, across the whole country. It must also aim to secure people's rights to land and resources, in both law and in practice, within a range of tenure systems that must receive dedicated institutional support from government.

Given inherited inequalities and the predominance of women in rural social formations, gender equality in land rights should become a central objective. Land that was forcibly dispossessed must, wherever possible, be restored through the restitution programme, and provinces where a substantial proportion of land is under claim (Kwazulu-Natal and Limpopo) can make a major contribution to an equitable distribution of land. In addition, land reform must increase the tenure security of farm-workers and labour tenants, and provide them with access to land in their own right wherever possible.

But land redistribution, restitution and tenure reform, however necessary, will not be sufficient. An agrarian reform is required that is much broader in scope, and aim to restructure rural economic space and socio-political relations, creating the conditions for 'accumulation from below'. Not only land, but also access to inputs, tools and equipment, draught power, and marketing outlets is required. Infrastructure for irrigation, transport and communications, and support services such as extension, training and marketing advice are needed.

A decisive break with market-led approaches to land reform is required; these must be replace by an approach premised on the central role of the state, together with progressive forces in civil society, in driving processes of land acquisition and redistribution

Experience since 1994 suggests that the dichotomy between demand-led (or market-based) and supply-led (or state-based) land reform is not particularly useful. Rather, a *pro-active* state, acting in concert with progressive forces in civil society, can make use of market and other mechanisms to drive land reform in regions of emerging opportunity where need (and demand) are also found (Aliber and Mokoena, 2002; Hart, 1996; Lahiff, 2001).

Where market acquisition is slowed down by unwilling sellers, government's powers of expropriation can be used (or threatened), and procedures such as the designation of blocks of land to be acquired for land reform can be considered. If government set out to match supply and demand in these regions, large numbers of farms could be acquired at reasonable cost (Aliber and Mokoena, 2002). If an alliance between the state, NGOs and social movements, as well as rural people interested in acquiring land at the local level, came into being, the changing political balance of forces might even see land owners offering up significant areas of land as a self-preservation strategy, as seen in Zimbabwe in recent years.

This approach would not preclude market transactions and 'negotiated transfers' (Van den Brink 2002). Its departure point, however, is that willing seller / willing buyer mechanisms and market-based land reform have failed to redistribute land on a significant scale anywhere in the world (Borras, 2003; Riedinger et al, 2000), and are failing to do so in SA. Key lessons from history are that the central state must drive land and agrarian reform, that democratic local government also has an important role to play, and that popular participation in decision-making can ensure that it is people's own needs and priorities, not those of officials or other interest groups, that determines the details of specific projects.

Area-based land reform is required to create the conditions for agrarian reform

A state-led approach would facilitate planning for area-based land and agrarian reform. Infrastructure and support services could then be provided to land reform projects in a much more cost-effective manner than is possible within the current patchwork, or 'black-spots-in-reverse', pattern of land acquisition. Although the central and the local state should play lead roles, a range of other agencies (in the private sector and civil society) can undertake service delivery functions and usefully complement the efforts of government.

The essential components of an area-based approach include the careful selection and designation of districts or zones of both need and opportunity. Within these, government must provide the funds for and facilitate a transparent process of land identification and acquisition by groups and individuals. Key decisions in relation to land use, systems of production and land tenure should be made by the participants themselves, not by officials or consultants (Levin, 2000). A range of scales of production and degrees of 'commercialisation' on the acquired land should be allowed, and variable definitions and interpretations of the 'viability' of production should be accepted.

Within the targeted areas, government would need to undertake district-wide or zonal planning for infrastructure and service provision, especially in relation to post-transfer support, including marketing of produce. Both private sector agencies and NGOs can assist in service provision, but government must create a coherent and comprehensive framework for this. Planning for land and agrarian reform should be made central to the processes leading to the formulation of Integrated Development Plans by local government bodies (reversing the current syndrome of neglect).

State land can be contributed to land reform where appropriate, and a common set of legal instruments and administrative support structures would enable the integration of land redistribution, restitution and tenure reform. An area-based approach facilitates coherent planning for land transfers on a large scale, the securing of land rights, local institutional development, and investment aimed at creating conducive conditions for smallholder production and other land-based livelihood strategies.

This approach builds on the commitment of government to a decentralised and integrated approach to land reform that was announced in the early stages of land policy formulation (see the White Paper of 1997 and Levin, 2000), but which has been implemented in only a fitful and partial manner thus far. A pilot project on area-based approaches in Makhado District in Limpopo, currently being undertaken by land NGO Nkuzi Development Association in collaboration with the DLA and the district municipality, will provide useful lessons for policy-makers. However, the broader implications of this approach for policy have not yet been explored in policy debates.

Paradigm shifts are required to focus state policies on agrarian reform

Four paradigm shifts are required to realise the vision of agrarian reform set out in this article.

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- The first involves policy-makers questioning their widespread and deep-rooted scepticism about the potential for smallholder production and their consequent bias in favour of large-scale commercial production (Lahiff and Cousins, 2004).

- Secondly, the multiple and diverse character of the livelihoods of the rural poor, and emerging opportunities for petty commodity production, must be a key focus of policy (Andrew *et al*, 2003). Land and natural resources are vitally important, but cannot be the only focus of development efforts; complementary forms of rural enterprise must also be promoted (Philip, 2000).

- Thirdly, government must recognising its central role in land and agrarian reform, and devote sufficient resources to the relevant sub-programmes. An adequate budget for implementing these policies must thus be secured from Treasury.

- In the fourth place, the active participation of the 'beneficiaries' of agrarian reform in processes of policy-making, planning and implementation must be secured (Levin, 2000; Cousins, 2004b). To date only lip service has been paid to the notion of community participation.

Land and agrarian reform requires a major investment in capacity building as well as innovative institutional arrangements

Inadequate capacity for implementation of land reform is a 'recurring problem' (Adams, 2000). This has been the case not only in relation to central government departments in SA since 1994, but also in relation to local government bodies and NGOs, and has hamstrung implementation of land reform. A concerted effort to strengthen the capacity of organisations active in rural areas is urgently required.

Capacity building has the following dimensions: ensuring that appropriate *policies* are in place; providing sufficient *funds* to implement policies; employing professional *personnel* in sufficient numbers to undertake a wide range of tasks; equipping staff with appropriate *skills and expertise* via a range of in-house training programmes; structuring the institutions to ensure efficiency and effectiveness; streamlining *systems and procedures; managing* programmes and projects effectively; and building systems (monitoring and evaluation) to maximize *learning from experience* and the inevitable mistakes that will be made.

Supporting institutional development at local community level is also crucial, and facilitates active participation by rural people in agrarian reform. The experience of Communal Property Associations and trusts established since 1996 to take ownership of land in redistribution and restitution projects is relevant here. Many of these are now dysfunctional. Constitutions have been poorly drafted and often misunderstood by members, and the rights of members (especially in relation to land and resource use) are often ill-defined.

The problems derive in large part from inadequate government oversight of and levels of support to these groups. The lesson is that appropriate support for local capacity building is a vital component of land and agrarian reform.

The state must become the lead agency in processes of agrarian restructuring, assisted by progressive elements of civil society, and ensure that national policies are integrated into provincial and local government planning. Capacity needs to be built to realise this ambitious vision, and innovative institutional arrangements need to be developed.

It is clear that co-ordination between government departments and programmes is a major problem, and that simply requesting local government bodies to include land reform projects in their Integrated Development Plans is not a solution. One possibility worth investigating is the idea of district-based Agrarian Reform Institutes, funded by central government but with strong links to both local government bodies and provincial government departments.

Another idea to pursue is Rural Enterprise Development Centres, (similar to those supported in the past by the Mineworkers Development Agency), which seek to pro-actively transform the material conditions of petty rural enterprises, integrated where possible with land and natural resource-based livelihoods (Philip, 2000). A third is the promotion of input and marketing co-operatives within the land reform programme.

Political feasibility

International experience shows that elites tend to capture the benefits of land reform unless there are decisive shifts in power relations in favour of the poor. In SA this means avoiding capture of land reform and development projects by elite groupings, including traditional leaders; the renegotiation of the terms and conditions of employment of both permanent and seasonal labour in the commercial agricultural sector; and addressing the concentration of economic power within agro-food commodity chains in the hands of big business (Lahiff and Cousins, 2004: 53-54)

A key weakness in SA's land reform programme to date has been the lack of an organised political constituency in rural society, articulating a powerful rural voice able to counter the persistent urban bias in the country's politics and economics (Greenberg 2000; 2002; 2004). Land sector NGOs have consistently advocated pro-poor policies and greater levels of state investment in rural areas, but their reach is limited and their impact on policy has been uneven and often very limited. Rural social movements pushing for fundamental change did not emerge on any scale in the 1990s.

Another site of struggle is the state, and thus also the ruling party and the tripartite alliance. Both government and the ANC regularly assert the importance of resolving the land question, but both the very small annual budgets allocated to the DLA and the Department of Agriculture and the general absence of internal policy debates suggests that land and agrarian reform have been somewhat marginal to the core concerns of the ANC in power. The ANC's alliance partners have also, until recently, paid little attention to rural questions, although this is now beginning to change.

There is little doubt that government's efforts since 1994 to stabilise the economy have taken precedence over socioeconomic restructuring, although recent increases in social spending and what some term 'developmentalist' policies mean that that characterisations of government economic policies as neo-liberal must be tempered to some degree. Also important, however, in explaining relative marginality are deeply rooted ideas about agriculture and rural life, whether they be in relation to the efficiency of large farms or the inherent limits of land reform in the face of contemporary realities.

However, four developments indicate that the political feasibility of radical agrarian reform may be increasing.

- First, events in Zimbabwe since 2000 have given land reform a much higher public profile. Across the region, a variety of interest groups have pondered the implicit question posed by Zimbabwe: is the snail's pace of land reform a prelude to large-scale land invasions supported by powerful political interests? There is a near consensus across the political spectrum that an unresolved land question is a political time-bomb, and progress in land reform in most countries in the region (but in particular those with large commercial agricultural sectors still dominated by white farmers) is too slow, and needs to be speeded up (International Crisis Group, 2004).

- Secondly, the rise of the Landless People's Movement (LPM), supported by the National Land Committee, has seen government being challenged on the inadequacies of its land reform programme, not only by activists and academics, but by thousands of angry rural (and urban) people. Although it is too early to pronounce on just how widespread the support for the LPM is, or how effective it is in organisational terms, there is no doubt that the LPM's calls for an end to farm evictions and for real progress in land redistribution have resonated widely. In the same period a number of civil society organisations have engaged in campaigns on a diverse set of issues, indicating widespread dissatisfaction with a number of government policies.

- Thirdly, there is the beginnings of a real interest in land and agrarian reform by Cosatu and more recently by the SACP, which launched a Red October campaign in 2004 with the slogan 'Mawubuye umhlaba: land, food, jobs!' Concern over rising food prices and food insecurity has been linked to the need to assist people to grow their own food. Calls by officials and policy analysts from the union movement for a review of government economic policy have increasingly included land reform as an important measure. These shifts by the ANC's alliance partners might be the beginning of serious national policy debates on land and agrarian reform for the first time since 1994.

- Fourthly, some policy analysts have begun to see land and agrarian reform as essential for addressing the 'two economies' problem (Terreblanche, 2002; Makgetla, 2004; May *et al*, 2004: 20). Scepticism about smallholder agriculture and the contribution of land-based livelihoods may be lessening.

However, what commercial farmers understand by land redistribution is highly problematic. Stressing the strategic importance of commercial farming for food production and also export earnings, commercial farmers are offering to assist with the mentoring of black 'emergent' commercial farmers. Implicit is their understanding that for the foreseeable future the latter are unlikely to constitute a large and powerful interest group capable of mounting a serious challenge to the dominant interests within the sector. Agri-SA spokesmen are clear that in their view transferring land to 'subsistence farmers' under forms of communal tenure will be a national disaster.

Underpinning large-scale agriculture's strategic control of key food production and export earning sub-sectors within the economy, and strengthening their organisational power, is the power of the commercial farming narrative, the notion that 'only commercial agriculture is real agriculture'. Countering the commercial agriculture lobby, then, will have to mean tackling its power both materially and ideologically. This remains a major challenge in SA.

Conclusion

What is now required is a radical restructuring of agrarian economic space, property regimes and socio-political relations to realise the potential for 'accumulation from below' in both agricultural and non-agricultural forms of petty commodity production, and through expanded opportunities for 'multiple livelihood strategies'.

Key paradigm shifts required to realise this vision include abandoning negative stereotypes of smallholder production and embracing a positive view of the possibilities for land-based rural livelihoods, as well as participatory approaches that bring rural people into the centre of decision-making processes.

The state must become the lead agency in processes of agrarian restructuring, assisted by progressive elements of civil society, and ensure that national policies are integrated into provincial and local government planning. Area-based planning could be a powerful mechanism for ensuring coherence, and help to integrate diverse elements. Capacity needs to be built to realise this ambitious vision, and innovative institutional arrangements need to be developed.

Policy advocacy has to be grounded in political realities. As recent events in Zimbabwe so clearly demonstrate, changes in the balance of forces can dramatically alter the terrain of land reform policy, and a crucial variable is the degree of mobilisation and organisation of rural people themselves – always recognising that this population is highly diverse and internally differentiated, and that collective interests are not simply givens but have to be constituted by 'political leadership and political choice' (Bernstein, 1997). Political dynamics, rather than rational arguments, are likely to be the key determinant of the content of land and agrarian reform in SA in years to come.

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