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Saturday, 17 March 2007 close window

Posted to the web on: 05 March 2007

GEEKONOMICS

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A GROUP of Harvard economists has been commissioned to advise the South African government on a wide range of economic policy matters. Their work on macroeconomics, industrial development and labour markets has received some attention in the local press. But we have seen nothing written on their interesting and useful work on SA's trade performance and policy.

The neglect of trade policy is not only the fault of the media. The trade and industry department's new industrial policy apparently pays scant attention to the role of tariffs. This despite the fact that tariff liberalisation has been one of the primary drivers of industrial reform in SA. Asgi-SA too does not recognise SA's weak trade performance and crippled trade policy as a key constraint to economic growth.

The Geeks from Harvard (to be fair, one of the two authors is from the University of Cape Town, but he is still a geek) suggest that we should be very concerned about SA's recent trade performance. Despite a weakening rand and robust commodity prices, export volumes increased at an annual average rate of just 2,7% from 2000 to 2005 (compared to average import growth of 7,6%). Net exports of goods and services fell from a surplus of 3,9% of gross domestic product (GDP) in 2001, to a deficit of 1,5% in 2005.

Does this mean that the substantial trade liberalisation undertaken by SA in the early 1990s has been a failure? Not at all. This new research confirms that there is a very strong relationship between tariffs and export performance. In particular, they attribute the rapid rise in SA's non-commodity exports between 1992 and 2000 to the sharp drop in tariff protection over this period.

How can import tariffs affect exports? Protection reduces the demand for imports and hence for foreign exchange, driving down the real exchange rate received by exporters. Import liberalisation does the opposite. Protection reduces imports and exports. Liberalisation increases them.

In addition, import tariffs raise the cost of key inputs (whether imported or not), relative to their cost in the absence of tariffs, further penalising exporters. It is possible for exporters to receive rebates on tariff duties, but this is administratively costly and is only a partial offset of this penalty.

The Harvard geeks construct a complex statistical model to demonstrate this simple economic truism in the SA context. They show, unsurprisingly, that lowering tariffs increases the profitability of exporting, and show a clear and strong relationship between tariff liberalisation and export growth over the 1990s.

They show as well that nominal exchange rate changes have much less of an impact on exports, since any temporary advantage is soon dissipated by compensating changes in domestic prices. A nominal exchange rate depreciation is no silver bullet for our current export problems.

So why have South African exports stalled? Precisely because the liberalisation process that began in the 1990s has also stalled. Despite a commitment at the beginning of the reforms to reduce the number of tariff rate bands to six (0%, 5%, 10%, 15%, 20% and 30%), the total number of bands is currently 38, exactly the same as in 1990. For imports from the EU the number of bands was 54. In addition, the complexity of the tariff structure has been increased by the use of special rebates and by detailed differentiation of tariffs within sectors.

The proliferation of special rates and rebates reflects a product and sometimes even firm-specific approach to tariff policy. This made-to-measure approach involves deliberations on tariff policy based on the claimed or perceived needs of individual firms. Rather than setting relatively low and uniform tariffs across all products, as intended at the launch of the reforms, tariff policy has continued to be negotiable.

SA has also become one of the world’s most prolific users of World Trade Organisation anti-dumping provisions. At the end of 2003 SA had 90 different anti-dumping duties in place, placing it fourth in the world, behind the US, India and the EU. The trend has continued, and in the first half of 2005 SA achieved the distinction of launching more anti-dumping investigations than any other country in the world.

Finally, excessive focus on trade negotiations has led to an erroneous and harmful mercantilist approach to trade based on “offensive” and “defensive” concerns defined by narrow special interests rather than the long run growth objectives of the South African economy. Unilateral and MFN-based tariff reforms have been replaced by bilateral and other preferential negotiations as the engine of policy change.

For all of these reasons, it is apparent that trade reform still has a long way to go in SA. This might help to explain why the dividends from trade reform have been less than might have been hoped.

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