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DEBATES about import parity pricing illustrate why the availability of raw materials from domestic sources can be a double-edged sword for downstream manufacturers.

The competitive availability of industrial inputs should help downstream users by reducing the time, logistical, transport and other costs of sourcing internationally.

However, if domestic raw materials are produced at high cost behind the protection of tariffs and transport costs, or if it they are exported competitively to world markets but sold at higher prices domestically, then downstream users are penalised relative to producers in other countries.

This appears to be the case in SA's iron, steel, plastics and textile industries. And, in the face of such practices, downstream users might be better off without domestic raw-material industries.

The trade and industry department is aware of this dilemma and has prepared a national import pricing strategy, which was due to be released by the middle of this month.

In the absence (and in anticipation) of this strategy, we consider the causes of import parity pricing in SA and some of the possible solutions.

What is import parity pricing? Most basic industrial raw materials are traded in world markets and have prices that are quoted in international trading centres, such as London, New York, Singapore and Tokyo.

The import parity price is what a South African importer has to pay to purchase the product in the world market and have it delivered for domestic sale in SA. It includes all shipping charges, other transactions costs, and import duties and surcharges levied in SA.

Why would domestic producers charge the import parity price for raw materials they make and sell in SA, even when they do not incur any transport, transaction or customs charges?

The answer, put simply, is because they can. The absence of foreign and domestic competition gives producers pricing power in the local market.

Downstream buyers have two options — to import at the import parity price or to buy from the local supplier (at this same price).

This problem is not peculiar to SA. Prior to trade policy reform in Indonesia and Vietnam, for example, protected monopolistic producers of plastics and steel impeded the development of downstream manufacturing through high prices, uncertain delivery and poor quality.

The affected industries were far more labour intensive than upstream steel and plastics. And many of the downstream products were consumed disproportionately by the poor.

A recent study for the trade and industry department estimates the cost of import parity price in the South African iron and steel markets. The study concludes that the difference between the import parity price and the price received on steel exports is often as high as 50%. Most of this "wedge" is accounted for by transport costs.

The study provides many examples of labour-intensive and often export-competitive downstream products that have been harmed as a result of monopolistic import parity pricing of basic steel.

What can be done? The first and perhaps easiest step is to eliminate tariffs and antidumping duties on raw material imports. Tariffs on basic steel and plastics are low, but SA is a prolific user of antidumping duties in these sectors and this certainly constrains foreign competition. Tariffs on textiles are extremely high.

Eliminating trade taxes will have no effect on the (double) transport wedge that facilitates import parity price by monopolistic raw material suppliers. This requires a second set of actions to remove or reduce unnecessary impediments to export and import trade.

Such changes could include improvements in transport infrastructure, port facilities and services and customs procedures.

An export tax is sometimes proposed as a means to reduce exports and lower the domestic price of raw materials. However, in the presence of monopolistic import parity pricing, an export tax will have no effect on the raw material producer's domestic market power.

The only alternative for downstream users is the same as it would be in the absence of the export tax, to source through imports at the same import parity price as before. In addition, it creates an unnecessary and costly disincentive to efficient exports of upstream products.

Finally, because the most important occurrences of import parity pricing are a reflection of monopolistic behaviour, it is quite natural to look to competition policy for remedies.

Recent work done for the department suggests that major players have been quite successful in controlling distribution networks to facilitate their non-competitive pricing behaviour, and that these practices violate conditions imposed by the competition authorities.

The Competition Commission should act to make price discrimination impossible, or to forbid discriminatory pricing.

It is possible that government will look to price controls and regulations to administer import parity price; or that they will try to negotiate private deals with specific raw material producers.

This is not the answer.

Much of the success of trade and industrial policy over the past decade has arisen from the dismantling of complex price and other regulatory systems.

Let us hope that government's strategy focuses on increasing foreign competition through reduced impediments to exporting and importing and on sanctions against the most egregious forms of domestic anticompetitive pricing.

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