

Policy Brief – Trade

Robert Lawrence

May 2008

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Note: This is a non-technical policy brief based on "SACU Tariff Policies: Where Should They Go From Here?" by Lawrence Edwards and Robert Lawrence, available at <http://www.cid.harvard.edu/cidwp/169.html>, as well as "South African Trade Policy Matters: Trade Performance & Trade Policy" by Lawrence Edwards and Robert Lawrence, available at <http://www.cid.harvard.edu/cidwp/135.htm>.

This paper is part of the CID South Africa Growth Initiative. This project is an initiative of the National Treasury of the Republic of South Africa within the government's Accelerated and Shared Growth Initiative (ASGI-SA), which seeks to consolidate the gains of post-transition economic stability and accelerate growth in order to create employment and improve the livelihoods of all South Africans. For more information and the entire series of papers, visit the project's web site at <http://www.cid.harvard.edu/southafrica>.



Center for International Development
at Harvard University

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SACU trade policies should be reformed using a strategy that focuses on liberalizing input tariffs so that tariffs on final products can also be reduced and exports stimulated through the creation of a competitive input base. The tariff structure should be radically simplified using zero and just one or two rates although a limited number of temporary measures could also be implemented for infant industry and safeguard purposes. In addition, the SACU tariff revenue sharing formula should be renegotiated with distinct revenue-sharing and development components. South Africa should take the lead in encouraging African economic integration but avoid entanglements in unrealistic Customs Union agreements.

South African trade policy has exerted a major influence on the composition and aggregate growth of trade. In the Apartheid period, trade protection seriously impeded both exports and imports, and the economy depended on favorable global commodity price trends to avoid running into an external constraint. By contrast, trade liberalization in the 1990s not only increased imports but, by reducing both input costs and the relative profitability of domestic sales, also boosted exports and stimulated productivity. This evidence suggests that given the right incentives South African firms will increase their exports and thus additional trade liberalization could be part of the strategy to enhance export diversification. It also points to the importance of policies that afford South African firms with access to inputs at world prices as well as a competitive real exchange rate

While considerable progress was made in the 1990s in liberalizing and simplifying SACU's tariff structure, over the past few years such movement appears to have slowed. This is unfortunate because trade performance is a key constraint in attaining South Africa's growth objectives. The tariff structure remains excessively complex and opaque and biased against exports. Specific tariffs in rands are still used in agricultural products. There are about 100 different bands and individual products in the same sector are given disparate amounts of protection. The differentiation appears mainly to be the result of historical accident and does not appear to be justifiable as efficient job preservation, equitable income distribution or on infant industry grounds. On average South African workers earn 95 thousand Rand per year working in manufacturing. Yet consumers, many of whom are poor spend almost 2 million Rand for each job that tariffs save. South African society as a whole foregoes welfare benefits that are almost three to four times the average wage of each job saved.

Some still continue to defend a complex structure as necessary to provide producers of particular products with precisely the amount of protection they need to become competitive. But their arguments are unconvincing. There may be a case for exceptional temporary safeguards and infant industry protection but a broad complex structure is likely to allocate resources inefficiently: channelling them away from activities in which South Africa is competitive and towards those in which it is less efficient. Protection of inputs is particularly damaging and distorting of the choices of those seeking to benefit and export. In addition, the government simply does not have the requisite information (or instruments) to apply such differentiation appropriately to such a large number of products. Inevitably, therefore the structure encourages and reflects rent seeking.

Using simple tariff structures that have a zero and just one or two additional tariff bands it is possible simultaneously to provide benefits to consumers, limit employment dislocation by conferring a reasonable degree of effective protection on finished goods, reduce export taxes, improve transparency and provide a norm against which industrial policy priorities can be set. Implementing such an approach would also lead to a more competitive Rand. The long run goal would be a globally competitive SACU region that provides producers with access to inputs at world prices.

South Africa's regional trade policies require attention. The African continent plays a key strategic role in South Africa's export diversification strategy and regional development is a vital priority. The current SACU tariff sharing formula is expensive and defective. A major reform of SACU tariffs would make particular sense for the BLNS countries, allowing these nations access to cheaper inputs and final products. It would also provide the opportunity to renegotiate the SACU revenue-sharing formula, more clearly and rationally separating its aid and tariff-revenue sharing components. SACU should share its tariff revenues on a per capita basis, and South Africa should establish a separate regional development fund.

SACU should avoid unrealistic commitments to customs unions with other African partners. In its other regional arrangements (e.g. with SADC) SACU should place primary reliance on free trade agreements and other projects (e.g. infrastructure) that enhance integration. South Africa should underscore its commitment to African integration by granting its FTA partners more lenient rules of origin, a concession that would become feasible with a more competitive domestic input base. It should also propose a SADC-COMESA FTA.