

**ASSESSING THE TRADE POLICY SPACE TO IMPLEMENT INDUSTRIAL  
POLICY IN SOUTH AFRICA**

By

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## CONTENTS

<b>DECLARATION.....</b>	<b>iii</b>
<b>ABSTRACT.....</b>	<b>iii</b>
<b>ACKNOWLEDGEMENTS .....</b>	<b>v</b>
<b>ABBREVIATIONS.....</b>	<b>vi</b>

### **CHAPTER 1: INTRODUCTION**

1.1 Background .....	1
1.2 Research Problem .....	2
1.3 Hypothesis.....	3
1.4 Research Aims and Objectives .....	3
1.5 Research Approach and Method .....	4
1.6 Outline of the Study.....	4

### **CHAPTER 2: GLOBAL CONTEXT AND DEBATE ON INDUSTRIAL AND TRADE POLICY**

2.1 Introduction .....	5
2.2 What is industrial policy?.....	6
2.3 Approaches to Industrial Policy .....	6
2.3.1 Neoliberal Approach .....	7
2.3.2 Structuralist Approach .....	8
2.4 Nexus between Industrial and Trade Policy.....	9
2.5 Policy Space in the WTO for the Industrial Policy Instruments .....	10
2.5.1 General Agreement on Tariffs and Trade (GATT) .....	11
2.5.2 Trade Related-Aspects on Intellectual Property Rights (TRIPS).....	12
2.5.3 Trade Related Investment Measures (TRIMs) .....	12
2.5.4 Agreement on Subsidies and Countervailing Measures (SCM) .....	13
2.5.5 Regional Trade Agreements.....	14

### **CHAPTER 3: HISTORICAL AND ANALYTICAL APPROACH TO INDUSTRIAL AND TRADE POLICY IN SOUTH AFRICA**

3.1 Evolution of the Industrial Policy in Africa.....	15
3.2 Industrial Policy in South Africa .....	16
3.2.1 Industrial Policy in the Apartheid Era .....	17

3.2.2 Growth-led Industrialisation .....	18
3.2.3 Industrialisation-led Growth .....	19
3.3 Trade Policy in South Africa .....	20
3.3.1 Trade Policy in the Apartheid South Africa .....	20
3.3.2 Trade Policy in the Democratic South Africa .....	21

## **CHAPTER 4: IS THERE POLICY SPACE TO PURSUE INDUSTRIAL POLICY IN SOUTH AFRICA?**

4.2 The Level of Manufacturing in South Africa .....	25
4.3 Tariff Analysis on Priority Sectors Identified in the IPAP .....	26
4.4 Compatibility of Incentives in South Africa to the WTO Rules .....	28
4.4.1 Industrial Development Zones.....	28
4.4.2 Aquaculture Development and Enhancement Programme (ADEP) .....	29
4.4.3 Automotive Investment Scheme (AIS).....	30
4.4.4 Manufacturing Competitiveness Enhancement Programme (MCEP) .....	31
4.4.5 Export Marketing and Investment Assistance Scheme (EMIA).....	31
4.5 Is Localisation Permitted under TRIMS.....	32
4.6 Can South Africa Rely on Government Procurement as Instrument of IP?.....	32

## **CHAPTER 5: CONCLUSION REMARKS: POLICY SPACE AVAILABLE IN THE WTO**

<b>REFERENCES.....</b>	<b>39</b>
------------------------	-----------

### **LIST OF TABLES**

Table 1: South Africa's Manufacturing Performance.....	26
Table 2: The Difference between Applied and Bound Tariff Rates on Selected Sectors.....	27
Table 3: Sectors and Subsectors designated under the PPPFA.....	33

### **LIST OF APPENDIX**

Appendix 1 Tariff phase-down under the WTO .....	37
Appendix 2: Structure of South Africa's MFN tariffs – 2000, 2008 and 2009/2010 .....	38

## **DECLARATION**

I declare that the work submitted is my own work and original. This research work has not been submitted anywhere else for any degree and all sources have been acknowledged.

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## ABSTRACT

This paper undertook qualitative research to determine the trade policy space for South Africa to implement its industrial policy action plan (Ipap). The South African economy was transformed from import substitution in the 1970s to export-orientation in the 1980s. The apartheid regime failed to develop coherent policies for industrialisation. In the 1990s, there was a deliberate government decision as articulated in the GEAR policy to liberalise the economy and with regard to trade this is associated with accession to the World Trade Organisation and commitments made thereof. In 2007, the country adopted the national industrial policy framework to guide its reindustrialisation efforts and subsequently various iterations of the Ipap. Therefore, given that a lot of policy space was lost when the country joined as the WTO as a developed country, the question is “does South Africa have enough policy space to use some of the instruments that were used by successful Asian countries to industrialise”. The WTO made some of these instruments illegal.

To analyse policy space, the paper looked at the effect of WTO Agreements on Subsidies and Countervailing Measures (SCM), on Trade-Related Investment Measures (TRIMS), on Government Procurement (GPA), as well as the tariff commitments. The study found that although SCM has made certain subsidies illegal, other kinds of subsidies are allowed such as those for economic development in disadvantaged regions and for rural development. Therefore, strategy and packaging of these subsidies for development is important. TRIMS was found to have significantly reduced policy space by making a number of instruments on foreign direct investment illegal such as enforcing local content as well as export requirements. Since South Africa is not party to the GPA, it retains policy space to use government procurement to promote industrialisation in the country. In terms of tariffs commitment, the study found that there is no “water” between applied and bound rate for a number of critical sectors such as textile, clothing, footwear, and furniture. However, other important sectors such as automotive and automotive components and white goods still have “water” to increase tariff in future as necessary. Therefore, the study concluded that there is policy space to implement industrial policy in South Africa but this requires strategy and closer look at the WTO rules for flexibility.

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## **ABBREVIATIONS**

AsgiSA	Accelerated and Shared Growth Initiative for South Africa
ANC	African National Congress (ANC)
BITs	Bilateral investment agreements (BITs)
BRICS	Brazil, Russia, India, China, South Africa
The dti	Department of Trade and Industry
EOI	Export-oriented industrialisation
FTAs	Free-trade agreements
GATT	General Agreement on Tariffs and Trade
GATS	General Agreement on Trade in Services
GDP	Gross domestic product
GEAR	Growth, Employment and Redistribution
GPA	Agreement on Government Procurement
ISI	Import substitution industrialisation
IDZ	Industrial Development Zones
IP	Industrial policy - IP
IPAP	Industrial Policy Action Plans
IPR	Intellectual property rights
IMF	International Monetary Fund
KAPs	Key action plans
MVA	Manufacturing value-added
NIPF	National Industrial Policy Framework
NEDLAC	National Economic Development and Labour Council
NICs	Newly industrialised countries
RTAs	Regional Trade Agreements
RDP	Reconstruction and Development Programme
SAP	Structural adjustment programme
SCM	Agreement on Subsidies and Countervailing Measures (SCM)
TRIPS	Trade Related-Aspects of Intellectual Property Rights
TRIMS	Trade Related Investment Measures
TPSF	Trade Policy and Strategy Framework
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organisation

WB World Bank  
WTO World Trade Organisation

## CHAPTER 1

### INTRODUCTION

#### 1.1 Background

The majority of the newly industrialised countries (NICs) in East Asia have used industrial policy (IP) to promote industrialisation. According to Rodrik (2012), industrialisation, in particular manufacturing industries, will bring about structural change that will result in unconditional convergence. In departure from neoclassical growth theory, Rodrik maintains that countries that manage to effect the requisite structure change will grow rapidly while those that fail do not. To this end, Rodrik indicate that what high-growth countries typically have in common is their ability to deploy policies that compensate for the market and government failures that block growth-enhancing structural transformation. Pack and Saggi (2006) defined industrial policy as selective government intervention that attempts to alter the structure of production in favour of sectors that are expected to offer better prospects for economic growth. Industrial Policy (IP) is pursued through a number of instruments, which amongst others include trade policy as it was the case with the NICs (Valila, 2008).

The establishment of the World Trade Organisation (WTO) in 1995 led to binding commitments on issues such as patents (through WTO Agreement on Trade Related-Aspects on Intellectual Property Rights (TRIPS)), regulation of foreign investment (through WTO Agreement on Trade Related Investment Measures (TRIMs)), trade in services (through General Agreement on Trade in Services (GATS)) as well as tariff reductions (Chang, 2005). Consequently, WTO through its undertakings made illegal some of the policy instruments that made the East Asian countries successful (and perhaps also the early industrialisers as documented by Chang (2002)) in their industrialisation path.

This led Page (2007) to pose a question, are we ‘kicking away the ladder’ that other countries used to develop? Similarly, Chang (2005) argues that “policy space” available for the developing countries has shrunk so much that their ability to achieve economic development is threatened. Page (2007) described policy space as the scope for domestic policies, especially in the areas of trade, investment and industrial development, and how it is framed by international commitments as well as global market considerations. Chang (2005) and

Shadlen (2005) indicated that, in addition to the WTO, the developed countries have used bilateral and regional free-trade agreements (FTAs) and bilateral investment agreements (BITs) to impose on developing countries further restrictions that they cannot get accepted in the WTO.

In an effort to promote industrialisation, South Africa launched a National Industrial Policy Framework (NIPF) in 2007 (the dti, 2007) and several iterations of Industrial Policy Action Plans (Ipap) have since been designed, the latest being Ipap III (the dti, 2012). The NIPF outlines an industrialisation path for South Africa whilst IPAP 3 identifies specific priority sectors. South Africa's Trade Policy and Strategy Framework states that the country's trade policy is an instrument for the IP (the dti, 2010).

In the past there have been concerns within the National Economic Development and Labour Council (NEDLAC) as to whether there is policy space given the existing obligations in the WTO (NEDLAC, 2003 & 2006). This was due to the fact that South Africa undertook obligations in the WTO as a developed country which translated, amongst others, into deeper cuts in tariffs and other commitments. This research will interrogate the extent to which South Africa's international commitments may act as a constraint on the country's proposed industrial policy.

## **1.2 Research Problem**

Following its accession to the WTO in 1994, South Africa has substantially liberalised its tariffs (Edwards and Lawrence, 2006). The average applied tariff rate for the South Africa was 7.7% in 2010 (WTO, 2011). Further, the WTO statistics shows that the average applied tariff rates for agricultural products and non-agricultural goods were 9% and 7.5%, respectively. As compared to other BRICS countries, India has the highest applied tariff with an average of 31.8% for agriculture, and 10.1% for non-agricultural products. While the average applied tariff for Brazil was 10.3% for agricultural, and for non-agriculture 14.2%, China (15.6% for agricultural, and for non-agriculture 8.7%), and Russia (13.53% for agriculture, and for non-agriculture 8.9%). This shows that South Africa's tariffs are quite low compared to its BRICS partners.

In addition, South Africa, due to single undertaking in the WTO<sup>1</sup>, is signatory to multilateral Agreements such as on TRIMs, GATs, TRIPs, and SCM. These show that South Africa has undertaken a number of binding commitments in the WTO on patents, regulation on investment, and trade in services. South Africa is however not part of the Plurilateral Agreement on Government Procurement, which has been described as the most constraining for IP prospects by Kattel and Lember (2010)<sup>2</sup>.

Therefore, the overall question this research attempts to answer is “Does South Africa have policy space within WTO to implement its industrial policy”. The specific questions that the research will address are as follows, 1) does South Africa have space in its tariff structure to increase protection of the IPAP 3 priority sectors; 2) do the rules in the TRIMs permit use of certain IP instruments, and 3) does TRIPs provide space for South Africa to acquire the technology required in the implementation of IPAP 3. Furthermore, once the study has identified potential constraints to implementing industrial policy, it will attempt to find ways and means South Africa can better utilize limited policy space within WTO and circumvent potential stumbling blocks.

### **1.3 Hypothesis**

The study hypothesises that South Africa’s commitments in the WTO provide the necessary space to implement its industrial policy. Whilst the WTO imposes obligations on member countries, it does provide sufficient space for developing countries to pursue domestic policies in the areas of trade, investment and industrial development. In addition, the WTO rules does allow special and differential treatment for developing countries, which bode well industrial policy space in South Africa.

### **1.4 Research Aims and Objectives**

There is a perception, amongst some policy makers, academics and civil society organizations, that South Africa’s membership of the WTO and its undertaking of commitments has severely impacted on the policy space to pursue a developmental agenda,

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<sup>1</sup> The “Single Undertaking” designates the obligation of all WTO members to accept and apply all the agreements negotiated under the auspices of the organization (Negrescu and Truica, 2006).

<sup>2</sup> Plurilateral Agreements are those multilateral agreements treaty between a limited number of states with a particular interest in the subject of the Agreement but not the whole membership of WTO.

(Nedlac, 2003, 2006). As a result, this research attempts to establish whether South Africa has the required policy space, from a trade policy perspective, to use policy instruments that NICs used to pursue their IP as part of its developmental agenda.

### **1.5 Research Approach and Method**

The project will apply a mix of qualitative-descriptive and quantitative-descriptive approaches. In order to test whether there is “water” between applied and bound tariffs for IP sectors, the research will analyse South Africa’s tariff book available from the South African Revenue Service as well as the country’s commitment schedules in the WTO. This will be compared to BRICS countries. To test for IP space in the TRIPS and TRIMS for South Africa, the study will analyse relevant WTO Agreements as well as the country’s commitment schedules in the WTO. Over and above this, interviews will be conducted with relevant South African policy makers as well as the country’s representatives in the WTO in Geneva with a view to understanding past, current and future industrial and trade policy trajectory.

### **1.6 Outline of the Study**

The study will be arranged as follows. Chapter 2 reviews the literature on Industrial/trade policy instruments. This chapter will review literature on various approaches to IP and proposed instruments to implement the industrial policy. Emphasis will be on economic theory underpinning these approaches. In addition, this chapter will review previous studies on policy Space in the WTO on the industrial/trade policy instruments.

Chapter 3 will review official policy documents in South Africa on the NIPF and the industrial policy action plan as well as the trade policy in the country. This Chapter will review literature on the industrial and trade policy in South Africa from a historical perspective. Chapter 4 briefly outlines the research approach and the methodology as well as the analysis and results for the study. Chapter 5 provides conclusion and recommendations.

## CHAPTER 2

### GLOBAL CONTEXT AND DEBATE ON INDUSTRIAL AND TRADE POLICY

#### 2.1 Introduction

There is a long-standing realisation on the need for industrialization in developing countries; however, the differences have been on the role of the state in the industrialization process. The role of the state has been changing over the last seven decades. In the period following World Wars and the Great Depression, the role of the state was prominent in developing countries and in particular those in Latin America and East Asia. The state used various instruments to support the industrialization process and they were not constrained by either regional or international agreements. Even in the 1970s in the presence of the GATT 1947, these countries still managed to find a way around the prevailing rules.

The 1980s saw the introduction of neoliberal policies which Williamson (1990) termed the Washington Consensus and these policies advocated for no or minimal role of the state in the economy. Furthermore, there was a surge in international and regional agreements that constrained the ability of the state to use IP instruments, used by the NICs, to support their industrialization process. However, the financial crisis and economic meltdown that started in 2008 brought back the discussion on the role of the state in the economy (Palley, 2012).

This lead to the question, do governments have adequate policy space to intervene in the economy, how much “policy space” has been eroded by the Washington Consensus policies. This is the question that has occupied the minds of a number of researchers and institutions over the recent past. This section will first review literature on the definition as well as various approaches to the industrial policy. Furthermore, the paper will review literature and identify various instruments used to pursue IP in Latin America and East Asia. Lastly, the paper will discuss policy space in the WTO to pursue industrial policy.

## **2.2 What is industrial policy?**

Rodrik (2004) defines industrial policy as policy that focuses on economic restructuring in favour of more dynamic activities located within industry or manufacturing. According to Rodrik, industrial policy can trigger industrialisation as envisaged by neoclassical economics. Pack and Saggi (2006), and Valila (2008) indicated that IP is “any type of selective government intervention or policy that attempts to alter the structure of production in favour of sectors that are expected to offer better prospects for economic growth in a way that would not occur in the absence of such intervention”. Both definitions indicate that IP is concerned with how developing countries can transform their productive capacity to produce products associated with high growth. This augurs well with views by Amsden (1997), who argued that production should be at the heart of industrialisation process, not exchange.

The reasons and motivations why countries in Latin America and East Asia pursued industrialisation are adequately covered by Hunt (1989) and Shapiro (2007) and will not be discussed further in this paper. However, it is worth mentioning that developing countries adopted Washington Consensus policies hoping that this will result in convergence in income. According to Rodrik (2012), neoclassical growth theory establishes a presumption that countries with access to identical technologies should converge to a common income level. But as observed by Lall (2004), diverging industrial competitiveness in the developing world is one of the basic causes of the growing disparities in income that are now a pervasive feature of the world scene. Therefore, industrial policy and industrialisation is important for economic development as unconditional convergence occurs in manufacturing industries rather than the entire economy (Rodrik, 2012).

While there seem to be consensus on the definition of the industrial policy, there are differences on what should be the function of this policy and the specific role of the state. The next section considers various approaches to industrial policy.

## **2.3 Approaches to Industrial Policy**

Lall (2004) identified two approaches to IP and these include neoliberal and structuralist. This paper will situate various discussions on IP under these two approaches.

### **2.3.1 Neoliberal Approach**

The views represented by this approach have been changing over the years, from total rejection of IP to acknowledgement of the importance of industrial upgrading to economic growth and development [Williamson (1990), Stiglitz (1998), Lin and Chang (2009), Wade (2010), Lin (2010) and Singh (2012)]. According to Peres (2007), industrial policies gradually lost legitimacy over the course of the 1980s due to high debt and balance of payment problems. Hence, in the 1980s, the Bretton Woods institutions encouraged developing countries to adopt Washington Consensus policies and these policies included amongst others, fiscal discipline, reordering public expenditure priorities (to focus on basic health and education, and infrastructure), competitive exchange rate, trade liberalisation, liberalisation of inward foreign direct investment, privatisation, deregulation as well as protection of intellectual property rights (Williamson, 1990). Washington Consensus did not foresee any role for government in the economy except to provide essential public goods like human capital and infrastructure (Lall, 2004). Markets were considered efficient in allocating resources and even if there is market failure, it was assumed that such failure was lower than government failure.

Then in the late 1990s, Stiglitz (1998) provided a critique of the Washington Consensus and advocated for a move towards post-Washington Consensus. Stiglitz emphasised the role of regulatory environment (sound financial markets and competition) as well as the role of government to complement markets. He point-out that financial liberalisation and privatisation are not necessary conditions for growth but sound regulations of markets as well as competition.

Three decades after the Washington Consensus, in 2009, through a debate with Ha-Joon Chang [Chang and Lin (2009) and more detailed in Lin (2010)], Justin Lin, the then Chief Economist and Senior Vice-President of the World Bank, signalled a departure by the Bank from Washington Consensus and acknowledged the importance of industrial upgrading in economic growth and development. However, Lin preferred a facilitating state that facilitates the private sector's ability to exploit the country's current comparative advantage. He foresees the role of the state as correcting markets failures such as information externalities and coordination problems. Similar to Washington Consensus, Lin indicated that the state should intervene with subsidies to encourage innovation in order to deal with informational

externalities and also provide soft and hard infrastructure to deal with coordination problems. Further, countries should specialise in sectors in which they have comparative advantage (CA).

Rodrik (2004), and Hausmann, *et al* (2008) favours a government that support firms in their self-discovery process of new products by addressing any potential market failures, rather than helping firms to exploit current comparative advantage. In this regard, government should restrict subsidies to self-discovery in new, non-traditional industries but it should not pick winners. Again, Rodrik (2012) noted the importance of manufacturing industries to bring about industrialisation.

Singh (2012) while applauding the changing perspectives on IP by the World Bank, argued that this represent “one step forward (the approval for the enhanced role of the state) but also one if not two steps backward (by strong encouragement to countries to seek their current comparative advantage in pursuing industrial policy)”.

### **2.3.2 Structuralist Approach**

This approach has its roots in Latin America following the Great Depression and the World Wars and it is associated, amongst others, with scholars such as Raoul Prebisch, Hans Singer, Celso Furtado, and Oswaldo Sunkel (Hunt, 1989). It unceremoniously ended in the 1980s due to the debt crisis and was then replaced by a neoliberal approach in Washington Consensus. However, since the turn of the 21 century, developing countries have been trying to reclaim this approach and the global financial crisis followed by the economic meltdown helped fast-track and legitimise this process.

The structuralist approach favours transformation of the economic structures in developing countries from raw-material-and-resource based economies to value-added and industrial products based economies (Hunt, 1989). In this regard, policy recommendations entailed government intervention to assist the private sector to change these structural characteristics through promotion of import-substituting industrialisation (ISI). This approach maintains that government interventions are necessary to improve market outcomes. In fact, (Lall, 2004) argues that many poor regions that have implemented neoliberal policies recently have not experienced the industrial growth or export success that characterized more interventionist

economies. In addition, this approach rejects the notion of world division of labour on the basis of specialization according comparative advantage. It advocate for defying and creating comparative advantage.

According to Ha-Joon-Chang is his debate with Justin Lin (Lin and Chang, 2009), it is simply not possible for a backward economy to accumulate capabilities in new industries without defying comparative advantage and actually entering the industry before it has the ‘right’ factor endowment. However, Chang concede that comparative advantage does offer a useful guideline as to how much a country is sacrificing by protecting its infant industries. The more countries deviate from their comparative advantage, the more that country will pay in order to acquire capabilities in new industries.

Pack and Westphal (1985) indicated that successful East Asian countries pursued dual industrialisation policy, which encouraged investments in established industries where there was a static CA as well as investments in infant industries where there was a potential for dynamically achieving a CA. Similarly, Wade (2010) argued that the East Asian IP comprised of two kinds: ‘leading the market’ and ‘following the market’. ‘Leading the market’ policy entail the government making an investment decision that the private sector would not make, while the ‘following the market’ policy referred to the government supporting some of the initiatives of the private firms. Wade noted that a lot of East Asian countries’ industrial policies were not the leadership kind but followership aimed at accelerating movement in the directions that the private sector wanted to take. Wade criticised Lin approach to industrial policy, indicating that it says little about the role of government in creating comparative advantage. Lastly Amsden (2001) debunked the notion that industrialisation in East Asian was market-led indicating that these countries had to “get the prices wrong” to advance their economic development.

#### **2.4 Nexus between Industrial and Trade Policy**

The discussion on the relationship between industrial and trade policy is quite an interesting one taking into account the views of orthodox economists on one hand and heterodox economists on the other. Both these economists agree that trade policy is an instrument of industrial policy and has a potential to bring about industrial upgrading and development but significantly disagree on the how part. This section reviews literature from both orthodox and

neoclassical, and heterodox school of thoughts on the role of trade policy in industrialisation process. It is important to indicate at the onset that the bone of contention between neoclassical and heterodox economists is whether to follow or defy CA.

Shafaeddin (2010) summarised key positions of orthodox economists as follows: the free-market based approach to development; the lack of active government intervention in the process of industrialization and development; universal and across-the-board trade liberalization; and devaluation. Both Williamson (1990) and Rodriguez-Clare (2005) agree that a policy of protecting domestic industries against foreign competition create costly distortions that end up penalizing exports and impoverishing the domestic economy. But according to Williamson, Washington Consensus does allow strictly temporary protection to the infant industries. Similarly, Lin (2010) advocated for a gradualist approach to trade liberalization and in the transition period, the state may consider some temporary protection to industries that are not consistent with a country's CA.

On the heterodox side, Shafaeddin (2010) argued that trade policy should be development-oriented, that is, it should be an integral part of industrial and development strategy. According to Shafaeddin, this justifies the use of any relevant policy instrument to protect the domestic industries, including tariffs and/or quantitative restrictions, or payments of subsidies for particular good. Literature has shown that both developed countries and the newly industrialized economies (NIEs), with the exception of Hong Kong, used infant-industry protection to industrialize [Shafaeddin (2010), Chang (2002 & 2010), and Lall (2004)]. Ha-Joon Chang in his book kicking-away the ladder has shown that the developed countries have actually practised an infant industry protection in their development path (Chang, 2002).

Most importantly, Shafaeddin indicated that the NIEs also used infant-industry support not only for import substitution but also for export promotion. It is widely agreed that the East Asian countries used complementary import substitution and export promotion in their industrialisation process.

## **2.5 Policy Space in the WTO for the Industrial Policy Instruments**

A number of authors have indicated that the current policy space in the World Trade Organisation restrict developing countries in implementing their national developments

strategies. Developing countries have to contend with several multilateral agreements that were not in existence when the developed countries of today were developing (Pack and Saggi, 2006). Rodrik (2004) note that there has been tendency to discipline national economic policies through multilateral, regional, or bilateral agreements, and these disciplines impose restriction on the ability of developing countries to conduct certain types of industrial policies.

The establishment of the World Trade Organisation (WTO) in 1995, following the conclusion of the Uruguay Round talks in 1994, led to binding commitments on issues such as patents and copyrights (through TRIPS), regulation of foreign investment (through WTO Agreement on TRIMs), trade in services (through GATS) as well as tariff reductions (Chang, 2005). Consequently, WTO through its undertakings has made illegal some of the policy instruments that made the East Asian countries successful (and perhaps also the early industrialisers as documented by Chang (2002)) in their industrialisation. UNCTAD (2004) indicated that enhanced coherence between national development strategies, on the one hand, and international obligations and commitments, on the other, would contribute to the creation of an enabling environment for development. In this regard, UNCTAD expressed their concerns on the impact of international policies and processes on the scope for implementing national development strategies.

### **2.5.1 General Agreement on Tariffs and Trade (GATT)**

Page (2007) and Gibbs (2007) noted that import tariffs can be an important IP instrument, which both East Asian NIEs and Latin American countries used to encourage specific industries. To this end, Page argues that the single largest loss of policy space take places when countries joins GATT or the WTO due to obligation to reduce tariffs. Similarly, Gibbs argues that tariff reductions may undermine industrialisation policies in developing countries. Nevertheless, Page found that most countries still have the space to use tariff to undertake industrial policy. Equally, Shadlen (2005) argued that countries typically bounded their tariffs at level significantly higher than actual applied tariffs leaving room to adjust tariffs in support of domestic objectives. This implies that, according to Shadlen, tariff reduction due to accession to the WTO does not represent a significant impediment to pursuing the IP.

### **2.5.2 Trade Related-Aspects of Intellectual Property Rights (TRIPS)**

TRIPS introduced protection on trademarks, copyrights, industrial design, data secrets, and patents. Page (2007) indicated that the introduction of rules on patents and copyright in the Uruguay Round was probably one of the most important sources of concerns over policy space and agrees that TRIPS may have had a more profound restrictive effect on potential policy freedom. According to Wade (2003), Japan, Taiwan and South Korea were each known as ‘the counterfeit capital of the world in their industrialising time while the US was known as a bold pirate of intellectual property’. Similarly, Kumar and Gallagher (2007) points-out that developed countries have used lax IPR to benefit from innovations in other countries during their process of industrialisation. This implies that both early and late industrialisers employed a strategy of reverse engineering and coping technologies developed in other countries to industrialise and catch-up. But this is now illegal under TRIPS.

According to Rodrik (2004), and Di Caprio and Amsden (2004), TRIPS currently make it virtually impossible to use the strategies mentioned in the preceding paragraph while Wade indicated that TRIPS raises significant development obstacles for many countries that the earlier developers did not face. Nevertheless, Shadlen (2005) indicates that TRIPS still provide countries with policy space for developing countries. He point out that “by imposing stringent rules on disclosure and subsequent granting narrow patents, for example, or by allowing for wide-ranging research exceptions, countries can provide local actors with opportunities to invest around patents without risking litigation for infringement”.

### **2.5.3 Trade Related Investment Measures (TRIMs)**

Wade (2003), Rodrik (2004), Di Caprio and Amsden (2004), Shadlen (2005) and Shafaeddin (2010) agree that TRIMS outlaws key investment regulations that have been at the heart of development strategies in NICs. They pointed-out that performance requirements that are no longer permissible in the WTO include local content regulations (which obliged foreign investors to source some of their inputs locally), trade balancing requirements (which required foreign investors to include sufficiently high levels of domestic inputs in exports to offset imported inputs) as well as export requirements.

Amsden (2001) attributed the success of East Asian NICs to their ability to impose reciprocal control mechanisms. In this regard, Mayer (2009) indicated that TRIMS makes it difficult to link investment support to export-related disciplines aimed at withdrawing support from producers who do not achieve international competitiveness within a pre-defined period. According to Shafaeddin, TRIMS prohibit support for infant industry as it obliges the host country to treat local and foreign companies equally even though they lack equal capabilities

In practice, Di Caprio and Amsden indicated that potential industrialisers do not claim to be significantly affected by the limits imposed by TRIMS as most welcome and are actively looking for any development investments. Consequently, Di Caprio and Amsden concluded that TRIMS does not yet pose much of a limit on potential industrialisers as none of them has reached the stage of having the capacity to use such measures. Furthermore, according to Di Caprio and Amsden, “as long as governments lack a clear-cut strategy, the degree of freedom in the WTO is redundant”. This view is shared by Kattel and Lember (2010) who indicated that developing countries need to develop the policy capacity to take advantage of the complex and multi-layered IP space still available under WTO rules.

#### **2.5.4 Agreement on Subsidies and Countervailing Measures (SCM)**

Di Caprio and Amsden (2004) notes that the strategic use of subsidies was one of the key development tools of the last industrialisers and the developed countries before them but these are now on the list of actionable subsidies. Rodrik (2004) and Shadlen (2005) indicated that export subsidies either directly to exporters or for domestic suppliers of inputs, which East Asian NIEs used to industrialise and support their export promotion efforts, are now WTO-illegal for all countries with the exception of least developed countries. In addition, Rodrik noted that this Agreement essentially render illegal all free trade zones (which in his paper he referred to as export processing zones).

Shadlen (2005) and Gibbs (2007) indicated that the SCM also makes provision for some subsidies as long as they do not cause serious prejudice to the interest of other countries. These include ‘drawbacks’ in which countries reimburse firms for the taxes they pay on imported goods that are later used in exports, as well as subsidies for the promotion of research and development. Shadlen (using a quote from Amsden and Hikino, 2000) asserted that “under the guise of science and technology, developing countries can continue to support

their own industries, to target national champions for government assistance, and to advance the general cause of the national competitiveness”.

However, Di Caprio and Amsden (2004) and Mayer (2009), while they agree with analysis by Shadlen, notes that the fiscal cost might be a constraints as some developing countries cannot afford to subsidies their firms. Therefore, the issue here is not necessarily of policy space but affordability. On the other hand, Kumar and Gallagher (2007) argued that while export subsidies were outlawed in the WTO, countries like the US and those in the European Union continue to provide substantial export subsidies to their enterprises. This talks to the issue of non-compliance by some developed countries.

### **2.5.5 Regional Trade Agreements**

It is a known fact that most RTAs between developed countries and developing countries tend to include WTO-plus issues such as investment, government procurement and intellectual property rights. As an example, Rodrik (2004) and Shadlen (2005) indicated that the U.S has pushed for tighter restrictions in the areas of investment regulations, intellectual property rights protection, and capital account whenever they negotiate a free trade agreement (FTA) with a developing country. Shadlen argue that the RTAs prohibit implementation of industrial strategies that are designed to alter comparative advantage and achieve upward mobility in the international economic order. According to Gibbs (2007), some countries use RTAs to impose tighter and more extensive disciplines on a trade partner that cannot be achieved in the WTO. This further reduces the policy space for developing countries to pursue various kinds of industrial policies.

Page (2007) argued that most policy space is lost outside the WTO, in the RTA when countries reduce their applied tariffs to below their commitments in the WTO. On the other hand, Di Caprio and Amsden (2004) indicated that some developing countries use RTAs as a way of maintaining some of illegal TRIMS instruments such as local content. The RTAs concessions are governed by preferential rules of origin, which are usually biased towards a home country. That is, countries usually insist on high percentage of local content.

Therefore, RTAs can be an instrument of industrial policy or it can erode the policy space, all depend on whether developing have a policy capacity and strategy for development.

## CHAPTER 3

### HISTORICAL AND ANALYTICAL APPROACH TO INDUSTRIAL AND TRADE POLICY IN SOUTH AFRICA

#### 3.1 Evolution of the Industrial Policy in Africa

Industrial policy in Africa has occupied the minds of both researchers and policymakers for the last five decades. United Nations Conference on Trade and Development (UNCTAD) and the United Nations Industrial Development Organisation (UNIDO) (2011) indicates that industrial development in Africa has gone through three broad phases since independence in the 1960s. These include import substitution industrialisation (ISI) phase, structural adjustment programme phase, and the poverty reduction strategy paper phase. This paper will focus on ISI and SAP phases in Africa.

The ISI phase started in the 1960s and ended in the 1970s. The start of ISI phase coincided with the independence of many African countries. Lall and Wangwe (1998) attested that industrialisation has been an integral part of African development strategies throughout the post-Independence era. This phase involved substantial government support and protection of domestic firms from foreign competition through (i) restriction of imports to intermediate inputs and capital goods required by domestic industries, (ii) extensive use of tariffs and non-tariff barriers to trade, and (iii) provision of direct loans to firms, amongst others.

The ISI came to an abrupt end in the late 1970s due to oil prices shocks, decline in commodity prices and emerging debt problems. According to UNCTAD and UNIDO (2011), Africa countries then sought bail-out from the International Monetary Fund (IMF) and the World Bank (WB). In response, these Bretton Wood Institutions diagnosed problems in the continent as poor domestic policies and directed that African countries should adopt structural adjustment programme (SAP). However, the SAP did not lead to structural transformation and export diversification and African countries continued to be haunted by enormous foreign debt accumulated during the ISI phase. Therefore, this debt became an impediment to growth and development.

The ISI phase coincided with an increase in the share of African manufacturing in gross domestic product (GDP) from a low of 6.3% in 1970, to 11.9% in 1980 and 15.3% in 1990 (UNCTAD and UNIDO, 2011). The second and third phases corresponded with decline in the share of African manufacturing in the GDP to 12.8% in 2000 and 10.5% in 2008. Jerven (2009) has shown that the GDP indices for African were greater than those of South and East Asia in both 1965 and 1970 but it was overtaken in the subsequent period. In 1990, the GDP indices were almost half those of East Asia. On the global front, the share of manufacturing in GDP declined from 1.2% in 2000 to 1.1% in 2008. Resource-based manufacturing remains the most dominant sector in Africa accounting for 49% in 2009 while medium/high and low technology manufacturing accounted for 31% and 20% of the total manufacturing value-added. According to Lall and Wangwe (1998), this growth in manufacturing, in fact, conceals the continued stagnation or falls in manufacturing value-added in many African countries and the fact that Africa has suffered the most serious deindustrialisation in recent times in the developing world.

Sundaram *et al* (2011) indicated that structural adjustment and liberalisation in Africa weakened the manufacturing sector. They asserted that during the ISI phase, African countries were increasingly gaining comparative advantage in labour-intensive manufacturing but trade liberalisation prematurely exposed the infant industries to global competition against much more mature industries. Similarly, Moudud and Botchway (2007) found that trade openness will not guarantee income convergence and growth in Sub-Saharan Africa countries and that there is a need to bring back the role of the developmental state in order to facilitate the international competitiveness of African countries. Using the experience of Ghana, Lall (2005) indicates that this country was the strongest adjuster in Africa and found that the adjustment process was followed by relative stagnation and little manufactured export diversification.

### **3.2 Industrial Policy in South Africa**

Industrial policy in South Africa underwent a number of changes over the last seven decade starting in 1948 when the National Party took over government and implemented the apartheid system. In 1994, the new African National Congress (ANC)-led government introduced a different approach to IP to facilitate the industrialisation trajectory in South Africa. In the beginning of the 21<sup>st</sup> century, there was some rethinking on the IP and the

government decided to adopt some of the experiences from the East Asian newly industrialised countries. This resulted in the adoption of the NIPF for the country. This paper briefly reviews the three stages of industrialisation in South Africa over the last seven decades. The study has divided the stages into three periods, pre-1994 (mainly import substitution), post 1994-2006 (Growth-led industrialisation), and post 2007 (industrialisation-led Growth).

### **3.2.1 Industrial Policy in the Apartheid Era**

According to Newman (2011), South Africa's prevailing industrial structure has its roots in the discovery of minerals such as diamond and gold in the 19<sup>th</sup> century. Newman indicated that the centrality of mining activities in the South African economy in the turn of the 20<sup>th</sup> century shaped the development of manufacturing sector into activities such as downstream mineral processing, engineering, steel and chemical sector, other manufacturing sectors and banking.

Industrial policy in South Africa also involved import-substitution particularly in relation to inputs for the mining industry (Altman and Mayer, 2003). Further, Altman and Mayer indicates that with the intensification of apartheid policies and South Africa's increasing foreign isolation, IP turned to substantial subsidisation of heavy industries such as steel, synthetic fuels and the defence industry. However, Altman and Mayer, and Newman argue that due to the small size of the economy and poor distribution of income, import-substitution opportunities were largely exhausted by the late 1970s.

Fine and Rustomjee (1996) argues that the apartheid regime failed to develop coherent policies for industrialisation. While Green (2009) pointed-out some weaknesses of industrialisation under the apartheid system and these included policies that caused the South African industry sector to be dominated by large firms that relied on subsidies and suppressed small and medium enterprises, and no investment were made to develop the human capital of the majority of the population. In addition, Altman and Mayer indicates that apartheid laws repressed African entrepreneurship. In summing-up IP under the apartheid regime, Chang (1997) indicated that IP was burdened with many objectives that ultimately undermined its viability in the long run and these objectives included building up of Afrikaner capital, job creation of Afrikaner workers, military objectives, evasion of international sanctions, and the

satisfaction of the aspirations of the elite consumers to imitate the consumption patterns of the most advanced economies.

### **3.2.2 Growth-led Industrialisation**

The new ANC-led government adopted three important policies between 1994 and 2006, and these include Reconstruction and Development Programme (RDP), Growth, Employment and Redistribution (GEAR), and the Accelerated and Shared Growth Initiative for South Africa (AsgiSA). According to Altman and Mayer (2003), these policies marked a radical departure from previous IP under the apartheid regime. Newman (2011) indicates that RDP did not focus on the industrial structure or its transformation and everything was left to the market. She pointed-out that RDP focused on increasing rates of investment and expected that this will result in higher growth rate and in turn, the higher growth rate will result in equal distribution of income and wealth.

In 1996, Government launched its macroeconomic strategy in GEAR (National Treasury, 1996). Policies covered under GEAR, amongst others, included fiscal policy, monetary and exchange rate policy, trade, industrial and small enterprise policies. GEARS favoured a shift away from demand-side interventions such as tariffs and subsidies to supply-side measures designed to lower unit costs and expedite progress up the value chain (National Treasury, 1996). Altman and Mayer (2003) describe demand-side interventions as those that increase the demand for the output of particular industrial sectors and import-substitution industrialisation is an example of this kind of interventions. While supply-side interventions are those that enhance the productive capacity and competitiveness of firms. Based on these descriptions, South Africa made a U-turn from import-substitution through protectionist policies to enhancing productive capacity and competitiveness of domestic firms supported by trade liberalisation. To a large extent, South Africa embraced Washington Consensus policies.

The then Deputy President of the Republic, Ms Phumzile Ncguka, launched AsgiSA in 2006 and its main objective was to close the gap between the “first” and “second” economy, and to promote the emergence of the black capitalist through Broad Based Black Economic Empowerment. AsgiSA, like GEAR, focused more on the supply-side activities such as investment in infrastructure, and skills and education initiatives (Newman, 2011). Edwards

and Lawrence (2006) argued that it was striking that trade performance per se was not mentioned as a major constraints to growth in AsgiSA.

Nevertheless, the IP pursued during this period did not live up to expectations that included diversification of the economy, reduction in unemployment as well as poverty reduction. This led to rethinking of the IP to address challenges of the 21<sup>st</sup> century in South Africa. To this end, Chang (1997) argues that “South Africa at the moment needs, and it committed to, a major industrial restructuring and this requires a more active industrial policy....” Chang recommended that any future IP has to include some level of targeting, going through a “Scandinavian road” (of developing products “nearby” their natural endowment”), and creating comparative advantage in other high-technological products. Further, Chang argues that South Africa should pursue an IP in which supply-side measures work hand-in-hand with demand-side measures.

### **3.2.3 Industrialisation-led Growth**

In 2007, the South African Government adopted a NIPF, which signalled a departure from laissez faire policies under the GEAR (the dti, 2007). The objectives of the NIPF amongst others include facilitating diversification beyond current reliance on traditional commodities and non-tradable services, and promotion of broad-based and labour-absorbing industrialisation. According to the dti (2007), the core objective of the NIPF was to set-out government’s approach to industrialisation trajectory and help align both private sector and public sector efforts. This implies that South Africa adopted views expressed by Rodrik (2004) and Hausmann *et al* (2010) that IP should be a negotiated process between the private and public sector. Furthermore, the NIPF aims to support the process of ‘self-discovery’ in developing and strengthening the sector strategies.

In order to implement the NIPF, each year the dti develop and launch a revised three-year rolling Ipap with a ten year outlook. The South African Government, through the Department of Trade and Industry, developed and launched the first Ipap in 2007 for the financial year 2007/08 and the latest Ipap is for the financial year 2012/13.

The key sectors that are prioritised in the Ipap 2012/13 have been clustered into three groups (the dti, 2012). Cluster 1 covers new areas of focus and include sectors such as boatbuilding,

agro-processing, green and energy-saving industries, and upstream oil and gas. Metal fabrication, capital and transport equipment sector have been added to Cluster 1 but with respect to large public sector investments. Cluster 2 covers existing Ipap sectors such as automotive products and components, plastic, pharmaceuticals and chemicals, clothing, textiles, footwear and leather, forestry, paper, pulp and furniture, etc. Cluster 3 covers sectors with potential for long-term advanced capabilities such as nuclear, advanced materials, aerospace, defence and electrotechnical and ICT.

The instruments to implement the Ipap 2012/13 include, amongst others, on the supply-side interventions such as incentive programmes like manufacturing competitiveness enhancement programme (MCEP) and industrial financing mainly through the Industrial Development Corporation (IDC). The demand-side interventions include preferential procurement policy framework Act (PPPFA) and developmental trade policies. Other interventions include those focused on skills and innovation policies and stimulating sub-regional growth. The focus on this paper will be on supply-side and demand-side interventions as they relate to trade policy instruments under the WTO.

### **3.3 Trade Policy in South Africa**

There is quite overwhelming evidence and consensus amongst researchers and policy makers that trade policy is an important instrument of industrial policy. South Africa, like all other countries globally, have used trade policy to pursue industrial development and diversification in the country. This section provides an overview of trade policy in South Africa in the 1970s, prior to 1994, and Post 1994. The interest here is to understand various policy instruments that South Africa used and/or will use to pursue its industrialisation objectives.

#### **3.3.1 Trade Policy in the Apartheid South Africa**

Prior to the 1990s, South Africa pursued its import substitution programme behind a tariff wall with quantitative restrictions (QRs) on imports [Cassim *et al*, 2004 and Edwards *et al* (2009)]. Due to exhaustion of the import substitution (IS) in the 1970s, South Africa then complemented the IS with effort to promote exports [Newman (2011), Cassim *et al* (2004)]. To this end, South Africa introduced export incentives to counter the effects of distance from

markets and the influx of subsidised exports from other countries (Cassim *et al*, 2004). In addition, they indicated that South Africa replaced the QRs with equivalent tariffs and other duties. In the 1980s, South Africa changed the publication of a positive list (which specified items needing no approval for importation) to a negative list of items that needed approval prior to importation. This indicates that South Africa, whilst maintaining import protection, pursued a number of efforts to promote exports by providing incentives.

An important development in the early 1990s was the introduction of General Export Incentive Scheme to help exports offset the price disadvantage exporters faced in international markets (Cassim *et al*, 2004). The exports with higher value-addition and domestic content qualified for a higher subsidy and the opposite applied to exports with low value-addition and local content.

### **3.3.2 Trade Policy in the Democratic South Africa**

According to Edwards *et al* (2009), South Africa undertook an important shift in development strategy from export promotion with import controls to greater openness through tariff liberalisation. In 1994, South Africa became a founding member of the World Trade Organisation (WTO) and undertook commitments under the single undertaking rule, in which the country acceded to all multilateral agreements. The South African Government took a decision to make its offer to the WTO as a developed country, which resulted in deeper cuts in tariffs and commitments. Why South Africa made commitments as a developed country warrant another debate, which will not be pursued in this paper but there were some debate between Minister of Trade and Industry in South Africa, Dr. Rob Davies and the then University of Cape Town Professor Mills Soko on the subject<sup>3</sup>.

According to Cassim *et al* (2004), South Africa's offer to the WTO consisted of a five-year tariff reduction and rationalisation programme aimed at reducing a number of tariff categories from over hundred to six. In addition, average weighted duties were to be reduced from 34% to 17% for consumption goods, 8% to 4% for intermediate goods, and 11% to 5% for capital goods. This indicates that South Africa pursued greater trade liberalisation. Appendix 1 shows the tariff phase-down under the WTO.

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<sup>3</sup> Business Day, March 10th, 2011

Appendix 2 shows the tariff profile for South Africa between 2002 and 2009 while for more historic data Flatters and Stern (2007) shows the structure of SACU tariffs between 1990 and 2004. The dti (2012a) indicated that South Africa's average tariff declined from around 23% in the 1990s to 7.7% in 2010. The average tariff for agriculture declined from 9.6% in 2002 to 9% in 2010 and for non-agricultural products from 11.6% to 7.5% in the same period. Most importantly, 56.3% of South Africa's 7,240 tariff lines (HS6 level) were zero-rated in 2012. In addition, the tariff regime in South Africa was simplified from a tariff schedule consisting of 13, 609 tariff lines in 1990, of which 28% were subject to import controls, to 6, 767 tariff lines and no import controls in 2006.

Gonzalez-Nunez (2008) indicates that the highest tariff reduction occurred in sectors such as clothing, footwear, beverages, motor vehicles, textiles, printing, plastic products, and metal products. Nevertheless, Cassim *et al* (2004), Edwards and Lawrence (2006), Flatters and Stern (2007) and Edwards *et al* (2009) argued that the effective rate of protection was still higher in South Africa and warranted further tariff reform. Nevertheless, they admit that the political and economic will for further comprehensive trade reform by government is not strong.

In addition to tariff reductions, South Africa had to eliminate quotas, export subsidies and import surcharges (Gonzalez-Nunez, 2008). Gonzalez-Nunez (2008) and Edwards *et al* (2009) asserted that South Africa phased-out its export subsidies under the GEIS in accordance with WTO commitments but introduced WTO-compatible supply-side incentives such as the now defunct Motor Industry Development Programme (MIDP) for the automotive industry as well as the Clothing and Textile Competitiveness Improvement Programme (CTCIP), which replaced the Duty Credit Certificate Scheme (DCCS). However, she noted that the compatibility of the MIDP to WTO has been questioned. The MIDP has now been replaced by the Automotive Production and Development Programme.

When South Africa made commitments to the WTO in 1996, the country did not have either a trade policy or industrial policy. Following the launch of the NIPF in 2007, Gonzalez-Nunez (2008) indicates that there were calls for the country to have its trade and industrial policies more closely aligned. She pointed-out that trade policy need to be reinforced by clear industrial policy.

In 2010, South African Government adopted a Trade Policy and Strategy Framework (TPSF 2010) and this framework is government's way of aligning the trade policy and the IP (the dti, 2010). However, the TPSF address only the tariff reform and ignore other important trade-related policies such as on government procurement, investment, subsidies or incentives, etc. According to the dti (2012b), the TPSF 2010 set the tone for South Africa's tariff policy by stipulating that all reform would be pursued strategically to support industrial development. Further, the dti (2012b) argues that tariff reductions undertaken since 1994 had not induced the necessary structural changes in the economy to significantly alter the export basket beyond the range of products that reflect South Africa's static comparative advantage.

In contrast to the view that the country must simplify its tariff schedule, the dti argues that South Africa's tariff regime is open, transparent and not overly complex. In addition, the department maintain that where tariffs have been reduced, the affected sectors have experienced growth in import volumes. Therefore, in order to support industrial development and diversification in the country, tariff setting will be decided primarily on a sector-by-sector basis, dictated by the needs and imperatives of the sector strategies. This point was also reiterated in the Ipap 2012/13.

According to the dti, "[a]s a general guideline, tariffs on mature upstream input industries could be reduced or removed to lower the input costs for the downstream, more labour creating manufacturing sectors. Tariffs on downstream industries, particularly those that are strategic from an employment or value-addition perspective, may be retained or raised to ensure long-term sustainability and job creation in the context of domestic production capabilities/potentialities and the degree of trade and production distortions on these products at the global level". This respond to the views around anti-export bias as well as high effective protection rates in that Government will work to reduce tariffs on intermediate inputs in order to increase international competitiveness of exports abroad. To this end, the dti (2012a) indicated that now trade policy and IP are closely aligned.

The dti (2012b) indicates that, informed by the alignment of trade and industrial policies, South Africa has since the onset of the Global Recession in 2008 introduced higher duties on 137 lines (mainly textiles and clothing); introduced 10 rebates; while tariffs on 9 lines have been reduced. Therefore, the dti argues the policy space for tariff sequencing is important in

order to build industrial capacity, promote technological investment and upgrading, and stimulate competitiveness.

## CHAPTER 4

### IS THERE POLICY SPACE TO PURSUE INDUSTRIAL POLICY IN SOUTH AFRICA?

#### 4.1 Research Approach and Method

This research applied a mix of qualitative-descriptive and quantitative-descriptive approaches. The study relied on available official policy documents as well as tariff data available from official sources. This approach represents the best way to both analytically and quantitatively answer the question regarding possible policy space. In order to test whether there is “water” between applied and bound tariffs for the sectors identified in the industrial policy action plan III, the research analysed the South Africa’s tariff book available from the South African Revenue Service as well as the country’s commitment schedules in the WTO in 1994 available from the dti.

To test for IP space in TRIMS, GPA as well as SCM for South Africa, the study analysed relevant WTO Agreements. Over and above this, interviews were conducted with relevant South Africa policy makers responsible for trade policy. There was an effort to consult with business and labour, but due to the December-January holidays, they did not respond to the questioner sent to them. However, the information and data available was sufficient to complete the research. Furthermore, the official responsible for IPR at the dti could not respond to the questionnaire due to other work commitments. As a result, evaluation of policy space under TRIPS was excluded from the analysis.

#### 4.2 The Level of Manufacturing in South Africa

Table 1 below indicate that manufacturing value-added (MVA) per capita in South Africa increased from 551 in 1990 to 581 in 2010, which represent compound annual growth rate of 0.3%. If MVA is accepted as a measure for industrialisation, then this indicate that South African has been industrialising albeit at a low rate. MVA is dominated by resource-based manufacturing (RBM) which accounted for 52% of the total MVA in the country. This is followed by 31% for medium and high technology manufacturing (MHT) and 17% for low technology manufacturing. The UNIDO and UNCTAD Report (2011) indicate that while

RBM can contribute to higher growth rates, they involve low value-addition and can make countries vulnerable to external price shocks. Therefore, there is a need for South Africa to move-up the value chain and increase its share of MHT manufacturing.

**Table 1: South Africa’s Manufacturing Performance**

Manufacturing value-added (MVA) per capita (1990)	551
MVA per capita (2010)	581
MVA per capita (Compound annual growth rate 1990-2010)	0.3
Resource-based (RB) manufacturing share of MVA (2009)	52
Low Technology (LT) manufacturing share of MVA (2009)	17
Medium and High technology (MHT) manufacturing share of MVA (2009)	31

Source: UNIDO and UNCTAD Report (2011)

### **4.3 Tariff Analysis on Priority Sectors Identified in the IPAP**

The analysis on sectors and subsectors prioritised in the industrial policy action 2012/13-2014/15 will focus on automotive and automotive components, clothing, textile, and footwear, furniture, white goods industry, and boatbuilding and associated services industry. These sectors were selected because Ipap identified growth of imports as a constraint as well as based on media reports about manufacturers indicating that tariffs are too low for some of these sectors.

With regard to the clothing, textile, footwear and leather sector, tariffs on imports have been a major issue, which in the past prompted the South African Government to request China to undertake voluntary restraints on its exports. Amongst constraints identified in the Ipap relating to the white good industry include the high volume of imports (the dti, 2012a:61). Although Ipap intent to reduce import duties on intermediate and manufactured inputs for the boatbuilding sector to increase competitiveness in export markets, this paper will only be limited to the final products, which are boats and yachts.

Although agro-processing is identified as a priority sector, the dti indicated that agro-processing face constraints that are related to developed-country trade policy such as subsidies, tariffs, and sanitary and phytosanitary measures (the dti, 2012a:75). Therefore, the constraints on agro-processing are not on imports but exports. As a result, this sector was excluded from the analysis.

**Table 2: The Difference between Applied and Bound Tariff Rates on Selected Sectors**

	Auto Parts	Vehicles	White Goods	Boats	Clothing	Textiles	Foot wear	Furniture
Number Tariff lines	62	68	49	5	333	633	57	50
No. less than 5%	2	13	4	5	192	438	35	34
No. between 5% & 10%	29	0	10	0	104	69	0	0
No. between 11% & 15%	0	0	10	0	19	2	1	0
No. between 16% & 20%	11	0	16	0	4	61	5	16
No. between 21 & 25%	2	28	0	0	1	54	0	0
No. greater than 25%	18	27	9	0	13	9	6	0
Average applied rate (%)	12	21	9	10	26	15	14	13
Average bound rate (%)	30	50	25	10	42	21	20	20
Average "water" level (%)	18	23	17	0	16	7	6	7

Source: Own calculations based on data from SARS and the dti

- a. Automotive parts falls under chapter 8703 of the tariff book
- b. Vehicle 8703
- c. White good industry – Chapters 73.21, 84.18, 84.21, 84.22.1, 8450. The bound rate for tariff lines was less than applied.
- d. Boats – 8903
- e. Clothing – chapter 61-63
- f. Textile - chapter 50 – 60
- g. Footwear – chapter 64
- h. Furniture – chapter 94

Note: non-ad-valorem duties were excluded from the calculations.

The average applied tariff for automotive parts (AP) was 12% while the average bound rate was 30%, yielding average “water” level of 18%. The applied tariff for AP ranged from 5% to 30%. Therefore, there is “space” to exercise the tariff policy to protect the AP industry if need arises. For vehicles, the average applied tariff was 21% and the average bound rate was 50%, leaving out an average of 23% of “water” level between the applied and bound rate. The applied tariffs for vehicles ranged zero-rated to 25%.

The average applied tariff for white goods was 9% while the average bound rate was 25%, yielding average “water” level of 17%. The applied tariff for white goods ranged from 10% to 30%. For boats, the average applied tariff was 10% and the average bound rate was 10%, leaving out no “water” level between the applied and bound rate. For clothing, the average applied tariff was 26% and the average bound rate 42% yielding average ‘water’ level of 16%. The applied tariffs ranged from 0 to 45%. The average applied tariff for textiles was 15% while the average bound rate was 21% leaving out an average of 7% to increase tariffs. For textiles, the applied tariffs ranged from 0 to 30%.

For furniture industry, the average applied tariff was 14% while the average bound rate was 20%, yielding average “water” level of 6%. The applied tariff for furniture ranged from 0% to 20%. The average applied tariff for footwear was 13% and the average bound rate was 20%, leaving out an average of 7% of “water” level between the applied and bound rate. The applied tariffs for footwear ranged zero-rated to 30%.

Table 2 indicate that a significant number of tariff lines in the clothing, textile and footwear industry and furniture industry have the “water” level either zero or less 5%. Analysis at HS6 level has revealed that for some clothing and textile lines, applied tariffs are equal to bound rates. This shows that for some of tariff lines of significant importance to South Africa there might not be policy space to use tariffs to protect “infant industries”.

#### **4.4 Compatibility of Incentives in South Africa to the WTO Rules**

##### **4.4.1 Industrial Development Zones**

Tang (2008) defined IDZ as an insulated export area strategically linked to a port or airport, and offers fiscal and non-fiscal incentives to industrialists to make their export internationally competitive. Similarly, the dti (2012c) indicated that the purpose of the IDZ programme was to promote export-oriented manufacturing and service industries in order to accelerate economic growth and employment creation. Since 2001, South Africa implemented an industrial development zones programme and currently have four IDZs, namely, Coega IDZ, East London IDZ, Richards Bay IDZ and OR Tambo IDZ, although some are not operational. The South African Revenue Services offered incentives to the IDZs such as relief from custom duties to any goods for storage, raw material for manufacture or machinery used in the manufacturing process as well as tax credits<sup>4</sup>.

McCallum (2011) indicated that different countries use different names to refer to EPZ. In his study, McCallum found that three of the four cases do not always use EPZ as the preferred title, opting instead for “special economic zones” (China), “industrial development zone” (South Africa), and “maquiladora” (Honduras). McCallum indicated that export

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<sup>4</sup> South African Revenue Service - Industrial Development Zone, [www.sars.gov.za/home.asp?pid=44747](http://www.sars.gov.za/home.asp?pid=44747), accessed 20/12/2012

processing zones (EPZs) are special regulatory areas within countries established to promote export-led growth. This implies that IDZs or EPZs are subsidies manufacturing for export purposes.

The incentives given to firms located in the IDZs can be interpreted as export subsidies in line with Article 3a&b and also Annex I of Agreement on Subsidies and Countervailing Measures if custom duties on imports are exempted on conditions that value is added to those products (imports) and then they be exported. In addition, Article 3b prohibits subsidies contingent upon use of domestic over imported product. McCallum (2011) affirmed that the regulatory conditions that characterize EPZs are often in violation of, and fundamentally incompatible with, the recommendations of the WTO Agreement on Subsidies and Countervailing Measures (SCM). Furthermore McCallum indicate that this incompatibility with WTO rules has not deterred the governments of developing nations from pursuing EPZs because an export-oriented growth strategy is often seen as the only palliative to lagging economic growth.

However, writing under correction, no country has been taken to WTO for IDZs or export processing zones (EPZs). Tang (2008) indicated that there were 3500 zones in 130 countries globally in 2006. Of these, only 2.6% are in sub-Saharan Africa and 25.7% in Asia. Therefore, it is unlikely that South Africa can be taken to WTO for implementing SEZs or IDZs as the country is in the same boat as many developing countries.

#### **4.4.2 Aquaculture Development and Enhancement Programme (ADEP)**

According to the dti programme guidelines, the Aquaculture Development and Enhancement Programme (ADEP) is an incentive programme that offers a reimbursable cost-sharing grant of up to a maximum of R40 million qualifying costs in machinery and equipment; bulk infrastructure; owned land and/or buildings; leasehold improvements; competitiveness improvement activities and commercial vehicles and work boats.

In order to qualify for the ADEP grant, a project must meet economic benefit criteria, which amongst other include own capital investment, job creation, geographical spread and contribution to broad-based black economic empowerment. This programme constitutes a subsidy as defined in Article 1 & 2 of the SCM. Then the next question is whether this

subsidy is actionable or non-actionable. Article 8.2 (b) indicate that subsidies that provide “assistance to disadvantaged regions within the territory of a member given pursuant to a general framework of regional development and non-specific shall be non-actionable”. One of the criteria for ADEP is an aquaculture establishment in areas with unemployment above 25%. Therefore, it can be argued that the ADEP programme is meant to provide assistance to disadvantaged region, hence non-actionable. To this end, this shows that the WTO rules provide trade policy space for South Africa to pursue its IP goals.

#### **4.4.3 Automotive Investment Scheme (AIS)**

The Automotive Investment Scheme (AIS) provide incentives designed to grow and develop the automotive sector through investment in new and/ or replacement models and components that will increase plant production volumes, sustain employment and/ or strengthen the automotive value chain. The AIS provides for a taxable cash grant ranging from 20 to 40% of the value of qualifying investment in productive assets as approved by the dti.

In order to qualify for this programme, the project must meet the economic benefit requirements that amongst others include substantial support for the development of the local vehicle related tooling industry, spend at least 5% of the value of the investment project on applied research and development, design in the country, employment creation, strengthen automotive supply chain, and substantial increase in local content with respect to value addition of products. Based on these criteria, it seems the emphasis is on local content, which is prohibited under TRIMS. To the knowledge of the author, so far no country has expressed concern of the AIS. This is because most automotive producing countries provide incentive and attach certain conditions which may or may not include local content and export performance.

Therefore, legally speaking, TRIMS can constrain implementation of national development strategies but in practice countries have found a leeway around TRIMS.

#### **4.4.4 Manufacturing Competitiveness Enhancement Programme (MCEP)**

The MCEP is an incentive programme introduced by South Africa through the Department of Trade and Industry aimed to support manufacturing enterprises with competitiveness improvement interventions. This programme consists of the following components: the production incentive grants and industrial financing loan facilities. The production incentive grants support capital investment, green technology and resource efficiency improvement, enterprise-level competitiveness improvement, feasibility studies, and cluster competitiveness improvement. The industrial financing loan facilities cover pre/post-dispatch working capital facility as well as IP niche projects fund. The objective of the pre/post-dispatch working capital facility is to offer finance to manufacturers at a preferential interest rate that will lead to improved competitiveness by reducing the cost of finance. While the IP niche project fund cover projects identified as strategic that otherwise could not be financed by the commercial banks or the Industrial Development Bank.

The grants and preferential interest rates offered under MCEP constitute subsidy to the industry. According to the NIPF, “the industrial financing will be customised to addressing specific opportunities and constraints, within the disciplines of the WTO rules. Consequently, WTO provisions on amongst others subsidies will frame the types of industrial financing that is possible”. The MCEP can be justified under Article 8.2 (c) as non-actionable due to the support being made available to all firms that adopt new equipment and/or production processes. The WTO rules provide a number of loopholes for countries to exploit “if they have a strategy” as articulated by Di Caprio and Amsden.

#### **4.4.5 Export Marketing and Investment Assistance Scheme (EMIA)**

The aim of the Export Marketing and Investment Assistance (EMIA) scheme is to develop export markets for South African products and services and to recruit new foreign direct investment into the country. This programme is a critical instrument of the IPAP in order to promote South Africa’s industrial exports in line with the NIPF. EMIA provide grants that cover individual exhibition participation, primary market research and FDI, and individual inward missions. To qualify, the beneficiaries have to be South African entities. This programme does not include elements prohibited in Annex I of SCM and it is compliant to WTO rules.

#### **4.5 Is Localisation Permitted under TRIMS**

The WTO Agreement on Trade-Related Investment Measures prohibits any TRIM that is inconsistent with the provisions of Article III or Article II of GATT 1994. These, amongst others, include local content requirements, trade balancing requirements as well as export requirements. South Africa currently does not impose any local content on FDI and therefore the country is in compliance with WTO rules under TRIMS. Local content requirements are only implemented with respect to government procurement, which is governed by Agreement on Government Procurement.

However, South Africa cannot embark on industrialisation process along the lines of the East Asian countries as the ladder has been pulled below it. The country is currently promoting inward investment but cannot insist on local content requirements or compel firms to export some of their products. But, Shadlen (2004) indicated that foreign firms do not have “right of establishment”, as a result countries can put some restrictions. The case of Wal-Mart versus the State in South Africa has provided some lessons that these TRIMS need to be read in conjunction with other WTO Agreements such as GATS. South Africa’s offer to WTO under GATs provided Wal-Mart with “right of establishment” and as a result Government is unable to set any threshold for local content.

Therefore, for South Africa, it can be concluded that TRIMS prohibit instruments that the country could use in its industrialisation process. The country has IP framework or strategy but instruments to pursue it are limited.

#### **4.6 Can South Africa Rely on Government Procurement as Instrument of IP?**

South Africa views public procurement lever as a critical instrument for the success of the IPAP across a range of sectors (the dti 2012a: 39). In an effort to aligning public procurement, South Africa adopted Amended Regulations to the Preferential Procurement Policy Framework Act (PPPFA) in December 2011. The PPPFA enables the country to designate some sectors or subsectors for local procurement and binds all government departments and state-owned enterprises (SOEs) as gazetted by the Minister of Finance on 08 June 2011 (Government Gazette No. 34350). Subsequently, the Department of Trade and

Industry designated some sectors for local procurement. Table 3 provide the current list of designated sectors.

**Table 3: Sectors and Subsectors designated under the PPPFA**

<b>Industry/sector/sub-sector</b>	<b>Minimum threshold for local content</b>
Buses (Bus Body)	80%
Textile, Clothing, Leather and Footwear	100%
Steel Power Pylons	100%
Canned / Processed Vegetables	80%
Pharmaceutical Products: OSD Tender	70% (volumes)
Rail Rolling Stock	65%
Set Top Boxes (STB)	30%

Source: the dti (2013)<sup>5</sup>

In addition, the dti is still considering designating other industries, sectors and sub-sectors. Companies, local or foreign, that want to take advantage of government tender relating to designated sectors, have to meet the relevant minimum threshold for local content. This demonstrates that the South Africa is using government procurement to promote localisation.

Then the questions becomes whether government procurement is permitted under the WTO rules. The WTO Agreement on Government Procurement (GPA) is a plurilateral trade agreement, and not part of single undertaking in 1994. This implies member states elect whether or not to join the GPA and it only applies to those member states. South Africa is not a member state to the GPA and as a result it can use government procurement to promote industrialisation in the country through localisation. Therefore, being not a member state to the GPA provides South Africa with the trade policy space to pursue its IP action plan.

<sup>5</sup> Accessed on 09 January 2013, [http://www.thedti.gov.za/industrial\\_development/ip.jsp](http://www.thedti.gov.za/industrial_development/ip.jsp)

## CHAPTER 5

### CONCLUSION REMARKS: POLICY SPACE AVAILABLE IN THE WTO

There is an emerging realisation on the need for industrialization in developing countries; however, the differences have been on the role of the state. The role played by the state has been changing over the last seven decades. In the period following World Wars and the Great Depression, the role of the state was prominent in the development process in developing countries and in particular those in Latin America and East Asia as well as in the African Continent. The state used various instruments to support the industrialization process and they were not constrained by either regional or international trade agreements. Even in the 1970s in the presence of the GATT 1947, these countries managed to find a way around the prevailing rules.

The 1980s saw the introduction of neoliberal policies and approach to IP which Williamson (1990) termed Washington Consensus and this policies advocated for no or minimal role of the state in the economy. Furthermore, there was a surge in international and regional trade agreements that constrained the ability of the state to use IP instruments, used by early and late developers, to support their industrialization process. However, the financial crisis and economic meltdown that started in 2008 brought back the discussion on the role of the state in the economy.

There are no disputes that trade policy is and remains an important instrument of industrial policy. The literature indicated that successful East Asian economies used trade policy instruments such as selective protection (high tariffs, quotas, import licencing), stringent domestic content requirements, sub-contracting promotion, and selectivity on FDI, to develop their economies. However, the establishment of the WTO in 1995 introduced some rules and led to binding commitments on issues such as patents and copyrights (through TRIPS), regulation of foreign investment (through TRIMs), trade in services (through GATS), regulation on subsidies (through SCM) as well as tariff reductions. Consequently, WTO through these undertakings made illegal some of the policy instruments that made the East Asian countries (and perhaps also the early industrialiser) successful. This led to some

authors posing a question, ‘are we kicking away the ladder’ that other countries used to develop?

Most African countries, following their independence in the 1950s and 1960s, pursued ISI path. However, due to a number of factors, key among them debt crisis, these countries had to abandon their industrialisation ambitions and adopt the Washington Consensus policies. As a result, most African countries do not have IP while some have recently introduced them.

In South Africa, pre-1994, the apartheid government pursued an import substitution through state-owned enterprises behind a tariff wall, subsidies, quotas, amongst others. Enterprises with greater domestic content received more protection and support. International sanctions against the apartheid government also forced the country to look inward for development. Fine and Rustomjee indicated that the apartheid regime failure to develop a coherent policy towards industrialisation. Following the democratic elections in 1994, South Africa pursued neoliberal policies through adoption of Washington Consensus policies. The country adopted GEAR in 1996 and there was little emphasis on industrial policy. South Africa had to wait until 2007 to adopt its first national IP framework and prioritise some sectors for development.

Similarly, trade policy in South Africa closely followed and supported IP objectives. During the import substitution phase, the country pursued a more protectionist trade policy. The same applied with adoption of neoliberal policies in the mid-1990s, which saw the country joining the WTO as a developed country and undertaking deeper cuts. In addition, South Africa negotiated trade agreements with the European Union, European Free Trade Association as well as within the Southern Africa Development Community. Therefore, the question that remains is whether South Africa has the trade policy space to pursue its industrialisation ambitions as outlined in the NIPF as well as in various iterations of the industrial policy action plan.

The study reviewed various official policy documents as well as WTO Agreements. In addition, the study analysed the tariff policy in the country to check whether there is some “water” to increase tariff if need arises. The results have shown that although South Africa does have space to use its tariff policy at a sectoral level, analysis at HS6 has revealed that some tariff lines do not have “water” between applied and bound rate. This implies mainly to

sectors such as clothing, textile, and footwear. While sectors such as automotive and automotive components and white goods have significant “water” between applied and bound tariff.

Furthermore, the study found that WTO Agreement on Subsidies and Countervailing Measures would not constrain industrial policy in South Africa as most of the incentives that the country provides to the private sector are not actionable. Exports subsidies have been outlawed but this does not impact on South Africa as the country discontinued them in the early 1990s. TRIMS make illegal some instruments such as enforcing local content on foreign direct investments as well as export requirements. Therefore, TRIMS have eroded policy space for South Africa to impose restrictions on FDI.

South Africa has relied on Government procurement to pursue its IP objectives through Preferential Public Procurement Framework Act (PPPFA) and Government has outlined some subsector for local procurement by state-owned enterprises as well as local content of such products. South Africa is not a member to the Plurilateral Agreement on Government Procurement; consequently the country can and should use government procurement to pursue industrial development.

Therefore, the WTO is indeed constraining policy space for the country to pursue its industrial policy. Nevertheless, Government procurement offers some option for the country but it alone may not be “enough”. South Africa should continue to exploit the policy space available in the SCM to support its priority sector on improve their competitiveness.

### Appendix 1 Tariff phase-down under the WTO

Description	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
<b>3 Textiles</b>	30.1	33.8	31.8	24.9	23.4	21.9	20.3	18.7	17.3	17.3	17.3
<b>4 Clothing, excl. footwear</b>	73.7	73.6	68.2	54.6	50.5	46.4	42.4	37.7	33.2	33.2	33.2
<b>5 Leather and leather products</b>	14.9	14.8	14.1	16.5	15.7	14.8	14.8	14.8	14.8	14.8	14.8
<b>6 Footwear</b>	37.5	41.6	39.1	36.8	34.2	29.1	29.1	29.1	29.1	29.1	29.1
<b>7 Wood and wood products</b>	13.9	3.6	3.4	3.5	3.3	3.1	3.1	3.1	3.1	3.1	3.1
<b>8 Paper and paper products</b>	9.6	9.3	9.1	8.8	8.7	8.5	7.9	7.3	6.8	6.2	5.6
<b>9 Printing and publishing</b>	8.1	1.3	1.2	1.1	1	1	1	1	1	1	1
<b>10 Petroleum and petroleum products</b>	1.6										
<b>11 Industrial chemicals</b>	9.3	7.5	7.5	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
<b>12 Other chemical products</b>	9	3.8	3.7	2.7	2.6	2.5	2.5	2.5	2.5	2.5	2.5
<b>13 Rubber products</b>	30.5	14.5	14.1	15.8	15.4	14.9	14.6	14.4	14	14	14
<b>14 Plastic products</b>	19.8	14.7	13.7	13.2	12.6	12	12	12	12	12	12
<b>15 Glass and glass products</b>	11.8	9.5	9	8.3	7.9	7.6	7.6	7.6	7.6	7.6	7.6
<b>16 Non-metallic mineral products</b>	10.6	8.7	8.1	8.4	8	7.7	7.7	7.7	7.7	7.7	7.7
<b>17 Basic iron and steel products</b>	7.6	4.4	4.2	4.2	4.1	3.9	3.9	3.9	3.9	3.9	3.9
<b>18 Non-ferrous metal products</b>	2.3	2.3	2.3	2.3	2.2	2	2	2	1.9	1.7	1.7
<b>19 Metal products, excl. machinery</b>	13.1	8.2	7.8	7.8	7.6	7.4	7.4	7.4	7.4	7.4	7.4
<b>20 Non-electrical machinery</b>	6.5	1.4	1.3	1.4	1.3	1.3	1.3	1.3	1.3	1.3	1.3
<b>21 Electrical machinery</b>	11	6.1	6	5.8	5.8	5.7	5.7	5.7	5.7	5.7	5.7
<b>22. Radio, television and communication apparatus</b>	12.1	5.1	3.7	2.4	2.3	2.3	2.3	2.3	2.3	2.3	2.3
<b>23 Professional equipment etc.</b>	7.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
<b>24. Motor vehicles, parts and accessories</b>	55.4	33.5	31.7	29.3	27.9	26.1	24.8	23.2	22.1	22.1	22.1
<b>25 Other transport equipment</b>	1.4	0.4	0.4	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2
<b>26 Furniture</b>	28.1	21.4	20.8	20.2	19.6	18.9	18.9	18.9	18.9	18.9	18.9
<b>27 Other manufacturing</b>	2.9	1	1	5.2	5.1	5	4.9	4.9	4.9	4.9	4.9
<b>28 Mining</b>	2.7	0.6	0.6	0.5	0.4	0.4	0.4	0.4	0.4	0.4	0.4
<b>Total</b>	11.7	7.2	6.8	6.1	5.8	5.5	5.3	5.1	4.9	4.9	4.9

Source: Cassim et al (2004) adopted from IDC

## Appendix 2: Structure of South Africa's MFN tariffs – 2000, 2008 and 2009/2010

		2002	2008	2009
1.	Bound tariff lines (% of all tariff lines)	98	98	98
2.	Duty-free tariff lines (% of all tariff lines)	43.4	54.1	56.5 (2010)
3.	Non- <i>ad valorem</i> tariffs (% of all tariff lines)	25.0	3.1	3.2
4.	Tariff quotas (% of all tariff lines)	3.8	4.6	4.6
5.	Non- <i>ad valorem</i> tariffs with no AVEs (% of all tariff lines)	25.0	0.8	0.8
6.	Simple average tariff rate	11.4	8.1	7.7 (2010)
	Agricultural products (WTO definition) <sup>a</sup>	9.6	10.1	9.0 (2010)
	Non-agricultural products (WTO definition) <sup>b</sup>	11.6	7.9	7.5 (2010)
	Agriculture, hunting, forestry, and fishing (ISIC 1)	5.3	3.7	3.7
	Mining and quarrying (ISIC 2)	0.7	0.8	0.8
	Manufacturing (ISIC 3)	11.8	8.5	8.5
7.	Domestic tariff "spikes" (% of all tariff lines) <sup>c</sup>	3.9	8.5	8.5
8.	International tariff "peaks" (% of all tariff lines) <sup>d</sup>	34.8	20.8	20.8
9.	Overall standard deviation of applied rates	12.6	11.1	11.1
10.	"Nuisance" applied rates (% of all tariff lines) <sup>e</sup>	0.0	1.0	1.0

Source: WTO – SACU 2009 Trade Policy Review; own calculations for 2010

a WTO Agreement on Agriculture definitions.

b Excluding petroleum.

c Domestic tariff spikes are defined as those exceeding three times the overall simple average applied rate.

d International tariff peaks are defined as those exceeding 15%.

e Nuisance rates are those greater than zero, but less than or equal to 2%.

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