Report of

SARPN-IGD Policy Dialogue
The Impact of Liberalisation on the South African Economy: The case of the tourism and clothing sectors

INTRODUCTION

The Southern Africa Regional Poverty Network (SARPN) and the Institute for Global Development (IGD) co-hosted a policy dialogue on "The Impact of Liberalisation on the South African Economy: The case of the tourism and clothing sectors" on 23 May 2007 at Gallagher Estates in Midrand, South Africa. The policy dialogue brought together a number of experts to discuss two research studies carried out by IGD. Participants provided feedback on the two papers and discussed the relevance of the studies and the issue of trade liberalisation more broadly, in the context of the Southern African Development Community (SADC) region. The studies and the policy dialogue were financed by the Consumer Unit Trust Society Africa Resource Centre (CUTS).

Mr. Jack Jones Zulu, head of the Economic Dimensions programme at SARPN, welcomed participants and explained the objectives of the policy dialogue. These were to:

a) input into the case studies on the tourism and clothing sectors in South Africa;
b) examine the linkages between trade, development and poverty in South Africa and the SADC region; and
c) draw out key messages to engage with policy makers on trade, poverty and development.

Dr. Siphamandla Zondi, Africa Director at IGD, noted that the policy dialogue coincided with the closing of the Common Market for Eastern and Southern Africa (COMESA) Heads of State Summit. He noted that COMESA took nearly ten years from the point of deciding to work towards a customs union, in 1997, to adopting common external tariffs, which were decided by the Council of Ministers at the most recent Summit. The delay highlights a number of challenges facing the establishment of a customs union in the region, including: a) the need to consider the consequences in terms of membership in other customs unions, such as the Southern Africa Customs Union (SACU); b) the policy instruments that need to be put in place to establish a customs union; c) the legislative interventions that must be undertaken by Member States, in order to harmonise trade and other policies; and d) the broader question of how to promote competitiveness at regional level. Dr. Zondi noted that COMESA, SACU and the East African Community (EAC) have already begun discussions about the steps needed for a single effective customs union across the entire region. Such a customs union would need to address: the balance between encouraging global competitiveness and opening up economies; the promotion of diversification; how to overcome supply side constraints; how to mitigate against the negative effects of liberalisation; and the prioritisation of key sectors for economic growth and transformation.

Dr. Zondi raised a number of questions to guide discussions over the course of the policy dialogue, including:

a) What nature of state would be desirable to put in place these economic policies?
b) Do we want a developmental state? What does that mean and what should it do to manage development?

c) What should be the role of the regional economic communities (RECs) and the customs unions?
d) Is deeper trade integration the way to go? Should we go more slowly and build capacity before integrating?

THE CASE STUDIES

Mr. Brendan Vickers, Senior Researcher on Multilaterals at IGD presented the two case studies. He noted that the studies raise issues around industrial policy, the role of the developmental state and the Accelerated Shared Growth Initiative (ASGISA). With regard to the linkages between trade, development and poverty, Mr. Vickers reminded participants that it is very difficult to measure trade or poverty. However, trade liberalisation tends to affect the poor through: a) price transmission (consumption and production); b) enterprises (profits, employment and wages); and c) taxes and spending (fiscal position of the state). The question to keep in mind with regard to trade liberalisation is: who benefits?

Mr. Vickers reviewed a number of studies that have shown the adverse effect of liberalisation in South Africa on the poor. These studies have highlighted the unevenness of economic growth, disparities between male and female wage levels, a general lack of employment benefits because the majority of the poor are disconnected from the formal wage economy and a tendency for liberalisation to raise the skill intensity of production and exacerbate income inequality.

The Clothing Sector

Mr. Vickers noted that the clothing sector could be considered a “sunset” industry, in which imports exceed exports by a factor of three and with employment at 110,000 to 160,000 (of which 70-80% are women). The sector has seen rising Chinese imports, the end of the multi-fibre agreement, and tariffs reduced from 100% in 1994 to 40% in 2005.

The clothing sector in South Africa saw significant unilateral liberalisation before the Uruguay round. It declined under the structural adjustment programme of the 1980s, due to: insulation and inefficiencies under apartheid; concentrated production and ownership leading to high overheads; the predominance of family run businesses with conservative spending and minimal capital investment; the lack of alternative strategies beyond labour cost flexibility and the problem of labour relations marked by apartheid mentality.

Some of the negative consequences of liberalisation of the clothing sector include:

a) Job shedding (close to 70,000 jobs lost over the last ten years), informalisation and a proliferation of household enterprises (cut make and trim, or CMT). Of those who lost their jobs, 69% have not been reemployed.
b) Social dislocation, which has been especially acute for women, who are often the sole low wage breadwinners in poor households and who have few alternative job opportunities.
c) Dumping and import penetration, especially from China (imports have increased from 85 million units in 2001 to 335 million units in 2004).

The sector has attempted to adjust by: shedding manufacturing to focus on design or imports; outsourcing apparel assembly (as CMT); or reorienting production for export. The latter option has been unsuccessful in light of declining exports to the US under AGOA, the high value of the rand and problems with ‘rules of origin’. The industry seeks WTO safeguards to stem

Chinese dumping, and South Africa signed an MoU with China for quotas on 31 categories and 100 products. However, there are questions about the enforceability of the MoU, as well as its implications for other SACU member states.

Looking to the future, the possibilities for black economic empowerment (BEE) in the sector deserve further examination, especially considering the labour-intensive nature of the industry and the need for skills development and recapitalisation. Another possible approach is to reorient production toward niche markets in value added apparel, to avoid trying to compete with cheaper mass producers. Regional and vertical integration of the textile and clothing value chain the SADC region would benefit the sector.

The Tourism Sector

Mr. Vickers referred to tourism as a "sunrise industry," characterised by an increase in arrivals (from 640,000 in 1994 to almost 8.4 million in 2006). Tourism is South Africa's largest foreign exchange earner and contributes 7-8% of (including through indirect means), and has been targeted by ASGISA to reach 12% by 2014. The sector employs 3% of the workforce, and is expected to increase to up to 1.2 million for the FIFA World Cup in 2010. However, the sector has been criticised as elitist, seasonal and linked to problems such as rising local costs, prostitution and loss of access of communities to local resources.

A possible pro-poor tourism strategy has emerged, with three pillars.

a) First, tourism should increase economic benefits. This entails boosting local employment and wages; boosting local enterprise opportunities (food, crafts, guides); and generating collective income sources (fees, revenue shares).
b) Second, tourism should enhance non-financial livelihood impacts. This entails capacity building and training; mitigation of environmental impacts; addressing the problem of competing use of natural resources; improving social and cultural impacts of tourism; and increasing local access to infrastructure and services.
c) Finally, tourism should enhance participation and partnership. This involves greater involvement of local communities in planning; increasing the participation of the poor in decision making; and build pro-poor partnerships with the private sector.

The sector faces a number of challenges, including:

a) Transformation: The sector adopted a BEE scorecard and charter in 2004, with a target of 36% black ownership by 2014. Transformation has been slow, however. The Department of Environmental Affairs and Tourism (DEAT) conducted a baseline survey of six provinces which found very low black ownership and control—only 1% of 23 caterers; 4.4% of 90 hotels, and 15.6% of 321 B&Bs. An estimated 90% of businesses in the sector are small, medium and micro-enterprises (SMMEs), making transformation more complex.
b) Geographical distribution of tourism benefits across provinces: With reference to both domestic and international tourism, a few provinces derive most of the benefits. Gauteng, the Western Cape and KwaZulu Natal (KZN) capture 74% of international tourism, while KZN, Gauteng and the Eastern Cape receive 60% of domestic tourism.
c) Seasonality: This exposes communities to fluctuation in income and employment.
d) Market access and investment environment: The sector has seen significant growth of inbound tour operators, from 460 in 1999 to 800 in 2004, with significant foreign direct investment (FDI) and internationalisation. Six firms dominate, with smaller firms in niche markets. Many believe that South Africa expects too much from the World Cup.

e) Liberalisation of regulatory environment: The deregulation of aviation is a major issue, with calls for an open skies policy in the face of a very protected market for South African Airlines (SAA). Demand for flights to South Africa exceeds supply, and while cabinet adopted an airlift strategy in 2006, there are various costs and benefits that require further examination.
f) Risk management of unpredictability: Volatility of the rand has a serious impact on the sector.
g) Sustainability of sector: This is linked to broad based black economic empowerment (BBBEE).

Debating industrial policy

In the last year, economists and labour organisations have proposed a number of possible alternatives to increase employment and promote economic growth in South Africa. One school of thought, championed by Harvard economist Dani Rodrik, blames underperformance of the non-resource tradable sector for South Africa's disappointing growth rate. Rodrik recommends the Malaysian strategy of industrialisation based on labour intensive manufacturing, in light of South Africa's low skills context. Another school of thought recommends further liberalisation of the economy for intermediate inputs, to boost manufacturing and thereby non-commodity exports.

The Congress of South African Trade Unions (COSATU) has painted two scenarios. The redistributive scenario involves continued dependence on mineral exports and manufactured imports. This scenario would not elicit any change in the ownership structure and would require social grants to combat poverty. Wages could remain around R5000 per month, and there would be no need to weaken labour laws or change the role of the state. However, a fall in commodity prices could lead to unrest. The second scenario involves industrialisation through developing agriculture, light industry and services. This scenario would increase the number of SMMEs (thereby altering the ownership structure) and would require the state to restructure activities to prioritise employment creation. In turn, rising employment would reduce poverty. While no weakening of labour laws would be required, this scenario would entail lower wages (approximately R1000-2000 per month). The risks in this scenario include failure to develop sustainable new activities and the possibility of a high exchange rate due to a commodity boom undermining new industries.

DISCUSSION

In the discussion session following the presentation of the two case studies, a number of key issues were raised. An over-riding theme was the need to understand the linkages between trade, development and poverty. Some of the questions guiding the discussion included:

a) How do issues of regional integration impact upon policy choices, and vice versa?
b) What are the safeguards to mitigate against the negative consequences of liberalisation?
c) What are the policy options? What are the risks associated with the different policy options and how can they be balanced with long-term benefits? How effective are policies like social safety nets, skills development and training, BBBEE, etc?

Regional integration

With regard to regional integration, participants stressed the importance of solidarity amongst African countries and suggested that the African Union might play a role in that regard. Much of the world population lives in the South, and most raw materials come from South, so Africa should leverage its bargaining power.

Participants also noted that the Lagos Plan of Action (1980) and the Treaty Establishing the African Economic Community (1991) provide an excellent example of regional integration and the developmental state. However, participants noted that Africa has been talking about integration for a long time, with leaders at the top saying the right things, but not enough actual integration taking place on the ground.

Another challenge is the fact that the RECs do not always negotiate with other trading partners as a bloc. The EU refused to negotiate with RECs as blocs, so COMESA member states are negotiating Economic Partnership Agreements (EPAs) individually or in other groupings. COMESA should adopt a common position on EPAs right away.

With regard to South Africa, it was noted that the country is far from a number of large markets (like Europe), and therefore has higher transport costs. Regional integration could enhance competitiveness. For example, Kenya now exports more manufactured goods into COMESA than to the EU. Ghana's exports to ECOWAS countries are also value added. Further, it is important to remember that the South African tourism sector is actually linked to the rest of the region, through trans-frontier parks and multi-country travel packages.

Effects of liberalisation

While liberalisation does tend to benefit consumers, in the form of lower prices, the negative impact in terms of unemployment can offset those benefits. In discussing the effects of liberalisation, the question of whether it is possible to separate the effects of privatisation, deregulation and liberalisation on the economy was raised.

A practical example of the negative impact of liberalisation on livelihoods is the second-hand clothing industry in Southern Africa, which tends to be a source of livelihoods for vulnerable populations. As a result of liberalisation, Chinese imports can be even cheaper than second-hand textiles.

The negative consequences of liberalisation were also highlighted with regard to Zambia, where Zambia Consolidated Copper mines (ZCC) generated over 60 percent of foreign exchange until it was dismantled under the structural adjustment programme (SAP), broken into smaller units and privatised under suspicious circumstances involving major tax holidays. At present, royalties from copper in Zambia are only 0.6%, compared with 3% elsewhere in the world. Government is getting very little from copper boom, though there is discussion of developing a windfall tax. A number of donors (especially the UK) are opposed to such a tax. Also, before privatisation of the mines there was a strong corporate social responsibility (CSR) role (provision of schools, sports facilities, clinics etc), but not anymore. CSR etc was not in the government's contracts with the private companies and is therefore neglected.

Zambia is taking advantage of the crisis in Zimbabwe to lure investment, but the new businesses (e.g. tourism) tend to be foreign owned. The investment act allows 100% externalisation, so all profits are repatriated. The problem with tax holidays is that companies leave at the end of the tax holiday and then return under a new name to avoid taxes.

Furthermore, tax holidays may actually be greater than the aid coming from the home country of the companies getting the tax holidays.

Some of the other problems that can be associated with liberalisation include:

a) internationalisation/ foreign ownership of assets,
b) repatriation of profits,
c) currency volatility as a result of capital flight,
d) extended tax holidays which do not allow government to maximise revenues from foreign investment,
e) corruption and government wastage.

The difficulties experienced by Zambia and other African countries highlight the importance of a good policy framework to regulate investment and allow the country to benefit form its natural resources. Some of these policy options include: controlling the tariff regime (as India does); controlling the economy; and requiring a minimum percentage of local ownership.

Policy options and the International Financial Institutions (IFIs)

Participants pointed out that while South Africa faces constraints when making economic policy, the rest of the region has even less room to manoeuvre because other countries are more dependent upon foreign aid and loans. Government officials don't have the confidence to confront the policy advice of the IFIs, or if they do, they are penalised for it. African countries need budget independence from donors. For example, until recently the Zambian budget was 63% donor financed. Thus while the adverse economic effects of liberalisation on industry and the economy were predicted, the country had no choice but to accept the policy prescriptions of the Bretton Woods institutions. Similarly, the Economic Partnership Agreements (EPAs) being negotiated with the EU make aid/grants contingent upon liberalisation. In addition, the General Agreement on Trade in Services (GATS) and other trade agreements further limit policy space.

However, some participants argued that African governments do have autonomy and sovereignty, but they have abdicated responsibility and allowed external circumstances to shape policies. Rather than allowing policy capture, participants asked, why can't governments use tax policies, interest rates, inflation, agriculture subsidies or other measures to promote development? It was noted that during the Cold War there was more policy space, and that the rise of the East might provide a new opportunity for Africa to reclaim policy space and assert sovereignty.

A number of examples of countries that have managed to retain control over policy were discussed. For example, Kenya has not included aid in its budget for last two years (initially because the IFIs stopped providing funding). Now the Kenyan government no longer factors in donor assistance. Government focused on better internal controls and the economy has grown at 6% this year. Kenya also deliberately looked east to play East against West. This changed the tune of the usual western donors. In Zambia, Kaunda got rid of the IFIs and the international corporations and developed a strategy of growth from natural resources. The economy reached 6% growth, but it wasn't sustainable and collapsed in 1989, partly because of a lack of solidarity from neighbouring countries. Vietnam waited until January 2007 to join the WTO.

Participants highlighted the global movement towards the feminisation of labour, since women's labour is cheaper and underscored the need to find means to empower women to earn the same amount as their male counterparts. The importance of skills development was also raised. In the case of the South African tourism and hospitality sector, there is a Sector Education and Training Authority (SETA) to promote skills development, and the Department of Trade and Industry (DTI) is supporting a Tourism Enterprise Programme (for new entrants).

Nature of developmental state

While participants noted the paradox of examining the nature of a developmental state after discussing the loss of policy space, they nonetheless attempted to determine what sort of policies a developmental state would adopt.

One policy option would be a corporatist arrangement, based on a social contract in which the state, labour and industry/capital agree on fundamental principles such as wage and price controls. This would allow for peak bargaining. In Scandinavia it has allowed for a strong base of redistribution.

With regard to the issue of foreign direct investment versus local investment, Kenyan local companies are producing cheaper goods than multinationals, because of favourable policies and government support for local producers. Government recognition of second economy has helped. Conversely, government 'double taxes' local companies in Zambia and elsewhere by taxing property and profits while foreigners get tax holidays.

As noted earlier, the Lagos Plan of Action contains the main ingredients of a developmental state. Indeed, participants noted that Africa is replete with examples and possible models. These have tended to fail not because of bad policies but because they have been stopped by external forces. African states should be activist states.

There should be a partnership between government and civil society, based on cooperation and support rather than only criticism. Civil society could do impact studies, propose policies and collaborate with government to develop solutions. At present there is very little participation in the development of macro-economic policies. It should be expanded to include other actors. African states need strategies for enhancing national ownership. Of course, civil society organisations are also dependent on donor funding, which raises questions about their independence.

CONCLUSION AND WAY FORWARD

In closing, Dr. Nhamo Samasuwo, Multilateral Director at IGD, summarised some of the key issues raised during the discussion, including the elements of a developmental state and the need for African governments to demonstrate leadership in enacting developmental, pro-poor policies. Mr. Vickers explained that the comments made during discussion would be inputted into the papers during revision.