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Services Trade Liberalisation and the Role of the Services Sector in South African Development

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ABSTRACT

South Africa's 2010 Trade Policy and Strategy Framework (TPSF) document envisages a 'strategic tariff policy' in line with government's major development objectives, key among which are employment creation and industrial development and restructuring. The TPSF also outlines a policy of 'strategic integration into the global economy' designed to participate in the world economy while preserving sufficient policy space to pursue domestic objectives. This policy emphasises the need to develop a trade strategy on the new generation trade issues, including trade in services. The rationale for a work programme on trade in services rests on the high share of services in domestic and global value added, increases in services trade and the significant proportion of foreign direct investment destined for services sectors. Pressure on developing countries to liberalise their services trade at multilateral, regional and bilateral levels is an additional concern.

The paper explores debates surrounding the role of the services sector in development and the inferences for South Africa's employment creation and industrial policy goals. It considers questions about the feasibility and desirability of services trade liberalisation at the regional–bilateral and multilateral levels, as well as in North–South versus South–South configurations, and the associated implications for development policy space. The paper finds that a focus on the services sector to the neglect of manufacturing will be insufficient as a development strategy. Research on the distributional consequences and employment effects of services trade liberalisation at the subsectoral level is needed in light of the linkages between manufacturing and services sectors.

The paper highlights increasing concern about the impact on policy space of pressure on developing countries to make GATS–plus obligations in North–South regional and bilateral negotiations, particularly in services, investment and intellectual property. The paper concludes that, although efficient and reliable services are needed for industrialisation, generalised services trade liberalisation is not the appropriate strategy for the services sector either in South Africa or in developing countries more generally. Services trade liberalisation in GATS or in North–South trade agreements such as the Economic Partnership Agreements is also not necessarily the best way to improve services sector efficiency and exploit the sector's growth and employment potential. The paper stresses the importance of services trade policy formulation, however, as envisaged in South Africa's TPSF document, and outlines research needed on the services sector in view of South Africa's employment creation and industrial policy goals.

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ABBREVIATIONS AND ACRONYMS

BPM5	IMF Balance of Payments Manual, 5th edition, 1993
CGE	computable general equilibrium
COMESA	Common Market for Eastern and Southern Africa
EAC	East African Community
EPA	Economic Partnership Agreement
EU	European Union
FATS	foreign affiliates trade in services
FDI	foreign direct investment
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDP	gross domestic product
ICT	information and communications technology
IMF	International Monetary Fund
SACU	Southern African Customs Union
SADC	Southern African Development Community
TPSF	Trade Policy and Strategy Framework
US	United States
WTO	World Trade Organization

INTRODUCTION

South Africa's Trade Policy and Strategy Framework (TPSF) document[1] proposes a developmental trade policy designed to support and facilitate the country's revised industrial strategy.[2] The TPSF document envisages a 'strategic tariff policy' to be pursued in line with the government's major development objectives. These are employment creation, economic growth, poverty reduction, industrial development and restructuring, and the promotion of high value-added exports. The TPSF also outlines a policy of 'strategic integration into the global economy' designed to participate in the world economy while preserving sufficient policy space to pursue domestic objectives. This global strategy has bilateral, regional and multilateral dimensions.

The TPSF emphasises that strategic global integration requires South Africa to develop a trade strategy on the so-called new generation trade issues. These include services, investment, competition policy, trade facilitation, government procurement, intellectual property rights, standards and the environment. The document identifies the need for a trade policy work programme focusing in the first instance on trade in services. The rationale for this focus lies in the high share of services in domestic and global value added, increases in services trade and the significant proportion of foreign direct investment (FDI) destined for services sectors.[3] The role of the services sector in facilitating and supporting manufacturing production and trade, as well as in the mining and agricultural sectors is a further important aspect.

These elements, together with the pressure on developing countries to liberalise their services trade at multilateral, regional and bilateral levels, raise a number of critical questions that a services trade policy work programme should address. They include debate about the role of the services sector in development and the inferences for employment creation and industrial policy goals. There are also questions about the feasibility and desirability of services trade liberalisation at the regional–bilateral versus multilateral level as well as in North–South versus South–South configurations, and the associated implications for development policy space.

With some important exceptions, there has been little systematic analysis in South African literature on the social and economic role of the services sector and on the associated implications of services trade expansion and liberalisation. Indeed, the benefits of services liberalisation are often simply assumed without question. The emphasis is on how to manage such liberalisation rather than debate on its desirability per se. However, South Africa has already undertaken extensive commitments under the General Agreement on Trade in Services (GATS) during the Uruguay Round of trade negotiations and has been involved at the regional level in drafting the Southern African Development Community (SADC) Protocol on Trade in Services. On the other hand, South Africa and its Southern African Customs Union (SACU) partners have not yet developed a common position on services trade negotiations despite agreeing to negotiate trade agreements post-dating the 2002 SACU Agreement as a bloc. This has led to tensions between SACU members in the Economic Partnership Agreement (EPA) negotiations with the EU. The services question has also affected SACU–US trade negotiations and is already proving to be a discussion point in the drafting of the Tripartite Agreement between the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and SADC.[4] These matters reinforce the pressing need for South Africa to develop a comprehensive trade policy work programme on services.

The purpose of this paper is to explore the implications of services trade liberalisation for employment creation and industrial policy goals in South Africa. It begins by critically examining the debate surrounding the role of the services sector in development, with a particular focus on its role in facilitating industrialisation. It then considers the implications of increased trade in services and the growing pressure on developing countries to liberalise their services trade in light of both the economic and social roles of the services sector. The paper highlights South Africa's GATS and other commitments in the services field, with reference to the regional–bilateral versus multilateral liberalisation debate. The final section outlines research needed on the services sector in light of South Africa's employment creation and industrial policy goals. The aim is to provide a review that will facilitate more in-depth analysis exploring the strategic balance between services sectors to develop domestically, regionally or to open multilaterally, taking account of South Africa's international obligations and national development objectives.

THE SERVICES SECTOR IN DEVELOPMENT

The role of the services sector in development has received increasing attention due to significant increases in services trade over the past few decades and pressure on developing countries to liberalise their services trade in exchange for concessions on market access from the developed world. This focus has been reinforced by the growing importance of the services sector in supporting and facilitating manufacturing, particularly in a context in which international production-sharing and global networks of production and trade have become increasingly dominant.

The contribution of the services sector to gross domestic product (GDP) and employment is frequently used as a rationale for positioning the sector in a dominant role in a country's development strategy. This view is controversial, as aggregated data on the sector's share of output and employment could conceal a wide range of survivalist activities and poorly remunerated work. Nonetheless, it is frequently argued that the services sector itself should become the engine of growth and economic development. According to Sheehan[5], there are growing constraints to the pursuit of growth and development through industrialisation for the majority of developing countries, particularly through export-oriented industrialisation. He identifies a number of constraints with reference to the historical experience of developed countries, and to apparent evidence of a shift in China to a development strategy focused on agriculture and services sectors, as well as to rapid growth emanating largely from the services sector in India.

Greater competition in global manufacturing trade from the newly industrialised countries, Eastern Europe and particularly China, constrains the ability of most developing countries to break into manufactured export markets, and has resulted in significant import penetration into their economies. Although the impact of the rapid increase in trade with China will differ according to a country's ability to feed the resource demands or capital good requirements of the Chinese economy, it could be unfavourable for a number of less-developed countries.[6] The changing nature of the manufacturing production process and its impact on manufactured trade is another factor. An important amount of recent trade expansion has been in 'fragmented trade', with trade in intermediate manufactured goods comprising 40% of global non-fuel trade in 2008.[7] It may be difficult for developing countries to access global production networks or to meet the necessary technological and standard requirements to participate in such networks. Such requirements are likely to become even more stringent in future with respect to energy use and the environment.[8] This view could be countered by emphasising strategies to address the greater technological requirements of manufacturing such as improving the efficiency of the relevant service sectors, as opposed to abandoning manufacturing as a development strategy.[9] There is also emerging literature on the possibilities for industrialisation and upgrading in South–South global value chains.[10] However, Sheehan argues that 'in current conditions "big push" industrialisation is unlikely to drive the growth of any new developing countries outside East Asia in the foreseeable future'.[11]

While it is not clear that a convincing case has been made for this perspective, Sheehan's analysis does directly raise the question of the feasibility of alternative development strategies based on agriculture and services. He argues[12] that China's 2006–2011 Five-Year Plan portrays a strategic shift in the country's development trajectory in response to difficulties related to its rapid industrialisation, particularly with respect to energy use, pollution and environmental problems, growing inequality, and macroeconomic vulnerability. By contrast, India's growth acceleration is driven largely by services, despite efforts to increase manufacturing growth and exports. Sheehan highlights the role of information and communications technology (ICT) services in particular and the importance of the domestic private sector, as well as the limited reliance on FDI.[13] However, there is little analysis of the potential limitations of a services-led development path for countries at a low or intermediate stage of development, particularly from an employment perspective. Nonetheless, the challenges he poses – that the implications of rapid growth based on services need to be better understood, as do linkages between services and the rural sector – warrant further consideration.

The centrality of industrialisation in the development process, particularly associated with post-Keynesian, structuralist and Schumpeterian thought, considers manufacturing as the most effective vehicle for development. This is because of its particular characteristics, and despite the difficulties of pursuing export-led industrialisation in the current global context. As Palma explains:[14]

> the pattern, the dynamic and the sustainability of growth are crucially dependent on the activities being developed. In particular, there are specific growth enhancing effects associated with manufacturing due to its capacity to set in motion processes of cumulative causation. This is because 'learning-by-doing', dynamic economies of scale, increasing returns, externalities and spillover effects are more prevalent in manufacturing than elsewhere in the economy ... [I]ssues such as technological change, synergies, balance-of-payments sustainability and the capacity of developing countries to 'catch up', are directly linked to the size, strength and depth of the manufacturing sector.

Dasgupta and Singh and Tregenna describe this perspective in further detail,[15] with reference to the pioneering work of Kaldor and Hirschman.[16] What Tregenna refers to as the 'specificity' of manufacturing derives from the idea that an increase in value added in manufacturing has a stronger effect on economic growth than a corresponding addition to value added in services or agriculture. Reasons include the nature of the forward and backward linkages between manufacturing and the other sectors of the economy; more pervasive dynamic economies of scale; greater technological change in manufacturing and more extensive technological diffusion to other sectors; and price and income elasticities of imports that are more favourable to easing balance of payments constraints on growth.[17]

Dasgupta and Singh distinguish various structural trends that appear to challenge Kaldor's notion of the central position of manufacturing as the engine of growth and development. These include evidence of 'premature deindustrialisation'; jobless growth in manufacturing in both lower-growth regions and rapidly growing countries like India; and more rapid long-term growth rates of services.[18] Premature deindustrialisation refers to the decline in the share of manufacturing employment at significantly lower levels of per capita income than in the case of present industrialised countries. The essential question is whether such a phenomenon is inevitably detrimental to growth and development prospects, and in particular to employment creation.[19] The central concern is whether labour in lower-income countries in particular is likely to gravitate into informal manufacturing and informal services jobs of poor quality as a result.

Although deindustrialisation could be seen as the decline in manufacturing employment associated with the change from manufacturing to specialised services in mature economies once a particular level of per capita income is attained, Palma analyses the phenomenon in a more complex framework. He identifies three additional sources of deindustrialisation: a relationship between per capita income and manufacturing employment that declines over time; a fall in the level of per capita income associated with the turning point; and an expanded conceptualisation of the 'Dutch disease'.[20] The latter is associated specifically with premature deindustrialisation, with reference to particular Latin American countries and also to a certain degree South Africa. In these countries, a degree of industrialisation was achieved through import substitution. However, this was followed by significant premature deindustrialisation in employment terms due in part to far-reaching economic policy changes associated with neoliberal reforms.

Sheehan[21] contends that the special characteristics of manufacturing identified as important for growth and development are present in modern services sectors as well as in manufacturing. Dasgupta and Singh explore the influence of ICT developments on the structural change taking place from manufacturing to services at much lower per capita income levels, with particular reference to the case of India. They argue that at lower per capita income levels the income elasticity of demand for manufactures will still be comparatively high. This suggests that, in general, manufacturing remains crucial in maintaining external balance in middle-income countries.[22] In the case of India, ICT and other particular services sectors are identified as 'dynamic' in the Kaldorian sense, and hence as potential additional or complementary engines of growth. ICT exports also make a significant contribution in balance of payments terms.

The Indian case is often taken to be the 'model' of a services-led growth path for emerging economies to emulate. However, the contribution of the ICT sector in the country needs to be placed in context, particularly with regard to employment and output. Singh[23] notes that questions have been raised about the sustainability of rapid GDP growth based on a high growth rate of services coupled with jobless growth in manufacturing. The inability of the rapid growth in services to generate formal employment growth within the services sector itself is a major concern, with low or falling employment elasticities in a number of fast-growing services sectors. Further, Singh reports that the information technology subsector accounts for less than 1% of GDP. It employs less than 0.22% of the labour force and is directly reliant on educated labour.[24] In addition, the success of information technology has evidently exacerbated the impact of globalisation on inequality. This has significant implications for both industrial and social policy.

It is apparent that linkages between growth rates of manufacturing and services need to be explored both at the subsectoral and at the sectoral level. Singh highlights that on the one hand, for subsectors such as information technology, development and expansion of the services subsector facilitates the growth in manufacturing production and trade.[25] Similar arguments have been put forward regarding the growth and extent of international production sharing and fragmented trade. The reduction in the costs of the service links required to co-ordinate production blocks across borders has been an important factor driving the emergence of international production networks.[26]

On the other hand, for services subsectors such as transport and retail, the growth of services can be seen as a response to the performance of the manufacturing sector. This is in line with the Kaldorian view of the relationship between aggregate and sectoral growth rates. Tregenna's[27] work on sectoral structure, growth and employment in South Africa finds that manufacturing is a significant source of demand for the services sector. The inference is that manufacturing contraction would impact adversely both on services growth and on growth in general. Her analysis reveals the importance of distinguishing between services growth and employment changes due to outsourcing from manufacturing and those changes that are due to a growing demand for services by the manufacturing sector.[28] Intersectoral outsourcing from manufacturing to services has evidently been significant in South Africa, and the services sector is found to be particularly important for employment creation. At the same time, in the case of low-skilled labour, manufacturing is found to have a higher employment multiplier than services.[29] The implications of these linkages and findings for job creation and industrial policies therefore need to be closely examined at the subsectoral level.

The discussion thus far suggests that, notwithstanding the centrality of manufacturing, changes in the global structure of production, trade and investment necessitate increased recognition of the role of the services sector and the impact of services trade liberalisation, particularly as developing countries contend with the rise of global production networks. This does not mean that a focus on the services sector to the neglect of manufacturing will suffice as a development strategy. Indeed, part of the special role of manufacturing in the growth process relates to the fact that a decline in manufacturing will have an adverse impact on the services sector.

Furthermore, aggregate statistics on the size or growth performance of the services sector relative to GDP should be interpreted with caution. This is because an early expansion of the sector in terms of output and employment may signal premature deindustrialisation. In such instances, the benefits of services sector growth could be concentrated among managerial classes in specific sectors such as finance and retail, with the bulk of unskilled labour engaged in survivalist or poorly paid employment. In addition, gender impacts and the effect on inequality need to be explored properly.

Recognition of the importance of the services sector does not imply that either services trade expansion or services trade liberalisation will automatically benefit developing countries. As in the case of goods trade, it is often simply assumed that liberalisation will result in greater efficiency, higher welfare, growth and poverty reduction. Much of the discussion on services liberalisation merely transfers the alleged benefits of goods trade liberalisation to the case of services. However, two important points should be emphasised. Firstly, the case for liberalisation of trade in goods as part of a development strategy has itself been subject to extensive theoretical and empirical critique.[30] Secondly, liberalisation of trade in services is more complex than that of trade in goods. This implies that there are added dimensions to the usual debates surrounding liberalisation and development that deserve attention in the case of services.

SERVICES TRADE, LIBERALISATION AND GATS

Whether or not it is argued that the role of the services sector in the development process lies primarily in a shift from industrialisation to services as the path to development, or more in the promotion of the services sector to advance development via industrialisation, the desirability of services liberalisation needs to be critically evaluated. Developing countries, including South Africa, are under strong pressure to open up their services markets multilaterally, as well as in bilateral and regional trade agreements. Such pressure has arisen from developed country trading partners in particular, in response to the saturation of their own services markets. The extent to which domestic regulatory frameworks and legislation are in place in developing countries is often ignored by those pressing for commitments in services negotiations. It is also deflected by the offer of 'technical assistance' to develop such frameworks as part of a package of inducements in return for services market access. Since existing domestic regulation is often considered 'part of the problem' by liberalisation advocates, the offer to assist in the reform of such frameworks is reminiscent of the one-size-fits-all policy prescriptions of the Washington Consensus. The central role of domestic regulation in the services sector and services trade is one key aspect of the added complexities to be considered in the analysis of services trade liberalisation.

At an even more fundamental level, the question of the definition and measurement of international trade in services requires discussion. This is important as the empirical case for services liberalisation often rests on the results of computable general equilibrium (CGE) models and cross-country or cross-sectoral econometric studies, as in the liberalisation of trade in goods. The critique of the methodologies used in the literature on goods trade liberalisation would be compounded, in the case of services, by controversies and problems related to defining and measuring services trade.

Lee and Lloyd[31] distinguish two definitions of trade in services. The first is from the International Monetary Fund (IMF) Balance of Payments Manual (BPM5 of 1993) and comprises transactions on the current account other than those involving goods and income payments. The second is that which appears in Article I of GATS, the World Trade Organization (WTO) Agreement governing services disciplines at the multilateral level. Here, services are classified according to their 'mode of supply', since international services transactions generally involve the movement of the producer or the consumer, or the movement of capital for investment in service activities.[32] Four modes of supply are distinguished:[33]

Mode 1: Cross-border supply: non-resident service providers supply services across borders into a WTO member's territory.

Mode 2: Consumption abroad: member's residents purchase services in another member country.

Mode 3: Commercial presence: service suppliers from abroad establish, operate or expand commercial presence (such as a branch or subsidiary) in a member's territory.

Mode 4: Presence of natural persons: foreign persons enter and temporarily stay in a member's territory in order to supply a service.

The essential problem is that the balance of payments definition corresponds largely (and imprecisely) to Modes 1 and 2 of the GATS classification, and partly to Mode 4.[34] Mode 3 (commercial presence) accounts for most of the difference between the two definitions and is considered to be significant. To bridge the gap between the balance of payments approach and the GATS modes of supply classification, a framework has been developed to guide the collection and reporting of services trade data.[35] The first Manual on Statistics of International Trade in Services[36] was published in 2002 based on BPM5 and the 1993 System of National Accounts. It initiates an Extended Balance of Payments Services Classification that disaggregates the BPM5 services components into more detailed subcomponents to capture more information in respect of Modes 1 and 2. Lee and Lloyd[37] report some controversy over whether Mode 3 (commercial presence) should be designated as international trade or rather recorded outside GATS under a multilateral investment agreement. However, the GATS mode of supply classification appears to have become entrenched via the current web of multilateral, regional and bilateral services trade negotiations. The 2002 manual therefore describes the development of a database on 'foreign affiliates trade in services' (FATS) to build up information on the supply of services via Mode 3. An annex to the 2002 manual begins to address the issue of data collection under Mode 4 (presence of natural persons), the most sensitive mode of supply.[38]

The 2010 Manual on Statistics of International Trade in Services emphasises that the implementation of recommendations concerning the collection of services trade data is recognised as a long-term goal. It distinguishes core elements to be implemented in the first instance (such as disaggregation of balance of payments data and the collection of FDI and FATS data) from other elements such as the allocation of transactions over the GATS modes of supply and the collection of statistics on Mode 4.[39] Cronjé[40] notes that the guidelines of the manual are not yet fully applied by developing countries. Given the differences in commitments to date across developing countries at the multilateral level, it is hard to imagine that a record of transactions across the GATS modes of supply would be available in the near future, particularly for least-developed countries.[41] The state of affairs regarding services trade data, particularly for low-income countries, should be borne in mind when assessing empirical work on the purported benefits of services trade liberalisation for developing countries.

Another key factor in the case of services trade liberalisation is that barriers to services trade are primarily non-tariff in nature and generally form part of domestic laws and regulations.[42] This raises a set of issues related to the measurement of services liberalisation, as well as important considerations associated with domestic economic and social policy objectives.

Measurement and impact of services liberalisation

In orthodox analysis of services trade liberalisation, the measurement and impact of liberalisation are analysed with close reference to the domestic regulatory system and the notion of domestic regulatory reform. Copeland and Mattoo explore the economics of services trade in both traditional comparative advantage and new trade theory frameworks.[43] In the traditional analysis, static resource reallocation gains from trade raise aggregate welfare under restrictive orthodox assumptions in the usual way. Two particular services-related aspects are highlighted. Firstly, services trade will occur largely via the movement of factors of production (labour or foreign investment). Secondly, static efficiency gains will be augmented by efficiency 'rectangles' from lower costs in sectors that use the service as an input.[44] However, such static gains from trade are typically small, and depend on a narrow set of assumptions that do not hold in reality. In addition, there is no clear theoretical causal link to higher long-term economic growth in this perfectly competitive framework.[45]

Copeland and Mattoo identify the benefits of services trade under imperfect competition in a similar way as for trade in goods, namely in terms of increased product variety and economies of scale. They highlight the existence of firm-specific intangible assets as a relevant factor in the provision of services via FDI, and hence as a source of gain from services trade via commercial presence. They also identify potential benefits from agglomeration economies and access to networks as sources of the gains from trade in a range of services sectors.[46] However, each of these potential sources of gain is subject to some degree of qualification. For example, the new trade theory based on economies of scale and imperfect competition can also provide arguments for strategic protection in the presence of external economies of scale or in oligopolistic industries.[47] Such arguments could be readily applicable to particular services sectors. Further, substantial literature debates the question of whether the potential gains from FDI into developing countries will be forthcoming, particularly in terms of technological spillovers and the enhancement of skills.[48] In the case of services trade liberalisation stimulating agglomeration economies, potential distributional consequences in the periphery need to be considered.

Dynamic benefits from services trade liberalisation depend on whether linkages to higher growth rates can be established. Mattoo, Rathindran and Subramanian argue that services sectors like telecommunications, software, financial services and transport have possible growth-enhancing characteristics. These include 'learning-by-doing' and the enhancement of product variety and quality. However, even if technological spillovers are harnessed and productivity benefits follow from services trade liberalisation, employment of domestic factors may fall with trade dominated by factor flows.[49] Further, the presumption that greater competition would be forthcoming or even desirable would need to be interrogated with reference to the characteristics and position of a particular services sector in the domestic economy. Networks, for example, tend to be dominated by a few firms and are generally highly regulated. International differences in these regulations will be seen as barriers to trade,[50] whereas domestic laws and policy goals become important considerations in such instances. This raises the key issue of the implications of services trade liberalisation for domestic regulation and policy autonomy.

The discussion above suggests that the empirical assessment of the impact of services trade liberalisation using cross-country and cross-sectoral econometric and CGE analysis will be difficult. Firstly, measures of services trade at appropriate levels of disaggregation and in comparable form across countries are still under construction. Data is particularly scarce for countries that are most vulnerable to the adverse effects of premature services liberalisation. Secondly, measuring levels of protection in services industries is problematic, as tariffs are rare and most 'barriers' to services trade are non-tariff measures that are part of a country's domestic laws and regulations.[51] Such non-tariff measures have a wide range of objectives other than and beyond protection against services imports. The motives for deregulation or calls for 'domestic regulatory reform' in the context of services trade liberalisation should be carefully examined, as they may serve the commercial interests of developed country trading partners to the detriment of domestic development objectives.[52]

Copeland and Mattoo[53] suggest that the 'protective effect' of regulatory policy should be separated from the 'beneficial effects', and that 'rules for liberalisation that provide the benefits of increased trade while ensuring that other legitimate policy objectives are achieved' need to be found. 'In many cases', they argue, 'trade liberalisation may not be possible or viable unless it is accompanied by domestic regulatory reform'. This perspective, pervasive in the orthodox literature on services trade liberalisation, reflects what Kelsey[54] refers to as the market model of services regulation. The presumption is in favour of liberalisation, since the 'protective effect' is evidently seen as distinct from any 'beneficial effect'. In addition, because domestic regulations are seen as potential trade barriers, they should be designed to interfere minimally in markets (hence the presumption in favour of domestic regulatory reform) and their legitimate objectives should be pre-specified. Kelsey contrasts this market model with a social model of services regulation. This alternative perspective recognises the essentially social nature of services, and the central role and responsibility of the state, rather than the market, in services provision. In this view, the wider functions of domestic regulation are emphasised, and governments require the policy space and flexibility to follow the objectives that are appropriate at a given time.[55]

Services liberalisation, GATS and development policy space

On 1 January 1995, GATS entered into force at the start of the Uruguay Round implementation period. It contains general provisions, namely most favoured nation treatment and transparency, and specific obligations of national treatment and market access. The latter are specific to services sectors included in a country's schedule of commitments. GATS classifies services into 12 main sectors, which are further disaggregated into 160 subsectors. A country's GATS schedule reflects its commitments using a positive list approach in which only the commitments it is prepared to make are specified. For each subsector for which commitments are made, however, the country must indicate a particular level of market access and national treatment, as well as any restrictions or limitations on these under each of the four modes of supply.[56] At the outset, no minimum number of commitments was required although countries had to agree to engage in future rounds of services trade negotiations. Kruger notes that countries accordingly made a wide range of initial commitments. Within SACU, South Africa made commitments in 92 out of a possible 160 subsectors, Lesotho 78, Botswana 20, Swaziland nine and Namibia only three.[57] As a least-developed country, Lesotho was not obligated to make any commitments under GATS but was evidently under pressure after joining the Uruguay Round negotiations late in the process.[58] The mismatch between Lesotho's schedule of obligations and its domestic laws and policies provides an important illustration of the consequences of over-hasty liberalisation commitments.

In the mid-1990s, negotiations continued on a voluntary basis in telecommunications and finance. South Africa signed the Basic Telecommunications Agreement (known as the GATS Fourth Protocol) as well as the Fifth Protocol on Financial Services, which entered into force in 1998 and 1999 respectively. However, since 2000 GATS negotiations have effectively stalled. This reflects the general lack of movement in the Doha Round; the complexity of services negotiations; problems related to agricultural market access and non-agricultural market access; and developing country concerns over shrinking policy space. GATS offers that have been submitted in the Doha Round evidently go little further than scheduled Uruguay Round commitments, despite many countries having altered domestic frameworks significantly in some of these areas. This indicates a reluctance to bind what is currently applied in the domestic policy context.

Extensive literature addresses the question of the extent to which GATS (as well as other Uruguay Round Agreements such as the Trade-Related Investment Measures and, in particular, the Trade-Related Aspects of Intellectual Property Rights Agreement) has affected policy space for development.[59] According to Wade[60], GATS commitments restrict the use of a range of development policies previously employed by successful developers. He notes that there is little evidence that GATS has increased FDI inflows to developing countries. However, there is increasing concern over unstable financial flows and greater pressure on developing countries to open their services markets without due regard for development consequences. Although there is scope for targeted sectoral liberalisation under GATS, Dabee[61] argues that 'the selection of some important sectors may be influenced by the larger or more advanced member countries at the level of the WTO', particularly in respect of sectors such as telecommunications and financial services. Rodrik and Subramanian have strongly criticised the purported benefits of financial liberalisation.[62] Large capital inflows can lead to inflated domestic financial sectors and a 'Dutch disease' scenario characterised by an overvalued currency and the transfer of skilled resources into the financial sector to the detriment of manufacturing. This is an obvious concern in the case of South Africa.[63]

Gallagher[64] identifies that a major shortcoming of GATS is the absence of safeguard provisions similar to those in the General Agreement on Tariffs and Trade (GATT). He discusses evidence of foreign firms failing to provide equitable access and reasonable pricing in key services sectors following liberalisation. A study by Mosley reports reduced access to rural credit in poor African countries following financial services liberalisation. Uganda is an exception, where domestic regulation was targeted specifically towards access and poverty reduction.[65] Temporary safeguard provisions could have protected domestic investment in this instance, were such provisions available under GATS. Developing country proposals for an emergency safeguard mechanism to be added to GATS in the Doha Round of negotiations have met with little success. Developing countries have also been unable to obtain any significant undertakings from developed countries with regard to Mode 4 (presence of natural persons). Despite this, developing countries are being asked to commit 50% of all services sectors, with particular pressure on Brazil and India in the case of financial services.[66]

The Doha Round impasse has prompted the emergence of a web of bilateral and regional agreements in both North–South and South–South configurations that appear, in a number of ways, to have 'overtaken the multilateral regime'.[67] There is increasing concern about the impact on development policy space of pressure on developing countries to make GATS-plus obligations in North–South regional and bilateral negotiations.[68] This is a particular feature of trade negotiations involving the US and the EU. Such arrangements have become a platform from which deeper commitments are extracted from developing countries in areas such as services, investment and intellectual property in exchange for greater market access. The implication is that industrial policy space that would still have been available in terms of WTO rules is being closed off.[69] In addition, least-developed countries are obliged in these agreements to undertake commitments in areas that they are not required to commit to at the multilateral level. This has been a particular concern for least-developed African, Caribbean and Pacific countries in EPA negotiations with the EU.

SERVICES LIBERALISATION IN REGIONAL AND BILATERAL TRADE AGREEMENTS

Article V of GATS governs services provisions of regional trade agreements.[70] It evidently requires services commitments at the regional and bilateral levels to be more substantial than at the multilateral level. Regional agreements should have 'substantial sectoral coverage' with respect to the number of sectors, the amount of trade and the modes of supply, and should provide for 'the absence or elimination of substantially all discrimination' within a reasonable period of time.[71] The degree to which a country has to undertake deeper commitments at the regional–bilateral level to attain 'substantial sectoral coverage' across sectors and modes will therefore depend in practice on the extent of the country's initial GATS commitments. According to Kruger, however, 'substantial sector coverage' has not yet been clearly defined. Further, countries with more extensive initial commitments in GATS (like South Africa) will find it harder to make a GATS-plus offer at the regional–bilateral level than countries with fewer existing obligations.[72] The reluctance of WTO members to make offers that bind what is currently applied in the domestic policy context at the multilateral level in the Doha Round could therefore be related to the protection of space to manoeuvre in regional–bilateral services trade negotiations.

Fink and Jansen analyse ways in which Article V of GATS results in less potential for discrimination in services provisions of regional agreements than Article XXIV of the GATT governing regional agreements on trade in goods.[73] For example, rules of origin are considered to be more liberal under Article V of GATS. The provisions of Article V.6 of GATS suggest that service suppliers in a country that is part of the regional agreement need not be locally owned or controlled to qualify for regional preferences, provided they engage in 'substantive business operations' in the area.[74] However, Article V.3 of GATS, governing special provisions for services trade agreements among developing countries, allows such agreements to limit preferences to providers of services 'owned or controlled by persons of the parties'.[75] This could be important for Southern African regional agreements, although Fink and Jansen report that developing country services agreements have made little use of the provisions of Article V.3(b) to date.

Much controversy surrounds the pressure on developing countries to make services commitments in North–South regional and bilateral trade agreements. However, South–South regional services provision may be beneficial in certain services sectors. According to Mattoo and Fink, regulatory co-operation may be more feasible in a regional context, with potential benefits from economies of scale.[76] In the SADC region, agreements in transport services, construction and engineering, and in professional services could be explored. From a development perspective, although regional suppliers may initially have higher costs, learning-by-doing may offset such costs in the longer term. In-depth sector-by-sector analysis is needed of which services are more suitably supplied domestically, regionally or internationally. Many South–South regional agreements with services provisions in Latin America, have adopted a negative list approach to regional services liberalisation (with restrictions affecting all sectors listed) in contrast to the positive list approach of GATS (which requires only information on commitments made in specific sectors listed).[77] Although the negative list approach is considered to be more 'transparent', it entails more extensive commitments which restrict policy space.

SOUTH AFRICA'S COMMITMENTS AND NEGOTIATIONS IN THE FIELD OF SERVICES

As noted, South Africa undertook comparatively extensive multilateral services commitments in the mid-1990s in the Uruguay Round of trade negotiations, with coverage in 92 services subsectors out of a possible 160. South Africa also participated in further negotiations on basic telecommunications and financial services, and signed the Fourth and Fifth GATS Protocols in the late 1990s. As a result of the lack of progress in multilateral negotiations on services in the 2000s, there is often a significant difference between current domestic policy and what is reflected in countries' GATS schedules. Kruger points out that GATS schedules therefore tend to be of limited use in guiding analysts and policymakers on domestic laws and regulations in member countries in the services field.[78] His own assessment of the services market in South Africa, with reference to a range of main sectors and subsectors, is that it is well developed and relatively open to foreign enterprise establishment (Mode 3).[79] Exceptions include sensitive sectors such as broadcasting and health, as well as sectors with significant government involvement such as postal services, transport and energy. Detailed sectoral studies that explore the current state of domestic regulation and policy with reference to each mode of supply could provide a fuller picture of how current domestic realities relate to South Africa's GATS schedule. Such studies would also inform an investigation of how the services sector could be harnessed to further the country's employment and industrial policy goals.

Other than its multilateral obligations under GATS, South Africa is involved in the drafting of the SADC Protocol on Trade in Services. A detailed discussion of this process is beyond the scope of this paper. However, a draft protocol is reportedly being circulated for approval after which more in-depth negotiations will begin. The current focus on the COMESA–EAC–SADC tripartite free trade area negotiations may give some impetus to the slow progress. Discussions on services at the tripartite level will, to some extent, be contingent on the state of services provisions in each of the three regional agreements.[80]

In recent years, Southern African regional organisations have experienced more difficulty with the conflict and controversy surrounding the EPA negotiations with the EU. A fundamental problem is that three negotiating configurations exist in Southern and Eastern Africa that cut across existing regional groupings.[81] The SADC–EPA configuration does not conform either to SACU or to SADC as a legal entity. South Africa and Namibia have not yet signed the interim EPA (although Namibia has initialled the document); various deadlines for the conclusion of the talks have passed and there are still a number of outstanding issues to be resolved.[82] SADC member countries have been divided in the face of EU pressure for full and comprehensive EPAs covering investment, intellectual property rights, services and competition, with some countries such as Botswana proceeding with negotiations on services, for example. South Africa's position is that domestic and regional (SADC) frameworks in these areas need to be developed before these issues are negotiated in the EPAs, with time needed to develop negotiating, institutional and regulatory capacity. Negotiations on services are not required for the EPAs to be WTO-compatible. However, the EU strategy has been to link negotiations on the new generation issues to duty-free, quota-free market access for developing countries. This is seen as contradicting the purported development objectives of the EPAs. The concerns raised above reinforce Shadlen's view that:[83]

> [i]n analysing contemporary development strategies, the most useful contrast is not between the alternatives that countries have under the WTO and the alternatives that countries had in the past under the WTO's predecessors, but between a constraining multilateral environment and even more constraining regional and bilateral environments that condition increased market access on the sacrifice of the very tools that countries have historically used to capture the developmental benefits of integration into the international economy.

IMPLICATIONS FOR RESEARCH AND POLICY

Chang argues that in the current global environment countries have to be particularly imaginative in their policies to find ways of taking advantage of new opportunities in areas such as global value chains and services outsourcing.[84] In particular, the pressures and restrictions related to the global trading environment should not prevent countries from continuing to build capacity for an appropriate industrial policy. Further work is required in a number of areas in order to explore how the services sector could be harnessed to advance South Africa's employment creation and industrial policy goals.

The revised Industrial Policy Action Plan emphasises the development of green and energy-efficient goods and services.[85] There is significant interest in research related to the green economy and its potential for employment creation in South Africa. Wade[86] predicts a 'major surge of innovation' in the near future around energy, water and environmentally sustainable industry and services. South African policy should explore how to take advantage of these new opportunities in the relevant services industries.

Wade[87] highlights the difficulties involved in benefiting from technological spillovers from FDI for development purposes and the limited role that FDI has been able to play in increasing domestic research capacity in host countries and in employment creation. These concerns call for further research in the South African context, particularly in the case of services. Mode 3 (commercial presence) accounts for a significant portion of services trade, and a considerable portion of FDI is destined for the services sector. Work is needed on ways to orientate FDI into services sectors in support of the country's development goals.

A further area for research relates to prospects for industrialisation and upgrading in regional and global South–South production chains co-ordinated by integrated industrial policy. This would require rules of origin and regional transport and infrastructure barriers to be addressed, as well as issues surrounding regional industrial policy and preferential trade agreements with countries such as India and Brazil.

The data and measurement issues discussed indicate that there are significant limitations to current estimates of the growth, employment and poverty effects of services trade liberalisation based on cross-country and cross-sectoral econometric studies as well as CGE analysis. Sectoral case studies and further exploration of linkages between manufacturing and services at the subsectoral level, and more detailed consideration of the distributional consequences and employment effects of services trade liberalisation are important areas for research.

CONCLUSION

South Africa faces stagnant domestic growth coupled with an extreme problem of unemployment. Manufacturing and services sectors in the country have experienced differing output and employment performances for a variety of reasons. However, there is evidence that manufacturing is a key source of demand for the services sector. Services are particularly important from an employment perspective, and a decline in manufacturing would have serious consequences for job creation both directly and indirectly.[88] From this perspective, South Africa should be concerned about questions of premature deindustrialisation related to rapid policy changes associated with Washington Consensus-style reforms and liberalisation. At the same time, an effective manufacturing strategy increasingly requires efficient and cost-effective service provision in a wide range of sectors, including finance and insurance, business services, transport and communications. In the South African context, energy provision is a key issue, and the development of effective linkages between industrial and energy policy need to be explored and researched.

The South African debate on services needs to distinguish clearly between the importance of the services sector (both socially and economically) and the importance of services trade (and accordingly services trade liberalisation). Efficient and reliable services are needed for industrialisation. However, this does not necessarily imply that generalised services trade liberalisation is the appropriate strategy for the services sector – either in South Africa or in developing countries more generally. Discussion surrounding the role that the sector should play socially and in relation to industrial policy has to some extent been overwhelmed by the web of activity surrounding services trade negotiations and the associated pressures. It does not follow that services trade liberalisation, either in GATS or in North–South trade agreements such as the EPAs, is the best way to improve services sector efficiency and to exploit the sector's growth and employment potential.

However, services trade policy formulation is important, even if generalised liberalisation is not. There is thus a need to work on a trade strategy for the services sectors as envisaged in South Africa's TPSF document. Given the central role accorded to industrial policy in the formulation of South Africa's trade strategy, extended and comprehensive co-ordination between the domestic agencies involved in trade and industrial policy formulation on both services and manufacturing is essential.

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