

ICTSD Programme on Trade in Services and Sustainable Development



# Opportunities and Risks of Liberalising Trade in Services



Country Study on South Africa

By **Ian Steuart and Rashad Cassim**,  
School of Economics and Business Sciences, University of  
the Witwatersrand, Johannesburg



International Centre for Trade  
and Sustainable Development

Issue Paper No. 2

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7 chemin de Balexert, 1219 Geneva, Switzerland

Tel: +41 22 917 8492 Fax: +41 22 917 8093

E-mail: [ictsd@ictsd.ch](mailto:ictsd@ictsd.ch) Internet: [www.ictsd.org](http://www.ictsd.org)

Executive Director: Ricardo Meléndez-Ortiz

Programme Manager: David Vivas-Eugui

Programme Officer: Alexander Werth

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These can be forwarded to: [dvivas@ictsd.ch](mailto:dvivas@ictsd.ch)

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## FOREWORD

Ten years after services were included in the multilateral trading system, the WTO's General Agreement on Trade in Services (GATS) remains an unfinished project. Given the arguably low level of liberalisation attained so far, it continues to arouse scepticism among its original proponents, as well as deep concern among others with regard to the policy orientation of its provisions. In the context of international negotiations, the GATS was the result of a knotty process of political *quid pro quos* that catapulted services into a major component of the Uruguay Round negotiations. By and large, major services providers in the US and Europe acted as *demandeurs* for WTO rules and for a process that would lead to global trade expansion in the sector. Their counterparts in developing countries were confused, and their development concerns – omnipresent in the process – were ultimately left appallingly vague. The absence of data, commercial insecurity and a crippling perception of an unfavourably tilted playing field prevailed in development circles throughout the negotiations. Broad public policy issues remained off the negotiating table. Difficult tensions – arising, for instance, from the fundamentally different approaches of diverse public law traditions to the role of the State in the provision of certain services – permeated the discussions. The eight years of talks to design the GATS represented a hugely rich, creative and analytical effort, characterised by complexity, technicality and a high degree of politisation.

The implementation of the Agreement has perpetuated the pattern. In the past few years – as we move into the liberalisation phase mandated as a built-in agenda in the GATS – policy-makers in developing countries, academics, civil society analysts and advocacy organisations have expressed serious reservations about the potential implications of requiring developing countries to make greater market access concessions; the need to sequence liberalisation; the lack of adequate domestic regulatory frameworks; the imperative of universal access for essential services; and institutional reform and good governance. The unresolved discussion on whether liberalisation and further advancement of negotiations can proceed in the absence of the mandated impact assessment of implementation seems to be most troubling for practically all parties. Indeed, a comprehensive policy analysis of the implications of trade in services for sustainable development, and of the policy spaces available for implementing public policies, is still missing.

At the national level, the impact of services liberalisation on the local economy is among the most challenging and controversial issues. To address this concern, ICTSD has commissioned a series of studies on the opportunities and risks of liberalising services trade in selected developing countries, including South Africa, Bangladesh and Tanzania. In South Africa, the services sector is considered increasingly important for economic development both in terms of its contribution to growth and its export potential. Exposing the services sector to the “fresh winds of international competition” has the potential to unleash significant economy-wide gains. However, deep and justified concerns regarding unemployment, poverty alleviation and universal access to basic services have led South Africa to adopt a cautious

approach to the progressive liberalisation of key services under the GATS. The opportunities and risks of liberalising trade in services in South Africa are thus delicately balanced in an environment in which regulatory and competition authorities have only been recently established and the restructuring of state assets is still far from complete.

The submission of initial requests in services to South Africa by 16 WTO Members in all the major services sectors has underscored the importance of developing a coherent and co-ordinated approach to liberalising services in South Africa. Any well-designed strategy for services liberalisation must maximise the gains and minimise the associated adjustment costs. Notwithstanding general improvements to the institutional foundations for services liberalisation – notably the establishment of (largely independent) regulatory authorities committed to transparent and non-discriminatory rule-making procedures – we argue that South Africa does not presently have such a strategy and efforts to formulate one are constrained by a trade negotiating apparatus operating sub-optimally on a number of levels. In this case study, we suggest an approach to developing a services liberalisation strategy and highlight a number of issues on which the balance of opportunities and risks of liberalising services in South Africa is likely to turn.

This case study is the second in a series of Issue Papers on topics relevant to the current GATS negotiations produced under ICTSD's programme on Trade in Services and Sustainable Development. This programme aims to *empower developing country policy-makers and other stakeholders at regional and international levels through information, dialogue, capacity-building and research targeted at influencing the international service trading system to advance the goal of sustainable development.*

We hope you will find this pleasant and informative reading and an effective contribution to the debate.



Ricardo Meléndez-Ortiz  
Executive Director, ICTSD

## EXECUTIVE SUMMARY

In terms of its contribution to growth and its export potential, the South African services sector is an increasingly important dimension of the country's economic development. The opportunities and risks of liberalising trade in this area are delicately balanced in an environment where regulatory and competition authorities have been established only relatively recently, and in which the restructuring of state assets is still far from complete.

The South African government adopted a high-level policy mandate to stimulate the services sector in January 2004 as a key tool in halving unemployment (in excess of 30 percent) and poverty by 2014. The sector is already a large contributor to economic development, accounting for 74 percent of GDP and 72 percent of formal employment in 2003. The government itself plays a central role in the services sector: 40 percent of output is directly attributable to government activities, and the role of state-owned enterprises in the electricity, transport and communication sectors is substantial.

Projected growth trends in output and employment indicate that, with respect to growth in value-added, five service sectors exceed the economy-wide average: construction and engineering; medical, dental and other health/veterinary services; business services; government services; and catering and accommodation. Many of the same sectors exceed the projection of economy-wide growth rates in employment. These include business services, medical, dental, and other health/veterinary services, government services, finance and insurance, and wholesale and retail services.

Parts of the South African services sector are highly tradable and the country is becoming an increasingly significant exporter of services, particularly to the rest of Africa. Indeed, South Africa became a net exporter of services in 1998, when the value of exports exceeded imports for the first time since 1985. During the 1980s South Africa's exports were a fraction (10 percent) of that of other developing countries. The 1990s, however, saw South Africa's exports grow at an average annual rate of 6.3 percent, compared to an average of 9 percent for developing economies.

## Liberalisation and Privatisation in South Africa

The government's strategy towards the liberalisation of the services sector is inextricably linked to its privatisation strategy. In 1993, the democratic government inherited more than 300 state-owned enterprises (SOEs), with four of the firms accounting for 86 percent of aggregate turnover, 94 percent of total income, 77 percent of all employment and 91 percent of the total assets of these enterprises. The major state-owned enterprises (or parastatals) today are Eskom (energy), Transnet (transport), Telkom (telecoms) and Denel (defence). Key

producer services are still state-owned, although some of these sectors are partially privatised or are in the process of partial privatisation.

As far as these state-owned utilities are concerned, privatisation itself may have little impact on the quality or price of a service. In sectors such as communications and energy, the importance of introducing competition is a more formidable challenge than simply selling assets to the private sector without a pro-competitive change in market structure. As far as the provision of private services is concerned (such as finance, tourism and education), major regulatory changes have already taken place. In addition, the government has established a number of regulatory agencies committed to transparent and non-discriminatory rule-making procedures. The National Electricity Regulator (NER), for example, was established in 1995 to regulate the generation, distribution and transmission of electricity. Similarly, an independent communications authority was set up to oversee broadcasting and telecommunications.

One of the major challenges is the independence and credibility of these institutions in ensuring fairer competition in the sectors under their jurisdiction. In this regard the role of competition policy assumes critical importance. South Africa has made considerable progress in the area of competition policy since its democratic transition. The legal framework is set out by the Competition Act (Act 89 of 1998), which came into effect on 1 September, 1999. Three institutional bodies were established by the Act: the Competition Commission, the Competition Tribunal, and the Competition Appeal Court. There are still some important jurisdictional issues that need to be resolved between the Commission and the various sector-based regulators, particularly in areas such as finance, communications and energy. It is envisaged that once the process of liberalisation in these sectors is complete all issues relating to competition will fall under the jurisdiction of the Competition Commission.

## Liberalisation and the GATS: the Road So Far

The GATS negotiations have important implications for South Africa's domestic reform initiatives. Although issues of market access differ from those of domestic competition and the regulatory regime, the two sets of issues are interconnected. The major challenge facing government is to ensure coherence and consistency in policy. On the domestic efficiency side, market access may be less effective than competition policy. On the export side, South Africa stands to derive major gains from the global liberalisation of services since it has clear comparative advantages in several sectors – particularly with respect to the rest of Africa.

While South Africa has received requests from a number of Members – which together cover every major sector currently listed in the W/120 sectoral classification list – it has not yet submitted requests or an initial offer to the WTO. It has, however, developed initial requests in business services, communication services (particularly mobile cellular services),

construction and related engineering services, environmental and energy-related services, and financial services.

The bulk of these requests are to SADC Members<sup>1</sup> and other African countries. Indeed, the most comprehensive requests (i.e., those that cover the most sectors and sub-sectors) are to Members in sub-Saharan Africa, which reflects the increasing activity of South African service-providers in the region. Of requests to non-African Members, the majority are to Members in Asia and South America – the latter largely due to the activity of South African mining companies.

Post-Cancun, the key elements of what is likely to comprise South Africa's initial offer to the WTO is more difficult to predict. Given South Africa's extensive bilateral agenda, it is likely that the initial offer will be determined by what is negotiated bilaterally in services with various negotiating partners, particularly the free trade agreement with the United States. Consequently, when it is released, South Africa's initial offer is likely to be reasonably comprehensive and include a range of services already negotiated under various bilateral agreements.

What is certain is that publicly-provided services (education and health) will not form part of South Africa's initial offer to the WTO. While South Africa received requests in education and health services during the recent request-offer process, and trade in both services is growing robustly, they are perceived as highly-sensitive domestically.<sup>2</sup> Given South Africa's intensive bilateral negotiating process and the conditions set forth in Article V of the GATS, it is unclear how these services can be kept off the GATS negotiating table indefinitely.

## South Africa's Trade-Negotiating Machinery

Observers generally agree that South Africa's formal support mechanisms for trade negotiations are not operating optimally from the viewpoint of promoting effective participation. Compounding this, there is significant variation in the awareness of, and interest in, trade negotiations by other government departments, regulators and organised business. At the heart of the problem lies a persistent inability to form enduring and co-ordinated institutions of deliberation both to support the trade negotiating agenda and influence the outcomes of the negotiations themselves.

The ministry responsible for trade negotiations, the Department of Trade and Industry (DTI), continues to suffer from severe capacity constraints, which is compounded by a complex and an ever-intensifying bilateral agenda.<sup>3</sup> Interaction between the DTI and other departments is inconsistent while organised business remains under-prepared to deal effectively with, and participate meaningfully in, South Africa's trade-negotiating agenda. Unfortunately, a recent initiative by the DTI to establish a permanent trade forum which would facilitate inter-

governmental co-operation on trade issues was not ratified by the Cabinet. The constraints inherent in South Africa's trade-negotiating machinery are therefore likely to persist.

## Conclusion

The liberalisation of services in South Africa is at a delicate stage. The process of domestic regulatory reform must distinguish between regulations necessary to meet legitimate economic objectives and the conceptions of distributive justice in a post-Apartheid South Africa from those that are merely protectionist and serve to prolong economic inefficiency, constraining economic growth and hindering labour absorption. In a context in which all the backbone infrastructure sectors (telecommunications, transport and energy) are state-owned or partially state-owned monopolies, the efficacy of regulation is critical in determining the adequacy and efficiency of these sectors and their contribution to growth and development.

With respect to the GATS, however, South Africa should not only endeavour to lock in the unilateral reforms made since 1994 but also commit to the timing of future liberalisation measures in its schedule of commitments. This will improve South Africa's negotiating leverage, provide an external mechanism by which to protect the government against politically influential lobby groups opposed to liberalisation, and hold government departments accountable to further reform.

## 1. INTRODUCTION

### 1.1 The Role of Services in the South African Economy

The economic importance of services in the South African economy has grown considerably. Firstly, it plays an important role as an input to manufacturing and can critically influence the competitiveness of this sector. Secondly, parts of the services sector are highly tradable and South Africa is increasingly becoming a significant exporter of services. The full list of services that constitutes part of the World Trade Organisation (WTO) agenda accounts for almost 70 percent of the South African economy.

A major obstacle to developing a full appreciation of the role of the services sector is the difficulty of accumulating data. This has to do with both the complex nature of the industry and that many governments, particularly in developing countries, suffer resource constraints that have prevented initiatives aimed at improving data collection on services. The problem is compounded by the fact that individual service sectors differ markedly and so require drastically different statistical and measurement procedures. These differences are particularly important when it comes to estimating the impact of services reform on the economy. For example, producer services such as telecommunications, finance, transport and electricity have economy-wide effects because they are relied on heavily by consumers and other producers of goods and services. Therefore, the efficiency or otherwise of these producer services affects other economic agents and the economy in quite fundamental ways. Although other services such as environmental and professional services have economy-wide effects, their impacts are not on the scale of the producer services.

Producer services contribute close to 50 percent of the total services production in South Africa. However, their contribution to the efficiency of the economy is more critical than this figure suggests. Other important sectors in this regard include community/social services and retail trade.

The South African economy has grown at a very modest pace in the last decade, averaging a real growth rate of 2 percent. As shown in Table 1, the major growth in terms of the value-added to the economy occurred primarily in the services sectors, specifically in business

services, transport and trade. Sectors such as agriculture and mining, however, have been contracting at significant rates. This has important implications for the future growth potential of the South African economy.

**Table 1: Average Annual Growth (1990-2002) of Selected Sectors of the South African Economy<sup>a</sup>**

Sector	Percentage Increase
Business services	4.45%
Transport	5.40%
Trade	2.00%
Manufacturing	1.55%
Agriculture	0.50%
Construction	0.30%
Community services	0.85%
Electricity	2.20%
Mining	0.55%
All industries	2.15%

<sup>a</sup> Average annual growth given in value-added terms (constant values).

Source: TIPS.

Employment has declined consistently for the past decade in mining, manufacturing and agriculture. Indeed, services is the only sector that has created employment. Within the services sector, positive employment growth has occurred in financial services, tourism and distribution. Table 2 shows that similar to value-added shares, services contributes close to 70 percent of employment in South Africa.

**Table 2: Share of Employment (2002)**

Sector	Number of employees	Employment Share
Agriculture, Fishing & Forestry	1,477,255	0.13
Mining & Quarrying	481,343	0.04
Manufacturing	1,596,496	0.14
Services	8,455,550	0.68

Source: Bhoart (2004)

These services sectors, as mentioned, represent important industries in their own right, with some becoming increasingly tradable. Measuring exports and imports, however, is extremely complicated. What is evident from a series of case studies is that South Africa

is a major exporter of services, specifically to the African region and in sectors such as finance, retail, construction and business services. Some of these trends will be looked at later on in this study. Equally important to trade is the impact of South African services on the competitiveness of manufacturing and agricultural products. The difficulties of measuring trade notwithstanding, it is possible to get a sense of receipts from services as shown in Table 3.

This may not be an entirely accurate reflection of trade trends. For example, many foreign tourists who spend money in South Africa are contributing to exports – but this is hard to capture. The important point to emphasise, however, is that by viewing services as tradable South Africa’s government is looking for ways

to develop comparative advantages in services rather than relying solely on primary or manufacturing for generating foreign revenue.

**Table 3: Total Services Exports and Imports (2000)**

All service receipts	Imports	Exports
Value (Rand millions, current prices)	38,906	35,297
Share of GDP (%)	4.4	4.0
Share in exports of goods and services (%)	17.0	14.0

Source: South African Reserve Bank Quarterly Bulletin.

## 1.2 Services and South Africa’s Economic Policy Landscape

There is no generic policy towards the services sector due to its highly diversified nature – in contrast to the usual policy approach in both the manufacturing and agricultural sectors. Services have been identified by the economic ministries – such as the Ministry of Trade and Industry – as critical to export success in manufacturing. Moreover, there has been some policy discussion about services in which South Africa has a particular comparative advantage. No cross-cutting subsidies or incentives to services have been introduced to date, but many policy initiatives exist at the level of individual services sectors.

One of the major policy challenges facing the South African government is the mandate of services, i.e. which parts of government should be responsible for the services sector. Traditionally this role was the preserve of line ministries, but there is growing recognition of the widespread implications of services for the rest of the economy. Consequently, the Treasury and the Ministry of Trade and Industry have lobbied for a broader, cross-ministerial services mandate. Hence, the services sector has played a major role in prompting government to pay more attention to the co-ordination of economic policy across ministries.

In view of the dramatic changes in services, regulatory issues have gained increasing prominence in policy discussions in South Africa. The current government has emphasised microeconomic reforms as a major area of focus, particularly those creating more accountability in

economic institutions and more competition in the economy. Central to the microeconomic reform initiative are the privatisation and deregulation of services and utilities, and the development of an effective competition policy.

Some of the services in the economy are utilities such as water, gas, electricity and telecommunications. As public goods, they often have implications in the sequencing of reforms and constitute special cases relative to other services. Services and utilities have come under scrutiny in South Africa during the last decade. This is not because of the importance of utilities in WTO negotiations, but due to domestic structural problems. Indeed, as discussed later, the GATS negotiations provide an important opportunity to link domestic reform to global trade negotiations.

In the mid-1990s, South Africa’s utilities attracted attention because they were considered to be contributing to the slow growth of the economy. This was due to three main factors:

- Many of utility sectors lacked investment and relied on outdated technology despite their obvious potential to grow and become dynamic.
- Service provision tended to be erratic and unreliable.
- The existence of large under-served areas, both regionally and across income groups.

The government's strategy towards the services sector is inextricably linked to the country's privatisation strategy. In 1993, the democratic government inherited over 300 state-owned enterprises (SOEs), with four of the firms accounting for 86 percent of aggregate turnover, 94 percent of total income, 77 percent of all employment and 91 percent of the total assets of these enterprises. Today the major SOEs are Eskom (energy sector), Transnet (transport sector), Telkom (telecommunications sector) and Denel (defence industry), with each SOE dominating its respective sector. They also comprise 91 percent of estimated total state assets and 77 percent of all employees of the 30 major SOEs. The key producer services such as energy and transport are still state-owned, although some sectors such as telecommunications are largely privatised.

Privatisation of state-owned utilities may have little impact on the quality or price of a service. Aside from simply selling assets to the private sector, the more formidable challenge is to change the market structure to foster competition, particularly in the communications and energy sectors. The government is currently grappling with these kinds of issues. Major regulatory changes are also occurring in private services such as finance and tourism.

The government has set up various regulatory agencies. For example, the National Electricity Regulator (NER) was set up in 1995 to regulate the sector as a whole – where generators, distributors and sellers of electricity have to apply for a licence from the NER to settle disputes (see Eberhard, 2003). Similarly, the Independent Communications Authority of South Africa (ICASA) was set up to oversee broadcasting and telecommunications. The Telecoms Regulatory authority was set up in 1996 to oversee the liberalisation of the telecommunications market and in 2000 it was merged with ICASA. A critical review of these independent regulators is beyond the scope of this paper, but it is clear that South Africa has begun the process of

developing an institutional infrastructure in response to competition and the privatisation of various services and utilities.

The independence and credibility of these regulatory institutions is dependent on ensuring fair competition in the services sector. More open competition in utility and services sector markets is also fostered through South Africa's competition policy. The legal framework for competition policy is set out in Competition Policy Act (Act 89 of 1998), which came into effect on 1 September, 1999. Three institutional bodies were established by the Act: the Competition Commission, the Competition Tribunal and the Competition Appeal Court. This represents an important departure from the past, in that the government is now more accountable for rulings and decisions. Ensuring the effectiveness of competition policy, however, remains a major challenge.

There are some important jurisdictional issues that still need to be resolved between the Competition Commission and the various sector-based regulators, specifically in the areas of finance, communications and energy. For example, the NER is currently responsible for competition in energy. Once the sector is liberalised, however, the competitive areas will fall under the jurisdiction of the Competition Commission.

The negotiations under GATS have important implications for South Africa's domestic reform initiatives. It is important to stress that market access issues are different from those of domestic competition and regulation. Clearly, there are strong inter-connections and the major challenge facing the government is to ensure coherence and consistency in policy. In terms of domestic efficiency, market access may be less effective than competition policy. On the export side, South Africa could derive major gains from global liberalisation of services because of its comparative advantage in several sectors.

## 2. SERVICES LIBERALISATION IN SOUTH AFRICA: THE MULTILATERAL NEGOTIATING PROCESS

### 2.1 Overview

This section presents a summary of South Africa's existing Uruguay Round commitments in selected services sectors. It highlights scheduled limitations to market access and national treatment that form the basis of requests to South Africa by key Members under the current round of negotiations. The following sectors are prioritised for the purposes of this study: finance, telecommunications, education, construction and engineering, and energy. Arguably, all of these sectors have significant export potential, at least with respect to the rest of the continent. Financial services, telecommunication services, and energy-related services are examples of infrastructural or 'backbone' services from which significant and economy-wide efficiency gains could be realised through liberalisation.

Due to the importance of these backbone services, however, their liberalisation potentially poses the greatest risk. Education – like health – is crucial to social development and is an interesting sector to examine due to the cautious approach adopted by the line ministry with respect to the GATS negotiations. While South Africa has not made commitments in education or energy-related services during the Uruguay Round, the unilateral liberalisation of financial services and telecommunications since 1994 could potentially strengthen its position in the current round of services negotiations. The impact of all of these sectors on South Africa's negotiating strategy in services is discussed in Section 5.

### 2.2 Summary of South Africa's Commitments in Key Sectors

#### *Financial Services*

The majority of restrictions on the provision of financial services contained in South Africa's Uruguay Round commitments relate to commercial presence (Mode 3). For life insurance and insurance-related activities, while there are no national treatment limitations, there are limitations regarding the form of commercial presence and the acquisition of shares or any other interest in a registered insurer. Also, the commitment sets forth residency requirements for the executive chairman, the public officer, the majority of directors and life insurance actuaries. An additional commitment is undertaken stipulating that 85 percent of the assets of foreign insurance companies must be locally held.

With respect to South Africa's commitments in banking and other financial services, the following restrictions apply:

- Branches of foreign banks in South Africa must maintain a minimum balance of R1 million on the deposit accounts of natural persons.
- Dealings in foreign exchange in South Africa must be carried out through a dealer authorised by the South African Reserve Bank (SARB). Only banks registered to operate in South Africa with the required minimum capital base are eligible to seek authorisation as a foreign exchange dealer.
- Companies involved in asset management, collective investment schemes and custodial services for securities and financial instruments (including equities and bonds) need to be incorporated as public companies in South Africa and registered with the supervisory authority.
- Trading for the account of customers on a licensed exchange requires separately capitalised incorporation in South Africa as a public or private company and registration with the relevant supervisory authority.

### *Telecommunication Services*

South Africa's existing commitments in telecommunications cover facilities-based and public-switched telecommunication services (PSTS), mobile cellular telephone services, satellite-based services, and value-added services (i.e., no commitments have been made on the resale of basic services). The cross-border provision of basic services (PSTS, mobile, and satellite) is restricted due to the extension of monopoly rights to the incumbent service provider, Telkom, until 2003. Commercial presence is similarly restricted until the second network operator is licensed, after which the provision of facilities-based and PSTS (as well as satellite-based services) will be limited to the duopoly. For mobile cellular telephone services, commercial presence is limited to two providers. The commitment states that an additional licence will be granted within two years. Furthermore, foreign investment in suppliers of facilities-based and PSTS and mobile cellular telephone services is limited to a cumulative maximum of 30 percent.

As far as value-added network services are concerned, South Africa's existing commitments state a general

restriction on the bypass of South African facilities for the routing of domestic and international traffic. Further, VANS providers can only supply international services with the consent of Telkom. The commitments explicitly state the absence of a formal licensing regime for international VANS and that applications are to be dealt with on an informal, *ad hoc* basis. However, South Africa's commitment in telecommunications does anticipate the establishment of a regulatory authority.

Finally, South Africa has made an additional commitment on regulatory principles to ensure interconnection, which differs from the Telecommunications Reference Paper. South Africa's commitment excludes interconnection rates that are the same as those provided by the major supplier to itself, and permits the authorities to determine different rates for different areas or different services. South Africa's offer also does not commit to making publicly available the period of time normally required to make a decision concerning an application for a licence.

### *Architectural, Construction and Engineering Services*

South Africa made extensive Uruguay Round commitments in architectural, construction and engineering services. The only restriction contained in South Africa's commitments in this sector applies to the provision of architectural services – specifically, for building plans of 500m<sup>2</sup> and over the services of a locally registered architect must be used. In all other

sectors, there are no limitations to market access and national treatment except for the cross-border provision of construction and related engineering services, which remain unbound for reasons of technical infeasibility. South Africa has not made any commitments in Other Construction and Related Engineering Services.

### 3. SOUTH AFRICA AND THE REQUEST-OFFER PROCESS

#### 3.1 Overview

This section presents a summary of requests received from key WTO Members (EC, US and Japan) as well as requests received from other African Members (Egypt and Kenya) in the sectors prioritised for this study. The requests are synthesised in order to highlight the commonalities between them. A detailed overview of requests to South Africa from selected countries in selected sectors is contained in the Appendix.

To date, South Africa has formally received requests to liberalise services from 16 WTO Members: Australia, Canada, China, Egypt, the EC and its member states (hereafter, the EC), Hong Kong, India, Japan, Kenya, Malaysia, New Zealand, Norway, Panama, Switzerland, Taiwan and the US. Combined, the requests cover every major sector currently listed in the W/120 services

sectoral classification list. In addition, South Africa has received requests to liberalise services in new categories not currently listed in W/120. These include energy and related services, received from the US and the EC, and logistics and related services from Hong Kong. South Africa has also received requests in sectors in which a reclassification of services already listed in W/120 is proposed, notably environmental services<sup>4</sup> and certain aspects of maritime transport services. More than a third of the requests received by South Africa fall under the general category of business services, reflecting the growing internationalisation of these services rather than the extent of restrictions governing their provision by foreign service-providers to the South African market.

#### 3.2 Requests Received in Prioritised Sectors by Key WTO Members<sup>5</sup>

##### *Financial Services*

South Africa has received requests to liberalise financial services from the following WTO Members: Australia, the EC, Egypt, Japan, Norway, Panama, Switzerland, Taiwan and the US. Unsurprisingly, the requests received from the EC and the US on financial services are detailed and comprehensive. Tables 1 to 3 (in the Appendix) summarise the requests received from the EC, the US and Egypt – the only other African Member to submit a request to South Africa on financial services.

Requests in financial services can be classified under three broad categories. The first set of requests concern

the anti-competitive behaviour of local banks with respect to access to the national payments system. A second set of requests relates to the movement and residency of experts in the financial services industry. The third set of requests concern the removal of limitations that are largely of a prudential nature, such as allowing foreign bank branches to use their parents' capital. These requests may have both positive and negative consequences for the economy. A detailed analysis is needed to examine their economy-wide impacts.

##### *Telecommunication Services*

South Africa has received requests to liberalise telecommunication services from the following WTO Members: China, the EC, Hong Kong, Japan, Norway, and the US. Tables 4 to 6 (in the Appendix) summarise the requests received from the EC, Japan, and the US.<sup>6</sup> The similarities between the requests from the EC and the US suggest that they are based on South Africa's existing commitments in telecommunication services, rather than presented as a blanket request to Members

at similar levels of development. (A reading of Japan's request to South Africa on telecommunications, for example, suggests the latter.)

There are a number of restrictions to the provision of telecommunication services contained in South Africa's existing schedule of commitments, largely due to the highly regulated nature of the country's telecommunications industry at the time. Unsurprisingly,

many of the requests in telecommunication services from WTO Members are simply to relax the restrictions. A number of requests focus on the removal of

restrictions placed on VANS providers, who currently can only provide services with the consent of the major fixed-line monopoly.

### *Education Services*

South Africa received requests to liberalise education services from the following WTO Members: Kenya, New Zealand, Norway and the US. Partly as a result of sustained public criticism by the South African government of the liberalisation of education through the GATS, Norway formally withdrew its GATS request on education to South Africa on 6 October 2003. Tables 7 and 8 (in the Appendix) are summaries of the requests in education made by the US and Kenya – the latter

being the only other African country to submit a request to South Africa on education services. The majority of requests in education services are in higher education and training services, adult education and other education services. They reflect the growing internationalisation of these services as well as an opportunity for certain Members to use the South African market as a springboard for the provision of these services to the rest of sub-Saharan Africa.

### *Architectural, Construction and Engineering Services*

South Africa has received requests on architectural, construction and engineering services from the following WTO Members: China, the EC, Egypt, Japan, Kenya, New Zealand and the US. Tables 9 to 13 (in the Appendix) summarise the requests received from the

EC, the US, Egypt and Kenya, respectively. A common request is to remove the requirement to use the services of a locally-registered architect for building plans greater than 500m<sup>2</sup>. (See Section 5.5 for an interpretation of the current commitment.)

### *Energy-Related Services*

South Africa has received requests in energy-related services from only two WTO Members: the EC and the US (see Tables 14 and 15 in the Appendix). Requests in energy services by the EC and the US reflect the radical restructuring and liberalisation of key energy markets since the end of the Uruguay Round. Also, there is no separate classification of energy services in W/120. There is presently no agreed definition of energy services and the existing classification does not

explicitly include the emergence of new energy services such as the operation of power pools, energy trading and brokering, and energy management. The US, EC, Japan and other Members have only recently proposed the development of a new, comprehensive classification of energy services. Again, the implications of these requests are complex and need to be considered in the context of an analysis of the changing energy sector in South Africa.

## 3.3 Requests by South Africa to WTO Members

Between August 2002 and March 2003, South Africa developed initial requests to 52 Members. By December 2003, the initial requests had still not been released to relevant Members. By failing to submit initial requests in services before the Cancun Ministerial, South Africa missed an important opportunity to signal its commitment to, and continued interest in, the on-going

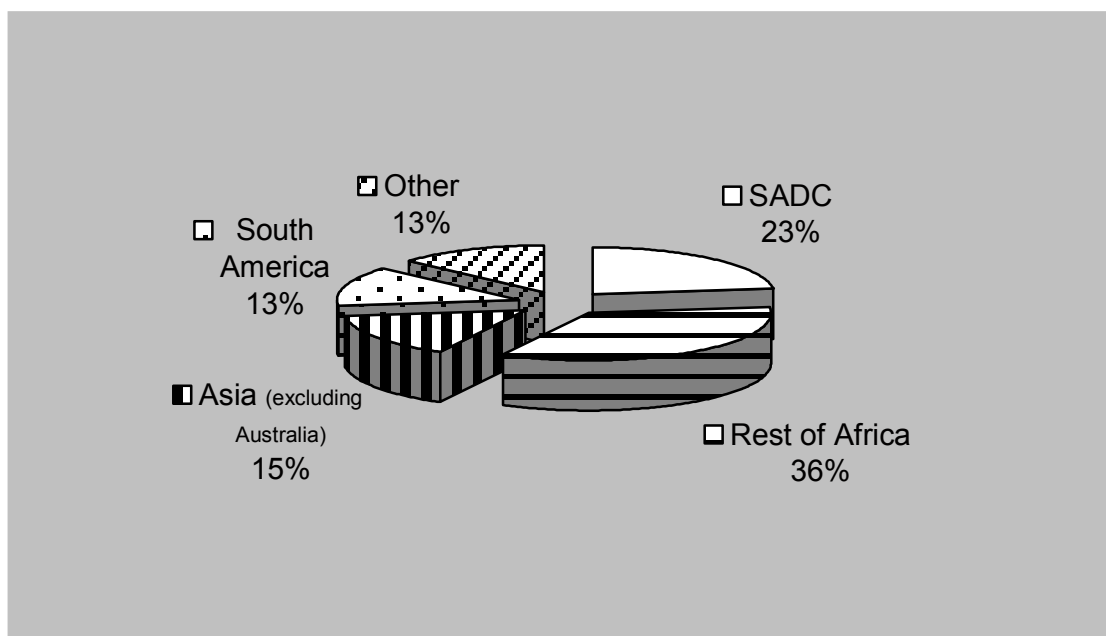
services negotiations at the WTO, notwithstanding the Ministerial's final outcome.

Of the general service categories listed in W/120, South Africa developed requests in the following sectors: business services, communication services, construction and related engineering services, environmental services,

and financial services. In addition, South Africa developed requests in energy-related services, adopting the proposed classification of energy services by the US. Requests in telecommunication services and financial services are limited to African countries only. Although South Africa’s requests cover half of the general service categories listed in W/120 this belies their specific nature, reflecting the relatively focused interests of South African service providers. For example, South Africa’s requests in communication services are limited

to telecommunication services (specifically mobile cellular services) and requests in business services are limited to engineering and architectural services, and services incidental to mining. Of requests to non-African Members, regionally Asia and South America predominate, the latter largely due to the activity of South African mining companies. Figures 1 and 2 illustrate the regional breakdown of South Africa’s requests to all Members and non-African Members, respectively.

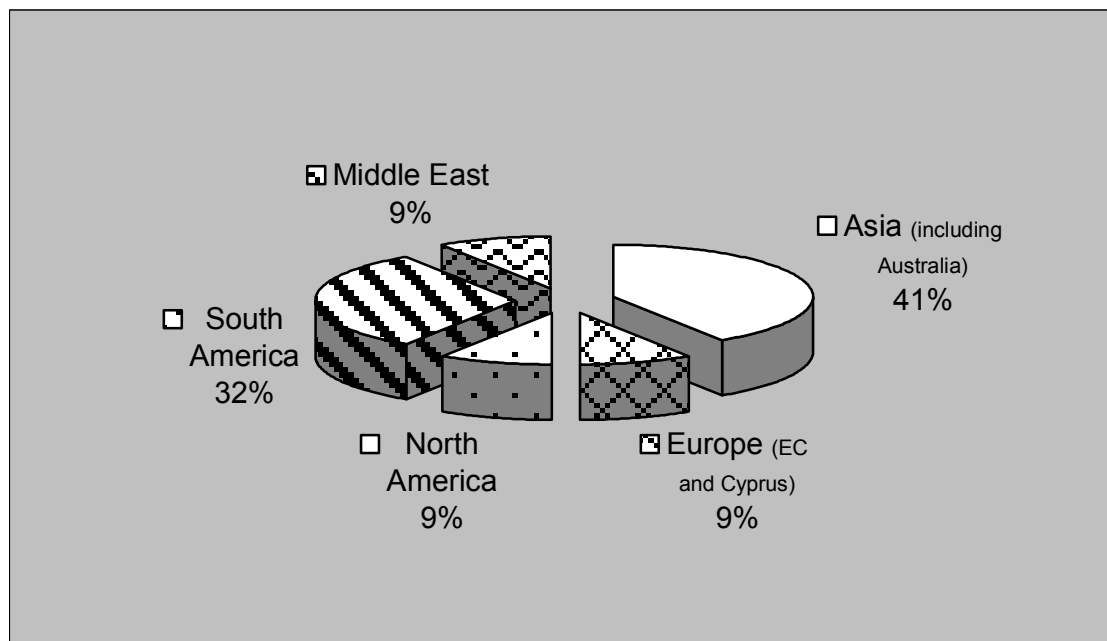
**Figure 1: South Africa Requests by Region (All Members)**



Unsurprisingly, the bulk of South Africa’s initial requests are to SADC Members<sup>7</sup> and other African countries,<sup>8</sup> reflecting clear comparative advantages in the provision of services to the region and the rest of the sub-continent. Indeed, the most comprehensive requests (i.e., those requests to Members covering the most sectors and sub-sectors) are to Members in sub-Saharan Africa. Of South Africa’s requests to SADC Members (South Africa did not make an initial request to the Seychelles), one-third contain requests in four of the six main categories of services in which South Africa

developed its requests (i.e., business services, communication services, construction and related engineering services, environmental services, financial services and energy services) while half contain requests in five or more categories. Requests containing the full compliment of service categories were made to Botswana, Namibia, Zambia and Zimbabwe. Of South Africa’s requests to non-SADC African countries, nearly a third contain requests in four or more of the main service categories listed above (i.e., Cameroon, Ghana, Kenya, Nigeria and Uganda).

Figure 2: South Africa Requests by Region (Non-African Members)



The development of the requests was driven by a questionnaire – based on the questionnaires used by the United States Trade Representative (USTR) and the EC – which aimed to identify the existence of barriers faced by South African service providers in foreign markets. Sectors were prioritised and then lead exporters identified and asked to complete the questionnaire. Health and education sectors (in which clear export potential exists both to Africa and, in the case of health services, to advanced industrialised Members) were excluded from the process of developing initial requests. This was due to socio-economic sensitivities surrounding the provision of health and

education services and the reticence of line departments in opening up these sectors to the GATS negotiating process and progressive liberalisation (see Section 6). Interestingly, it was only through the questionnaire that requests were developed in areas not originally prioritised by DTI. A clear example of this were the requests for environmental services, which are provided by South African construction and engineering companies to the rest of the sub-continent. The classification of requests in environmental services is based on the EC proposal for the reclassification of environmental services (S/CSS/W/38).

### 3.4 South Africa's Initial Offer to the WTO

By the end of December 2003, South Africa had yet to submit its initial offer to the WTO. As a signalling device, a 'rough and ready' offer could have been developed relatively quickly in a range of non-sensitive service sectors in which South Africa either did not schedule commitments at all or liberalise fully at the end of the Uruguay Round. These include legal and auditing services, research and development services,

advertising services, packaging services, printing and publishing services, other business services not classified elsewhere, and recreational, cultural and sporting services (other than audiovisual services). Post-Cancun, the key elements of what is likely to comprise South Africa's initial offer is more difficult to predict. Given South Africa's extensive bilateral agenda (see Sections 4 and 5), it is likely that the initial offer will be

determined by what is negotiated bilaterally in services with various negotiating partners, particularly the free trade agreement (FTA) with the US due to conclude by the end of 2004. Moreover, when it is released, South Africa's initial offer to the WTO is likely to be reasonably comprehensive and include a range of services already negotiated under various bilateral FTAs. Consequently, intensive consultation with line departments responsible for these services will not be necessary. The delay in South Africa's submission of

requests and offers to the WTO is symptomatic of the institutional malaise at the Department of Trade and Industry (DTI). This is discussed in more detail in Section 4. Section 5 outlines South Africa's multilateral negotiating strategy in services and assesses requests made by key WTO Members in the context of autonomous liberalisation since the conclusion of the Uruguay Round. In doing so, it provides a good indication of the likely form of South Africa's initial offer in services.

## 4. SOUTH AFRICA'S ROLE IN THE NEGOTIATING PROCESS AND FEEDBACK BETWEEN NEGOTIATORS AND LOCAL STAKEHOLDERS

### 4.1 Overview

South Africa's role in the negotiating process is dependent to a large degree on the nature and effectiveness of feedback between the trade negotiations team in the DTI and local stakeholders. Active participation at the WTO and the domestic consultation and lobby process are not mutually exclusive and can support each other in important ways. In both spheres

of activity, however, South Africa is performing sub-optimally due to a range of institutional deficiencies. These are beginning to be addressed independently by government and the business community, although at different paces and to varying degrees of success. This is discussed in more detail below.

### 4.2 The Department of Trade and Industry

The DTI is responsible for trade negotiations but suffers from severe capacity constraints, particularly within the trade negotiations team. Institutional deficiencies include the absence of a well-resourced in-house research unit and a dedicated legal services team. The establishment of these support units would ease existing capacity constraints and facilitate knowledge transfer across the entire division.<sup>9</sup> At present, the DTI trade negotiations team has six members, including the Department's Chief Trade Negotiator and excluding administrative support staff. Not only is the team directly responsible for the full range of multilateral trade issues but it is also heavily involved in the division's ever-expanding bilateral agenda. Apart from its multilateral agenda, the International Trade and Economic Development Division (ITEDD) of the DTI is currently involved in negotiating the Southern African Customs Union<sup>10</sup> (SACU), the US FTA, the SACU-EC FTA, the SACU-Mercosur FTA, and with plans afoot to negotiate a SACU-India FTA, SACU-China FTA and a SACU-Nigeria FTA. Furthermore, a renegotiation of the South Africa-European Union Trade and Development Co-operation Agreement (TDCA) is likely, especially in light of the SACU-US FTA. The DTI's shift in emphasis towards the negotiation of bilateral FTAs is both a reaction to, and a reflection of, the global proliferation of regional trade agreements. This shift in the nature of negotiations, coupled with the limited capacity of the trade division, has led to little development in terms of a multilateral negotiating strategy in services, especially since South Africa's bilateral trade engagements with the US and the EC began in earnest towards

the end of the first quarter of 2003. Finally, the DTI is not yet sufficiently organised to exert an influence on the policy of other departments in the context of trade negotiations. This has been most notable in the DTI's acceptance of the position of the Ministry of Education on the current round of GATS negotiations (see Section 5.4).

Until recently, South Africa's permanent mission to the WTO suffered from similar capacity constraints. The mission was restructured in 2002 and a new staff compliment replaced what was effectively a one-man operation. However, if the submission of position papers and proposals to various services committees is taken as a proxy for South Africa's involvement in services negotiations, the impact of restructuring has been marginal. While capacity constraints have eased in Geneva, it is clear that institutional deficiencies continue to persist. Critically, limited participation in the negotiating process inhibits South Africa's ability to form strategic alliances with countries that have common interests in services (i.e. strong sector-based alliances such as the Cairns Group in agriculture).<sup>11</sup> Indeed, active participation and meaningful alliance-building mutually reinforce each other. Alliance-building is facilitated through active participation and regular position papers. In turn, the deliberations of alliances tend to sharpen country positions. As noted above, however, South Africa's sub-optimal performance in this activity should not be seen in isolation from the nature and effectiveness of the feedback between trade negotiators and stakeholders domestically. This is discussed in the next section.

### 4.3 Domestic Institutional Arrangements Supporting Trade Negotiations

The network of domestic institutions that supports South Africa's trade negotiations is in a state of flux. According to Draper (2004), while South Africa has formal institutional mechanisms to support trade negotiations – such as the National Economic Development and Labour Council (NEDLAC) and parliament – they are “not operating optimally from the viewpoint of promoting effective participation in trade negotiations”. Compounding this, there is significant variation in awareness of, and engagement in, negotiations by other government departments, regulators and organised business. At the heart of the problem lies a persistent inability to form enduring and co-ordinated institutions of deliberation both to support the trade negotiating agenda and to alter the outcomes of the negotiations themselves. This section discusses two sets of relations within the context of trade negotiations generally and multilateral services negotiations in particular. These are: the nature and effectiveness of deliberation (i) within NEDLAC, parliament, and organised business; and (ii) between the DTI and other government departments.

Historically, the DTI has involved non-government stakeholders in the preparation of negotiating positions primarily through the trade and industry chamber in NEDLAC and national consultative conferences (NCCs). While NEDLAC is a permanent institutional arrangement, NCCs are *ad hoc* processes, geared towards consensus-building before WTO Ministerials. NCCs provide business, labour, and civil society with the opportunity to express their views. Typically, they last no more than two days and are held a month or two before a WTO Ministerial. The views expressed in NCCs – particularly by labour and civil society – have tended to offer little beyond repeated calls to dismantle the multilateral trading system. There is also the question of the extent to which views expressed in the NCC inform and influence positions in the DTI. Given the *ad hoc* nature of the process and the shortness of time between NCCs and WTO Ministerials, the impact of the views expressed on negotiating strategy is likely to be marginal.

By contrast, the NEDLAC, established in 1995, is a permanent institutional arrangement with the capacity for deliberation on key issues between the major stakeholders in the economy. In the four chambers of the NEDLAC the government comes together with organised business and organised labour on a national

level in an attempt to reach consensus on a range of social and economic policy issues. South Africa's trade negotiating agenda is discussed in the Trade and Industry Chamber. Among close observers of trade policy issues in South Africa there is a growing consensus that NEDLAC is an increasingly inappropriate forum in which to develop, and deliberate on, detailed negotiating positions. While NEDLAC has an important role to play in the consensus-seeking process, it is not in control of corporate strategy and will therefore find it difficult to deliberate effectively on offensive interests in services (or any other) negotiations (Draper, 2004).

Parliament's constitutional role is to ratify trade agreements. This is an important component of the negotiation process, as failure to ratify could completely undermine carefully constructed international trade agreements (Draper, 2004). Under Section 231 of the Constitution, parliament is not empowered to amend international agreements, which is the Executive's prerogative. Presumably, parliament could refuse to ratify a trade agreement but this has not been tested in practice. Parliament is, however, increasingly interested in interrogating legislation emanating from the Executive. Consequently, organised business, in particular, should carefully consider how to interact with the Parliamentary Portfolio Committee on Trade and Industry with a view to strengthening parliament's involvement in the trade negotiations process (Draper, 2004).

Services negotiations, by their nature, entail a regulatory focus and so effective interaction between the DTI, line departments and regulators is paramount. There has been a consistent improvement in the DTI's interaction with other government departments since initial requests in services were received from WTO Members. Moreover, this process has been consolidated since South Africa's bilateral FTA negotiations began with the US and the EC. Nevertheless, the quality of interaction still depends to a significant degree on the respective line department involved and the resources they devote to trade negotiations. In turn, this depends on the priority each department accords to trade negotiations, given their own objectives and, in many cases, the dispositions of upper management. Unlike the Department of Agriculture, for example, which has been active in the formulation of trade strategies since the Uruguay Round, none of the departments

responsible for regulating the provision of key infrastructural services (financial services, telecommunications, transport, and energy) have units committed on a full-time basis to tracking developments in trade negotiations or the formulation of

negotiating strategies in conjunction with the DTI. There are, however, plans to establish a Permanent Trade Forum, in which officials from various line departments will develop a more co-ordinated and systematic approach to South Africa's trade agenda.

## 4.4 The Role of Organised Business

The most important stakeholder in the development of an offensive position in multilateral services negotiations is organised business. Before the launch of the Doha Round, business advocacy in trade strategy was virtually non-existent. It was only through the development of initial requests by South Africa to other WTO Members that the nature and effectiveness of interaction between the DTI and key service providers notably improved. Even so, improved communication between the DTI and individual service providers is very different from enhanced business advocacy by organised business. Indeed, following Kostecki (2002), if one interprets business advocacy as a special form of persuasive activity undertaken by business to influence government thinking on international trade issues, involving (1) monitoring trade policy-making for a group interest; (2) building a case in favour of that interest; (3) presenting it – with varying degrees of pressure – to policy-makers for their acceptance and support; (4) assisting the authorities in reaching the desired outcome in trade negotiations; and (5) controlling the

advocacy process and evaluating the benefits obtained, then one must conclude that organised business in South Africa remains under-prepared to participate meaningfully in dialogue with government on trade negotiations.

As a matter of urgency, organised business in South Africa must develop appropriately-structured, deliberative institutional arrangements of its own, as well as internal co-ordination mechanisms in order to meet the demands that will be placed on it by an ever-expanding trade negotiations agenda. There are plans for organised business to develop both a "consistent and co-ordinated approach" to South Africa's trade negotiations and "longer-term trade strategies" in relation to the WTO and the international trading environment.<sup>12</sup> The precise structure of the approach has not yet been determined. Once organised business has developed appropriate and co-ordinated deliberative institutional arrangements, however, it must push "for the establishment of a dedicated government-business structure focused on developing positions for trade negotiations" (Draper, 2004).

## 4.5 Conclusion

In conclusion, South Africa's trade negotiating machinery is presently ill-equipped to meet the demands of an ever-expanding trade negotiations agenda. This applies in particular to services negotiations and other "Singapore Issues" which are primarily regulatory in nature, have far-reaching consequences and require the interaction of a diverse range of stakeholders. While a number of positive changes are in the pipeline, much work still needs to be

done to improve the effectiveness of the interaction between trade negotiators and local stakeholders, and to alleviate the severe capacity constraints within the DTI itself. Furthermore, the state of flux in domestic institutional arrangements to support trade negotiations is having an adverse impact on South Africa's role in the negotiating process, especially on its ability to form strategic alliances in services negotiations.

## 5. NEGOTIATING STRATEGIES FOR SOUTH AFRICA

### 5.1 Overview

Like most other countries, services liberalisation in South Africa consists of a combination of unilateral, regional and multilateral liberalisation. Unilateral liberalisation is the simplest, most direct form of services liberalisation in which countries proceed with the project of regulatory reform autonomously. Regional and multilateral liberalisation has the added advantage of "locking-in" reforms made unilaterally. It also provides countries with opportunities to gain concessions for their reform efforts from negotiating partners, which they would not otherwise enjoy under unilateral liberalisation. Unlike multilateral liberalisation, however, regional liberalisation can lead "to a patchwork of opaque, overlapping and discriminatory procedures" which might "easily divert time and resources from, and weaken the non-discriminatory nature of, both unilateral and multilateral liberalisation" (Sally, 2002).<sup>13</sup>

There has been significant regulatory reform of services in South Africa since the end of the Uruguay Round. As a result of the outcome of the sixth Ministerial Meeting in Cancun, it is increasingly likely that in the short-term South Africa's services liberalisation strategy will be influenced more by its bilateral agenda than by developments on the multilateral front. The ability of regional trade agreements to divert time and resources from multilateral liberalisation efforts is clearly apparent in the South African context, where the sustained development of a co-ordinated, multilateral strategy for services liberalisation has virtually ground to a halt since the start of free trade negotiations with the US and EC in April 2003. The precise impact this will have on South Africa's ability to minimise the costs and maximise the benefits of services liberalisation is difficult to assess. Much depends on the success of initiatives to improve the effectiveness of South Africa's trade negotiating machinery. Arguably, however, a liberalisation strategy built on multilateral services negotiations (and in conjunction with unilateral reform) offers a more favourable set of payoffs than one based on regional liberalisation alone.

Whatever the form of services liberalisation (unilateral, regional, or multilateral), a comprehensive, well-designed strategy for services liberalisation that maxi-

ses the gains from liberalisation and minimises the adjustment costs is critical. Following Hodge (2002), a successful strategy depends on three key factors: (1) preparing the institutional foundations for liberalisation; (2) the sequencing and timing of liberalisation; and (3) managing the liberalisation process. An important part of the institutional foundations for liberalisation is an effective and well-oiled trade negotiating machinery which facilitates the flow of general and specific trade negotiating strategies. Together these strategies, both collectively and simultaneously, should maximise the advantages and minimise the risks of being exploited by a negotiating partner (Mashayekhi and Tuerk, 2003). South Africa's trade negotiating machinery (discussed in Section 5) is lacking on a number of fronts. Equally important, however, is the regulatory framework put in place to deal with the processes of progressive liberalisation as a broad policy. The regulatory framework must ensure that liberalisation efforts are credible and non-discriminatory, and continue to address social objectives based on legitimate conceptions of distributive justice in a post-Apartheid South Africa (for example, universal access, affirmative action and black economic empowerment).

The second dimension of a successful liberalisation strategy deals with the appropriate sequencing and timing of liberalisation. Here the strategy needs to set out the sequence and timing of liberalisation across the different sectors, the modes of supply, and the two groups of barriers: market access and national treatment (Hodge, 2002). Ideally, as Hodge (2002) points out, reform should be targeted at those sectors likely to bring about the most significant gains for the country. These sectors typically include the key infrastructural or 'backbone' sectors of the economy (finance, telecommunications, transport, and electricity). Their historical protection has resulted in considerable inefficiency costs to society. The extent to which these services can be liberalised, however, depends largely on the progress made in laying the institutional foundations for regulatory reform in relation to their provision. Finally, the third dimension of a successful liberalisation strategy concerns the management of the reform process itself. The central

idea here is to prevent vested interests from maintaining the *status quo* and hindering or derailing the reform process.

The remainder of this section examines the service sectors prioritised for purposes of this study (see Section 2) in terms of the institutional foundations for liberalisation and the timing and sequencing of specific liberalisation measures, both within sectors and across them. With respect to the second dimension, the key

issues examined include: (i) an assessment of requests received by key WTO Members in the context of unilateral (autonomous) liberalisation since the conclusion of the Uruguay Round; and (ii) an assessment of specific requests that do not directly address existing commitments but nonetheless would be covered by current regulatory frameworks. Therefore, the following analysis does not constitute a comprehensive services liberalisation strategy, but rather suggests an approach as to how one might be constructed.

## 5.2 Financial Services

The financial services sector is generally regarded as stable, sophisticated and well-regulated. Following the transition to democracy in 1994, the sector has witnessed an influx of foreign participation in brokerage, short-term insurance and investment banking. Other sub-sectors are dominated by local institutions and tend to be characterised by significant levels of concentration. The three industries that comprise the financial sector are independently regulated. The Registrar of Banks, the Bank Supervision Department of the South African Reserve Bank, is responsible for regulating the banking industry. The Financial Services Board (FSB) is responsible for regulating the insurance industry and the securities market, although the Johannesburg Securities Exchange performs the day-to-day monitoring of the latter

(Hawkins, 2002). Since 1994, a number of regulatory reforms have been introduced in all three industries, improving markedly the level of compliance with each of the relevant international bodies (the Bank for International Settlements, the International Association of Insurance Supervisors, and the International Organisation of Securities Commissions, respectively) (Hawkins, 2002). On the whole, the regulatory reforms do not discriminate between foreign and domestic suppliers of financial services and the remaining restrictions are focused on entities (foreign and local) meeting the prudential requirements set forth by the respective regulatory authorities. Exchange controls are still in place and while the government is in principle committed to the gradual removal of exchange controls, there has been little activity on this recently.

### *Insurance and Insurance-Related Activities*

Based on current regulation, South Africa's potential offer in insurance and insurance-related activities would not differ significantly from its current commitment. Currently, foreign insurance companies may only establish themselves as subsidiaries and not as branches. This is likely to change to allow for branching activity in the insurance industry, although regulation has not yet been introduced by the FSB to this effect. As far as the solvency requirement for foreign insurers is concerned, this is a prudential requirement following from the form of legal entity allowed. Hence, if branching were allowed this restriction would, in all likelihood, be removed. There are, however, no plans to

remove the residency requirements applying to the executive chairman, the public officer, the majority of directors and life insurance actuaries<sup>14</sup>, nor are there plans to remove the requirement relating to the acquisition of shares in a locally-incorporated insurance company in excess of 25 percent.

Cross-border trade in services (Mode 1) are permissible subject to exchange control regulation, but the foreign company must be established locally. For example, foreign banks and insurance companies without any local presence may not advertise their services locally (Hawkins, 2002).

### *Banking and Other Financial Services*

Current policy in banking is focused on enhancing the stability of the banking system, meeting Basle II requirements, facilitating black economic empowerment in the banking industry through the Financial Services Charter, and improving access to basic financial services such as saving products for the majority of South Africans. Recent regulation has ensured that foreign providers of banking and other financial services are treated no differently from their local counterparts. Hence, national treatment concerns raised in requests on financial services by WTO Members have, on the whole, been addressed by regulatory reform post-1994. For example, the restriction requiring foreign banks to maintain a minimum balance of R1 million on the deposit accounts of natural persons has been removed.

In terms of market access, foreign banks may open subsidiaries, branches or representative offices. Registered banks operating as branches or subsidiaries may trade fully as banks, whereas representative offices may only play a facilitating and marketing role, and cannot accept deposits (Hawkins, 2002). All legal forms of banks have the same capital and other regulatory requirements. Foreign banks wanting to operate in South Africa, however, must meet the capital requirements without recourse to parent capital offshore (Hawkins, 2002). It is unlikely that the regulatory authorities will accede to requests relating to amendments to capital requirements as these are seen as necessary prudential measures which lend stability to the system. However, there are current proposals for the creation of a second tier of banks, aimed at the lower-end retail segment of the market, for which market access requirements will be less stringent. Second tier banks will, of course, be restricted from certain activities, for example, foreign exchange dealing.

The issue of anti-competitive behaviour by local banks is contentious, particularly with respect to their control of the national payments system. While it is difficult to establish the extent to which local banks are complicating the entry of new participants – and whether their behaviour constitutes a significant market access limitation – the national payments system is effectively owned by those who run it. Since more than 99 percent of the volume of all financial transactions in South Africa goes through the four largest local banks, claims of anti-competitive behaviour by key WTO Members appear to have some legitimacy. While this is an issue for the local competition authority, it is likely that the GATS negotiations will be used as an external mechanism through which to apply pressure on South Africa to investigate these claims.

In the securities market, only subsidiaries are recognised as legal entities for both domestic and foreign securities firms (Hawkins, 2002). The allocation of operating licences to securities firms is non-discriminatory provided that all firms meet various membership requirements relating to technical competence and capital adequacy (Hawkins, 2002). Other market access restrictions on commercial presence concern dealings in foreign exchange, asset management, collective investment schemes and custodial services for securities and financial instruments, and trading for the account of customers on a licensed exchange. These restrictions are either prudential requirements designed to protect the consumer and ensure the stability of the system or, in the case of foreign exchange dealings, directly related to existing capital controls. Again, cross-border banking and other financial services are permissible, subject to exchange control regulation, but the foreign company must be established locally.

### 5.3 Telecommunication Services

Post-1994, the process of opening-up the South African telecommunications sector has not been as smooth as the liberalisation of the financial services industry. Regulatory reforms have resulted in the licensing of two mobile telephony providers, the corporatisation and partial equity sale in the fixed line monopoly (Telkom), and the opening of the VANS sector. The extension of

Telkom's exclusivity period in local, long-distance and international telephony was granted to ensure achievement of the goals of infrastructure roll-out and universal access in under-served areas and to priority customers. The extension of the fixed line monopoly, however, has prevented competition from reducing price-cost margins and accelerating productivity growth

(Hodge, 2003). Consequently, the liberalisation of South Africa's telecommunications sector has not seen the dramatic falls in cellular call rates and fixed-line prices characteristic of liberalisation processes in other

countries. Telkom's exclusivity period expired in 2002 yet there have been significant delays in the process of licensing a second network operator (SNO).

### *Basic Telecommunication Services*

In the context of requests received by key WTO members, market access restrictions remain on the ability to supply facilities-based and public-switched telecommunication services (PSTS), mobile cellular telephone services, and satellite-based services. The cross-border provision of all forms of basic telecommunication services is restricted to the networks of the three current licence holders (Telkom, Sentech, and the SNO). In line with the process of managed liberalisation, the provision of facilities-based and PSTS is restricted to the current duopoly. Similarly, the provision of mobile cellular telephone services is restricted to the three existing operators. Restrictions on foreign investment remain, although the permitted cumulative maximum has increased to 50 percent in the case of facilities-based and PSTS, and 60 percent in the case of mobile cellular telephone services. Furthermore, the granting of all major licences can stipulate a share reserved for historically disadvantaged groups of up to 30 percent, which effectively limits the form of foreign participation to a joint venture.

The next stage in the process of liberalising facilities-based and PSTS is to consider the feasibility of addi-

tional entrants once the SNO has established itself. The government may be more amenable to introducing resale competition faster than facilities-based competition since the former still guarantees leasing revenue to the facilities operators. Due to the natural limit of national facilities operators, a more immediate step in the process of facilities liberalisation might be to permit limited regional or long-distance competition. The process of managed liberalisation also applies to mobile cellular telephony. Once the natural limit of the number of mobile cellular operators has been reached, full commitments can be taken under the GATS without affecting existing operators adversely. Although the liberalisation of mobile cellular multimedia services is intended, the Ministry has yet to indicate precisely when the process will begin. Finally, there appears to be no intention to lift restrictions on mobile operators from owning their own fixed links and international gateways, nor being able to re-sell any excess capacity they lease. Once these markets (fixed-line and re-sale) are fully liberalised, however, there would be no effective barriers to mobile operators' owning or re-selling capacity.

### *Value-Added Network Services*

Currently, value-added network services suppliers must make use of the facilities of the three international and two national network operators under the provision of VANS in relation to Mode 1 and Mode 3, respectively. Furthermore, VANS suppliers may not provide voice services over their networks. Therefore, the primary limitations are with respect to the inability to own or re-sell network capacity and to provide VOIP services. The government does not yet appear willing to change its stance on ownership and VOIP since the restrictions

are a means of protecting the revenues of Telkom and any further facilities-based entrants, enabling them to meet universal access and infrastructure roll-out obligations. It is likely that the government will sooner liberalise the re-sale of non-voice services and may actually have to do so in order to comply with the current GATS commitment. References in the existing commitments to Telkom as South Africa's *de facto* regulator no longer apply since the formation of the new regulatory body, ICASA.

## 5.4 Education Services

Education in South Africa is characterised by a combination of not-for-profit, commercial, and statutory institutions. The statutory basis for the regulation of education in South Africa is provided by a number of Acts of Parliament promulgated after 1994 to meet the objectives of the country's national transformation agenda and quality assurance requirements.<sup>15</sup> All acts permit and envisage the establishment of private institutions at different levels of education and training. With respect to higher education, since 1994 South Africa has assumed a liberal position on the opening-up of the sector to foreign providers (Goldblatt, 2003). This was due largely to the policy vacuum prior to the promulgation of the Higher Education Act, which resulted in "the proliferation of both local and foreign private providers of varying and sometimes dubious quality" (Goldblatt, 2003). With respect to foreign providers specifically, South Africa was seen (and continues to be seen) as a springboard to the provision of education services to the rest of the sub-continent.

South Africa is a significant exporter of education services, particularly through Mode 2 (consumption abroad), and specifically with respect to the rest of Africa. Despite this, and notwithstanding a stable and non-discriminatory regulatory environment, the Ministry of Education has expressed a number of reservations about the GATS in education. These reservations range from the philosophical – regarding the excessive marketisation, commodification, and homogenisation of higher education – to the practical – regarding issues surrounding the negotiating process, the provision of government subsidies and the consequences of renegotiating commitments once scheduled. Consequently, the Ministry of Education has decided not to make any commitments in education services in the

current round of multilateral negotiations. Furthermore, the Minister of Education has called for a "fundamental re-thinking of the inclusion of education in the GATS". The Ministry is in agreement with the "Joint Declaration on Higher Education and the General Agreement of Trade in Services"<sup>16</sup> which supports the notion of reducing obstacles to international trade in higher education using conventions and agreements outside of a trade policy regime (Knight, 2002).

The exclusion of education from the negotiating process will reduce South Africa's negotiating leverage and hence its ability to secure a favourable aggregate outcome in the GATS negotiations. Moreover, while the GATS is described as a voluntary agreement, it also contains the imperative of progressive liberalisation. Therefore, it is likely that the Ministry will come under increasing pressure from the DTI to make commitments in education under the GATS in future negotiating rounds. Indeed, South Africa may be forced to include education in various bilaterally-agreed free trade agreements to meet the conditions laid down in Article V of the GATS on economic integration. If this is the case, the current stance by the Ministry of Education with respect to the GATS will become increasingly difficult to sustain. It is imperative that South Africa establishes institutional arrangements to provide advice to the higher education sector and the government on trends and developments on the GATS and other changes in international aspects of higher education. This institutional arrangement should also have the capacity to deliberate with fraternal bodies in the region, Africa and internationally, to identify convergent principles, policies and action plans (Goldblatt, 2003).

## 5.5 Architectural, Construction and Engineering Services

Regulatory reform in the architectural, construction and engineering services industries is focused on limiting volatility in the demand for construction services, increasing the black empowerment share across all sectors, and improving labour practices and human resource development.

With respect to South Africa's existing commitments in architectural, construction and engineering services, the liberalisation of the sector is highly advanced and only modest scope exists for further offers of market access (Teljeur and Stern, 2002). Indeed, requests from all Members in construction and related engineering ser-

vices have targeted South Africa's only restriction in these services: locally-registered architects have to be used for building plans of 500 m<sup>2</sup> or more. The wording of the commitment appears to have created some confusion since the Architects Act of 1970 stipulates the use of a "locally certified" architect. This does not require that the architect must be South African, but that architects wishing to supply their services in South Africa are certified by the relevant body, in this case the South African Council of Architectural Professionals (SACAP). The purpose of the requirement is to ensure

that architects are familiar with local building codes. While it may be feasible to continue to maintain quality standards embodied in building codes through the building-plan approval process, licensing procedures for architects in South Africa do not discriminate between local and foreign architects. In addition, in accordance with the terms of Article VI of the GATS, licensing procedures are based on objective and transparent criteria, are no more burdensome than necessary, and do not in themselves constitute a restriction on the supply of the service.

## 5.6 Energy-Related Services

The liberalisation of the South Africa's mineral-energy complex has the potential to unleash significant economy-wide gains. As with telecommunications, South Africa has proceeded with a process of managed liberalisation of the energy sector, with the most fundamental reforms occurring in the electricity sector. Currently, this involves the corporatisation of Eskom - the seventh largest electricity utility in the world - the vertical and horizontal unbundling of generation, transmission, and distribution, as well as the introduction of competition, partial privatisation, and a new regulatory framework (Eberhard, 2003).

The coal sector is entirely privately-owned and largely unregulated while petroleum, by contrast, is highly regulated in terms of market access and prices (Eberhard, 2003). Independent regulators with transparent and non-discriminatory rule-making procedures are in place in the electricity and gas sectors. There is also an independent petroleum pipelines regulator. The Petroleum Agency oversees the

issuing of rights and permits for exploration and production. Since the agency is located in the Department of Minerals and Energy, however, questions may arise regarding its independence. Finally, there are plans to merge the gas and petroleum pipeline regulators with the National Electricity Regulator (NER).

With respect to requests received in energy-related services by key WTO Members, and the absence of commitments made by South Africa in energy services, substantial scope exists to lock in reforms made since 1994 in a revised schedule of the GATS commitments, despite the continued restructuring of the industry. Current regulations and proposed reforms to market access and national treatment in the provision of networks and services for the supply and marketing of energy are discussed below. (There are no national treatment restrictions and relatively few market access restrictions on the provision of services related to exploration and production, storage services, and services related to decommissioning.)

### *Services Related to Networks*

Network-related services do not include actual ownership of the network but rather services involved in their operation. In the electricity sector, ownership and operation of the networks are licensed together by the NER. Effectively, therefore, ownership and operation of transmission networks is limited to Eskom, while the ownership and operation of distribution networks is limited to Eskom and local municipalities with geographic monopolies. It is envisaged that transmission will remain a monopoly but it is uncertain at this stage

whether monopoly rights will remain with Eskom or be granted to a separate public company. Distribution will be consolidated into six regional electricity distributors (REDs) which will be owned by the government, Eskom, and local municipalities. The concessioning of the operation of distribution networks is feasible but there are no plans to do this soon. In the gas sector, there are no market access or national treatment restrictions on establishing new pipelines, new distribution networks, or obtaining third party access to them. The sole

exception in this regard is the Sasol-Mozambique pipeline to which Sasol has been granted exclusive rights until 2012 without needing to grant third-party access. In the petroleum sector, the new draft

Petroleum Pipelines Bill provides for a non-discriminatory regulatory environment with no restrictions on market access.

### *Services for the Supply and Marketing of Energy*

Currently, there are no restrictions on the wholesale supply of electricity. The retail supply of electricity is licensed to either Eskom or local municipalities. Trading and brokering of electricity and related contractual instruments are limited to Eskom only. With the ring-fencing of Eskom generation and the introduction of independent power producers, a fully-fledged multi-market for wholesale trading in electricity will be established in South Africa. Retail supply will be liberalised for customers using over 100GW hours per annum but not for small industrial and residential consumers who will continue to be supplied by Eskom and the REDS. Many of the market access limitations to the provision of services for the supply and marketing of

energy will fall away as reform of the sector proceeds. In the gas sector, owners of distribution networks will have limited geographic monopolies, including trading monopolies for limited periods. This will not pertain to the supply of gas to high industrial users. Furthermore, no third party access is currently mandated for the supply of retail services. In the petroleum sector, importing final petroleum products is only allowed if local refineries cannot meet demand. However, there are no trading restrictions when importation is required. Finally, wholesale margins, refinery exit prices, and retail prices and margins are all determined by the government.

## 5.7 Conclusion

On the whole, South Africa has fulfilled the first condition for the development of a successful negotiating strategy in services. In many sectors, including sensitive sectors such as education, regulatory authorities are in place, largely independent, and committed to transparent and non-discriminatory rule-making procedures. However, general improvements to the institutional foundation of services liberalisation, while necessary, are insufficient to ensure a favourable outcome for South Africa in the GATS negotiations. In many sectors, the process of regulatory reform and liberalisation remains sensitive. In energy, for example, the merging of various sub-sectoral regulators may create additional institutional flux halting the liberalisation process, if only temporarily. In telecommunications, the inability to license the SNO has delayed the further liberalisation of the sector, including assessment of the feasibility of additional entrants. Thus for many sectors, the second dimension of a successful services liberalisation strategy – the sequencing and timing of liberalisation – assumes critical importance.

Where possible, therefore, South Africa should not only endeavour to lock in unilateral reforms made under the

GATS since 1994 but also commit to the timing of future liberalisation measures in its schedule of commitments. Committing to a timeline for future liberalisation will serve three useful purposes: first, it will improve South Africa's negotiating leverage; secondly, it will provide an external mechanism by which to protect the government against politically influential lobby groups opposed to further reform; finally, it will hold the various ministries accountable to further reform.

Arguably, with reference to the above discussion, South Africa's multilateral negotiating strategy in services should be developed around three key service sectors: finance, telecommunications and energy. In each of these sectors, there is much scope for locking in unilateral reforms and committing to a timeline for future liberalisation. These are sectors in which the South African economy stands to derive significant efficiency gains from liberalisation, in which significant export potential exists with respect to the rest of the continent, and in which the requests of key Members are the most detailed and comprehensive. Therefore, South Africa's negotiating leverage will depend largely on its ability to make meaningful commitments in these sectors.

Negotiating leverage also depends on South Africa's ability to make effective use of various negotiating tools, specifically the ability to build partnerships and form strategic alliances in negotiations on services. The importance of alliance-building to the outcome of any

Geographically-related alliances tend to be more stable, but South Africa's interests in services diverge from the majority of African Members. Presently, South Africa may well benefit from offensive, sectorally-focused alliances with key non-African and non-South Members – for example, with the EU and the US in the energy sector and Australia in the mining sector. South-South alliances may be particularly expedient in advancing certain negotiating issues collectively, particularly on issues – such as credit for autonomous liberalisation, assessment and the establishment of an emergency safeguard mechanism – that industrialised members have strategically-manoeuvred to their benefit during the course of the mandated negotiations (Mashayekhi and Tuerk, 2003). Geographical alliances in services will become stronger and more strategically-relevant over time as African Members develop comparative advantages in a range of services. Even so, South Africa should seek to build partnerships and find areas of common interest with Egypt and Kenya – to date the only other African Members to have submitted requests on services to South Africa (see Section 3 for requests by Egypt and Kenya in prioritised service sectors).

Finally, there are three issues that might become increasingly important in the development of South Africa's strategy in services as the multilateral negotiations gather pace. First, Black Economic Empowerment (BEE) is a broad policy implemented by the democratic government to address historical inequities through the transfer of skills and other productive assets to companies run by black entrepreneurs. The overall framework for the BEE programme involves a "scorecard" system under which enterprises receive points for black ownership, preferential procurement from BEE enterprises and employment equity. When the government "engages in any economic activity" (whether procurement, a concessionary arrangement or a divestment), it will award contracts or shares on a preferential basis to companies who achieve high scores according to the criteria. Each sector is responsible for developing a charter on how specific BEE objectives will be achieved.

negotiating strategy is crucial. However, building alliances in services negotiations is likely to present South Africa with a set of unique challenges and opportunities.

BEE is seen by many South Africans as an integral part of post-Apartheid redistributive justice. Policies like BEE may make sense from a social or politico-economic perspective, but they are nonetheless fundamentally incompatible with basic principles of non-discrimination. In terms of the GATS, BEE (as presently envisaged) could be seen as inconsistent with the general principle of national treatment because it discriminates against investors who are not black South Africans. While there is room in WTO agreements to accommodate socially-integrative policies if countries specify exemptions in advance, the exemption process presumes a depth of *ex ante* knowledge that is both theoretically and practically unreasonable. The effect of BEE on South Africa's negotiating strategy in services will depend on the extent to which Members perceive BEE as non-discriminatory in practice, as well the ability of South Africa's trade negotiators to minimise its impact on negotiating leverage if exemptions on BEE need to be taken (either horizontal or sector-specific).

Second, related to the BEE policy, although wider in scope, is the possibility of having to renegotiate South Africa's existing in services made at the end of the Uruguay Round in 1994. It is important to note that South Africa scheduled its GATS commitments less than a year after the first democratic elections in April 1994. South Africa's accession to the WTO and the commitments it made in services under the GATS were part of the informal negotiations on economic issues that paralleled the formal, political transition. After the transition, old legislation was repealed and replaced by legislation attempting to address a revised set of social and economic imperatives. New legislation since 1994 has been drafted largely in ignorance of existing GATS commitments and raises the possibility that current legislation could reflect tougher restrictions than those scheduled at the end of the Uruguay Round. For example, South Africa's existing commitment in the movement of natural persons (Mode 4) allows for the temporary presence of service salespersons, intra-corporate transferees, and personnel engaged in establishment for a period of up to three years. In terms of the Immigration Act 13 of 2002 – which replaced the previous Act under which South Africa's existing Mode 4

commitments were made – an intra-corporate transferee may work in South Africa for a period **not exceeding two years**. This effectively represents a more stringent restriction than the current commitment and South Africa may have to negotiate compensatory adjustment with an affected Member (on a most-favoured-nation basis) in terms of Article XXI of the GATS.

Third, South Africa's multilateral services negotiating strategy is likely to be significantly influenced by the services agreement negotiated in the SACU-US FTA. In many respects, strategy is simply a matter of timing. This is certainly true in the case of services, where the SACU-US FTA will be concluded well before substantive multilateral negotiations in services begin as part of the Doha Round, compressing negotiating space and limiting the range of options available to the trade negotiating team. For example, if the SACU-US FTA is not to fall

foul of Article V of the GATS on regional integration then the services agreement therein must cover all trade, regardless of its architecture (specifically, the option to include sensitive sectors in a second tier of commitments). Once sensitive sectors such as health and education are included in regional agreements, the argument to exclude them from the ambit of the GATS is significantly weakened. While starting with open position on sectors up for negotiation in the GATS might have originally strengthened South Africa's position, committing to them in one arena while attempting to bar them from another reveals an underlying weakness in strategy formulation which key WTO Members are likely to exploit. This underscores the importance of close co-ordination between the regional and multilateral tracks of services liberalisation, rather than the substitution of one for the other, which presently appears to be the case in South Africa.

## 6. IMPLICATIONS OF THE SERVICES NEGOTIATIONS FOR THE SUSTAINABLE DEVELOPMENT OF THE SOUTH AFRICAN ECONOMY

An in-depth analysis of the impact of the GATS reforms poses formidable challenges and is beyond the scope of this study. This is due to two main factors. Firstly, the impact of the GATS is difficult to measure relative to the effects of other reforms. Secondly, the uniqueness of different service sectors requires detailed sectoral analysis. The problem is compounded by the difficulty of generalising about the impact of services on sustainable development. Owing to their vast differences, some sectors have a more direct impact on economic growth, while others a more direct impact on welfare, poverty and the environment. For example, there is no obvious link between business or professional services and the environment. There is, however, a strong link between tourism and the environment. Financial services, on the other hand, can have a significant effect on South Africa's long-run growth prospects.

The impact of services reform varies from creating more efficiency in the economy, more or less inequality through changes in the prices of services and employment loss, to other factors such as environmental impacts. Access to services is another important factor that needs consideration. Health and education, for example, are considered basic public goods, particularly for the poor who cannot afford private medical or educational services. The liberalisation of these social sectors is not as straightforward as other more commercialised sectors. Moreover, the other side of the GATS reforms is the potential for a Member to significantly increase its services exports through further reductions in barriers by partner countries. This can have a significant impact on the domestic economy and implications for sustainable development must be considered here too.

Notwithstanding the difficulty of linking services trade to sustainable development, this section refers to some brief evidence of the impact of services in selected sectors, as well as providing some insights into how future liberalisation ought to proceed.

In liberalising services, it is important to ensure that the policies aimed at creating market access and non-discrimination are not at the cost of sustainable development. Indeed, an important question to ask in South Africa is the extent to which multilateral services

liberalisation would lead to adverse social consequences. Any assessment of services trade in South Africa is closely related to changes in the political and economic landscape that have occurred since the transition to democracy in 1994. Over the last ten years, access to many services – such as energy, roads, education and water – has improved for the poor. This has less to do with actual reforms, however, than with changing budgeting priorities of the government. It is also important to take into account that lack of access to these services is often the result of widespread poverty and not necessarily because of any reform in services. This poses specific difficulties for the South African government. For example, the government needs to make decisions over whether it should simply redistribute income or subsidise the provision of services to the poor.

As mentioned earlier, the only way in which to go beyond a superficial assessment of the development impact of the GATS is to embark on sectoral analysis. Although this is beyond the scope of the study, there is some casual evidence emerging from some sectors. The energy sector in South Africa provides an interesting sectoral case study. It is a concentrated, regulated and largely publicly-owned sector, dominated by one company with a monopoly in the generation, transmission and distribution of energy (see Section 5 for an overview of reform the energy sector). Surprisingly, the cost of electricity in South Africa is very low by global standards. This might lead one to conclude that if energy prices are low, the market structure of the sector, whether dominated by a monopoly or highly competitive, is irrelevant. This is not true, however, and the presence of a monopoly that typically prices above its marginal costs is more complex.

There are two fundamental sets of factors that explain why energy prices are low in South Africa. First, the financial viability of the state monopoly, Eskom, is attributed to various distortions, such as prices that are below international averages. This is due to the use of low-grade coal-based energy, the production of which does not internalise environmental costs. Second, Eskom has until recently enjoyed implicit subsidies, such as exemptions from taxation and dividends. Effectively this meant that there was no accountability

in the way capital was invested. Hence, it is important to distinguish between the economic efficiency and financial profitability of the sector. Although these firms may be financially viable, they may not be economically efficient because they receive either explicit or implicit subsidies from the government.

South Africa's electricity industry is currently undergoing a restructuring process, including the introduction of competition in certain parts of the electricity supply chain. There are essentially four facets to the energy industry: generation, transmission, distribution and retail. Although developing countries are under some pressure to open-up their services under the GATS, the South African government has, from its own national consideration, recognised the need to open-up some of its services, including the energy sector and energy-related services.

Accountability to the GATS would ensure that the future development of the energy sector is carried out within a framework of pro-competitive reform. In the context of sustainable development, the key issue is the impact this would have on poverty and the environment. If multilateral services liberalisation results in an increase in prices for the poor, one policy option might be to subsidise the provision of energy to poor households. How this is done is a different matter. Similarly, the potential damage to the environment requires a different policy instrument such as an environmental tax, rather than decelerating or halting the liberalisation process.

Tourism services are particularly significant in the South African context. One of the major concerns is the extent to which the liberalisation of tourism may lead to increased economic opportunities in the short-run, but have adverse social consequences in the long-run. Critical environmental and social issues include: water use; waste and pollution; land use and exploitation of natural resources; inappropriate tourist behaviour; inequities in jobs and incomes; opportunity costs; increase in undesirable activities; effects on culture; and benefit-sharing (ISSD, 2003). Moreover, the link between liberalisation and the GATS may not be direct. For example, while South Africa's tourism regulations are fairly liberal, it is competition policy at the domestic level that is more significant than actual GATS disciplines.

The tourism industry itself is not unduly regulated and thus will not see direct impacts from trade

liberalisation. The intermediate services which are crucial to the delivery of tourism services may experience changes depending on the level of the GATS commitments undertaken. The downstream impact of these changes will be the largest impact on tourism. One concern about reform running at too fast a pace is the implications it has for countries with no regulatory capacity. Indeed, this is quite important to future GATS negotiations. Providing market access or allowing more competition is dependent on institutional capacity.

The telecommunications experience in South Africa is equally instructive. It is clear that market access without an effective regulator or competition policy is counter-productive. Fixed-line telephony is still a monopoly. Access to communications services has been limited partly because telecommunications prices in South Africa are well above international averages.

In health services, the concern is that further liberalisation under Mode 4 may exacerbate the emigration of health care professionals in a country that has already experienced significant brain drain (Cleary and Thomas, 2003). Cleary and Thomas (2003) argue that concerns in the health sector are centred on the extent to which multilateral liberalisation undermines the importance of equity and meeting basic needs. They recommend that the government would be wise to hold off on extending liberalisation in the health sector pending further research. It is clear that the WTO negotiations need to take these kinds of issues on board. It is important, however, to make sure that the links between reform and impact are more clearly defined. In the case of South Africa's health sector, the constraints on commercial presence are government regulations on limits to the number of hospital beds in the country. If this constraint is applied to both domestic and foreign providers, the implications are different than if it is just applied to foreign providers. It may encourage domestic providers to provide inferior services.

In education services, there are concerns that opening-up this sector could be dangerous because it fulfils a social function. There is a tendency, therefore, to exclude education services from progressive liberalisation under the GATS because of perceived adverse social consequences. Naturally, if the GATS reforms do produce adverse social effects, South Africa should pursue a more prudent GATS reform agenda. What is lacking, however, is an examination of positive effects,

most notably including the role of competition in increasing efficiency and education service quality, and the lowering of prices.

The other important aspect of the impact of services liberalisation is the benefit to South Africa from market access in the global economy. As mentioned earlier, there are several sectors where South Africa's export potential is high such as financial services, construction services, and business services. Recognition of this is important from the perspective of any cost-benefit analysis of the GATS reforms.

Any liberalising reform in South Africa poses formidable challenges to the government given the country's highly-skewed income distribution and high poverty incidence. As such, it is important that South Africa addresses any short-term adjustment costs of liberalisation that might exacerbate levels of inequality or poverty. Ultimately, however, this will depend on whether resources are available to cushion those most affected by the negative impacts of reform.

## 7. DEVELOPMENT CO-OPERATION AND THE LIBERALISATION PROCESS

Development co-operation in the trade liberalisation process can assist developing countries in two ways: through the identification of national interests and in linking these to the negotiating process. In many cases there is no clear distinction between the two activities. This often leads to a suspicion by the recipient country that the negotiating process is somehow compromised through the donor support it receives. In the South African context, the evolution of donor support to the liberalisation of services in the WTO has focused far more on the first activity – that is, assisting South Africa in identifying national interests – and much less on linking national interests to the negotiating process itself. In 2002, for example, the DTI received significant support in creating awareness about the importance of the GATS negotiations and its implications for organised business and services exporters in particular. Through the support received by the DTI, it was able to develop requests more effectively than otherwise. Donor support, however, did not extend to the development of the requests themselves. Development co-operation also played a major role in elevating research on services across a number of sectors. This process was driven by the Trade and Industrial Policy Secretariat (TIPS, now Trade and Industrial Policy Strategies), an independent research institution which manages a network of researchers and consultants who specialise in the areas of trade, industrial and regulation policy.

Currently, donor support and development co-operation is focused on assisting and strengthening the activities of a number trade-related research institutes and development programmes, which have been established over the last two years.<sup>17</sup> Indirect donor support, such as this, is likely to achieve the best results in the South

African context given that a critical mass of awareness of trade issues (including services) appears to have been reached in civil society, organised business and the research community. For example, donor support is unlikely to be effective if it plays a direct role in the institutional restructuring of organised business or in establishing a coalition of services industries. These initiatives must be undertaken by the relevant stakeholders. By supporting local programmes and institutes, however, development co-operation will strengthen their ability to mobilise resources in a way that minimises perceived interference from “outside” organisations. Consequently, new institutional arrangements which are put in place to manage an ever-expanding trade agenda are more likely to receive the support of local stakeholders whose interests they are intended to serve.

Adequate support for more sophisticated research on services still remains a critical component of development co-operation for services liberalisation in South Africa. While there is now a much greater understanding of the services sector in South Africa and the implications of the GATS for local service providers, other issues remain to be addressed. These include:

- Improving services data and the reclassification of services sectors for the purposes of more disaggregated data collection.
- Quantifying the restrictions on trade in services in South Africa.
- Assessing more thoroughly the impact of services liberalisation on sustainable development, welfare and poverty in South Africa.

## 8. CONCLUSION

South Africa has developed initial requests in services to over 50 WTO Members and has received requests in services from 16 Members, including the European Union, Japan and the United States. In addition, South Africa has received GATS requests from two African Members - Egypt and Kenya. South African service providers are increasingly active in African markets and in a wide range of service sectors, reflecting the high export potential to the rest of the sub-continent. Therefore, South Africa has a keen interest in the successful conclusion of the GATS negotiations and in the development of a comprehensive and well-designed multilateral negotiating strategy.

Unfortunately, institutional arrangements supporting the development of an effective negotiating strategy are either absent or inadequate to deal with an ever-expanding negotiating agenda. South Africa's trade negotiating machinery is operating sub-optimally. There are significant capacity constraints in the lead department for trade negotiations, the DTI. Interaction between the DTI and line departments is erratic and organised business is in a state of institutional transition, reducing its capacity to provide effective input into the negotiating process. Furthermore, the weakness of the domestic trade negotiating apparatus is having an adverse impact on South Africa's ability to build partnerships, forge alliances and put forward positions and proposals in the various negotiating fora.

Since 1994 South Africa has undertaken substantial unilateral reforms in services, creating the space to make meaningful commitments in the new round of services negotiations. While some sectors are considered

sensitive, the possibility exists to develop a negotiating strategy around three or four key sectors, in which substantial commitments can be made, improving South Africa's negotiating leverage in other areas. Where possible, South Africa should also commit to a timeline for future liberalisation, improving leverage and holding line departments accountable to further reform. Simultaneously, there is a need to establish an external mechanism to protect the government against politically influential lobby groups opposed to further reform.

Notwithstanding serious institutional deficiencies in South Africa's trade negotiating apparatus, a multilateral negotiating strategy for South Africa is likely to be influenced by three factors: the extent to which Black Economic Empowerment (BEE) is perceived by Members as a practical limitation to the provision of services in the South African market; the need to modify or renegotiate existing commitments in light of legislation that effectively increases market access or national treatment restrictions; and the outcome of the services agreement currently being negotiated in the SACU-US FTA.

Currently, the opportunities and risks of multilateral services negotiations in South Africa are finely balanced. Indeed, in terms of the impact of further liberalisation of key sectors on sustainable economic development, the picture is unclear. It is difficult to generalise across sectors because the impact of reform will vary greatly from one sector to another. Further sector-specific research is needed.

## APPENDIX: Requests Received by Prioritised Sectors by Key WTO Members<sup>18</sup>

*Table 1: EC Request to South Africa on Financial Services*

<b>Insurance and insurance-related activities</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in Mode 1 in reinsurance and MAT insurance (including intermediation) in accordance with the Understanding.</li> <li>• Remove the requirement of discretionary authorisation for acquisitions in excess of 25% in locally incorporated insurance companies (Mode 3).</li> <li>• Commit to direct branching in all sub-sectors of insurance and insurance-related activities (Mode 3).</li> <li>• Remove the residency requirement applying to executive chairpersons, public officers and the majority of directors and life insurance actuaries (Mode 3).</li> <li>• Clarify the existence of discriminatory solvency requirements in reinsurance.</li> </ul>
<b>Banking and other financial services</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in Modes 1 and 2 for the provision and transfer of financial information and financial data processing, and for advisory and other auxiliary financial services.</li> <li>• Make full commitments in Modes 2 and 3 in pension fund management.</li> <li>• Remove discriminatory capital requirements under national treatment (Mode 3).</li> <li>• Allow foreign banks' branches to use parent's capital to meet prudential requirements (Mode 3).</li> <li>• Take into account the guarantee extended by the branch's head office or by another foreign bank for additional lending volume (Mode 3).</li> <li>• Remove restrictions on dealings in foreign exchange.</li> <li>• Clarify why the limitation that restricts foreign bank to holding 49% of the equity of any seat on the JSE has not been scheduled.</li> </ul>

**Table 2: US Request to South Africa on Financial Services**

<b>Insurance and insurance-related activities</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in Mode 1 in reinsurance, MAT insurance (including intermediation) and services auxiliary to insurance.</li> <li>• Make full commitments in Mode 2 in life insurance, non-life insurance, MAT insurance, reinsurance, insurance intermediation and services auxiliary to insurance.</li> <li>• Make full commitments in Mode 3, including the removal of restrictions on a supplier's ability to establish preferred form of commercial presence (subsidiary, branch or joint venture) and at the level of equity participation preferred by the service supplier.</li> <li>• Remove the approval requirement for acquiring shares in existing companies (Mode 3).</li> <li>• Remove the residency requirement for the majority of directors (Mode 3).</li> </ul>
<b>Banking and other financial services</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in Mode 1 in financial information and advisory services and for certain other activities where the consumer is deemed sufficiently sophisticated to manage any attendant risks.</li> <li>• Make full commitments in Mode 2 in all sub-sectors.</li> <li>• Make full commitments in Mode 3 in all sub-sectors, especially where limitations might constrain choice of preferred form of commercial presence or level of equity participation.</li> </ul>
<p>In addition, the US has highlighted the following specific limitations to the provision of banking and other financial services and requests of South Africa "the earliest possible accommodation and, where appropriate, binding" (i.e., the removal of the limitations listed below):</p>
<b>Mode 3</b>
<ul style="list-style-type: none"> <li>• Discriminatory conditions are imposed on foreign banks opening branches: parent must have capital of US\$ 400 million and a minimum individual deposit of 1 million Rand.</li> <li>• Foreign bank branches are not allowed to use their parents' capital to meet prudential requirements.</li> <li>• Concerning regulation on bank branch capital, the fact that the branch's head office or another foreign bank guarantees additional lending volume is not taken into account.</li> <li>• Prohibition on foreign banks from using global capital as open exchange position (net open foreign currency position limited to 15% of branch capital and reserves).</li> <li>• Restriction of access for foreign banking firms to the stock exchange: foreign banks are restricted to holding 49% of the equity of any seat on the JSE.</li> <li>• Restriction applied to institutional investors who may obtain foreign assets by an asset swap of up to only 15% of their total assets.</li> <li>• Cartel of local banks controlling the automatic clearing-houses complicates entry by new participants.</li> </ul>
<b>Mode 1</b>
<ul style="list-style-type: none"> <li>• South Africa has made no commitment in the processing of financial information.</li> <li>• South Africa has made no commitments in advisory and other services that are auxiliary to banking and other financial services.</li> <li>• South Africa has made no commitments in asset management.</li> </ul>

**Table 3: Egypt's Request to South Africa on Financial Services**

<b>Insurance and insurance-related activities</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in Mode 1.</li> <li>• Remove the restriction that all insurers &amp; reinsurers (and insurers on whose behalf policies are sold) need to be incorporated as a public company in South Africa (Mode 3).</li> </ul>

**Table 4: EC Request to South Africa on Telecommunication Services**

<b>Basic Services</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Remove the restriction regarding the supply of services on a facilities basis (all modes).</li> <li>• Remove the restriction on the number of operators (including cellular telephony).</li> <li>• Remove the restriction permitting foreign investment in suppliers up to a cumulative maximum of 30 per cent (Mode 3).</li> </ul>
<b>Value-Added services</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Remove restrictions on the bypass of South African facilities for routing of domestic and international traffic.</li> <li>• Introduce a regulator that is independent of all operators, allow an unlimited number of operators and, if licences are necessary, a licensing regime that abides by the principle of the Reference Paper.</li> <li>• Remove the regulation that VANS providers can only provide international services with the consent of Telkom SA.</li> <li>• Make full commitments in market access for all value-added services (Mode 2).</li> </ul>

**Table 5: Japan's Request to South Africa on Telecommunication Services**

<b>Basic &amp; Value-Added Services</b>
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Remove restrictions on types of commercial presence.</li> <li>• Remove restrictions on the participation of foreign capital</li> <li>• Remove nationality or residency requirements for executives and/or employees.</li> <li>• Remove restrictions on the use of specific media regarding the provision of telecommunications services</li> <li>• Remove restrictions on voice transmission services supplied through the use of domestic leased circuits interconnected with public switched networks</li> <li>• Remove restrictions on the number of licences (except for restrictions due to frequency limitations)</li> </ul>

**Table 6: US Request to South Africa on Telecommunication Services**

Basic & Value-Added Services
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Remove restrictions on the ability of service providers to supply services on a facilities basis only.</li> <li>• Remove restrictions on the number of service operators in basic telecom services.</li> <li>• Remove limitations to foreign investment.</li> <li>• Remove references to the possible need for different interconnection rates with major suppliers.</li> <li>• Remove restrictions on the bypass of South African facilities for routing of domestic and international traffic.</li> <li>• Remove references in the schedule to Telkom's status as a <i>de facto</i> regulator and that VANS firms can provide services only with Telkom's consent, as well as the <i>ad hoc</i> nature of dealing with international VANS providers.</li> </ul>

**Table 7: US Request to South Africa on Education Services**

Higher education and training services, adult education and other education services
<p>South Africa to:</p> <ul style="list-style-type: none"> <li>• Make full commitments in higher education &amp; training services, adult education and other education services (all Modes).</li> <li>• Remove burdensome requirements, including non-transparent needs tests, applicable to foreign universities operating, or seeking to operate, in South Africa.</li> </ul>

**Table 8: Kenya's Request to South Africa on Education Services**

Secondary and higher education services
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in secondary and higher education services (all Modes).</li> </ul>

**Table 9: EC Request to South Africa on Architectural, Construction & Engineering Services**

Professional services
<ul style="list-style-type: none"> <li>• South Africa to remove the requirement to use the services of a locally registered architect for building plans greater than 500m<sup>2</sup>.</li> </ul>
Construction and related engineering services
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 3 in other construction and related engineering services.</li> </ul>

**Table 10: Japan's Request to South Africa on Architectural, Construction & Engineering Services**

<b>Construction and related engineering services</b>
<ul style="list-style-type: none"> <li>• South Africa to make commitments in other construction and related engineering services (CPC 511+515+518)</li> </ul>

**Table 11: US Request to South Africa on Architectural, Construction & Engineering Services**

<b>Professional services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in architectural services, engineering services and integrated engineering services (all Modes).</li> </ul>
<b>Construction and related engineering services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in construction and related engineering services (Modes 2 &amp; 3).</li> </ul>

**Table 12: Egypt's Request to South Africa on Architectural, Construction & Engineering Services**

<b>Professional services</b>
<ul style="list-style-type: none"> <li>• South Africa to remove the requirement to use the services of a locally registered architect for building plans greater than 500m<sup>2</sup>.</li> <li>• South Africa to make full commitments in Mode 4 in architectural services, engineering services, integrated engineering services, and urban planning and landscape architectural services.</li> </ul>
<b>Construction and related engineering services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 4 with respect to the following professionals: architects, engineers and related professionals; general managers in construction; extraction and building trade workers; construction labourers; manufacturing labourers.</li> </ul>

**Table 13: Kenya's Request to South Africa on Architectural, Construction & Engineering Services**

<b>Professional services</b>
<ul style="list-style-type: none"> <li>• South Africa to remove the requirement to use the services of a locally registered architect for building plans greater than 500m<sup>2</sup>.</li> </ul>

**Table 14: EC Request to South Africa in Energy Services**

<b>Services related to exploration and production</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 3 in related scientific and technical consulting services, and construction and related engineering services.</li> </ul>
<b>Services related to networks</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 3 in the operation of transportation/transmission and distribution facilities, and the transportation of petroleum and natural gas.</li> </ul>
<b>Storage services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 3 in bulk storage services of liquids or gases.</li> </ul>
<b>Services for the supply of energy</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in Mode 3 in the following: wholesale trade services of electricity; retail sale trade services of electricity (for industrial supply); trading of energy products (including Modes 1 &amp; 2, non-network energy products); the brokering of energy products (including Modes 1 &amp; 2, non-network energy products).</li> </ul>
<b>Services related to decommissioning</b>
<ul style="list-style-type: none"> <li>• South Africa to remove all limitations to services related to decommissioning.</li> </ul>

**Table 15: US Request to South Africa on Energy Services**

<b>Exploration and development services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in exploration, evaluation, drilling, development and completion activities<sup>a</sup> (all Modes, excluding commitments to obtain a proprietary interest in minerals and hydrocarbons).</li> </ul>
<b>Services incidental to energy distribution</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in services ancillary to the transportation, transmission and distribution of the energy source<sup>b</sup> (all Modes).</li> </ul>
<b>Energy marketing services</b>
<ul style="list-style-type: none"> <li>• South Africa to make full commitments in the marketing, trading, and brokering of energy commodities and related contractual instruments, and the provision of customer services (all Modes).</li> <li>• South Africa to make additional commitments in the access to, and use of, essential facilities for the transportation of the energy source necessary to providers of energy marketing services (all Modes).</li> </ul>
<b>Other services important to energy services<sup>c</sup></b>
<ul style="list-style-type: none"> <li>• South Africa to make commitments in the following: engineering and integrated engineering services; construction services (excluding marine dredging); environmental services; management consulting services and services related to management consulting; facilities management services (i.e., the management and operation of energy facilities on a contractual basis, applying only to measures affecting the ability of a foreign firm to compete for a management services contract); financial services; maintenance and repair of equipment; computer and related services (excluding airline computer reservation systems); rental and leasing services relating to other machinery and equipment; education and training services.</li> </ul>

<sup>a</sup> The US request provides a non-exhaustive list of services that include “but are not limited to” activities related to exploration, evaluation, drilling, development and completion.

<sup>b</sup> Similarly, the US request provides a non-exhaustive list of services incidental to electricity distribution and transmission.

<sup>c</sup> Here, the US request provides a good example of the “cluster approach” to the services negotiations: the grouping of commercially related service sectors in market access negotiations

## ENDNOTES

<sup>1</sup> The Southern African Development Community: Angola, Botswana, the Democratic Republic of Congo (DRC), Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

<sup>2</sup> Ironically, South Africa's existing commitments in professional services include medical professionals.

<sup>3</sup> South Africa is currently negotiating FTA with EFTA, Mercosur, and the US, and plans to begin negotiations with China, India and Nigeria in 2005.

<sup>4</sup> With the exception of the US, all of the requests to South Africa in environmental services are based on the EC's proposed reclassification of the sector (see S/CSC/W/25 at <http://www.wto.org>).

<sup>5</sup> A detailed analysis of these requests is beyond the scope of this paper. Indeed, one of the major challenges facing the South African government is to review the welfare implications of these requests for the economy as a whole.

<sup>6</sup> Norway's request to South Africa in telecommunication services is identical in all respects to the EC's request to South Africa in telecommunication services. Unlike the EC, however, Norway did not request that South Africa liberalise postal and courier services nor audiovisual services.

<sup>7</sup> The Southern African Development Community: Angola, Botswana, Democratic Republic of the Congo, Lesotho, Malawi, Mauritius, Mozambique, Namibia, Seychelles, South Africa, Swaziland, Tanzania, Zambia and Zimbabwe.

<sup>8</sup> Although South Africa has not formally submitted its requests to other Members, the list of non-SADC African countries to which initial requests were developed between August 2002 and March 2003 is as follows: Benin, Cameroon, Congo, Cote d'Ivoire, Egypt, Gabon, Ghana, Kenya, Madagascar, Mali, Mauritania, Morocco, Nigeria, Rwanda, Senegal, Sierra Leone, Togo, and Uganda. The countries to which initial requests are formally made, however, may differ from those listed here.

<sup>9</sup> An economic analysis and research unit was established in the DTI's trade division at the beginning of 2001. Subsequently, as part of the restructuring of the department, the research process was centralised in 2002. Divisional research units were dissolved and a central research unit was established to provide support to the various divisions in the DTI from a single point. Unfortunately, the research requirements of the trade division are no longer served effectively under the new arrangement, neither with respect to the WTO nor the division's various bilateral negotiations.

<sup>10</sup> The Southern African Customs Union: Botswana, Lesotho, Namibia, South Africa and Swaziland. Formed in 1910, it is the oldest customs union in the world. A new SACU agreement was negotiated in 2002, effectively ceding sovereignty over trade policy formulation and implementation to new supra-national institutions, which have yet to be established (Draper, 2003). While South Africa is negotiating free trade agreements as part of SACU, the new agreement between SACU Members does not extend to services.

<sup>11</sup> Since South Africa is not a major economic power, except in relation to sub-Saharan Africa, the formation of strategic alliances in multilateral fora like the WTO is essential (Draper 2004).

<sup>12</sup> Comments made by James Lennox, Chief Executive, South African Chamber of Business, reported in the Business Day, December 12 2003 ([www.bday.co.za/bday/content/direct/1,3523,1504488-6078-0,00.html](http://www.bday.co.za/bday/content/direct/1,3523,1504488-6078-0,00.html)).

<sup>13</sup> Consequently Sally (2002) recommends for developing countries "a mutually fructifying combination of unilateral and multilateral liberalisation".

<sup>14</sup> In practice, this restriction has been eroded, particularly concerning activities related to the securities market. Thus there appears to be scope for negotiation on this matter and an opportunity for South Africa to derive negotiating leverage.

<sup>15</sup> The South African Schools Act, 84 of 1996; the Higher Education Act, 101 of 1997; the Further Training and Education Act, 98 of 1998; and the Adult Basic Training and Education Act, 52 of 2000.

<sup>16</sup> The Joint Declaration on Higher Education and the General Agreement on Trade in Services, adopted by the Association of Universities and Colleges of Canada, the American Council on Education, the European University Association and the Council for Higher Education Accreditation.

<sup>17</sup> Notable examples include the Development Through Trade project at the South African Institute of International Affairs (SAIIA) and the Trade Law Centre (TRALAC) for Southern Africa.

<sup>18</sup> The information contained in these tables was obtained from interviews with government officials and academic researchers between January and April 2004.



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