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WTO VS. BEE: WHY TRADE LIBERALISATION MAY BLOCK BLACK SOUTH AFRICANS' ACCESS TO WEALTH, PROSPERITY OR JUST A WHITE-COLLAR JOB

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"Black Economic Empowerment" (BEE) in South Africa

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Abstract

South Africa's policy of Black Economic Empowerment (BEE) is intended to alleviate the racially determined disparities in the distribution of the country's wealth and income. It aims at increasing the participation of black South Africans in the formal private sector economy: more black company owners; more black investors; and more formal jobs, preferably at management level, reserved for blacks. To this end, BEE comprises a wide range of policy instruments aimed at domestic market regulation in favour of black South Africans. Some of these instruments are, however, inconsistent with fundamental rules of international trade set out by the World Trade Organisation (WTO), which puts BEE at odds with WTO and may jeopardise the success of the policy's *raison d'être*: bringing wealth, prosperity and white-collar jobs to black South Africans. This paper analyses the problematic relationship between BEE and WTO. It approaches the issue step-by-step: first, it provides an overview of WTO, its relevant sub-agreements and the obligations these impose on South Africa. Second, it introduces BEE and systematically examines the inconsistencies between BEE and WTO rules. Finally, it reviews the possible repercussions and concludes.

Introduction

South Africa's policy of Black Economic Empowerment (BEE) is intended to alleviate the racially determined disparities in the distribution of the country's wealth and income. It aims at increasing the participation of black South Africans in the formal private sector economy: more black company owners; more black investors; and more formal jobs, preferably at management level, reserved for blacks. To this end, BEE comprises a wide range of policy instruments aimed at domestic market regulation in favour of black South Africans. Some of these instruments are, however, inconsistent with fundamental rules of international trade set out by the World Trade Organisation (WTO).

WTO aims at removing barriers that hinder cross-border trade. Those that are erected at the border in form of tariffs and quotas, as well as those that are erected (intentionally or unintentionally) beyond the border in form of domestic rules and regulations. Certain WTO rules, therefore, aim at limiting the policy space of member countries to regulate international trade. The rules are legally enforceable and as a founding member South Africa is obligated to respect them. A fundamental aspect of WTO rules is non-discrimination: favouring based on nationality is generally prohibited. But discrimination is a defining aspect of BEE – the policy favours black South Africans over not only other South Africans, but also non-South Africans. This puts BEE at odds with WTO and may jeopardise the success of the policy's *raison d'être*: bringing wealth, prosperity and white-collar jobs to black South Africans.

Considerable debate over WTO rules has centred on the infringement of policy space. Some argue that it is a fair price to pay for a predictable multilateral trade system with enforceable rules to the benefit of all. Others see the WTO system as inappropriate and worry that its rules will impair member countries' ability to adopt proper development strategies and safeguard against market failures. This paper contributes to this debate by analysing the relationship between South Africa's BEE and WTO. It approaches the issue step-by-step: first, it provides an overview of WTO, its relevant sub-agreements and the obligations these impose on South Africa; second, it introduces BEE and systematically examines the inconsistencies between BEE and WTO rules; finally, it reviews the possible repercussions of these inconsistencies and highlights various strategic options for the South African government.

The World Trade Organization[1]

Established in 1995, the WTO administers around 30 trade agreements negotiated by its members. These agreements set the rules of the multilateral trade system The most important are the General Agreement on Tariffs and Trade (GATT), the General Agreement on Trade in Services (GATS) and the Trade-Related Aspects of Intellectual Property Rights (TRIPs) agreement (Hoekman, 2002). The establishment of the WTO was a 'single undertaking' – all its provisions apply to all member countries. Whereas the pre-WTO multilateral trade system allowed for countries to 'opt-out' of disciplines by not signing specific agreements, WTO is an 'all-or-nothing' deal.

One important aspect of the WTO is that many of its agreements are aimed directly at securing convergence or coherence between domestic and international systems of market regulation (Gibbon and Ponte, 2005). Consequently, many of WTO's rules and obligations deal not with 'border' issues like tariffs, but with 'beyond-the-border' issues of a domestic character not previously considered to be trade-related. In this way, WTO trespasses on the domestic policy space of member countries. Not all laws and regulations of some member countries are consistent with WTO rules and obligations.

WTO rules and obligations rest on a set of basic principles of which two are of relevance in this context: (1) non-discrimination; and (2) binding and enforceable commitments. Non-discrimination has two major components: the most-favoured-nation (MFN) rule and national treatment. MFN requires member countries to treat foreigners equally by giving a product, service or service supplier from one WTO member no less favourable conditions than a similar ('like') product, service or service supplier from another member. The national treatment principle obligates a WTO member to treat foreigners and locals equally by giving foreign goods, services or service suppliers the same treatment as the member's own.

Binding and enforceable commitments are made by WTO members in negotiations or on accession to WTO. They are specified in country schedules and essentially establish the level of trade liberalisation each country has committed to. To ensure that countries adhere to their market access commitments, every member country that feels that actions taken by another country have the effect of nullifying or impairing commitments made, may bring the issue to

[1] This section builds on WTO (2003) unless otherwise stated.

the WTO Dispute Settlement Body (DSB). DSB has the authority to adjudicate over whether a contested measure violates WTO rules. The system is strictly government-to-government – any private parties (such as a company) that feel wronged by another government would need to persuade their own government to bring the matter to DSB.

Two WTO agreements are of a so-called plurilateral type – meaning that they are not part of the 'single undertaking'. WTO-members individually decide whether to join these agreements or not. One covers trade in civil aircraft, the other government procurement. South Africa has not signed-up to the latter. Therefore, WTO rules do not cover goods procured by the South African government or the agencies it controls.

Two central WTO agreements are relevant for BEE: GATT and GATS. Additionally, two agreements closely linked to GATT, the Agreement on Subsidies and Countervailing Measures (SCM) and the Trade-Related Investment Measures (TRIMs) agreement, can also apply. In the following sections, I examine these four agreements and their consequences for the policy space of WTO members.

GENERAL AGREEMENT ON TRADE AND TARIFFS (GATT)

The current GATT builds on the pre-WTO multilateral trade system, also called GATT. With the establishment of WTO, the 'old' GATT (GATT 1947) was incorporated as the merchandise trade 'arm' of WTO in a updated vision (GATT 1994). The updated GATT works as an umbrella agreement for trade in goods. It has various closely linked agreements dealing with specific issues on trade in goods such as TRIMs and SCM. The primary aim of GATT is to secure that trade barriers only occur at the border in form of tariffs and that these are reduced over time.

The national treatment principle (GATT Art III) is a central part of GATT. It targets barriers occurring beyond the border. It requires that once foreign goods have crossed the border and entered the market of a member country, they shall be treated the same as 'like' domestic goods. According to GATT, the following measures cannot be applied to imported or domestic products as a means to protect domestic production: discriminatory measures in form of taxes and other internal charges; laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products; and internal quantitative regulations requiring the mixture, processing or use of products in specified amounts or proportions. For GATT, it is irrelevant whether a policy actually affects a foreign exporter: if a policy is discriminatory, it is prohibited. Another central part of GATT is

the rule on quantitative restrictions (GATT Art XI). This rule, in principle, prohibits quantitative restrictions on imports and exports of goods (except for agricultural commodities) in any other form than non-discriminatory duties, taxes or other charges.

TRADE-RELATED INVESTMENT MEASURES (TRIMS) AGREEMENT

Even though TRIMs is an agreement in its own right, all it really does is to clarify the application of GATT Articles III (national treatment) and XI (quantitative restrictions). In fact, a definition of 'a trade-related measure' is not even provided in TRIMs (Bora, 2002). Instead, the agreement provides an illustrative list of measures that are inconsistent with the two central parts of GATT. The list relates both to measures which are mandatory or enforceable under domestic law and to measures for which compliance is necessary to obtain an advantage. Policies which are explicitly prohibited include:

- 'Local content' requirements ('indigenisation') – e.g. a requirement that a company purchase or use products of domestic origin, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production;
- Trade balancing requirements – i.e. that a company's purchases or use of imported products is limited to an amount related to the volume or value of local products it exports;
- Foreign exchange generation requirements – e.g. restrictions on a company's import of products used in (or related to) its local production, such as limiting its access to foreign exchange to an amount related to the foreign exchange inflows attributable to the company;
- Restrictions on exports – e.g. restrictions on a company's exports, whether specified in terms of particular products, in terms of volume or value of products, or in terms of a proportion of volume or value of its local production (see TRIMs Annex).

TRIMs, like GATT, is ownership neutral – it is not limited to policies targeted exclusively at foreign companies. It applies whether a foreign company is affected or not.

THE AGREEMENT ON SUBSIDIES AND COUNTERVAILING MEASURES (SCM)

SCM applies to non-agricultural products, as special rules exist for agriculture. Subsidies are defined as, *inter alia*, grants, loans, loan guarantees, equity infusion (investment), tax

concessions or credits provided by the government (or another public body) (SCM Art I). The agreement distinguishes between two types of subsidies: non-specific, which are outside WTO rules, and thus allowed; and specific, which are covered by WTO rules. A subsidy is non-specific if based on objective, non-discriminatory and horizontal (not sector-specific) criteria. It is deemed specific if it is conditional on export performance, the use of domestic inputs (local content requirements), or limited to a company, industry or specific geographical region (English and de Wulf, 2002).

Specific subsidies are divided in to two categories: prohibited and actionable.[2] Subsidies that depend on export performance or on local content requirements are prohibited.[3] Actionable subsidies are not prohibited – most subsidies fall into this category. However, they are subject to challenge if they cause adverse effects to the interests of another WTO member. Adverse effects include injury to a domestic industry, nullification or impairment of tariff reductions, or if the subsidy reduces the exports of other WTO members (Ibid).

THE GENERAL AGREEMENT ON TRADE IN SERVICES (GATS)

The pre-WTO regime primarily regulated trade in goods, but the creation of the WTO expanded international trade regulation into services, included through GATS. The Agreement has explicit implications for systems of domestic market regulation. The latter follows from the fact that trade barriers in the form found in merchandise trade are difficult if not impossible to impose on services, and that barriers to trade in services are therefore maintained through domestic laws and regulation. GATS explicitly acknowledges the rights WTO members in general, and developing country members' in particular, to use regulation in order to meet national policy objectives, and provides flexibility for this (see below).

The scope of GATS is broad. It applies to all measures taken by countries affecting trade in services, whether in the form of a law, regulation, rule, procedure, decision, administrative action or any other form. It applies to all levels of government, whether national, provincial or local and to non-governmental bodies exercising delegated governmental powers. It covers international trade in all services except those supplied in the exercise of governmental

[2] A third category, non-actionable subsidies, was originally part of SCM. These were of three types: Research and development (R&D), aid to disadvantaged areas, and subsidies to facilitate the adaptation of production to new environmental standards. However, this category applied provisionally for five years ending in 1999 and is now understood to have lapsed (Pangestu, 2002).

[3] Except for some developing countries, not including South Africa.

authority, defined as services that are 'supplied neither on a commercial basis, nor in competition with one or more service suppliers' (Article 1:3). In this way, GATS seeks to exclude 'the public sector' from its scope. The expressions used are, however, ill-defined and are yet to be clarified. As a result, it is unclear which types of public services are excluded form the agreement and which are not.

Government procurement is exempted from the strongest obligations. Consequently, any measures related to government procurement are GATS-consistent. Subsidies are covered by GATS, but the agreement provides no formal definition of subsidies similar to that provided in SCM on trade in goods. This has led to some confusion on whether subsidies are covered by GATS obligations or not. The WTO secretariat assumes that they do (WTO, 2005: 38), but essentially the issue will have to clarified either through negotiations or by the DSB.

GATS provides a sector-based system for classification of services built on the United Nations Central Product Classification (CPC) list. It identifies 12 core service sectors, which are further subdivided into some 160 sub-sectors. GATS aspires to cover not only all governmental measures affecting all service sectors but also all aspects of trade in services. It does so by defining four modes through which services can be traded – called 'modes of supply':

- (Mode 1) Cross border trade -- defined as delivery of a service from the territory of one country into the territory of other country;
- (Mode 2) Consumption abroad -- covers supply of a service in one country to a service consumer from any other country;
- (Mode 3) Commercial presence -- which covers services provided by a service supplier from one country in the territory of any other country ;
- (Mode 4) Presence of natural persons[4] -- which covers services provided by a service supplier from one country through the presence of natural persons in the territory of any other country.

Through the four modes, GATS covers not just cross-border trade, but any form in which companies or individuals can supply services internationally.

[4] A 'Natural Person' is a human being, as distinct from legal persons such as companies or organisations

The primary purpose of GATS is to facilitate progressive liberalisation of trade in services. It provides a framework for countries to make liberalisation commitments in specific services sectors. An essential part of trade liberalisation in services is to secure non-discrimination between countries' services and service suppliers. The agreement seeks to achieve this through a number of obligations that countries shall abide to.

The strongest GATS obligations are *market access* and *national treatment* but they only apply conditionally to service sectors that countries have specifically committed to GATS. This means that a country is free to chose which service sectors it wishes to commit to the most restrictive GATS provisions and which sectors it wishes to omit from them. Additionally, a country can attach limitations to the committed sectors. This is done through the submission of 'country schedules': each country has submitted a schedule to the WTO specifying which sectors it wishes to commit to GATS and which limitations it wishes to attach to the specific sectors, if any. Whereas the scheduling of sectors is done positively, the scheduling of limitations and conditions is done negatively. If a service sector is not included in a country's schedule, it has no obligations on market access and national treatment in that sector. If a service sector is included, a country is obliged to provide full market access and national treatment in that sector, unless it has specified specific limitations in its schedule.

In this way, GATS does not prescribe the sector scope or the extent of trade liberalisation. It is up to each WTO member to decide which sectors to schedule and the range of commitments within these. Hence, all WTO members have flexibility to decide their own level of liberalisation in accordance with policy priorities. The flexibility, however, is limited by two important constraints:

- GATS is only flexible when the liberalisation process moves forward. Should a country wish to retract or change its commitments, it can only do so after three years have elapsed from when they were made. If that is the case, the country may be asked to

make compensation 'payments'[5] if another country can show that it will be affected by the changes. This makes the process a potentially expensive and complicated affair, particularly if a wide range of sectors are involved. Yet, if no countries oppose the changes, they can be implemented without compensation;

- The opportunity to schedule limitations 'for free' is only given at the time the original commitment is made. This is what in trade jargon is called 'list it or lose it': if countries do not list GATS inconsistent policies from the start, they lose the opportunity to use them in the future.

As mentioned, the two strongest GATS obligations are *market access* and *national treatment.* It is in relation to these that countries specify their limitations to the committed sectors. In relation to *market access*, GATS sets out six types of restrictions that a country cannot impose on service suppliers from another country in the absence of scheduled limitations:

- Restrictions on the number of service suppliers – e.g. nationality requirements for suppliers of services;
- Restrictions on the total value of service transactions or assets – e.g. foreign bank subsidiaries limited to x percent of total domestic assets of all banks;
- Restrictions on the total number of service operations or the total quantity of service output – e.g. restrictions on broadcasting time available for foreign films;
- Restrictions on the number of natural persons that may be employed in a particular sector or by a particular supplier – e.g. foreign labour cannot not exceed x percent and/or wages y percent of the total;
- Measures that restrict or require supply of the service through specific types of legal entity or joint venture – e.g. commercial presence must take the form of a partnership with a local entity or person;

[5] Compensation does not take place in the form of cash payments to the affected country, but through offering new liberalisation commitments within other sectors that shall be not less favourable to trade than what existed before the changes and are made on a MFN basis (so that all countries and not only the affected country is 'compensated'). A Member that wishes to change or withdraw commitments must notify WTO of these changes no later than 3 months before implementation. Members that feel affected by the change(s) or withdrawal(s) must request negotiations on compensation within the 3 months period. If a solution is not reached through negotiations within the given timeframe, the matter may be resolved through arbitration on request. Commitments cannot be changed until compensation has been granted by the modifying member in conformity with the conclusions of the arbitration.

- Percentage restrictions on the participation of foreign capital, or restrictions on the total value of foreign investment – e.g. limiting foreign ownership of a company to x percent.

It is irrelevant whether these restrictions are non-discriminatory (that is, whether they also cover national services and services suppliers) or not; for a country to impose limitations on market access, it most have specified this in its schedule. Should a country choose not to limit market access, it cannot invoke any regulations or policies that contravene the six types of restrictions to market access.

National treatment obliges a country to give foreign services and service suppliers the same treatment as the country's own. Again, limitations may be listed in relation to non-conforming measures, such as discriminatory subsidies and tax measures, residency requirements and so on. It is the responsibility of the individual country to ensure that all potentially relevant measures are listed, as GATS does not provide an exhaustive listing of the types of measure that would constitute limitations on national treatment as it does for market access (see above). National treatment applies *de jure* as well as *de facto* – that is, both to formally discriminatory measures (*de jure*) and to identical measures (*de facto*) that go against the national treatment obligation. In fact, there is no requirement to treat national and foreign suppliers in a formally identical way. What matters is that foreign suppliers are given equal opportunities to compete as national suppliers.

Examples of limitations to *national treatment* made by countries, and thereby what countries assume to be inconsistent with national treatment, include:

- Eligibility for subsidies reserved to nationals;
- Higher license fees charged for non-residents;
- Agents or managers must be citizens;
- Residency requirement for managers and the members of the board of directors of a company;
- Condition of licenses is one year previous residency;
- Foreign companies are required to have a registered office in the country;
- The foreign service supplier must prove commitment to recruit and develop more local human resources;
- Foreign service suppliers are required to offer on-the-job training for national employees. (WTO, 2001)

SOUTH AFRICA'S GATS COMMITMENTS

South Africa has made commitments in 91 of the 160-odd possible service sectors. This is fairly considerable for a developing country and more on par with the general pattern of developed countries' level of commitments. Of the 12 core sectors, South Africa has made commitments in business, communication, construction, distribution, environmental, financial, tourism, transport, and other services. The sectors related to health-related and social and educational services were left out because of the political sensitivity associated with these. Yet, South Africa has made commitments within some health services as a number of these are listed as sub-sectors under business services.

For a conflict to exist in a specific service sector between GATS and BEE, two things must apply: (1) the sector must be among the 91 sectors South Africa has scheduled; and (2) the BEE policies related to the sector must be outside the scope of scheduled limitations made by South Africa in relation to these 91 sectors.[6] To decide whether these two prerequisites apply, an assessment of South Africa's GATS schedule is necessary. Given that a systematic analysis of potential conflicts between BEE and GATS would require 91 individual sector analyses, this paper assumes a scenario in which South Africa has made full commitments in all sectors. Whether the conclusions apply to a specific sector depends on South Africa's GATS schedule.[7]

RELEVANT DISPUTES

To date, South Africa has been part of two WTO dispute settlement cases – both as a respondent ('wrong-doer') and both in relation to anti-dumping. South Africa has not been part of any disputes related to services.[8] The following will give a description of disputes involving other WTO-members but covering issues relevant in this context. Seven cases relate to trade in goods and one to trade in services.

[6] The latter would be coincidental. Since South Africa's commitments were made in 1994, the limitations to them predate BEE. Consequently, none of South Africa's GATS limitations specifically refer to BEE.

[7] The WTO web site includes South Africa's GATS schedule and a guide on how to read it (http://www.wto.org/english/thewto_e/countries_e/south_africa_e.htm).

[8] This does not mean that conflicts between South African laws and regulations and GATS do not exist. Sinclair (2005) has argued that essential parts of South Africa's new national health act are in conflict with South Africa's health services commitments.

The seven cases[9] related to goods all involve automobiles and motor vehicles and they have all been brought against large developing countries (India, Indonesia and the Philippines) by large developed countries (EC, Japan and US). They all concern allegations of, *inter alia*, local content requirements ('indigenisation') violating GATT, TRIMs and illegal subsidies violating SCM, and they all concluded to the advantage of the complainants (EC, Japan and US).[10] The respondents were found to have been implementing policies which violated, *inter alia*, GATT article III (national treatment), TRIMs article 2 (national treatment and quantitative restrictions) and SCM Article 5 (c) (adverse effects: serious prejudice to the interests of another member). Consequently, the respondents were required to change their WTO-inconsistent polices.

The case related to services[11] (the 'Telmex case') concerns telecommunication (telecom) services. The US accused Mexico of violating its GATS commitments and obligations by failing to ensure that Telmex (a major Mexican supplier) provided interconnection to US telecom providers at reasonable rates, terms and conditions; by failing to ensure US telecom providers reasonable and non-discriminatory access to public networks and services; by failing to provide national treatment to US-owned telecom providers; and by failing to prevent Telmex from engaging in anti-competitive practises.

Mexico, *inter alia*, argued that, while not agreeing with the US on the more technical arguments, the explicit acknowledgement in GATS of the right of WTO members and developing country members in particular to pursue national policy objectives should be taking into consideration by WTO and that if WTO followed the arguments of the US, Mexico would be deprived of an important policy tool in the development of its telecom infrastructure. The WTO ruled in favour of the US and Mexico has consequently changed its policies (WTO, 2004).

In sum, the disputes demonstrate that: (1) the major developed countries are willing to bring cases against developing countries if their trade interests are significantly compromised; (2) local content requirements ('indigenisation') have been deemed in violation of WTO rules in

[9] Disputes: DS54 (European Communities (EC) against Indonesia), DS55 (Japan against Indonesia), DS59 (US against Indonesia), DS64 (Japan against Indonesia), DS146 (EC against India), DS175 (US against India), and DS195 (US against the Philippines).

[10] Except DS195 which is still pending.

[11] DS204 (US against Mexico)

several disputes related to trade in goods; and (3) explicit acknowledgement of WTO members' right to regulate in favour of national policy objectives in GATS is subordinate to the interpretation of the GATS commitments and limitations made by the same members, i.e. for such a policy to be allowed a WTO members GATS schedule needs to be calibrated accordingly.

WTO vs. BEE: Inconsistent Elements[12]

In 1994, South Africa's policy of apartheid came to an end. A defining feature of apartheid was the exclusion of black South Africans from the economy as anything else than cheap labour. Although apartheid is a thing of the past, exclusion of the black majority remains a central feature of the South African economy. BEE aims to change this. Defined by the Broad Based Black Economic Empowerment Act of 2003 as 'the economic empowerment of all black people including women, workers, youth, people with disabilities and people living in rural areas through diverse but integrated socio-economic strategies',[13] BEE seeks to:

- Promote economic transformation for inclusion of black people in the economy;
- Achieve a substantial change in the racial composition of ownership, management structures and in the skilled workforces of existing and new companies;
- Increase the extent to which communities, workers, cooperatives and other collective bodies own and manage existing and new companies and increase their access to economic activities, infrastructure and skills training;
- Increase the extent to which black women own and manage existing and new enterprises, and increase their access to economic activities, infrastructure and skills training;
- Promote investment programmes that lead to broad-based and meaningful participation in the economy by black people in order to achieve sustainable development and general prosperity;
- Empower rural and local communities by enabling access to economic activities, land, infrastructure, ownership and skills;
- Promote access to finance for black economic empowerment.

[12] The description of BEE in this section is based on DTI (2003, 2005) unless otherwise stated

[13] Government Gazette, 9 January 2004, p. 4.

The same act defines 'black people' as 'a generic term which means Africans, Coloureds and Indians'. Although there is no reference to citizenship in the act, the later issued BEE Codes of Good Practice emphasises South African citizenship as a criteria for qualifying as a black person.

The Codes of Good Practice on Broad Based Black Empowerment ('the Codes') are mandated by the BBBEE act and set out the further interpretation and definition of BEE. According to the Codes, all organs of state, public entities and enterprises which undertake any business with any organs of state or public entity must implement BEE. The government expects every company in South Africa to immediately commence implementation of BEE with a view to become compliant within a 10-year-period[14]. Whereas organs of state and public entities (that is, the government) will be bound to do so by law, companies will not. To encourage the private sector to implement BEE, the government will employ a 'carrot and stick' approach: a number of financing mechanisms will be used to support BEE, while various policy instruments will be available to enforce BEE.

These regulations are targeted at all companies and natural persons doing business in South Africa – foreign companies and natural persons will be subject to be BEE in the same way as South Africans are. This brings some of the BEE policy instruments and financing mechanisms under WTO coverage. To enforce BEE in the private sector, the government will only engage with private companies that comply with BEE whenever: it issues licences, concessions or other authorisations; procures from the private sector; sells off state-owned enterprises; and enters into public-private partnerships. The issuing of licences, concessions or other authorisations is covered by GATS but not by GATT. Procurement by the South African government is not covered by WTO rules, which effectively excludes the three remaining policy instruments from WTO coverage.

An additional component of BEE compliance is that compliant companies are themselves supposed to procure from or engage in meaningful economic partnership with other BEE compliant companies. This creates a 'chain of compliance' whereby BEE will be imposed on companies further along the value chain (Ponte, Roberts and van Sittert, 2006). The first link of the chain is clearly not covered by WTO rules. But it seems likely that the downstream links are, since the regulation covers 75% of total procurement by companies and not simply

[14] Speech by Trade and Industry Minister Mandisi Mphalwa, March 2005.

procurement of component goods and services that are dedicated for use in government contracts.

Besides the 'stick-like' policy instruments, the government has set aside finance to support BEE. This support will be targeted at BEE compliant private companies in the form of: grants and incentives; state-facilitated lending; project financing; venture capital; and targeted investment. All these mechanisms fall under the SCM definition of subsidies, and are covered by the provisions of the agreement. BEE-related subsidies are also vulnerable to challenge through GATS, despite the fact that GATS contains no formal definition of what constitutes a subsidy.

Essentially, whether BEE is WTO-consistent or not depends on whether the policy's operational forms are consistent with WTO rules. These operational forms are summed-up in the so-called BEE scorecard. The scorecard will measure the compliance of companies according to seven specific elements of BEE:

- Ownership
- Management control
- Employment equity
- Skills development
- Preferential procurement
- Enterprise development
- A residual element

In this way, the scorecard sets out the concrete policies of BEE. The following paragraphs provide an assessment of the scorecard's WTO consistency, element by element.

OWNERSHIP

The scorecard measures ownership against two criteria: voting rights and economic interest. Voting rights refers to the rights of an owner to determine strategic and operational policies of a company. The scorecard sets out a compliance target of a 25%+1 share of voting rights to black people. Most likely such a demand would be deemed in breach of the GATS market access rule banning measures that restrict or require supply of the service through specific types of legal entity.

Economic interest refers to corporate ownership. The compliance target is 25% of ownership being in the hands of black people. This effectively limits foreign ownership to 75%, thereby violating the GATS market access rule prohibiting percentage restrictions on the participation of foreign capital, or restrictions on the total value of foreign investment.

The Codes contain a carve-out clause for multinationals companies: the scorecard's ownership requirements will be measured only against the multinationals' South African activities. But the market access rule applies regardless of non-discrimination. Consequently, the carve-out clause *per se* does not make BEE compliant with WTO.

MANAGEMENT CONTROL

The management control element is measured at two levels: board participation and top management participation. The compliance target for board participation is 50% black board members, whereas the target for top management is 40% black managers. This is a clear violation of the GATS national treatment rule: requirements that board members or managers must be citizens or even residents are prohibited.

EMPLOYMENT EQUITY

The employment equity element sets out various compliance targets for the percentage of black people employed by a company at various levels. Again, this is a violation of GATS national treatment requirements related to citizenship of employees are prohibited.

SKILLS DEVELOPMENT

Skills development refers to the development of competencies of black people. It sets out various compliance targets for the percentage of spending on skill development directed at black people. Such requirements violate the GATS national treatment rule: foreign companies cannot be obligated to develop local human resources.

PREFERENTIAL PROCUREMENT

The preferential procurement element is intended to spread BEE more broadly into the South African economy as it establishes requirements for the procurement policies of companies. Like the government, companies are expected to apply BEE criteria when procuring from other companies. The compliance target is that 75% of a company's total procurement is to be

based on BEE criteria. As argued above, this element is covered by WTO rules. Consequently, the applied BEE criteria need to WTO-consistent. The conclusion of this analysis is that they are not. The 'chain of compliance' created by this element is, therefore, in breach of GATS, GATT, and TRIMs.

A second form of preferential procurement imposes restrictions on imported goods and services in form of local content requirements. In doing so, BEE is clearly violating the national treatment rule of GATS, GATT and TRIMs and the rules on subsidies in SCM.

ENTERPRISE DEVELOPMENT

The enterprise element concerns investment by companies in other companies or commercial partnerships between companies. It can take two forms: investment in black-owned or black-empowered companies, and joint ventures with black-owned or black-empowered companies. The former is in conflict with the GATS national treatment rule; the latter with the GATS market access rule banning joint venture requirements.

RESIDUAL

This element is measured in relation to two aspects: corporate social investment and 'industry specific contributions' targeted at black people and their communities. What this includes more specifically is left for the specific sectors and companies to determine. But the government encourages the sectors and companies to consider including: infrastructural support to suppliers and other companies in the local community, labour-intensive production or construction methods, beneficiation, investment and support to companies operating in rural and disadvantaged communities, and investment in the social wage of employees (such as, housing, transport, and health care). Most likely this would be considered in conflict with SCM, since most of the elements seem to constitute prohibited government subsidies imposed by implication.

In sum, BEE is envisioned to affect every company in South Africa in 10 years time. To ensure this, the South African government will implement a range policies aimed at encouraging private companies to become BEE compliant. It is obvious that the impetus of some these policies goes against a fundamental principle of WTO – non-discrimination. Other aspects appear to be in breach of specific WTO agreements. Therefore, it is no surprise that virtually all aspects of the BEE scorecard are inconsistent with WTO rules. However, those policies implemented in relation to government procurement are outside WTO coverage.

Possible Repercussions

The South African government has invested significant political capital in BEE. It sees the policy as an essential part of its overall growth strategy. It must thus be assumed that it is highly unlikely to be withdrawn or significantly changed to make it WTO-consistent. Conversely, not all policy tools of BEE are covered by WTO. If those that are were abandoned, BEE would be WTO-consistent. But this would deprive the government of some of the main tools it has chosen for implementation of BEE: granting of licences, concessions or other authorisations to companies in the service sectors; and all of the 'carrot-like' instruments. Most likely the 'chain of compliance' element also would have to be abandoned. Altogether, this could entail a watering-down of South African government's authority to implement BEE in the private sector – an aspect which is deemed essential to its success.

Another option could be to re-define 'black people' so that it did not exclude foreign nationals, i.e. by taking out the citizenship requirement. Seemingly, this would retain most of the gains that BEE is expected to bring. It is unlikely that a significant number of foreigners would be in a position to enjoy the rewards. However, while BEE without citizenship requirements would not be in breach of GATS national treatment *de jure*, it is likely that it would be deemed in breach *de facto* as BEE would arguably continue to favour South Africans and South African companies. Also, the policy's local content requirements would not be affected and thus remain prohibited.

This leaves two options for the South African government: (1) enter negotiations with other WTO countries to adjust South Africa's GATS schedule to BEE and remove the local content requirements of the scorecard's preferential procurement and residual elements; or (2) ignore the issue and go ahead with the implementation of BEE.

Modifying and withdrawing GATS commitments is largely uncharted territory[15] and a potentially costly and time-enduring process. The formal procedure would require South Africa to notify WTO on the changes in its GATS schedule no later than 3 months before they take effect. South Africa would then have to negotiate compensatory measures with affected WTO countries. GATS Article XXI states that such negotiations should be entered

[15] The only example of use of a GATS schedule modification procedure (invoked by the EU in 2003) is still being negotiated.

'with a view to reaching agreement on any necessary compensatory adjustment. In such negotiations and agreement, the Members concerned shall endeavour to maintain a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to such negotiations'.

In principle, other WTO members could decide to weigh the social development objectives of BEE higher than their own trade interests and forfeit compensatory claims. On the one hand, the sensitivity of the issue would most likely cause countries to enter such negotiations with a view to 'save' BEE. On the other hand, this would go against not only the spirit of the legal text but also the overall purpose of GATS: to facilitate continued trade liberalisation. Further, it would contradict the stand of most developed countries in the now suspended Doha round negotiations emphasising the essential nature of further opening of markets. Also, making GATS commitments that safeguard development objectives is a difficult and resource demanding process – without guarantees that the WTO will interpret them in the same spirit.

Ignoring the issue and adopting a wait-and-see approach would mean gambling on the possibility that South Africa will not be challenged on the issue by other WTO countries. Again, the sensitivity of the issue, not least in the context of current developments in Zimbabwe, would cause countries to hesitate in doing so. Also, a number of agricultural support schemes of the US and the EU are deemed to be vulnerable to scrutiny by DSB. Yet, several factors indicate that odds may not be to South Africa's advantage:

- BEE has been noticed by trade negotiators. The US has expressed concerns: "[Speaking on BEE] We support the goal and think it's very important ... but at the same time we must ensure it is done in a way that does not disadvantage US companies"[16]. Likewise, BEE is considered to be among the main issues hindering consensus in the negotiations on a new US-SACU trade agreement;[17]
- An outcome of the Doha collapse may very well be a turn away from negotiations to litigation leading to more dispute settlement cases.[18] In a more litigation-friendly environment, a case against BEE is more likely to occur;
- An evaluation of relevant dispute cases (see above) indicates: that developed countries are willing to bring cases against developing countries if their trade interests are

[16] Statement by Florizelle Liser, United States' trade representative for Africa, as in *Business Report* (5 June 2003).

[17] *Business Report*, 17 March 2005.

[18] *Bridges*, 2 August 2006.

compromised; and that multinational companies will not easily accept discrimination to the advantage of direct competitors – they are also aware of the possibilities WTO provides to counter this.

None of these options are particular appealing. Because the conflict between BEE and WTO is fundamental, no 'easy fixes' exist. If South Africa wishes to secure BEE from WTO scrutiny, it would either have to water-down its authority to enforce BEE thereby jeopardising the success of the policy or have to rely on the goodwill of its WTO partners – a worrying prospect. The South African government seems to be caught 'between a rock and a hard place' by WTO rules and may be forced to reconsider its BEE strategy altogether.

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