

Exports, Growth and Employment in South Africa

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There is no shortage of policy recommendations to enhance export performance in South Africa. The Integrated National Export Strategy (2015), the National Development Plan (NDP) Vision 2030 (2017), and the Department of Trade and Industry's Industrial Policy Action Plans all see raising exports and diversifying the export bundle as central policy objectives. Under the NDP, the objective is to increase export volumes by 6% per annum by 2030, with non-traditional exports growing by 10% a year (NDP, 2017:54). The New Growth Plan maintains that "increased exports to the Southern African Development Community (SADC) alone can generate almost 60 000 additional direct jobs by 2015 and 150 000 by 2020".¹

In this piece, I would like to frame the narrative around the key features of South African exports which are related to growth and employment creation.

The imperative of raising exports

If South Africa (SA) is to sustain economic growth at a higher level, it has no choice but to raise exports. This is firstly required as export revenue will be necessary in order to offset the rising import bill that will be associated with higher rates of investment, production and consumption. SA has a long history of its growth process being choked off by a lack of foreign exchange. Econometric estimates predict that to sustain an annual economic growth rate of 6%, export growth will need to increase to 8% per annum.² This requires a considerable boost to the current growth rate in exports of goods and services that averaged less than 2% per annum from 2011.

Exports need to do more than just support economic growth, they need to *lead* economic growth. The domestic economy is too small in terms of its absorptive capacity - consumption, governments, investment and import expenditure - to drive sustained levels of economic growth. Regional and global growth in demand for goods and services has exceeded economic growth in SA for several years. The region is particularly attractive in that the composition of SA's exports are more oriented to manufacturers in contrast to the rest of the world. By tapping into faster growing foreign markets, exports help overcome the domestic demand constraints to growth. Worryingly, growth in global trade has plateaued, but SA's low share of world trade still implies considerable scope to expand into export markets to drive higher economic growth.

A third reason is that improved growth in exports, particularly of manufactured goods, is needed to drive structural transformation. Manufacturing is declining as a share of gross domestic product (GDP), raising concerns that the economy is prematurely de-industrialising. One explanation for premature de-industrialisation is the failure of the economy to grow a competitive manufacturing industry that competes in export markets on a global level. If South Africa is to grow its industrial base, it will need to do so through expanding exports of manufactured goods.

The shift towards exporting will yield further benefits in terms of raising aggregate productivity. The firm level evidence for SA illustrates that exporters of manufactured goods are up to 50% more productive (value added per worker) than non-exporters. Exporters are also larger in terms of employment (over 70% larger) and pay 27% higher wages (Matthee et al., 2016). Some of this association reflects the selection

¹ Presentation prepared for Portfolio Committee on Trade and Industry's Trade and Investment Policy Workshop, Cape Town 22 July 2015. Accessed 6 March 2020 from <https://www.thedti.gov.za/parliament/2015/INES.pdf>.

² This is based on econometric estimates of export and import functions for South Africa. The income elasticity of demand for imports averages around 1.5 reflecting an elastic import response to growth. The elasticity will be higher if growth is investment driven, given the high import content of investment expenditure.

of efficient firms into exporting, but the evidence for SA is that some of this productivity premium arises from learning from exporting and investments in new productivity-enhancing technologies. Growth in exports will thus boost aggregate productivity by raising productivity within the firm, as well as shifting the composition of aggregate production towards these relatively productive firms.

Despite the imperative for raising exports, SA's export performance has been poor over the past decade. Real exports of goods and services as a share of GDP have not yet recovered to pre-financial crisis levels (29% in 2017/18 vs. 0.33 in 2006/07). Exports of mining products have been particularly weak. For example, real mining output, the bulk of which is exported, is lower in 2018 than it was in 1994. Part of this can be attributed to the collapse in commodity prices after 2008, but even during the commodity boom between 2000 and 2007, mining output grew more slowly than the rest of the economy. While mining may not generate much employment directly, it is a major source of foreign currency required to sustain growth, savings, investment and government tax revenues.

Firm and product level export data corroborate the picture of mediocre export performance. Exports are concentrated amongst super-exporters to a degree that exceeds that of comparator countries (Purfield et al., 2014). For example, the top 5% of SA's exporting firms account for more than 90% of its exports. The transition of domestic firms into exporting is low (Edwards et al., 2018) and those that export have been losing dynamism and competitiveness with relatively slow export growth and mediocre expansion into new products and markets (Purfield et al., 2014). While there are many exceptions to the above narrative, the aggregate story is one where exports are not contributing enough to economic growth in SA.

To export and grow, we need to change how we think about imports

The focus of policy and research is often on export performance, but participation in global value chains (GVC), the vehicle through which manufacturing trade predominantly takes place, entails both exporting and importing. Manufacturing requires access to a broad set of intermediate inputs. What the data reveals for SA is that foreign markets are a key source of these

inputs. This is shown in the Trade in Value Added (TiVA) data that decomposes sources of value added in production, consumption and exports. Foreign value added in SA exports rose from approximately 18% in 1995 to 30% by 2015 as exporters integrated through backward linkages into the global trading environment.³ At the firm-level, over 50% of direct exporters in manufacturing in SA also directly import intermediate inputs. If indirect imports are included, the share rises further.

Importing is also shown to have a direct effect on firm performance. SA manufacturing exporters that import, have higher export values and export more products to a wider range of countries. Further, the higher the number of varieties of inputs imported, the greater the diversity of exports in terms of number of products and destinations. These two-way traders (importer-exporters) consistently demonstrate premiums in terms of output, employment, wages and productivity compared to firms that do not trade, or only export or import. One explanation is that imports enable SA manufacturing firms to upgrade their technical capabilities through the use of higher quality inputs that embody new technologies and access to a wider range of complementary inputs. For example, a 10% increase in the number of varieties imported by a firm in manufacturing in SA is associated with a 0.3% increase in its productivity (Edwards et al., 2016). The use of imports in production, therefore, reinforces the productivity gains that have been shown to accrue to SA manufacturing firms through exporting.

The implication is that barriers that raise the cost of accessing imports, such as tariffs, transport barriers, non-tariff barriers, etc., hamper export performance and productivity growth (Edwards and Lawrence, 2008). Further, boosting the integration of SA manufacturing firms into foreign markets and GVCs presents an opportunity for the country to raise exports and aggregate productivity.

Can exports create jobs?

Given the unemployment problem in SA, a key consideration is whether exports can be a major driver of employment. Several characteristics of SA exporters suggest that their direct capacity to significantly reduce unemployment is limited. Mining tends to be relatively capital intensive, and as mechanisation takes hold, employment opportunities through export of minerals may diminish further. Manufacturing has

³ Based on United Nations Industrial Development Organization (UNIDO) data for 1995 and OECD Trade in Value Added (TiVA) data for 2015.

the potential to raise employment growth through expansion of output, but unless we see a dramatic change in the product composition of exporters, the direct jobs that will be created will not absorb individuals who are currently unemployed. The South African Revenue Service (SARS)'s tax and trade data on firms shows that manufacturing exporters tend to be capital and skill-intensive. These firms, by and large, do not employ low-skill individuals who are currently unable to find employment opportunities.

There are four key considerations in this regard:

Firstly, policy makers and academics tend to discount the importance of services in exports. The Department of Trade and Industry (dti) has a comprehensive set of policies to further industrialise the economy. This includes several trade agreements covering trade in goods (e.g. free trade areas covering goods trade with the SADC and the European Union). A comprehensive services trade agreement is lacking. Yet, the opportunities for service exports to boost employment growth are substantial. For example, the retail industry serves as one of the primary channels through which SA products enter the region. Outward investment by banks and telecommunication companies has established a SA firm presence across Southern Africa. These firms have had to do so without formal service agreements.

Services exports also include tourism, a sector with enormous potential to expand. Tourism expenditure comprises a high share of domestic value added, implying that its growth has strong direct and indirect effects on the rest of the economy, including employment. Other opportunities include business process outsourcing (BPO), which has been effective in creating jobs.

Manufacturing exports are also highly dependent on service inputs. According to the TiVA data, the value added from the services sector accounts for 28% of the gross value of manufacturing exports in SA.⁴ The implications are twofold: firstly, growth in manufacturing exports has a strong positive spillover

effect (indirect effect) on demand for services and through this employment in that sector. Secondly, a competitive services sector enhances the competitiveness of manufacturing exports.

The second consideration is the implicit 'tax' on labour arising from costly and inefficient services related to border processes, transport/freight, communication, as well as electricity. In a global market, competitiveness is driven by the cost of non-traded inputs in production. Because exporters cannot pass higher input costs onto foreign consumers, their only option is to reduce labour costs or restrict exports, and thus employment. This is a particularly pertinent issue in SA, given the extensive control that state-owned enterprises have over many of the key services inputs (border procedures, ports, rail, telecommunication, electricity) used intensively by exporters.⁵ Exporters are doubly 'taxed' by inefficiencies in the provision of these services – when they import intermediate inputs and then again when they export their products.

The third consideration is whether it is possible to develop a low-wage labour-intensive export sector. Critically, this boils down to labour costs relative to productivity (assuming efficient and cost-effective trade costs and trade facilitation). The Centre for Development and Enterprise (CDE), for example, has touted the idea of turning the Coega Port facility, combined with an extension of the existing employment tax incentives, into an export processing zone.⁶ They argue that this package will make SA labour costs as competitive as those in Cambodia. What matters are unit labour costs, so productivity levels will also have to be compared to assess the net labour cost competitiveness of the proposal. Nevertheless, making use of Export Processing Zones (EPZs) to reduce trade costs through targeted provision of transport infrastructure and services, and labour costs through subsidies is an idea that requires further exploration. EPZs also allow the government to experiment at the margin and overcome constraints to firm operations, which are difficult to resolve quickly at the national level.

⁴ Services make up 30% of final demand.

⁵ Border procedures (waiting times) and port costs are expensive relative to many competing countries. See the 2018/19 Global Pricing Comparator Study by the Ports Regulator of South Africa. While the relatively high costs have fallen, users in container ports face a Port Authority Pricing premium (including cargo dues) of 198% (terminal handling charges are 211% higher). Further, bulk commodities are charged total port costs that are much lower than the global sample averages, resulting in a relative disincentive to import or export manufactures, e.g. the discount for coal is 56% and for iron ore is 37% relative to the global average (includes cargo dues, terminal handling costs, port authority costs).

⁶ See the 2016 Op Ed by Ann Burnstein "Export processing zone could be big boost for bay economy", <https://www.cde.org.za/export-processing-zone-could-be-big-boost-for-bay-economy/>.

Finally, export growth can have large positive indirect effects on employment through demand for services and intermediate inputs. Income from exports feeds into domestic consumption, which then further indirectly stimulates employment growth. Therefore, while the direct impact of growth in exports on employment may be limited, the indirect effects can be substantial.

Policy implications

Many policies to enhance export performance are already covered in government policy documents. Several policy recommendations follow from the above discussion. This includes promoting service exports and experimenting with an export processing zone. In relation to this, I will discuss three main policy implications:

1. Industrial policy to facilitate export participation needs to look beyond the industry of the firm and consider common constraints and needs of exporters. The firm-level data reveals enormous heterogeneity in exporters and characteristics that do not coincide with their industry status.⁷ Export participation by firms is found in all manufacturing industries in SA. They face common challenges in competing and getting their products to the international market. Further, the rising importance of GVC participation in driving exports requires co-ordination across all industries, including the service industry. A narrow sector-driven industrial policy faces the danger of missing these cross-industry commonalities, thus reducing their effectiveness in building a competitive export base.⁸
2. To enhance export growth, it is critical to reduce the cost of trading. Exporters face a double penalty with high transport and trade costs – both with regards to imports and exports. For example, high trade costs associated with poor transport infrastructure and cumbersome import and export procedures are detrimental to GVC participation by manufacturing firms, *irrespective* of their industry classification. Alleviating these constraints to participation can be expected to generate more entry of firms into exporting from all industries, having stronger effects for the medium sized firms. As noted above, state-owned enterprises are in several cases a major source of these high costs.
3. The African Continental Free Trade Area (AfCFTA) presents an enormous opportunity to expand manufacturing exports into the region. Demand for goods by consumers in the region are expected to grow rapidly as income rises and the population grows. With its established trading network in the region, SA firms stand to benefit from this growth. Further, the regional demand for SA goods is strongly oriented towards manufacturers. For example, 66% of SA's exports to the SADC region are made up of manufactured goods in contrast to 38% to the rest of the world. Critical, however, is that SA also opens up its market to imports from the region through, for example, more lenient rules of origin. The current trade imbalance threatens the conclusion of the trade agreement as regional countries fear competition from SA firms, while not seeing increased opportunities to access the SA market.

⁷ E.g. the firm-level data shows that major determinants of export participation are firm size and productivity, which are not necessarily related to the firm's industry status.

⁸ There are additional dangers of a strict sector-driven industrial policy. Given concentration in industries, industrial policy and the associated incentives are more easily captured by industry lobby groups. The large incentives provided to the vehicle industry have been effective in growing exports, but potentially at the cost of developing a larger more diverse manufacturing export base. Industrial policy targeting industries are further narrowed and reinforced by other policies that coalesce around the industry focus. This includes the Sector Education and Training Authorities (SETAs) that provide training. The skills required for most occupations are not industry-specific, implying that the sector focused training programmes are inefficient vehicles to overcome skill-deficits constraining economic growth. The sector based bargaining councils with sectoral wage determinations implicitly assume that the industry designation is the dominant commonality across all firms in that industry. Further, the dominance of large firms and unions in the bargaining process can result in outcomes that reflect the narrow interests and characteristics of the large concentrated firms to the exclusion of the smaller labour-intensive firms, which may be more similar to firms in other industries than the large productive firms in their own industry.

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