

**The recipe for success in many countries, especially in Asia, has been their ability to increase exports. South Africa's performance in this regard has not been stellar. What macroeconomic and microeconomic policy changes would you recommend to increase South Africa's export potential?**

15<sup>th</sup> May 2009

**Abstract**

In keeping with the assertion that fiscal intervention is necessary to further state interests, this essay has promoted the use of strategic interventionist macroeconomic and microeconomic policy. This essay examined the implications of both the economy within its African context, and the ideological approach of following a Chinese model in terms of positively affecting the trade balance. Under macroeconomic policy, the discussion dealt with both monetary and fiscal roles in supporting the export industry. Microeconomic policy and the role of government in increasing and enhancing exporting firms and industries were also examined. There is much work for government institutions to do in order to improve export performance to a level comparable with Asian countries, but a shift in emphasis in certain policies and spending schemes opens up great potential for South Africa's international trade volume. Word Count: 2390



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## INTRODUCTION

Economic success in many countries, particularly in Asia, has resulted from their ability to expand exports. South Africa has not fared as well in this area in comparison with other middle income countries. This essay will examine how exports can be increased in this nation, through the implementation of strategic macroeconomic and microeconomic policy.

Economic theory is based upon the premise that nations can increase their consumption of all goods by channelling scarce resources towards the production of goods and services in which they hold a comparative advantage (Parkin, 2005: 751). South African export growth over the last twenty years has been second-rate, in terms of comparison with other middle-income countries, and relative to the growth of imports (Edwards *et al.*, 2009: 1). It is especially mediocre in contrast to the economies of Asia. If South Africa is to reach a growth target of six percent, it is imperative that exports increase substantially (Hausmann, 2008: 13).

The long-run vision of South African government is a “competitive fast-growing economy which creates sufficient jobs for all work seekers” (Department of Finance, 2009: 1). Many identify the most urgent challenge facing South Africa as the lack of sustained economic growth and job creation, both of which are indispensable to poverty reduction and improved quality of life for all citizens (Lewis, 2003: 1). The current account deficit<sup>1</sup> is a constraint to future growth (Edwards, 2009: 1). A robust export performance buttresses the macroeconomic sustainability of the growth path (Department of Finance, 2009b: 22).

### The African Context

A more holistic analysis of the South African condition would be an acknowledgement of the African context in which it exists. Africa’s global position is such that the entire continent accounts for only 1-3 percent of total world trade and investment, and almost all of it is in extractive industries (Meidan, 2006: 86). Another real problem in Africa is the flooding of markets with cheap Asian goods with which they cannot compete (Meidan, 2006: 83). Many of the commodities South Africa exports are increasingly being produced several times more efficiently outside of Africa under capitalist conditions of production, combined with the fact that commodities produced by labour-intensive methods are less and less in demand (Leys, 2004: 35). Africa faces harsh conditions in the world market, including a huge productivity gap, barriers to manufactured exports, debt burden and conditionality (Leys, 2004: 44).

### Looking to China

If this essay would hold the economic performance of Asia as a benchmark for South Africa, it would be pertinent to examine the policies of these high export performers. China forms

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<sup>1</sup> 7% of GDP in 2007.

one of the top five countries in the world in terms of trade volume<sup>2</sup>, and had a trade balance surplus of 8.1 in 2006 (Froyen, 2009: 300). The implications of the question of this essay would be that their approach is a model which can and should be emulated by the South African state. This would entail the adoption of the neo-mercantilist approach taken by China in its global trade interactions (Meidan, 2006: 76). This would assert that state action is necessary to instigate the developing capitalist system to further the interests of the state. This translates into developing home industry, reducing the consumption of imported goods, and developing both natural and human resources (Froyen, 2009: 33). China has utilised this methodology in terms of export investment subsidies, and the development of 'colonies' (through FOCAC) to create a market with which to flood manufactures. For example, the African market allows China to export diverse low-quality commodities, among them weapons and military supplies (Meidan, 1994: 85). This is not a ready option for South Africa, thus economic policy in terms of the development of the domestic export industry's potential is the chosen direction.

In keeping with this assertion that fiscal intervention is necessary to further state interests, this essay will now promote the use of strategic interventionist macroeconomic and microeconomic policy. This is certainly necessary in South Africa. Accelerated and Shared Growth Initiative (ASGISA) emphasises that investments in industry are needed for employment creation and correct the growing current account deficit (Department for Trade and Industry, 2007: 23). Evidence shows that export firms are larger, relatively more productive, more capital-intensive and skill-intensive and pay more than non-exporting firms (Edward *et al.*, 2009: 8). The essay will focus first on macroeconomic, then microeconomic policy. Under macroeconomic policy, the discussion will deal with both monetary and fiscal roles in supporting the export industry. Then, the essay will continue with microeconomic policy, and the role of government in increasing and enhancing exporting firms and industries.

## **MACROECONOMIC POLICY**

### **MONETARY POLICY**

The main objective of monetary policy remains "the maintenance of financial stability and the reduction of the inflation rate" (Department of Finance, 2009b: 11). Overall financial stability and higher economic growth require positive real interest rates and low inflation, as well as avoiding exchange rate volatility.

In the aim of cultivating competitive advantage, it is necessary to keep the real effective exchange rate of the rand at a competitive level. Stability is key, and although short-term fluctuations are inevitable, monetary policy measures will focus on long-term real effective exchange rate stability (Department of Finance, 2009b: 11). This stable environment is

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<sup>2</sup> The top five countries being the United States of America, the United Kingdom, China, Germany and Japan.

essential for the planned expansion of export industries. China allows its currency to depreciate, and thus increase exports and decrease imports and having a huge trade balance surplus (Froyen, 2009: 301). However, government policies need to extend beyond maintaining the level of the exchange rate (Edward *et al.*, 2009: 22). At a microeconomic level, policies which facilitate the development of infrastructure and create incentives in industrial export policy need to be utilised to boost export South African performance. It is individual firms who decide to enter or exit the international market and thus create much needed labour demand (Edward *et al.*, 2009: 2). However, too little data is produced about firm level responses to changes in macroeconomic variables, such as the exchange rate. Thus, it is not known whether a weaker exchange rate would promote a greater number of firms to enter the export market, or if it would cause existing exporters to export more. The support for a weaker exchange rate policy from COSATU is thus difficult to address (Edward *et al.*, 2009: 2).

## FISCAL POLICY

### The revenue side and tax concessions

To stimulate new investments, particularly in manufacturing<sup>3</sup>, tax allowances need to be implemented as incentives. Approved projects should receive tax exemptions for certain periods, determined by job creation, regional location, and priority industries (Department of Finance, 2009b: 14). The reform of the system of industrial finance is well advanced. The Industrial development Corporation (IDC) will continue to provide loan finance, equity, and credit guarantee facilities, and will adapt its programmes to satisfy new needs. Other support institutions such as the Board of Tariffs and Trade, the Competition Board, the South African Bureau of Standards, and the National Productivity Institute are also focusing on partnering with industry to meet the challenge of global competition and employment creation (Department of Finance, 2009b: 14).

### The Expenditure Side

#### i) Stimulating comparative advantage and the product life cycle

The Treasury already has plans to enhance industrial innovation support programmes. This will be achieved by incentives<sup>4</sup>, matching grants<sup>5</sup>, and a technology transfer programme<sup>6</sup>. Programmes to promote productivity have been initiated,<sup>7</sup> and NEDLAC is developing a programme to encourage best practice work organisation (Department of Finance, 2009b: 13).

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<sup>3</sup> See page of this essay, under "Competitive capacity and the diversification of export compositions"

<sup>4</sup> This policy is under the Special Programme for Industrial Innovation, which has been encouraging domestic advances.

<sup>5</sup> This policy is under the Technology and Human Resources For Industry Programme.

<sup>6</sup> This policy, instituted by the Department of Trade and Industry, allows firms to access required technology.

<sup>7</sup> For example, the IDC's Multi Shift and World Player schemes.

## ii) Public Goods

A key ingredient of increased export potential is the strategic provision of public goods. Industrial infrastructure and transport are crucial. A challenge within South Africa is that funds for national infrastructure are prioritised towards the provision of essential services. A large percentage of the population who have basic needs unmet, such as potable water, sanitation systems and housing (Department of Finance, 2009b: 16). The precedence given to business-orientated infrastructure such as roads, railways, airports, harbours, and telecommunications is thus constrained by this reality. The Treasury needs to carefully balance the needs to improve quality of life in communities, whilst prioritising the expansion of productive economic capacity. The annual budget for this year has allocated 6.4 billion for public transport, roads and rail infrastructure (Department of Finance, 2009a). But one public good that encompasses both the aims of upliftment and economic success, is that of education. This leads on to the next key area of government expenditure.

## iii) Education

This essay would have government policy that more emphatically highlighted the intrinsic relationship between a successful education system and economic prosperity. The fact is that "progress in education shows up consistently in comparative studies as a key determinant of long-run economic performance and income redistribution" (Department of Finance, 2009b: 15). Only 40 per cent of South African children currently complete secondary education, and of these, pass rates in science and mathematics are inadequate for South Africa's economic needs (Department of Finance, 2009b: 15). By expanding the skills base of the South African labour force, growth will increase through the creation of jobs. Human capital is the most productive asset of the nation, but it is starved of education and training (Lewis, 2003: 13).

Surveys show that 80 percent of large firms experience great difficulty in finding managerial and professional staff, while 70 percent have great difficulty in locating employees with service and craft skills. However, only about a third of firms provide training to about a third of their workers (Lewis, 2003: 13). Supply-side strategies, such as subsidising employment and training need to be examined (Lewis, 2003: 15), and new ways to strengthen the relationship between educational institutions and industry need to be designed (Department of Finance, 2009b: 13).

## MICROECONOMIC POLICY

In order to boost exports, a project that will create much needed employment opportunities and address the current account deficit, sector processes will need to evaluate constraints to exports (Department of Trade and Industry, 2007: 23). It has been shown that large firms are more likely to export than small firms (Edward *et al.*, 2009: 9). There is a very low proportion of output exported by South African firms (less than 20 percent), which is much lower than other African economies and Asian countries such as China. Trade also plays a

relatively limited role for small, medium and micro firms (SMMEs)<sup>8</sup>. In many other countries, SMMEs have been directed towards international markets. They often experience greater success in adopting new technologies, in developing new markets, and adapting to altering international conditions. This low trade dependence means that “an important potential source of dynamism and growth is missing” (Lewis, 2003: 8).

This could be the result of the fact that South Africa has a relatively large domestic market. Its neighbouring markets are relatively minor and geographically, this country is a great distance from developed countries markets. Other possibilities are that the demands for South African firm’s export product’s markets are limited (Edward *et al.*, 2009: 11). This essay will now discuss three areas in which microeconomic policy can be altered to support export firms and industries.

### The importing of inputs and trade agreements

One strategy that government can utilise in order to stimulate the supply-side of total production factors is customs duties and tariffs, in regards to imports which are utilised as inputs for export commodities. Exporting firms, who import goods, should be allowed to offset the cost of imports against the proceeds of exports (Department of Finance, 2009b: 12). To create an international competitiveness, a shift must come from tariffs and subsidies, to supply-side measures which will lower marginal unit costs. In 2008, South African producers were adversely affected by a series of economic shocks. These included electricity shortages, rising input costs, higher interest rates and diminishing demand. Sectors such as mining, manufacturing, retail trade and residential construction have suffered (Department of Finance, 2009a). Many middle-income countries have initiated rebate systems that allow exporting firms to obtain inputs at world prices, and avoid the impact of higher average tariffs (Lewis, 2003: 16).

An important policy emphasis for government is the expansion of market access<sup>9</sup>, in terms of both increasing import availability and providing competitive terms of trade arrangement for exports. Preferential trade agreements with industrialised countries and regional economic integration will aid both small and large firms (Department of Finance, 2009b: 12). Efforts to improve the access of South African firms to foreign markets should focus on arrangements with major trading blocs and the continued participation within the World Trade Organisation. A further crucial focus is the steady integration of Southern African economies through SADC trade and investment protocols. The impact of the EU-South Africa trade agreement and SADC free trade area to the prospects and prosperity of the economy cannot be underestimated (Lewis, 2003: 16).

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<sup>8</sup> Only 22 percent engage in any trade, the average export share being around 15 percent.

<sup>9</sup> Such schemes have been implemented by the Industrial Development Corporation (IDC) and the Regional Industrial Development Programme (RIDC).

## Labour laws and increasing productivity through human resource development

In continuing with comparisons to China's export success, the fragmented nature of the South African labour market is a huge drawback to export performance as well as domestic efficiency. Conflict-ridden labour relations and poor productivity have undermined the country's competitiveness, and thus investment. In terms of the Labour Relations Act of 1996, government has a responsibility to ensure fairness and appropriate systems of dispute resolution (Department of Finance, 2009b: 18). However, the inflexible labour market system heavily favours 'insiders', at the expense of new entrants and the unemployed. The disproportionate power of trade unions in terms of wage gains have not concretely led to productivity increases (Lewis, 2003: 11). South African business leaders, and the ranking of South Africa as last in a fifty-nine nation comparison<sup>10</sup>, cite a lack of labour flexibility as extremely problematic. Compared to other economies, South Africa is last in terms of flexibility, labour relations and general work ethic (Lewis, 2003: 12).

International indicators have also proved South African investment in human resource development inadequate. Growth strategy is highly dependent on improving both the level and effectiveness of training across all employment sectors, enhancing human capability through training is central to productivity improvement. This will allow technological flexibility as well as adding competitive value. An implementation of regulated flexibility of the labour market, as mentioned above, must also allow employees to increase their productivity. The government needs to incentivise management training and best work practices modernisation in order to enhance efficiency and marginal productivity of labour (Department of Finance, 2009b: 19).

## Competitive capacity and the diversification of export compositions

The Department of Trade and Industry has policies in place to both enhance export growth and diversify export compositions (Edwards *et al.*, 2009: 2). Strong government focus is needed to improve competitive capacity, especially in terms of employment absorption of manufacturing (Department of Finance, 2009b: 13). Improving performance in exports, "particularly in more sophisticated, value-added products" is a key goal of industrial policy (Department of Trade and Industry, 2007: 23). There are substantial productivity gains for Africa if it orientates its manufacturing sector towards exporting. Its current weakness in manufacture exports has undermined growth potential and job creation for the large unskilled labour force, particularly as manufactured goods tend towards being relatively unskilled labour-intensive (Edward *et al.*, 2009: 26). Stimulating export growth and diversifying the composition of South African exports should be high on the government's agenda. Towards this, the National Industrial Policy Framework (NIPF) launched by the Department of Trade and Industry in 2007 argues that "improving our non-traditional export performance – particularly in more sophisticated, value added products – is an important objective for industrial policy" (DTI, 2007: 23). For instance, instead of allowing the extraction of our coal and iron ore, we should be using these products to create our own secondary goods.

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<sup>10</sup> Conducted by the World Economic Forum's Global Competitiveness Report

## CONCLUSION

In keeping with the assertion that fiscal intervention is necessary to further state interests, this essay has promoted the use of strategic interventionist macroeconomic and microeconomic policy. This essay examined the implications of both the economy within its African context, and the ideological approach of following a Chinese model in terms of positively affecting the trade balance. Under macroeconomic policy, the discussion dealt with both monetary and fiscal roles in supporting the export industry. Microeconomic policy and the role of government in increasing and enhancing exporting firms and industries were also examined. There is much work for government institutions to do in order to improve export performance to a level comparable with Asian countries, but a shift in emphasis in certain policies and spending schemes opens up great potential for South Africa's international trade volume.

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