

## Chapter 8

### Implications for policy

*Successful strategies and policies link theory and practice (DTI, 2003).*

#### 8.1 Introduction

Sustainable long-term economic growth and stability can contribute both to solving many economic and therefore even some social problems. In an ever-increasing globalising world, the significance of trade in policy formulation is escalating. Policy-makers have to take policy imperatives together with global and domestic economic conditions (and determinants of exports) into account.

The identification of the determinants of South African exports outlined in the previous chapters will be worthless if they do not contribute to solve the economy's most crucial problem, viz. growing unemployment and the associated poverty.<sup>1</sup> Chapter 2 identified many of the determinants of exports from an historic perspective. Many issues are unique to South Africa and need to be addressed. Chapters 4, 5 and 6 analysed South Africa's trade and determinants of exports empirically. As already highlighted, there are problems with the data, particularly the trade data. Because of these limitations it is difficult to provide definitive policies, particularly macro policies. Nevertheless, this chapter highlights broad policies and guidelines that will address these issues. Chapter 7 looked at the export determinants from the enterprises perspective. Because of South Africa's history there are many issues that have to be addressed.

Policy must focus on achieving the intended outcome. Although an important contributor to economic growth, increased trade will not necessarily lead to increased employment nor reduction in poverty. Export development and promotion (and trade liberalisation) are *instruments* and not *objectives* of policy. The relevant measure of the effectiveness of trade-related policies is whether they contribute to increased exports, and in turn whether this contributes to the ultimate objectives of promoting sustainable growth with full employment.

The purpose of this chapter is therefore three-fold:

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<sup>1</sup> Although there are other economic goals that government needs to address, this chapter will focus on employment. At different stages of development, countries will have different economic priorities. These include increased tax receipts, increased foreign exchange, decentralisation of industry (geographic spread) and distribution of wealth and income. Normatively, South Africa's high unemployment demands that this should be the priority, although objectives are not necessarily mutually exclusive.

1. Identify potential export sectors that may increase labour absorption of the economy and reduce unemployment;
2. Summarise the determinants of South African exports; and
3. Identify policies that will contribute to increased exports.

## 8.2 Policy goals

South Africa's Industrial Strategy, as articulated by the Department of Trade and Industry, is focussed on increasing value addition within the South African economy, lowering costs, and shifting the economy into more knowledge-intensive activities. Government is also addressing the microeconomic constraints to growth (DTI, 2003). Although exports are prioritised, no explicit export development or trade promotion strategy can be identified.

Trade promotion is not an end in itself. The ultimate goal of increased exports is to achieve greater welfare. Even though the mercantilists hold that the purpose of increased exports is to increase the stock of precious metals and neo-mercantilists maintain that a positive trade balance increases welfare, this study adopts the neoclassical approach to welfare that rather looks at increased income or wealth that is distributed equitably. Increasing the number and quality of jobs, could contribute to these two neoclassical goals. The classical economists showed that welfare is increased when a country trades according to its comparative advantage. Policies should therefore focus on trading according to comparative advantage. Even though the discussion on the policy focus is on exports, imports are equally important when it comes to welfare maximisation.

Many of the policy recommendations are aimed at improving the efficiency of the economy and therefore apply equally to tradables (exports and imports) and non-tradables. Although countries should trade according to their comparative advantage, this is not static and can be influenced by policy (nurture). South Africa's policies should therefore focus on areas where it has comparative advantage and direct the development to areas that will contribute the most to welfare. This, however, does not imply that a pro-export bias should be created.

### 8.2.1 Unemployment in South Africa

Unemployment in South Africa remains alarmingly high. In 2003 unemployment was estimated<sup>2</sup> between 28 per cent (about 4,8 million workers) and 42 per cent (about 8 million workers),

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<sup>2</sup> Unemployment can be estimated from Stats SA's Standardised Employment Series, Population Census, October Household Surveys, Surveys of Total Employment and Earnings and the Labour Force Survey. The narrow definition of unemployment includes those who are unemployed and looking for work,

depending on the definition of unemployment used. This high unemployment rate means that the nation's resources are not fully utilised and welfare can be Since 1994, macroeconomic stability and trade liberalisation have contributed to improved economic growth performance. Despite real growth, the economy's ability to create jobs has been dismal.

Clearly, macro policy alone, although important, has not been sufficient to lay the necessary foundation for increased employment-creating economic growth. The decreasing labour absorption capacity of the economy reflects changes in the relative prices of labour and capital. The fact is that the increase in the relative price of labour exceeded that of other input prices (especially capital). The unemployment problem has now reached a level where new innovative ideas and initiatives are vital. Although increased exports alone will not solve this problem, they can make a contribution.

### **8.2.2 Targeting export sectors that accelerate labour absorption**

The debate regarding the targeting of sectors by government has not been settled. Given that South Africa has emerged from isolation, has had various market failures, and has limited resources, targeting is necessary. Since different sectors use inputs and technology differently, and face various market conditions, this study has also focussed on identifying sectoral determinants. Policies should be structured accordingly to inform government what public goods to provide to minimise input costs and maximise results.

Although there are a few caveats, the classical economists showed how a country's welfare is increased through specialisation. This implies that a country should export the products in which it has a comparative advantage and import products in which it has a comparative disadvantage. However, as discussed in Chapter 3, comparative advantage changes over time and can be created. Sectors that exhibit the characteristics that will improve welfare the most and with the appropriate endowments should be targeted.

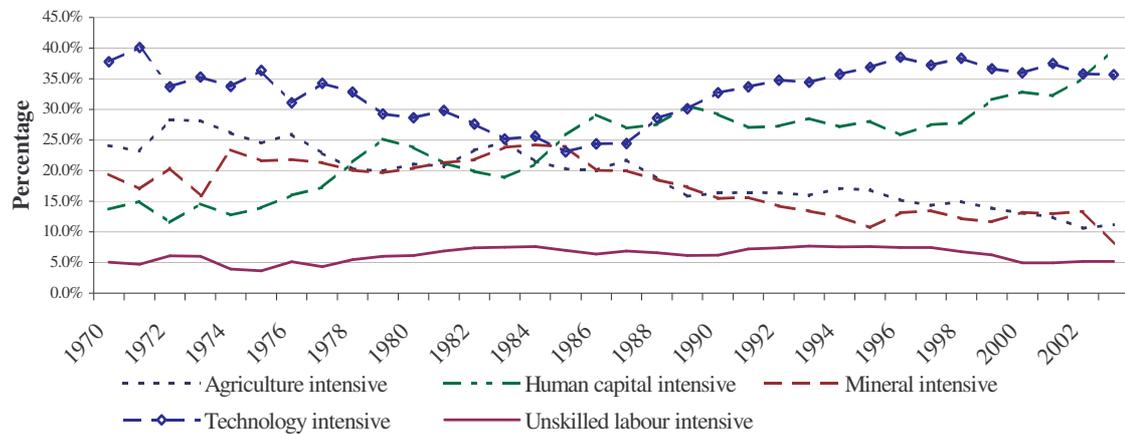
Various sectors use inputs in different quantities to achieve a given output. The combination of capital and labour as well as various inputs depends on the technology and processes used by these industries. When looking at South Africa's share distribution of manufacturing exports according to factor usage, there is a low percentage of unskilled labour intensive exports relative to the technology and human capital intensive exports.

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while the expanded definition includes these and those who are unemployed and are not looking for work but would accept work if it was offered to them.

The contribution of technology-intensive and human-capital-intensive exports has risen, while the importance of resource-intensive exports has fallen.<sup>3</sup> These are conveniently summarised in Supply and Use Tables (Stats SA, 2002). Input-Output tables derived from these can be used to estimate employment multipliers.

**Figure 1 South Africa export according to factor input**



Source: Own compilation using Quantec (2004) data and Krause (1999) classification.

Fine (1997) points out that although promoting small business is imperative, it should not be at the expense of distracting attention from policymaking for large-scale business. It is big business on whom small business will probably depend. The University of Pretoria (Ntsika, 2000) disaggregated the national input-output tables into large, medium, small and micro-enterprises. Backward and forward linkages between and within the various industrial sectors can be worked out and the best interventions determined. An analysis of what industrial sector (and what size firm) would contribute the most to job creation should be used to identify sectors in which to promote exports.

<sup>3</sup> This analysis is based on foreign categorisation and not on the South African manufacturing structure and therefore does not take intermediary inputs into account.

**Table 1 Total employment multipliers by sector and size of enterprise**

	Micro	Small	Medium	Large
Agriculture	1,174738	1,135736	1,216289	1,423245
Total mining	1,806743	1,623075	1,856527	1,594421
Food processing	2,776586	3,747975	5,448272	4,679211
Beverages & tobacco	8,934782	9,697386	5,655405	6,055123
Textiles & wearing apparel	1,728490	1,729969	1,662631	1,905078
Tanneries & leather products	1,841405	1,720575	1,836159	2,071494
Wood & furniture	1,692615	1,771902	1,884511	1,821352
Paper & pulp	2,240481	2,589465	3,307929	4,205362
Chemicals, rubber & glass	3,136188	3,278562	4,142351	5,190406
Pottery, glass & bricks	1,459941	1,392702	1,520857	2,855375
Iron & metals	28,37872	18,67223	16,91971	4,965174
Machinery	1,875452	1,986593	2,180219	3,066127
Other manufacturing	2,999353	3,660804	4,167623	9,306348

Source: Ntsika, (2000).

From Table 1 above, the best intervention in certain sectors (machinery and other manufacturing) would be to stimulate large firms (possibly MNCs), because of the employment multiplier (Ntsika, 2000). Further disaggregation, particularly of the manufacturing sector, is needed to identify specific industries more accurately. Nevertheless, the above information provides a building block, which together with other research, paints a picture that can be used to inform policy. Interventions should be made giving due consideration to South Africa's comparative advantages.

### 8.3 Determinants of South African exports

Clearly, from the descriptive, theoretical and empirical analysis, exports cannot be ascribed to only one cause. Trade is dependent on a nation's infrastructure: transportation, logistics, information technology and telecommunications. Chapter 2 shows the importance of endowments in the early development of the South African economy, where policy played an important role. Initially trade policy focused on developing the interests of the colonialists and to raise revenue. Trade was determined by endowments, especially after the discovery of minerals. Later South Africa developed an active industrialisation policy based on import substitution. This was successful in the early years but eventually had a negative impact on South African exports. Chapter 3 showed the importance of endowments in establishing a country's comparative advantage. However, endowments are giving way to other determinants of exports. The new trade theories contribute to a more comprehensive picture of trade, and an analysis of IIT using an adapted Fontagné *et al.*, (1997) methodology reveals sectoral determinants. No longer does labour, technology or capital determine trade – a variety of other factors also play a role.

The United Nation's International Trade Centre (ITC, 2003: 5) maintains that a "strategy which realistically assesses the national capacity to export, the level of demand in the international marketplace and the resources needed to consolidate the fit between the two is critical to sustained improvement in national export performance". The discussion of the critical determinants follows the typography of factors affecting exports presented in Table 1. These can be categorised as being either in-border (focusing on the supply side), out-border (market access) and border (trade facilitation) issues.

### **8.3.1 Supply side (border-in)**

Exports are realised when firms sell to foreign markets, which can only be achieved if the firm is competitive, usually in terms of price although non-price factors such as service and quality are important. Firms therefore have to have products available to export. Creating supply capacity is paramount in any export development strategy. Without products to sell, improving market access, trade facilitation and demand is to no avail. Although spare capacity can be used to satisfy export demand, this is generally short-lived until domestic demand picks up. (The vent-for-surplus is discussed below.) Supply is a function of a number of factors, including the export price. The two most important factors in determining export prices are the unit labour costs and the user cost of capital. However, there are a number of other factors including: FDI, wages and productivity, skills, general education and lifelong learning, technology, trade policy (the impact of effective rate of protection and the anti-export bias), export subsidies, vent-for-surplus, drought, shipping costs, impact of the oil price, sunk costs, SMME and management development, and R&D incentives. The policy relevance of these factors, quantified in Chapters 5 and 6, are discussed below.

The improvement of competitiveness within an economy should therefore be a key element of any national export strategy. Competitiveness results from an interaction of policies and strategies at three levels: macro, meso and micro. However, "progressive liberalization of markets and their consequent globalization mean that local firms will face more and stiffer competition, both at home and in the international market place. The competitive advantages that any firm now possesses will become smaller and less durable (ITC, 2000:1)." By dissecting the sectors, and understanding the causes of comparative advantage, policy that contributes to competitiveness can be made.

#### **(i) Export model and export prices**

Chapter 5 describes the time series techniques that were used to estimate export volumes and prices for the South African economy, manufacturing sector and various industries. Generally, as

expected, price elasticities (or relative export price elasticities) were statistically significant and negative in most sectors. The exceptions are beverages, tobacco, leather, footwear, paper, basic chemicals, other chemicals, machinery, electrical machinery, motor vehicles, transport equipment and furniture. There are therefore two policy responses needed to increase exports:

- The sectors with statistically insignificant coefficients or positive price elasticities generally produce differentiated products. Policy should focus on developing the product's attributes and acquiring economies of scale.
- Exporters producing products in the sectors with negative price elasticities need to contain costs in order to increase or retain export volumes. Export price is largely determined by the user cost of capital, unit labour cost, shortage of skilled workers, and the cost of intermediary inputs (which are affected by the effective rate of protection and the anti-export bias). These and other factors are briefly discussed below.

However as Kaplinsky *et al.*, (2001: 22) point out (see **Error! Reference source not found.**) the order winning factor for exporters has gone a full circle in the past three decades. The focus of international competitiveness has shifted from availability, to price, then to quality. Later product differentiation and the ability to shorten the time to introduce new products to the market became important determinants of competitiveness. Price has again become the main determinant - with high quality and differentiation considered minimum entry conditions. Therefore, although there are other critical factors, price remains paramount, and will be discussed first.

## **(ii) Export prices: the cost of capital**

As discussed in Chapter 2, although South Africa is a labour abundant country, in common with many resource intensive exporters, the capital content of its exports has always been high. With capital-intensive production processes being used increasingly, the user cost of capital plays an important role in South African export determinants.

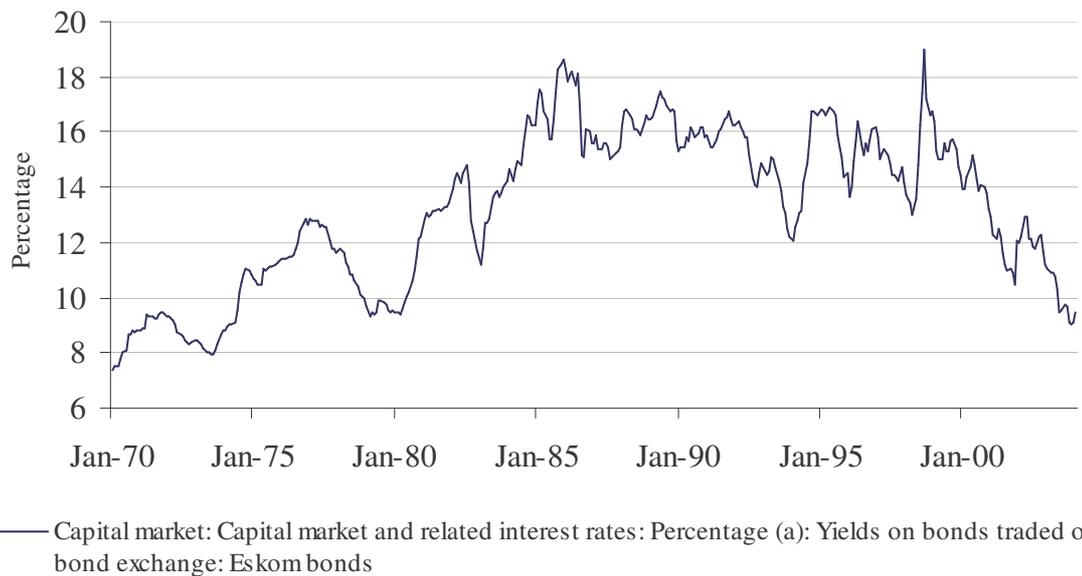
Figure 2 Manufacturing: capital-labour ratio



Source: NPI (2004)

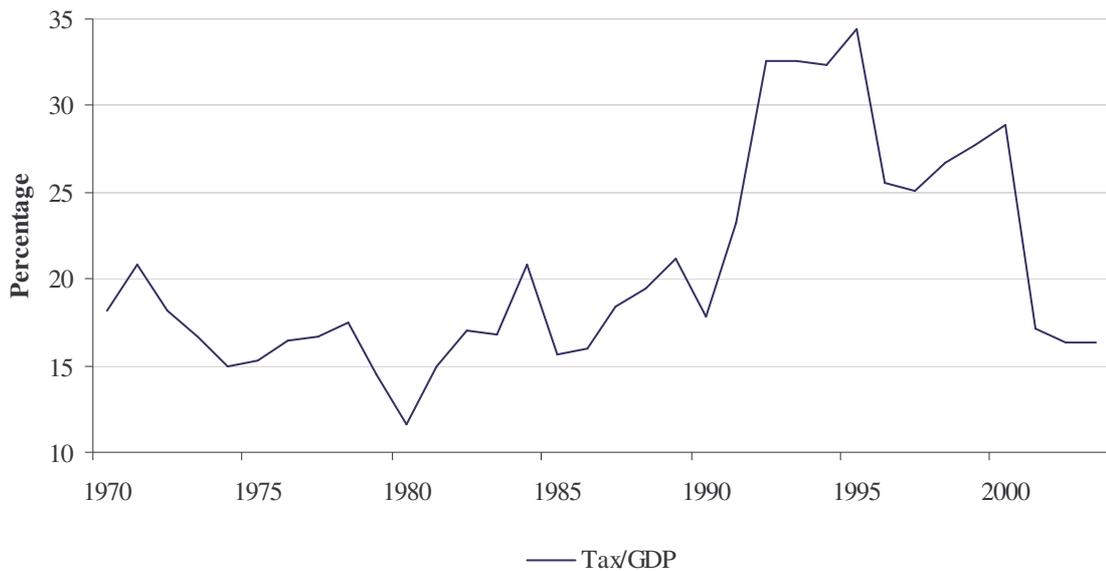
The user cost of capital (*ucc*) is affected by the interest, tax and depreciation rates and was calculated as set out in Appendix 10. These are graphically depicted below.

Figure 3 Interest rate: Yield on Eskom bonds



Source: SARB Quarterly Bulletin (S-029))

Figure 4 South African tax rate



Source: SARB Quarterly Bulletin (S-129) and (S-109))

The *ucc*-variable was lagged to make allowances for decision makers to react. Although, both short- and long-term interest rates were tested to ascertain the impact on working capital, statistically the *ucc*-variable fitted better. As exporters are also able to access foreign loans, the variable that included foreign interest rates was also tested, but again did not provide the fit given by the *ucc*-variable. The relative difference in interest rates is not a significant factor. The higher the user cost of capital, the higher the price of exports. As shown in Chapter 5, in some sectors, an increase in the South African export price leads to a decrease in exports. In sectors with differentiated products, the increase in unit costs simply erodes the firms profit's and hence its long-term incentive to export.

The supply and cost of capital is affected by government policy and actions. The supply of capital is influenced by amongst others, the size of government surpluses or deficits, personal savings, and foreign capital flows. Mechanisms for allocating capital are also influenced by policy and regulation. From a policy perspective, lower tax rates, higher depreciation allowances and lower interest rates are called for. Lower interest rates and higher depreciation allowances would lead to capital- rather than labour-intensive operations. These, in turn, would require skilled and highly skilled workers that are in short supply. Lower tax rates, which benefit labour and capital-intensive sectors equally, therefore seem to be the appropriate policy for this scenario.

**(iii) Export prices: wages and productivity**

Ricardo postulates that the relative immobility of capital contributes to differences in the nations' labour productivity that causes foreign trade. Capital therefore partially determines the commodity composition of trade. He assumes that the relative commodity prices would vary proportionately to the labour costs, with each country exporting those goods in which it possesses a comparative advantage. South Africa has experienced an impressive improvement in productivity levels in manufacturing<sup>4</sup>, with "a productivity revolution on a par with Australia in the 1980s that is leaving the US standing still" (Bruggemans, 2001:1). With the output per employee in manufacturing that has grown on average by over 3 per cent per year, since 1994 to 2001, export prices should decline. The only sectors that have experienced a significant decline in labour productivity were clothing, textile and footwear. Although Erwin (2001) ascribes the improvement in industrial relations environment as a key contributor to improved manufacturing productivity, the structural changes that resulted in increased capital-intensity (and increased unemployment) cannot be ignored.

A unit labour cost index (wage-productivity) (see Appendix 10) was calculated for each sector and its impact on export prices was estimated. Generally, higher wages and lower productivity caused export prices to increase. Productivity is influenced by a number of factors:

**Skills**

Since South Africa's productivity is low and can be partly ascribed to lack of skills, it is imperative that South Africa should upgrade the skills of its citizens and workforce. "Increasing the education of the population will be crucial for expanding higher-value-added manufactured exports, increasing per capita incomes and reducing earnings inequality in South Africa" (Ismail, 1995:11).

This is confirmed from the econometric analysis described in Chapter 5, where it was deduced that shortages of skills determine export prices. Using the shortage of skills component of capacity utilisation (see Appendix 10), the impact of availability of skills on export prices was estimated. Although in most sectors it did not prove to be significant in the long-run, in the short run, a shortage of skilled workers did lead to an increase in the export price. (Although sectors with differentiated products did not experience the same impact.) This is confirmed by the World Bank-GJMC survey of executives from 325 large firms that concluded that skills shortages were one of the most important constraints to higher growth, investment, and job creation.

General education and lifelong learning is necessary in a globalised world to ensure that workers can continuously upgrade how they produce in whatever sector they might be employed. The skills framework has been designed to upgrade the skills levels in South Africa.<sup>5</sup> Although formal education is still in the hands of the public sector, the firm decides when it comes to on-the-job training, including the level and type of investment in skill acquisition.

### **Technology**

Technology determines how efficient enterprises combine labour and capital. This in turn determines the price and how competitive the product will be on the global market. Rather than using either the Hicks-neutral or Harrod-neutral technical progress specifications, an attempt was made to partially endogenise technical progress in the model. A technology index was created to capture imported technical progress (through FDI – which is not available for individual sectors), human capital augmentation (through the inclusion of an education index), and productivity.

Research programmes are also critical. Although programmes such as the Strategic Partnership for Industrial Innovation (SPII), and the Technology and Human Resources for Industry Programme (THRIPS) are available to develop and stimulate new technology, these should be integrated into a trade development strategy. These two programmes jointly have a budget of only R250m over the 2003-2006 period, but have nevertheless been successful at assisting with the development of internationally competitive products.

Exporters are exposed to foreign technology through contact with their buyers, competition and even suppliers. As more firms emerge from isolation and are exposed to foreign competition (through importing or exporting), technology levels should accelerate. However, to become competitive, it is not enough to match technology – it should be bettered. Again, education and training policies are critical to enable firms not only to apply existing technology, but also to develop new technology.

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<sup>4</sup> These labour productivity increase during this period however can be ascribed to shedding of jobs that actually contributed to increased unemployment.

<sup>5</sup> SAQA (Act No 58 of 1995), National Education Policy Act (Act 27 of 1996), South African Schools Act (Act 101 of 1996), Higher Education Act (Act 101 of 1997), Skills Development Act (Act 97 of 1998), Further Education and Training Act, No 98 of 1998, and the Skills Development Levies (Act No 9 of 2000).

**Living conditions and distance travelled**

As indicated in Chapter 3, the conditions under which many workers live and the distances they have to travel has a negative impact on productivity. Fallon and De Silva (1993: 14) estimate that South African unskilled workers travel three times that of their counter-parts in developed countries. Densification of urban areas with better houses closer to factories and other places of work will contribute to better output per worker.

**(iv) Export prices: trade policy and the anti-export bias**

Over the past 30 years, exporters have been subjected to highly restrictive barriers, including both economic sanctions imposed by the rest of the world and high tariffs applied by the South African government. Protection against imports stimulated public enterprises, privately owned firms, and parastatals to develop import-competing productive activities. This contributed to an overvalued currency, and contributed to a bias against exports. As a result, many South African manufactured products are not internationally competitive.

Although the effective rate of protection for South Africa has already come down significantly since 1994 (Rangasamy and Harmse, 2002: 344), the gravity equation still indicates the negative impact that high effective rates have on exports. South Africa imports a significant portion of its intermediate inputs, a lowering of import tariffs enhances competitiveness by reducing input costs. Generally, both the gravity model and the trade equations (ECM) found that the effective rate of protection has a negative impact on exports. The gravity model estimates that a 1 per cent increase (effective rate of protection) will almost lead to a 1 per cent decrease in exports. It is important to note that the effective rate of protection increases due to either higher tariffs on outputs or lower tariffs on inputs. The anti-export bias described in Chapter 5 therefore provides a less ambiguous methodology. Thus, it seems as if the potential exists for further gains in liberalisation.

**(v) Exchange rates**

There has long been a debate in the literature on the ability of changes in the real exchange rate to improve the merchandise trade balance of developing countries in the medium and long run (Ghei and Pritchett, 1999). Exchange rate movements alter the relative competitive position of firms in different countries, implying either:

- A currency appreciation that will wipe out improvements in international competitiveness achieved by innovative firms on the basis of improved labour productivity; or

- A currency that depreciation can give a further boost to the international competitiveness of an innovative firm and maintain the relative competitive position of non-innovative enterprises in the short run.

However, long-term economic success and maintaining international competitiveness depend on sustained improvements in productivity. Dependency on currency depreciation may allow time to adjust to changes in the relative competitive position of foreign competitors, but often results in a process of continuing devaluations.

The impact of relative exchange rates was tested bi-laterally using the gravity model. The exchange rate coefficient is relatively small.

The exchange rate of any country is a multilateral phenomenon and the South African exchange rate is often limited by the global capital market's influence and the policy of other countries. Policy options are therefore limited in this regard and focus should therefore be on maintaining stability of the currency.

#### **(vi) Export subsidies and incentives**

To reduce the negative impact of the anti-export bias, various incentives (subsidies or bounties) have been offered by government since 1970. Some of these have been permissible in terms of GATT and the WTO, although the majority were not. This study, using the final GEIS and categories A and B subsidies, confirmed the finding of Holden and Gouws (1997) that GEIS did not contribute to export volumes.

Although GEIS was phased out in 1997, various sectoral programmes were retained. For example, the automotive local content programme changed the definition of the local content from weight to value, and critically, exports were also considered "local content." The Motor Industry Development Programme (MIDP) succeeded the local content programmes in 1995. Its new objectives were to improve the international competitiveness of firms in the industry; to enhance its growth through exporting; to improve vehicle affordability; to improve the industry's highly skewed trade balance; and to stabilise employment levels. It was not possible to obtain data from DTI and to create a variable. A dummy variable to estimate the impact was not statistically significant.

The increased exports from the motor industry are driven by FDI. The FDI is in turn driven by availability and productivity of skilled staff. Incentives – though important to a firm's

profitability – do not drive investment decisions. From various discussions with industry representatives,<sup>6</sup> it is clear that there is concern about the duration of the schemes. No sooner does government begin implementation of a scheme, than it begins to question its impact and sustainability. In an uncertain policy environment, investment decisions are either delayed or abandoned. Therefore, if government does introduce subsidies, it should guarantee the terms and amounts contractually to ensure maximum efficacy of the programme. A conducive, business friendly environment, including efficient markets and low tax rates, is preferable to artificial corrections such as subsidies.

### **(vii) Vent-for-surplus**

Vent-for-surplus refers to producers that export surplus production and usually occurs when a country experiences an economic slowdown. South Africa has traditionally been a country that has exported mineral or agricultural products. The manufacturing sector simply catered for domestic needs. Under this scenario, it would be expected that firms would export only if they had excess capacity after supplying the domestic market. In a protected environment, this would be true. To test this theory, capacity utilisation is included in the export volume equation.<sup>7</sup>

Generally, the vent-for-surplus does not play a role in determining South African exports. However, in the clothing, printing, basic chemicals, glass, non-metal, and non-ferrous products the coefficients are significant. Policy should therefore encourage enterprises to increase capacity. This can be achieved by further capital investments or better utilisation of current capital. Increasing capital investment would be achieved through lower user cost of capital (lower taxes, high depreciation allowances, lower interest rates).

Better utilisation of capital can be achieved through the introduction of second or even third shifts by enterprises. This is difficult to achieve in South Africa - workers live far from their employment and rely on public transport. Attempts have been made in the past by the IDC to stimulate additional shifts, but have not been successful (Gouws, 1996). Government, especially at a local level, will have to make provision for housing closer to factories and make transport available.

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<sup>6</sup> Including a presentation made by the CEO of BMW SA, Mr Forster, to councillors and officials of the Greater Pretoria Metropolitan Council in 1998, justifying their investment in South Africa.

<sup>7</sup> Stats SA determines capacity utilisation by means of a survey that unfortunately includes neither the agricultural, mining nor services sector. There are also problems with certain of the manufacturing sectors (series are not continuous), and it is impossible to include capacity utilisation when running regulations in these sectors.

Finally, moral suasion is important. An export culture needs to be entrenched among enterprises. This requires that investments must be made to serve the global market, and not only the local market. Producers have become more aggressive since protection has decreased. The remaining sectors should be encouraged to become more aggressive international marketers.

### **(viii) Drought**

It could be hypothesised that the weather affects the export price of sectors that are dependent on the natural elements, such as agriculture, food, beverages and tobacco. This however, is not the case. Neither in the short nor the long term is the drought dummy a factor for agriculture, beverages and tobacco, although it is for food exports. As agricultural products are sold on commodity markets with prices set in dollars, export volumes increase when the real effective exchange rate strengthens.

South Africa's trading partners generally regulate the markets for agricultural products. South African sugar exports to the USA are subject to a quota that is imported at a favourable tariff. Therefore, even in a drought, the South African Sugar Association would ensure that this lucrative market is served. Similarly, although no formal voluntary restraint agreements have been negotiated for the export of apples to the EU, South Africa has reached consensus about the tons exported (DTI, 1990: 64).

Policy should therefore be focused at liberalising international agricultural markets, particularly aimed at reducing and eliminating production subsidies.

### **(ix) Entrepreneurial development**

As shown in Chapters 2 and 7, apartheid and sanctions that followed had a negative impact on the development of entrepreneurial activity and the firms' propensity to export. The normalisation of the political environment after 1990 has had a beneficial impact; as has the economic stability due to the macro and monetary policies implemented since 1994.

The tendency to supply the safer South African market is been addressed by reducing the anti-export bias. This essentially is done providing the same returns to exporters, as they would expect in the South African market.

The export councils too have a role in identifying areas where positive externalities can be created and using moral suasion to attract new entrants into foreign markets and assisting existing exporters to grow. These aspects are discussed below.

Nevertheless, entrepreneurial activity remains low and requires intervention if exports are to continue to grow in an ever globalising environment. The Global Entrepreneurship Monitor (2003) identifies lack of skills and suitable role models as causes for this. They recommend that attention should be focussed on young people particularly young men. The Global Entrepreneurship Monitor (2003: iii) recommends: “The education system could play a powerful role in helping to bring about an increase in entrepreneurial involvement of young adults, not only through formal teaching but also through the introduction of learners to positive role models with entrepreneurial background.” This supports the recommendations made above and, besides increasing the number of businesses, it will also have a positive contribution to the export price.

From the analysis in Chapter 7, government can contribute to assisting potential exporters by ensuring the availability of appropriate information, training and counselling or even providing it. Even though information is expensive to collect, it is cheap to disseminate and has a very low marginal cost. It therefore seems appropriate that an export information dissemination strategy should be devised. As described in the entrepreneurial model in Chapter 7, appropriate training and mentoring should compliment this.

#### **(x) Brain drain**

Although a dummy (see Appendix 10) was used to test the impact of a “brain drain”, it was not significant. However the “diaspora option” represents a different approach to the brain drain and sees it not as a loss, but a potential gain to the sending country. Highly skilled expatriates are seen as a pool of potentially useful human resources for the country of origin, the challenge is to mobilise these brains. The diaspora option is based on network approaches where a network can be defined as a regular set of contacts or similar connections among individual actors or groups (Granovetter and Swedberg:1992:9). From a policy point of view, the diaspora option should be investigated and efforts made to set up connections/linkages between highly skilled expatriates and between them and South Africa.

### **8.3.2 Demand-side (border-out)**

From the demand side, trade relations and market access are important. However, a rising tide raises all ships and the role of the trading partner’s income is an important determinant of South African exports.

#### **(i) Income**

As expected, South African export trade responds positively to an increase in trading partners’ income. An interesting exception is paper products, where South Africa tends to export less, with

an increase in trading partners' income. In this sector, South African firms are global players, having made substantial investments in foreign markets. They therefore source products from their cheapest producers, as do most MNCs. In this case, distance from the market plays an important role, as the gravity model has confirmed. As South Africa is further from its markets than its rivals are, it will might to lose out.

Generally, income elasticities are rather low and this explains the loss of market share over time. The furniture and footwear sectors have high income elasticities and both these sectors have high labour to capital ratios. In addition, these industries employ low skilled labour. Competition in the footwear industry is particularly high from both Latin America and NICs. Furniture exports, on the other hand, have consistently exhibited exceptional growth rates since 1970.

The income multipliers do not provide enough information, especially in sectors where differentiated products dominate. Even though the disaggregated information provided by customs data does not necessarily give information about individual products, it can highlight areas where trade is growing. Once data have been collected across the world, comparative analysis can be undertaken. Government should make this information available to export councils and industries. Again, as was described above, government should provide incentives for research and development, design, and other measures for developing brands.

## **(ii) Trade policy and preferential market access**

South African exporters have benefited from preferential market access arrangements. The European Union-South African Free Trade Agreement has only been in operation since 2000. Sufficient data using this methodology were not available to undertake a comprehensive impact analysis. Various dummies were tested, but were not statistically significant and therefore were not reported. However, according to US trade figures, it seems as if the Africa Growth and Opportunity Act (AGOA) contributed to South African exports that have increased by more than 40 per cent to \$1,8b in 2003.

However, it is doubtful whether preferential market access stimulates long-term investment for exports. Firms already exporting tended to reap windfall profits. International investors in "footloose" sectors have set up operations in SACU, particularly Lesotho. Many of these investments are in the clothing and textile sectors. In terms of WTO agreements, the Multi Fibre Agreement (MFA) will expire and without this incentive, foreign investors simply relocate to low cost production countries. Policy should therefore focus on improving productivity and reducing costs.

The role of multi-lateral organisations is also debateable. Rose (2004: 13) used the gravity model to find the impact of the WTO but was unable to find “reliable evidence that membership increases the predictability of trade flows.” He used both bilateral and multilateral data sets that span over 175 countries and 50 years and different econometric techniques, relying extensively on estimators that include fixed effects, and control for a host of potential factors. He complained that “despite an extensive search and a number of robustness checks, I have not been able to find strong indications that the GATT/WTO makes trade flows more stable and predictable. The WTO’s goal of making trade flow more predictably for its members is laudable; it is hard to imagine many benefits of trade volatility. It is far from clear that the WTO has achieved this objective.” Nevertheless, in a rules-based environment, it is important that no new rules are introduced or old rules remain that unfairly inhibit South African trade.

### **(iii) Impact of sanctions**

Sanctions dummies were constructed to test for various years. It would appear that sanctions had an effect during the entire 1980s, and ended in 1991. Although it is generally believed that sanctions gripped the economy after 1985, various institutions and consumer groups had already begun to boycott South African products from the mid-1970s, yet the effect was only felt from 1980. Sanctions affected not only the demand of products, but also the supply. South African exporters were reluctant to sink costs into market and product development, or to make investments to supply international markets. For the quarterly data from 1988, sanctions did not have an impact. It would seem that by 1988, exporters had discounted the impact of sanctions and had secured alternative markets. The South African export data from 1986 to 1990 are unreliable. Even when using mirrored data, there are discrepancies that cannot be explained. Although sanctions did not affect export volumes significantly they did have a negative impact on export prices, except in the glass, non-ferrous metal and motor vehicle sectors. Multinational corporations determine the price of motor vehicle exports. As incentives were based on total export value, it was in their interest for these to be as high as possible, and then later to transfer the profit as dividends.

### **(iv) Unrealised export demand**

There are various reasons why a country will not realise its export potential. This can occur even if all the supply-side measures are in place. The gravity model, described in Chapter 6 provides useful information where there is unrealised potential. Markets that exhibit unrealised potential can then be further analysed to determine possible causes and remedial action that can be take. Tariff or non-tariff barriers can be addressed through either bilateral or multilateral negotiations. Problems with market demand are more difficult to identify.

### 8.3.3 Border issues and trade facilitation

Since the democratisation of South Africa in 1994 and the creation of the WTO in 1995, market access, although important, is not as important as focusing on supply-side issues.

South Africa is some distance from its trading partners. Transport costs influence the willingness to supply for exports in two ways. First, imported inputs are negatively affected when transport costs go up and, second, exporters who realise that their products are only marginally competitive will not even bother to attempt to penetrate foreign markets.

Theory predicts that the trading partner with the greater price elasticity would absorb the greater share of the transport costs. Therefore, should South Africa's elasticities be higher, any small change in the price would negatively impact the firm's profit and influence its decision to supply the foreign market.

Internal transport is generally charged in local currency, while the foreign leg is charged in US dollars. Therefore, any depreciation in the South African currency would have a negative impact on the export supply. Local transport costs are dependent on many external factors, including the price of fuel which in turn is influenced by the exchange rate.<sup>8</sup>

It appears from both the export model and the qualitative analysis, that South African exporters take shipping costs as a given, even though shipping and related charges can form a substantial part of the CIF or landed price of the product. Shipping costs do not play an important role in the decision to export. Wood and wood products was the only sector where shipping costs proved to be statistically significant. Surprisingly exports from this sector are positively related to freight rates. The Timber Product Exporter's Association managed to negotiate rates with the conference lines that are more favourable for their members. In other words, relatively lower prices may spur various sectors to export. Unfortunately, these data are not available and therefore it is not possible to run regressions for sector-specific rates. For this reason, from a policy point of view, it might be prudent for government to intervene when freight rates are high and export councils should negotiate lower rates for their members.

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<sup>8</sup> The shipping costs were kindly provided by Mihalis Chasomeris (2003) from the University of Natal. Although this series captures only northbound freight, to Europe, it was used as a proxy for all shipping costs.

## **8.4 Export development and promotion strategy for South Africa**

Besides sector specific strategies drafted by Export Councils and the Integrated Manufacturing Strategy<sup>9</sup> very little official documentation is available about South African export development and promotion strategy. Based on the identification of the critical determinants of South African exports, this section will identify ingredients of a successful export strategy. These components include export promotion, export development, and trade facilitation. Export promotion comprises an integrated set of technical and financial services to enhance the global competitiveness of enterprises and thus facilitate their entry and increasing participation in international trade and typically include outward selling missions and inward buying missions; participation in foreign trade fairs; and devising a branding strategy to support entry into a foreign market. Typical trade development activities include developing and adapting products for foreign markets; assisting enterprises to exploit opportunities that exist in global value chains; and ensuring training in different aspects of the international trade process.

Once formal trade barriers come down, other issues become more important. For example, companies need to be able to acquire information on other countries' importing and exporting regulations and how customs procedures are handled. Cutting unnecessary bureaucratic procedures at the point where goods enter a country and providing easier access to this kind of information are two ways of "facilitating" trade. Trade facilitation is therefore the simplification and standardisation of procedures and associated information flows required to move goods internationally from seller to buyer and to pass payment in the other direction. This definition applies to a wide range of activities such as import and export procedures (e.g. customs or licensing procedures); transport formalities; and payments, insurance, and other financial requirements. Typical trade facilitation activities include access to trade finance; support at the enterprise level including access to business information, use of information technology, adaptation/development of new products, advice on standards, packaging, quality control, marketing and distribution channels; commercial representation; functioning of trade promotion organisations; improved international purchasing and supply management; promotion of trade in services.

### **8.4.1 Macro-economic policies**

A business environment conducive to supporting the efforts of entrepreneurs is needed if exporters are to succeed in the highly competitive international market. From the evidence

presented in the previous chapters, the neoclassical school propose that efficient resource allocation based on comparative advantage, exploitation of economies of scale, and exposure to international competition so as to induce technological change, contribute to trade. However, the policies essential for this to occur are stability, realistic valuation of exchange rates, free access by exporters to world markets, and absence of incentives biased against exports. In addition, relatively free labour and capital markets were also important.

Government's role therefore is to provide a stable macroeconomic environment (including the real effective exchange rate), facilitating access to information on export markets, investing in and maintaining infrastructure, and providing education and training for the work force. This means maintaining a consistent monetary policy, liberalising the exchange control, stimulating investment, freeing trade, investing in infrastructure and improving flexibility in labour markets.

Obviously the necessary infrastructure must also be in place. Although more and more trade is now in the form of services or electronic products, the vast majority of exports remain physical goods. Physical goods need an efficient transport infrastructure to move the goods to the foreign market. These include ports, airports and roads. In addition, the importer needs to pay for the goods. Dealing across borders with strangers and a myriad of legal systems is risky and difficult. Fortunately, financial systems with well-established global networks facilitate trade.

FDI and domestic investment is a barometer of these policies. South Africa is like any other developing country in the sense that foreign investors do experience difficulties during the investment process. The following are the major areas of concern that have been reported by foreign investors. A general burden of bureaucracy at different levels of government (CTMM, 2002:1) with respect to setting up business and include issues such as:

- Lack of information with respect to the requirements to set up a plant;
- Long lead times for utilities such as electricity and telephones;
- Inadequate bandwidth;
- Difficulties in securing work permits for managers and professionals, as well as long waiting periods for such documentation; and
- Costs and "hassle factor" of compliance with labour legislation.

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<sup>9</sup> The IMS builds on various government policies that can be traced back to the Freedom Charter (1955), Ready to Govern (1992), the Reconstruction and Development Programme (RDP) (1994) and the Growth, Employment and Redistribution (GEAR) (1996).

Notwithstanding these South Africa has all the “necessary but not sufficient” conditions for trade to take place. It can be argued that the efficiency and effectiveness may be improved, but nevertheless the basic infrastructure and institutions are present.

#### **8.4.2 Export promotion and development**

Firms, not governments export. This section focuses on enterprise level policies that need to be implemented. The development and promotion of South Africa’s exports must be undertaken with due cognisance of its comparative advantages. Sectors that face comparative disadvantages should be allowed to disappear in the face of foreign competition. Only enterprises in sectors that exhibit comparative advantages or have potential comparative advantages and can contribute to other welfare enhancing goals, should be supported. Even though it would appear as though a pro-export bias development policy is being proposed, this is not the case. Government’s resources should be focussed at exploiting South Africa’s comparative advantages. Resources should only be allocated to providing services that are clearly public goods, (for example where the marginal cost is low) or market failures (due to apartheid). With the necessary macro policies in place, South African export promotion and development policy can only focus on four goals:

- i. To retain market share in existing markets;
- ii. To expand market share of existing markets;
- iii. To enter new markets with existing products; and
- iv. To develop new products.

Each of these four goals contributes to export objects, but requires different interventions and actions.

#### **8.4.3 Retaining market share**

For exporters to retain market share, policy should focus on ensuring that the infrastructure is efficient (that the banking system is sound, no unnecessary logistic details at ports), that price remains competitive (containing unit labour costs and unit price of capital) and exchange rates remain stable. Since there is no emphasis on gaining share, and exporters already have established relationships, firms must simply retain the status quo. If they sell to hi-tech markets or markets that stress innovation, enterprises will have to ensure their products develop at least as fast as their competition. Therefore grants or tax incentives should be used to stimulate research and development. From the firm’s perspective however, emphasis should be on developing the relationship and government can contribute through the Export Marketing and Investment Assistance (EMIA) scheme.

In line with comparative advantage, assistance needs to be focussed on achieving government's policy objectives. Therefore sectors with high employment multipliers should be targeted and given preferential assistance.

**(i) Retention of exporters**

To retain market share, it is important to ensure that exporters do not exit global markets. Incentives are in place to attract new exporters, but not enough is being done to retain existing exporters.

Exporting is undertaken by enterprises often run by profit-seeking, risk-taking entrepreneurs. Firm behaviour is critical to understanding the determinants involved. Entry and exit of firms, how they work together, and the impact of macro factors are important. Accurately determining the entry and exit pattern of exporters in South Africa is difficult. Approximately 5 000 firms export each year, but there is a high attrition rate. In 1990, the DTI began a registration campaign of exporters for GEIS and approximately 5 000 firms registered in the first year. By 1993, the exporters' database had grown to over 20 000. The DTI no longer maintains this database, making it difficult to ascertain current dynamics. However, it is estimated that 1 000-2 000 enterprises export regularly, with 3 000 new exporters replacing 3000 exiting exporters, maintaining a constant export population of 5 000.<sup>10</sup> Roberts and Tybout (1996) hold that the set of producers that export is constantly changing and therefore the net entry into the export market is important. The turnover has implications for aggregate exports, as firms entering the export market are likely to export on a larger scale than firms on the way out and thus increase aggregate export volumes.

Sunk costs are high when either entering exports or entering new markets. The DTI provides financial assistance through EMIA and training through Ntsika's EU-sponsored Trade and Industry Development Programme (TIDP) to enterprises entering new markets. No strategy could be found to retain or grow existing exporters besides EMIA. Retaining and growing existing exporters makes sense because the initial sunk costs or fixed costs can be amortised over time and exports can be increased.

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<sup>10</sup> These estimations are based on personal experience at DTI from 1982 to 1996 and various discussions with other trade promotion officials.

**(ii) SMME and management development**

For historic reasons as discussed in Chapter 2, SMMEs in South Africa are generally underdeveloped. The promotion of their development is therefore a central component of the Government's strategy for employment creation, income generation and black empowerment. The development of small and medium businesses and the promotion of entrepreneurial skills contribute to improved skills and productivity. A broad range of institutions and measures to support the development of SMMEs exists including:

- Low interest loans;
- Loan guarantees;
- Pre-shipment export finance guarantee;
- Financial support (for advice on, and training in technology and marketing);
- Equity investment for businesses with a high average expected return on investment, but limited security;
- Loans to businesses with an acceptable capital structure and adequate collateral, but limited access to capital markets;
- Equity participation and loans to businesses which do not have ready access to capital markets, an acceptable capital structure or sufficient collateral; and
- Equity participation and loans to businesses wishing to purchase business premises.

Export activities of SME's (excluding micro-enterprises) seem to be growing. The development of an export strategy to incorporate SMMEs should be comprehensive. Following information gleaned from qualitative analysis techniques (focus groups), SMMEs need to be assisted to become "export ready" as set out in Chapter 6. Excluding any components from an SMME export development strategy will decrease the efficacy of the other components.

Nevertheless, as discussed above, prioritisation within target sectors is important. SMMEs within target sectors should be given the government's main concern. Generic as well as sector-specific programmes need to be developed and implemented.

**8.4.4 Expand market share**

Expanding market share of existing markets is probably the most efficient strategy to optimise use of resources. However, new products and new markets are also successful since the firm already understands the export process; sunk costs are considerably less than developing a new exporter. Exporting is also a function of a company's growth. A company reaches a stage where it actually

makes more sense to export than to expand domestic operations. Cateora and Graham (1999: 33) identify the traditional phases of company growth:

Stage 1: Establish and build up local (usually regional) market;

Stage 2: Expand nationally in domestic market;

Stage 3: Expand domestic market share by selling more of same product/product range;

Stage 4: Expand domestic market share by diversifying product range;

Stage 5: Move into exports, directly, indirectly, through franchise or license, or joint venture, or wholly owned manufacturing subsidiary abroad;

Stage 6: Become an international marketing company; and

Stage 7: Become a global company.

Each stage is going to require different levels and types of intervention. Generally, exporters need to “cut their teeth” in the domestic market. Policy should therefore be targeted at successful domestic enterprises. With a few exceptions, most exporters have progressed through these phases. A number of “readiness” tools have been developed and should be used to identify exporters with high potential. These can also be used as pedagogical tools and also to identify areas of intervention to increase the number of successful exporters.

Although the “readiness” tools identify the micro aspects of successful exporting, many ignore the importance of an export “champion” in the enterprise. Van Zyl (1990) confirmed that South African exporters respond similarly to their counterparts internationally and found that exporters perceived the main influence to be an individual (usually the MD or CEO or marketing director) who has a personal desire to see the enterprise operating globally. All real and perceived barriers can be overcome by the drive or ego of the champion. Policies required to increase new exporters therefore should include:

- Creating an export culture (moral suasion); and
- Export activation.

Most of South African export promotional attention has been focused on attracting new exporters. New exporters are necessary for two main reasons:

- They tend to be innovators and therefore more likely to have products that will suit the new global markets; and

- From a socio-political perspective, SMMEs and black-owned business have been excluded from business and must be brought into main stream business.

Retention of exporters is important since various investments have been made. It is easier to promote the exports of an enterprise that is already export ready.

**(i) From raw material supplier to value-added supplier**

Following the discussion on new trade theory and intra-industry trade, it is important to increase value-added exports. South Africa should continue to reduce its reliance on primary produce exports as the main source of foreign exchange and shift to the export of manufactures. Initiatives to boost exports of beneficiated raw materials have also been identified as being crucial to launching the economy onto a higher growth path. This is important, given the country's perceived advantage in carbon steel, stainless steel, aluminium and timber products. The passing of these advantages, in terms of price, service and quality would be beneficial to downstream producers.

**(ii) Role of R&D**

As already indicated innovative products are important to increase exports and therefore need to be developed. This can only be done through product development and research. Incentives need to be provided, either through grants or tax rebates.

**(iii) Development of meso-level interventions**

Classical economists pointed out the advantages of identifying products and specialising in their manufacture. Therefore to optimise the use of scarce resources, policies should focus on strengthening comparative advantage and focus on these sectors.

Nations that specialise tend to improve their welfare even though there is not perfect mobility of either labour or capital as assumed. From a policy perspective, sectors and industries that can contribute the most to general welfare should be targeted and supported to maximise the benefit of comparative advantage. Strategies should be put in place to facilitate the movement of especially labour and human capital to sectors with comparative advantage.

While generally not leading directly to new export capacity, national networks lead to synergies. Clusters provide not only an incubator for competitiveness, but also a platform for business alliances, helping enterprises to specialise, attract suppliers and buyers, spread ideas and the capacity to innovate. The mere existence of a concentration of enterprises operating in the same

sector is no guarantee that competitiveness-enhancement partnerships will evolve. Policy and interventions should be put in place to ensure these external economies emerge. South Africa has established a system of export councils to develop clusters and networks to capture any synergies that can contribute to the sector of industries competitiveness. The export councils facilitate the development of domestic export orientated firms and sectors by tackling the global market place as a collective force. Lourens (2002) claims that of more than 90 incentive and assistance schemes offered to private sector by government's trade and industry department, the export council concept has emerged as one of the top programmes in terms of its value to industry. The export councils are managed by Trade and Investment South Africa's (part of the DTI) export council secretariat.

Although the export councils focus on incentives offered by government, councils have been successful in reducing the costs of doing international business. The department provides funding for industry sectors to set up export councils and provides further financing for specific initiatives by the councils. It also assists by involving members of the councils in exhibitions, trade and investment missions overseas. From a policy perspective, export councils can play a useful role.

#### **(iv) Development of micro-level interventions**

Before any export promotion strategy can be determined, it is important to understand why manufacturers export. Obviously, the main reason why the entrepreneur is in business is to make a profit. If it is easier to make a profit in the local markets, the entrepreneur will be less likely to venture into more risky and more complicated foreign markets. All things being the same, it is clear that some firms have grasped foreign market opportunities and exploited them while firms facing similar factor endowments, infrastructure, labour, capital, and interest rates, have not ventured into new territories.

### **8.5 Other policy measures**

#### **(i) Moral suasion**

Governments play an important role in developing exports by encouraging an international outlook. Most governments do this through the provision and dissemination of foreign markets and technical information.

#### **(ii) Government procurement**

Government affects the demand conditions of a nation and through its spending can improve the quality of domestic demand. Procurement can either enhance or weaken domestic industries.

Domestic firms may be given preference over foreign firms which will limit trade. Porter (1990: 645) highlights the following steps government can take in improving long-term competitive advantage: early demand, demanding and sophisticated buyers, procurement reflecting international needs, procurement process that facilitates innovation, and competition.

## 8.6 Policy coordination

The international economic environment has changed during the past two decades and South Africa's trade has particularly been influenced by: economies that have become more interdependent as world trade has grown; increasing liberalisation of trade (focused mainly on tariffs but increasingly on non-tariff barriers); the imposition and relaxation of sanctions and other punitive economic restrictions, the importance and extent of the rules-based international trading system with greater regulation of international trade in especially goods but also in services and intellectual property rights; the composition of trade away from agriculture and mining to manufactured products; growth in the number and importance of regional groupings; and the changing nature of competition (there is less emphasis on price); comparative advantages which are founded on the factor endowment of a given national economy are losing their importance while knowledge- and technology-based advantages become decisive; and technological networks like clusters and industrial districts are of increasing importance

South African policy makers have to take these conditions into account. They have to ensure that macro-, meso-, and micro-policies work together to achieve maximum welfare and the creation of employment opportunities. Competitiveness is not simply resulting from a stable macroeconomic framework or of entrepreneurship on the micro-level. It is rather the result of complex and dynamic interaction between various agents including government, enterprises and intermediate institutions. This is best achieved by a thorough understanding of the determinants of South African exports. Macro-policy needs to ensure that an environment conducive for trade and increased exports need to be maintained or created. Extending the format used in Table 1, Table 2 shows policy interventions.

**Table 2 Macro-level policy coordination**

		Policy goal	Policy target	Instruments
Border-in	Macro	Creating export supply capacity	Reduce export price	Interest rate
				Cost of capital
				Income tax
				Depreciation
				Cost of labour
Skills				
				South African labour market
				Technology

				(Policies to recruit skilled employees internationally; General education and training programmes: Improvement of management skills; and Entrepreneurial skills.)
			Trade policy	Reduce the anti-export bias Incentives/subsidies
		Increase investment (FDI and local)	Stable environment	Monetary policy
				Fiscal policy
				Reduce crime and corruption
		Reduce labour costs		Skills
				South African labour market
				Technology
		Reduce anti-export bias		
		Vent-for-surplus	Increase production using existing capital	Tax allowance for second and third shifts

Source: own compilation.

Similarly, Table 3 summarises the meso-policy imperatives that need to be undertaken. The meso-level between the macro- and the micro-level, is essential for the development of sustainable competitiveness. Macroeconomic reforms and modernisations on the micro-level are insufficient to improve the competitiveness. Meso-policies tend to be selective and aim at strengthening of the strong. Meso-policies build up a dynamic industrial nucleuses and efficient locations. These have a stimulating spillover effects on other, less developed areas. Policies on the meso-level generally concentrate on industrial clusters with potentials of development. Although meso-policy focuses on the design of the specific environment of the enterprises, the physical infrastructure (transport, communication and power distribution systems) and other sector policies (especially of the education, research and technology policy) are oriented towards competitiveness.

**Table 3 Meso-level policy coordination**

		Policy goal	Policy target		Instruments
Border-in	Meso	Increase labour absorption export sectors	Sector development and targeting		Sector specific skills
		Diversify exports	Sector development and targeting	Export promotion	Sector specific information Training Business counselling Networking (Including focussed sectoral specific inward and outward bound trade missions and exhibitions)
		Diversify markets	Sector development and targeting	Export promotion	Market specific information Training Business counselling Networking (Including focussed sectoral specific inward and outward bound trade missions and exhibitions)

Source: own compilation.

Table 4 deals with the instruments that can be used to develop enterprises as exporters.

**Table 4 Micro-level policy coordination**

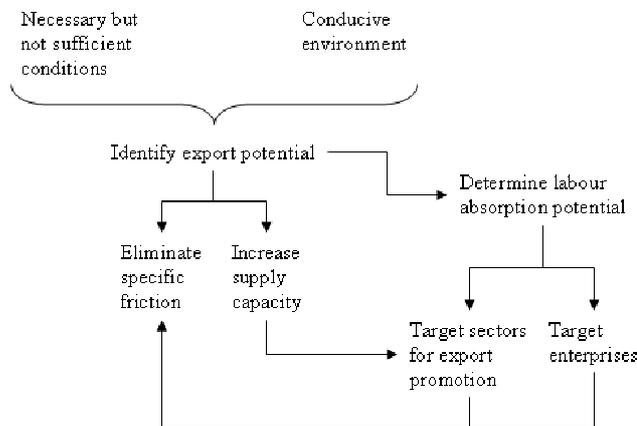
		Policy goal	Policy target	Instruments
Border-in	Micro	Increase export base	SMMEs	SMME development
Business management skills Export readiness assessment Information Training Business counselling Networking (Including focussed sectoral specific inward and outward bound trade missions and exhibitions)				

Source: own compilation.

Assuming that an environment conducive to export growth has been created, policies focused at expanding exports into the areas that will contribute the most to policy imperatives needs to be applied. Again using the format used in Table 1, Figure ?? shows the process that can be used. The gravity model discussed in Chapter 6 provides the basis for identifying potential trade. Since the gravity model is based on bilateral trade, this process is research intensive. Firstly, the potential trade and actual trade for each sector and for each trading partner needs to be determined.

Although many of the “frictions” are common to all sectors, their impact on export potential is easier to describe at sectoral- or meso-level. Figure 5 below classifies potential friction. Further

**Figure 5 Policy coordination at a macro- and meso-level**



Source: Own compilation.

research is necessary to identify and quantify the impact of each variable. The export council’s can play a valuable role in achieving this. Since it is the enterprise that actually exports, attention at the micro level is also necessary. Information, training, mentoring and counselling, and networking were found to be necessary by the enterprise. Although there are certain generic needs, specific needs by sectors will contribute to illuminating barriers to exporting. Firms can be distinguished by size, sector, region or the firm’s experience as an exporter. Interventions and

policies should therefore take cognizance of these firm characteristics. Once sectors have been identified by the gravity model, sectoral export programmes should be drafted. Each sector and sub-sector should have different priority interventions. The number and firm-size composition of the sector will give an indication of the labour absorption potential. Priority should be given to sectors with the greatest export and labour absorbing potential. The origin of exports should be identified by province or even city. Regional weaknesses and characteristics may be strengthened through improved infrastructure and other interventions.

### **8.6.1 Interaction between the three levels**

A successful macro-policy is the indispensable prerequisite for measures on the micro- and the meso-level. Conversely, without a stable macro-economic framework the formulation of aims on the other levels is problematic, but is not sufficient for enduring development of competitiveness.

### **8.6.2 Interaction between the three spheres of government**

Within any country there are various spheres or tiers of the executive branch of government. In South Africa these include central, provincial and local government. Local government is responsible for the supply of key inputs such as electricity and water. This sphere also provides critical infrastructure. It is therefore important that government coordinate key economic goals in general and export goals in particular.

## **8.7 Conclusion**

The determinants of trade are complicated. Interventions in any sector of the economy will have spillover effects in another. Policy must therefore be aimed at maximising its desired goal with minimum side-effects. Firstly, government must ensure that all the necessary conditions and macro economic policies are in place. With the goal of employment creation as the primary function of trade policy, the second step would be to identify sectors that will contribute most to employment if exports were increased. The determinants of trade discussed above identify what the causes of the comparative advantage are.

Prices, however, remain important and policies should focus on reducing production costs. From a policy perspective the effective rate of protection and anti-export bias should be reduced, particularly in those industries with an anti-export bias, export potential and the greatest employment opportunities. An overvalued currency measured by the real effective exchange rate contributes particularly to the manufacturing industry not being able to compete. A volatile currency adds risk and uncertainty, and also adds to the cost of doing business internationally. Increases in productivity generally lead to a lowering of export prices. Policies to increase

productivity should be introduced. Labour needs to be upgraded and equipped with the necessary skills. Even though there is high unemployment, prices have increased because of a shortage of skilled- and highly-skilled workers. General education and lifelong learning is imperative. The user cost of capital also contributes to the export price. Although monetary policy is focused on inflation targeting, relatively high interest rates contribute to the high user cost of capital. From a fiscal point of view, the high tax rate and long depreciation allowance also increase the export price.

Past efforts using export subsidies (or incentives) to stimulate manufactured exports have been unsuccessful. They are also administratively clumsy and lead to rent-seeking and even corruption. (Corruption or even perceived corruption adds to the cost of doing business and should be dealt with). Direct export subsidies are now prohibited by the WTO and cannot legally be given to South African exporters.

Finally, focus needs to be put on the enterprise. Export Council's should identify what the enterprises objective is (retain market share, grow existing markets, or acquire new markets) before recommending or providing interventions.