



Supporting South African exporters

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RECOMMENDATIONS

- Reduce costs associated with transport through investment and increased competition. This includes costs associated with loading and unloading at ports, time and costs in clearing borders, and actual costs of transport.
- Create policies that increase firm level productivity and allow more firms to cross the productivity threshold that separates exporters and non-exporters. This can come from changing the types of inputs into the production process, offshoring some of the production processes to more-productive countries, or by competitive pressures arising from domestic competitors or imports.
- Increase the pool of firms that are the correct size to export. This means encouraging firm growth and the entry of new firms and requires certainty in policy, property rights guarantees and a general pro-business environment.
- Create export processing zones (EPZs) to provide an environment where policy experiments can be trialled. Examples of possible policies that can be experimented with include labour costs and bargaining council coverage (low-skilled/low education garment manufacturing can be possible if unconstrained by bargaining councils); labour regulations (relax constraints in firing and relax the Commission for Conciliation, Mediation and Arbitration administrative burden); company tax (a simpler 'flat' tax may have a bigger impact than complicated tax breaks); and port costs (an EPZ port could encourage competition and reduce port fees).

EXECUTIVE SUMMARY

Aggregate exports are the result of the number of firms participating in the export market and the amount exported by each firm. Designing policies to increase total exports requires an understanding of the drivers of these two distinct processes. South African exporters are bigger, more capital-intensive and have higher levels of labour productivity than non-exporters. The gap in total factor productivity between exporters and non-exporters seems to depend on the export destination. Theoretical models and empirical research indicate that productivity levels, firm size and transport costs are important for export participation. To increase the number of South African firms participating in the export market, policies need to encourage the growth of existing firms, the entry of new firms and improve firm level productivity. Transport costs need to fall, as these make firms uncompetitive in the international market. Export processing zones can also provide an opportunity to experiment with policies before they are implemented countrywide.

INTRODUCTION

There are a number of reasons why increasing the amount South Africa exports is a desirable policy goal. One of the most important is that exporting breaks the constraints of the domestic market. Companies are no longer limited by domestic demand in terms of both the size of the market and the types of products they produce. The increase in turnover that comes from participating in the export market allows firms to reduce average costs (particularly if they have incurred large fixed costs, for example in buying machinery or investing in research and development), to expand and

employ more people, and to be more profitable. Furthermore, exporting allows for specialisation and increases in productivity through interactions with other more-productive international firms.² This can all lead to increased employment and higher average incomes.

Policy debates do not often give thought to what increasing exports actually means. Aggregate total exports is the sum of the exports of individual firms. There are two components that make up aggregate exports: whether a firm participates in the export market; and, should it participate, how much a firm exports. The determinants of these may be different and it is important to reflect on what policy should aim to do: increase the number of exporters; or get existing exporters to export more; or both. To determine which of these aims is most desirable, and how policy would achieve this, it is important to know what exports currently look like at the firm level, and which factors are associated with its export participation and the amount exported.

Increasing the number of exporters and the amount a firm exports are both desirable outcomes. It thus makes sense to focus on increasing the pool of exporting firms, through encouraging the establishment of new firms and encouraging existing firms to enter the export market, and on increasing the amount exported by encouraging entry into new markets. Since export participation is significantly related to firm level productivity and to the transport costs that firms face, policies that increase productivity and reduce transport costs are important.

SOME STYLISTED FACTS ABOUT EXPORTERS

A number of stylised facts related to exports at the firm level have emerged owing to increasing availability of such data across a number of countries. Most is known about US firms – exporters are larger, are more productive (in terms of both labour productivity and total factor productivity or TFP), pay more, and are more skill-intensive and capital-intensive than non-exporters.³ Only 4% of all US firms and only 18% of manufacturing firms export. Aggregate exports

are concentrated; the top 10% of exporting firms in the US accounted for 96% of total US exports. The average exporting firm exports very little, concentrated in a limited number of products, to a small number of destinations.

The picture for South Africa, despite limited firm level data, seems similar. Exporters are bigger, more capital-intensive, have higher levels of labour productivity and, in addition, are more likely to be foreign owned.⁴ The gap in TFP between exporters and non-exporters seems to differ depending on the export destination. Southern African Development Community (SADC) exporters have similar levels of TFP to non-exporters, and TFP levels for firms exporting outside SADC are higher than non-exporting firms.⁵ The typical exporting firm exports less than 10% of its output. Both rates of export participation and the amount exported are below comparator countries such as Malaysia and China.⁶

One possible explanation for the similarities between South African and US exporters may lie in the similarities between the economies. Both have relatively large domestic markets, relatively small neighbouring markets and both are geographically far from the markets of developed countries. Other possible explanations are that the markets for the types of products South African firms export internationally may be limited, or that exporting to these markets is only occasional (ie international distributors or firms approach South African firms for once-off deliveries), or that firms use these markets merely as a ‘vent-for-surplus’.

IMPORTANT FACTORS FOR EXPORTING

Theoretical models and empirical observation suggest a number of important factors to consider for exporting at the firm level. The first is that there are sunk costs to entry into the export market. These are non-recoverable costs that are incurred regardless of whether a firm then participates in the export market. Examples of these include travelling to the destination country to establish the suitability of the market,

creating distributional networks and advertising the product, and reaching some accreditation level. These costs act as a barrier to entry and can cause firms to continue participating in the export market, even if it is currently not profitable, to avoid incurring these costs again should they have to re-enter. There may also be additional sunk costs associated with entry into different export markets.

The second factor is transport costs. These are usually a per unit cost and although there may be some economies of scale in, for example, filling up a container, these transport costs are added to the cost of production of each item. High transport costs therefore make products less competitive in regional and international markets. The gap between South African rail costs and best practice costs is minimal. However, South African road transport costs are 12% more expensive than international best practice costs.⁷ The large market share of road transportation compared with rail has a significant impact on overall freight costs. In addition, South African port charges are considerably higher than the international norm.⁸ The 21% price gap between South African container shipping and international best practice is due to local port policy. South African firms that export through 'traditional' means (domestic ground transport and then by sea) are disadvantaged compared with their international competitors in at least three ways. Firstly, they are more likely to use road rather than rail. Per kilometre costs for road transport are generally more expensive than those for rail, but firms choose road transport rather for its reliability and flexibility, and South African road costs are more expensive than international best practice. Secondly, port costs are relatively high. Thirdly, given South Africa's geographical position, its goods have to travel further. Even if per kilometre costs were comparable, overall transport costs would be generally higher than those of competitors. This means that South African firms have to produce at significantly lower costs with higher productivity to be competitive in international markets. In addition, the incentive is to export high-value products where per unit transport costs are a relatively low proportion of

the final price. These types of products require relatively skilled (and higher paid) workers,⁹ who are scarce in South Africa.

The third important factor to consider for exporting is foreign market characteristics. These include demand factors and competition, which have implications for the type of product produced, the technology chosen to make the product and, ultimately, firm level and labour productivity (including labour demand).

WHAT THIS MEANS FOR EXPORTING

In a practical sense these factors suggest that two things are important for encouraging exporting. The first is that firm level productivity is important. This is required as firms have to overcome transport costs and still be able to price competitively if they are price takers on the world market.

The second is that the size of the firm (in terms of employment) is strongly associated with export participation. Scale is needed to be able to overcome the sunk costs associated with export participation. More employment allows for specialisation, including in administrative roles. Exporting can be an administratively intensive activity. It requires dedicated people within the company to liaise with foreign clients, track shipments and engage in other export-specific tasks. Among South African firms, the size threshold for entry into the export market seems to be between 50 and 100 employees.¹⁰ Firms smaller than this are unlikely to become successful exporters. However, in this size range of 50 to 100 employees, other regulations such as those associated with employment equity and procurement, which often have significant associated costs, also start to become applicable.

There are three direct implications for policy arising out of this size-exporting relationship. Firstly, policies and programmes that are designed to help firms with less than 50 employees enter the export market are ineffectual, since these firms do not have the scale to become successful exporters. Secondly, creating more exporters requires creating a larger pool of

potential exporters of the requisite size. This means supporting the entry of new firms but also encouraging the growth of existing smaller firms. Encouraging new investment (particularly foreign investment) requires competitive returns to this investment and guarantees of the security of this investment. These competitive returns could result from, for example, particular market characteristics (access to the Southern African region), competitive labour costs, or tax breaks. Encouraging existing firms to grow requires addressing issues that firms cite as constraints, such as policy uncertainty, labour regulations, infrastructure investment and anticompetitive behaviour. Thirdly, policies aimed at redress, such as the Employment Equity Act, and which are size dependent may discourage growth, increase costs and discourage export participation. These outcomes may be better pursued through other mechanisms.

It is unlikely that exchange rate manipulation will push more firms into exporting. Research on Colombia¹¹ suggests that changes in the exchange rate need to be perceived as permanent and there needs to be a pool of firms on the threshold of entry into exporting. In Colombia these firms contributed a very small amount to aggregate exporters. Rather than depreciate the exchange rate, it is better to aim for monetary policy stability.

ENDNOTES

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- 2 Edwards L, Rankin N & V Schöer, 'South African exporting firms: What do we know and what should we know?', *Journal of Development Perspectives*, 4, 1, 2008, pp. 67–92.
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