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The National Development Plan and exports as a catalyst to generate growth: Can it work?

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Small and medium-sized firms hold the potential to absorb most of the unemployed in South Africa. In this the NDP may be correct. However, the NDP may not be correct in arguing that exports can be the main catalyst of the growth the country needs to address poverty and employment. Several factors hinder such a strategy. A more domestically-focused policy aimed at production (and services) for local consumption might bear more fruit.

The National Development Plan (NDP) is an ambitious initiative to address a range of social and economic issues. Topping the list are high unemployment, poverty and low economic growth. The plan sets out a roadmap to 2030. How realistic and achievable is the plan?

With unemployment at roughly 25% in 2010, the NDP aims to put policies in place so that by 2030 unemployment will decrease to 6% while the labour force participation rate will increase from 54% to 65%. This means that employment needs to increase from 13 million to 24 million people – an 11 million, or roughly 85%, increase in employment over the eighteen year period.

The goal is for GDP to grow by 5.4% per annum, meaning that by 2030 the economy will be 2.7 times its size in 2010. This will imply a per capita GDP increase from R50 000 to R110 000, lifting most, if not all, out of poverty. The national saving rate is set to increase from 16% to 25%, while investment is set to increase from 17% to 30% of GDP. Therefore, by 2030 the saving-investment gap is projected to increase from roughly 1% per annum, to 5% per annum.

That gap needs to be financed from external sources. Exports are projected to increase by 6% per annum, which in turn is projected to increase income and thus saving out of income. However, a saving-investment gap of 5% of GDP means that, in order to finance that gap and balance the national accounts (given the sectoral balance identities), it will have to be matched by a current account deficit (imports increasing more than exports). That the plan will result in a rather large current account deficit is not recognised or mentioned in the NDP document, though.

Can it fly? Competitiveness and export demand

To attain high growth, increased employment levels and the desired reduction in poverty, the NDP projects that 90% of new jobs will be created by “small and expanding firms”, while the share of small and medium-sized enterprises in output will increase. (Which size firms are included in the “expanding firms” category is not clear, but presumably it refers largely to small and medium-sized firms.)

Although the small and medium-sized firms are projected to create the majority of jobs, the plan sees exports as a major, if not the key driver of growth and employment. Employment growth will occur through the backward linkages between export firms and the domestic economy. The plan states that although, due to competition, the country cannot compete in either low- or high-skill industries, it could do so in so-called 'mid-skill manufacturing and services' and niche markets that do not require economies of scale.

Key to any export-led initiative is the competitiveness of the country. Central to competitiveness is unit labour cost, defined as the labour cost per unit of output, or alternatively, labour cost divided by output per worker. This is a ratio, which means that not only the skill levels and thus productivity of workers are important, but also real cost of employing those workers. Although countries like China and India have large numbers of unskilled workers, those workers are also paid significantly less than in many other countries hosting workers with comparable skill levels. In Germany, on the other hand, workers are paid much higher wages, but their skill levels and accompanying productivity are such that even though these workers are highly paid, German companies are still competitive – productivity drives down the otherwise high unit labour cost.

Whether the average South African worker can really be classified as mid-skilled compared to his or her Chinese or Indian counterpart is an open question. A large proportion of those currently unemployed in South Africa never finished school. Given the country's poor performance in international studies comparing the competency of learners in different countries, a serious question can be raised as to the real skill level of the unemployed (i.e. the to-be-employed).

The Diagnostic Document that the National Planning Commission issued in 2011 states that the average wage in South Africa is five times the level in China and India, three times the level in Mexico and Malaysia and significantly higher than in Brazil, Russia and Turkey – a list that includes all the BRIC countries with which South Africa wishes to associate. Brazil, Mexico and Malaysia are peer countries that presumably also fit the mould of 'mid-skill countries' (though countries like China increasingly produce high-tech electronic goods and sophisticated cars).

The NDP makes it clear that wage reductions are not on the cards. On this point the plan probably is correct. Given the significant wage gap inherited from the apartheid era as well as a very militant labour sector, the reduction of wage levels, even in real terms, is politically untenable. If anything, the battle seems to be to *contain* wage increases (and as recent developments in the mining sector show, it sometimes is quite literally a battle).

The required increase in productivity for South Africa to become a larger exporter by becoming more competitive internationally needs to be large enough to allow South African exporters to compete with countries where unit labour costs are much lower due to lower wage rates. Many of these countries currently are also experiencing economic slowdowns due to the international financial crisis, which means that their wage rates are not set to increase significantly in the foreseeable future. (The exception might be China, which is trying to become a more consumer-oriented economy, but with wage rates a fifth of what they are in South Africa.) In addition, the fallout from the International Financial Crisis, the Euro crisis and the spill-over into emerging markets is set to keep international demand subdued for quite a number of years. The head of the IMF, Christine Lagarde, has raised the possibility of a 'lost decade' for Europe.

A stagnant or shrinking international market combined with being not very competitive internationally limits the possibilities to expand South African exports. The National Development Plan largely disregards this. The plan suggests the examples of exporting nuts, cherries and berries, but it is doubtful that enough such markets exist to significantly help increase employment in our economy by 85% within eighteen years.

Which growth model? Germany, China – or Brazil?

This raises the question: If the German-style high-wage/high skill and the Chinese-style low wage/low skill models for export are precluded, either because South Africa does not have the skills or because its labour is too expensive relative to its competitors, what options remain?

One possibility might be a Brazilian-style model, but it is not one that focuses on exports. Exports constitute only 14% of Brazilian GDP. Given relatively higher wage levels in Brazil, it can largely depend on domestic consumption and investment to drive aggregate demand (compared to China's dependence on exports and investment). Higher consumption stimulates services and local manufacturing for local consumption.

A more domestically-focused policy aimed at production (and services) for local consumption might bear more fruit in South Africa. However, if South Africa pursues such a model, local producers must compete with imports and therefore still need to improve their competitiveness, i.e. reduce unit labour cost. Nevertheless, it presumably is easier to compete in one's home market than in foreign markets.

Will it fly? Some obstacles

A number of problems undermine any development plan that the government might contemplate implementing. First, South Africa has a very adversarial labour relations system, characterised by mistrust between business and labour. Recent developments seem to indicate that mistrust is increasing – even affecting the relationship between labour unions and their members – a situation made worse by the increasing inequality of the past decade.

Secondly, while the NDP is correct that in the long run wage increases can only occur in line with productivity increases, the apartheid-era legacy of wage gaps still exists. Such wage gaps contribute to the persistently high Gini coefficient (high inequality). The need to address such gaps is frequently used as a reason why wages should increase by more than productivity. Addressing these gaps with a workable plan and timetable will go far to strengthen the argument that once the gaps have been addressed, further increases need to be productivity related. Any such plan should recognise and deal with legacies of the past in a way that ensures the continued legitimacy of the labour relations system, continued business viability and the success of the plan.

Thirdly, the NDP chapter on the economy and employment does not mention or discuss the informal economy, and the role it could play in addressing unemployment and growth challenges. The informal sector in South Africa is relatively small and mostly retail-based. If the small and medium-sized firms discussed in the NDP are meant to include those in the informal sector, more should be done to analyse why the sector is so small and what barriers to entry and expansion might exist in the informal sector. Another question might be how to turn survivalist activities into viable for-profit micro enterprises (maybe still operating in the informal sector).

Last but not least is education. Whether South Africa goes for the export-oriented approach of the NDP or a more domestically orientated model, improving productivity is essential to success – especially since reducing wages is not a feasible option. Education is essential to increase productivity and improve skills. Without good education and skills the best-laid growth plans will come to naught.