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Trade and Industrial Policy for South Africa's Future

Policy Paper 31

November 2024

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Trade and industrial policy for South Africa's future¹

South Africa is facing an export crisis. Over the past decade, the proportion of real exports to GDP has decreased, the number of exporters has dropped, and the number, diversity and complexity of exported goods has diminished. To foster export-led growth, South Africa must rethink its trade and industrial policies. Current localization strategies will not develop a robust export base. Success in boosting exports requires a shift in mindset regarding imports, as the two are interconnected. Industrial policy should prioritize horizontal approaches that address widespread constraints on export activities, rather than focusing on select sectors. Effective industrial policy must facilitate coordination among the state, business, and labour. To achieve these objectives, the Master Plans should be revised to serve as platforms for engagements between firms and government around alleviating specific constraints to firm growth and the provision of productivity-enhancing public inputs, rather than relying on subsidies and tariffs. Trade policy needs to simplify the tariff structure, eliminate tariffs on non-produced goods, end reciprocal agreements, and pursue trade agreements with emerging markets. Furthermore, trade in services should not be overlooked. The rise of digitalization offers new potential for services exports, but this necessitates reducing the restrictiveness of South Africa's regulatory environment, engaging in the World Trade Organization's Joint Statement Initiative on e-commerce, and including services in both existing and forthcoming trade agreements.

¹ This report draws on several papers and reports on exports that I have authored or co-authored, including Edwards (2020), Baduel et al. (2022) that is a background paper to the World Bank (2024) report, and Chien et al. (2024). The report was financed by Centre for Development and Enterprise (CDE) and was used in their report "Action 7: Re-think Growth, Jobs and the DTIC" (<https://cde.org.za/action-seven-rethink-growth-jobs-and-the-dtic/>).

1 Introduction

The recent elections and subsequent formation of the Government of National Unity opens up opportunities to review, assess and reconsider established economic policies, and, where deemed appropriate, reform these or initiate new policies. This holds for trade and industrial policies, now under the control of Mr. Parks Tau, the new Minister of Trade, Industry and Competition.

Minister Tau's challenge is enormous. His term commences in a period of continued declines in the contribution of manufacturing to gross domestic production (GDP), stagnating export performance, and geopolitical tensions. He takes over the reins of ex-Minister Ebrahim Patel's Reimagined Industrial Strategy that emphasises localisation, implementation of Master Plans, and a more assertive stance towards dealing with concentration by the Competition Commission. With the exception of the African Continental Free Trade Area (AfCFTA), the strong inward focus of the Reimagined Industrial Strategy has overshadowed policies focusing on boosting exports.

One indicator of the immediacy of the challenge, is the dramatic decline in merchandise trade volumes (8.4% for exports and 8.7% for imports) in the first quarter of 2024 according to United Nations (UN) Trade and Development data. South Africa's trade performance falls far below its comparator countries. A further, and related indicator, is the recent ranking of ports in the World Bank (2024) Container Port Performance Index 2023 where the port of Cape Town ranked last out of 405 international ports in terms of container vessel time in port. The port of Cape Town was not alone in the low rankings, with Ngqura ranked 404, Durban ranked 398 and Port of Gqeberha (formerly Port Elizabeth) ranked 391. The effect of these constraints on exports is considerable. Transnet's operational obstacles have led to a decline in coal exports from Richards Bay to their lowest levels since 1992 (Minerals Council, 2024). The logistics constraints are estimated by the Minerals Council of South Africa to have resulted in losses of R98 billion (1.4% of GDP) in export revenue from coal and iron ore exports from 2021 to 2023.

If South Africa is to grow, it is imperative that export growth recovers. A continuation of existing policies is unlikely to dramatically change the current malaise. The weak export performance can in part be attributed to the existing policy frameworks. A re-think and re-focus of South Africa's trade and industrial policy towards facilitating the emergence of a competitive export-oriented industrial sector is required. This report presents an argument motivating for such an approach. The report first presents a broad overview of South Africa's export crisis. This is followed by a critical assessment of the government's prioritisation of localisation as a driver of industrialisation. South Africa's export performance and limitations of the current approach towards industrialisation provides motivation for a shift in policy towards raising exports.

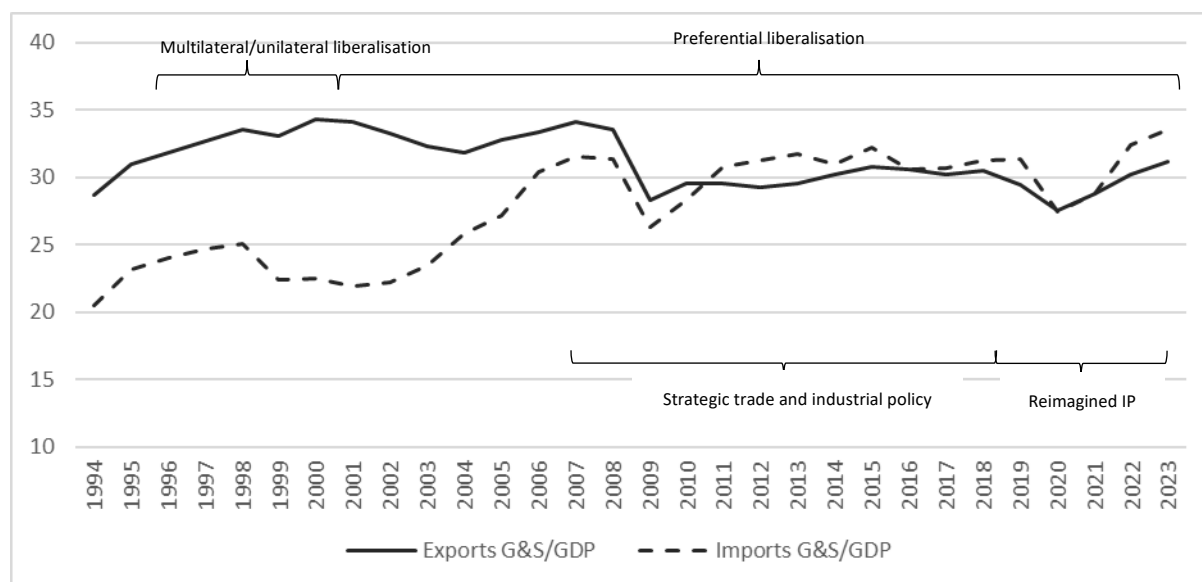
2 South Africa's export crisis

The Integrated National Export Strategy (2015), the National Development Plan (NDP) Vision 2030 (GoSA, 2012), and the Department of Trade and Industry's Industrial Policy Action Plans all see raising exports and diversifying the export bundle as central policy objectives. Under the NDP, the aim is to increase export volumes by 6% per annum by 2030, with non-traditional exports growing by 10% a year (GoSA, 2012). The Economic Recovery and Reconstruction Plan (ERRP), released in 2020, prioritizes a reorientation of trade policies and regional integration to stimulate exports, employment, and innovation (GoSA, 2020).

Export growth, however, has disappointed. Whereas export volumes of both goods and services initially grew strongly in response to the opening up of the economy in the early 1990s, from 2000 the pace of export growth slowed, despite the commodity boom. Aggregate export volumes of goods and services grew by only 1.5% per annum from 2012, the year the NDP was launched, to 2023; a far cry from the desired 6% per annum growth. Growth in export volumes have also lagged growth in real gross domestic product (GDP). This can be

seen in Figure 1, where exports of goods and services to GDP plateaued in 2000 after rising in the prior decade. Towards the end of 2008, trade volumes collapsed in value and relative to GDP in response to the global financial crisis. While exports as a share of GDP recovered marginally in 2010 from the 2009 lows, it has never recovered back to pre-2008 levels. By 2023, real exports of goods and services to GDP (valued in 2015 prices), were still 2.4 percentage points below 2008 values. The broad implication is that, whereas exports helped to drive economic growth in the 1990s, from 2008 export growth has had a retarding effect on economic growth.

Figure 1: Exports and imports of goods and services to GDP, real values



Source: Own calculations using data sourced from the South African Reserve Bank.

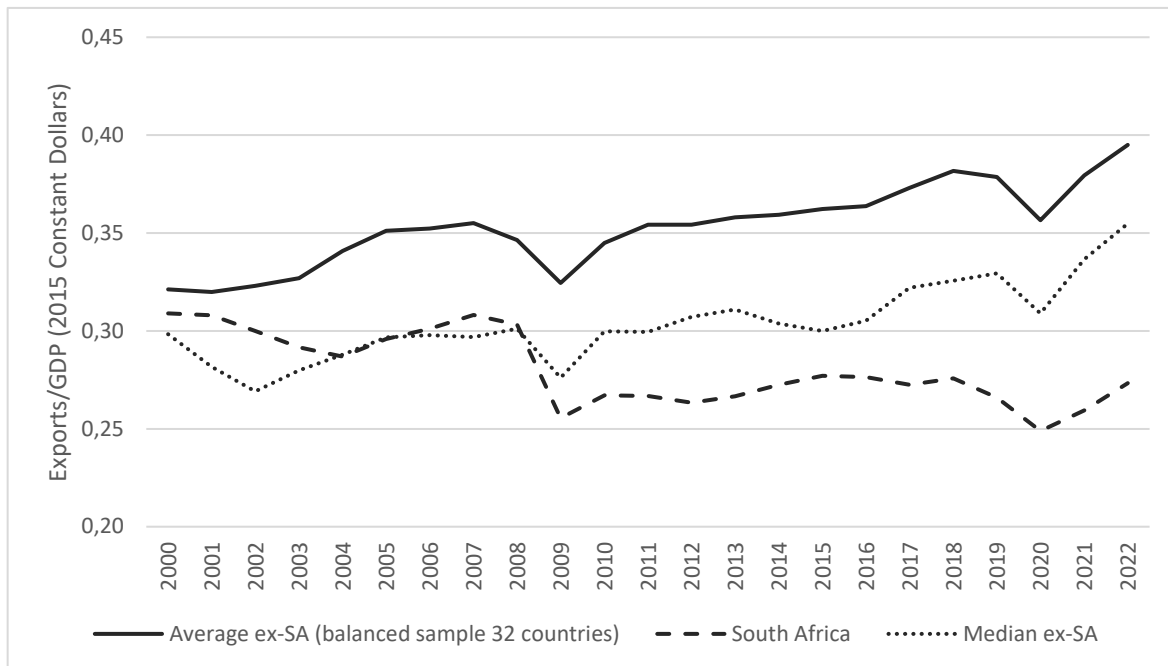
Notes: G&S denotes goods and services.

South Africa's export performance has lagged that of comparator middle-income countries (see also World Bank (2024) and Chien et al. (2024)). Figure 2 compares exports (goods and services) to GDP ratios for South Africa against the average and median value for a sample of 32 upper-middle-income countries. Similar to SA, exports to GDP remained relatively stable for the median upper-middle-income country from 2000 to 2009. From 2009, after the financial crisis, the trends diverge. Whereas exports to GDP remained below trend for South Africa, upper-middle-income countries experienced rising shares. By 2022, the gap in exports to GDP between South Africa and the average upper-middle-income had risen to 12 percentage points, compared to 1 percentage point in 2000 (i.e. 11 percentage point increase in gap).

These trends also signal a shift in the contribution of exports towards economic growth. Whereas export growth boosted real GDP growth in the 1990s, from 2008, weak export growth served as a drain on economic growth (because export growth lagged GDP growth). Counterfactual outcomes are difficult to measure. Using back-of-the-envelope calculations, if South Africa had experienced the same increase in exports to GDP as the average upper-middle-income country from 2000 to 2022, then SA GDP in 2022 would have been 4.3 percent higher, or 178.8 billion Rands in 2015 prices.²

² According to income accounts, $GDP = A + (X - M)$ where A is absorption (expenditure consumers, government and investment), X is exports and M is imports. If SA experienced the same percentage point increase in X/GDP as the average upper-middle-income country, then X/GDP in SA would be 11 percentage points higher in 2022. X/GDP in 2022 was 0.27, therefore, $\frac{X^*}{GDP^*} = 0.11 + 0.27 = 0.38$, where $*$ denotes hypothetical outcome. Let A and imports (M)

Figure 2: Real exports of goods and services to GDP – South Africa compared to upper-middle-income countries



Source: Chien et al. (2024) and own calculations using World Development Indicator data.

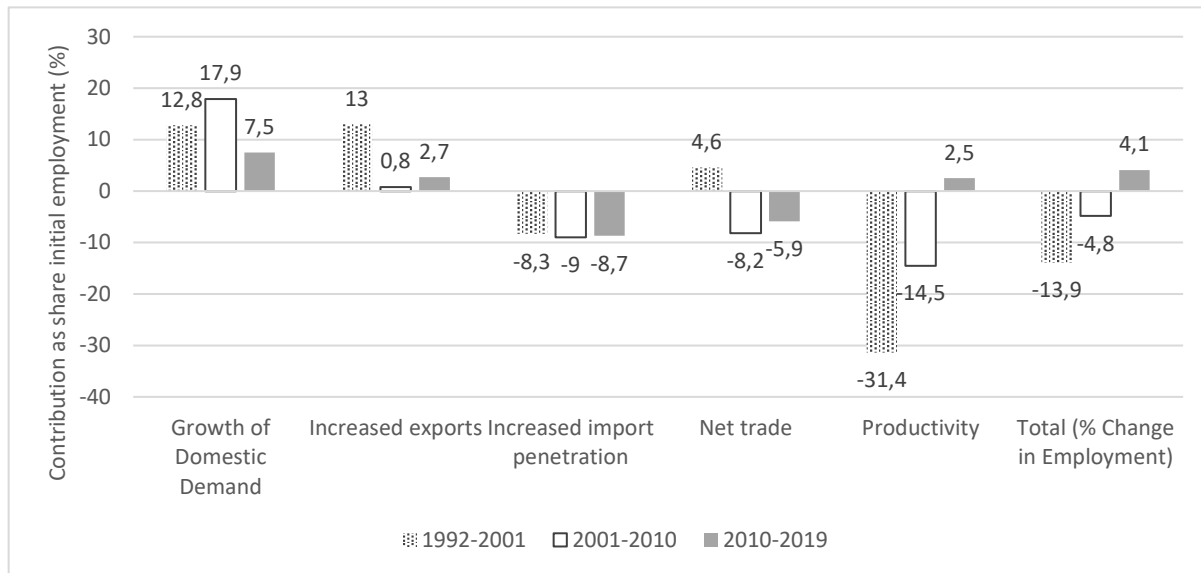
The decline in export performance is also reflected in its declining contribution to output and employment growth in manufacturing. Figure 3 presents a decomposition of the sources of employment growth in manufacturing in different periods from 1992 to 2019. The figure draws on data provided in Edwards (2021) and the reports by World Bank (2024) and Chien et al. (2024). Declines in employment over this period were concentrated in the 1992 to 2001 period, followed by the 2001 to 2010 period. From 2010 to 2019, employment in manufacturing actually rose marginally by 4.1%.

The dominant drivers of manufacturing employment growth are domestic demand and productivity (which reduces employment per unit output). Of primary interest to this report, however, is the contribution of trade to employment. As shown in the figure, the contribution of net trade (exports minus imports) to employment was positive from 1992 to 2001, raising manufacturing employment by 4.6%. This changed from 2001 to 2019 when net trade had a negative effect on employment of between 6% and 8%. The declining contribution of trade to employment growth is driven by changes in the contribution of exports, not imports. Rising import penetration is associated with consistent reductions in employment in all periods of between 8.3% to 9%. These don't reflect actual reductions in employment, but rather 'hypothetical' losses calculated as the difference in employment should import penetration (imports as share consumption) not have risen over the period. In the case of exports, we see a dramatic decline in contribution to employment from 13% over the period 1992 to 2001, to below 3% in the subsequent periods.

in 2022 remain constant. We can then rewrite $\frac{X^*}{GDP^*} = \frac{X^*}{(A+X^*-M^*)}$, where M^* includes initial M plus the imports embodied in X^* , which, using the foreign value added share in exports obtained from the OECD Value Added database from 2010 to 2020 equals $0.79X^*$. Incorporating this into the prior equation gives $\frac{X^*}{GDP^*} = \frac{X^*}{(A+0.79X^*-M)} = 0.38$. Solving out yields, $X^* = \frac{0.38(A-M)}{(1-0.79 \times 0.38)}$. Similarly, given that $\frac{X}{(A+X-M)} = 0.27$, we can solve out X as $\frac{0.27(A-M)}{(1-0.27)}$. The percentage change in GDP if only X changed, is $\frac{GDP^*}{GDP} - 1 = \frac{(A+0.79X^*-M)}{(A+X-M)} - 1$. Substituting X and X^* into this gives $\frac{1+(0.79)(0.38)/[1-(0.79)(0.38)]}{1+(0.27)/(1-0.27)} - 1 = 0.043$.

Further decomposition of these results according to labour intensity of sectors shows that the weak contribution of exports to employment growth can be attributed largely to the ultra-labour-intensive sectors (Edwards, 2021; World Bank, 2021; Chien et al., 2024). The conclusion is that it is the failure to grow exports, particularly labour-intensive exports, and not the rise in imports that can largely explain the low (and negative) net contribution of trade to manufacturing employment growth in South Africa.

Figure 3: Sources of employment growth in manufacturing, 1992-2019



Source: Own calculations using data from Table 3 in Edwards (2021).
 Notes: Based on 44 manufacturing industries at the 3-digit level of the Standard Industrial Classification (S. Trade data are obtained from UNComtrade via World Integrated Trade Systems, and employment and output data are sourced from Statistics South Africa. Employment data from 2010 to 2019 are based on the Quarterly Employment Series, while the data prior to this is based on the Survey of Employment and Earnings.

Behind these aggregate trends is a hollowing out of South Africa's export bundle, as measured by the number of exporters and exported products (World Bank, 2024). Around 20% of South African manufacturing firms export, but these firms on average only export around a fifth of their output (the median exporter exports only 4%) (Matthee et al., 2016). Exporters differ from non-exporters in that they are larger in terms of output and employment, pay higher wages, are more capital intensive and more productive (Matthee et al., 2016; Edwards et al., 2008). Much of the exporter premiums can actually be attributed to firms that both export and import (Edwards et al., 2018, 2020).

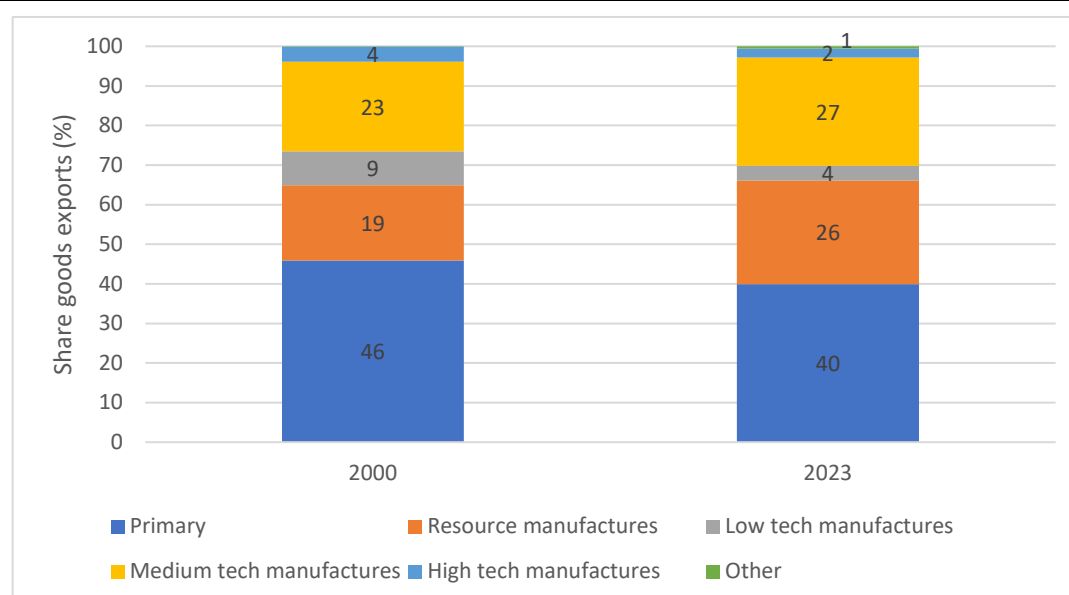
Looking over the past decade firm export data reveals falling exporter numbers driven by low levels of entry and declining survival rates, and high and rising levels of concentration (World Bank, 2024; Baduel et al., 2022). The total number of exporters according to export transaction data for South Africa fell from 42 096 in 2015 to 35 595 (or -15.4%). Exporters of manufactured goods account for most exporter numbers, and were the primary drivers of the firm exit from exporting (World Bank, 2024). The value of exports is also highly concentrated amongst few exporters, far more so than South Africa's peers (World Bank, 2014). For example, the export share of the top 5% of firms is around 92%. Export concentration has also been rising within most industries in recent years (World Bank, 2024). These high levels of concentration are sustained by a lack of dynamism amongst South African exporters. Although South Africa has a long tail of small exporters that export irregularly and at a very small scale, these firms do not transition into becoming very large exporters (World Bank, 2014). This points to a "missing-middle" of exporting firms, and the presence of barriers inhibiting growth of small and medium sized firms (World Bank, 2024; Chien et al., 2024).

The falling competitiveness of South African exporters is also reflected in a decline in the number of products with a revealed comparative advantage. Between 2010 and 2022, the number of products (defined at the 6-

digit level of the Harmonized System) that South Africa had comparative advantage in fell from 854 to 714.³ Behind this trend are some important dynamics. For example, South Africa lost comparative advantage in 410 products, but gained a revealed comparative advantage in 270 products. Only 444 retained a comparative advantage in both periods. Nevertheless, the number of products with a revealed comparative advantage fell because more products lost comparative advantage than products that gained comparative advantage.

One implication of these trends is that South African exports remain concentrated in minerals and metal products. Figure 4 presents a breakdown of South African exports in 2000 and 2023 according the Lall (2000) Technology Classification of exports (see Table A1 in the Appendix for more details). While the share of manufacturing in total exports rose from 54.1% in 2000 to 59.5% in 2023, this largely reflects rising share of resource-based manufactures, particularly minerals-based products. The share in exports of non-resource-based manufactures that exclude resource-based manufactures and iron & steel products, actually fell from 30.6% in 2010 to 28.5% in 2023. The failure to diversify into higher quality, non-traditional exports, is reflected in the declining share of high-technology products in South Africa's export bundle. The share of these products in total exports of goods fell from 3.8% in 2000 to 2.2% in 2023.

Figure 4: Composition of South African exports by technology classification, 2000 and 2023



Source: Chien et al. (2024) and own calculations using Uncomtrade data.

Notes: The data excludes SA exports to the other SACU members, as this data are only reported from 2010. Categories are based on the Lall (2000) Technology Classification of exports. Resource-based manufactures includes iron & steel that is classified as medium technology in Lall (2000)

There are exceptions to the general picture. Sub-Saharan Africa has emerged as the dominant market for South Africa's non-mineral exports. Africa in 2019 accounted for over half of total exports of non-metallic minerals, rubber & plastics, and electrical machinery, food products, clothing & textiles and wood products, with Southern African Customs Union (SACU) members accounting for nearly half these exports (Chien et al., 2024). South African exports are also an important source of intermediate inputs for exports from African countries, particularly for Eswatini, Botswana and Namibia where SA contributes over 18% of value added in gross exports from these countries (Black et al., 2020). However, backward linkages of South African exporters into the African region are very weak, with the African countries making a negligible share of value added in South Africa's gross exports.

³ Based on export data obtained from BACI (Gaulier and Zignago, 2010).



The type of firms that export to Africa, differ significantly from firms that export outside of the region. SA exporters to Africa are smaller and less productive compared than firms exporting outside of the region (World Bank, 2024). Exports to SACU and the Southern Africa Development Community (SADC) are also shaped enormously by preferential access with relatively high values of exports in goods with high preference margins. The World Bank (2014, 2024) therefore argue that the African market may not be the ideal springboard for preparing South African exporters to enter into the highly competitive global markets.

Other exceptions include automotive exports that have risen strongly in value and as a share of manufactured exports. This outcome reflects the generous subsidies (direct investment subsidies and indirect subsidies through import duty rebates) provided to the automotive industry via the Motor Industry Development Programme (MIDP) from 1995 to 2012 and the Automotive Production and Development Programme (APDP) that followed from 2013.

Finally, when looking at the product level data, we also observe several success cases. Export of citrus have grown dramatically and now constitute a major source of export revenue for the agricultural sector. South Africa has become a leading exporter of high-end sailing catamarans. The country has also developed revealed comparative advantages in products such as photographic equipment, pumps for liquids, raw hemp, several processed metal products (tubes and pipes), etc. While there are many lessons to be learned from the failures of exporting, the success cases also provide insight into how policies can enhance export growth.

3 Re-direct South Africa's industrial policy away from localisation and protection to export promotion

The imperative of raising South Africa's exports is increasingly being recognised in policy circles. Recent media statements by both Minister Tau and the Deputy Minister Andrew Whitfield articulate boosting exports as a priority.

"As you would appreciate, in the short-term, the domestic market is too small and growing too slowly to sustain manufacturing-led growth. In order to reduce our dependence on our small domestic market, the dtic will implement new export measures, coupled with expanding the current measures and improving their effectiveness. In partnership with government, business, labour and civil society, we will work together to expand our export footprint" (Media statement, Minister Tau, 16 July 2024)⁴

"South Africa must also create an export-oriented economy. A dedicated focus on manufacturing growth will also lead to export growth.... The creation of an export-oriented economy can be realised through a dedicated focus on implementing measures to boost the competitiveness of local industries in global markets, streamlining export processes, lowering trade barriers, offering financial and technical assistance to exporters, and cultivating beneficial trade alliances with other nations" (Media statement, Deputy Minister of Trade, Industry and Competition, Mr Andrew Whitfield, 31 July 2024).⁵

Momentum needs to be built around driving an export-led growth agenda. To do so, however, requires a re-direction of South Africa's trade and industrial policy, from its current inward focus towards a more export-

⁴ <https://www.thedtic.gov.za/industrial-policy-will-be-in-the-centre-of-economic-development-strategy-minister-tau/>

⁵ <https://www.thedtic.gov.za/south-africa-can-become-an-export-oriented-economy-deputy-minister-whitfield/>

oriented focus. This in turn requires a re-consideration of the sources of South Africa's industrialisation challenge, as well as the sectoral focus of industrial and trade policy.

3.1 Re-think the drivers of deindustrialisation.

A central thrust of the ex-Minister Ebrahim Patel's Reimagined Industrial Strategy is its emphasis on localisation as a means to (re)industrialise the South African economy. This line of thought is also prevalent in the post-COVID Economic Recovery and Reconstruction Plan (ERRP) that stipulates a key priority area to be *"Employment orientated strategic localization, reindustrialization and export promotion"* (GoSA, 2020: 3). These objectives are to be achieved by a decisive shift in state procurement to local procurement, the use of industrial funding, tax incentives, licensing, tariffs and others public measures to enable conditionalities to be placed for localisation, support for local beneficiation of minerals, the localisation of supply chains, and special measures linked to infrastructure investment plans (GoSA, 2020: 13-14).

While the focus on boosting exports is appropriate, the emphasis on industrialisation through localisation is misplaced. The view reflects a deep-seated perception that the decline in the contribution of the manufacturing sector to employment and output growth arises from import competition with tariff liberalisation having contributed significantly to deindustrialisation.⁶ This is a misunderstanding of the long-term drivers of deindustrialisation in South Africa.

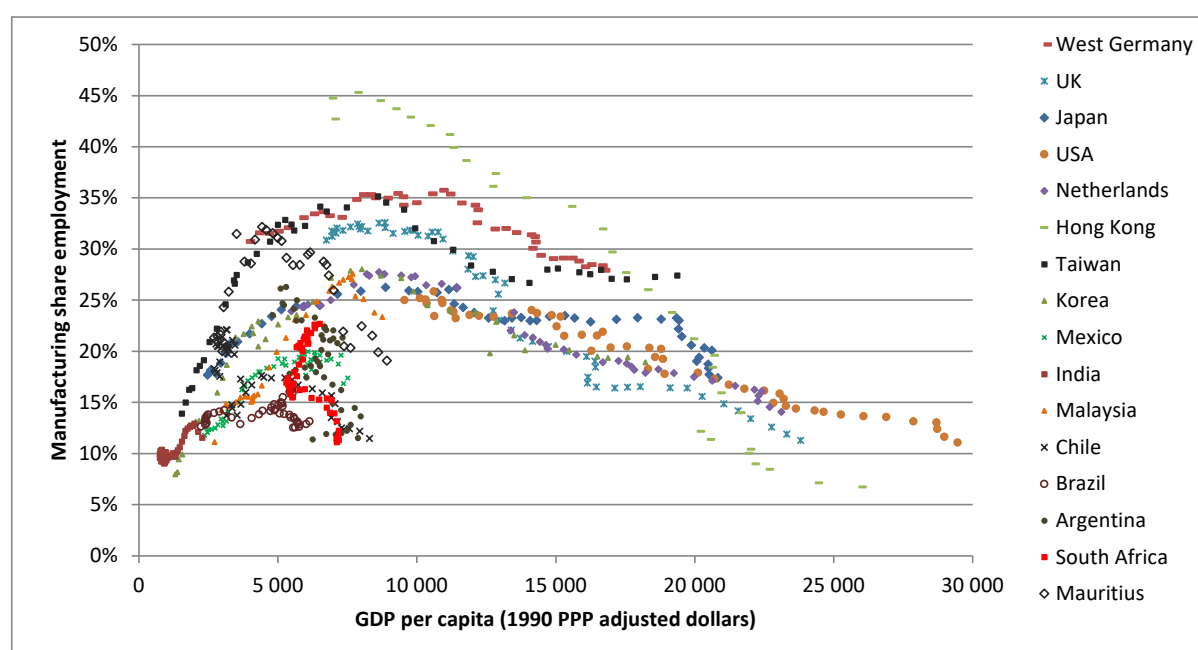
Deindustrialisation, as is commonly measured using the manufacturing share of total employment, is a function of several factors. A major driver of structural change, including deindustrialisation, in the long-term is technological progress. At the early stages of development, rapid productivity growth in agriculture releases labour that enters into manufacturing and services. The effect is a rise in the share of manufacturing in total employment (also services). However, as economies advance and the agricultural sector declines in importance as a source of employment, relatively fast productivity growth in manufacturing results in a structural shift in employment away from manufacturing towards services. Manufacturing therefore declines as a share of total employment. The resultant inverted U-shaped relationship between manufacturing share of employment and economic development, as measured by GDP per capita, can clearly be seen for the advanced economies of Germany, UK, Netherlands, Japan and US in Figure 5. The manufacturing share of employment peaked around US\$ 10 000 per capita (in 1990 purchasing power parity prices), after which it declined.

Also important to consider in this adjustment is the role of demand (Edwards and Lawrence, 2013; Lawrence, 2024). Fast productivity growth reduces the amount of labour required to produce each unit of manufacturing output, but also drives the relative price of manufactured goods downwards, thereby increasing demand for manufactured goods. However, if the price elasticity of demand is inelastic, then the increase in output from the demand response is insufficient to offset the loss in employment from the improvement in labour productivity, and the share of employment in manufacturing falls (e.g. a 10% improvement in labour productivity from technological change, will require at least a 10% increase in demand for the product to offset any employment losses). Critical therefore is the demand elasticity. In closed economies where the manufacturing sector primarily sells to the domestic market, demand elasticity will be lower than in countries that are internationally competitive and can export to the global market where demand is very elastic. Deindustrialisation from technological progress is, therefore, more likely to be slower in countries with outwardly-oriented competitive manufacturing industries.

⁶ See for example the media statement *A Trade Policy for Industrial Development and Employment Growth* (20 May 2021) accessible via https://www.thedtic.gov.za/wp-content/uploads/SA_Trade_Policy.pdf. This statement states *"SA's treatment as a developed country during the Uruguay Round (during the apartheid era) is a source of considerable concern as the tariff reduction commitments contributed significantly to de-industrialization"* (pg 6).

There is a further consideration. As shown in Figure 5, emerging economies have reached their peak share of manufacturing in employment at lower levels of income compared to the advanced post-industrial economies. The peak of the inverted U-shape curves has also occurred at much lower shares of employment in manufacturing. Rodrik (2016) terms this as ‘premature deindustrialisation’ that he argues arises from a combination of globalisation and labour-saving technological change. As emerging economies opened up to trade, those countries without a comparative advantage in manufacturing were exposed to increased international competition squeezing their manufacturing industries. Secondly, with globalisation, emerging economies became more exposed to declines in the relative prices of manufactured goods originating from technological change in advanced economies. The outcome for emerging economies, particularly if they did not have a comparative advantage in manufacturing, was a decline in the manufacturing share of employment *and* real output. Trade liberalisation and international competition in this scenario can be a key driver of deindustrialisation.

Figure 5: Manufacturing share of employment and GDP per capita.



Source: Own calculations using data from Groningen Growth and Development Centre. For South Africa, the share of manufacturing in non-agricultural employment is presented. The data from 2013-2019 is extrapolated using employment data obtained from SARB.

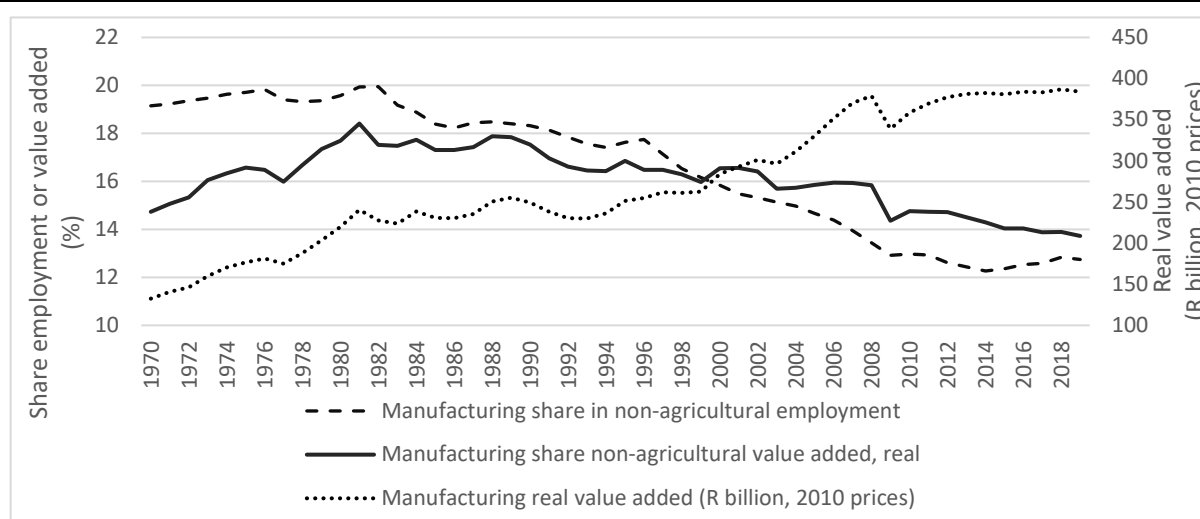
This process of premature deindustrialisation does not neatly apply to South Africa. Figure 6 plots manufacturing real value added and the share of manufacturing in non-agricultural employment and real value added for South Africa from 1970 to 2019. The figure illustrates that the slowdown in growth of manufacturing production occurred in 1981. 1981 is also the point where the share of manufacturing in employment, as well as in output, began to fall. Both these declines commenced well before the South African manufacturing sector was opened up to international competition. Deindustrialisation as measured in terms of manufacturing’s share of employment and output in South Africa pre-ceded trade liberalisation. This is inconsistent with premature deindustrialisation as articulated by Rodrik (2016).⁷

⁷ Tregenna (2016) adopts a more nuanced view of deindustrialization that takes into account whether the level of manufacturing employment and GDP have also started to diminish. Even in this case, deindustrialization appears to have occurred from 1980 as real volumes of manufacturing collapsed, and the sectors share (real and nominal) of total GDP reached a peak. Manufacturing employment levels, however, continued to rise, only starting to decline from the late 1980s.

What lies behind the transition in 1981 is not trade liberalisation or international competition, but rather the decline in domestic demand for manufactures associated with the decline in gold production from the 1970s (the volume of mining and quarrying production peaked in 1970), the collapse in the gold price in 1980, together with a dramatic decline in gross domestic fixed capital formation that close to halved from 29.2% of GDP in 1976 to 14.7% of GDP in 1993 (See Figure A1 in the Appendix) (Edwards, 2021). All these factors dramatically reduced demand for domestic manufacturing output that was oriented towards supplying the domestic mining industry and domestic consumers.⁸ The effect was a reversal of industrialisation for South Africa that was combined with declines in GDP per capita. Figure 5 also includes data for South Africa. From 1981 to the early 1990s, South Africa backtracked down the inverted U-shaped curve that it rose up on in the 1970s.

The high dependence on domestic demand of a manufacturing industry that arose through an import substitution industrialisation policy, that was still very prominent in the 1980s, made the sector particularly vulnerable to domestic demand shocks. While protection was effective in developing an industrial base, it did not establish the necessary foundation for a competitive export-oriented industry. Consequently, the failure of manufacturing to grow substantially during the 1980s also reflects the failure of the manufacturing industry to transition into exporting.

Figure 6: Manufacturing gross value added and manufacturing share in non-agricultural employment and gross value added



Source: Own calculations. Real value added for manufacturing and non-agriculture are obtained from South African Reserve Bank Quarterly Bulletin statistics. Employment data are obtained from Quantec.

Growth in real manufacturing production only recovered in the early 1990s, but this was precisely when South Africa re-entered the global economy through liberalisation and the ending of sanctions. The share of manufacturing in output in 2002 was exactly the same as it was in 1994, at 16.4%. This is again inconsistent with international competition being the main driver of premature deindustrialisation in South Africa during this period. The manufacturing share of employment continued to fall, but this is mainly attributed to labour-saving technological change not tariff reductions. This is shown in the decomposition of employment change

⁸ Lawrence (forthcoming) presents a model that illustrates how demand for manufactures through investment is a key contributor towards deindustrialization trends in advanced and emerging economies. He also shows that export-oriented economies are not immune from the deindustrialization trends.

from 1992 to 2001 in Figure 3, where labour saving productivity growth contributed to a 31% decline in manufacturing employment.⁹

During the 2000s, sharp increases in imports from China following its accession to the World Trade Organisation in 2001 were a contributing factor towards the decline in manufacturing employment (Edwards and Jenkins, 2015). Interestingly, the manufacturing share of real output stayed relatively constant. It is really the failure of manufacturing production to recover from the 2008/9 financial crisis that accelerated the decline in manufacturing's share of output.

What are the implications of these findings? Trade liberalisation and exposure to international competition are not the primary sources of deindustrialisation in South Africa. A combination of technological change, domestic investment and declining mining production are the key factors explaining deindustrialisation. In this context, protectionism that orientates domestic firms towards production for the domestic market will exacerbate deindustrialisation. Competitive firms that are able to increase sales to the global market (i.e., export) are required to escape/delay/attenuate the deindustrialising forces of technological change. Localisation policies that create protected inefficient manufacturing industries will merely accelerate the long-term deindustrialisation of the economy. Tariffs and protection through preferential procurement may provide temporary relief, but unless the policy results in competitive firms, any gains will be short-lived (equivalent to moving up the steps on a downward escalator).

It can be argued that the incorrect diagnosis of South Africa's source of deindustrialisation, has led to protectionist policies that will accelerate the decline in the contribution of manufacturing to employment. A re-direction of trade and industrial policies towards the development of *competitive* industries that can grow exports is imperative.

3.2 Exporting requires an open trade policy whereby firms can import¹⁰

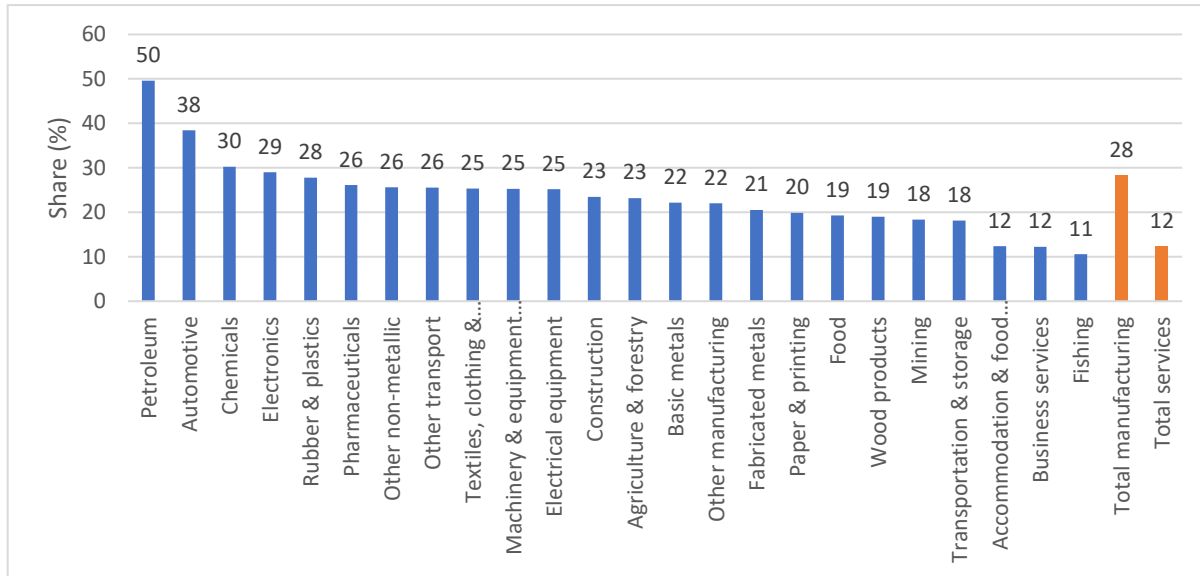
Importing goes hand-in-hand with exporting, particularly for manufactured products. Participation in Global Value Chains, the vehicle through which manufacturing trade predominantly takes place, requires firms to import and add value to intermediate inputs before exporting the produced product to downstream firms or consumers. The importance of imports for exports has been shown globally, as well as for South Africa.

Figure 7 presents the average share of foreign value added in South African exports from 2015 to 2020 using the OECD Trade in Value Added database. The foreign value added reflects the contribution of value added embodied in imports that is used directly and indirectly in the production of exports. It provides a measure of the backward linkages of South African exporters into the global trading environment. As shown in the figure, the importance of foreign value added varies across industries, with the share for manufacturing (28%) much higher than for services (12%). Petroleum product exports embody the highest share of foreign value added at 50%, and is followed by Automotive (38%), Chemicals (30%) and Electronics (29%). The lowest share of foreign value added in exports is in Fishing (11%), Business services (12%) and Accommodation and food services (12%).

⁹ In his study of South African manufacturing, Rodrik (2008) argues that liberalisation contributed towards a decline in the relative price of manufacturing and therefore manufacturing share of employment. However, his results also show that the 'bulk' (83.5%) of the decline in the relative price of manufacturing, and therefore the associated decrease in employment, can be attributed to an unexplained time trend that is consistent with the effect of technological change.

¹⁰ This section draws from Edwards (2020).

Figure 7: Average foreign value added as share gross exports, 2015-2020



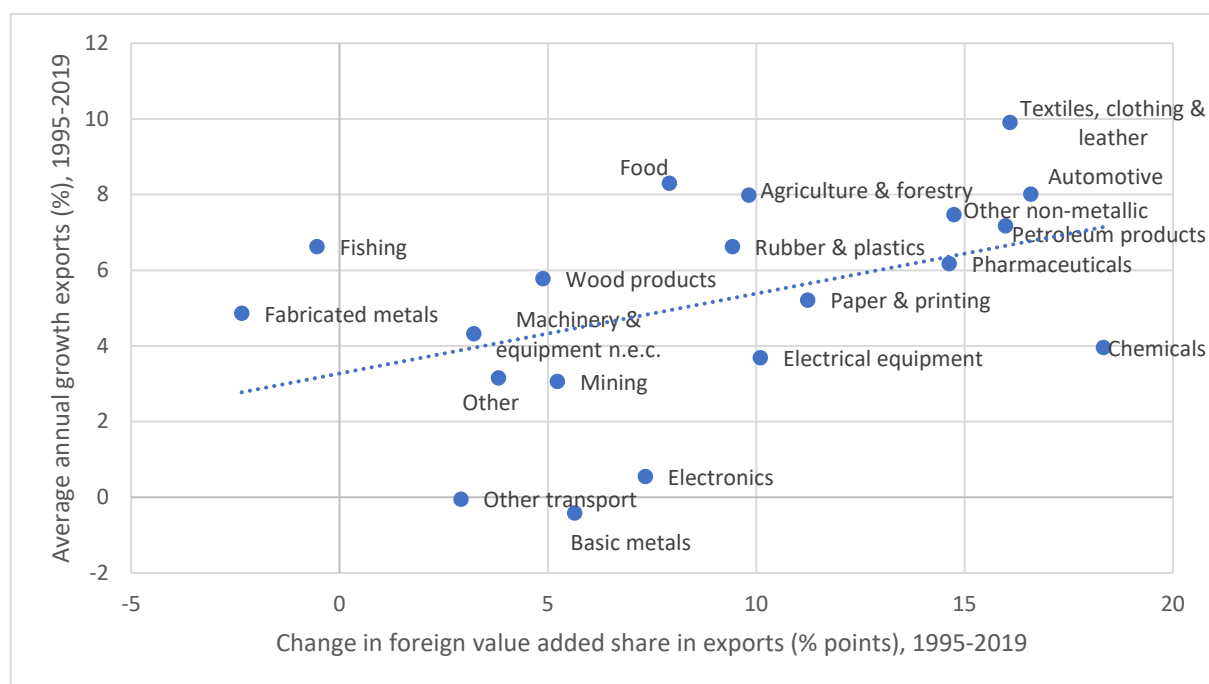
Source: Own calculations using data for South Africa from the OECD Trade in Value Added database.

Access to foreign inputs is also associated with faster growth in exports. Figure 8 illustrates this by plotting the change in share foreign value added in exports against the growth in exports from 1995 to 2000. Although there is lots of variation around the trend, there is a clear positive association between the two variables. Industries experiencing larger percentage point increases in the share foreign value added in exports experienced higher growth rates on average.

Importing is also empirically shown to have a direct effect on firm performance. South African manufacturing exporters that import have higher export values and export more products to a wider range of countries (Edwards et al., 2018). Manufacturing firms that both import and export consistently demonstrate higher values of output, employment, wages and productivity compared to firms that do not trade, or only export or import. One explanation is that imports enable South African manufacturing firms to upgrade their technical capabilities through the use of higher quality inputs that embody new technologies and access to a wider range of complementary inputs. For example, a 10 % increase in the number of varieties imported by a firm in manufacturing in South Africa is associated with a 0.3 % increase in its productivity (Edwards et al., 2020). The use of imports in production, therefore, reinforce the productivity gains that have been shown to accrue to South African manufacturing firms through exporting.

The implication is that barriers that raise the cost of accessing imports, such as tariffs, transport barriers, non-tariff barriers, etc., hamper export performance and productivity growth. Transport and port inefficiencies doubly tax exporters, by raising the cost of importing intermediate inputs and the cost of exporting the final good produced.

Figure 8: Relationship between growth in exports and the change in foreign value added share from 1995 to 2019



Source: Own calculations using data for South Africa from the OECD Trade in Value Added database.

3.3 Reduce focus of industrial policy on targeting sectors and focus on firm-oriented horizontal policies

The prioritisation of sectors is a key tenet of South Africa's broader economic policy landscape, including industrial policy. The Sector Education Training Authorities (SETA) are structured around providing skills development and training to workers according to economic sector. Wages are set by the centralised sector Bargaining Councils or Sectoral Determinations.¹¹ Government and provincial departments are defined according to sector (mining, agriculture, tourism, etc.). The same holds for South Africa's industrial policy that took a sharp turn towards sectoral targeting following the launch of the National Industrial Policy Framework in 2007 (DTI, 2007) and the subsequent Industrial Policy Action Plans (IPAP).¹² With increased recognition of the importance of value chains, this policy evolved into the use of industry Master Plans to drive industrialisation.

The view of the economy as being characterised by sectors has become outdated, particularly in relation to exporting. Traditional trade theory depicted the world in terms of sectors/industries, with sectoral comparative advantage determining whether firms export or not. The now wide-spread availability of firm data illustrates the fallacy of this position. Firms vary enormously in terms of their characteristics, with differences between firms within the same sector frequently exceeding differences between firms in different sectors. Firm productivity in South Africa, for example, varies widely between firms, and productivity growth is more closely associated with firm size (larger firms are more productive) and trade status, than the industry classification (Kreuser and Newman, 2018).

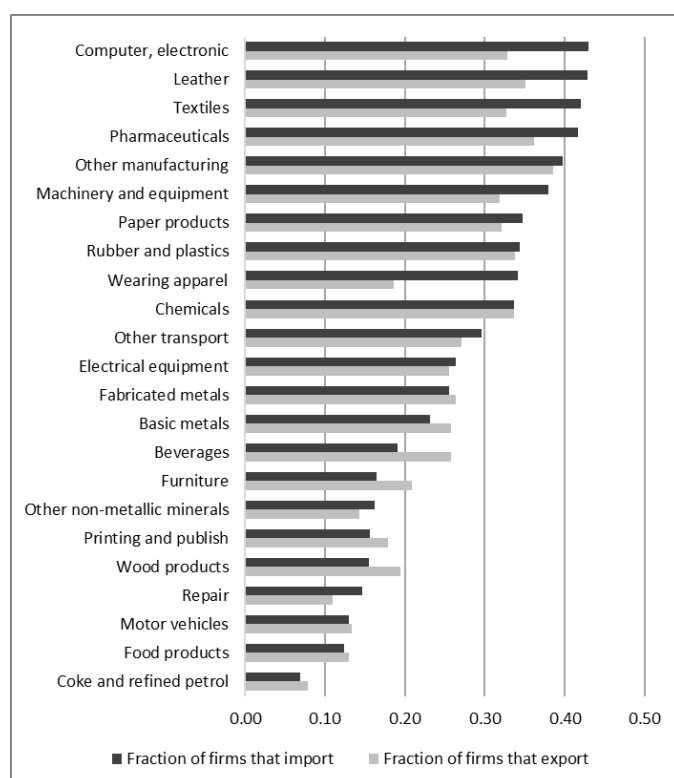
¹¹ Wage setting and the conditions of service are determined by the 1995 Labour Relations Act and the Basic Conditions of Employment Act (BCEA) of 1997.

¹² "High impact sector strategies that are well designed and implemented are crucial to place the economy on a higher growth and more developmental industrialisation path" (DTI, 2007: 18).

Productivity is a key determinant of whether a firm engages in international trade, whether through exporting or importing (Bernard et al., 2007; 2011). The wide variation in productivity across firms, irrespective of sector, implies that the association between sectors/industries and exporting is weakened, as is revealed by the presence of exporting firms within all industries. This holds for South Africa, as can be seen in Figure 9 that presents the share of firms that export and import by manufacturing industry in South Africa for the period 2009 to 2013. Firms directly engage in international trade across all manufacturing industries, reflecting the heterogeneity within industrial categories. Roughly a third of manufacturing firms directly engage in exporting or importing, with 70% of exporters also importing (Edwards et al., 2018).

The share of firms exporting does differ across industries, in line with the predictions of the traditional models of comparative advantage. The fraction of firms exporting is relatively high in Other Manufacturing, Pharmaceuticals, Chemicals, and Computer and electronics, and relatively low in Coke and refined petroleum and Food products.¹³ Nevertheless, the defining feature of the data in Figure 9 is that firm exporting and importing is not industry-specific.

Figure 9: Importers and exporters as a fraction of firms by industry in South Africa, 2013-17



Source: Edwards et al. (2020). The data are sourced from the SARS-National Treasure administrative tax data and covers 20000 to 26000 manufacturing firms each year from 2013 to 2017. Only firms for which total factor productivity estimates can be calculated are included.

The fragmentation of production and the emergence of global value chains that have driven growth in manufactured good exports has also diluted the association between industry and export performance. With fragmentation of production, competitiveness in specific segments or tasks in the production process, not the industry, drive export participation and performance. Kraemer et al. (2011) illustrate this in the geographical distribution of value for the iPad. Although China exports the iPad, the share of value attributed

¹³ The share exporters in motor vehicles is low, but this appears to be linked to the use of trading companies by vehicle manufacturers to export their products. These trading companies could not be linked to the producers in the database.



to the country is only 2% as only the labour-intensive assembly stage of production through Foxconn, a Taiwanese company, and the manufacture of some inputs occurs within the country. The rest of the value attributed to Apple profits and the production of components (batteries, software, screens, electrical components, etc.) accrues to other countries such as US, Japan, and Korea amongst others.

In a world of global value chains, competitiveness is determined by proximity to markets, the cost and productivity of labour to complete specific tasks, logistics costs associated with importing and exporting, access to foreign technology, and access to foreign networks through, for example, multinational companies. South African exports of yachting sails, for example, do not depend on access to domestic production of sail fabric, but rather on the company's connection to the international economy via imports of high-end fabrics, acquisition of foreign technology and design through licences, investment, and access to a global network of retail outlets. While the relative importance of the determinants of GVC participation do vary across sectors (Pathikonda and Farole, 2016), there remain large commonalities irrespective of the industry. For example, labour cost competitiveness is a key determinant of whether a firm participates in the assembly process of the GVC, irrespective of whether the firm is in the clothing industry or the electronics industry.

Viewing export participation through the lens of the firm and not only the industry provides different insights for the role of industrial policy. Industrial policy to facilitate participation in GVCs should consider the diverse characteristics and needs of firms across all industries. The implication is a greater focus on *horizontal* policies, rather than vertical policies or targeted policies that favour particular sectors or firms. For example, high trade costs associated with poor transport infrastructure and cumbersome importing and exporting procedures in South Africa are detrimental to GVC participation by manufacturing firms, irrespective of their industry classification. Mitigating these constraints to participation can be expected to generate more participation by firms in exporting from all industries with stronger effects for medium sized firms.¹⁴ Cross-cutting constraints to exporting such as access to imported intermediate inputs, cheap and efficient logistics, foreign investment, etc. also need to be prioritised. An export-led industrial policy needs to provide an environment in which all exporters and potential exporters are able to improve competitiveness (through reduced costs and improved productivity) and grow exports.

The evidence on export performance points to the importance of access to frontier technologies. R&D tax incentives are already provided for, but their use has fallen in line with a decline in business R&D in South Africa and restrictive eligibility conditions (e.g. must produce patentable intellectual property).¹⁵ The tax incentives are also more accessible for large firms. Moreover, the focus on in-house sources of innovative knowhow ignores the importance of accessing foreign knowhow through licencing/royalty agreements, foreign ownership and technology embodied in imports. These have been shown to be important drivers of South African export performance, particularly of high-technology products (Edwards et al., 2022).

The focus on horizontal policies also applies to the Sector Education and Training Authorities (SETAs). The data shows that exporters draw heavily on relatively skilled labour. Exporters are technology-intensive and require flexibility in the work-place to adjust quickly to changes in international demand, both in terms of adjusting production levels, but also in developing new products (product innovation). Competitive pressures require constant process innovation to improve productivity. This requires workers with relatively high levels of cognitive skills, i.e. the ability to think, remember, acquire new knowledge and apply this in knowledge to different settings (Jansen and Lanz, 2013). While some of these skills are industry specific (e.g. knowledge of the value chain and firm specific technical knowledge), many are generic skills that are easily transferable across firms and across industries. The sector specific focus of the SETAs implies that these institutions are not well placed to provide learnerships and training designed around enhancing exports. The Global Exporters Passport Programme (GEPP) of the DTIC does provide training to small, medium and large

¹⁴ See <https://iap.unido.org/articles/african-manufacturing-firms-and-their-participation-global-trade>

¹⁵ The conditions have recently been loosened, which may give rise to an increase in R&D expenditure.



enterprises that wish to expand their export opportunities. This initiative can be expanded, but an alternative may be to re-structure the SETA programme to allow for the provision of learnerships to firms and workers around exporting, irrespective of the industry they are located in.

Such policies do not preclude industrial policies that target sectors or specific firms. But the emphasis on improving competitiveness and boosting exports will shape the type of policies that are utilised. Take, for example, the sectoral Master Plans that have been elevated to be a key mechanism driving the industrialisation programme. Ostensibly, establishing a platform between government, formal business and labour to develop joint initiatives to achieve agreed-upon aims, can be effective in unblocking constraints to growth. However, the broad strategic aim of the Master Plans has not been clearly articulated (Makgetla, 2024), or at least it has not been articulated in terms of creating a competitive sustainable industry. The implication is that the Master Plans have primarily served as vehicles to increase production for the domestic market in the face of imports and to lobby for increased protection and local procurement in return for increased firm investment.¹⁷ Further, the Master Plans mainly represent established formal firms and labour, and not consumers and small businesses or potential businesses (Makgetla, 2024).

An alternative is to re-orientate Master Plans towards improving competitiveness by creating a platform to target specific obstacles to productivity, enhancing investments and resolving government (national and municipal-level) administrative and institutional failures around the provision of productivity-enhancing public goods, rather than as a vehicle to negotiate trade-offs between investment, employment, subsidies and protection.¹⁸ This approach falls in line with the concept of ‘embedded autonomy’ used to characterize an alternative model of regulation, based on iterative collaboration between government and firms (Juhász et al., 2024).¹⁹

3.4 Adopt a simpler and more coherent trade policy

Internal dimension of trade policy

Over the past decade and half, South Africa has adopted a strategic product-level approach towards trade policy, as outlined in the National Industrial Policy Framework (NIPF) (DTI, 2007) in 2007, and the Trade Policy and Strategy Framework (TPSF) launched in 2010 (DTI, 2010). Both frameworks critically assessed the impact of tariff liberalization on South Africa's economy and advocated for a revised policy whereby industrial policy is to lead trade policy, and tariff decisions are to be “conducted on a case-by-case basis, taking into account the specific circumstances of the sector involved” (DTI, 2010: 3). The policy frameworks emphasise the importance of ensuring alignment between tariff policy and industrial policy.

This approach has been characterised by a halting of tariff reductions following the multilateral and preferential trade liberalisation of the 1990s and the 2000s, combined with an increase in product-level tariff changes. As shown in Figure 10, average MFN tariffs hardly changed from 2011 to 2019, in contrast to the declines in protection in the prior periods. In fact, the average MFN increased marginally from 7.9% to 8.1%

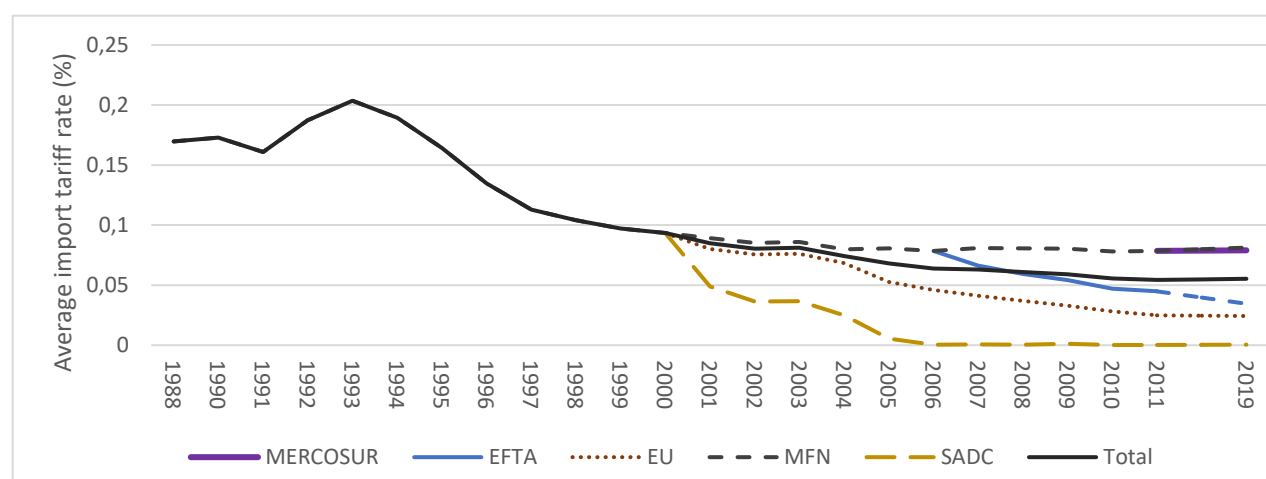
¹⁷ For example, the Furniture Master Plan focuses on supporting local furniture manufacturers to increase local capacity in order to respond efficiently to the growing domestic demand and to reduce dependency on imports. The primary objective of the Clothing, Textile, Footwear and Leather (CTFL) Master Plan is to grow domestic output (to 330,000) and local procurement by retailers along the CTFL value chain, with the aim that local products reach 65% share of total retail sales by 2030. The main goal of the Poultry Master Plan is to grow the output (and jobs) in the domestic poultry industry, increasing its share in consumption over time as well as exporting to regional and international markets. The aim is not to create a competitive poultry industry in which the very high import tariffs are to be reduced.

¹⁸ Poultry example around establishment of domestic institutions to enable exporters to meet the sanitary and phytosanitary requirements to access European markets. However, the primary focus of the Poultry Master Plan

¹⁹ See also the ‘open-window’ approach promoted by the ‘Harvard-group’.

over the period. At the product level, there has been more active use of import-related interventions including changes in customs duties, duty rebates, subsidies and temporary trade measures (anti-dumping duties and safeguard duties). According to Global Trade Alert data (<https://www.globaltradealert.org/>), South Africa imposed 26 harmful trade measures compared to 11 liberalising trade measures on imports of goods each year from 2011 to 2023. Increasingly, reciprocal agreements, where domestic firms are required to make specific commitments on prices, purchases of local goods, employment and/or investment, are required in tariff amendments (XA Global Trade Advisors, 2024).

Figure 10: Simple average tariffs by preference agreement, 1988 to 2019



Source: Chien et al. (2024). Notes: To calculate the simple average tariff rate, tariff rates at the 8-digit product level of the Harmonized System (HS) classification are first aggregated to the HS 6-digit level. The simple average of these 6-digit tariff rates, inclusive of ad valorem equivalents, and import surcharges in the early 1990, are then presented for each preference partner. The average total tariff from 2000 is the weighted average of the General or Most Favoured Nation (MFN) tariff and preference region tariffs using total imports in 2000 from each preference region and the rest of the world as weights.

There are several concerns about whether the approach to tariff setting can be effective in realising industrial policy objectives in a coherent, consistent and effective manner. The first issue is that the approach in the DTIC that the setting of tariffs are not based on any “*a priori* position on the appropriate levels of duties [and] decisions on applications for tariff adjustments or rebates are determined on the basis of case-by-case, detailed investigation and analysis” (DTIC, 2021:2). This approach is fundamentally flawed as it fails to recognise that tariffs impose distortions on the domestic economy, and work as a tax on consumers and a subsidy on producers. The *a priori* position on tariffs should be that they should be set at zero, unless there are clear merits for deviating from this level. Such a position sets a better foundation to consider the determination of appropriate tariffs for industrial policy purposes. Tariffs for industrial policy purposes, in this case, are an *exception*. Clear motivation is thus required for any deviation from the default of zero tariff. Without any rule (*a priori* position), there is no counterfactual to assess the appropriateness of any tariff level or tariff change.²⁰

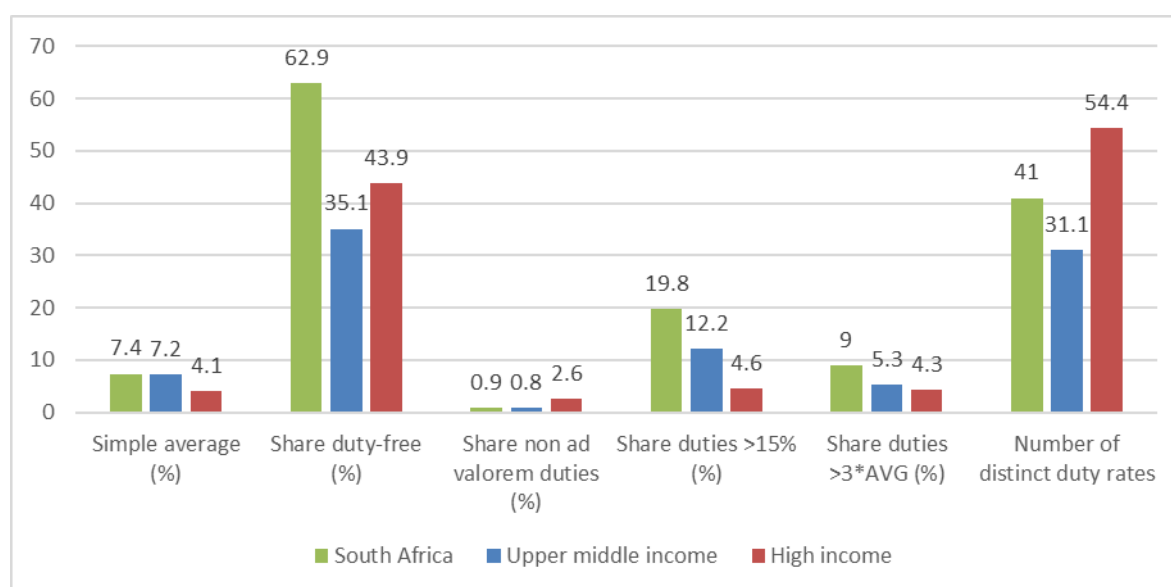
Secondly, the argument that there is no *a priori* position on the appropriate level of tariffs is incorrect, at least in relation to existing tariffs. The implementation of the new tariff policy was not accompanied by a comprehensive re-evaluation of the appropriateness of the existing set of tariffs.²¹ The structure of tariffs adopted, in part, reflects the country’s long history of industrial policies and industrial lobbying. The *a priori* position is, therefore, by default that the existing structure of tariffs provides appropriate incentives and are aligned with South Africa’s industrial policy.

²⁰ See Edwards and Lawrence (2007) for further discussion on the SACU tariff structure.

²¹ There was a re-assessment of some tariff lines in 2009, but this re-assessment was not comprehensive in its coverage of products.

Thirdly, South Africa's tariff structure is relatively complex compared to other middle-income countries. Although the tariff structure has been rationalised, the South African (rather SACU) tariff book retains a relatively high number of distinct tariffs (41 compared to 31 for upper-middle-income countries), with higher shares of non-agricultural products facing duties in excess of 15% (19.8% vs. 12.2% for upper-middle-income countries) and duties above 3 times the average (9% vs. 5.3% for upper-middle-income countries) (Figure 11). A contrast with the East African Community (EAC) customs union is illustrative. The EAC CET has a four-band structure of 0% for raw materials and capital goods, 10% for intermediate goods, 25% for finished goods and 35% for a list of specified products. Member states can also apply to include products on a separate sensitive products list that may attract duty rates of above 25%. The contrast with South Africa is that the EAC process is subject to clear(er) rules, is more transparent and results in a simpler tariff structure that provides clearer indications of the incentives provided.²²

Figure 11: International comparison of SACU tariffs on non-agricultural goods, 2023

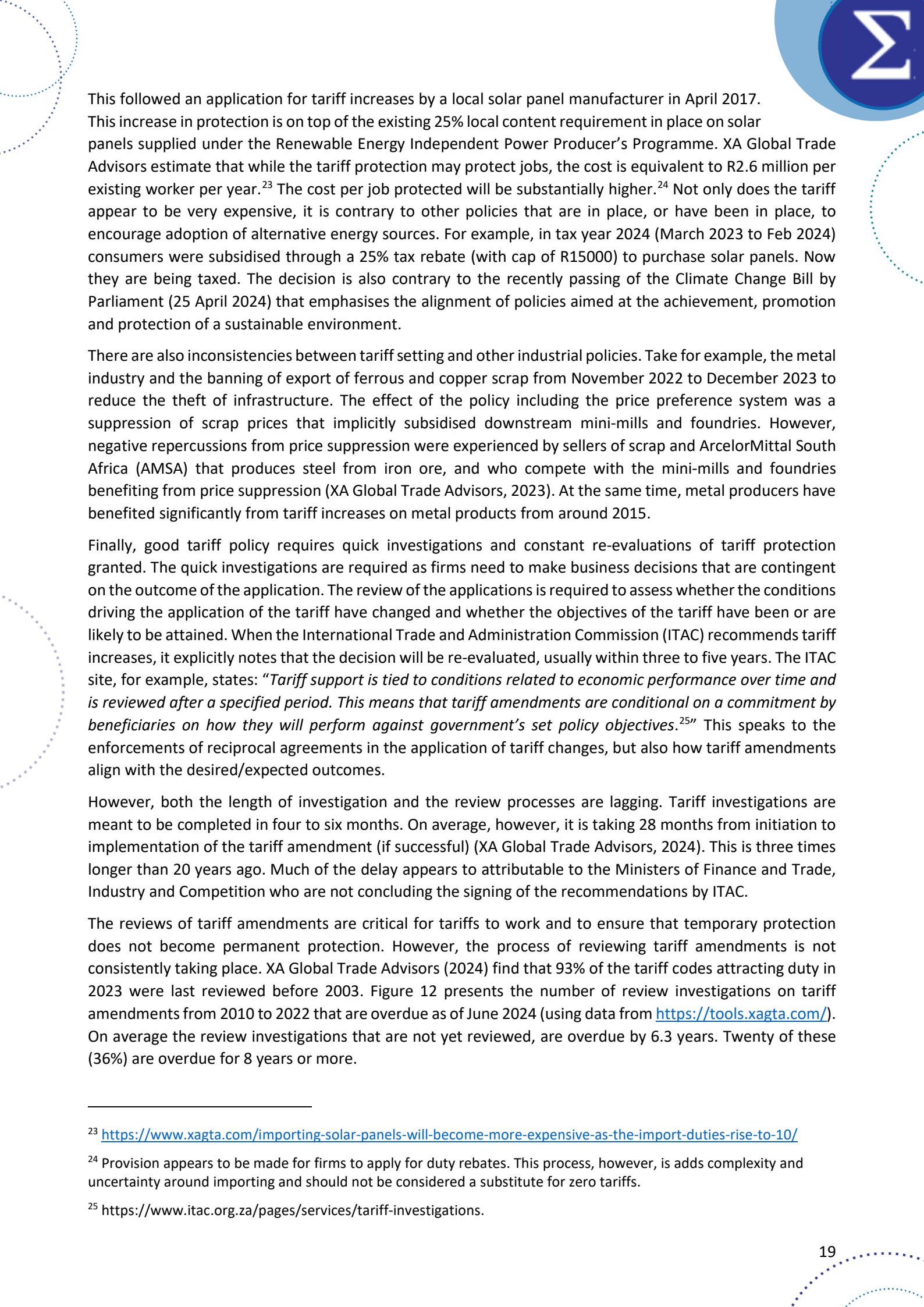


Source: Own calculations using data obtained from the World Trade Organisation World Trade Profiles 2024.

Fourthly, too little consideration has been placed on the price implications of tariff setting. In the tariff applications, as reflected in the tariff investigation reports, much emphasis is placed on the domestic firm's competitiveness with respect to imported products, including input costs, profit margins, market share, job losses, and price suppression. Tariffs are then set to offset the price disadvantage. Without a clear rule governing the level of tariffs that are possible (e.g., distinct bands), this approach has the danger of rewarding inefficiencies. Further, from an assessment of the tariff investigation reports, there is little rigorous analysis on how tariffs are likely to impact consumer prices or downstream users. Exceptions are the several applications by the South African Poultry Association for increases in the general duty and anti-dumping or safeguard duties on poultry imports, given the importance of the product for low-income consumers, and the active media debate on the price effects. These considerations, nevertheless, did not prevent large increases tariff and anti-dumping duties on frozen chicken imports (e.g. tariff on frozen bone-in chicken pieces rose from 220c/kg or 18% ad valorem equivalent to 37% in September 2013 and then to 62% in March 2020). These tariff increases have been associated with a rise in retail prices, with disproportionate negative impacts on poor households (Edwards et al., 2022).

Fifthly, the product-by-product tariff setting approach has led to inconsistencies between trade policy and other economic policies. In July this year, for example, import tariffs on solar panels rose from zero to 10%.

²² Although, increased use of the Stays of Application by countries for deviations in tariffs from the common external tariff in the EAC are undermining the effectiveness of the customs union (Rauschendorfer and Twum, 2022).



This followed an application for tariff increases by a local solar panel manufacturer in April 2017. This increase in protection is on top of the existing 25% local content requirement in place on solar panels supplied under the Renewable Energy Independent Power Producer's Programme. XA Global Trade Advisors estimate that while the tariff protection may protect jobs, the cost is equivalent to R2.6 million per existing worker per year.²³ The cost per job protected will be substantially higher.²⁴ Not only does the tariff appear to be very expensive, it is contrary to other policies that are in place, or have been in place, to encourage adoption of alternative energy sources. For example, in tax year 2024 (March 2023 to Feb 2024) consumers were subsidised through a 25% tax rebate (with cap of R15000) to purchase solar panels. Now they are being taxed. The decision is also contrary to the recently passing of the Climate Change Bill by Parliament (25 April 2024) that emphasises the alignment of policies aimed at the achievement, promotion and protection of a sustainable environment.

There are also inconsistencies between tariff setting and other industrial policies. Take for example, the metal industry and the banning of export of ferrous and copper scrap from November 2022 to December 2023 to reduce the theft of infrastructure. The effect of the policy including the price preference system was a suppression of scrap prices that implicitly subsidised downstream mini-mills and foundries. However, negative repercussions from price suppression were experienced by sellers of scrap and ArcelorMittal South Africa (AMSA) that produces steel from iron ore, and who compete with the mini-mills and foundries benefiting from price suppression (XA Global Trade Advisors, 2023). At the same time, metal producers have benefited significantly from tariff increases on metal products from around 2015.

Finally, good tariff policy requires quick investigations and constant re-evaluations of tariff protection granted. The quick investigations are required as firms need to make business decisions that are contingent on the outcome of the application. The review of the applications is required to assess whether the conditions driving the application of the tariff have changed and whether the objectives of the tariff have been or are likely to be attained. When the International Trade and Administration Commission (ITAC) recommends tariff increases, it explicitly notes that the decision will be re-evaluated, usually within three to five years. The ITAC site, for example, states: *"Tariff support is tied to conditions related to economic performance over time and is reviewed after a specified period. This means that tariff amendments are conditional on a commitment by beneficiaries on how they will perform against government's set policy objectives."*²⁵ This speaks to the enforcements of reciprocal agreements in the application of tariff changes, but also how tariff amendments align with the desired/expected outcomes.

However, both the length of investigation and the review processes are lagging. Tariff investigations are meant to be completed in four to six months. On average, however, it is taking 28 months from initiation to implementation of the tariff amendment (if successful) (XA Global Trade Advisors, 2024). This is three times longer than 20 years ago. Much of the delay appears to be attributable to the Ministers of Finance and Trade, Industry and Competition who are not concluding the signing of the recommendations by ITAC.

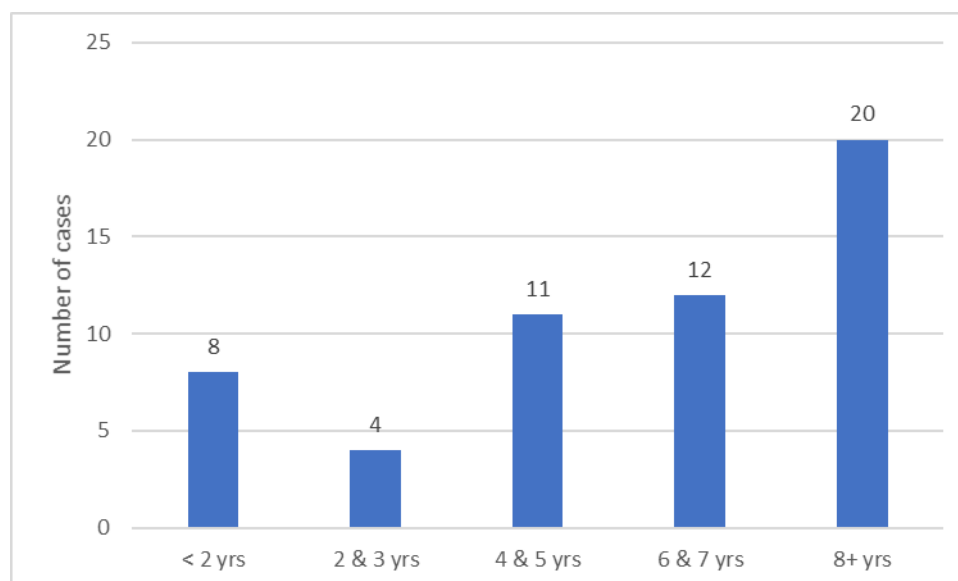
The reviews of tariff amendments are critical for tariffs to work and to ensure that temporary protection does not become permanent protection. However, the process of reviewing tariff amendments is not consistently taking place. XA Global Trade Advisors (2024) find that 93% of the tariff codes attracting duty in 2023 were last reviewed before 2003. Figure 12 presents the number of review investigations on tariff amendments from 2010 to 2022 that are overdue as of June 2024 (using data from <https://tools.xagta.com/>). On average the review investigations that are not yet reviewed, are overdue by 6.3 years. Twenty of these (36%) are overdue for 8 years or more.

²³ <https://www.xagta.com/importing-solar-panels-will-become-more-expensive-as-the-import-duties-rise-to-10/>

²⁴ Provision appears to be made for firms to apply for duty rebates. This process, however, adds complexity and uncertainty around importing and should not be considered a substitute for zero tariffs.

²⁵ <https://www.itac.org.za/pages/services/tariff-investigations>.

Figure 12: Number of review investigations overdue, by years overdue, 2010-2022



Source: Own calculations using data obtained from XA GTA <https://tools.xagta.com/>. Data as of June 2024.

External dimension of trade policy

Trade policy also has an external dimension, namely improving exports through enhancing access to foreign markets. The primary mechanism to achieve this has been through free trade agreements, but government-to-government negotiations on non-tariff measures (e.g., sanitary and phytosanitary barriers and technical barriers to trade) have become increasingly important, particularly for agricultural exports.

With the exception of trade agreements with Africa, the external dimension of trade policy has been neglected. Whereas in the 1990s and early 2000s, market access for South African exporters improved through multilateral liberalisation under the WTO and a programme of trade agreements that covered substantially all trade in goods (but not services) (e.g. the European Union and Southern African Development Community), this shifted following the TPSF. The TPSF adopted a more defensive stance towards multilateral tariff liberalization within the World Trade Organisation that emphasised market access in developed countries, the elimination of industrial country subsidies and support to agriculture, and the ensuring of sufficient policy space for developing countries to pursue developmental objectives (Edwards and Lawrence, 2012). South Africa has also shown resistance to participation in plurilateral discussions on e-commerce in WTO. More analysis on the costs and benefits of an e-commerce agreement for South Africa needs to be done, but by not participating, South Africa faces the danger of being left out of the discussion and losing opportunity to shape global policies on e-commerce.

Moreover, the TPSF signalled a shift towards narrower and more strategic objectives concerning trade and investment agreements as reflected in the partial scope agreement that covered very few products with the Southern Common Market (MERCOSUR) from 2016 onwards. There is little evidence that there has been any substantial benefit in terms of increased trade from the MERCOSUR agreement. This approach on using partial scope agreements in bilateral trade negotiations should be re-considered.

Trade agreements with Africa are the exception, with several successes of the DTIC. Starting in 2015, members of the Southern African Customs Union (SACU) initiated negotiations for the establishment of a Tripartite Free Trade Area involving the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC), and SADC. These negotiations were overshadowed by the subsequent discussions on establishing the more extensive African Continental Free Trade Area (AfCFTA), which officially commenced on January 1, 2021; and the Tripartite Free Trade Agreement has still not been concluded.



The AfCFTA has the potential to substantially increase South African exports to the region. Although SA already has preferential access into the SADC region through a Free Trade Agreement, tariff barriers by other African countries on SA exports are relatively high. The AfCFTA also includes services that have been left out of South Africa's existing trade agreements. This provides South Africa with an opportunity to cement and expand services trade with the region. Further, the AfCFTA contains a Protocol on Digital Trade, plus Annexes that cover trade facilitation, border cooperation, and non-tariff measures. Reductions in trade costs through implementation of these annexes will have significantly larger impacts on SA exports to the region than the tariff reductions alone (World Bank, 2020).

Finally, the global trading environment is changing rapidly. Geopolitical tensions are driving inshoring, nearshoring and friendshoring.²⁶ Climate change policies, the greening of trade and green industrialisation are shaping industrial policies abroad, with implication for South Africa. Large production subsidies by other countries, for example on solar panels, may close opportunities for development of these industries locally. The implementation of carbon border taxes (CBAM) by the EU, which are also being considered by other countries (UK, Australia) pose particular challenges for South African exporters given the direct and indirect carbon-intensity of production. Other parts of the EU's Green Deal (for example regulations on deforestation-free supply chains) will also reshape global trade.²⁷ Digital trade (services) and digitally enabled trade (e-commerce platforms) are opening up new opportunities to access international markets, but also pose competitive threats to domestic import competing firms. Plurilateral discussions on e-commerce in WTO are working at shaping global policies on e-commerce. These policies require government-to-government cooperation on digital technical governance and digital technical standards (e.g. policies on open global internet, digital identities, e-invoicing, personal data protection, cross border data flows, AI governance framework, online consumer protection).²⁸ South Africa's trade and industrial policy will need to be dynamic and responsive to this changing global trade environment.

Concluding points on trade policy

The above discussion signals the need for a re-think of the role, objective and approach towards trade policy and its implementation in South Africa.

First, a comprehensive process of reviewing all existing tariffs should take place. At first, this process can focus on identifying products that are not or no longer produced by domestic firms. The tariffs on these goods should be reduced to zero immediately as there are no economic benefits from the tariffs. This can then be followed by a process whereby tariffs on products currently produced domestically are reviewed.

Second, the review process needs to be superseded by a re-evaluation of the purpose of tariff protection, and how specifically the setting of tariffs are supposed to align with industrial policy. In particular, greater emphasis should be placed on how tariff protection will improve the international competitiveness of the domestic industry or firm.

Third, the tariff structure should be simplified. Currently, there is no consistency in the level of protection afforded to different products. For example, the tariff on imports of fresh potatoes is 0.44c/kg but 30% if frozen, on fresh peas the tariff is 15% but 10% if frozen and 30% if dried and split, whereas fresh bean face zero tariff, compared to 10% if frozen and 15% if dried. Fresh cauliflower, lettuce, and carrots face no tariffs, but onions and leeks face a 10% tariff and garlic is taxed at 325c/kg with a maximum of 37%. Such a complicated tariff structure does not send clear signals to producers of the industrial policy priorities of the government. The recommendation is to significantly reduce the number of tariff bands (for example to 4 as is recommended by Edwards and Lawrence (2008)).

²⁶ <https://unctad.org/news/global-trade-resumes-growth-first-quarter-2024>

²⁷ <https://www.chathamhouse.org/2023/01/global-trade-2023/trade-and-transition-green-and-digital-economies>.

²⁸ See the Digital Economy Partnership Agreement (DEPA) between Singapore, Chile and New Zealand.



Fourth, the decision on tariff amendments should place much more weight on the price impacts and the downstream implications for consumers and producers using the goods as inputs in production. The tariff amendment application form requires applicants to answer *“To what extent will your firm’s selling price for the product be influenced should the application for amendment in the duty be successful?”*.²⁹ This can be expanded to include the costs (not just benefits) to downstream users of price increases, the impact on retail prices, plus how households at different income levels will be affected. Further, the investigators in ITAC should provide independent evaluations of the price effects through internal research, without relying too heavily on the submissions of the applicants and the respondents. Finally, the evaluations of the tariff changes should explicitly cover the cost to society of the tariff change, as measured for example by price changes, cost per job, and upstream and downstream effects.

Fifth, there needs to be greater transparency on how the tariff decision is made, and the conditions associated with the reciprocal agreement (if any). This information should be published in the investigation report. Further, firms in tariff investigation reports are able to hide critical information, e.g., on prices, employment, sales, profitability, from the public. This needs to be re-evaluated, and sufficient information should be provided in the published investigation reports for the public to hold the firms and ITAC to account. The cost of the tariffs are born by the broader society, while the gains are concentrated amongst few firms. Sufficient information should be available for the public to draw their own assessment of the gains and costs of the tariff change.

Sixth, a trend appears to be emerging whereby tariff increases are granted, but provisions are provided to allow for duty rebate to import should domestic supply not be available. This process should not be encouraged. Duty rebates are not a substitute for zero tariffs. They require lengthily bureaucratic procedures, often including confirmation by domestic suppliers on availability of products, and they benefit larger firms that have the capacity to apply for them. They impose uncertainty on the cost of access and availability of intermediate inputs, and thereby increase the risk to firms in meeting supply obligations.

Seventh, there needs to be much stronger and more regular reviews and evaluations of the economic effects of the tariffs plus how the protection has contributed towards improving the competitive outcomes of the firm. One approach is to set automatic time limits to tariff amendments to avoid the current situation whereby temporary protection becomes permanent protection. Extension by default would then require a re-evaluation of the merit of the tariff change.

Eighth, the external dimension of trade policy should shift beyond Africa and consider how to improve market access in new countries. South Africa already faces low tariff barriers in accessing markets of advanced economies (e.g. EU trade agreement, African Growth and Opportunity Act with the United States). The exception is in agricultural products, where tariffs are high and non-tariff barriers are prevalent. It is in accessing emerging economies that South African firms face the highest tariff barriers. Strategies, including possible trade agreements that cover substantially all trade (not the partial trade agreement approach) with emerging economies need to be considered. A market access strategy, supported by empirical research, can inform the government and firms of new export opportunities, and barriers to realising these opportunities.

Nine, the AfCFTA provides an opportunity to grow South African exports. However, the gains will mainly be associated with reductions in trade costs following implementation of the annexes covering trade facilitation. South African government can take a lead in fast-tracking discussions within the AfCFTA on these annexes.

3.5 Stop ignoring services

Trade and industrial policy has prioritised manufacturing to the neglect of services. While South Africa has several trade agreements that cover trade in goods, no trade in services agreement has been concluded. This

²⁹ <http://www.itac.org.za/pages/services/tariff-investigations/application-forms>.



is expected to change with the implementation of the AfCFTA Protocol on trade in services. Nevertheless, this lack of emphasis on services agreements, particularly in relation to the region, is surprising given the strong presence of South African services companies in Africa (telecommunications, entertainment, construction, retail, banking). A much stronger focus of trade and industrial policy on services is merited on several fronts.

Firstly, while manufacturing has traditionally been seen as the vehicle through which to propel structural change and productivity growth, there is increasing recognition that services are also pathway to achieving this outcome (Nayyar et al., 2021). Empirical analysis, for example, shows how services, particularly in financial services, appear to have played a more significant role than manufacturing in both within-sector and between-sector productivity growth in most world regions, including Sub-Saharan Africa (Heitzig et al., forthcoming 2024). This blurring of the line between services and manufacturing as a source of productivity growth requires industrial policy to move beyond manufacturing to include services (Juhász et al., 2024).

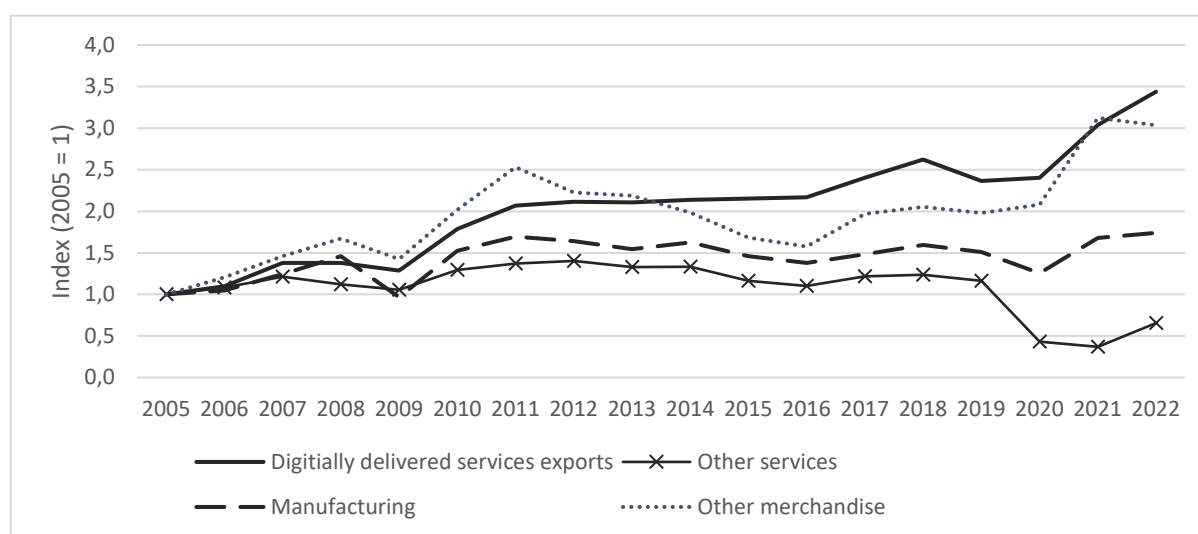
Secondly, digitalisation has expanding access to markets and opportunities for innovation and trade in the services sector (Nayyar et al., 2021). This includes trade in research and development services, data processing, professional services (e.g. architectural, legal, management, scientific, etc.), education and health services, audio-visual services, etc. Globally, digitally delivered services trade (Mode 1) have experienced a nearly fourfold increase in value since 2005, significantly outpacing the growth of goods and other services exports.³⁰ This trend holds for South Africa as well. As shown in Figure 13, digital delivered services exports by South Africa rose by 244% between 2005 and 2022 (from 1.73 US\$ billion in 2005 to 5.93 US\$ billion in 2022). This far exceeded the growth in other services, that fell by 35% over the period (mainly due to tourism following COVID-19 pandemic), and merchandise exports (138%) raising its share of services exports from 14.9% in 2005 to 48% in 2022 (or from 2.7% to 4.4% in total exports). South Africa's digital delivered services exports, nevertheless, grew slower than the global average of 276% over the period.

Digital trade requires different policies. The promotion of digitally delivered services requires policies around provision of **digital infrastructure** (duty free access of imports of ICT goods, competition in provision of telecommunications), an enabling and predictable **regulatory environment** (covering data regulations, ensuring cybersecurity, data privacy, consumer protection...), plus clear and consistent **digital governance** through multilateral, bilateral and regional trade agreements that deal with cross-border data flows.

There is much policy work for South Africa to do in these areas. According to OECD data, South Africa's regulatory environment is more restrictive than other countries, on average, with restrictive regulations governing infrastructure and connectivity the most binding (Figure 14). In 2023, South Africa was ranked the 15th (out of 90 countries) most restrictive economy in terms of digital trade. On digital governance negotiations under the World Trade Organisation (WTO), South Africa is not participating in the plurilateral track to discuss e-commerce rules through the Joint Statement Initiative (JSI). By not participating, South Africa is losing an opportunity to influence the direction and content of these negotiations.

³⁰ Digitally delivered services covers all international trade transactions that are delivered remotely over computer networks. https://www.wto.org/english/blogs_e/ce_ralph_ossa_e/blog_ro_15dec23_e.htm

Figure 13: Index of South African exports of digitally delivered services, other services, manufacturing and other merchandise from 2005 to 2022 (2005 = 1)

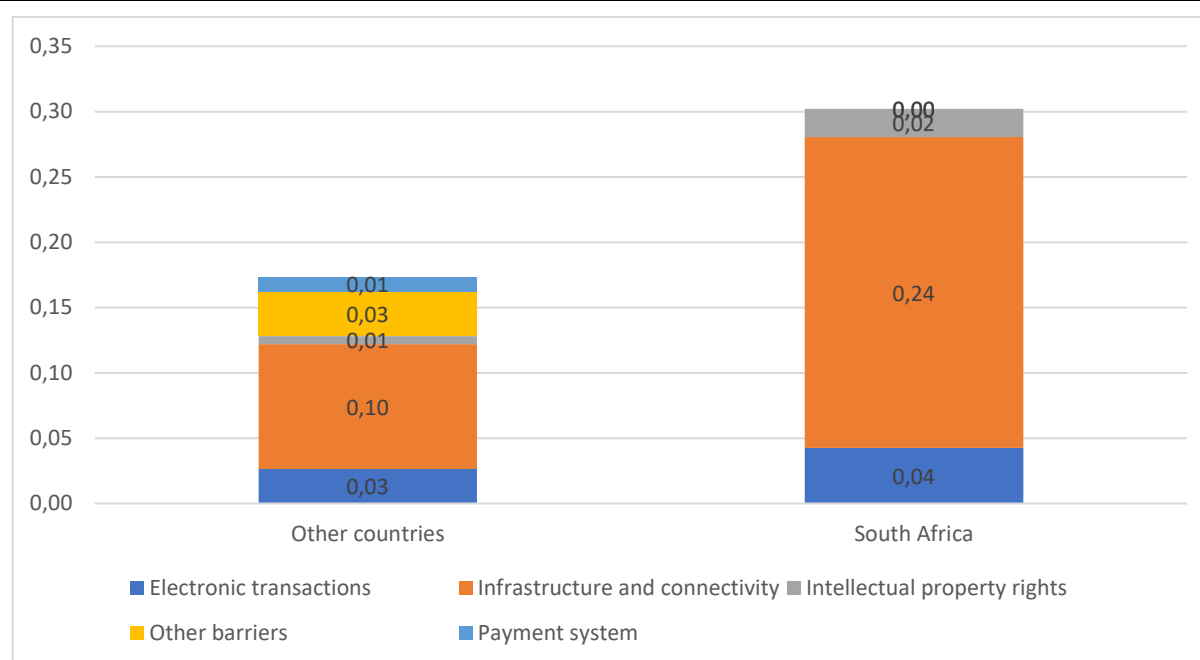


Source: TradeMap for commercial services exports, WTO-OECD Balanced Trade in Services dataset for digitally delivered services, and WTO Stats for merchandise exports. All data are originally valued in US\$. Digitally delivered trade is defined as all international trade transactions that are delivered remotely over computer networks.

A third reason for a stronger focus on services is that services are increasingly an enabler for manufactured good exports. This is particularly the case for global value chain industries where services provide a dual function as an intermediate input in production, and as a facilitator co-ordinating the different stages of production across geographical locations (Manghnani et al., 2021). According to the OECD Trade in Value Added database, the value added from services and utilities (electricity, water, waste, construction) make up 36% of the gross value of manufacturing exports in SA. The implications are twofold: firstly, growth in manufacturing exports has a strong positive spillover effect (indirect effect) on demand for services, and, secondly, a competitive services sector enhances the competitiveness of manufacturing exports (Edwards, 2020).

Finally, exports of services can be an effective vehicle to generate jobs, including for the less-skilled. Tourism, for example, is a sector with enormous potential to expand. The collapse in tourism during the COVID-19 pandemic was the major driver of the decline in services exports during this period, and has yet to recover to pre-COVID levels. Tourism expenditure comprises a high share of domestic value added, implying that its growth has strong direct and indirect effects on the rest of the economy, including employment (Edwards, 2020).

Figure 14: Digital trade restrictiveness index for South Africa compared to the average for other countries, 2023



Source: Own calculations using Digital Services Trade Restrictiveness Index data obtained from the OECD data explorer. The values for Other countries are calculated as the simple average across 89 countries.

4 Conclusion

If South Africa is to sustain higher levels of economic growth, it is imperative that exports increase. This necessity arises because export revenue is crucial to offset the rising import costs that accompany higher rates of growth in investment, production, and consumption. Exports must not only support economic growth but also lead it. The domestic economy is too limited in its absorptive capacity—consumption, government spending, investment—to drive sustained economic growth levels. For several years, regional and global demand for goods and services has outpaced economic growth in SA. By tapping into faster-growing foreign markets, exports can help overcome domestic demand constraints to growth. Although global trade growth has plateaued, SA's small share of world trade still offers considerable potential to expand into export markets and drive higher economic growth.

Another reason for boosting export growth, particularly in manufactured goods, is to drive structural transformation. Manufacturing's share of gross domestic product is declining, raising concerns about premature deindustrialisation. One reason for this is the economy's failure to develop a competitive manufacturing industry that can compete globally in export markets. Use of protective barriers to insulate domestic firms from competition are likely exacerbate deindustrialisation, unless these firms are able to grow into exporters.

Shifting towards exporting also raises aggregate productivity. Manufacturers who export in South Africa are up to 50% more productive (measured by value added per worker) than those who do not. This outcome arises because more efficient firms are more likely to enter into exporting, but also because firms learn through exporting and investing in productivity-enhancing technologies. Thus, growth in exports will boost aggregate productivity by increasing productivity within firms and shifting the aggregate production composition towards these relatively productive firms.

Finally, export growth can have large positive effects on employment, both directly, and indirectly through demand for services and intermediate inputs. Income from exports feeds into domestic consumption, which



then further indirectly stimulates employment growth. Services, including tourism, present an additional opportunity to grow exports, and given their labour intensity, to boost employment.

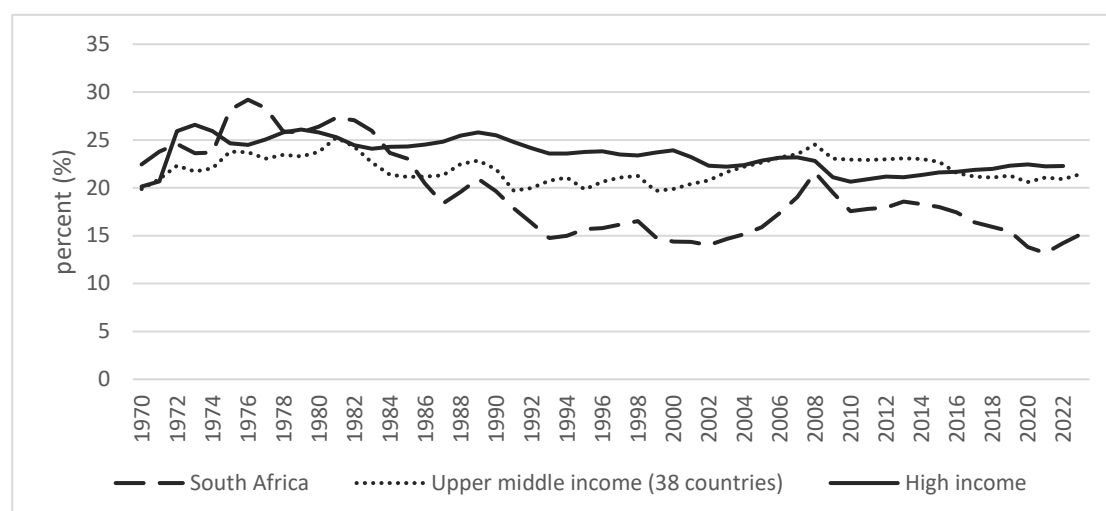
To achieve export-led growth requires a change in South Africa's approach towards trade and industrial policy. Localisation policies will not generate an export base. Policies that specifically target exporting are required. Emphasising export policy is consistent with what is happening abroad. As reviewed by Juhász et al. (2003), contemporary industrial policies, more often than not, target outward-orientation and export promotion, rather than inward-looking protectionist policies. This generally involves, amongst others, prioritisation of export and trade facilitation and provision of trade finance. Further, modern industrial policy increasingly focusses on engagements with firms around alleviating specific constraints to firm growth and the provision of productivity-enhancing public inputs instead of subsidies and tariffs (Juhász et al., 2003). Many of these policies are horizontal in nature, and not sector specific. Much can be learnt by detailed studies of successful export-driven industrial policies abroad.

Appendix A

Table A1: South African exports by technology classification

South African exports by technology classification	2000	2010	2023
Total value (US\$ billions)	29.8	79.1	99.9
Share total value (%)			
Gold	13.5	10.3	6.3
Primary, excl. gold	32.4	30.1	33.6
Total manufacturing	54.1	59.2	59.5
Manufacturing industries			
<i>Resource based manufactures</i>	<i>19.0</i>	<i>24.1</i>	<i>26.2</i>
RB1: Agro/forest-based	7.7	5.6	5.3
RB2: Minerals-based	11.3	18.5	20.8
<i>Low technology manufactures</i>	<i>8.6</i>	<i>5.7</i>	<i>3.7</i>
LT1: 'Fashion cluster'	2.3	0.6	0.6
LT2: Other low technology	6.3	5.1	3.2
<i>Medium technology manufactures</i>	<i>22.6</i>	<i>27.0</i>	<i>27.3</i>
MT1: Automotive	5.6	7.9	11.5
MT2: Process industries	10.7	11.5	9.7
MT3: Engineering industries	6.3	7.6	6.1
<i>High technology manufactures</i>	<i>3.8</i>	<i>2.4</i>	<i>2.2</i>
HT1: Electronics and electrical	2	1.5	1.2
HT2: Other high technology	1.8	0.9	1.0
Total resources (Primary, resource manufactures, iron & steel)	69.4	71.8	71.5

Figure A1: Gross fixed capital formation as share GDP (%)



Source: World Development Indicators. Upper-middle-income countries cover 38 countries for which data are available over the 1995 to 2023 period. Prior years are extrapolated using the simple average across all available upper-middle-income countries for which data are available (21 to 38 countries per year).

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