South Africa's new economic proposals highlight the role of services

By Justin Visagie

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South Africa's Finance Minister Tito Mboweni recently published a package of economic policy proposals that warrant serious consideration. They are aimed at reviving the flagging economy whose growth over the past five years has averaged only 1.1% while the real rate of unemployment has climbed towards 40%.

South African companies have strengths on which to build on, particularly in telecoms Shutterstock

A novel feature is the attention given to the role of service industries in bolstering the economy.

This emphasis on service (or tertiary) sectors is partly justified by their strong growth of over 6% per annum since 2009. This is much faster than primary or secondary industries. A recent World Bank study found that increases in service industry productivity in South Africa have also outstripped agriculture, mining and manufacturing over the last three decades. So services seem to be well-positioned for further growth.

Services are prominent in three of the five overarching themes in the Ministry of Finance's growth agenda:

- modernising network services, such as telecommunications and transport;
- prioritising labour-intensive growth, including tourism in rural and urban areas; and
- export competitiveness and regional growth opportunities, which flags the potential for construction, logistics and financial services.

A growing role for services

Services have traditionally not featured strongly in developing countries' economic strategies. They have been viewed as "non-tradable" – their production and consumption often take place within the same territory. This means that trade in services is usually local. It follows that the creation of an industrial base can sustain domestic demand. Manufactured goods, by contrast, are tradable. This is why manufacturing was the engine of growth in economies such as South Korea, Taiwan, China, Malaysia and other East Asian countries.

However, the role of services is changing. They are making a bigger contribution to global value chains. Advances in digital technology and air travel have improved the tradability of many services. Leading multinationals are also outsourcing routine activities, including labour-intensive manufacturing. They are focusing instead on higher-value services such as research and development, design, marketing and after-sales support. As a result, service exports have risen from 9% of global exports in 1970 to 20% in 2014. They are now the fastest growing portion of global trade.

Services are becoming a significant input into manufactured goods. This is in response to consumer demand for more sophisticated and branded products. Knowledge-intensive services are also a key ingredient in raising productivity and competitiveness across agriculture, mining and other sectors. Advanced producer services strengthen other industries by upgrading their capabilities. They help to adapt products to new markets, reduce waste and facilitate external trade.

This shows that, rather than being an alternative to manufacturing, mining or agriculture, services are complementary.

Challenges of building capabilities

Of course the service economy is far from homogenous and generalisation is dangerous. There is a huge variety between service firms in terms of their capital intensity, technical sophistication, skill requirements and types of destination markets.

Less complex sectors such as transport and tourism have considerable scope for business start-ups and growth. They also have enormous potential for job creation. The outsourcing of all kinds of business processes and data management from advanced economies to third-party providers, offers other opportunities for rapid job growth for countries like South Africa.

Building capabilities in higher-value services is more challenging but offers strategic benefits. These include helping other firms to upgrade and adapt to changing market conditions and intensified foreign competition. For instance, advanced design and engineering services can help local and regional economies adjust to a whole series of disruptive new technologies. These include artificial intelligence, robotics and the "internet of things".

Opportunities for service exports

Recent regional trade agreements create possibilities for expanding trade in services between African firms. For instance, the Southern African Development Community's Trade in Services Protocol commits countries to explore opportunities in six priority sectors: communications, construction, energy, finance, tourism and transport.

South African companies have real strengths on which to build, particularly in telecoms and financial services. Telecoms giant MTN currently has more than 230 million subscribers and the dominant market share in 14 of the 22 African countries where it operates. This excludes South Africa, where it is number two. Standard Bank claims to be Africa's largest lender and generated more than 30% of its headline earnings outside South Africa. The insurance group, Sanlam, has major operations in 11 countries across Africa.

Our research suggests that these successes are somewhat isolated. Service exports across Southern Africa are not realising their true potential. They typically contribute less than 15% of each SADC country's trade balance. Service exports are also skewed towards lower-value transport and travel sectors.

There are signs, though, of stronger growth in certain higher-value commercial services such as IT and telecoms.

What's to be done?

Further research is needed to understand the market opportunities.

For instance, there is enormous scope to build a cluster of integrated urban services to support rapid urbanisation occurring elsewhere on the African continent. Building functional cities requires holistic planning and massive investment in urban infrastructure and the built environment. South Africa is further forward in the urban transition. It has a range of competencies to offer other African countries in mutually-beneficial arrangements.

Different businesses, universities and professional bodies engaged in engineering, design, real estate, surveying and finance could be encouraged to work together to pool their know-how and technical expertise. In building roads, dams, power stations and sewage systems there would be valuable linkages back to construction companies and domestic suppliers of plants and equipment.

Vision and leadership are required to connect these skill-sets and to create partnerships with other governments and companies to harness the potential.

More research is also required on how to overcome the obstacles faced by South African firms and to boost their performance in different service sectors. It matters a great deal whether their growth is mainly constrained by trade barriers and bureaucratic procedures, or by the restrained mindsets and strategies of the firms themselves.

The proposals outlined in the Ministry of Finance's economic policy paper could open up new possibilities for a range of service industries where South Africa has proven capabilities and unrealised potential.

ABOUT THE AUTHOR

Justin Visagie, research specialist: Human Sciences Research Council, *Human Sciences Research Council* and Ivan Turok, Executive Director, *Human Sciences Research Council*