

Dancing with dragons

Can South African firms compete with Chinese imports?

China's growing edge in export manufacturing has caused concern for low-income and middle-income countries seeking to develop robust manufacturing sectors. China's recent transition from an exporter of lower-tech goods, such as garments, to more advanced products, such as components for high-tech products has strengthened these concerns, especially for middle-income countries trying to build or maintain a competitive edge in more technologically advanced sectors. Policy makers and other experts worry that Chinese imports might undermine the breadth and depth of ongoing industrialization in the developing world.

Since the end of apartheid, South Africa has experienced increasing integration into the global economy alongside ongoing intensification of competition from China. This process has gone hand-in-hand with severe unemployment, poor growth performance, and premature deindustrialization which makes South Africa, a major middle-income country, an excellent case study.

Despite concerns that competition from Chinese imports may play a role in shaping the performances of manufacturing firms in South Africa, the issue has never been studied. The release of new company data allows for the first evidence-based analysis of the issue.

The impact of growing Chinese imports on South African firms

From 2010 to 2017, direct exposure to Chinese imports in the South African market grew rapidly from around 5% of total domestic consumption to over 8%. The increase may have negatively affected employment growth, sales growth, and the survival rate of South African manufacturing firms. Over this period, every percentage point increase in Chinese import penetration was found to be associated with a decrease in annual firm employment growth and sales growth of approximately 1.3 and 1.4 percentage points respectively.

Given firm-level differences, we checked if Chinese import penetration is associated with similarly negative

FINDINGS

Chinese imports to South Africa have increased over the last decade, especially in advanced manufacturing sectors

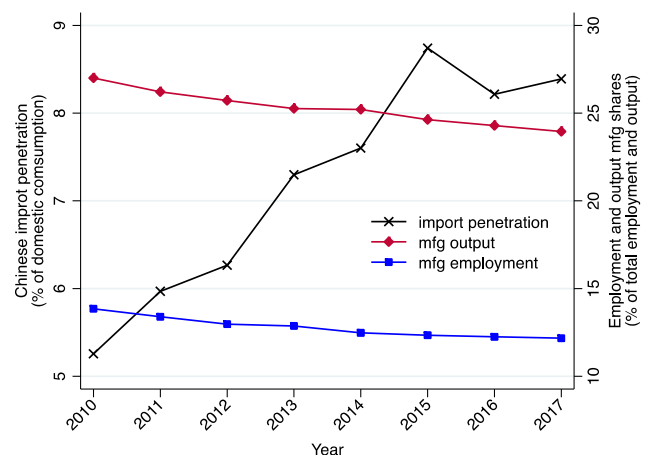
Chinese import competition in South Africa is negatively impacting manufacturing firms in terms of their employment growth, sales growth, and survival rates

Manufacturing firms that invest in developing capabilities are more resilient to Chinese competition and have reduced risk of shutting down

The negative impacts of Chinese imports on domestic firms tends to propagate along the supply chain upstream, that is from a firm to its suppliers backward in the domestic supply chain

impacts across types of firms. Two main groups were compared, finding that firms which invest in capabilities development — such as machinery, R&D, royalties, training — tend to be more resilient to Chinese import penetration than firms that do not. In fact, the less companies invest the greater the chance of a shut-down resulting from Chinese import penetration. Specifically, over 2010–17, a 1 percentage point increase in import penetration from China is associated with a 0.4 percentage

Figure 1: Trends in manufacturing output, employment, and Chinese import exposure in South Africa, 2010-17



point increase in the probability of closure for these firms.

However, while firms investing in capabilities development do relatively better, they are only able to mitigate the negative impact of Chinese import penetration to a limited extent. This is because the number of firms in South Africa making substantial and sustained investments is currently too small to have a positive systemic impact through spillover effects.

An important feature of the research is its analysis of the extent to which Chinese import competition has a systemic impact on the South African productive economy overall; specifically, propagating from one firm to another. According to the estimates, increasing Chinese imports among a firm's downstream clients also contributes to the reduced employment growth, sales growth, and survival rates of supplying firms.

This indirect effect of import competition, which propagates through domestic intersectoral linkages, is particularly important to middle-income countries like South Africa as they work to increase domestic value addition and productivity to escape the middle-income trap and reverse the course of premature de-industrialization.

Why it's hard to dance with dragons

The fact that the negative impact of Chinese import penetration is still significant, and only marginally smaller for capability-investing firms, points to three related dynamics. First, capabilities development and accumulation take time and require scale-appropriate and sustained investments. Second, in South Africa there are a limited number of firms investing in capabilities. This means that firms not investing do not benefit from other firms specializing in complementary capabilities and diversification. Finally, given their small scale, domestic orientation, and limited access to industrial finance, suppliers along the chain cannot immediately benefit from their investments when their market is shrinking due to crowding out by Chinese imports.

This brief is based on WIDER Working Paper 2019/63 '[Dancing with dragons: Chinese import competition and the performances of manufacturing firms in South Africa](#)', by Sofia Torreggiani and Antonio Andreoni.



photo: Vanveen JF

The negative effects of Chinese import competition are thus intertwined with the long-term structural problems of the South African production system as a whole. The specific weaknesses of some firms along several domestic value chains enhance the risks overall and limit possibilities for mitigating them. Indeed, the increasing impact of Chinese imports on higher value and more technologically intensive sectors, like machinery, points to the need for a better understanding of the evolutionary pathways of import competition and the importance of coordinated intervention in those sectors where South African firms retain a competitive edge.

How to dance with dragons

This initial analysis points to the importance of coordinated reactive investments in capabilities development to reduce the negative impacts of import-related competitive pressures. Indeed, these investments ultimately lead to strategic responses by domestic firms, such as product differentiation, lateral migrations into other market segments, functional specialization, and upgrading to high-value added activities. However, the extent to which companies can capture the return from these investments will also depend on the extent to which the broader structural weaknesses of the South African production system are addressed. Over the coming years, focused industrial policies are needed to shape the strategic engagement of South Africa with its largest trading partner, China.

IMPLICATIONS

Due to dramatic upgrading of Chinese companies, even firms operating in advanced manufacturing sectors are exposed to import competition

Investments in capabilities development can reduce the negative impacts of competitive pressures and will have a positive impact only if they are significant, sustained, and distributed across firms

Localization policies should consider the impact that Chinese import penetration has along supply chains

The effects of Chinese import competition are linked with the long-term structural problems of the South African economy, thus concerted industrial policies are needed

