Review of South Africa’s industrial policy and implications for SACU

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tralac gratefully acknowledges the financial support of the Danish International Development Assistance (Danida) for the publication of this Working Paper.
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1. Introduction

South Africa is currently reviewing and formulating its industrial policy. The objective of this paper is not so much to present an examination of the South African Industrial Policy per se but rather to assess its industrial policy in a wider sense as to how it relates to and integrates and interacts with other policies that may or may not be thought of as industrial policy proper.

A comprehensive understanding of South Africa’s approach to industrial policy is important in the context of the Tripartite Free Trade Agreement (T-FTA) between the Common Market for Eastern and Southern Africa (COMESA), the East African Community (EAC) and the Southern African Development Community (SADC) for at least two reasons. The first is that South African policy makers have been of the belief that there are important synergies between the country’s industrial policy and its policy for the region, and this has led to South Africa actively championing the T-FTA agenda. Second, industrial development is to be a central focus of the T-FTA, and given South Africa’s economic weight within the T-FTA region, its industrial policy goals are likely to find their way into any forthcoming regional industrial development plan promoted under the T-FTA.

The starting point in the assessment undertaken in this paper will be the South African Economic Sectors and Employment Cluster 2010/11 – 2012/13 Industrial Policy Action Plan (IPAP) of February 2010. This document was supplemented and updated in February 2011 by the Department of Trade and Industry (dti) in what may be regarded as a ‘progress report’ since it contains little or nothing in the way of policy.

Many of the ‘and’ policies are rather obviously part of industrial policy: wage and employment conditions, trade policies, infrastructural development (in the wider sense), for example, are evident ones. Others, for example environmental policies, are perhaps not so obvious, although these issues are becoming more ingrained into industrial policies globally. Importantly, the 2010 IPAP sets the framework for this analysis, as it examines many of the “ands” in detail. The IPAP starts from the basic premise that profitability is a prerequisite and that factors inhibiting this profitability include an
exchange rate which is volatile and generally overvalued, the cost and allocation of capital to labour-intensive and value-adding sectors of the economy, a failure to address government procurement policies and opportunities, monopolistic provision and pricing in many sectors, a relatively weak skills set in South Africa, and a damning report on infrastructural problems (including electricity supply). In general, the IPAP sees the seven areas of linkages between macro- and microeconomic policies; investment and finance priorities; procurement; trade policies; competition and regulation policies; skills and innovation development; and the coordination of all these policies to strengthen the industrial sector as formulating the new industrial policy.

Recognising the need for a broader approach the South African government also published the 2011 National Development Plan – Vision for 2030, a report that comprehensively lays a blueprint for taking South Africa into the future. Here the central challenges of unemployment, education standards, infrastructure, the reliance on an unsustainable resource extraction economy, the quality of the public sector and associated corruption, and inequity and division in society are all recognised. These challenges are an essential part of the overarching problems addressed in the IPAP, and as such they provide a strong linkage to the IPAP and industrial policy. In particular, the National Development Plan recognises that labour-intensive manufacturing and medium-skilled services exports are essential if South Africa is going to combine growth and jobs in the future.

The IPAP represents an impressive platform for industrial growth, and this is complemented by the National Development plan. The objective of this study is to examine and build upon that platform, and, as outlined above, the dti seems on course for publishing annual ‘progress reports’ as noted by the dti 2011 report. This coordination is essential.

**The background setting**

In searching for examples where industrial policy has powered nations to dramatic economic growth one needs to look no further than East Asia, home of the so-called East Asian miracle, a term immortalised by the World Bank Report ‘The East Asian Miracle’ of 1993 that provided a definitive (although not undisputed) account of how many economies in East Asia achieved rapid growth using what seemed to be standard policy instruments. The general thesis of the report is that growth was associated with carefully limited government activism, an overall ‘market friendly’ approach focused
on getting the fundamentals right and emphasising education\(^1\), an investment friendly regime, open trade policies\(^2\) and stable macroeconomic policies\(^3\). The report does also, however, acknowledge the role of selective intervention in some sectors of most economies, but argues that these interventions were carefully targeted and, more importantly, performance monitored to the extent that they were ‘allowed to fail’ in the more open-market sense. The World Bank categorised policies as the broader ‘fundamental’ ones and ‘selective interventions’ such as the low interest rate policies and directed investment along with selected industrial promotion and trade policies promoting exports. For the latter, it stressed that ‘pragmatic flexibility’ or the capacity and willingness to change policies was as much a hallmark of the landscape as any single policy instrument.

Moving on from the original World Bank (1993) report, the updated paper by John Weiss from the Asian Development Bank (ADB) in 2005 examined the role of export growth and industrial policy in economic development (with industrial policy defined broadly, as we have done, to cover a range of interventions) to change the structure and raise the growth of exports. He considers that there is general agreement on the standard package for export growth. This package is based on a combination of appropriate price incentives, access to imported inputs at world prices, a sound base of physical and social infrastructure, and adequate finance for export production. However, the main thesis from Weiss is that the international environment has changed, although we would argue that the empirical evidence from China’s astonishing growth may refute this. In any case, we agree with Weiss that the globalisation of trade flows and investment is now much stronger, and that in particular the rules-based World Trade Organisation (WTO) inhibits domestic policy space.

A more recent picture affirms the views of Weiss in that updating to the present time we can highlight the role that the well-known Chinese manufacturing export growth plays in African manufacturing. We contend that not only are Chinese imports dominating African domestic manufacturing in almost all small industries but they are simultaneously making it extremely difficult for those African countries that do have some industrial capacity to export both within Africa and globally. The clothing sector is a case in point, but the argument equally applies to the multitude of

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1. This included rapid technological catch-up.
2. We must qualify and perhaps dispute this particular claim, as most of these economies had (and still have) high protection levels on many imports such as agricultural imports.
3. This included careful control over exchange rates to ensure that these rates remained at a level to assist exports (i.e., undervalued exchange rates).
goods stamped ‘made in China’ that are sold by street vendors throughout the continent. We furthermore contend that South Africa has in fact ‘missed the bus’ in that when emerging from the troubled years of the early 1990s it eschewed a low-wage Asian approach to manufacturing and instead of capitalising upon its undoubted industrial capacity of the time ended up with more of a ‘no wage’ economy as the high unemployment rates attest. Meanwhile, the growth magnet of the US market for industrial goods is both saturated with Chinese products and, in the face of economic problems that include a burgeoning trade deficit, is losing some of its powers that fuelled Asian growth. Furthermore, Europe has been the traditional market for Africa in general and South Africa in particular, and that continent is facing even deeper economic woes.

This general pattern for manufacturing in Africa is confirmed by Sandrey and Edinger (2009) who show that while a succession of Asian countries have exhibited dramatic growth over the last thirty to fifty years, African manufacturing has largely stagnated. The Asian expansion has been driven on the demand side by manufacturing exports to the US in particular over a prolonged period when the US was sucking in huge imports, and enabled on the supply side through an overall constructive policy package that opened markets, implemented favourable trade and exchange rate policies, and provided a sound and stable government that inspired investment and secured property rights. Conversely, Africa has been unable to put a comprehensive package in place, and this has resulted in a manufacturing sector whose contribution to both Gross Domestic Product (GDP) and export shares is significantly below the continent’s developing country peers. Growth in natural resource-rich developing countries in general has lagged behind those with a manufacturing focus, and this is especially the case in Africa with its poor linkages into unskilled labour and its appetite for rent-seeking activities. A key recommendation from Sandrey and Edinger is that the linkages between tariff and trade policies on the one side, and industrial policies on the other, both essential parts of the ‘umbrella’ of the full policy package, need to be considered in tandem. But in some instances, and South Africa is an outstanding example, a combination of earlier unilateral liberalisation and bilateral, regional and multilateral agreements means that the necessary policy space to nurture industrial development has been lost. This will be examined in more detail in this paper.
Policy space

One theme that emerges from the discussion above is that with the advent of the WTO in particular and regional trade policies in general through the 1990s there may be limited ‘policy space’ for South Africa in the sense that the rules-based environment limits many policies that may have been successful in the past. These strictures apply to the supports and tariffs associated with trade policies per se as well as a raft of other areas that are associated with the WTO such as the restrictions on direct assistance to the manufacturing sector. In addition, there are several other factors that limit the abilities of the South African (or any other) government to enable industrial production, and these include the globalisation of the world’s production and trade and, as outlined above, the dominant position of China as the competitor.

The linkages between the WTO and industrial policies is examined in Bora et al. (2000), who concur that the context of industrial policies has changed since the classic East Asian ‘miracle’ as the global economy is very different from what is was during the ‘miracle’ period. Indeed, the term ‘industrial policy’ is not well defined, and they cite a working definition from the World Bank that considers industrial policy as being ‘government efforts to alter industrial structure to promote productivity based growth’. Especially relevant to South Africa, they also emphasise that the term ‘industrial’ should not neglect the processing of agricultural and mining products and the role of services in providing support in a ‘flanking’ role. Their conclusions are that in general the case for direct government supports is weak, and that the new WTO disciplines on subsidies (including export subsidies), the new provisions on patents and copyright under Trade-Related aspects of Intellectual Property Rights (TRIPS), local content and other measures is indeed restricting the use of a number of policies. However, the effect of these rules is positive in that it shifts the emphasis of government to the supply side and more generic policies that concentrate upon infrastructure, human capital formation, innovation, technology and competition policies.

In a more recent update Shelia Page (2007) also examines the extent to which the WTO is preventing development by restricting policy space. While South Africa is a developing country in the WTO sense, it does have many of the characteristics of a developed country, with the result that we are somewhat uncomfortable with analysing the country in this less restrictive context. Certainly, the WTO imposes constraints on tariff levels, but it must be emphasised that these restrictions apply to
bound and not applied tariffs – and, furthermore, it is often the case that bilateral and regional agreements are more constraining. Although not generally thought of as industrial policies, agriculture-related restrictions are not often binding enough to constrain policy space on their own, and similarly, not binding enough for services where countries virtually ‘self declare’ their space. TRIPS does restrict policy space, but that is what it was designed to do, while little extra in the way of constraints was imposed on investment policies. In conclusion, Page considers that in actuality the WTO has limited space constraints upon developing countries and moreover that bilateral and regional agreements may be more restrictive. She even goes as far as to suggest that ‘locking in’ policies may well be in the best interests of most countries anyway.

Again, although not strictly industrial policy, Sandrey et al. (2008) examine the degree to which South Africa is constrained in its ability to increase agricultural tariffs, the classic tool of trade policy. The answer was that at that time some 14.1% of the imports were ‘locked’ by the WTO bound rates, with an additional 7.5% almost at those bound rates. Another 22.9% were effectively ‘locked’ and an additional 15.2% ‘almost locked’ by the South Africa-EU Trade, Development and Cooperation Agreement (TDCA) and the Southern African Development Community (SADC) Free Trade Agreement, giving some 59.7% of total imports that were, for all practical purposes, locked into the current tariff policy regime. Another 14.6% were classified as animal feed inputs, thereby raising the caution flag that increasing these tariffs would directly pass a cost increase on to South African poultry and meat producers. The researchers isolated the imports of wheat (6.7% of the total) and argued that while there was policy space to increase wheat tariff rates they were staple foodstuffs; they provided supporting analysis that showed that increasing these tariffs was welfare reducing for South Africa. This left only 19% of all agricultural imports where there was some policy space, but the majority of these imports are subject to WTO tariff rate quota (TRQ) obligations and thus not totally under the control of South African trade policy authorities. Similarly, it quickly became apparent when South Africa was seeking ways to protect its clothing and textile sector that the most common bound tariff of 45% left little extra protection from the generally applied rate of 40%.
Examining South Africa’s industrial policy

Kaplan (2007) outlines the issue for South Africa very succinctly, and we believe that his views are worth repeating verbatim:

The two key institutional requirements for an effective industrial policy are the professionalism and capacities of the government and the effectiveness of the strategic collaboration as between government and business. As outlined above, both are currently very limited in South Africa. Moreover, the limited capacities of the government are currently exacerbated by a lack of focus and cohesion around the objectives, content and conduct of industrial policy. In addition, distributional conflicts make it difficult to develop institutions and practices that manage the rents that are a constituent feature of active industrial policies. Finally, the principal objective of industrial policy, namely to enhance technological capacities and raise firm level productivity, is severely constrained by the current scarcity of skills and the limited training being undertaken. Two broad conclusions emerge from this analysis. The first is that government should not expect too much of industrial policy. Under current conditions, industrial policy is likely to have only a limited impact on GDP growth. The second conclusion is that the design of industrial policy needs to be fundamentally re-examined. The constraints and institutional limitations outlined above should be factored into a consideration of the scope and content of industrial policy.

We concur with Kaplan’s statement. We believe that more recently the South African government has taken heed of these comments and moved to develop a new plan for industrialisation that is cognisant of these views. This is set out in the 2010 IPAP.

This IPAP starts with an excellent introduction setting out the objectives of the approach to industrialisation. These are to diversify beyond the current South African reliance on traditional commodities and non-tradable services to a knowledge economy that can absorb more labour (and in particular previously disadvantaged members of society) and lead South Africa to make a greater contribution to Africa’s wealth. The report considers that many of the ‘easy to do’ actions have been done in recent years. These actions include strengthening competition activities, giving more certainty to the automotive sector and the clothing and textile sector (as both the automotive and clothing and textile sectors are crucial components of the current industrial sector in South Africa), attracting more investment into business process services, lowering input costs by examining tariffs on imported inputs and helping to ameliorate the electricity supply crisis through energy efficiency.
While these actions are commendable, the report fully recognises that the government must move from the ‘easy to do’ to the much harder ‘need to do’ actions.

The problem statement outlines how South African GDP growth has lagged behind its peers in recent years, and, even more worrying is the fact that this growth has been dominated by consumption that is not underpinned by growth in the productive sectors. The divergence in manufacturing growth has seen growth in capital-intensive sectors such as natural resource sectors and the automotive industry rather than in employment-intensive sectors where growth remains precariously dependent upon the credit-driven retail sector. This is accentuated by the low profitability in manufacturing relative to sectors such as finance (thus highlighting the high cost of capital), a weak skills endowment, poor infrastructure that includes uncertainty in electricity supply and public procurement that is not considered to be doing enough to support local industry.

The policy response to strengthen the productive side of the economy clearly shows that the government fully appreciates both (a) the lessons from past global success stories and (b) industrial policy in the new global economy. These seven sets of critical policies (except perhaps the need to develop and strengthen infrastructure in the broadest sense) deserve to be repeated here, as we consider that they are very comprehensive and consist of:

i. **Stronger articulation between macro- and microeconomic policies.**

ii. **Industrial financing channeled to real economy sectors.**

iii. **Leveraging public and private procurement to raise domestic production and employment in a range of sectors, including alignment of Broad Based Black Economic Empowerment (B-BBEE) and industrial development objectives, and influence over private procurement.**

iv. **Developmental trade policies which deploy trade measures in a selected and strategic manner, including tariffs, enforcement and standards, quality assurance and metrology (SQAM) measures.**

v. **Competition and regulation policies that lower costs for productive investments and poor and working-class households.**

vi. **Skills and innovation policies that are aligned to sectoral priorities.**
vii. Deploying these policies in general and in relation to more ambitious sector strategies, building on work already done.

Section 5 of the IPAP highlights the report in relation to other policies and shows how clearly the need to integrate industrial policy with other actions of government is appreciated. The IPAP and industrial policy are integrated into generating a new growth path that has the objective of combining value-adding with employment opportunities throughout the economy. This is followed by Section 6 which again stresses the need for coherence between macro- and microeconomic policies. In particular, the macroeconomic focus should be on a competitive and stable exchange rate regime and competitive real interest rates, while microeconomic policies of importance include competition policies, lowering the cost of inputs and promoting investment.

In the next four sections the report identifies the four key areas of industrial financing, procurement, trade policies and competition policies as being a crucial part of industrial policy. Each of these is discussed in turn with their opportunities and constraints followed by Key Action Plans (KAPs) for each one and closing with detailed key milestones and timetables to be reached in each area.

The section on industrial finance laments the low profitability of manufacturing and follows up on the analysis given earlier in the report that shows South Africa’s cost of capital relative to major trading partners is very high. Indeed, the 2007 data shown gives South Africa as having the second highest real interest rate of the 18 economies given. Most of the 18 are under two percent, with only the United Kingdom (3.1%), Australia (4.4%), South Africa (4.9%) and Brazil (7.5%) being above 3.0%. The IPAP makes a case for increased use of concessional funding from the government through the Industrial Development Corporation, and uses the example of Brazil’s Banco Nacional De Desenvolvimento Econômico e Social (BNDES) to justify an expansion of development lending. The problem is, of course, that while in theory such an approach seems fine, in practice the real outcome is often an expensive failure from poor governance as such institutions become lenders of last resort. Care must be exercised in providing concessionary finance, and the example of the BNDES does not negate the fact that examples of global failures with concessionary finance abound.

An issue not touched upon in the IPAP and supporting documents is the role of foreign direct investment (FDI). In a recent publication, Sandrey (2012) writes that the National Development Plan is strangely silent on FDI. It recognises the need to raise the rate of investment, but dedicates little
over one page discussing how this is to be achieved and what the benefits are of doing so. It sees this increased investment being sourced from (1) higher levels of public-sector fixed capital formation with an emphasis on infrastructure building, (2) more private sector investment, and (3) foreign investment. The plan considers that, ‘over time, a larger share of investment should be funded domestically, but this will depend on how well resources are used in the short term to raise productivity, incomes and employment’. It is almost as though foreign investment is seen as a failure of South Africans to be able to fund their own development with the grudging admission that foreign investment is needed. Perhaps this view is based upon the analysis of Sandrey (2012) that the manufacturing sector is not the most significant recipient of FDI into South Africa; it has received around one-quarter to one-third of the total in recent years, a figure very similar to that of both (a) mining and (b) business and financial services.

Government procurement is highlighted as an essential element in the IPAP, and detailed proposals are outlined to ensure that more local content is used in major projects. In addition, linkages between B-BBEE and industrial policy have not been adequately articulated to date and the IPAP emphasises that more needs to be done in this area. Several KAPs are outlined to advance domestic procurement, but as always when sourcing from the second-best provider caution must be exercised that the discretionary margins do not impose costs elsewhere in the economy. Globally, the Agreement on Government Procurement is a legally binding agreement in the WTO focusing on the subject of government procurement, with its present version having entered into force on 1 January 1996. However, South Africa is neither a signatory nor an observer to this agreement so it is therefore not bound by its provisions. Were South Africa a signatory, it would be obliged ‘to accord to the products, services and suppliers of any other Party to the Agreement treatment “no less favourable” than they give to their domestic products, services and suppliers’ under the terms of the agreement. Perhaps it is appropriate to add a quote from the dti (2011): ‘Parts of South Africa’s agro-processing sector have an unfortunate history of engaging in anti-competitive conduct, thereby contributing to the high prices of basic food products’.

The IPAP next moves to examine trade policies and their linkage to industrial policies. Here the report is on fertile ground, as there are numerous aspects of trade policy that directly or indirectly impact upon domestic production. The first and most obvious one is tariff policy, and here the report recognises that multilateral, regional and bilateral trade agreements are putting pressure on
tariffs as a strategic instrument. The converse, of course, is that these same agreements also open preferential access for South Africa. Earlier in this paper we outlined tralac research that shows how limited the ‘policy space’ for agricultural protection through the use of tariffs has become, and how the WTO allowed South Africa to raise tariffs on clothing and textile imports from their 40% applied rates to the WTO bound maximum of 45% as the experiment in placing quotas on Chinese clothing and textile imports proved to be ineffectual (Van Eeden and Sandrey, 2007). A detailed examination is needed to assess the so-called ‘water’ between WTO bound and applied rates and the influence of other trade agreements product by product to assess just how much protection there potentially is.\(^4\)

It is also relevant to point out that a tax on imports is, all other things considered, a tax on consumers who are obliged to pay more for goods by either increased prices on imports or purchase domestically made goods that were originally unable to compete with imports of these goods.

Similarly, the IPAP is acutely aware of the role that technical barriers to trade (TBTs) and non-tariff barriers (NTBs) to trade play in restricting global trade. While generally thought of as barriers to exports, the IPAP moves beyond this misconception and discusses how addressing TBTs and NTBs can assist local producers. For example, internal transport costs in South Africa and southern Africa are high and on occasions perversely make it cheaper to use imported merchandise within the region. Special emphasis is given to technical standards and how strengthening these are likely to give flow-on benefits. This is a major responsibility for government, and several KAPs outline proposed steps to take. Here one must add that the IPAP is fully aware of some of the ‘new’ barriers becoming important in international trade. These include the use of carbon tax regulations and geographical indicators, both areas on which South African technology and historical trade items should be able to capitalise.

Next, considerable attention is given to the area of customs fraud and illegal imports such as smuggling and under-invoicing. This is closely associated with corruption, and this corruption is generally perceived as being a disincentive to development in South Africa; the World Bank ranks South Africa at 101 out of the 210 countries it surveyed in 2010.\(^5\) While this is not a good place to be, we must note that it ranks just one place behind Malaysia and two above Brazil, both of which are considered to be among the new ‘tigers’, suggesting that corruption may not necessarily be a barrier

\(^4\) This, of course, ignores the generally accepted end result that tariffs hurt the imposing country and not the target.

to development. tralac research has examined two aspects relating to this. The first was the clothing imports from China, where detailed analysis of both the South African SARS import data and the Chinese Ministry of Customs export data highlights that the value of imports from China into South Africa was only at 80 per cent of the value of the exports from China to South Africa in recent years, and for volume data average prices for imports were at a lower unit value than exports (Van Eeden and Sandrey, 2007). The second was an examination of informal trade in southern African agricultural products that concluded this to be a very minor problem in South Africa but much more prevalent in neighbouring countries (Sandrey and Jensen, 2010). The set of KAPs outlined in the IPAP clearly indicate that these border problems are recognised and are being addressed.

**Competition policy** is examined in a separate section, and rightly so. This is an important area where South Africa has both strong legislation in place and an increasing appetite to enforce this legislation.

Section 11 then changes focus and lists the 13 sectors that have been grouped into ‘clusters’ and singled out for consideration in the IPAP. These sectors, as listed, are:

**Cluster 1 – Qualitatively new areas of focus**

- Realising the potential of the metal fabrication, capital and transport equipment sectors, particularly arising from large public investments
- ‘Green’ and energy-saving industries
- Agro-processing, linked to food security and food pricing imperatives

**Cluster 2 – Scale up and broaden interventions in existing IPAP sectors**

- Automotives, components, medium and heavy commercial vehicles
- Plastics, pharmaceuticals and chemicals
- Clothing, textiles, footwear and leather
- Biofuels
- Forestry, paper, pulp and furniture
- Strengthening linkages between cultural industries and tourism
- Business process servicing
Cluster 3 – Sectors with potential for long-term advanced capabilities

- Nuclear
- Advanced materials
- Aerospace

Of special mention are the automotive sector, the textile/clothing/footwear (TCF) and leather sectors, cultural industries and the tourism and business-processing sectors. The latter three sectors show how comprehensive the IPAP is insofar that it reaches into areas that traditionally would be simply regarded as services. The business processing sector is one that has demonstrated rapid growth in Asian economies such as India, Malaysia and the Philippines, and it is a welcome entry to an industry plan.

The challenges of the TCF sector have been the focus of considerable attention in recent years as the importation of Chinese clothing and textiles have made serious inroads into South African manufacturing capacity. It is an important sector as it provides employment opportunities for many who have limited alternatives, but the sector has been in trouble in recent times. Chaddha et al. (2009) from the Harvard Porter project provide an excellent background to the sector in a framework that perfectly complements the IPAP report. In particular, they outline that labour cost in South Africa is much higher than that of the competitors and that the sector is losing in the price competition to cheaper imports with declining employment. They develop a future direction similar to that outlined in the IPAP that concentrates on price competition for low-end firms, high-end manufacturing for mainly export and an emphasis on what they call ‘diversify to value-added products’ for new niche market in value-added unique products. As recognised by IPAP ‘the key opportunity is to recapture domestic market share by improving competitiveness through a range of interventions. These include a focus on product, process and delivery efficiencies and harnessing proximity to local retailers’. After a futile attempt to protect the sector by imposing Chinese import quotas the government raised tariffs to the WTO bound maximum and then, recognising the basic problem, sensibly adopted an encompassing plan to improve skills and hence productivity. Whether this will be enough to return the bolting horse to the stable is a moot point.
The automotive sector is both the major and the most controversial of South Africa’s industrial sectors. It is undoubtedly a sector that is technically efficient by international standards. But analysts such as Frank Flatters⁶ are concerned about the economic efficiency of the sector and, despite the protection afforded the sector, South Africa is a net importer of vehicles. In a global environment that is extremely distorted despite WTO rules against industrial subsidies, the importance of the sector to South Africa is outlined in the IPAP. The Automotive Production and Development Programme (APDP) aims to strengthen, broaden and deepen the automotive, components and medium and heavy commercial vehicles sector to keep the sector a cornerstone of South African industry. Tariff reviews are mentioned as part of the possible policy package, but here the TDCA with the EU may well limit policy space. As above with the TCF sector, will the IPAP actions be enough?

**Productivity**

If there is one term that encapsulates the objectives of the policies discussed in this paper, it is ‘productivity’. Sandrey and Jensen (2012) discuss how in its classical form an economy is driven by production or total output, and this is a function of the land, labour and capital inputs used. This total output can be increased by (a) increasing the inputs or (b) increasing the efficiency with which these inputs are combined; and this latter, in its simplest form, is productivity. Earlier in this paper we discussed how industrial policies have sequentially powered the East Asian growth economies over the last half century: the base factor in this growth has been productivity. Sandrey and Jensen emphasise that the total factor productivity (TFP) in both China and India is significantly superior to other countries analysed, and that these countries are similarly forecast to have significantly higher growth rates than the rest of the world through to 2020. They then proceed to use the widely accepted Global Trade Analysis Project (GTAP) computer model to simulate how increasing the TFP rates in South Africa to levels that are still below the best Asian benchmarks can dramatically power GDP growth in South Africa. They do this by treating TFP as exogenous (i.e. adjusted from outside the model) and re-running simulations to ascertain the impacts on both growth rates and trade performance. They find that keeping everything else constant and increasing the TFP in South Africa to an average annual increase of 0.6% over the period from its currently forecast rate of 0.2% increases South African GDP by an additional 4.0% (i.e. to 7.8%) over and above the baseline.

One factor driving this GDP increase is changes in global capital flows, where South Africa and its neighbours benefit at the marginal expense of others. Capital accumulation in the GTAP model summarises the long-term welfare consequences of changes in the stock of capital due to changes in net investment. Rising income will increase demand for produced goods, pushing up factor returns and thus attracting more investments. Generally, economies with the highest growth will be prepared to pay the largest rate of return to capital, and will obtain most of the new investments. Therefore we will tend to see that the long-term welfare gains from capital accumulation reinforce the short-term welfare gains deriving from allocative efficiency and terms of trade.

Reinforcing the relevance of the IPAP shows that the baseline projection for South Africa with continued TFP at 0.2% annually is not sufficient to change current unemployment rates from their 23%. South Africa must increase TFP to 0.6% which will reduce unemployment to 17%, while an even larger increase to the current 1.0% TFP levels of China and India will have a spectacular result as South African unemployment is forecast to reduce to 12% in this scenario. The policy implication is clear: TFP holds the key for growth and employment. South Africa’s aggregate welfare would be around US$250bn higher over the period to 2020 from a 2007 base should the TFP be increased to even 0.6%. The main contributions to this increase in order of importance are from increased capital flows, the TFP changes directly, allocative efficiency gains and labour market gains as more people enter the workforce. This in turn increases both output and trade, consistent with the objectives of the IPAP. In support of this we can do no better than repeat an excerpt from Kaplan’s citation: ‘Finally, the principal objective of industrial policy (is) namely to enhance technological capacities and raise firm level productivity...’ (Kaplan 2007).

**Regional integration and coordination**

In considering South African industrial policy and perhaps more specifically tariffs, it is well worth noting that South Africa does not have a tariff schedule – SACU does. Therefore there are wider considerations such as the views of Botswana, Lesotho, Namibia and Swaziland (BLNS), and in particular revenue implications from SACU tariffs for these countries (CIE, 2010). Enhanced industrial production in South Africa will have a downside for the BLNS in that these revenues will be reduced as this production displaces imports into South Africa, and, perhaps more importantly given the free-flow of goods from South Africa to the BLNS countries, make industrialisation even more difficult in
these BLNS countries themselves. Importantly, with respect to industrial policy, Article 38 of the 2002 SACU Agreement states on Industrial Development Policy that ‘Member States recognise the importance of balanced industrial development of the Common Customs Area as an important objective for economic development, and Member States agree to develop common policies and strategies with respect to industrial development’. In examining reports on industrial policies and overall development strategies for the BLNS we are able to report on Lesotho and Swaziland and give a preliminary report on Namibia.

**Namibia’s** Industrial Policy is anchored in the Vision 2030 statement which sets out development goals for the nation through to that time, and the need to align these two documents is stressed. Rosendahl (2010) provides a very good ‘warts and all’ background report on Namibia and considers that while many good things are taking place more needs to be done to activate this Vision 2030. Earlier, Kadhikwa and Hdalikokule (2007) in assessing the potential for the manufacturing sector in Namibia identified a number of constraints facing the sector. These included high input costs, particularly electricity, transport and harbour charges, the limited availability of quotas for the fishing industry, limited economies of scale in the meat-processing industry, unfair competition from South African companies, and again limited economies of scale in the manufacturing sector overall. This is accentuated by low levels of labour productivity and the impact of the HIV/AIDS pandemic on the workforce, the lack of domestic shelf space for Namibian manufacturers in supermarkets, and the low level of branding and marketing of Namibian products. They also lamented the availability of highly skilled professionals and suggested that technology and entrepreneurship centres be set up for local industry to address this problem.

Although we are unable to cite the draft document from the Namibian Ministry of Trade and Industry, Namibia’s Industrial Policy, newspaper reports suggest that Rosendahl in particular may have been heeded. However, a cautionary flag is raised by Duddy (2011a) who quoting from the draft states that ‘Government is aware that opening the economy too much or too quickly might come with additional regulation and control, which may, in turn, result in undesirable investment and unintended consequences that may thwart and negate local industrialisation efforts and initiatives’. Infant and strategic industries will therefore, from time to time, be protected by government. Namibia’s industrial policy will not be based on a ‘one-size-fits-all’ approach. As such, it may be targeted and clear framework documents will highlight priority areas. The policy will be
integrated, building on market integration, infrastructural development, and industrial development. In his response, Duddy (2011b) reports that the Namibian Government is aware that "ineffective and inefficient governance can seriously hamper economic development", and will therefore only intervene where necessary. In addition, interference will be "based on the principle of sustainable and prudent economic management".

Heita (2011) reports that the draft proposes pragmatic reforms to allow competitiveness and productivity, calling for a review of the labour environment seen as too rigid. It suggests flexibility to enhance productivity without taking away workers’ rights. The role of the state in the economy is clearly defined as ‘pro-developmental’, where the state sets the course of economic direction, and does not leave it to market forces to dictate. The private sector is asked to take ownership and increase its contribution to skills development, because ultimately it is the private sector that benefits from a skilled pool. State treasury is requested to consider spending a significant portion of funds on innovation, research and development in social areas where Namibia faces serious challenges, such as housing, health issues and access to financing.

Heita (2011) also states that the discussions and the industrial policy draft come at a time when SACU and the entire southern Africa region is seized with domestic regulation reforms that promote competitiveness along with regional integration. We consider that both South Africa and Namibia need to carefully consider the SACU Agreement as discussed earlier. We consider that there are two important aspects of regional plans that must be considered. The first is regional integration and industrialisation, while the second is the crucial need for coordination coupled with constant monitoring and evaluation. In these respects the Namibian programme must be aligned with the South African approach as discussed in this study.

**Lesotho** has also released a draft National Strategic Development Plan that parallels the plans from both South Africa and Namibia. This plan recognises up-front that the most binding constraints to growth in Lesotho are an uncompetitive business environment, poor infrastructure, low productivity and limited institutional capacity. In order to achieve high, sustained and job-creating growth, Lesotho needs to transform its economy by undertaking structural reforms to address these constraints.
Again, the Lesotho plan closely parallels South Africa’s IPAP in its comprehensiveness relating to all the ‘flanking policies’ rather than industrial policy per se. It also considers that there is considerable potential to expand export-led growth in labour-intensive manufacturing and assembly for the SACU/SADC market, and given that the only manufacturing capability in Lesotho is TCF we presume it would have to be this sector. An interesting aspect of regional industrial development is that there currently seems to be limited linkages between the TCF sector in Lesotho, a sector that exists almost entirely due to its ability to capitalise on the combination of cheap local labour, Asian finance and managerial expertise, and access through tariff preferences to the US market. On the one hand and the domestic market in South Africa that has been under siege from mostly Chinese imports that face 40% (now 45%) tariff walls. This should be an opportunity for regional cooperation and industrial development for Lesotho in particular.

Finally, the linkages between industrial and trade policies in Botswana have also been studied (Zizhou, 2009). The study considers that trade policy has largely been disengaged from industrial policy considerations as there has been a ceding of the latter to South Africa in recent years. This has been accentuated by the dominance of diamonds in Botswana’s economy and trade, and although the country has targeted industrialisation as a strategy, this has not yielded positive results for manufacturing and manufacturing exports in particular. Most exports rely on preferential access to markets to survive, and the policy of empowering citizens through local preference schemes in Botswana runs counter to SACU free trade principles.

**Summary**

In summary, the IPAP and its update in dti (2011) carefully outline strategies that recognise the challenges of industrial policy in the modern era. These policies are about strengthening the wider operating environment (‘flanking policies’) rather than any direct supports. In particular, the IPAP is to be commended for its forward-looking approach to where South Africa needs to be. This approach is superbly complemented by the 2011 National Development Plan – Vision for 2030, which widens the operating environment to cover every conceivable aspect. This includes the entire physical infrastructure of South Africa, the need to comprehensively upgrade skills, and the need to comprehensively involve more previously disadvantaged people in the economy. Perhaps it is overly ambitious and unrealistic, but then many Asian economies have shown how to achieve such levels of
sustainable and equitable development. Indeed, Brazil, an economy with many similarities to South Africa, is also showing that Asian achievements are possible outside of Asia. Industrial policy has changed comprehensively in recent years, and the IPAP clearly shows that this is recognised in South Africa. The key is increased productivity.

References


