University of Cape Town Industrial Policy roundtable with Ricardo Hausmann
Report by Sean Woolfrey

On Thursday 11 March **tralac** attended a discussion on South African industrial policy hosted by the School of Economics at the University of Cape Town. This is a particularly relevant topic at the moment in light of the recent release of the latest version of the Department of Trade and Industry's Industrial Policy Action Plan. Guest speaker at the event was Ricardo Hausmann, Director of the Center for International Development and Professor of the Practice of Economic Development at Harvard University's John F. Kennedy School of Government. Hausmann is probably best known in South Africa as the chairman of the International Panel on Growth, often referred to as the 'Harvard Group', convened by the National Treasury to advise the South African government on its Accelerated Shared Growth Initiative (ASGI-SA)*.

Hausmann began the discussion with a brief review of some of the more notable issues that had come out of the work conducted by the Harvard Group. The Group had found that South Africa's recent domestic consumption-led growth, which had been financed by a rising current account deficit, was likely to be unsustainable. They believed that sustainable growth would only be possible through increased exports. A second issue was that of South Africa's exchange rate levels and volatility. The Harvard Group had been of the opinion that South Africa's fiscal policy had been too loose in the boom years of the mid-2000s and had recommended that the government run a counter-cyclical fiscal policy focusing on the structural rather than actual deficit. They Group had also suggested that the South African Reserve Bank extend its focus to the exchange rate and use a wider range of policy tools to reduce the volatility of the rate. Two other notable recommendations arising from the Harvard Group's work were the introduction of a wage subsidy for school leavers in order to tackle the high rates of unemployment among young adults, and a more coherent trade policy that would focus on the liberalisation of tariffs on imported inputs for domestic industries.

With these and other findings having been reviewed, much of the subsequent discussion revolved around three further issues. Firstly, Hausmann reiterated his support for an 'open architecture' approach to industrial policy. Such an approach involves substituting or complementing government's targeted approach to industrial policy with efforts to encourage

self-selection by various industrial bodies. Instead of implementing government policies which seek to prioritise specific industries for which sectoral programmes are then developed, an open-architecture approach would involve the provision of industry-specific publicly provided inputs, such as infrastructure, regulation and research and development. These inputs would be identified by self-organising industrial and private sector bodies, who would be encouraged to co-finance proposed initiatives. Hausmann felt that such an approach would have the benefit of relieving capacity constraints in the Department of Trade and Industry by mobilising the energy and resources of the private sector. He also felt that an approach which relied on Government to prioritise certain programmes, industries or sectors, *a priori*, was too narrow a way of implementing industrial policy.

A second topic of discussion was the relative importance of informational externalities and coordination failures. In the recommendations of the Harvard Group, two specific market failures that necessitated government intervention were highlighted. The first concerned under-investment by the private sector in new activities, especially in developing countries. This occurs because firms worry that if they innovate, other firms will be able to appropriate the informational spillovers that result from this innovation, without incurring the costs of the innovator. The second cause for government intervention is the potential for coordination failures. An example of such a failure would be when a particular final good is not produced due to the lack of a specific input, while the lack of production of that input results from the absence of an industry producing the final good in question, leading to a 'chicken and egg' scenario. Hausmann claimed that recent work has led him to believe that market failures arising from informational spillovers are far less prevalent and important than those arising from coordination failures, and that industrial policy should therefore focus more on overcoming the latter type of market failure.

A final issue touched on was that of beneficiation. Hausmann reiterated the Harvard Group's recommendation that beneficiation not be used as the "basis for selective intervention and industrial promotion" in South Africa. He believed that privileging beneficiation was unwarranted and would take government's attention away from other opportunities that had the potential to create jobs in the country. Hausmann felt strongly that the majority of these opportunities are likely to be found in areas other than downstream processing.

* The working papers published by the Harvard Group can be accessed at http://www.cid.harvard.edu/southafrica/