Industrial Policy and South Africa:

A stategic view

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As South Africa opens itself to international competition, a comprehensive industrial policy is essential. South Africa could lead the continent in exploring new ways for government and industry to cooperate and support development.

For almost two decades, debate over industrial policy for developing countries has been dominated by the agenda set by the World Bank and the IMF. This has pitched the state against the market, with the Washington consensus heavily favouring the latter and breaking with an earlier traditional dependence upon industrialisation led or heavily influenced by the state sector.

More recently, longstanding theoretical and empirical criticism of the Washington consensus has begun to have an effect, particularly in the light of the experience of the East Asian NICs, for which state economic intervention has been shown to have been both necessary and highly effective.

To a limited extent, South African current industrial policy has incorporated this shift in emphasis towards more reliance upon the state. Nonetheless, policy remains marked by the market-led approach.

The South African example demonstrates that the state versus market approach is itself misleading, as the state must in part work through and with the market, not only in the provision of basic needs and social and economic infrastructure but also in industrial policy.

Moreover, due account must be taken of the economic and political interests that are influential upon the state as well as the capacity to formulate, implement and monitor policy. Such issues tend to be set aside when relying upon the more nebulous capacity of the market to deliver what is required.

A new direction

It would be unfortunate if South Africa continued to be unduly influenced by a market ideology when this is itself being steadily eroded by new initiatives and thinking in development and industrial policy.

Indeed, South Africa could itself take a lead in the formulation of a new agenda for industrial policy, to its own as well as to the advantage of other developing countries, especially those in Africa which have been least affected in practice by the new currents in development policy.

While South African industrial policy has rejected exclusive reliance upon the traditional supply-side measure of simply getting the prices right, it has not developed supply-side policies far enough in depth and scope by way of alternative.

Market ideology is being eroded by new thinking in industrial policy

Acknowledgement of spill-over benefits is not enough

Welcome acknowledgement of the spill-over effects of industrial clusters and the benefits of social and economic infrastructure does not in principle provide sufficiently for policy formulation. This needs to be worked out in detail for individual sectors and their vertical integration, against the background of a systemic strategy for South African industrial reconstruction.

Social awareness

In particular, there is a need for expertise to be developed in industrial policymaking in which due account is taken of full social cost benefit analysis, in the light of the strategic objectives of the RDP. The main goal must be the secure provision of basic needs for the vast majority, whether through growth, employment, or redistribution.

This may be associated with a number of intermediate goals, as in macroeconomic policy to generate business confidence and economic stability, the funding of various mega-projects to generate foreign exchange and knock-on employment, and reform of trade policy to induce competitiveness.

It is necessary to ensure that projected benefits do indeed accrue

It is only a first step to assess these factors in principle. It is also necessary to ensure that the benefits do indeed accrue in practice. For example, mega-projects designed to generate foreign exchange do not necessarily contribute to more fundamental goals if the earnings are freely invested abroad.

The formulation, implementation, and monitoring of policy needs to take account of the vested interests that can influence the policy process and to be assured that strategic goals are being met by including them within contracts where appropriate.

Apart from the normal requirements around price, quality and delivery times, these might include wages and working conditions as well as employment levels, export targets, technology transfer and provision of training and adult basic education, etc.

Industrial policy must be broadly conceived

Gold mines

The limited progress made with social plans for the gold mines is indicative of extreme weakness of industrial and other policymaking in South Africa.

No serious calculation seems to have been made of the relative merits of mine closures or downsizing, of maintaining the mines for the benefits they bring in employment, multiplier effects and foreign exchange earnings, or of retraining and redeploying a skilled and organised workforce for other employment.

What is true in this instance, where the leading issues involved are transparent to a degree, is even more disturbing in other cases of industrial policymaking where neither the capacity exists nor is the attempt made to come to decisions grounded in an overall strategy incorporating full impact analyses, taking account of sequencing, dynamic economies of scale and scope as well as the more direct and observable effects.

The first steps

In the first instance, three separate issues are involved in rectifying this situation.

- ❑ The systematic collection of adequate data for the policy process must be organised. Without such data, it is neither possible to formulate policy adequately nor to monitor its effects.
- ❑ Government departments must have the skills and motivation to carry out the necessary policy work.
- ❑ There must be the determination to overcome, or incorporate, the interests of the powerful conglomerates in formulating, implementing and monitoring policy.

These three aspects must be carried forward together with, for example, data collection responding to the impact analysis of policy work, and policy responding to and informing the strategies and activities of the conglomerates.

The discussion indicates that industrial policy should not be narrowly conceived, as trade or competition policy for example, as has previously occurred in South Africa as elsewhere from time to time. Rather, as a range of factors and policies impinge upon industrial performance, these need to be taken into account in the specific context within which they are being assessed.

How industrial policy is defined, quite apart from how it is formulated, implemented and monitored, will reflect competing economic and political interests. It is imperative that working people bring their perspectives to bear upon the policy process, otherwise it is liable to be partial in content and place important decisions outside the scope of government and public scrutiny.

The economic background

South African industrial development has been and remains seriously deficient. A major weakness of South African industry is the relative absence of productive capacity in intermediate and capital goods. This has a negative impact on the economy in a number of different ways:

- Economic expansion leads to growing imports of these goods and so creates balance of payments pressures.
- Up- and down-stream integration of economic activity is poorly coordinated, in terms of the provision of mutually reinforcing access to finance, markets and technology.
- Employment generation, broadening of the skill base, and the opportunities to diversify into new sectors of industry are severely constrained.

Further, South African industry has suffered from stagnation in investment since the early 1980s, whilst South African corporations have engaged in:

- capital flight, much of it illegal (estimated to be as much as 7% of GDP);
- speculative purchase of existing industrial assets as disinvestment was prompted by international sanctions;
- heavy lobbying for policies to promote their interests, whether materialising in the past under the previous apartheid regime or currently under the newly elected democratic government. This is most notable, for example, in the pursuit of state-subsidised mega-projects and the pressure for privatisation, in part to undermine the state's influence over the economy as well as to obtain productive assets cheaply.

Some key aspects, then, of the South African economy are:

- a lack of capacity in intermediate and capital goods;
- an aged capital stock, reflecting limited investment in the past;
- declining shares in critical world markets for manufactured exports, especially those in which other successful developing countries have been prominent;
- a lack of integration across sectors;
- limited skills and employment opportunities for the workforce, complemented by poorly trained and inadequate management;
- a highly concentrated pattern of corporate ownership which straddles the economy as a whole and not just industry;
- an institutional structure and governance that continues to reflect the economic and industrial imperatives of the past;
- a highly skewed distribution of economic and industrial activity both within South Africa and across the southern African region as a whole.

It is crucial to recognise that these general characteristics of the South African economy differ in weight from one sector to another and within sectors, and that these factors are integrated with one another in different ways depending upon the sector concerned.

Clothing and telecommunications, for example, have obviously evolved along quite separate paths and pose different policy challenges despite their common origins within the South African economy.

In addition, it is important to recognise that the South African economy enjoys certain advantages - such as large-scale public and private sector corporations, an extensive if unevenly delivered infrastructure, and, especially important, the capacity and prospect of delivering such social and economic infrastructure to a varying degree.

Industrial strategy

In this light, the following be given the highest priority in the direct and indirect formulation of industrial policy:

- Meeting of básic needs

A major weakness is the absence of productive capacity in capital goods

Industry has suffered from stagnation in investment since the early 1980s

The economy enjoys the advantages of large corporations and extensive infrastructure

Too great an emphasis has been placed on winning business confidence

- ❑ Generation of employment
- ❑ Education and training
- ❑ Sectoral policy
- ❑ Infrastructural provision and measures to ensure economic and social spin-offs
- ❑ Reform of the financial system to secure finance for industry
- ❑ Monitoring and control of foreign investment flows, particularly those outward investments by the conglomerates of South African origin
- ❑ Minimum labour standards and the narrowing of wage differentials
- ❑ Macroeconomic policy
- ❑ Regional integration within South Africa and across the Southern African region
- ❑ Restructuring of state assets
- ❑ The reform of the institutions for making industrial policy so that the allocation and coordination of responsibilities across government departments is rationalised and coherent

Privatisation merely transfers ownership, at a cost

Some of these are already high on the government's agenda but others are not. Even where they are high on the agenda, this is not always with sufficient detailed attention to their impact on industrial policy, as is the case for macroeconomic strategy, for example.

Misplaced attention

In relative terms, again without commenting in detail on the policies adopted, too great an emphasis has been placed on the following:

- ❑ Promoting a spurious business confidence, which remains elusive, constrains consideration of more effective and more certain policymaking, accords priority to a minority of opinion makers and business interest, and does not guarantee a calculable and positive net social return
- ❑ Promoting small business which is imperative but should not be at the expense of distracting attention from policymaking for large-scale business on whose fortunes small business will probably depend more than any other single factor
- ❑ Promoting privatisation, especially as a source of revenue, since this merely transfers ownership, at a cost, without otherwise formulating constructive policy
- ❑ Competition policy in the absence of a broader strategy for industrial and corporate restructuring, since this merely limits the scope of operation of big business without addressing the role of economies of scale and scope
- ❑ The promotion of mega-projects at the expense of ensuring their overall economic and commercial viability since these may generate foreign exchange and downstream processing but the net social benefits to the economy have to be shown and made to accrue

A major client of industry, the government can impose conditions on suppliers

In short, there is a need first to shift the industrial policy agenda to give top priority to those issues of most importance to working people and, then, to ensure efficient, effective and equitable policies are adopted within that agenda.

Contract compliance

One form in which the implementation and monitoring of policy can be effectively pushed forward is through contract compliance. As a major customer of industry, government can impose a number of conditions on its suppliers over and above the traditional concerns of price, quality and delivery time.

Contracts may usefully incorporate requirements on the development of education and skills, security of employment, and the development and sharing of technology, quite apart from trade union recognition, affirmative action, and observance of general government policy and specific sectoral policy, such as export targeting.

A contract compliance strategy with three separate arms is required: one concerned with compliance in the narrow sense of meeting contracts effectively in the absence of corruption and profiteering; one concerned with the employment and other impacts of businesses such as export and training levels; and the last to promote the role and interests of consumers.

More generally than through the government's own procurement, there is a tripartheid institutional structure for the implementation and monitoring of industrial policy, including industrial corporations themselves, financial institutions and government.

Together these comprise a financial system, broadly conceived. International evidence suggests that the nature of a financial system is crucial in determining the levels, composition and effectivity of investment.

Problems in finance

Despite some positive aspects in the capacity of conglomerates to generate finance for investment internally, the South African financial system has functioned in practice like a market-based as opposed to a banking system. This approach is generally acknowledged to be deficient in promoting appropriate industrial investment and policy, especially in a developing economy in transition.

Despite the discrediting of the de Kock reforms of the South African financial systems in practice and in principle, together with a complete change in domestic and external circumstances and in economic objectives, no serious consideration has been given to relations between finance and industry, and the capacity of government departments to coordinate and innovate in the formulation of policy. This is despite:

- inadequate provision of finance for industry;
- inadequate coordination of investment across sectors;
- inadequate formulation, implementation and monitoring of sectoral strategies;
- inadequate coordination across government departments and other agencies;
- corporate strategies that are inconsistent with the policies required for industrial reconstruction;
- macroeconomic policy that is unduly influenced by short-term financial rather than longer-term and other economic imperatives.

Consequently, it is recommended that an investigation into industrial policy be undertaken with a particular but not exclusive emphasis upon the role played by finance for industrial investment. The inquiry should address:

- a review of past, present and prospective sources of finance for investment together with the design of an appropriate system of data collection so that policy can be soundly formulated.
- a review of past, present and prospective institutional arrangements governing the relations between finance and industry, covering both macroeconomic and microeconomic issues, distinguishing between different sectors and enterprise scale and type of ownership.
- a review of past, present and prospective methods of, and personnel capacity for, the monitoring of investment in both the public and the private sector, as well as how the two interact. Particular attention needs to be paid to the coordination of policy across government departments.
- a review of past, present and prospective levels of capital flight, legal or illegal, and the regulatory and fiscal initiatives which might stem damaging outflow of capital.
- consideration of formalising financial monitoring of industry through policies such as directed credit for successful promotion of exports and other strategic objectives.
- institutional initiatives to strengthen the role of Task Forces in sectors such as automobiles and clothing/textiles and to introduce them into other sectors.
- how new sources of finance can be used to raise substantial additional capital for the developmental financial institutions, such as the IDC and DBSA, so that they expand their operations where social exceed private returns.

This review should also explicitly address the role played by direct foreign investment, drawing upon best practice in assessing the net impact of such investment according to a full social cost-benefit analysis.

The nature of a financial system determines the quality of investment

No serious consideration has been given to the relations between finance and industry

The role of foreign direct investment should be reviewed

Courting foreign investment can weaken domestic investment

There can be no presumption that the overall impact will be significant relative to what needs to be provided from domestic resources, and investments need to be carefully assessed on a piecemeal basis in the light of sectorally specific circumstances and outcomes.

Trade liberalisation

The undue courting of direct foreign investment will be damaging to policymaking more generally, and will engender support for policies that could even weaken investment from domestic resources as pressure builds for deflationary policies to allow for the lifting of exchange controls on capital movements.

Sectoral industrial studies are necessary prior to further liberalisation

Trade policy in South Africa has in general pursued trade liberalisation beyond the level even required by the developments arising out of the Uruguay Round. This is despite the potential for negative impact on the industries concerned and the failure to formulate and put adequate supply-side policies in place prior to liberalisation.

The justification for, and impact of, trade liberalisation has rested to a large extent on the calculation of effective rates of protection, EPRs. These are, however, ill-founded conceptually, in practice in how they have been calculated, and as a guide to policy in their imputed effects.

In particular, they take no account of:

- dynamic and static economies of scale and scope;
- excess capacity;
- capital-labour intensity;
- market structure;
- presence of multinationals;
- skill requirements of the labour force and management;
- developments in world markets;
- product differentiation and quality;
- commercial risk;
- age structure of capital stock;
- the differential impact of non-tradeables;
- the substitution between capital and labour in production in response to changing input prices.

In this light, it is inconceivable how EPRs can justifiably be used as the basis for industrial policymaking of which trade policy is an integral part. Doubts must be equally strong over its usefulness for measuring macroeconomic impacts on employment, inflation and growth.

Rather than assessing trade independently of industrial (or supply-side) policy, the two must be integrated with neither logical nor sequential priority attached to trade policy.

Exactly the opposite is occurring in South Africa in practice. The process of dismantling protection has preceded the election of the ANC government. It is gathering momentum. That it does so appears to reflect a lack of conglomerate commitment to the restructuring of many industrial sectors, with a preference for a strategy of global reorganisation of productive investment.

Accordingly, it is essential that appropriate sectoral industrial strategies are put in place, insisting upon cooperation from large business if necessary, prior to any further trade liberalisation. IPSA