SPECIAL REPORT

Government refocuses on industrial policy

The DTI is scheduled to table an industrial policy document before cabinet in January 2006. What is the current thinking? DTI minister Mandisi Mpahlwa provides some indication of where government is heading during a presentation in August to delegates at Cosatu's central committee meeting.

Debates around an industrial policy have taken place in a number of forums this year. These debates are necessary, as they feed into the policy making process of government, and will contribute to the shaping of the industrial policy that is currently being drafted by the DTI. The debates also occur at a time when discussions around state-led support for, and regulation of, industry are re-emerging globally.

POST-1994 INDUSTRIAL POLICY

The post-1994 industrial policy was constructed in an environment when both the South African and global economies were undergoing very rapid changes. In the early 1990s the country faced an economic crisis. Gross domestic product (GDP) had shrunk. Investment rates were declining. Externally there had been a persistent financial account deficit. Exports of goods and services were volatile and were very concentrated around mining and mineral products. There was an overvaluation of the exchange rate. The tariff regime and industrial incentive schemes were uncritically protective of domestic industry.

The economy has undergone substantial high-level restructuring since 1994, notably the stabilisation of macroeconomic variables and opening up to world trade. Industrial policy over the last ten years was based on upgrading the supply side of the economy. This included:

- Sector specific measures for the sensitive sectors of clothing and textiles; and automotives
- Fixed investment support
- Small business support
- Spatial initiatives
- Support for competitiveness and research and development
- Introduction of a new competition policy
- Constructing the policy framework for black and women's economic empowerment.

These changes themselves occurred in a rapidly changing global economy. Trade and investment liberalisation and lower transport and ICT costs, coupled with the entry of China and India into the global trading system, have generated much higher levels of international competition for products, services and investment. Technological advances have increased the skill and technological intensity of production, requiring that firms master increasingly sophisticated production techniques in order to remain competitive. Changes in multi-lateral rules have also imposed constraints on the nature and scope of domestic policy interventions. This context means that industrial policy must be designed in an environment that is unprecedented in terms of fierce global competition.

In retrospect, significant gains have been made in terms of achieving macroeconomic stability and steady and undisturbed growth during the first decade of democracy. However, both industrial and economy-wide growth and employment creation have not been adequate to meet the developmental challenges of our people.

Increasing evidence from the experience of developing countries indicate that the economies that have grown fastest have been the ones that have not blindly implemented 'Washington Consensus' policies. While they have maintained macroeconomic stability, they have intervened selectively and intelligently in their industrial markets. This is particularly true of the East Asian Tigers. The historical and empirical evidence from these economies, as well as from our own, indicates that the conditions for growth and equity do not necessarily emerge automatically from market forces. Rather, they often require purposive government action to govern and coordinate private sector behaviour.

More specifically, countries are not tied to their inherited comparative advantage of their resource-endowment. They are able to strategise and intervene with respect to their position in the global division of labour, taking into account their developmental needs. At certain stages of development and in certain contexts this requires 'getting the prices wrong'. During other phases it requires 'getting the prices right'. What is critically important, particularly when 'getting the prices wrong' is what Alice Amsden terms a 'reciprocal control mechanism' that imposes monitorable performance standards on firms in exchange for subsidies. In practical terms this refers to the ability of the state to set measurable performance requirements and

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withdraw or even clawback subsidies under circumstances where these performance requirements have not been met. It also refers to the will of the state to get the prices right by removing economic rents from powerful economic interests when these stand in the way of economic development.

It is the role of a developmental state to take on risks that the private sector will not undertake, but also to be honest and pragmatic, to change direction when it becomes clear that the risks are not achieving the necessary developmental rewards.

As is well known and increasingly recognised, economic development is beset with market and production failures. In particular there are three key requirements for a dynamic industrial economy which do not emerge automatically from the market, and which a developmental state must purposively pursue:

- a low cost production base;
- an increasingly sophisticated set of industrial capabilities;
- increasing economic inclusion of the marginalised, through both the labour market and entrepreneurship.

What are the lessons learned from the first decade of post-apartheid industrial policy? Our new democracy is sufficiently mature to allow for honest reflection on the strengths and weaknesses, in the light of our own experiences as well as those of other developing countries. A number of the post-1994 industrial policy measures enjoyed significant success. Foremost amongst these is the Motor Industry Development Programme (MIDP). Although criticised for limited job creation, without this programme we would not now have an automotive industry in South Africa of any consequence. Its broader multiplier effect on the economy has also been underestimated. It has led to the upgrading and employment creation in associated sectors, such as component suppliers and automotive leather. The various competitiveness, technology and export development programmes have increased the dynamism and competitiveness of many firms.

The policy framework around black and women's economic empowerment has brought these issues to the forefront of policy discourse.

WEAKNESSES OF POST-1994 INDUSTRIAL POLICY

However, there are numerous challenges that need to be confronted. One apparent weakness of post-1994 industrial policy may be that the package of supply side measures as a whole was of insufficient scale to restructure the manufacturing sector adequately to deal with the harsh winds of trade liberalisation. In deference to conventional wisdom, programmes have shied away from sector specific support and have been to some extent dissipated by being spread too thinly. To borrow from recent terminology coined by the president,

DTI Minister, Mandisi Mpahlwa at the Cosatu CC

these programmes may not have been of sufficient size to achieve the 'massification' necessary for structural change. These measures have in some cases also not been adequately tied to monitorable performance standards.

There is therefore a need for a more focussed, targeted and pragmatic industrial policy that is sufficiently resourced to achieve structural change in the industrial economy. By 'industrial economy' our approach also needs to stretch to include not just traditional manufacturing activities, but also areas such as selected service activities. Our early thinking around a new industrial policy indicates three main areas of focus for such a policy:

- sectoral interventions;
- cross-cutting interventions;
- capacity building and institutional leverage.

Our sectoral interventions need to be much more targeted and sufficiently resourced to achieve a step change in the targeted sectors. Although much of this resourcing is financial, probably the most important is sufficient human resources to engage in the detail necessary to coordinate structural change in key sectors. We are exploring the possibility of the synergies of grouping related sectors into related clusters. These clusters would comprise sectors that share common characteristics and face similar challenges.

One example is in the area of benefication where there are common issues of monopoly pricing, requirements for technological infrastructure support and related coordination issues. In labour-intensive sectors a distinction needs to be made between those sectors that have good growth potential going forward, and those that require restructuring. A major area in which job creation is possible is in certain services activities such as business process outsourcing. Our advanced manufacturing sectors such as automotives and aerospace can build off common technological platforms.

Probably the single most important cross-cutting intervention must be a rethink and re-organisation of our industrial financing. Again these need to be more targeted and on a larger scale. They must be more closely linked with monitorable performance requirements. We need to make better use of existing institutions such as the Industrial Development Corporation (IDC).

There are other major cross-cutting interventions. The capital expenditure programme (capex) of government and state-owned enterprises will be the largest source of fixed investment spending in the economy over the next five to ten years. This is a major opportunity to generate sustainable growth and employment by locking in as much domestic participation in these programmes as possible. This requires substantial coordination across government in order not only to unlock these opportunities, but also to place these industries on a higher growth path; even after the capex expenditure has been completed.

Black economic empowerment (BEE) must be deepened in the industrial sectors, and there is also a need to tie BEE more closely to industrial growth. This could be done, for example, by linking BEE to local content requirements. There is a need to deepen our interventions around technological and productivity upgrading, focussing on areas such as the commercialisation of domestically produced technologies and product development. The issue of regional industrialisation needs a coherent and sophisticated approach, which promotes sustainable economic growth beyond the three traditional metropoles, while taking into account the fundamental economies of agglomeration necessary to build sustainable economic activity.

There is an urgent need to revisit our institutional arrangements in support of an industrial policy. In order to implement a serious industrial policy it is necessary to be sufficiently resourced, particularly with respect to people. This means attracting, training and retaining high quality staff that can carry out this specialised function.

New and creative ways need to be found to engage our social partners. Harvard University economist Dani Rodrik talks about the need the for 'embedded autonomy' of the state whereby government is closely enough engaged to understand the industrial problems on the ground without being captured by sectional interests. In this regard existing power relationships need to be taken into account. Particular factions of capital often dominate current fora, namely big business which is well organised to lobby and articulate its interests. There is a need to find ways of engaging with the more dynamic and developmental industries and firms in order to bring their interests to the fore.

CONCLUSION

Our new industrial policy needs to be both bold and realistic. It must be bold in the sense that it should aim to achieve a real step change in the growth and employment trajectory of our manufacturing and services economy. At the same time it must be realistic in the sense that industrial policy must be paid for and is also subject to global rules of engagement. Similarly it cannot be seen as the definitive response to our employment challenges. While manufacturing is at the heart of the economy, it may not be able to generate as many jobs as some service activities. However, it has a powerful multiplier effect on the rest of the economy with an estimated 2.2 jobs created elsewhere in the economy for every job created in manufacturing.

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This is an edited version of a speech presented by DTI minister Mandisi Mpahlwa during Cosatu's CC on 17 August 2005.