The Future of South African Industrial Policy

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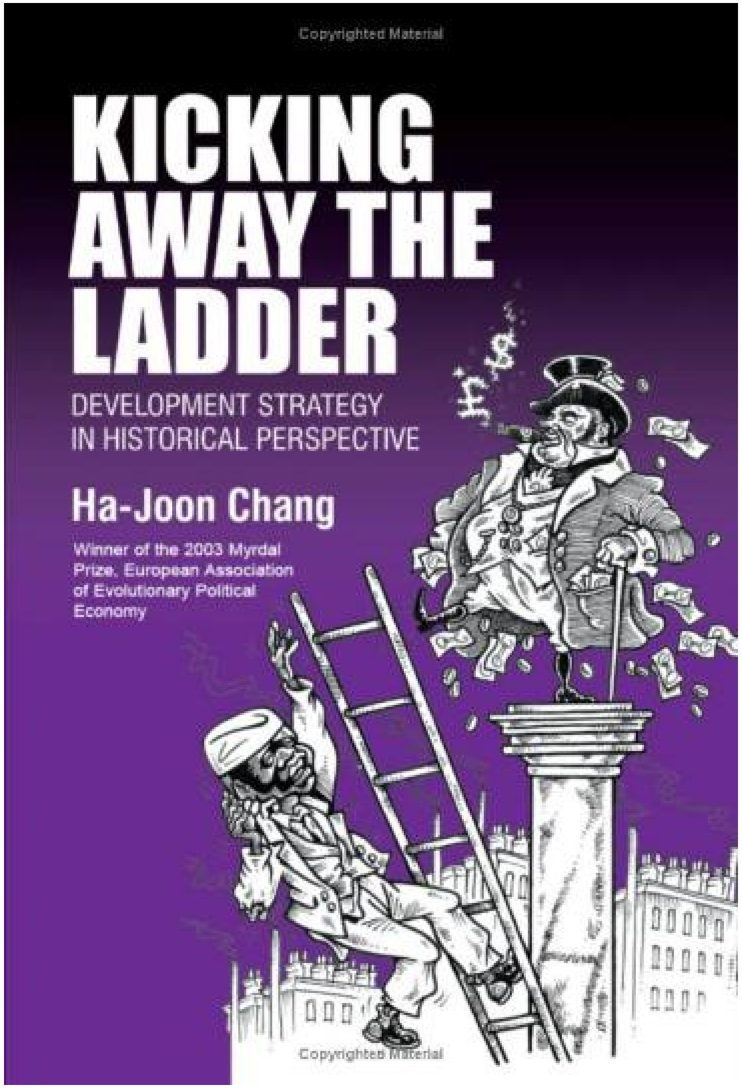
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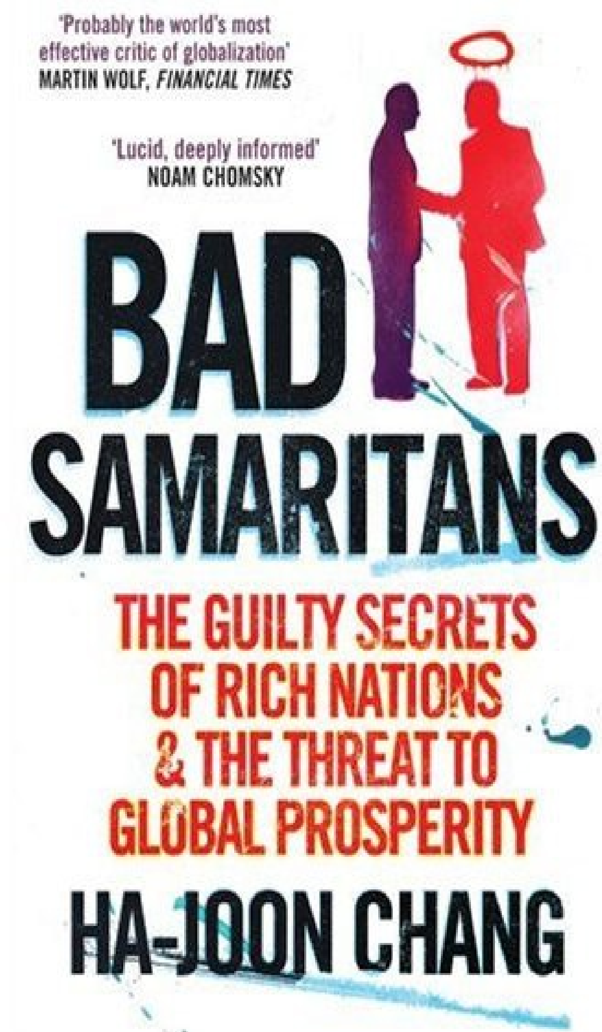
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Lessons from History

- Industrial and trade strategy **promoting the development of productive capabilities in the manufacturing sector** has been behind almost all cases of successful inclusive growth in the last few centuries (from 18^{th} century UK to today's China).
- **We know what works** (with appropriate local variations)
  - Tariffs
  - Subsidies
  - Regulation of FDI for capability building
  - Strategic use of SOEs
  - Active procurement policy
  - Investment in infrastructure, R&D and skills training

Why Manufacturing? I

- Manufacturing lends itself easily to mechanisation and chemical processing, so it has **inherently faster productivity growth** than agriculture or services.

- It is the sector **where most R&D is conducted**.
  - Even in the US and the UK, where manufacturing accounts for only around 10% of GDP, 60-70% of R&D is conducted in the manufacturing sector.

- Manufacturing **enables productivity growth in other sectors** by supplying inputs (e.g., fertilisers, computers) and organisational innovations (e.g., inventory management technique, computer-controlled feeding).

Why Manufacturing? II

- Many **high-value services** (e.g., banking, transport, design, management consulting) are **heavily dependent on manufacturing firms as customers**.
- Especially in the case of South Africa, which has one of the highest (formal) unemployment rates in the world, it is vital to develop manufacturing, because it is **the strongest driver for secure livelihood through more secure employment**.
  – Income transfers can be easily reversed.
- Manufacturing is **good for macroeconomic stability, as it is far more stable as a source of government revenue and export earnings** than primary commodities and sectors associated with them.

The State of South African Manufacturing

- **Once upon a time, South Africa was literally the most industrialised nation outside the 'core' capitalist world**.
  - In 1961, per capita MVA (Manufacturing Value-Added) of South Africa (in 1958 dollars) was $138, which was 61% that of Japan ($227) and 15% that of the US ($926).
  - It was 6.3 times that of Korea ($22) and Taiwan ($23) and 2.8 times that of Brazil ($50).
- **Today, it is not a serious manufacturing nation**.
  - Its per capita MVA may still be 18% that of the US, but it is now 11% (as opposed to 61%) that of Japan, 13% that of Korea (instead of over 6 times), 45% that of China, and 80% (instead of nearly 3 times) that of Brazil.
  - Only 23% that of Australia, the most resource-dependent advanced country.

Manufacturing Value Added Per Capita, 2015

(in constant 2010 US dollars; index USA=100)

- **Switzerland** $14,404 278 (world ranking: 1)
- Singapore $9,537 184 (2)
- Germany $9,430 182 (3)
- Sweden $8,568 166 (4)
- Japan $8,496 164 (5)
- Austria $8,338 161 (6)
- Korea $7,336 142 (7)
- USA $5,174 100
- Australia $4,158 80
- China $2,048 40
- Brazil $1,203 23
- South Africa $952 18
- India $298 6

Source: UNIDO, *Industrial Development Report, 2016*

*Excludes Ireland, whose ‘tax haven’ status makes the ‘booked’ MVA fluctuates wildly

What to do? I

- South Africa’s trade and industrial policies have been conducted **in the right direction since 2007**, although 13 years of ‘Washington Consensus’ policies had done a lot of damage before that.

- However, they **need to be more forceful and larger in scales**, as they were in the economically more advanced countries in the past and as they are in many countries today, advanced and developing alike.

What to do? II

- More forceful policies needed **(continued)**
  - Not even using the full **tariff** allowances under the WTO
  - Not actively using **subsidies** accepted by the WTO
    - R&D, regional equalisation, green energy
    - R&D only 0.8% of GDP (OECD average of 2.4% ; Korea and Israel and 4.5%; 3.3% of Japan, Taiwan, and Sweden)
  - Not enough **infrastructural investments**
    - Electricity crisis
    - Shortage of port facilities
  - Not extracting enough investments, R&D, and (direct and indirect) employment creation from **the firms in 'mineral-energy complex'**

What to do? III

- More forceful policies needed **(continued)**
  - Not extracting enough (informal) concessions from **TNCs** in terms of technology transfer, local sourcing, and worker training
  - Not enough policies for **indirect employment creation** by creating and developing SMEs
    - Creation: investment subsidies, enterprise development advice, incentives for large firms to invest in and help
    - Development: public provision or subsidies for R&D, export marketing, trade financing, training, consultancy)
  - Not using **procurement** policy effectively
    - Many industries have been developed through procurement policy in other countries (computer in the US and Japan, telecom in Finland, green energy in many countries)

What to do? IV

- Moreover, South Africa's trade and industrial policies have not even been able to have the influences that they could because of poor coordination with other policies, so **these policies need to change**.
  - Overly restrictive **macroeconomic policy**
    - Real interest has been one of the highest in the world and the Rand has been hugely over-valued and volatile
  - Anti-developmental **financial sector policy**
    - Lack of investment in general (investment/GDP have fallen from the height of 30%+ in the late 70s to around 18-20%, although it is higher than 15-18% of the 'Washington Consensus' years of 1994-2007
    - Especially lack of long-term 'development financing' (the role of the IDC is critical here)

What to do? V

- Need for **greater cooperation and coordination among several ministries** engaged in trade and industrial policies
  - 'Core' ministries (Trade and Industry, Economic Development, Mineral Resources, Science and Technology, Small Business Development, Public Enterprises)
  - 'Related' ministries (Finance, Transport, Public Works, Higher Education and Training, Basic Education)
- **Either re-orient and strengthen the National Planning Commission (NPC)** into an 'orchestrating' body, like the French Planning Commission or the Korean Economic Planning Board
- **Or complement the NPC with a coordinating body** more specifically charged with inter-ministerial coordination

Shrinking Policy Space I

- **Has the shrinkage in policy space** due to the establishment of the WTO and the proliferation of bilateral and regional agreements on trade and investment **made industrial policy impossible to use?**
  - **NO**

- There are **many** industrial policy **measures** that **can still be used legally**.
  - For some measures, international rules do not apply or do so rather leniently to developing and least developed countries – export subsidies that are illegal for all countries except the LDCs are the best example of this.
  - Some policy measures are inherently domestic in nature and thus not subject to international agreements.

Shrinking Policy Space II

- There are **many** industrial policy **measures** that **can still be used legally**. **(continued)**
  - Sometimes there are policy measures that could well be restricted by international rules but are not because no international consensus has evolved to place a bar on them.
  - Also, ambiguities in certain rules or their application can create further scope for pushing certain policies till they are detected or challenged.
  - As a rule of thumb, with regard to multilateral obligations, **if a policy measure does not affect exports or imports, it does not fall directly under WTO laws and should be allowed**.

The WTO – Tariffs

- WTO member countries are **only required to 'bind'** (that is, set the upper limit to) at least some of their **tariffs**.
  - Indeed, not all of them have bound all of their tariffs – there are **many members of the WTO (many of them in Africa) that have bound virtually none of their tariffs**.
  - Even many of the countries that have bound their tariffs have bound them **at quite high levels**.
- As **the current levels of tariffs** in most countries are **well below their bound levels**, they can raise tariffs.
- It is also possible (albeit difficult) to **re-negotiate bound tariffs** for some products.
- Developing countries can also apply **extra tariffs** or even quantitative restrictions **to address balance of payments problems**, although they require elaborate procedures.

The WTO – Subsidies

- Contrary to common misperception, the WTO **does <u>not</u> ban any subsidy other than export subsidies** (except for the LDCs and other poor countries) **and subsidies requiring local contents**.
- Of course, all subsidies are 'actionable' – that is, they canbe challenged in a WTO dispute and, should the challenge be successful, be removed.
  - However, it takes a few years before a subsidy is challenged and ruled illegal.
- There are **subsidies that can be more safely used**.
  - Subsidies for R&D, upgrading of disadvantaged regions, and developing environmentally friendly technology have hardly ever been challenged, at least partly because they are subsidies preferred by rich countries.

The WTO – FDI Regulation

- **TRIMs prohibits domestic content requirements** and **foreign exchange balancing requirements**.
- **But** it **permits many other measures** – those related to joint venture, technology transfer, or limitations on foreign equity ownership.
  - Moreover, many countries are still using thinly disguised local content requirements, for example, in relation to the oil and gas sector, so developing countries should more actively explore such possibilities.
- **GATS** does restrict countries' ability to restrict FDI in services.
- But developing countries have made few commitments, so their **room for manoeuvre is much greater** in this area, including in relation to local content requirements.

Bilateral and Regional Agreements

- Thus, the **restrictions** on industrial policy imposed **by the WTO** are **considerable but not overwhelming**.
- **However, bilateral (or regional)** trade and investment **agreements** between developing countries and developed countries, especially the ones with the US, are‘WTO-plus’, so they **severely restrict policy freedom**.
- However, even in this regard, there is some way out.
- Countries can **revoke or renegotiate BITs**
  - South Africa has recently revoked 14 of its 47 BITs while Bolivia, Ecuador and Venezuela have opted out of the controversial Investor State Dispute Settlement (ISDS) mechanism (which allows foreign investors directly sue governments).
  - India and Indonesia are also reviewing their BIT regime.