

## Cross-cutting issues emerging from Master Plans

### INTRODUCTION

Industry Master Plans have emerged as an important industrial policy intervention and approach to strengthening and growing South African industrial capacity. The approach to and process of developing these plans has brought about a comprehensive understanding of specific industry dynamics, engagements between key stakeholders in an industry, and the actions required to strengthen and grow that industry. Developing the Master Plans involved research, engagement and collaboration between stakeholders to identify and support the actions required. The Master Plans aim to collectively reposition the economy rather than solve a specific crisis faced by an industry. This policy brief explores some of the tensions that have surfaced in the Master Plan process.

### MASTER PLAN PROCESS

Three sets of tensions have emerged in the Master Plan process:

- a) Between cross-cutting and sectoral issues – industrial policy is distinguished by the emphasis on addressing specific industry-level problems; however, several cross-cutting issues impact on multiple industries and these require intervention.
- b) The need to take into account stakeholder views but not allow the process to devolve into a lobbying exercise or simply accepting the stakeholder views – rather the Master Plan process tests these views against the evidence, and also how they relate to aims of increasing competitiveness and, when relevant, inclusion.
- c) The importance of managing contradictions between maintaining short-run growth based on saving existing capacity, and the need for structural change to sustain long-run growth through higher competitiveness and diversification into more sustainable industries.

Several Master Plans have either been completed or are near finalisation. TIPS, which has been involved in several of these plans either as researchers or as research manager, has been able to identify many of the cross-cutting constraints that impact on the dynamism of an industry or hold back growth. These Master Plans include Plastics, Chemicals, Poultry, Steel, Furniture, Automotive, and Clothing, Textile, Footwear and Leather, all of which are important sectors for the South African economy and are connected through their

value chains and to other parts of the economy.

This “bird’s eye-view” over these common themes is summarised in this policy brief. It should be noted that the identified cross-cutting constraints affecting multiple industries are not necessarily impacting all the sectors but are in at least three of the Master Plans. These common constraints could be targeted for intervention more broadly, as they likely impact on sectors that have not yet been covered by Master Plans. Addressing these constraints would therefore support growth across several industries, particularly as the cross-cutting issues likely have a common systemic problem, whether it is weakness in existing institutions or the absence of appropriate support institutions or measures.

Many of the constraints are not new and several have been raised previously through the Industrial Policy Action Plan (IPAP) or other industry studies. Given their impact, it is important that addressing these constraints remains on the policy agenda. These constraints have persisted and continue to impact on the ability of South Africa’s industrial base to grow and thrive. It is not only about the short-term fixes that are required but also about addressing some of the more complex, systemic, structural or cross-cutting issues.

The constraints discussed in this policy brief are not only those of government or state-owned companies (SOCs). Constraints that can be resolved by industry or private sector players are included. Resolution of several issues also requires collaboration between different players in government,

Trade & Industrial Policy Strategies (TIPS) is a research organisation that facilitates policy development and dialogue across three focus areas: trade and industrial policy, inequality and economic inclusion, and sustainable growth

+27 12 433 9340  
[www.tips.org.za](http://www.tips.org.za)

Policy Brief by  
Saul Levin

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SOCs and the private sector (including industry associations), with the government playing a catalytic role in incentivising the changes or change in approach that is needed.

The benefit of the Master Plan approach is that it brings together players to support collaboration in an industry to unlock growth. These collaborative benefits, however, also need to be looked at across industries. There are various processes already in place to foster that collaboration, including through the National Economic Development and Labour Council (Nedlac), the Job Summit and the Public Private Growth Initiative.

## IDENTIFIED CROSS-CUTTING ISSUES

The cross-cutting constraints that have been identified are aggregate demand; imports; electricity; input or raw material costs and availability; rate of investment, technology upgrading, research and development (R&D) and supply chains; labour-related factors and human capital; collaboration; and industrial finance.

### 1. Aggregate demand

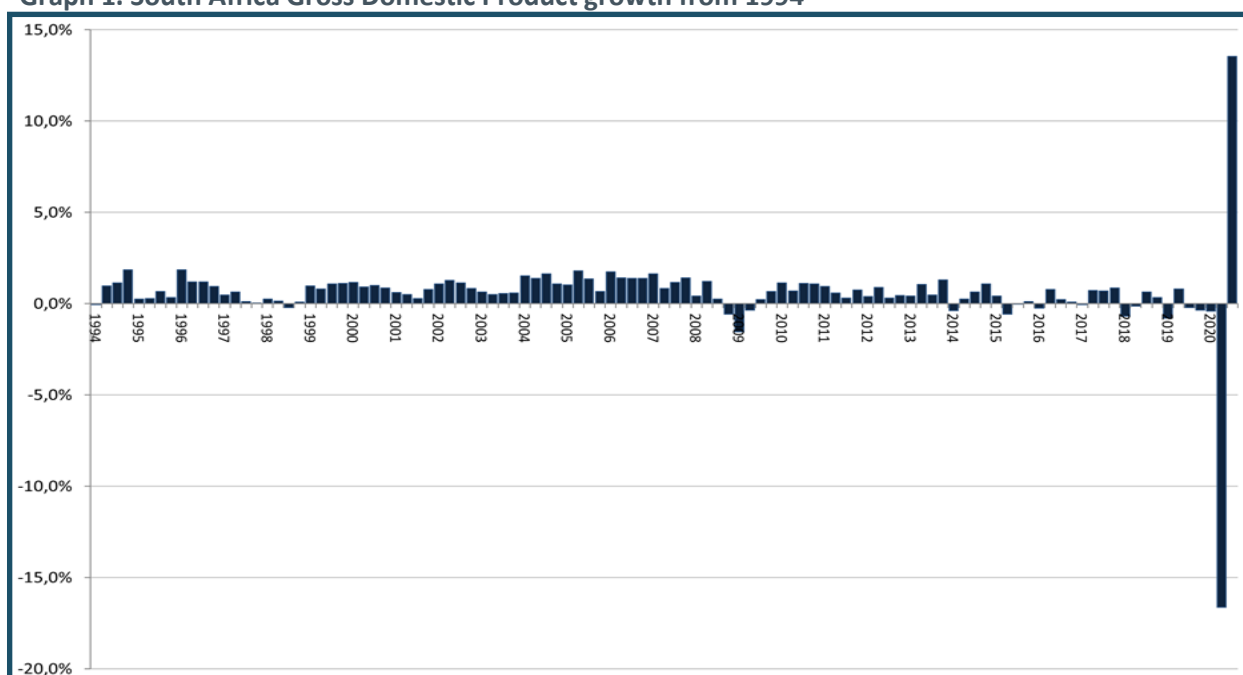
**Slow domestic growth:** One of the issues that impacted on several of the industries covered by the Master Plans was the low demand for products. This impacts both locally made products and imports. The

The low aggregate demand in the South African economy, already present when the Master Plans were undertaken, was then compounded by the recession in late 2019/early 2020 and then the disruption to the economy by COVID-19. The decline in government spending initially through cost-containment and then austerity has also had an impact on industry. As can be seen in Graph 1 on GDP growth, aside from the 2008/9 global financial crisis, the economy as a whole started slowing down in 2011 and even more so since 2015.

Most of the economy has been under pressure over the past decade, in particular the mining, construction and utility sectors, as shown in Graph 2 (on page 3). There is link between several of the manufacturing subsectors covered by the Master Plans through the provision of manufactured inputs, among other things.

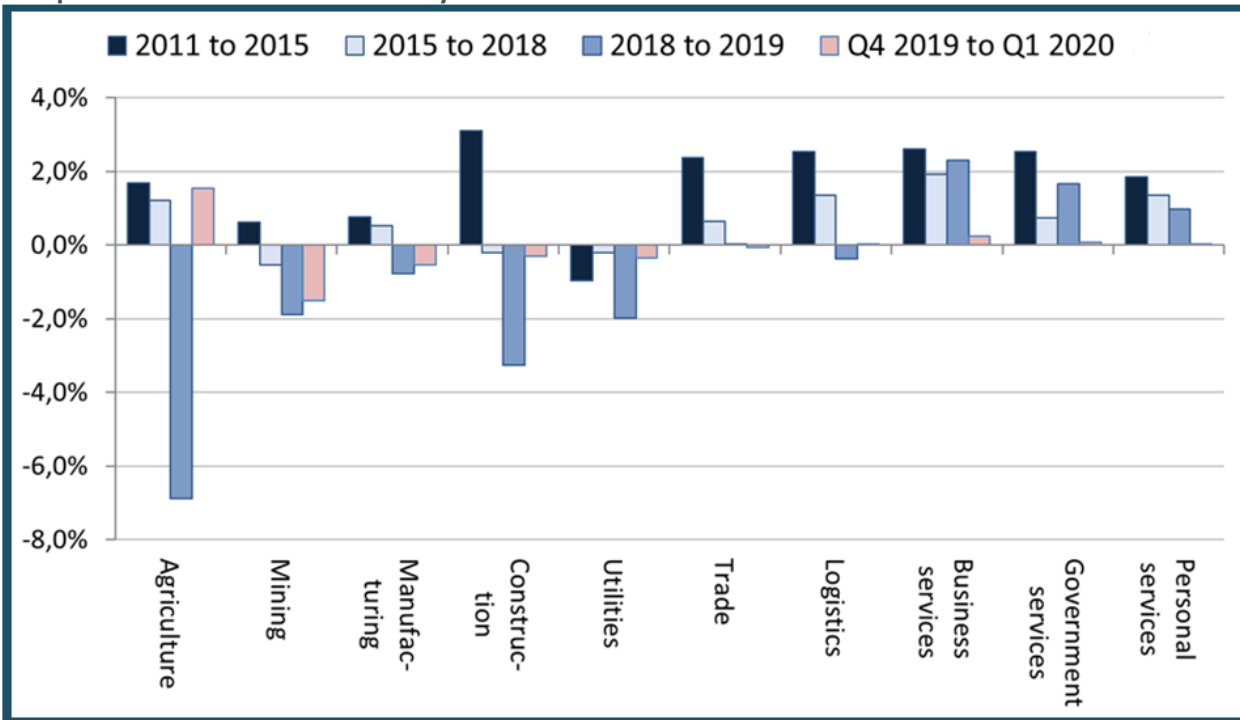
The knock-on impact of lower demand over the past few years has been significant for industries that are intermediate goods providers as well because consumers have been under pressure. In addition, there has been a higher cost for imported inputs as a result of the Rand's depreciation. Exports, however, were not able to fill the gap and take advantage of new opportunities and the weak currency due to other constraints, which are discussed in this brief.

Graph 1. South Africa Gross Domestic Product growth from 1994



Source: Statistics South Africa; see also TIPS Real Economy Bulletin Q3 2020. Data shows the percentage change in the GDP, quarter-on-quarter (not annualised).

Graph 2. Gross Domestic Product by sector



Source: GDP quarterly figures. Excel spreadsheet downloaded from [www.statssa.gov.za](http://www.statssa.gov.za) in March 2020; See also TIPS Real Economy Bulletin Q1 2020. Data is based on constant 2010 prices.

Exports are important and are often put forward as an alternative to dampened domestic demand, but not all industries and firms are suited to or able to export. In addition to the cost factors, exporting in certain industries has extremely onerous standards or sanitary and phytosanitary requirements, and in others the intensity of the competition from other exporting countries adds to the complexity and viability of entering the export market. Small firms, especially in sectors such as steel, furniture and plastics, are largely reliant on the domestic market. Developing export capabilities by either large or small firms therefore requires a significant investment, developing the necessary know-how, brand building, and establishing relationships.

The currency depreciation has not always helped to bolster industries. While a weaker currency should make firms more competitive on the domestic market against imports, the reliance on key imported inputs in the supply chain or inputs priced at global prices negates some of that advantage.

The combination of these factors has seen slow growth and low overall demand in the domestic economy.

## 2. Imports

Different aspects related to imports appear to be a common concern among most of the Master Plans. Part of the Master Plan process has been to undertake evidence-based research and data analysis to avoid perceptions related to imports or the experiences of one firm impacting on the recommendations taken forward.

The category of import concerns includes:

**Substandard or non-compliant imports:** The Master Plans raised that South African-based firms are required to comply with various standards and regulations, while competitors in other markets may not have the same responsibilities or circumvent health, safety or labour requirements, making their products unsafe or risky for use or consumption. Concerns were also raised about the effectiveness of the enforcement of standards by relevant authorities, with recommendations to increase engagements with industry and strengthen capacity.

**Cheap imports:** Three aspects emerge: First, several countries subsidise various aspects of their domestic industry or value chains in a sector to give them a production advantage. This issue was raised extensively in the agricultural value chain. Second, South African firms need to comply with extensive legislation and regulations pertaining to business operations and labour requirements, including environmental practices, quality standards, labour practices, salary levels, and safety standards, among others. In addition, socioeconomic issues are often added to these requirements. The concern was not about the importance and benefits of compliance but rather that if competitors from other countries do not have to meet the same obligations their cost structure is consequently lower. If imports are not subject to the same requirements, it then places local compliant firms at a disadvantage. The third issue is that some countries legitimately and with full compliance have a lower cost structure than South African firms – this may be related to technology used, energy efficient

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production processes, high productivity or (legitimate) lower input costs.

The issue of tariffs and the need to protect domestic industry from cheap imports was raised as a concern in almost all the Master Plans. It was also the basis for motivating for tariff protection. Importantly, when the first two issues are causes, the tariff levels the playing field, while the third one would risk propping up inefficient industries. Should the tariff measures be used to protect the industry, the Master Plans have identified that the necessary investments should take place by industry in order to compete on an equal footing. The tariff does, however, give the industry the room to make those investments and an argument could be made to ensure that the tariffs are time bound. Further, while the Master Plan processes allow for agreement to be reached on tariffs, these applications would need to follow the formal route whereby industries or firms submit an application to the International Trade Administration Commission (ITAC), and ITAC would undertake its own investigation.

***Under-invoicing and misdeclarations to avoid tariff lines or tariffs payable:*** This takes place when firms that are importing undertake measures to avoid the correct tariff line to avoid the required tax payable. The importers then use a different tariff line in particular the “other or “other other” tariff line, which is often at a lower tariff rate or is duty free. There is a purpose in having the category of “other” tariff line at a lower or tariff free rate. There are items that are not made domestically or do not require tariff support, and it is therefore unnecessary to have those goods impacted by a tariff which would unnecessarily raise the costs for either consumers or industry that use these items as inputs. Having that lower or tariff-free line item therefor has benefits. The Master Plans have identified that importers or players abusing that tariff line then create problems for the industry.

Related is the problem of under-invoicing on imports to avoid paying tax, thereby reducing the cost of the imported item. The mechanisms involved can then be linked to a range of illegal activities that could include use of tax havens but may extend beyond tax fraud and into drug smuggling and other illegal or illicit activities.

***Increase in volume of imports:*** The combined effect of all of these import issues has seen imports and high volumes of imports as a percentage of the local production being raised as a concern in almost all of

the Master Plans. However, it is not a given that there are always growing imports, particularly in the face of declining demand. How the latter issue is linked to low aggregate demand in the South African economy is discussed in section 1.

### 3. Electricity

Electricity came up as a constraint in all Master Plans reviewed for this policy brief. The two key issues are the increasing cost of electricity and the reliability/unavailability of electricity provision. As not all the sectors are energy intensive or even energy intensive within sectors, the negative impacts are not uniform.

The impact of the high electricity cost is therefore different for different industries but remains a significant and increasing cost.

***The unreliability of electricity:*** In the early stages of loadshedding, the lack of scheduling of outages had a significant disruptive effect, however since this was resolved, planning by firms has improved. The unavailability of electricity from time to time still remains a concern, with loadshedding a persistent problem resulting in downtime/unproductive time at firms. There are also non-monetary costs attached to this constraint. For example, it makes South African firms less effective against global competitors that are not affected by the same issue – competitors overseas do not have to worry about the unreliability of electricity and can then focus on the core issues of running their businesses effectively.

***Cost of electricity:*** The rate of increase in the price of electricity has been a longstanding cross-cutting constraint and is well-documented. The impact has been significant in the energy-intensive parts of industry, particularly steel. The high rate of increase has, however, affected manufacturing firms across the board.

### 4. Inputs or raw material costs and availability

Inputs or raw materials are a key concern for several industries. This takes the form of:

***Upstream producers limiting their product range:*** The impact is that firms that require specialist materials, for example in steel or plastics, are not able to get them locally, and these must be imported. However, the increasing lack of availability of specialist material due to the focus by upstream producers on few products has a knock-on effect and means that certain types of products are no longer

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able to be made in South Africa and must be imported. The challenge is that it is often not viable to import the specialist material and beneficiate it locally. In some sectors the lack of availability of specialist input materials has resulted in firms closing down, such as in steel, chemicals and plastics, and in some cases the situation is worsened by tariffs.

**High input prices:** The practice of import parity pricing of input or raw materials (or pricing slightly below the import price) affects the competitiveness of downstream producers and it is often the smaller firms<sup>1</sup> at the last stage of production that do not benefit from South Africa's mineral endowment.

In addition, upstream firms apply for protection from imports through tariffs, which then further reduces the cost efficiencies for downstream producers by increasing their input costs. There is a clear tension between the upstream and downstream manufacturing firms, particularly in sectors such as steel and plastics.

**Price volatility of inputs:** Sectors that rely on imported inputs have raised the concerns of currency volatility. The currency volatility also has an impact on imported equipment and licensing agreements.

## 5. Rate of investment, technology upgrading, R&D and supply chains

The rate of investment, specifically the low rate of investment, is on the one hand a constraint that inhibits growth of the value chain, but on the other hand could also be seen as the outcome of many of the other constraints identified in the Master Plans. In the case of the latter, it is important to understand and then resolve these constraints, which lead to low rates of investment. A distinction also needs to be drawn between firm-level constraints to investment rates, and systemic constraints to investment, i.e. institutional support for investment such as access to finance, or an ecosystem that enables access to new technologies and the necessary skills required.

**Low rates of investment:** Several of the industries have seen low investment rates in new capacity. At the firm level, the Master Plans identified that in several industries many firms are sweating their assets, and not investing in new plant and equipment or upgrading their technologies. At the industry level,

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<sup>1</sup> In steel, the upstream is also impacted by this approach. A shift has taken place in recent years where Kumba no longer supply ores to AMSA at developmental pricing, and this has contributed to cost pressures on this operation.

firm closures and the lack of new entrants have resulted in less industrial capacity. Furthermore, low investment levels have limited new product ranges and opportunities. Consequently, industries and firms are losing their dynamism, competitiveness, and product scope. The risk is a set of policies that allow firms and industries to survive without upgrading their technologies and falling further behind on the cost curve and competitiveness.

**Access to and use of technology:** Linked to the low rate of investment are firms which are not upgrading their technology. Latest technologies often have advantages in energy efficiency, throughput rates, reduction of waste, and lower downtime or change over time between production/batch runs, as well as supporting the shift to new or specialist products.

It is important to note that this trend is not universal across all industries or parts of industry but was identified in several of the Master Plans as a constraint. There are firms which have invested in the latest and best technologies, and combined with high skill levels and innovative approaches, are able to compete head to head with firms across the world.

**R&D and innovation:** Similar to the technology constraint, in several industries rates of investment in R&D or in innovation research are low. Concerns in the Master Plans also emerged around linkages between those that do the research (such as science councils or universities) and those in industry that would benefit from the research. The declining funding to several of the science councils was raised as having a knock-on effect on industry. The combination of these issues reduced capacity to innovate as well as improve products and processes. Again this is not universal as there are pockets of excellence, and in some cases private companies have had to develop in-house capacity or strengthened their own existing R&D capacity.

## 6. Labour-related factors and human capital

**Skills:** Weak human capital and skills at all levels came through in many of the Master Plans reviewed. This issue was raised as more than a factory floor issue – it is across the board and at all levels in an organisation, managers included. That constraint has a knock-on effect on how the firms are organised and the production process. This issue also links back to the technologies that are used – and the capacity to bring in and to use the latest technology. Some of constraints that arose included the entry-level skills of workers coming into the workplace, the disjunction



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between industry requirements and training provided by the education system, and outdated curricula.

**Workplace conflict:** Three Master Plans flagged the issue of workplace conflict and strike action. These industries had in prior years experienced strike action. South Africa remains a highly unequal society and these issues are also felt in the workplace. The legacy issues require both broader societal interventions, i.e. through government social policy, as well as industry and workplace interventions through, for example, improved dispute-settlement measures.

## 7. Collaboration

**Poor collaboration across different parts of the industry:** In three of the sectors, lack of collaboration between firms in the industry as well as firms in other industries was raised as a constraint. Domestic firms do not always use local suppliers when they could. The research showed that this has emerged because the firms have not established relationships – or even have knowledge about what can be made or is being made locally. Industry associations have not seen it as their role to link firms, and in sectors such as steel they are fragmented.

**Poor collaboration on input materials.** As was noted (in the section on specialist input materials) collaboration along the value chain has been recognised as weak in many of the sectors. The poor collaboration, for example on high-quality specialist materials not being available in the domestic market to make certain products, has a knock-on impact through the value chain.

## 8. Industrial finance

**Industrial finance:** The issue of access to finance came through in the sectors where there are greater numbers of smaller firms, rather than in those sectors where larger firms dominate, for example in the Retail – Clothing, Textile, Footwear and Leather (R-CTFL) value chain, steel and furniture. In other Master Plans, such as poultry, the issue of finance was specific to the small firms (typically black-owned operations) and the contract farmers. Lower investment rates – when firms are not investing in improving or growing their capacity – impacts on the need for industrial finance, although for example in the R-CFTL, the firms reported that the lack of finance decreased their ability to invest in plant and equipment, and identified that as a constraint. The ability to access industrial finance can then be linked to the earlier constraint identified on limited investment in new technologies.

## WHAT IS MISSING?

The analysis highlights a number of cross-cutting constraints, but does not include several constraints (some of which were raised in only one Master Plan):

- ⇒ Environmental constraints and the challenges that arise from water stress, pollution and waste. Some of these issues were raised by specific Master Plans but did not emerge as cross-cutting constraints.
- ⇒ Threats from the energy-intensive nature of the economy, which affects on exports, (through border carbon taxes for example), were not identified as a constraint in the Master Plans.
- ⇒ Lack of progress on the digital economy and transition to digitally integrated value or supply chains.
- ⇒ Only one of the sectors reviewed reported logistics and transport issues as a constraint.
- ⇒ Government procurement processes, outdated specifications and red tape have come up as issues in other industry research but did not come through as key constraints in the Master Plans.
- ⇒ Related to these is the difficulty of exporting to Southern African Development Community (SADC) countries because of infrastructure and challenges at borders.
- ⇒ Furthermore, given the African Continental Free Trade Area (AfCFTA) and possibility of exports beyond the region, limited demand in many African countries for many products due to low incomes remains a challenge.

While there are likely other constraints missing from the analysis, these few points highlight some gaps on issues that government has set as priorities, especially around shifting to more sustainable energy sources and managing the environment; the digital economy; growing exports to other African countries; and strengthening logistics as well as resolving border post constraints.

## CONCLUSIONS AND LESSONS

Reviewing the constraints identified in the Master Plans has also provided lessons about the process and how it can be improved. Important questions for consideration included:

- a. Has the Master Plan process been a useful tool in consensus building and getting relevant parties to agree on common developmental objectives?

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- a. Is this process achieving the quid pro quo in terms of government, industry and labour objectives all making a contribution to grow the industry; or is it just a vehicle for industry to table its concerns?
- b. Does the Master Plan process ensure that stakeholder perceptions/inputs are effectively tested against both the (a) evidence and (b) long-run outcomes?

The Master Plan process involves most if not all the key industry players, and there is value in undertaking and presenting the research both on the domestic and global market, and engaging on it with stakeholders. That, along with having group and individual discussions with industry and other roleplayers, contributes to a robust process that can bring the critical issues to the fore, identifying what the core constraints are as well as possible solutions.

The challenge is the number of issues raised as constraints through the research and engagement process. Given the limitations on implementation, scope is limited to addressing only a handful or the most critical issues. A key part of the Master Plan process has been to distil the most critical issues from a longer set of constraints to unlock growth of the industry. The remaining issues, however, still need to be addressed over time in order to contribute towards growth of the industry. Ensuring these are not dropped is therefore important.

A further challenge is that government departments and SOCs that could address some of the constraints are not always part of an individual Master Plan – some are present but not all. It is not always necessary or even possible to have all the required players or departments in the room. A process on how issues that impact on another department or on a SOC are taken through to that department or organisation for input or resolution is therefore critical.

An important part of the process that could be strengthened is on how government makes inputs into the Master Plans. Government officials are often reluctant to table their vision of what is required or needed to unlock growth and address the constraints in an industry. The experience was that officials hold back during the initial engagements, and then

either come in at the end or during the political engagements. A clear mandate to officials on their role within the process would resolve that challenge – so that government highlights what it wants out of the process to change the outcomes and impacts of the industry, particularly in terms of jobs, investment, competitiveness, and being more energy efficient or greener. This approach would also contribute towards prioritising the key constraints to unblock.

Another aspect of the approach is the balance between taking the evidence from the data and information provided, and balancing that against the view of firms or other industry players interviewed or engaged with as part of the process. That approach is beneficial as it moderates against claims that are based on perception or may impact only an individual firm rather than the industry as a whole.

The Master Plan process highlighted the importance of being rigorous in reviewing and engaging on the evidence, as stakeholders may not always be aware of some of the data, value chain issues or international experiences, and alternatively have a perspective on why some of the data is not a correct reflection of the issues, or provide alternative data sources. Further, the research can also bring in and identify issues not always known or considered as a constraint or challenge. The combination of research along with the industry, labour and government engagement allows for fact checking, and insider knowledge and experience to be brought into the Master Plan.

The collective approach to identifying constraints and measures to resolve the constraints has contributed to unlocking growth and investment through the Master Plans by giving players in the industry confidence in future profitability. The alternative, which has been seen in several industries already, is a downward spiral of firms holding back their investments, sweating assets, chasing short-term options such as tariff support to prop up the industry, or even closing down operations. While developing a shared vision, unblocking constraints, and firms investing to become more competitive will not always change the fortunes of an industry it is, however, much needed, and a recipe that has worked elsewhere. The Master Plans make an important contribution to that collaboration.