The Role of Industrial Policy and the Minerals-Energy Complex in the Decline of South African Textiles & Clothing

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1 Introduction

The aim of this paper is to assess the nature and evolution of industrial policy in post-war South Africa and to explore what elements and factors have led it to take the current shape and form. This is done in the light of economic decline and with a particular focus on the relationship between economic structure and industrial policy.

The South African economy and manufacturing in particular has experienced a slow overall decline despite adopting a range of recommended economic policies from protectionism and active state support in the period preceding political change (1994) followed by aggressive but selective liberalisation and more free access to markets thereafter. Much of the literature adheres to the neoclassical stance and has blamed the decline on factors ranging from government interference through industrial policy, poor skills, out-of-date technology and constrained input access, increasing global competition, high labour costs and a host of microeconomic factors unique to the sector. Evidence for these as explanations of the poor economic performance is at best mixed. Corrective attempts have also ranged from extensive government support and protectionism, on the one hand, to aggressive market-led economic liberalisation with a focus on supply-side policies, on the other. Despite the different approaches, these attempts have failed to stop the decline. A key weakness of the state versus market categorisations and remedies is that they focus on the perfect market as the starting point and allow room for state intervention in the presence of market imperfections. This juxtaposition is unrealistic as it fails to allow for both the market and state to play a part but also because it ignores the role of key elements of the South African political economy and economic structure. In particular, it does not explain the contradiction between rapid and extensive liberalisation in some parts of the economy and tighter controls in others. Despite political and economic change following the end of apartheid, some elements of industrial policy and economic structure have remained or even strengthened. For example, there is continuity in the influence (direct or indirect) that the large conglomerates (mainly within minerals and energy) exert on policy and economic structure. Labour market dualism persists despite the end of influx control and racial segregation. Government support to textiles and clothing as well as the motor vehicles industry remain whilst extensive trade and financial liberalisation are pushed forward across the rest of the economy. These developments highlight the shortcomings in current research where emphasis is on the market versus state approach. Many post-apartheid academic and government-commissioned studies have typically focused on single sectors or isolated causes. What is missing is a broader analysis from a political economy perspective to assess how and why policy has evolved as it has, and how this has influenced economic structure and performance.

Understanding the specific dynamics of industrial policy requires delving into what drives the South African economy and how specific sectors fit together with the underlying combination of economic and political priorities and changing external market conditions. This research aims to show how industrial policy reflects these economic and political priorities with particular focus on the dominant role of the mineral and energy complex (MEC) as a key driver of industrial and macroeconomic policy and economic structure. Also core to this analysis is seeking an understanding of the debate on post-war industrial policy and the roots for the unrepresentative market/state polarisation. Pro-market and liberalisation policies have gained momentum with the rise of the Washington Consensus during the 1990’s. South Africa’s policy choices follow but do not mirror these theory developments. Though state driven policy is typically associated with the apartheid period and the market driven model with the new Government of National Unity (GNU) post 1994, a closer look shows liberalisation began before the end of apartheid and elements of strong state involvement remain thereafter. This suggests that theoretical trends inform policy debate but do not drive policy choices and the causal link is not clear and direct.

What emerges is a pattern where post-war industrial policy can be described as disorganised import substitution, promotion of state-owned enterprises, failed decentralisation and unsuccessful support to small and medium sized enterprises during the period preceding political change. Though aggressive liberalisation and supply-side policies take over in the 1990's, the dominant role of the minerals energy complex remains a substantial influence over the economy. The poor manufacturing performance and alleged policy ineffectiveness reflects a broader failure to achieve structural transformation through diversification away from natural resources. It also points to the failure to achieve a break in the dominant class structure where a mature capitalist class controls the profits extracted mainly from minerals- and energy-related sectors. In addition to the influence of domestic and theoretical factors, global economic developments in trade and financial markets present another layer of complexity in understanding how and why industrial policy has evolved.

In line with these questions on policy and economic development, attention turns to assessing the decline of the textiles and clothing (T&C) sector (as an example of manufacturing unrelated to the MEC). The aim is to show that macroeconomic and industrial policy choices exacerbated the decline in conjunction with global and domestic economic changes. This is puzzling given that the T&C industry continued to receive preferential treatment through direct government support and exemptions or special arrangements to soften the adverse impact of macroeconomic policy (notably trade and financial liberalisation, macroeconomic stability and fiscal policy). In addition, the low skill and labour intensive nature of T&C fits with the government's claims to prioritise employment[1] and would reinforce the need to ensure the survival of this industry. Explanations for the failure to arrest this decline typically fall into one of the following categories:

- State intervention and market (failure) have resulted in poor policy and poor implementation.
- Poor output and productivity growth of the South African economy as a whole are connected to but not fully explained by the popular competitiveness analysis rooted in microeconomic analysis. Multiple explanatory variables such as poor skills, obsolete technology, structural and management shortcomings, organisational limitations etc. have been researched through case studies and statistical analyses. Recent supply-side policy measures are directly linked with this type of analysis.
- Developments in the global trading environment and other external market factors such as changes to the global T&C value chain, new entrants to the (liberalised) markets, and a proliferation of multilateral and bilateral trade agreements have played a dominant role over and above government actions to support vulnerable sectors.

Though relevant in highlighting specific elements of the decline, these explanations suffer from a static and descriptive nature that is devoid of contextual understanding. What is missing is an exploration of the underlying political economy conditions that drive the South African economy and policy; how T&C fits into the overall political and economic priorities and in particular; and how these priorities have evolved over time. Three possible scenarios are used to assess the above explanations in this light. Firstly, that for various external reasons the sector is bound to fail and policy is a way of controlled run-down or weeding out all but small competitive core. Secondly, any attempts to move up the value chain are obstructed by a range of internal and external factors (policy, interest groups, global competition, trade agreements etc.). Thirdly, rent-seeking and inefficient support by industry actors means the sector remains active but does not develop. These scenarios seek to show the developments of the T&C sector as examples that highlight the evolution of manufacturing and the structure of the economy in a broader context and in doing so move away from the restrictions imposed by fashions in economic theory.

In conclusion, the paper proposes the following hypotheses:

- South African development in the 1970-2005 period does not fit under existing industrial policy theorising and definitions polarising the state and the market
- The prospects for the development of the T&C sector were heavily constrained by the dominance of the MEC within the South African economy. Any development opportunities emerging within the T&C were limited or obstructed by the priorities set in the broader economic and political context.

The paper is structured as follows. The next section 2 details the industrial policy evolution pre- and post-apartheid. This is followed in section 3 by an evaluation of the policy debates within economic theory and policy circles and their possible influence on the South African choices. The final section 4 focuses on applying this structural and policy landscape in the context of a declining Textiles and Clothing sector.

[1] See South African government industrial policy white papers 1990 and 2006

2 Industrial policy and economic evolution in South Africa

A preliminary review of South Africa's industrial policy suggests a pattern not dissimilar to other post-independence African nations where strategic areas of production were protected through subsidies, import protection and specific support in order to generate a domestic consumer goods industry. At first glance, it also seems that policy closely mirrored the prevailing theoretical trends in development economics with the 1970's and early 80's associated with state led industrialisation policies giving way to market-led policies in the late 80's and early 90's. Closer inspection reveals a more complex evolution of industrial policy. Though protection and industry support were important elements of economic strategy and the state active in promoting industrial interests, import substitution industrialisation and the consumer goods industry were not the primary or exclusive targets or drivers of policy. The policy approach has shifted alongside political changes associated with the end of apartheid, however, this paper argues that there has been continuity in the structure and drivers of the economy and that these have been reflected in the various policy stances over time. The analysis draws on an alternative view that the economy has evolved around the dominant capital-intensive industry and associated interests known as the minerals-energy complex (MEC).[2] In line with this view, we argue that not only has South Africa's industrial policy evolved around capital-intensive mining and minerals extraction which has subsequently developed links into downstream industries creating a broad and loosely defined minerals-energy complex, it has also developed an independent form of capital accumulation though in-line with the theoretical debates on industrial growth and policy.

The following discussion explores post-war industrial policy and parallel economic and political developments within the proposed framework of capital accumulation around the MEC. It is shown that state investments, macroeconomic management and support for industries within or downstream from the MEC played a significant role in the period before the end of apartheid. Policy initiatives around the end of apartheid rule took a form similar to the Washington Consensus though with the state maintaining a strong role in supporting the MEC. Despite intermittent claims since 1994 to prioritise alternative targets for policy (especially the high unemployment, uneven distribution of resources, social issues of crime, health, education) and in particular an increased focus on developing labour-intensive sectors, the policy landscape post-apartheid continues to be dominated by capital accumulation with a moderate shift to value-added activities downstream of the core minerals and energy extraction.

To what extent could this be attributed to pressure from the prevailing neoclassical economic ideology and pressure from international financial institutions? This paper argues that in the case of South Africa, the policy stance was constrained by the global economic environment, however, the form of reform and was driven by domestic factors rather than enforced upon South Africa from the outside. Though the post-apartheid policy was predominantly neoclassical, explanations for this must be sought from within the political and economic structure of the economy.

This chapter begins with an outline of the evolution of the economic structure and accumulation strategy and connects it to key political developments up to the 1970's. A new look at industrial policy in the 1970's and 1980's explains the economic decline in part by external events such as minerals and energy price falls and in part by the narrow policy focus on capital and MEC-related growth[3]. This is followed by an analysis of post-apartheid industrial policy confirming the ongoing influence of the described capital accumulation structure despite political upheaval and economic policy shifts from more protectionist to pro-market. Finally, a recent revival of interest in the developmental state construct fails to alter the policy drivers and structural dynamics though it does raise useful questions about the scope for government-led policy transformation. This leads the discussion onto the last section of this chapter – the discussion about the influence of theory in South Africa's industrial policy. Conclusions highlight the need for a case study to expand on the role of the MEC, the prevailing policy debate, and the domestic and international economic environment on segments of the South African economy.

Capital accumulation as the driver of the economy

The following discussion focuses on the post-war South African economic structure and argues that the mining-led

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2 Notion put forward by Fine & Rustomjee (1996) and discussed in detail by Fine (2008)

3 The description of South Africa's industrial policy has been divided into two segments; pre-end of apartheid (post-war covering mainly 1970's to early 1990's) and the period after the end of apartheid from the early 1990's - 2007. Though the chronological split is important and useful in distinguishing between political regimes, the industrial policies evolved at a separate pace and crossed this political dividing line.

capital accumulation structure evolved largely due to the tensions between labour and capital and the increasing fragmentation of labour markets. Political segregation under the apartheid government and the associated control over labour organisation and movement consolidated this division and strengthened the influence of capital-owners over economic policy.

The discovery of gold and diamonds in the late 19th century consolidated a split economy and the emergence of the unique capital accumulation strategy.[4] This split, sometimes referred to as the 'Two Nation' society, refers to an economic divide between the international/capital bias of the mining/energy sector on the one hand and the local/state-dependent agricultural and manufacturing sector on the other. This split is also associated with a division between skilled (typically White) and unskilled (typically African) labour with associated separate unionisation patterns and additional and further divisions between urban and rural workers. Though these divisions were originally not rigid nor predestined, the different policy pressures they exerted on the political-economic system over time consolidated the dominance of state-capital relations over the needs of labour, racial equality, agriculture and low-capital industrial development.[5]

The mining industry requirements for access to international markets, external finance, and cheap labour pressured policy towards free trade and free financial flows. This integration into world markets as the provider of primary commodities helped finance the support needs (subsidies and protection) associated with agriculture and manufacturing.[6] It also set the roots for an economic structure dominated by capital accumulation and a dependent role for non-mining related economic activities.

Tensions between mining and agricultural or industrial capital persisted into the 1930's partially due to the association of agricultural capital with the Afrikaners and mining with the British colonial capital. Exacerbated by historical political divisions dating back to the Boer war, the influx of European immigrant labour (with better skills and pay) and the competition from capitalist agriculture, the Afrikaner identity remained disconnected from both the original African society[7] as well alternative 'white' society. Two key developments reinforced mining-led capital accumulation. Firstly, by World War 2, the reserve system of labour supply had collapsed and the integration of English (mining) and Afrikaner (agricultural) capital disadvantaged the development of a unified urban labour force favoured by manufacturing capital (promoting freedom from influx control, pass laws, colour discrimination in term of access to both skilled and semi-skilled jobs, and an extension of labour rights to all workers). Looking for low-cost labour to replace that provided by the failed reserve system, mining capital turned to rural migrant workers rather than established urban workers. Agricultural capital, seeking to curb labour flow from rural to urban areas also favoured tighter influx control and pass laws and was thus also biased against a unified urban labour force. These developments alone do not explain the increasing dominance of mining capital accumulation as the driver of the economy. On the contrary, a rise in manufacturing during World War 2 suggested an increasingly important role for non-mining related industry. For a fuller picture and the second key factor, the roles of post-war political developments and the rise of apartheid are reviewed .

The victory of the National Party (NP) in the 1948 elections consolidated power in the hands of Afrikaner nationalists and their associated bias towards mining and agricultural capital. Behind this political development were the defeats of the 'class based' workers resistance (white and black separately) and a shift towards nationalist rather than class politics. This united agricultural, mining capitalists and white workers and promised advantageous economic reforms whilst the black working class was left paralysed by both state repression on resistance and their inability to sustain the threats behind the resistance due to “the lack of numbers, concentration and bargaining power”[8]. Though the emergence of apartheid, pro-capital economic policies and a shift away from class politics characterised the start of NP rule, it is worth noting a number of caveats suggesting these developments were not purely political nor ideological but heavily driven by economic trends already in place and an unusual (unlucky) combination of domestic and global developments. Firstly, that the margin of victory was only five seats, secondly, the NP continued (apartheid) policies

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4 This section draws heavily on Marais (1998)

5 Polarisation of the economy also took place through religion and class divisions (see Davies et al quoted in Marais, 1998); urban-rural migration was affected by pass law systems, the creation of native reserves/homelands, increased mechanisation of agriculture, the 1930's Depression and state expropriation of land with varying impacts on the white and black.

6 Though the latter sectors had lower capital requirements in comparison with mining, they were also less able to raise the necessary funds given their local focus and lack of internationally competitive products.

7 referred to as peasantry by Bundy (1979) in Marais (1998)

8 Fine & Davis (1990,p12) cited in Marais (1998)

already set in motion by previous governments, thirdly, trade union activity was already in decline (linked to global political shifts away from Communism) and fourthly, the apartheid state policy did not exactly match the requirements of mining capital (but rather argued later to be historically contingent and simultaneously functional and contradictory).[9]

Once in power, the apartheid government moved swiftly to put in place promised support for what would later be seen as monopoly capital. This included vigorous controls for labour movement and organisation, support for the Afrikaner capitalist class through tariffs and favourable taxation, state intervention to support manufacturing (especially consumer goods) against foreign imports, and the set-up of state enterprises. The resulting fragmentation of labour and concentration of ownership ensured economic power to the capital-owners and accentuated the division into a two-tiered nation with pockets of modern industries contrasted by the racist segmentation of social and economic life for an increasingly impoverished and voiceless black majority.[10] In addition, there was investment into transport and telecommunications infrastructure to support the import-substitution policy and the development of manufacturing. Unlike other industrialising countries at the time (various South American and Asian countries) the state remained removed from production decisions and export-substitution and the focus was on the creation and supply of domestic markets. The exclusionary approach also applied to factors of production with labour surplus left disconnected from the economy (in dedicated homelands) and serving the primary purpose of reproducing the low-skill labour supply rather than as a source of domestic demand or a target of redistribution.

Given this capital/labour division of the economy, the strong economic growth in the 1960's and the accompanying inflow of foreign capital was largely associated with capital intensive mining and to a smaller extent, agriculture. The manufacturing sector remained dependent on the stagnating domestic market with little development of the capital goods branch. The result was a growing need for imported capital goods at the expense of foreign reserves and an inability to absorb the increasing labour surplus. The social divide between black and white workers and regulations regarding the types of jobs each could access left the economy short of skilled workers with a resulting decline in productivity.

The 1970's oil shocks and associated declines in precious metal prices exposed the vulnerability of the economy an highlighted the lack of structural change in developing industry beyond capital intensive minerals and mining. The decline in GDP and foreign reserves of the 1970's aggravated the already limited development of manufacturing. Capital goods imports became more expensive, primary commodity price fluctuation reduced the availability of foreign exchange and political unrest (e.g. Strike action between1971-1976, Soweto uprising 1976) linked with increasing unemployment and apartheid segregation discouraged new investment exacerbating the slow-down of the economy. The capital-led system of accumulation fed by a segregated labour supply had reached a turning point and was pushing the economy towards a decline exacerbated by external economic events and isolation. According to Stadler (1987), some of the initial reforms suggested re-modeling political institutions, economic and educational opportunities for blacks, and institutionalisation of the capital-labour relations.[11] Morris & Padayachee (1989) group these into three phases

- 1977-1982 restructuring of labour regime and urbanisation policies
- 1982-1987 change of NP leadership, conflicting demands and initiatives, continued lobbying of state by capital
- 1987-1989 suspended democratisation

Despite these proposals, this paper argues that the capital-intensive industry maintained its dominant status. Though there is evidence of change in policy discussions, there was disagreement between industry and the state on the best choice of actions to help the economy out of the political and economic crisis. International sanctions exacerbated the effects of economic decline with adverse effects in particular on foreign capital increasing the pressure on the capital-intensive industry. Other issues that were emerging within policy circles were the costly and inefficient duplication of government activities and the power struggle within the ANC. At the same time, class restructuring within African communities increased pressure for a negotiated settlement to the political crisis though this was not endorsed by capital. Despite the economic decline, the economic structure and policy bias remained unchanged. According to Marais (1998, p.66), sectors were affected in different ways and received varying types and levels of support to overcome the economic crisis but the capital-labour tension remained unaffected. In the light of the foreign capital shortages and the dependence of the economy on mining and energy-led capital accumulation, the state continued to comply with

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[9] Wolpe (1988) cited in Marais (1998)

[10] A concept originating from the regulation school sometimes narrowly described as racist Fordism which whilst somewhat relevant to consumption by the privileged few does not represent forms of production within the apartheid economy and as such is restrictive and limited in its use. See Gelb (1991), Fine & Rustomjee (1996). The different theoretical approaches to industrialisation are discussed later.

[11] in Marais (1998)

appropriate industrial and economic policy as well as with the stricter controls on labour movement and organisation.

The next section takes a closer look at industrial policy during latter stages of apartheid and shows how despite the economic decline, MEC interests remained at the forefront of economic policy and labour markets remained fragmented.

Apartheid industrial policy - import substitution and state enterprises

This section argues that popular explanations of South African post-war industrial policy, namely economy-wide import substitution industrialisation (ISI) and development of the consumer goods industry, conceal the continued dominance of MEC-led accumulation and associated needs within industrial and economic policy. Instead of seeking to build a globally competitive industry beyond the MEC, this section argues that government support for the supply of basic consumer goods for the domestic market was driven by apartheid government objectives of self-sufficiency and the need to generate employment in a labour-intensive sector and provide low-cost goods affordable to the low-wage majority of the labour force. The economic constraints resulting from the exclusion of the South African economy from foreign products due to sanctions strengthened these objectives in particular through the limitations on export and import activity. Thus, the main focus of industrial activity and policy remained within the MEC and surrounding activities. As such, the typical portrayal of import substitution and protectionism as the drivers of apartheid economic policy is limited and unrepresentative. Though policy debates at the time centred around ISI, decentralisation, support to small-and medium-sized enterprises (SME) and developing consumer goods industries, these debates did not translate into comprehensive policy actions or their impact was affected by policies promoting the interests of the MEC. A closer look reveals the links between the MEC interests and economic policy: macroeconomic stability ensuring suitable exchange rate for commodities exports such as gold and minerals, balance of payments to ensure energy imports, minerals exports, funding for state-owned enterprises (SOE) largely involved in minerals and energy, and labour market restrictions to ensure a supply of low-cost labour to the MEC. An increasing concentration of ownership and capital within the MEC exacerbated the already skewed distribution of economic power and increased the influence of the capital owners on the policy process.

The post-war period loosely focusing on the 1970's-early 1990's is typically characterised as a time of heavy government intervention to boost industries important to national security and self-sufficiency.[12] This intervention manifested itself in protectionist industrial policies, import substitution and export restrictions. In addition, the government had objectives of decentralising industrial activity, diversifying out of minerals and energy and developing small and medium-sized enterprises especially within the consumer goods sectors. Though import substitution and protectionism was present in policy, recent research reveals the limitations in the implementation and outcomes of these policies and proposes alternative factors as the drivers of apartheid-era policy.[13] These are grouped into the following three points.

- Apartheid era economic policy shows evidence of poorly managed ISI, limited support for consumer goods, little decentralisation and diversification, and almost non-existent support for small- and medium-sized enterprises implying poor policy design and implementation.
- The set-up and funding of state-owned enterprises connected to the MEC reveals the sectors' preferential status. Increased concentration of ownership within the MEC further skews the economic and political power balance.
- Extensive macroeconomic and financial management suggest policy capabilities exist but evidence suggests they directly or indirectly favour the MEC. Alternative policy debates condemned to remain debates.
- Labour market segregation under apartheid ensured a supply of low-cost labour essential for maintaining continuous profits in mineral extraction (especially for gold with fixed prices until 1971).

These alternative ideas suggest that there was policy capacity, policy awareness, and debate of policy options and that the economic decline cannot be due to poor policy structures. Despite the presence of capacity, debate and awareness, the nature of the economy and the dominance of the MEC consolidated the need for a segregated labour market but also divisions in industrial structure. On the one hand, the dominant MEC and associated sectors generated much needed foreign exchange and in return exercised both direct and indirect pressure for favourable economic policy. On the other, there was pressure to develop the domestic consumer goods sector in part to counter the effects of sanctions but also to diversify into other areas of internationally competitive products (primarily in manufacturing). The latter was important to absorb low-skill and low-cost labour but also to buffer against falling gold prices. This meant subsidies and other forms of support to help build new industrial capacity. However, policy space was taken up by the MEC needs for a stable and favourable exchange rate, access to finance, available and low-cost inputs (e.g. electricity, labour). To cater for these different needs, there were multiple government entities involved in policy design and implementation. The combination of conflicting domestic policy pressures, complex policy structures, finite government resources, and international sanctions is reflected in the web of policy choices and limited economic development beyond the MEC.

[12] For a good summary of the popular description of South Africa's economic evolution during the post-war apartheid period see Jones (2002), Davis (1995), Fallon & Pereira da Silva (1994), Hayter, Reinecke, Torres (2001).

[13] Fine & Rustomjee 1996, Marais 1998, Carmody 2002, Padayachee 2006

The following describes these four policy perspectives in more detail.

Limitations of import substitution, decentralisation and diversification policies

Firstly, government support for the manufacturing sector though widespread in terms of the number of subsidies and tariffs, was disorganised and the restrictions easily circumvented. The main focus of South African ISI was on the development of basic consumer goods industries in response to increasing consumption from white workers enjoying wage increases as part of apartheid benefits. In addition, the state sought to protect the manufacturing sector against foreign imports in line with policies selected by other industrialising economies such as Chile, Argentina, Brazil and the later East Asian NICs (Newly Industrialising Countries). However, a key difference was in the degree and type of state involvement. The South African government chose not to intervene in the workings of sectors, but rather to promote the conditions for capitalist growth using tariff and non-tariff protection for the labour-intensive manufacturing and the set up of parastatals in minerals and related capital-intensive sectors.[14] Not only did this strategy fail to develop an export-oriented manufacturing sector, the manufacturing that evolved was mostly labour-intensive leaving production exposed to price volatility in the imports of intermediate capital goods. In addition, Fine & Rustomjee (1996, p.188, 221) show that ISI policy was incoherent, tariffs were not so widespread or controlled, trade policy was used to protect the balance of payments and as such respond to various capital owners interests, and point to the poor management and increasing difficulty in operating under import substitution industrialisation as evidence of the limited impact of ISI as part of the industrial policy. Soludo, Ogbu and Chang (2004) also refer to incoherent and badly managed import substitution and tariff structure and confirm that post-war South African industrial policy was not the case of textbook protectionism and import substitution. Roberts (2006?) suggests that easy industrial activities were exhausted by the early 1960’s and that ISI became progressively more difficult in 1970’s suggesting that protection was not a key form of industrial policy. The poor outcomes in developing internationally competitive products for export highlight the policy shortcomings. Production remained labour intensive, focused on the domestic market, restricted to low-value added products with import protection holding back progress through lack of access to capital goods used as inputs.

Other factors prominent in the 1970's and 1980's industrial policy debate included diversification away from the capital-intensive MEC, decentralisation of industrial activities, as well as support for small- and medium-sized enterprises. Despite the debate, little diversification into secondary products was undertaken during the initial post-war phase though this soon changed with increasing interaction between English and Afrikaner capital. The resulting joint ventures and diversification focused primarily on products and sectors related to or directly downstream from the MEC. Chabane et al (2006, p.554) describe the two main phases of diversification: linkages built on mining led to steel, explosives and engineering; divestment of foreign firms and sanctions led to a focus on consumer goods and food products. The first form of diversification was driven by MEC investments (resulting from a constant flow of foreign exchange from booming commodity prices) in a climate where a combination of sanctions and finance outflow restrictions meant exporting funds from South Africa was difficult. Norval “anticipated bright prospects for (…) iron, steel, engineering, metal industries”.[15] A second form of diversification targeted consumer goods and food products and was largely funded by the foreign exchange reserves generated by the MEC though it was directed and funded through government unlike the inward investment within the MEC and related activities. As a result, diversification within the MEC was widespread and well funded whereas other industrial sectors, manufacturing in particular, remained small, labour-intensive, strapped for funding and unconnected to the MEC core.

Limited progress in two other policy areas: decentralisation and support to small and medium size businesses mirrored the poor outcomes of diversification and ISI. Decentralisation according to Hirsch (2005) begun as part of the labour control programme and served to keep black industrial labour out of urban centres. Fine & Rustomjee (1996, p.191) also agree that though a favourite component in industrial policy, decentralisation and SME support were driven by political and ideological rather than industrial concerns. For example, the programme neglected areas of investment for political rather than industrial or economic reasons. Marais (1998) and Fine & Rustomjee (1996) point to evidence that that decentralisation as an industrial policy was not actively pursued except in rhetoric. Though initiated in the 1960's, the programme only really became effective in the 1970's only to be scaled down by the end of the 1980's due to high cost and poor survival of decentralised operations beyond the subsidised period.

Another cause for poor success draws from the dispersed policy ownership. Though originally managed by the Industrial Development Corporation (IDC) and thus within the core of industrial policy influences, SME support was subsequently led by organisations such as the Board for the Decentralisation of Industry and the Small Business

[14] Marais (1998, p.21)

[15] BTI chair in 1950’s cited in Fine & Rustomjee (1996, p.183)

Development Corporation not within the core of industrial policy-making. This removed the interests of SME's from the field of active policy debate and influence. Marais (1998) and Fine & Rustomjee (1996) discuss 1950's attempts to create decentralised textile industry but costs, lack of sufficient funding, inability to guarantee low-wage workforce, union activism and workforce unrest led to disastrous results. In addition, competition from tariff protected, urban, well connected, privately funded textile companies emphasised the failure of the decentralisation experiment in textiles. A final drain on resources emerged with a high and costly requirement for training within textiles (a requirement not present to the same extent in mining). Subsequent decentralisation efforts by the IDC into phosphorus, coal, oil and gas were more successful partially due to the better cost control in more capital-intensive production with a history of coercive labour management.

The evidence for little diversification beyond the MEC, limited decentralisation, and low SME support, raises questions about the coherence, impact and importance of import substitution during the 1970's and 1980's. A more successful policy tool emerged in the support for the capital-intensive activities within and downstream of the MEC. Diversification and funding focused on activities related to the MEC constituted a key element of industrial policy in the post-war period with significant success in the set-up and funding of large state-owned enterprises and public-private conglomerates.

Set-up of state-owned enterprises

Extensive investments and policies targeted the capital-intensive sector emerging around the minerals-energy complex. In part the high capital requirements of mineral extraction led to the emergence of a range of large conglomerates involved initially in steel, chemicals, processed minerals and energy. As Marais (1998) details, beginning with The Iron and Steel Corporation (ISCOR) and Electricity Supply Commission (ESKOM) set up under the Smuts and Hertzog governments in the early 1920's, with further state investment into coal, oil (SASOL and SOEKOR), phosphates (FOSKOR) by the Industrial Development Corporation and various services such as postal delivery, telecommunications, broadcasting, airlines and of course arms (TELCOM, PX, SABC, SAA, ARMSCOR). Government support for large conglomerates was tied to two external factors: stable and high gold and mineral prices and the government need to generate foreign exchange.[16] This emergence of state corporations, interlocking of state and private capital, as well as diversification within the realm of MEC-related activities points to a unique path of industrialisation not reflected in discussions about state protectionism or liberal markets.

The early stages of the state owned enterprises were characterised by alternating cooperation and conflict between state and private capital with the latter seen as competitors. Initially this led to little interlocking with ISCOR's activities curtailed on purpose to limit the competition as well as to remain within the primary objective of providing cheap steel. Subsequent investments involved joint funding from private and public sources aligning the interests of Afrikaner and English capital and thus removing the competitive split. Subsequent investments also expanded out of mining focusing on synthetic fuel, chemicals, steel, energy and armaments. Large-scale investments were used in particular to increase capital and energy intensity though this type of policy was also driven by perceived comparative advantage and by issues pertaining to national security. The initial state investments helped crowd in private funds depriving other manufacturing (typically with a higher import propensity) of much needed capital. Greater mechanisation requirements meant funding needs continued to increase resulting in a concentration of funding and policy into MEC and related activities. As documented by Clark (1987), Fine & Rustomjee (1996) and Carmody (2002) ownership of fixed capital stock remained mostly unchanged since the 1960's with 25% of the fixed capital stock held by public authorities (central, provincial and local authorities), 18% by public authority business enterprises (such as Transnet and Portnet in transport and telecommunications) and 10% by public corporations as of 1990.[17]

Minerals and energy sector policy requirements were not shared by companies involved in other areas of manufacturing. More advanced production structures, capital intensity, targeting supply to the global rather than domestic markets implied the need for different economic policies. Though MEC favouring macroeconomic stability, funding of state-owned enterprises and a focus on capital-intensive investments did not preclude other forms and targets

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[16] See Clark (1987) in Fine & Rustomjee (1996) for a discussion of the role and emergence of state corporations in detail.

[17] It is of interest that even in the post-apartheid period and following policy debate around privatisation of state assets in the 1990's, there were multiple considerations for new state-led investments into various infrastructure and capital-intensive projects such as nuclear power, Gautrain rail link etc. suggesting this form of investment is still important.

of industrial investment and support, three structural and global factors contributed to the ongoing preference given to MEC needs. Firstly, the marginalisation of other manufacturing can in part be explained by the 1960's increases in gold and mineral prices. Secondly, the economic and political power of the MEC increased due to the concentration of ownership. Thirdly, the channelling of funds and decision-making power through two key institutions (the IDC and the BTI) limited the possibilities for labour-intensive manufacturing.[18]

The economic dependence on high gold prices and foreign exchange from selling commodities meant that government was reluctant to alter policies beneficial to the mineral extraction industry. Although manufacturing in 1960 contributed more to GDP than mining and agricultural products combined, export growth concentrated almost exclusively on primary products either from agriculture and mining (the latter dominated by gold).[19] Manufacturing growth depended on capital goods funded by the combination of high gold prices and access to foreign exchange through mining exports. Thus, the 1970's collapse of commodities (and gold) prices, increasing internal and external resistance to apartheid (through strikes and sanctions respectively) exposed the distortions in the economy and led to the poor economic performance of the late 1970's and 1980's.

An increasing concentration of ownership and capital within the MEC exacerbated the already skewed distribution of economic power and increased the influence of the capital owners on the policy process resulting in a stunted manufacturing development beyond the MEC but little or no policy change to counter this. As the table below shows, six large mining houses continued to dominate the mineral markets into the early 1990's. The mainly family owned conglomerates together owned over 80% of share ownership on the Johannesburg Stock Exchange (JSE). Capital and mining ownership were thus concentrated strengthening their lobbying power on government and improving access to funds.

Conglomerate (owners of top 80% of JSE)	**Mining House (subsidiary of conglomerate listed on left)**
Anglo American Corporation (AAC)	Johannesburg Consolidated Investment (JCI)
Anglo American Corporation (AAC)	Anglo American
Sanlam	Gencor
SA Mutual	Rand Mines
Rembrandt	
Anglo Transvaal	Anglovaal
Liberty Life	
	GFSA

Source: Based on Fine & Rustomjee (1996)

Though unbundling occurred later in the 1990's and 2000's, the dominant role of the MEC as an investor and target to government investment has remained. This suggests that the high concentration of ownership played an important role in consolidating (rather than being the direct source of) economic and political power of the MEC whilst drawing attention away from other manufacturing. It is also important to note that this financial domination took place at a time when foreign investment was limited by sanctions and but when the MEC would have competed with other industrial sectors for government funding given the need to promote self-sufficiency in basic consumer goods. A fragmented and uncompetitive manufacturing was thus disadvantaged in their access to government funds and in their comparative lobbying power.

In addition, the highly concentrated funding structure contributed to the lack of equivalent support for manufacturing. Two state organisations, the Industrial Development Corporation (IDC) and the Board of Trade and Investment (BTI) dominated funding decisions. Other agencies and institutions were involved with industrial policy and state funding but with very little interaction or coherence with the IDC and or the BTI. Their limited funds and lack of discourse further disadvantaged the development of manufacturing and industrialisation beyond the MEC.

The capital-intensive sector that had emerged around the MEC was not able to incorporate the labour surplus . Yet at the same time, apartheid labour policies were exacerbating the effects of high unemployment and limited labour mobility. All this contributed to the rise of resistance in the 1970's. The failure to develop exports beyond the raw minerals and

[18] Fine & Rustomjee (1996); Marais (1998); Carmody (2002)

[19] Based on Marais (1998, p.30)

energy also reflects the underlying objective of industrial policy. During the 1970's and 1980's industrial policy was very much based on creating the right environment for industrial growth rather than picking or targeting support. One of the ensuing problems for manufacturing was the difficulty in maintaining access to imported inputs. As a result, manufacturing was not able to develop exports that could rival the foreign exchange generating power of raw materials and energy. Nevertheless, the exposure of raw materials and energy to price fluctuations left this source of foreign exchange vulnerable to external events. As such, the inability to create an industrial structure able to sustain growth when mineral prices plummet highlights the shortcomings of industrial policy. The economic decline started by falling gold and mineral prices in the mid-late 1970's but was worsened by the limited diversification and decentralisation, the poorly managed manufacturing development through import substitution, and the underlying MEC dominance leaving policy and investment strategies unchanged despite economic decline. At the same time, global oil shocks, declining capital inflows, capital flight and continued sanctions exacerbated the economic decline and further paralysed the in many ways dysfunctional apartheid government.

Macroeconomic stability

Chronic macroeconomic problems such as maintaining the exchange rate and balance of payments were complemented by a decline in foreign exchange reserves (as mineral export revenues fell), stagnation and rising inflation. This jeopardised the imports of manufacturing inputs, and thus employment whilst the rising price level fuelled labour unrest. The apartheid system of labour segregation added to the economic problems. Skilled labour was becoming increasingly difficult to find as black workers were denied full training and promotion opportunities and sanctions restricted suppliers of manufactured goods to the small domestic market.

This leads us to the third argument proposing that macroeconomic stability as a policy stance was driven by needs of the MEC in return for generating foreign exchange. Key requirements for the MEC sector included access to inputs, global markets and capital to maintain production. As a result, extensive government resources were devoted to ensuring macroeconomic stability to promote competitiveness abroad, a stable and favourable exchange rate and inward investment in return for the foreign exchange generated. Carmody (2002, p.257) summarises this relationship as follows: "The context for conglomerate strategies is framed largely by state policies, and the context in which they, in turn are embedded." With the increasing domestic and global pressures on the economy, sustaining a suitable exchange rate for commodities exports, continued funding for state-owned corporations, maintaining labour market restrictions to provide a supply of low-cost labour to the MEC, continuing trade restrictions, and managing balance of payments became increasingly difficult. This in part contributed to the tight fiscal and monetary policies of the 1990's (discussed more later).

The poor manufacturing development and inability to sustain economic growth when faced with falling minerals prices are features sometimes explained away by poor government policy capabilities and overall skill shortages within the economy. The extensive policy influence in macroeconomic management as well as policies associated with the capital-intensive sectors suggest the presence of a limited policy focus rather than limited policy capability are behind the poor economic performance. In addition, the skills and technology requirements of the MEC suggest that at least parts of the economy were able to attract and develop labour skills. Evidence of government resources devoted to managing the MEC needs suggests that government policy formulation and implementation capabilities were far from poor.

Government policy capacity is supported by the continuous output of policy studies shown below, many raising the need to support manufacturing beyond the commodity based minerals. Their conclusions show a progressive shift from import protection to export promotion but many were not implemented for political reasons. The reports collectively fail to delve into the structural pressures which disadvantage non-MEC manufacturing. Policy, institutional structures as well as funding were seemingly geared towards the interests of capital-intensive industries. Privatisation of state-owned-enterprises was justified with lack of government funds for expansion, low efficiency and costly losses of these enterprises as well as to generate government revenue.[20] What they achieved was a shifting away of capital-ownership from the reach of the state and organised labour. In a similar fashion, export orientation and tariff liberalisation arguably set out to weed out uncompetitive industries and to improve performance. In reality, the removal of protection according to Fine & Rustomjee (1996, p.201) may have achieved the opposite by eliminating successful enterprises with little new entry from domestic producers. Funding from the IDC also reflected the increasing importance of capital-intensive industries with a shift away from small-scale manufacturing to large-scale, corporate MEC activity away from the influence of organised labour and state interests. As an example, the textiles sector (a primary focus of post-war

[20] http://www.sjsu.edu/faculty/watkins/southafrica.htm accessed 13th July 2008

decentralisation plans by the IDC) faced declining support from the IDC as it presented high costs, competition from private capital and performance fluctuations linked to labour activism. Increasing competition from foreign companies left it further exposed and requiring more funding whilst government plans for tighter labour regulation would result in further costs and restrictions and thus performance implications. The needs of the capital-intensive sector can be seen to influence the policy outcomes rather than be being independently managed by them.

The following table lists a selection of official inquiries, their findings and propositions. This selection includes research commissioned by the government rather than independent entities and thus arguably the outcomes should have had a more favourable reception within policy circles. Nevertheless, as the table shows, policy outcomes were driven not by the debates or the recommendations from research but by the political and economic structure. The dominance of capital-intensive industries seemed set in stone by the early 1990's with the formalising of government plans under the pro-market RDP and GEAR, despite the potential for new political and economic debate being opened by the end of apartheid.

Official Inquiry	**Key Findings/Proposition**	**Outcome**
Viljoen Commission (1958)	Intensifying secondary sector economic activity at a constant rate using a program of Import Replacement/Import Substitution complemented by encouraging exports as well as inducing foreign capital inflows.	Protect domestic industry using import tariffs and an economic quota system; supporting policy of export promotion never taken fully into account; manufacturers undertook high-cost, import intensive production processes.
Reynders Commission (1972)	Second wave of liberalisation. Decentralisation to promote exports. Government to provide additional incentives to potential exporters in border areas..	No restrictions on direct government export-promotion measures so debate suggested that instead, all exporters to be subsidised equally.[21]
Riekert Report (1979)	Urbanisation reform proposing increased division between urban and rural Africans.	Meeting demands from capital for more semi-skilled and skilled labour meant extending privileges to 'qualified' urban black.
Wiehahn Commission (1979)	Industrial relations reform resulting in freedom of association for all persons.	Reinforced capital-labour division by using small group of urban blacks as a buffer for political struggle. Increased productivity for capital as urban black accede more skilled jobs.
Van Huyssteen Committee (1978)	Continued concern over the high dependence on commodity exports (mainly gold) and unsustainable levels of capital and intermediate imports. Direct cash subsidies, tax and rail freight concessions, cash rebates on inputs and import duties.	Reinforced Reynders Commssion findings. Increased relaxation of quotas from 1972 succumbed in 1976 to industrial lobbying for protection.
Kleu Report (1982)	Import Substitution program development using natural growth and development of domestic industry, not increased import tariffs and trade quotas. Switch from Import Substitution to Export Promotion.	"Seek to stimulate domestic industry by advancing exports and finding new international markets for domestically produced goods."[22]
BTI Report 2614 (1988)	South Africa should focus on industrial restructuring by targeting industrial sectors according to suitable measures of existing and potential comparative advantage, and aid those sectors with specially designed programmes.[23]	The proposed programmes were rather complex for government to manage effectively, and vulnerable to special interests. Government never adopted the report.
IDC (1990)	Support for export incentives through trade	The IDC challenged the BTI interventionist

21 Bell (1973) in Bell (1997)
22 Everything2.com (2003)
23 BTI (1988) in Hirsch (2005)

	(especially tariff) liberalisation to induce structural change. Assessment of existing tariff efficiency.	approach claiming that poor industrial performance could be attributed to BTI tariff policies and import replacement. Inefficient industries need to experience competition to boost performance.[24]
NEM by CEAS (1993)	Central Economic Advisory Service, a government agency under the Reconstruction and Development Programme (RDP), proposed the Normative Economic Model based on a "conservative and static set of assumptions, particularly regarding the balance of payments".[25]	The NEM "failed to recognise the potential for capital inflows. The new document was irrelevant in a rapidly changing society. It was never published, and the CEAS was dissolved within a year of this failure."[26]

Source: Fine & Rustomjee (1996); Bell (1998), Marais (1998), Hentz (2000), Cassim et al (2002), Everything2.com (2003), Hirsch (2005), Aron & Muellbauer (2007)

<u>Labour market segmentation</u>

The last section under apartheid-era policies looks at the labour market restrictions and their use to ensure a supply of low-cost labour to the MEC. Labour movement was controlled with pass laws dating back to the 1910's restricting the movement of black South Africans. In addition, restrictions on where blacks could reside, private property and economic development ensured that the options for wealth creation were limited largely to employment. Though the influx control officially ended in 1986, regulation continued through other means such as housing and urbanisation strategies (Marais 1998, p.47). Wolpe (1972 in Hirsch 2005, ch.1) states that the prohibition of private property contributed to the emergence of a large landless class. Agricultural labour and mining remained the main options and land ownership laws prevented the urbanisation of the workforce. The low wages and poor education provision for black workers contributed to the continuity of this system and in doing so to the rising poverty.

Research on South African economic history has benefited from an extensive debate on the connection between apartheid and capitalism. Originally associated with left intelligentsia (Hirsch 2005), apartheid policies of land control, creation of reserves or homelands where the blacks were allowed to reside, poor infrastructure and education for blacks in homelands, and policies severely restricting economic activity are shown to benefit the interests of white labour and capital owners in particular mine-owners and white farms. Legassick (1974) and Innes (1984) go as far as to argue that capitalism and apartheid were 'essentially intertwined' and that other segments of capitalism such as manufacturing also benefited from the cheap labour and associated labour controls. As summarised by Hirsch (2005), in the 1970's, views on the capital-apartheid relationship were split between the liberals maintaining that capitalism and apartheid are inherently contradictory and that economic growth will bring about disintegration of the political system.[27] The radical position was that apartheid and capitalism are part of the same problem and both need to be eliminated. By the 1980's the debate became more nuanced with both camps accepting that apartheid was served by the specific form of capitalism but that it was holding back further economic development along capitalist lines.

The low labour costs were in largely due to structural factors. The South African economy was heavily dependent on gold exports and gold prices were fixed until the end of the gold standard. Thus, only input costs such as labour could improve profit margins. Changes in the global markets left the South African economy exposed. The end of the gold standard brought about a wildly fluctuating gold price which affected the exchange rate and balance of payments. However, the government had not taken adequate measures to protect the economy from exchange rate and gold price fluctuations. This led to declining gold production especially with increasing competition from the discovery of new gold fields and better mining technology helping access gold elsewhere. Gold also ceased to be the store of value and declining gold prices in the 1980's sealed the fate of the already declining economy. The South African economy was poorly protected from the external events but the failure to protect the economy through diversification, non-mining exports and exchange rate controls exacerbated the exposure to global events. As Kahn (1991 in Hirsch 2005, ch.1) points out, " the effects of the gold price masked the underlying decline of the country's competitiveness".

24 Fine & Rustomjee (1996, p.200-201)
25 Hirsch (2005), ch.3
26 Hirsch (2005), ch.3
27 See Dowd (1964) in Hirsch (2005) for more details.

This leads the focus onto the rapid liberalisation and supply-side strategies that dominated policy in the post-apartheid period. Despite the political and economic transformation, the continued influence of the MEC is visible through the policy debate and choices. Of interest is the adoption of a contradictory policy platform whereby on the one hand, an extremely market focused stance influenced the liberalisation of trade and the capital markets with appropriate structural adjustment to correct the macro-economy. On the other hand, the government maintained strict control over the labour market and continued to support specific sectors such as automotive and textiles and clothing. The next section looks at these contradictions in trade and financial liberalisation alongside tight fiscal policy followed by an assessment of their shortcomings and the overall impact on the minerals-energy-complex.

The conclusion from this sections' alternative ideas is that there was policy capacity, awareness, and debate of policy options. In addition, different economic pressures led to not only a segregated labour market but also divisions in industrial structure. On the one hand, the dominant MEC and associated sectors generated much needed foreign exchange but exercised pressure for favourable economic policy. On the other, the pressure to develop a consumer goods sector in part to counter the effects of sanctions but also to develop other areas of internationally competitive products through the diversification of manufacturing. This meant subsidies and other forms of support to help build new industrial capacity. However, policy space was taken up by the MEC needs for a stable and favourable exchange rate, access to finance, available and low-cost inputs (e.g. electricity, labour). To cater for these different needs, there were multiple government entities involved in policy design and implementation. The combination of conflicting domestic policy pressures, complex policy structures, finite government resources, and international sanctions is reflected in the web of policy choices and limited economic development beyond the MEC. The discussion so far suggests the industrial policies did not succeed in achieving sustained industrialisation beyond the minerals and energy complex. The structure of funding and ownership was biased towards the development and needs of the minerals-energy complex. Import substitution, decentralisation, diversification and support to SME's were not successful in developing a consumer goods industry able to maintain growth once commodity prices began to fall.

To summarise, there is evidence to support the proposition that post-war industrial policy was characterised by the alternative descriptions: disorganised protection through tariffs and subsidies, creation and funding of state corporations within the MEC, highly concentrated ownership exacerbating the skewed power relations between industry and government, and the implementation of macroeconomic policy catering (significantly though not exclusively) to the needs of the MEC. These policies not only supported core MEC activities and associated sectors but also limited other policy unrelated to the minerals/energy resource base. The MEC as a generator of foreign exchange had always enjoyed a strong position within the South African economy. Given this position of power, policy evolution and the growth of the MEC are interlinked and developments must be viewed in tandem to understand the nature of the constraints this environment imposes on other manufacturing sectors and policy making in general.

Contradictory post-apartheid economic policies

The post-apartheid period has seen an abundance of analyses on the policy changes as well as the justifications behind some of the more radical attempts at economic reform.[28] Though there is debate about the varying political motivations behind policy choices as well as about the exact impact of these policies there is agreement that the performance of the economy has not matched expectations.[29] Much of the literature on South Africa associates the end of apartheid and the takeover by the ANC government in 1994 with a phase of new economic policy. This era, it is argued, is characterised by giving prominence to pro-market policies and a focus on export and productivity growth to improve competitiveness. The justification behind such choices being to align with neoclassical theory and reduce government intervention to one of merely enhancing the liberalisation of markets through institutional and structural support. The new government focused on the removal of demand-side support such as the General Export Incentive Scheme (GEIS)[30] and tariff rationalisation as well as the introduction of supply-side programmes to compensate for subsidy and tariff reductions. The need to boost business and investor confidence also shaped policy choices of the new Government of National Unity and pushed them towards a pro-market stance. This view nevertheless does not represent post-apartheid policy accurately. Whilst macroeconomic stability and liberalisation do characterise much of the post-apartheid policy, strong elements of selective but very different government support remained for specific sectors such as minerals and energy, textiles and clothing, motor vehicles suggesting that liberalisation itself has been selective. As also discussed by Carmody (2002), pro-market financial and trade liberalisation is contrasted by state driven (strict) labour market controls. State involvement is also visible in the extension of support to select industrial sectors. Though much of the post-apartheid policy development resembles the recommendations of Washington-based institutions and prevailing economic views, there is evidence that the policy choices also reflect domestic pressures and continuity in the dominant role of the capital-intensive minerals and energy sector. South Africa is also not subject to loan conditionality from the World Bank and IMF and the prevailing economic fashions seem to inform rather than dictate policy. A key element of the neo-liberal influence has been in seeking to signal stability and market opportunities to encourage potential foreign investors. At the same time globalisation pressures from the capital-intensive sector have also biased policy towards liberalisation. This is evident in the complex bargaining and interdependency between this dominant sector and government. The main policy elements of trade and financial liberalisation, fiscal austerity and labour market reform have been implemented with notable government control, speed and to a greater extent than can be explained by simple adherence to mainstream economic theory. In return for the capital-intensive industry supporting one of the main redistribution and race-rebalancing policies, the Black Economic Empowerment (BEE), the government has accelerated macroeconomic, financial and trade reform. This suggests that policy capacity within government is substantial, though policy autonomy from domestic factors is limited. Changes in the global and trade financial markets have also constrained South Africa's policy choices. The poor overall economic performance can in part be attributed to the failings of these policies and the supply-side focus, and in part to the limited economic development (especially manufacturing) beyond the dominant minerals-energy complex. However, though the policy choices have been reduced by increasing globalisation, the poor economic performance in the post-apartheid period has also helped shift the policy debate away from the neo-liberal approach. The following section looks at the transition period and the associated policy contradiction with an liberal but controlled approach to capital market and trade reform countered by strict controls on the labour market and continued support for select sectors.

The first part looks at the early ANC policy stance and the constraints in taking over a declining economy with a strong capital-intensive sector but limited diversification. The rest of this section takes a closer look at policy evolution post-apartheid with a focus on trade and financial liberalisation alongside tight fiscal policy. The discussion then turns to the failings of pro-market and supply-side policies highlighting the continued importance of the capital-intensive sector.

The Government of National Unity (GNU) inherited a declining economy facing balance of payments problems, high interest rates slowing economic growth, dual Rand to protect from exchange rate fluctuations and low exports other than mining output. At the same time, as Hirsch (2005, ch.1) details, the financial sector and capital markets were well developed and regulated, inflation was declining, and parts of the country (business and white residential areas) had good transport and communications infrastructure. As well as correcting for the concentration of power under apartheid, the GNU also had to contend with rebuilding the ailing economy by reducing expensive protectionism, rebuilding relations with hastily privatised state-owned enterprise (in minerals and energy), maintaining relations with the trade

[28] Carmody (2002), Gelb (2005, 2006), Padayachee (2006), Cassim (2006)

[29] See Gelb 2005 for a summary of the post-apartheid economic performance.

[30] The General Export Incentive Scheme (GEIS) was introduced on 1 April 1990 with the objective of encouraging the production of value added exports.

unions, trying to encourage foreign investment, all along the social objectives of reducing poverty and income inequality. The list of social, economic and political objectives was long and complicated with high expectations from both domestic and foreign elements. Prior to taking over power, and without a ready-made economic agenda, the ANC drew on the Freedom Charter (1955) which was based on the ambiguous notions of returning power, wealth and rights to the people. Initial discussions and statements left open the option of nationalisation but also understood the need to support the private sector. This period (1990-1994) saw the emergence of a range of policy conferences, seminars, research groups debating and developing policy. In part this was a way for the ANC to exert pressure on the still ruling National Party. In part it was a method for engaging leading researchers from home and abroad to help formulate the ANC policy position.[31] Many of these research initiatives operated in parallel, sometimes in conflict with each other and mostly under unclear guidelines as to their exact influence on final policy. The newly established Department Economic Policy (DEP) was meant to coordinate and manage the policy research as well as obtain inputs from with local business communities to produce a final economic and social policy for the ANC to use as part of the elections. Though the DEP did circulate various economic policy documents, the final influence of the various research groups on policy was limited. This was partly due to contradictions and unresolved conflicts within the various research groups, in part due to contradictions between the research propositions and the ANC position as detailed in their early policy proposal Ready to Govern and in part due to a slow shifting of ANC's political and economic views towards the more orthodox position. The ANC was also keen to distance itself from Keynesian connotations of domestic demand management as well as elements of the East Asian solution which would require using the existing state bureaucracy perceived as untrustworthy and incompetent. The Reconstruction and Development Programme (RDP) continued the policy debate by coordinating research from multiple government departments into the summary paper: 'draft National Growth and Development Strategy' (finally released in February 1996), though multiple interests were represented, the outcome attempted to compromise and incorporate all views into one document. This centralised approach failed to represent the various views accurately and eventually the draft was downplayed by government.[32] By the time the RDP White Paper was released in 1994, the economic policy debate had been reduced to the following general strategies:[33]

- financial and monetary discipline
- establishment of economic industry conducive to growth
- trade and industry policies to foster greater outward orientation and sustain high employment levels
- modernisation of human resources programmes to meet the challenges of changing production processes
- reform of labour market institutions

Despite the bias towards a pro-market policy, the RDP did return an element of Keynesian domestic demand management with the 'growth through redistribution' whereby wealth and income redistribution would lead to rising domestic demand. Hirsch (2005, p61) summarises this as follows.

"The RDP was clearly an attempt to set out an Asian-type heterodox policy that combined investment driven hard by the public sector with institutional reform and orthodox macroeconomic stability."

By 1996, progressive RDP was abandoned in favour of the neo-liberal Growth, Employment, and Redistribution (GEAR). The reasons for this shift have been widely debated (see Carmody 2002, Gelb 2005 & 2006, Hirsch 2005). According to Carmody (2002, p.257), critics of GEAR link this shift to the history of the liberalisation struggle associating economic stagnation with strong government. The influence of the neo-liberal debate is also raised though as mentioned before, the government was not tied to conditionality and the Washington Consensus had faced criticism for poor results suggesting a decline in its influence. Carmody (2002) and Bond (2000) suggest that the ANC liberation struggle was based on the notion that linked the detrimental effects of strong government and skewed policy interventions. The nature of the ANC liberation struggle meant the ANC could not be seen to continue subscribing to similar government policies. Various political factors such as elite pacting or the petit-bourgeois nature of ANC leadership were also associated with the shift. Gelb (2005) and Hirsch (2005) discuss the differences of opinion within the ANC and the marginalisation of progressive voices. Other explanations refer to the decline in the Rand and an attempt to use GEAR to reassure foreign investors. Though these explanations are relevant, they alone seem insufficient to explain the full extent of the shift.

At the other end, it has also been argued that GEAR was not significantly different from RDP and merely represented the 'governmentalising' of the RDP (Carmody 2002, Gelb 2006). Similarly, Gelb (2006) also argues that many of the

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31 Examples of the various research initiatives range from the Economic Research on Southern Africa (EROSA), Economic Trends Group (ET), Industrial Strategy Project (ISP), the Macroeconomic Research Group (MERG) to the World Bank (see Fallon & Pereira 1994). For a full account of this process see Hirsch (2005, ch.1).

32 Hirsch (2005)

33 Government of South Africa (1994, p.26)

neo-liberal policies associated with GEAR were adopted under RDP – some even before the 1994 change of government. Nevertheless, the winding down of the RDP office and reinforced policies macroeconomic stability alongside financial and trade liberalisation were evidence of a shift away from the options for state involvement other than in the event of specific market failures. E.g. RDP (1994, p.30-31) proposed to alter "market structures that underpin high prices ...and that constitute major entry barriers to small and medium-scale enterprise" and where market forces are insufficient, human resources and technological capacity policies will complement.

Finally, Gelb (2006) also argues that alternative choices were not feasible. Partially due to the need to attract foreign investment and partially due to structural factors, For example, the post-apartheid government sealed the independence of the South African Reserve Bank and monetary policy from politics to reassure investors. This enabled the SARB to maintain high interest rates to counter inflation. Given low savings and investment, the government was also dependent on capital from minerals extraction and beneficiation. The needs of the capital-intensive sector are thus reflected in the RDP White Paper (1994, p.30-31) where support was pledged to sectors that could "show potential to emerge from existing protection" but also to " forward linkages and minerals beneficiation. Though there was talk of employment creation, other than agro-manufacturing, the focus was firmly on capital-intensive and higher value-added manufacturing. Trade liberalisation was also justified by the need to attract foreign investment and fiscal policy ensured low corporate taxation as well as avoiding crowding out of private investment. In addition, the import protection was a heavy financial burden for the government. Foreign investors were following the policy developments to assess the risk status of possible investments and the pro-market policies helped signal stability in terms of corporate ownership and taxation.

On the one hand, the economy had experienced ongoing decline since the 1970's with manufacturing suffering from low profitability and productivity, capital inflows and trade were stunted by sanctions, high production costs had left much of the manufacturing industry uncompetitive and trade and balance of payments problems were exacerbated by global commodity price volatility. This increased pressure to open the economy to foreign capital and trade. On the other hand, the economic decline had not affected the large conglomerates in the capital-intensive minerals and energy sector which not only continued to dominate the economy but were also a target for reform given their strong association with the apartheid class divide. The ANC government's dependence on foreign exchange from the white big business combined with the need to de-racialise ownership and access to goods and services whilst addressing the skewed allocation of public resources constrained the policy options and led to a focus on macroeconomic policies such as financial and trade reform alongside redistribution policies such as black economic empowerment (BEE). In what Gelb (2005) calls an 'implicit bargain', big businesses agreed to accommodate the government needs to rebalance ownership to undo racial discrimination. In return, the government agreed to a financial and trade liberalisation whilst also pursuing macroeconomic stabilisation policies to encourage domestic and foreign investment. This suggests that whilst the end of apartheid was associated with policy shifts, the underlying structure of the economy and the dominance of the capital-intensive sector remained unchanged.

Gelb (2005, p368) in his contribution to the "State of the Nation 2004-2005" draws attention to a key factor in the post-apartheid political and economic transition: "the transition was not a tabula rasa in which any policy option could be chosen". Economic constraints influenced the focus of policy whilst the (negotiated) nature of the transition and the continuity in economic structure meant the underlying economic and political power distribution influenced the parameters of the policy debate. Ultimately this meant compromising between policy autonomy but ensuring social objectives are included. Compromise between reassuring investors through liberalisation but losing policy autonomy to discipline capital and labour. Compromise also to avoid the influence of the World Bank and IMF but losing the opportunity to right some of the detrimental policy choices (financial liberalisation and privatisation of state-owned enterprises to name two) of the last apartheid government. As Carmody (2002, p.261) puts it: "the South African government is attempting a compromise between globalisation and social democracy. ... As the state globalises, the success of the government's development strategy increasingly depends on private sector actions and investment." Finally, compromise also in that by undertaking financial and trade liberalisation alongside tight fiscal and monetary policy, the government bought credibility for stricter labour market controls.

The contradiction in economic policy very much rested on the seemingly incompatible objectives of growth and redistribution in a declining economy and policy field constrained by both domestic and external factors.

Having explored the general explanations for a shift to policies of macroeconomic stability and liberalisation contrasted by continued and selective sector support and tighter government control especially of the labour market, the next three sections look specifically at the policies of trade liberalisation, capital market reform, and fiscal austerity. The aim is to assess why these policies took the form they did and what impact they had on the economy.

Trade liberalisation

Trade liberalisation has been one of the most prominent and debated elements of post-apartheid economic reform. Though initiated in the 1980's to improve access to global markets, the full force coincided with the transition away from apartheid and the subsequent negotiations with the World Trade Organisation. This suggests inaccuracies in the typical categorisations associating the apartheid era with state interference through extensive tariffs, quotas and subsidies and the post-apartheid era with market-led development, export promotion, end of import substitution policies and aggressive financial and trade liberalisation.[34]

Trade reform in South Africa took the form of 3 loosely defined phases. The period from 1972-1977 termed the first liberalisation episode by Cassim et al (2002) was marked by the Reynders report (1972) and characterised by export promotion and diversification using a variety of incentives (cash grants, tax concessions, transport concessions, rebates on import duties). The second liberalisation episode 1983-1990 focused on the revision of export incentives following the findings of the Van Huyssteen Committee (1977). Characterised by declining exports, increasing foreign debt and the collapse of the gold price with associated political instability, the measures undertaken to boost the economy included custom duty drawbacks and exemptions, export subsidies, reduction in quantitative restrictions (or replacement by tariffs) with the general aim to boost or generate local industry competitive advantage (Black, 1993). Alongside these developments was the increasing conflict between the department of trade and industry (DTI) and the board of tariffs and trade (BTT) and criticisms of poor implementation of trade liberalisation measures and opportunity for fraud due to poor design and insufficient monitoring. This draws attention to the complexity of coordinating industrial policy with multiple government agencies and institutions and supports the earlier suggestion that industrial policy did not neatly change from protection and import substitution industrialisation into liberalisation when the political regime change took place.

The third episode is connected with the political changes from the early 1990's onwards. This period continued the free market focus with the General Export Incentive Scheme (GEIS) which used a selective system of tax-free grants to help South African producers compete internationally favouring the high value-added industries. This period also marked the end of the attempts at import substituting industrialisation with the Industrial Development Corporation Report (IDC, 1990) arguing (with some exceptions) for lower protection and claiming resource mis-allocation and high costs of protection. The report promoted structural adjustment towards export oriented industrialisation associated macroeconomic measures (higher domestic savings, realistic exchange rate policies, improved supply of skilled labour). In comparison to the earlier developments, the third period was associated with the most aggressive liberalisation manifested by an extension of the already austere reforms proposed by the World Bank. This attempt at structural adjustment despite there being no loan conditionality to satisfy raises questions about underlying motives. Of particular interest is the fact that business, trade unions and government came together to prepare the GATT proposal resulting in a joint call for accelerated tariff reductions.

The aggressive pursuit of trade liberalisation is often explained by the political history of the ANC and to some extent by the prevailing economic ideology.[35] Views explaining the extensive liberalisation range from a belief in the economic and political merits of a market driven approach to a belief in the ability and willingness of the state to both shift focus away from select (protected) sectors and into more diverse manufacturing whilst countering any adverse effects. This mirrored the World Bank logic for trade liberalisation in seeking to boost the development of labour-intensive sectors (in which South Africa had a competitive advantage) as well as to support small-and-medium-sized enterprise through access to inputs and markets. Political pressure biased policy towards the neo-liberal stance using the association of the ANC with liberalisation and links to global markets (in contrast with the apartheid government protectionism). As Hirsch and Hanival (1998)[36] suggest: "cutting tariffs more deeply than required gave the government more flexibility should they need to be raised again in the future". The extent of trade liberalisation also helped gain more policy space for the more interventionist labour and supply-side policies.

A closer look reveals the need to improve investor confidence though subsequent investor performance remained poor. The South African government justified liberalisation by the need to attract foreign direct investment (FDI) and provide industry an incentive to reform in the face of global competition. FDI was seen as the key mechanism for increasing

[34] This ties in with the gradual political transition taking place through negotiations rather than revolution and with policy and institutional continuity even after the 1994 elections.

[35] This section is based on Carmody (2002), Cassim et al (2002), Soludo, Ogbu and Chang (2004)

[36] quoted in Carmody (2002, p.259)

employment and improving global competitiveness through diversification and technology upgrading. However, equally if not more significant in the liberalisation was the underlying pressure from MEC conglomerates (in order to access imported inputs vital for production, sell to global markets and to discipline labour) and manage the balance of payments.

Though the business community was concerned with likely adverse effects (short term employment losses, inability to compete with large-scale global multinationals or low-cost producers), the unions initially promoted liberalisation on grounds that tariffs were a 'state largesse'.[37] The protection, they argued, was directed at a small strata of business mainly within processed mineral or agricultural products. Adverse effects would be compensated by the government with various supply side (productivity enhancing) measures. Trade unions collaborated closely with the Industrial Development Corporation (IDC) to ensure industry needs were accurately represented within the supply-side strategy. Union support also justified the trade liberalisation with an expectation that this would raise the real wage through the reduction in consumer goods prices.[38]

This 'holier than GATT' approach may have gained political credibility with trade partners given the alignment with the prevailing neo-liberal economic ideology, but it exposed the reforming industries sooner than was necessary and beneficial in terms of achieving international competitiveness. Though the complex, lobby-driven and poorly managed system of trade barriers was in need of rationalisation, Reed, Lewis and Teljeur (2004) point to the emergence of very different views on the actual outcome of the GATT proposal. Depending on the perspective, the GATT offer to the Uruguay Round was actively supported or pushed through with an uncharacteristic degree of internal consensus with one side claiming radical changes were necessary for economic development and another maintaining the actual reduction of protection was not that significant.[39] Developments during the course of the 1990's converted the unions from supporters to increasing sceptics. This was partially due to the difficulties associated with targeting and timing supply-side compensating measures as well as their ineffectiveness in countering the decline in employment and loss of competitiveness in the short term, and partially due to the limitations of the regional and bilateral trade negotiations.[40] . Despite the adverse impact and increasing opposition, the process set a precedence in terms of cooperation between the ANC (IDC in particular) and unions and the interaction between South Africa and international financial institutions. Even the increasing opposition to trade liberalisation continued to unite various interest groups within South Africa.[41] It is to an extent this interaction and involvement by the government of various (opposing) interest groups that enabled the government to maintain their policy course.[42]

Trade liberalisation shows how the political and economic transition nevertheless allowed key forces to remain dominant within the economy. The MEC continued to exert pressure on policy. The alignment with prevailing economic trends served to raise confidence with foreign investors by helping upgrade the investment rating and in the process also reduce borrowing costs for the government. The internal consensus with the ANC government seeking to distance from the apartheid government and trade unions agreeing to managed liberalisation in the hope of government support and real wage raises as compensation. All this points to liberalisation as a solution which was politically and economically acceptable and implementable at the time and under the particular conditions. This reinforces the concept that poor economic outcomes cannot be blamed on poor implementation capacity. It also confirms that though trade liberalisation was a significant element within the policy platform, it cannot and does not constitute the main element of

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37 Lewis, Reed and Teljeur in eds. Soludo, Ogbu and Chang (2004, p.161)

38 Carmody (2002)

39 Preparation began prior to the 1994 election and was based on negotiations in the National Economic Forum which together with the National Manpower Commission was merged in 1994 to form the National Economic Development and Labour Council (NEDLAC) mandated to achieve a consensus of macroeconomic policy (effectively trade and industrial policy). The method of achieving consensus involved less transparent technical manipulations such as limits to the speed and extent of liberalisation in the two most protected sectors (auto assembly and clothing) for example.

40 A key point of which was market access. Greater market access would require further tariff reductions but South Africa's market opening was not reciprocated by the industrialised world (especially EU and US).

41 E.g. unionists, industrialists, farmers, environmentalists, human rights activists etc. (Reed, Lewis and Teljeur 2004)

42 As an interesting side comment, this path has enabled the South African government to become a prominent voice in developing the international policy rules and environment. In effect, by maintaining the pro-market liberalisation policy course, the government has increased credibility to influence the unfair global trade practices and to confront the 'legal' protectionism (i.e. strengthen anti-dumping legislation, customs and excise activity, regulation, institutions etc.) employed by industrial nations.

industrial policy.[43] As suggested, coexisting supply-side policies were expected to counter adverse effects on labour markets as well as previously protected/vulnerable sectors. Trade liberalisation was complemented by financial liberalisation with a similar trajectory and set of justifications. These are discussed next.

Capital market reform, monetary and exchange-rate policy

Financial market liberalisation has been one of the most influential forms of reform. Similarly to trade liberalisation, it was begun in the late stages of apartheid and has extended beyond expectations with the financial sector has covering approximately one fifth of GDP[44]. This "hyper-liberal"[45] approach has been very much tied to the objectives of attracting FDI and allowing South African conglomerates access to global financial markets. The separation of monetary policy from what Carmody (2002, p. 258) terms "democratic politics" very clearly marked not only the dominance of neo-liberalism but also the continued dominance of MEC conglomerates in policy.

Financial liberalisation has its roots in the 1980's recession. With a decline in the gold price, fall in profits and diversification to manufacturing and services already well in place (e.g. by the mid-1990's with over 100 domestic subsidiaries and approximately 30% of revenue originating from manufacturing), South African conglomerates were in need of new investment opportunities.[46] Geographical constraints, sanctions and exchange controls meant overseas investments were restricted and illegal capital flight only a limited solution. At the same time, the trend globally was for large corporates to globalise. The end of apartheid, the negotiated settlement and international pressures to liberalise all biased the new government to allow capital outflows. In addition, given the low private savings rate, this would open the economy to much needed foreign investment. Financial liberalisation was implemented in a widespread and accelerated manner alongside monetary and exchange-rate policy. Initially, the government sought to open capital markets to access external finance and easy the balance of payments constraints. A corollary stable exchange rate benefited international trade. Monetary policy contained inflation with high interest rates ensuring price stability though at the cost of stifling growth. These three policy courses were not mutually sustainable and 1998[47] marked the end of South Africa's 'trilemma'[48] with an end to exchange rate policy and a shift to focus on capital flow liberalisation and inflation targeting. There is a debate about the extent to which this shift in policy was due to the failure of neo-liberal macroeconomic management and to what extent was it driven by the Asian crisis. The choices forward were not under debate. The capital market liberalisation was perceived irreversible and necessary and inflation targeting a domestic priority thus leaving the exchange rate to be floated. Trevor Manual, the Finance Minister even argued that a flexible exchange rate would "help cushion the economy from external trade and capital shocks and mitigate the impact of economic contraction, especially for the poor"[49]. Little was said about the adverse effects that the capital liberalisation brought about. Swilling (2005) argues that it is unclear whether the interests of exporters were served by liberalisation of investment to the Johannesburg Stock Exchange and the rapid inflow of speculative and short-term portfolio capital that this invited. Similarly, the liberalisation of liquid assets rather than fixed assets (at least initially) has adversely affected job creation and labour absorption and now represents a mode of liberalisation that is held responsible (even by the IMF) for the 1998 Asian crisis. Finally, increased volatility since the floating of the exchange rate has, according to Gelb (2004), increased uncertainty and delayed investments in export-dependent sectors. Not only did the foreign investment not manifest in expected quantities, the type of investments were predominantly speculative investments rather than productive investments.

The financial and monetary policies also resulted in an increase in outward regional investments by South African conglomerates followed by shifting of stock market listings and headquarters out of South Africa. The justification was to increase shareholder value and thus to improve global competitiveness with the view to reinvesting the profits back into South Africa. In reality, this meant capital was exiting South Africa when inward investment was much needed and the large conglomerates were 'delinking' from the volatile and unpredictable South African market and currency. Global

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[43] Jones 2002, Davis 1994, Richardson 1990 in latter use a limited and misguided definition where trade policy synonymous to industrial policy. This generalisation has become widespread in neo-liberal analyses of South Africa's economic development.

[44] See Fine (2008) Response to the "Final Recommendations of the International Panel on Growth"

[45] Cox (1987) in Carmody (2002, p.258)

[46] Carmody (2002, p.262)

[47] The second of the foreign exchange crises with capital flow reversal and exchange rate collapse. 1996 and 2001 saw the first and third crises.

[48] According to Gelb (2004) South Africa attempted to simultaneously manage capital mobility to secure FDI, exchange rates to promote export competitiveness and interest rates to control domestic growth and debt.

[49] Gelb (2004), p.10-11

pressures to diversify were an element in this capital flight and de-linking, but high domestic production costs due to crime, HIV/AIDS, high unionisation and rising labour costs were equally significant. Domestic diversification opportunities had already been extensive into key/linked sectors. Unrelated industrial sectors such as labour-intensive Clothing or even capital-intensive Textiles were not considered profitable enough and thus did not attract funds from the MEC conglomerates.

In conjunction with the shift away from domestic investment, the large conglomerates were also unbundling or selling off non-core assets. This was partially a follow-up to the post-apartheid negotiations whereby big business agreed to a redistribution ownership under the Black Economic Empowerment (BEE) development. Avoiding the impact of new competition regulation and the freedom to invest profits overseas also contributed to the unbundling. Subsequently, there has been buying back of unprofitable or indebted BEE assets (at heavily discounted prices). Re-bundling has also taken the form of investments into and mergers with overseas companies in responding to global financial market pressures what Carmody (2002, p.266) quoting the Economist terms as “more tightly focused investment vehicles”. As such South Africa's capital-rich conglomerates initially searching for profitable investment opportunities have been absorbed by the financial globalisation trend where investments are disconnected from production decisions.

The outcome of these developments was a decline in domestic investment and consumption, a slowdown in the growth of exports (due to currency appreciation) and a deepening of portfolio capital. None of these served to expand the slow economic growth. Tight fiscal policy contributed to these developments.

Fiscal austerity

The impoverished state finances and extensive government spending that the GNU inherited prompted a commitment to fiscal deficit reduction. Despite pressure, the government was not keen to increase borrowing (in part to avoid exposure to IMF and World Bank involvement, in part to contain interest payments and in part due to lack of confidence in the ability to invest wisely) and tax increases would have discouraged private sector growth and investment and damaged the relationship between government and the large South African conglomerates. Over the course of the GEAR period of 1996-2000, the National Treasury succeeded in reforming the budget and expenditure process and research generally agrees that fiscal policy post-apartheid has been a success in terms of achieving desired goals. As documented by Carmody (2002) “Tight fiscal policy enables the continuing reduction of corporate taxes on FDI profits.”[50] As discussed earlier, reduction of government spending would reduce the crowding out of private investments whilst also limiting exposure to debt and thus volatility in financial markets. Reducing the fiscal deficit would also open the possibility of lower corporate taxes and thus offset firm costs (such as those due to AIDS/HIV).

Despite the success in implementing fiscal prudence, the desired outcome was delayed and impact mixed. The reduction in government spending may have reduced risks of crowding out investments, but the arguably greater benefits of crowding in investments thanks to government expenditure were also removed.[51] Though pursued aggressively from the mid-1990's, government debt only began to fall after 1999 and despite improved revenue collection and increased company tax revenues, expansion in expenditure did not begin until 2000. Even the eventual expenditure increases were not uniform and whilst social services (health, education and welfare) payments have increased, housing expenditure has declined.

Tight fiscal control enabled a reform of the public service and though government fixed capital formation remainsed low 1998-2001, thereafter, expenditure has steadily risen focusing on infrastructure as well as social services increasingly through provinces and municipalities. Interesting that despite claims to boost investments through corporate tax cuts, surplus revenue has been used to offer tax cuts to labour. Personal income taxes have declined whislt revenue from corporate income tax has risen. Though research agrees on the success of implementing fiscal control, the impact on growth and employment through investment has been minimal. Whether this is due to delays in the impact, due to other macroeconomic policies or mis-targeted government expenditure is unclear.

Shortcomings of the supply-side policies

The pro-market policies of market stability and liberalisation indicate government policy capacity as well as policy independence from external policy debates and theoretical trends. Despite these policies, the desired foreign investment and ensuing growth/employment creation has not manifested itself. Any market shortcomings should have been

50 Schoeman, Clausen, Robinson and de Wet (2000) in Carmody (2002, p.259)
51 See Hirsch (2005), Gelb (2005) and Gelb (2006) for further details of the impact of fiscal prudence.

countered by relevant supply-side policies. By the end of the 1990's, the ongoing poor performance of the economy suggested foreign investment was not responding to the supply side policies and that export-led growth had not materialised as predicted.[52] This was supported by the emergence of critical voices against the pro-market policies associated with the Washington consensus. A closer look at the assumptions behind three of pro-market policy elements of liberalisation, export growth and productivity growth highlight the limitations.

Firstly, the pro-market policies of liberalisation and matching supply-side support neglect the specific structure and nature of industry. SACP (1997) took a critical look at the assumptions made about industrial structure and the role of productivity especially in the context of the ISI policy. A focus on developing vertical linkages to improve manufacturing performances carries with it inbuilt limitations to concepts such as flexible specialisation and similar production organisation issues. There is also evidence that linkages within an industry serve to increase capacity rather than flexibility and thus constrain the kind of organic growth required to branch out to other areas of production. A blanket liberalisation ignores the relationship between the MEC and unrelated sectors and leaves the latter out of the policy and development loop. Underlying this are the usual questions surrounding the applicability of a general theory to a specific case. Finally, though the push for liberalisation became more noted with the new government, the divide between state-led industrial policies and pro-market liberalisation was not as clear cut as academic fashion would like it to be. This remains unresolved as recent literature points to poorly designed pro-market approach and critics claim (as found by the Harvard Group study in 2006/07) that market liberalisation was not implemented to a sufficient degree. This despite a resurgence in research on the developmental state, evidence of the limited impact of the supply-side policies, and the success of East Asian countries suggesting that rapid or extensive liberalisation is not conducive to industrial growth.[53]

Secondly, the supply-side policies do not accurately reflect the developments in manufacturing exports and output and neglect the importance of understanding domestic and international demand. The improvement in manufacturing production and exports following the end of sanctions in 1993/94 slowed down in 1996 due to weak domestic demand as well as tariff liberalisation. This suggests that the early export performance may have merely represented emergency or distress exports due to declining domestic demand. If the domestic market does not pick up and manufactured imports increase as well then the growth may be stifled by a worsening of the balance of payments.[54] A further source of concern is that much of the increase in exports is to other Sub-Saharan countries where markets are less demanding and growth opportunities limited. With limited growth in manufacturing investment and employment, the export growth seems to be a poor outcome of the supply-side policies. Furthermore, there are suggestions that even the up-take of these policies is limited leading us to doubt the direct relationship between policy and export performance. Two further conceptual issues emerge with regard to the source of the export improvements. Though the causality between export performance and improved production capabilities is debated, Walker & Jourdan (2003)[55] suggest that “exporting follows rather than leads the development of local capabilities”. This would imply that the increase in exports, despite poor domestic demand and limitations of the Sub-Saharan African markets, nevertheless reflects an improvement in productivity. Even if this were the case, this neo-liberal approach forgets that even for the successful East Asian NICs, exports were not a means of improving productivity but a measure of progress for firms. This brings us to the third point criticising the use of productivity increases as a confirmed path to economic growth.

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52 See Fine (2004) and Swilling (2005) for discussion

53 A series of studies commissioned by the National Treasury from the Harvard Group in 2006 support extending the already pervasive trade liberalisation based on the growth of non-commodity exports. For example, Edwards and Lawrence (2006) argue that this would diversify exports further and make the real exchange rate more competitive. The source of the increased non-commodity trades or other effects of trade liberalisation is not discussed. Though according to Roberts (2006?) these trades originate primarily from the motor vehicle sector with very fortunate external sourcing arrangements (Volkswagens decision to outsource part manufacture to South Africa) as well as the furniture sector which benefits from cheap timber due to a state planting programme going back to the 1970’s. Roberts rightly argues that there is no direct or simple link between trade liberalisation and diversification of manufacturing exports. Understanding the changes that have taken place as well as planning policy requires an in depth grasp of the detailed conditions in place for the specific sectors as well as industry as a whole. This level of granularity is not present in the ISP or the Harvard Group research. Secondly, the Harvard Group approach fails to distinguish between the different but significant roles played by domestic and international demand in enabling growth. In addition, successful government policy is unlikely to limit itself to either demand or supply side interventions suggestions. At a very general level there would be a mix of demand and supply side policies.

54 Lewis, Reed and Teljeur (2004), p.158

55 in Roberts (2006?, p.11)

Thirdly, the link between productivity increases and development is not clear cut. Lall (2004)[56] and Bell (1995) looking at the impressive performance of East Asian countries contest the automatic economic benefits of productivity improvements. They suggest that productivity is not at core of development and that in the case of the East Asian NICs, intervention in domestic markets through domestic demand was the key to development of economies of scale. Policy should therefore not simply seek specific sector productivity increases but look at the overall mechanisms of factor accumulation and the associated market failures. This moves away from the supply-side policies that arguably serve the interests of specific business groups rather than the economy as a whole.

South Africa's post-apartheid industrial policy has maintained contradictory elements of government-led protectionism alongside aggressive pro-market policies through selective targeting and compromise between liberalisation and government control. The discussion has also shown that policy autonomy was affected by domestic and external factors though careful compromises enabled the government to satisfy these pressures whilst maintaining an influence over other areas of the economy.[57] Thus far the discussion has focused on the drivers and constraints of the market-led policies. The next section discusses a specific policy stance from 2000 onwards which is the resurgence of the developmental state debate.

South Africa as a developmental state

In an attempt to tackle the persistent power dynamics and failures of economic policy (RDP and GEAR), the ANC government turned towards talk of a developmental state and more interventionist policy in the mid 2000's. Freund (2006, p.2-3) and Swilling (2005, p.8) taking a closer look at South Africa as a developmental state apply the following criteria:

- direct state involvement in economic and social policy with key economic indicators (may involve state ownership of major industrial, infrastructural and financial structures)
- dominance of an elite that has internalized developmental goals
- establishing the foundations of wide-ranging economies (e.g. industrialisation, electrification, housing, urbanisation, education)
- effective management of non-state economic interests (via formal structured compacts, incentives and penalties)
- weak and subordinated civil society (i.e. no rival centres for policy formulation)
- accessible and usable institutions

Freund and Swilling comment that some elements of this definition are no longer relevant or applicable under current political/economic conditions. They also discuss aforementioned limited scope for governments to exercise control. The discussion focuses on the role of the BEE and the extent to which the government has maintained/regained direct involvement in policy.

As part of this shift, the government increased efforts to create a new elite that would according to Freund (2006, p.3) "straddle boundaries between the management ranks in the private sector, the established bureaucracy and politicians": Black Economic Empowerment (BEE). The role of a new class would be to "shift the basis of growth away from the sale of natural resources and challenge the existing (mature) capitalist class.[58] Though this fulfils one of his criteria for a developmental state, Freund does question the extent to which this elite could survive beyond the current government, the extent to which an independent relationship has developed between the new and the established elite and also the extent to which this elite can shift the basis of growth away from natural resources. Foreign investors have commented on the BEE being the 'cost' of doing business in South Africa and domestic critiques claim the BEE rewards a narrowly defined select group of black families rather than addressing inequality and poverty more broadly.

Other changes that point towards a developmental state have included the financing of large infrastructural projects (e.g. Gautrain and construction of 2012 football world cup infrastructure) as well as a range of "institutional experiments aimed at capturing and directing funds into developmental and anti-poverty programmes"[59] Swilling argues that though aspirations and intent may have been present, South Africa only achieved policy coordination and capacity of the

[56] in Soludo, Ogbu and Chang (2004)
[57] Support to textiles and clothing will be discussed in chapter 2. Labour market developments in ch.3.
[58] Freund (2006), p. 11-12
[59] Swilling (2005) in Fine (2007), p.10

developmental state type in 2004. Prior to that the policy situation was at best contradictory. In 1994-1998, reckless capital liberalisation (to the benefit of certain business elites), exchange rate management, fiscal planning and inflation targeting accompanied plans for increased social spending. In 1998-2004 social and economic services spending rose whilst exchange rate management was abandoned though investment levels continued to decline. From 2004 onwards public, private and local investments have continue to rise alongside what Swilling terms limited institutionalisation of the various strategies and a focus mainly on infrastructure expenditure.[60]

No conclusions on South Africa as a developmental state can be drawn. Though elements of developmental state can be found to match the description, the government has only recently shifted policy focus away from the macroeconomic stability and liberalisation that characterised the 1990's though these policies remain very much in place. Given the recent resurgence, the debate on what constitutes a developmental state is also being redefined. As has been seen in the discussions on pre- and post-1994 policy evolution, South African policy is driven by a unique economic and political structure rather than theoretical frameworks. Seeking to fit it under the developmental state umbrella presents an equally narrow and restrictive approach as does categorising apartheid policy as protectionist/state-led and post-apartheid policy as exclusively market-led.

The shift of investments away from purely the national level also shifts the policy focus to a local and sectoral level. The same questions on how policy choices evolve as well as how to assess their impact still apply. To what extent is policy influenced by economic structures and to what extent is there policy autonomy? Will the commitment to a combination of market and state-led economic management continue to characterise policy? What external factors influence policy choices and autonomy? What is the role of theoretical debates in policy processes?

The next section summarises the theoretical issues with regard to industrial policy. This sets the stage for a closer analysis of policy processes on the sector level with textiles and clothing as the case study.

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[60] Fine (2007) and Swilling (2005) both agree that institutional capacity and the understanding rather than a shortage of funds has been the main drawback.

3 Industrial policy debates and their role in South Africa

This section delineates the main areas of debate on industrial policy and looks at the influence of these discussions in the South African context.

Two areas of debate complicate discussions on industrial policy: the juxtaposition of the state versus the market role and the definition of industrial policy. Neoclassical economists discourage active government involvement beyond the provision of basic public goods such as infrastructure, public goods such as security and rely on the equilibriating mechanism of static perfect markets to develop industry and the economy. In terms of global industrial policy advice, the neoclassical view is associated with the Bretton Woods institutions, WTO and major donors for whom the degree of government involvement is more of an ideological and political debate of an approach based on perfectly informed and operating markets. By discouraging interference in specific sectors or areas of the economy beyond the general facilitation of market operations, the government is reduced to playing a structural role with narrow scope for targeted or context specific support. The neoclassical view places the market and the state opposite each other and justifies policy based on market or state failure without considering the interaction between the two theoretical entities.

One group of critics[61] have raised market failures as a justification for government intervention. From a theoretical perspective these initially limited the role of government to correcting negative externalities and provision of public goods. The emergence of economic theories focusing on information and coordination failures[62] helped shift the industrial policy debate to one allowing for a more complex government role.

Though the theoretical criticisms of the neoclassical approach justify some form of intervention, the exact nature of these interventions and how to tailor them to the country context remains unclear. This exposes government intervention to criticism from the pro-market school of thought. They argue that the market is able to set clear objectives based purely on economic analysis (using the price and equilibrium mechanism to direct economic actors) whereas a government-led set of priorities depends on the political regime and will vary over time and from country to country. In addition, information and coordination problems faced by markets are not automatically corrected by governments. On the contrary, they argue, government is unlikely to have better access to detailed information about product quality, market opportunities, technology and skills. Though the government may be in a better position to tackle externalities and inter-firm coordination, this process does not always produce the ‘optimal’ outcomes. Administrative skills, agency problems, inflexibility, interest group politics and corruption influence the policy choices and the implementation process. As such policies reflect government capability as well as the targeted outcome and unlike market driven outcomes, there may be multiple solutions to similar problems rather than one single stable equilibrium.

The literature distinguishes between selective, functional and horizontal industrial policy to allow governments to target specific industries separately from skills and specific activities (functions) or to implement similar policy relevant to multiple sectors (respectively)[63]. Theoretically this is an improvement on the simple provision of public goods but in practice selective intervention is difficult and separating selective from functional interventions is complicated. In addition, this still leaves the neoclassical school to resist selective interventions (but allow functional) by arguing that market failures are not automatically corrected by government intervention nor is the possibility of government failure (corruption, inability to process information) excluded.

Another key weakness with this form of polarised theorising is the belief that markets and governments operate under separate conditions and have different abilities to process information, target sectors, implement selective interventions. In reality, the imperfections in processing information, the difficulties associated with identifying and targeting sector needs stem from the particular economic and political conditions. These influence both the market dynamics and scope for policy with further complexity arising from the interaction between the agents that make up the market or the state. That is to say, the state and market are theoretical constructions consisting of multiple interest groups, institutions and agents that are not uniform across time and place. A further area of contention arises from the assumption that only one of the two entities is required for a functioning economy. This excludes the possibility that both and involved state and

61 “The mainstream model of unfettered liberalisation and no industrial policy has been vigorously challenged in the literature” Soludo, Ogbu and Chang (2004, p.13). A range of critical views emerged in association with discussions on the East Asian NIC's; see Amsden (1989), Wade (1990), Aoki et al (1997). Chang (1994), Helleiner (1988, 1995) and various UNCTAD and Oxfam publications also covering critiques of the neoclassical approach.

62 Stiglitz 1994, 1996 in Soludo, Ogbu and Chang (2004)

63 Pack and Westphal (1986), Lall (1996) from Soludo, Ogbu and Chang (2004)

active markets are necessary for economic management.

The definition of industrial policy is also a source of debate amongst economists and policy-makers. Ranging from the narrow (e.g. selective and functional policy targeting sectors or activities) to the broader (horizontal or economy-wide), there is little consensus even within those acknowledging the need for some form of state involvement (be it to counter market failures or as the main method for economic development).

Selective or narrowly defined industrial policy suffers from the difficulties associated with identifying, defining and targeting the policy as well from the problems of assessing the impact. Selective intervention can at the extreme take the form of infant industry protection, be limited to supporting capital markets, or filling in for limited capital market function as an intermediate solution. The technological capability approach sometimes offered as an alternative to the neoclassical model still favours promoting the market mechanism (e.g. supporting capital markets rather than specific industries) but considers the possibility of industry intervention as an intermediate and second-best solution. This approach based on the Nelson and Winter (1982) evolutionary model attempts a more country-specific type of analysis by considering that capabilities and capacities are firm specific and that locally-owned firms are more exposed to market failures than are foreign-financed/owned. As a result, foreign-owned firms (especially MNC's taking advantage of intermediate markets in capital, technology and skills) are more likely to support the pro-market policy approach.

Broader industrial policy definitions[64] include all economic policy that influences industry and focus on the economy as one entity where even targeted policies may directly or indirectly affect other sectors or areas of the economy. These spillover effects make policy formulation and impact assessment very difficult. A broad approach also makes it difficult to plan policy to support industry or subsets of industry and to separate indirect the effects from direct effects. This can lead to the simplification and over-generalisation of policy if every type of economic policy can potentially influence industrial development. For example, in the case of South Africa, trade policy is often understood as the core of industrial policy[65]. Though an important influence on industry, trade policy does not encompass all the elements of possible or implemented industrial policy in the context of South Africa and the two should not be considered synonyms. Despite obvious difficulties, the holistic approach considers that industry does not operate in isolation from the economy as a whole. This opens up the possibility to assess the influence of the overall political economy in policy and in government priorities. Though the exact role of the government remains undefined, understanding a particular economy and the underlying dynamics holds a key to describing the interaction and relative roles of market and state.

The theoretical literature has yet to resolve the shortcomings of the state versus market debate and the different difficulties associated with the formulation and implementation of narrow versus broad industrial policy. Despite these theoretical disagreements and limitations, multiple studies[66] show that some form of interventionist industrial policy is highly relevant for developing countries. The type of intervention depends on the extent of market failure as well as on the capacity and capabilities (capital, skills and technology) available. These in turn vary by time and place and are tied to the political and economic climate of the economy under investigation.

The East Asian Tigers (Hong Kong, Singapore, South Korea, Taiwan) present an interesting comparison to South Africa and show how specific local conditions and policy choices as well as the global policy environment affect outcomes[67]. Though the context and constraints faced by the EA countries is not identical to the situation faced by South Africa , there are parallels in the starting positions and the difficulties caused by rising wages and declining manufacturing.

Hong Kong led with low technology exports in garments, toys, textiles, footwear. Though quality improvement and a shift to more complex products helped change the export structure, the pro-market policies led to little structural deepening. This accompanied with rising wages led to a stagnation of the industrial and export growth and resulted in relatively low technology levels. Singapore undertook strong industrial policy with a focus on selective investments (mainly into skills, technology and infrastructure) and FDI targeting to shift away from labour intensive activities and

64 see Fine (1997)
65 see Jones (2002)
66 Frey et al (1996, p.154 in Soludo, Ogbu and Chang 2004) state that "tariffs (and other trade restrictions are prevalent in all periods and countries, and that there is a continual danger of ever-increasing protectionism in the world". Dell (1988, p.602 in Soludo, Ogbu and Chang 2004) also note that "there is not a single industrial country that did not employ vigorous protection at some stage in it's history." Kaplinsky and Mhlongo (1997, p.57) note that "there are very few cases where sustained industrial growth has not involved a key role for played by government, albeit a role which allows for a substantial degree of entrepreneurial independence."
67 based on Soludo, Ogbu and Chang (2004)

mainly into petrochemicals, electronics and equipment manufacture. This led to structural deepening and a development of a hi-tech export structure though most of the innovation and technology sources remained under the control of foreign –owned MNC's. Korea and Taiwan saw manufacture upgrading and structural deepening similar to that of Singapore led primarily by domestic firms. The Korean government intervened through heavy industry and technology development in the form of Chaebols. Foreign investment was restricted and replaced by credit and subsidies, skills and technology support. Similarly, the Taiwanese government used state owned enterprises to develop heavy industry. Support though less detailed and pervasive than that of the South Korean government also extended into technology, training, finance and export and institutional support.

These cases suggest that a combination of specific industry support, domestic technology development, state-owned enterprises, as well as general finance, infrastructure and institutional support have been key to industrial development in East Asia. Product upgrading alone without government intervention to achieve structural deepening merely led to higher costs and declining manufactures/exports. In contrast to the neoclassical model, incentive regimes, finance/investment (domestic or foreign), technology skill and capability development, ownership structure (foreign, domestic, state-owned) and institutional and policy support (R&D, infrastructure, SME support, export promotion) were characteristics common to all of the above cases. However, the form and shape varied depending on the political economy constraints, government capabilities and the country-specific conditions (location, skills, capital, market and institutional structure).

Despite popular economic views, industrial policy in South Africa has not been driven by the theoretically fashionable state versus market split and the associated shift from import substitution industrialisation to export oriented industrialisation, but rather a development of the economy around the minerals and energy sectors and associated interests (known as the minerals energy complex, MEC). There is evidence that industrial support was at the same time selective and broad and that a combination of pro-market and state-driven policies were implemented.[68] For example, there was selective protection (though arguably mismanaged and not uniform) targeted at some of the consumer goods sectors (motor vehicles, textiles, clothing) through extensive tariffs, quotas and subsidies whilst the broader economic policies (balance of payments, exchange rate management, trade liberalisation, financial sector development/liberalisation, funding for state-owned enterprises) supported the needs of the dominant capital-intensive industry. Protection for the selected consumer goods sectors continued well after the end of the apartheid era despite the onset of Washington Consensus based neoclassical economic policy (including extensive trade liberalisation) though the growth pattern in these sectors remained unaffected by these policies. At the same time, despite the undertaking of market-led policies, the post-apartheid government did not favour or continue the privatisation of state-owned corporations.

Despite a break in policy with the end of the apartheid, there seems to be continuity in the economic structures and the dominance of MEC with the shift largely in rhetoric. This has done little to alter the poor manufacturing performance and increasing unemployment that have plagued the economy since the 1980's and were stated as key targets for the new ANC government in 1994. This suggests that South African industrial policy has evolved separately from the economic debate that took place within South Africa.

In addition, the policy evolution has also been unaffected by the global economic debate. Though the global policy environment has become more restrictive and the policy options available to the East Asian NIC's in the 70's and 80's (e.g. dual import protection and export promotion, suppression of domestic class politics, extensive state subsidies for skills, technology and infrastructure development) are no longer open to the South African government (increased global competition and decreased local policy autonomy), the South African policy approach is shifting towards a stronger government role with talk of South Africa as a developmental state whilst continuing the extensive trade and financial liberalisation that favours the export of surplus capital from the MEC. This reinforces the view that the global economic debate plays a very small and limited role in the actual formulation of SA'n industrial policy though it has some relevance in the 'window dressing' of South Africa's policy position. For example, when the pro-market theory was being questioned by the emergence of the Post-Washington Consensus, South Africa extended it's Washington Consensus-lookalike policies (RDP 1994) to include further trade and financial liberalisation (GEAR 1996). This it was

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[68] This argument has been raised extensively by Fine (1996, 2006, 2008) and recently also by Kaplinsky & Mhlongo (1997), Soludo, Ogbu & Chang (2004), Roberts (2006?), Padayachee (2006?) and builds on the literature criticising universal market-based policies. What is interesting to note is the shift away from:

- market failure driven government involvement (i.e. still rooted in the neoclassical tradition)
- comparative analysis across countries
- single sector studies and towards multi-sector / interlinked analyses

argued, was to help build investor confidence and attract foreign capital to South Africa. This independence was in part due to the strength of the MEC and it's dominance of the economy through the foreign exchange it continues to generate. The absence of any significant IMF funding and associated conditionality has also contributed to the independent evolution of South African industrial policy.

Industrial policy is set and defined by a heterogeneous group with shifting objectives[69]. Policy-makers need to adapt to changing circumstances and interests which affect performance. Attempts to assess industrial policy are further constrained by underlying factors that determine industrial performance and the scope of policy. Though the debate is active and difficulties abound, understanding industrial policy continues to be of paramount importance especially to economies such as South Africa with mixture of successful and struggling industrial segments and a decline in output growth and employment.

This leads the discussion to our sector focus on textiles and clothing. What have been the policy developments that have contributed to the decline of textiles and clothing and how important have these been in comparison with external factors such as changes in the global trading rules and increasing global competition?

[69] This section draws on the views of Fine in (eds) Elbadawi and Hartzenberg (2000)

4 Textiles and clothing decline in the broad policy and structural context

In the light of these economic structure and policy constraints the paper now turns to the Textiles and Clothing sector(s)[70] (T&C) as an example of a manufacturing sector with potential for low-skill labour absorption. Clothing in particular is often viewed as a sector that serves two key purposes in developing economies: employment as well as production of consumer goods relevant for both the export and domestic markets. South Africa has historically supported textiles and clothing with a range of restrictions on imports as well as subsidies for production and export promotion schemes. Even with the very liberal offering to the World Trade Organisation, exceptions were made for textiles and clothing as well as the motor vehicle industry to maintain higher protection and to progress liberalisation much more gradually than other sectors. Despite this ongoing support as well as the continued government commitment to support employment sectors, the decline has been significant.

The poor T&C performance is seen as part of an overall manufacturing decline which has been explained by a range of policy, supply-side and external factors. These have been grouped into the following three categories:

- State intervention initially and a market failure (in creating the competitive stimulus) have both in turn been blamed for poor policies as well as poor sector development
- Poor output and productivity growth of the South African economy as a whole are connected to the decline of textiles and clothing. An extensive supply-side literature (comprising of case studies, value chain analyses as well as statistical modelling) drawing on the competitiveness analysis points to factors such as poor skills, obsolete technology, structural and management shortcomings, organisational limitations etc. as the main causes of T&C decline.
- Developments in the global trading environment and other external market factors such as changes to the global T&C value chain, new entrants to the (liberalised) markets, and a proliferation of multilateral and bilateral trade agreements have played a dominant role over and above government actions to support vulnerable sectors.

Though clearly the post-war state support in the form of protectionism and the subsequent liberalisation have failed to generate competitive products, the fact that T&C has benefited from ongoing targeted support under both state and market driven policy environments suggests that either very different approach to industry support is needed or that unresolved constraints restrict the sectors growth despite support. This points back to the previous discussion about the false state/market juxtaposition and suggests that both are necessary to generate the right support and sector development incentives but also that the economic structure in which T&C operates plays a significant role in hindering sector growth. Similarly, the supply-side analyses have rightly identified shortcomings but do not link these to policy or economic environment. Both government and other sectors possess the capacity to generate competitive skills, technology, organisational structures etc. as has been witnessed by rapid service and capital-sector growth. This would reinforce the idea that structural constraints and the interplay of policy/market incentives play a more significant hindering role with regard to T&C. Finally, increased global competition and exposure to (through trade liberalisation) has disadvantaged T&C. In addition, import competition from low-cost countries such as China are also affecting local production. Nevertheless, there are various import restrictions, export schemes and trade agreements which have not been fully employed. Why this is so could also be due to domestic market constraints and policy shortcomings.

This section briefly highlights both domestic and external factors which have contributed to this decline. Firstly, the macroeconomic policies and financial liberalisation which has supported the operations of aforementioned large South African conglomerates and enabled them to unbundle and list on overseas stock markets has disadvantaged manufacturing sector with different needs and priorities. Indirectly, the capital flight has also deprived the domestic market of inward investment. Secondly, the limited investment that has taken place (both domestic and foreign) has targeted the capital-intensive sectors associated with the MEC rather than labour-intensive clothing or even medium-capital-intensive textiles.[71] The macroeconomic and liberalisation policies were in part justified as means to create an environment attractive to foreign investment though their success has been largely limited to portfolio investments. Two factors external to the South African economy that have contributed to the T&C decline have been the increased competition on global markets (alongside value chain changes shifting power towards the global buyers and away from the producers), as well as the increased competition and consolidation in the domestic input markets with imports from

[70] Though they are two distinct sectors, they are closely connected within an overall value chain which is now increasingly global.

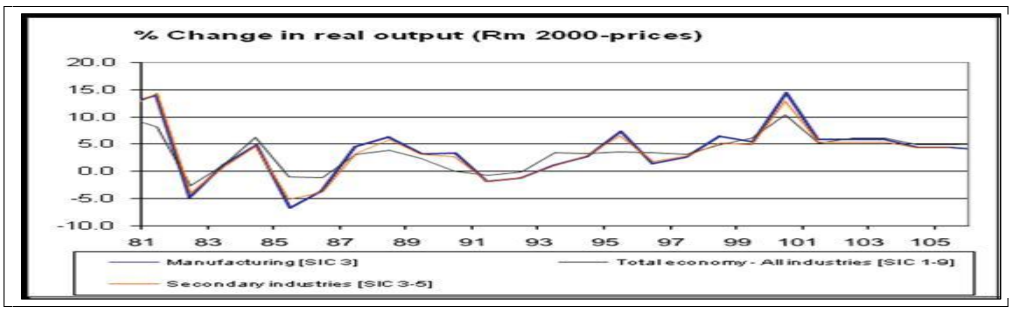
[71] Although parts of textile production are more capital intensive they have limited links to the MEC and are not large enough to benefit from investors looking for a high return on capital investment.

China acquiring an increasingly dominant role. Trade liberalisation alongside various global, regional and bilateral trade agreements have also played a significant role in these market developments.

The following subsections will look briefly at the evidence for the T&C decline, the impact of macroeconomic policy, declining investment and increasing global/domestic competition to highlight the need for specific industrial policy to counter the effects of global changes and structural factors.

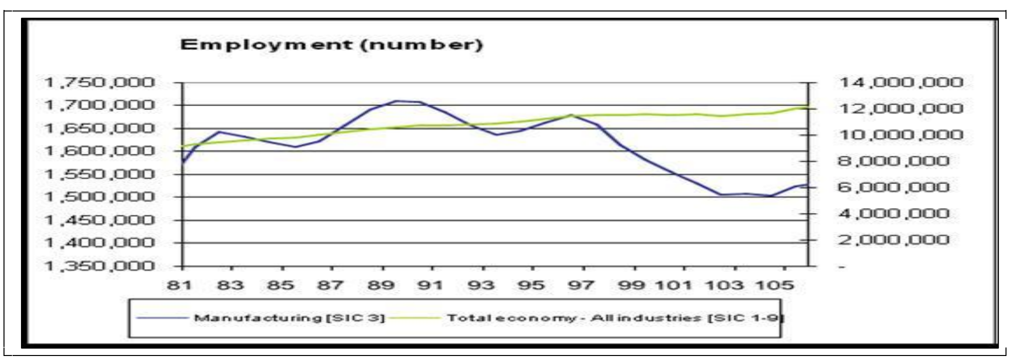
T&C Decline

The decline in overall manufacturing and in particular textiles and clothing has been widely documented.[72] The main features of this trend reveal a "continued lack of diversification within the primary and secondary sectors"[73] and thus a reliance on energy and resource-intensive products with very few exceptions. Though the contribution of minerals extraction to total production is slowly falling, a large proportion of national income generation maintains close ties to heavy industries in or linked to minerals processing. These downstream industries that are the main growth sectors in terms of exports, have been in basic metals, minerals processing and chemicals. According to Roberts and Mohamed (2006) downstream manufacturing is split between production linked to minerals and energy against other manufacturing, minerals- and energy-related manufacturing emerges as a dominant factor. Modest manufacturing growth in the 1994-1995 period turned into a decline by 1996 with trade liberalisation and small domestic demand restricting growth. Since then a slow growth has turned into a slow decline approaching zero change in real output (see table below).[74]



Source: Quantec RSA Standardised Industry Data accessed Sept 2008

Similarly, employment decline (see table below) has exacerbated the already substantial unemployment problem and associated issues of welfare and poverty. The decline in employment even when there was some manufacturing growth is largely due to the bias in investment and reinvestment back into capital-intensive manufacturing whilst labour-intensive manufacturing has declined.



Source: Quantec RSA Standardised Industry Data accessed Sept 2008

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72 see Vlok (2006), Hirsch (2005), Jauch & Traub-Merz (2006), ILO (2005), Salinger et al (1999), Barnes (2004, 2005), Roberts and Thoburn (2001, 2002)

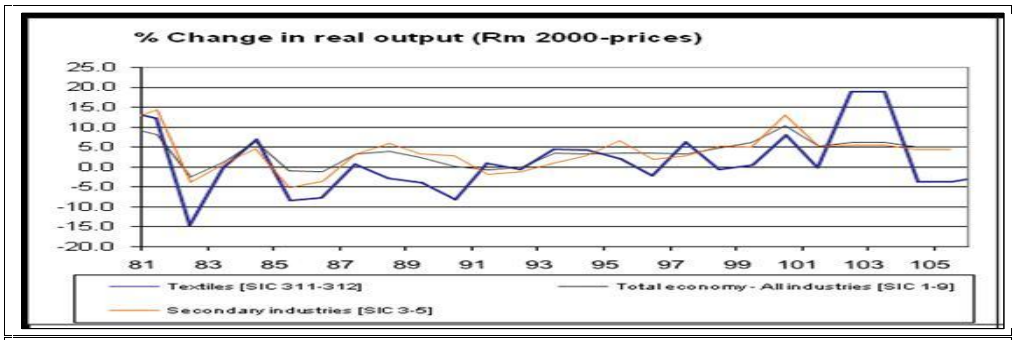
73 Mohamed and Roberts (2006), "Questions of Growth, Questions of Development", DPRU Conference Paper, pp.15

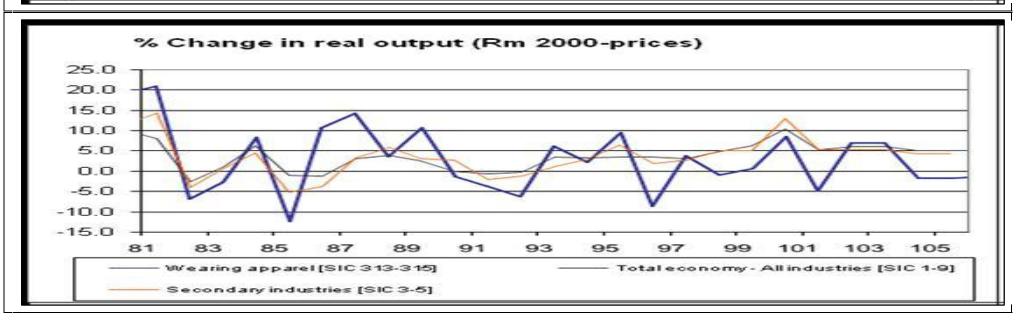
74 with the exception of 2000-2001 alongside a sharp deterioration of the rand

A closer look reveals the links to minerals and energy with Mohamed and Roberts (2006) noting that over half of GDFI in 2005 was accounted for by coke, refineries, basic chemicals/iron/steel, basic non-ferrous metals with the exception of motor vehicles as the one non-minerals-and-energy manufacturing sector. They also point to the high concentration with a small number of firms dominating production. This implies that not only is the economy at risk from natural resource price volatility but also dependent on the continuity and success of a few firms – a high risk strategy at best.

Manufacturing contributes to approximately 33% (in 1997, 31% in 2001) of national output but only in the region of 18% of value added with textiles and clothing typically representing ~2% of manufacturing output each but contracting value added (textiles -1.4% and clothing -3.8% in 1997-2001) due to the difficulty in achieving productivity improvements. In contrast value added growth of over 4% in basic and other chemicals, basic iron, steel and non-ferrous metals and the service sectors of transport, storage and communication (6.1% in 1997-2001) and finance, insurance and business services (5.7% in 1997-2001). Mining growth in output and value added was modest but contribution of gold and other mining (platinum and diamonds) to total exports significant (representing the two largest export categories jointly contributing to over 25% of exports).[75]

The textiles and clothing development presents a similar pattern to overall manufacturing with textiles output growth performing slightly better than clothing but with an overall stagnation in output growth and heavy decline in employment though clothing employment declining slightly slower than textiles.

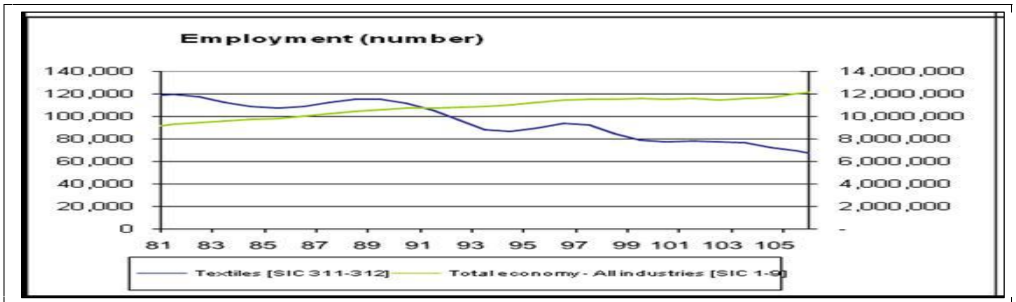


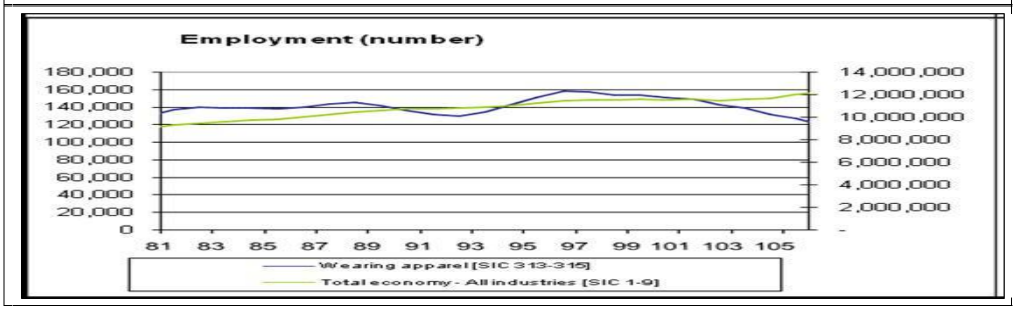


Source: Quantec RSA Standardised Industry Data accessed Sept 2008

Employment in textiles and clothing according to Vlok (2006) accounted for 12% of manufacturing employment in 2005 with approximately 2/3 in clothing. Though these exclude informal sector employment (which Vlok estimates could increase the total employment by another 70,000 they still represent a decline from over 37% of employment in manufacturing in 1996. The graphs below highlight this decline.

75 ABSA (2002)





Source: Quantec RSA Standardised Industry Data accessed Sept 2008

The response to these trends has been mixed. On the one hand, especially clothing has scope as an employment sector as according to an ABSA 2002-2007 sectoral outlook study wearing apparel remains the fourth largest sector by average employment growth (the previous four are wood & wood products, food, trade services, other mining). In line with this, the government has put forth a range of initiatives such as the Sector Specific Assistance Scheme (SSAS) that expressly recognise employment potential and target textiles and clothing. Recently the New Industrial Policy Framework (NIPF) also mentions the textiles and clothing as a sector performing less well than expected due to low-cost competition from China and a strong Rand but still with an important role in generating employment. At the same time, government trade liberalisation (using the gradual rather than accelerated method) textiles and clothing tariffs have fallen from 30.1 in 1994 to 17.8 in 2004 in textiles and 73.7 in 1994 to 33.2 in 2004 for clothing exposing these sectors further. The uptake of the AGOA agreement allowing duty free and quota free exports to the US has been low suggesting the market is not stimulating exports as expected.[76]

The macroeconomic environment has contributed to this decline. Though the links between broader macroeconomic policy and sector outcomes merits a more comprehensive approach than is possible here, three key factors are worth mentioning. The exchange rate, financial liberalisation and macroeconomic stability achieved through fiscal and monetary policy have all had an impact (if indirect and unplanned) on textiles and clothing. An undervalued exchange rate counters the deteriorating international conditions for gold (depressed prices and decreasing importance as central bank reserves) and but disadvantages sectors reliant on imports such as textiles. With comparatively (to other countries) high labour costs, manufacturers have had to absorb increasing input costs from a weak rand in order to remain competitive against imports in domestic markets and low-labour-cost products in global markets. A strengthening rand in the 2000's has led to export decline given the progressing trade liberalisation. It is of interest that textiles and clothing are not the most sensitive to exchange rate fluctuations with coke, petroleum, gold, coal and in particular other mining (platinum and diamonds) process imports almost twice as sensitive than for textiles and clothing.

Financial liberalisation has enabled large South African conglomerates to list on foreign stock exchanges and has contributed to capital flight and reduced inward investment. The increasing foreign ownership and pressure from shareholders to focus on core business and shareholder value has led to unbundling and thus reduced the potential for linkages and funding from the capital-intensive MEC. Macroeconomic stability achieved through tight fiscal policy, monetary policy to control inflation and interest rates has exacerbated the unemployment problem with associated low government expenditure and has not generated the foreign investment that such stability was expected to generate. Much of the investment has been short term and portfolio. This combined with difficulty in accessing funding for small- and medium-sized firms and the decline in government investment and subsidies towards textiles and clothing has meant the sector has struggled to uprade the skills and technology needed to remain competitive (see Vlok (2006) for a

[76] Abiola (2006)

discussion on this). The combination of these policies has meant the economy remains structured around minerals extraction, beneficiation and energy and an exporter of manufactured goods rather than diversifying away from this structure. Mohamed and Roberts (2006) have argued that the macroeconomic policies and financial liberalisation have exacerbated the vulnerability to speculation and price fluctuations in core mining and minerals products.

Though this is not an exhaustive description of the interaction between macroeconomic policy and industrial sector it does highlight a process that favours capital-intensive and services sectors. This is also where most GDP growth has been recorded. The implications for textiles and clothing are a decline in investment, decline in employment and a declining growth in output. In addition, whilst growth in services and minerals benefication generates employment, there are no long-term welfare benefits or linkages to generate growth in other exporting sectors.

As a final point, the increase in textiles and clothing imports especially from China[77] also point to a contraction. In line with this, on a sector-specific level, problems in the structure of what is known as the textiles-clothing-pipeline[78] have contributed to the difficulties in being globally competitive. These have included changes such as power shifts in favour of the global buyers and increasing pressure to respond to demands for quick product changes and smaller batches in production. The competition on global markets from the same lower-cost producers has been consolidated by ongoing government support in the competing countries as well as a gradual phasing out of preferential trade-agreements further disadvantaging South African producers. In part the volatile exchange rate reflecting the prices of minerals such as platinum and diamonds rather than South African skills and technology have also contributed to the lack in price competitiveness. What is required to support the textiles and clothing sector and thus employment growth is a coordinated strategy that helps counter for the effects of low government and foreign investment, the bias towards portfolio investment and the damaging effects of rapid trade liberalisation under the unfavourable exchange rate for South African manufacturers.

The New Industrial Policy Framework (2006, p.26-27) discusses five sectoral groupings: natural resource-based sectors, medium technology sectors, advanced technology sectors, labour-intensive sectors, and tradeable services in which much of the potential for our industrial growth and employment opportunities is anticipated. “The characteristics of these ... groups suggest that two broad sets of interventions need to be developed. The major challenge will be to identify new tradeable activities including the ability to service the growing domestic and regional market. The ASGI-SA has currently prioritised tourism and clothing/textiles as being important from an employment perspective, as well as business process outsourcing, which is discussed under tradeable services below. Although the overall focus of the NIPF is on non-traditional tradeable goods and services, Government will explore a range of further options for employment creation, including ways in which employment can be generated in non-tradeable services sectors.”[79]

The NIPF also raises a new focus on understanding industrial policy in conjunction with trade policy as well as alongside a range of macroeconomic policy tools with specific regard to managing the currency.

Three possible scenarios are proposed as outcomes of the discussion above. Firstly, that for various external reasons the sector is bound to fail and policy is a way of controlled run-down or weeding out all but a small competitive core. Secondly, any attempts to move up the value chain are obstructed by a range of internal and external factors (policy, interest groups, global competition, trade agreements etc.) and that unless this alters the sector will continue to struggle. Thirdly, rent-seeking and inefficient support by industry actors means the sector remains active but does not develop. These scenarios suggest that there is a clear role for policy change to enable the market to provide competitive stimulus whilst restricting the adverse effects of liberalised trade. This requires very specific support for domestic production and sourcing as well as support for dealing with the import competition in the domestic markets. Once this is in place there may be scope for policy support for export though this would be dependent on success in domestic markets and is not an automatic progression. Rather than seeing textiles and clothing as a primary export sector, it should be perceived first and foremost as a source of employment and skills acquisition and resource accumulation from which exports or shifts to other manufacturing may follow.

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[77] Documented in Jauch & Traub-Merz (2006)

[78] Also referred to as the value chain.

[79] NIPF (2006, p.26)

5 Conclusion

The aim of this paper was to assess the nature and evolution of industrial policy in post-war South Africa and to explore what elements and factors have led it to take the current shape and form. This is done in the light of economic decline and with a particular focus on the relationship between economic structure and industrial policy.

The paper began with an overview of the post-war economic and political developments and the evolution of the unique for of capital accumulation around the dominant minerals-energy sector. This was followed by an exploration of the nature and drivers of policy during apartheid with special focus on the inaccurate categorisation of this period as protectionist and state-led. On the contrary the limitations of import substitution, decentralisation and diversification alongside the set-up of state-owned enterprises suggest something else drives policy. The requirements of the capital-intensive sector emerge as a key structural factor behind policy choices and evolution.

Post-apartheid policy has been typically associated with the prevailing economic fashions of liberalisation and macroeconomic stability. Though these elements have certainly been present, there is also evidence of continuity in the role played by the capital-intensive sector – in terms of policy and structural influence though not in employment or spillover effects to employment sectors. The pressure from this sector on policy is compounded by further limitations from changing global trade and financial markets. This combined with the economic decline and inherited economic and political problems present the need to compromise between domestic and external pressures, managed liberalisation, and selective government support and control over the economy. A new trend in economic theory has raised questions about the validity of the state market split. This is arguably reflected in the T&C decline despite a range of state led measures in the early post-war period and market led stimulus characterising the 1990's and 2000's. The case study of T&C suggests the need to highlight South Africa's unique structural, policy and economic evolution. Though global market changes have played a significant part in constraining domestic production in manufacturing, the ability to respond competitively within the domestic and global market space depends to a greater extent on South Africa's policy and economic landscape.

This paper argues that the dominant elements of the economy and to an extent of the wider political-economy structure have retained a path-dependence which has disadvantaged labour-intensive manufacturing outside these dominant elements As a result, various industrial policy initiatives focusing on these non-core sectors also remain separated from the core economic policy. Recent policy discussions recognise the need to align macroeconomic policy with specific industrial policy. There is a renewed interest in diversifying the economy and in doing so, diversifying industrial policy. As evidence of this, discussions have broadened from industrial policy as trade or financial policy. Thus, trade policy continues as a mechanism of industrial policy rather than the main tool, with a renewed focus on other approaches to sector-specific needs and constraints. In addition there is renewed debate on the industry-impact of broader economic policies and processes outside what has traditionally been seen as industrial policy (including areas such as currency stability and level, and the coordination between multiple policies and governmental departments).

Though these developments have invigorated policy debate, the changes in scope and range of policies today is different and to a large extent reduced in comparison to for example the policy conditions faced by newly industrialising countries in East Asia during the 1980’s and 1990’s. These constraints contribute to the difficulties in altering the policy and economic structure and their role must be assessed as part of future industrial policy debates.

In conclusion, the paper proposes the following hypotheses. South African development in the 1970-2005 period does not fit under existing industrial policy theorising and definitions polarising the state and the market. The prospects for the development of the T&C sector were heavily constrained by the dominance of the MEC within the South African economy and policy environment. Any development opportunities that may emerge within the T&C thanks to policy, global market trends or trade agreements will be affected by the priorities set in the broader economic and political context. It is thus the impact and specific nature and developments of this context that should be the target of further investigations.

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