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# EVOLUTION OF ECONOMIC POLICY IN POST- APARTHEID SOUTH AFRICA<sup>1</sup>

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## *Abstract*

Since 1994 South Africa has been unable to sustainably achieve the rates of economic growth necessary to decrease its very high level of unemployment. Inadequate growth has been exacerbated by a structural increase in the share of private non-tradables (skill-intensive) employment alongside a parallel decline in tradable (low-skill) employment. Against this backdrop the concept of “The Developmental State” has resurfaced in policy discussions. The 2009 Manifesto of the African National Congress declared a “state-led” industrial policy will lead to the transformation of the economy. However, there are significant institutional and governance constraints that need to be overcome if “state-led” industrial policy is to succeed.

## 1. DEVELOPMENT OF ECONOMIC POLICY SINCE 1990

### 1.1 GROWTH THROUGH REDISTRIBUTION

THE MAIN OBJECTIVE BEHIND the development of economic policy in a newly-democratic South Africa in the 1990’s was to redress the apartheid legacy of high income inequality and abject poverty that characterised the South African economy (Natrass, 1992: 626). At the African National Congress (ANC) Workshop on economic policy for a post-apartheid South Africa (1990: 2), it was stated that the current system and its capital strategies would not be able to alleviate poverty and meet the needs of the majority of South Africa’s people. In line with the goal of restructuring economic activity in a democratic South Africa, the ANC (1990b: 4) “called for a programme of Growth through Redistribution, where redistribution acts as a spur to growth and where the fruits of growth are redistributed to satisfy basic needs.” This was expected to be achieved by increasing aggregate demand in a manner which would also result in the redistribution of income in favour of the poor (Moll, 1991: 314). This “Spare Capacity” view assumed that the economy had a sizeable amount of underutilised productive capacity at its disposal which could be more effectively utilised by increasing aggregate demand (Moll, 1991: 314).

An alternative view termed “Restructuring Demand” proposed that if the structure of demand changed to favour the poor and meet basic needs rather than the needs of the wealthy minority, then a more equitable, healthier and sustainable growth path would materialise (Moll, 1991: 314). The change in the structure of demand would also cause the productive organisation of the economy to be more in line with its resources (Moll, 1991: 314). According to Moll (1991: 314), “the ‘Spare Capacity’ approach, characterised the

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unemployment faced by the South African economy as ‘Keynesian’ unemployment.” There was insufficient aggregate demand within the economy to generate increased employment, so an increase in domestic expenditure was required to utilise the spare capacity. This would result in economic growth, and higher levels of prosperity and employment (Moll, 1991: 314).

There existed two variations in the “Spare Capacity” approach. The first one was that an increase in government spending would create the aggregate demand required to increase employment and utilise the spare capacity within the economy. The alternative approach (‘Demand Restructuring’) for achieving “growth through redistribution” proposed that the change takes place in the composition of aggregate demand rather than in its level (Moll: 1991: 320). This view suggests that moving towards a more equal distribution of income would boost the demand for low income goods such as food, clothing and housing and that all these products are produced using labour-intensive production processes producing an increase in employment at the same level of aggregate demand (Moll, 1991: 320).

An third approach, to achieving “growth through redistribution,” known as “restructuring supply” had elements of industrial strategy echoing through its proposals of how to restructure the economy to “expand both employment creation and the production of basic consumer goods” (Gelb, 1990: 35). Gelb (1990: 35) argued that the focus of strategy should be on “restructuring the supply-side (production)” of the economy. Therefore, redistribution should take place via investment rather than consumption (Gelb, 1990: 35). Investment in productive capacity would have to be increased with the source of funds coming, mainly, from financial markets (Gelb, 1990: 35).

Investment in productive capacity would have to result in a shift in the composition of production, away from the sectors producing sophisticated consumer goods to either labour-intensive industries in the formal sector (food, furniture and clothing) or it should be shifted into services such as electricity and telephones which are infrastructural in nature (Gelb, 1990: 36). This would result in the “development of the ‘informal sector’ manufacturing micro-enterprises producing consumer goods, and expanding employment” (Gelb, 1990: 36). An important question then is how was this redistribution of investment going to take place and what was the state’s role going to be? The state seemed to be the only vehicle which could drive economic development in a new direction, however Gelb (1990: 37) states that the “issues of the appropriate form of state intervention cannot be decided on general principles, but would be determined on the basis of strategy and policies developed on a sector-by-sector basis.” This strategy would change the “nature of the markets” from the reliance on the market to generate autonomous responses to a “mixed” market where there would be a combination of both “market and planning processes” (Gelb, 1990: 37).

The variations of “growth through redistribution” all placed great emphasis on the power of the state to dictate economic activity. In this respect ANC policy continued to echo its socialist origins in the Freedom Charter. But rather than state ownership, policy formulation now looked increasingly to the East Asian economic successes and the perceived role of the state in directing this success.

## 1.2 THE RECONSTRUCTION AND DEVELOPMENT PROGRAMME

The ANC developed economic policy based on Reconstruction and Development for its 1994 election campaign and its first period of government thereafter. The Reconstruction and Development Programme (1994: 78) outlined as its objectives, that “Reconstruction and Development would be achieved through the leading and enabling role of the State, a thriving private sector, and active involvement by all sectors of civil society which in combination would lead to sustainable growth.” The RDP contained elements of all three views of the South African economy outlined above, in that it tried to restructure production in favour of more labour-intensive production (housing being a key priority); it sought also to increase aggregate demand through enhanced public spending (excess capacity approach); and also to restructure demand in favour of basic goods consumed by the poor. The key role of the state in economic activity was only partly diluted by acceptance of a “mixed” market of public and private actors.

All policies within the RDP were designed to alleviate income and wealth inequalities as well as expand productive capacity. The programmes to achieve this included “urban and rural development, industrial strategy, and support for small and micro enterprise, job creation and land reform” (Reconstruction and Development Programme, 1994: 81). “The RDP soon became the paradigm within which all development policies were to be discussed - an extended wish list in which the homeless, the landless, workers, and even international bankers could take equal comfort. The ANC focused on meeting basic needs, eradicating poverty and investing in human capacities” (Visser, 2004: 7). There was also a major review of the country’s welfare system, which aimed to address the injustices of the system and to devise a welfare strategy that was compatible with the new government’s developmentalist commitments. South Africa’s RDP and its White Paper (1995) on developmental social welfare were compatible with the social development approach and in line with the ANC’s humanitarian and “people-centred” values. “While neo-liberal approaches prevailed in other parts of the world, the new South African government resurrected the social development approach and elevated it to a position of prominence” (Midgley, 2001:267).

However, the RDP soon found itself running into trouble because according to Bond (2002:90), the RDP was “fatally undermined by timid politicians, hostile bureaucrats and unreliable private sector partners.” The RDP was formulated in broad terms and did not provide details on how it was going to go about achieving its main objectives (Visser, 2004: 7). Despite its commitment to “industrial strategy” the RDP became increasingly focused on achieving redistribution through the Budget to enhance welfare. Actively boosting the supply-side of the economy, and especially labour intensive manufacturing aimed at producing goods for the poor, took second place to the redistributive objectives of fiscal spending. This was despite the fact that the country’s failure to grow at economic growth rates of between 4-6 percent also made it difficult for government to generate funds needed to implement the policy objectives (Visser, 2004: 8). “As economic considerations began to dominate government policy in the latter half of the 1990s, the lofty social commitments of the RDP were given less prominence than the need for rapid economic growth” (Midgley, 2001:270). According to Visser (2004: 8), “a final nail was driven into the coffin of the RDP when the new ANC government encountered its first major currency crisis, starting in February 1996 when the value of the rand plummeted by more than 25%. In order to calm domestic capital and foreign currency markets, the

government embraced a conservative macro-economic strategy, ‘Growth, Employment and Redistribution’ (GEAR)”.

### 1.3 GROWTH, EMPLOYMENT AND REDISTRIBUTION

In contrast to the RDP, GEAR adopted an orthodox macroeconomic strategy which focused on tight monetary policy, fiscal prudence and a shift from demand-side trade policy interventions (tariffs and subsidies) to supply-side interventions. The main objectives of fiscal policy under GEAR included the achievement of “a tighter short term fiscal stance to counter inflation, an appropriate medium-term deficit target to eliminate government dissaving, a further revision of the tax structure, and a range of budgetary restructuring initiatives to sharpen the redistributive thrust of expenditure and contain costs” (GEAR, 1996: 4). Macroeconomic policy was accompanied by an explicit recognition of the need to boost industrial output, especially output for exporting, taking advantage of the real depreciation of the Rand exchange rate in 1996. According to GEAR (1996: 4), “the trade and industrial policy reforms included “incorporating a further lowering of tariffs to compensate for the real depreciation, the introduction of tax incentives for a fixed period to stimulate investment, a campaign to boost small and medium firm development, a strengthening of competition policy and the development of industrial cluster support programmes.”

When evaluating the economic performance of South Africa under GEAR it is noted that there were improvements in the economic growth rate, a decline in the rate of inflation, a reduction in the budget deficit and limited improvements with regard to exports and foreign capital inflows (Habib and Padayachee, 2000: 12). Where GEAR failed to produce results was in creating employment, which actually worsened over the period 1996-98, and in achieving progress in delivering social and physical infrastructure to the disadvantaged majority (Habib and Padayachee, 2000: 13). In the period between April 1994 and the end of 1997 under the RDP South Africa’s GDP growth rate improved from 2.7% in 1994 to 3.4% in 1995 and 3.0% in 1996 and then dropped to 1.5% in 1997 (SARB: Quarterly Bulletin, various issues). In the period after 1997 growth rose from 3% in 2003 to about 4% in 2005 (SARB: Quarterly Bulletin, various issues). These growth rates were a considerable improvement from what was experienced in the decade pre-1994 (1% per annum) and during the brief RDP period (3% per annum), but they were still not high enough to deal with South Africa’s legacy of underdevelopment, poverty, unemployment and inequality (Habib and Padayachee, 2000: 11).

### 1.4 ACCELERATED AND SHARED GROWTH INITIATIVE FOR SOUTH AFRICA

“Conscious of the fact that growth was lackluster and that inequality was still very high, the government proposed in 2005 the Accelerated and Shared Growth Initiative for South Africa (AsgiSA)” (Hausman, 2008: 3). This proposal highlighted interventions which the government sought to take in order to deal with the “binding constraints” faced within the economy and was not to be seen as a shift in economic policy. AsgiSA did however; acknowledge “that while all successful economies have certain characteristics in common such as well managed fiscal and monetary policy and competent government administration, each country faces specific challenges in its

attempt to move from mediocre to successful.” This was in contrast with the “Washington Consensus” approach, “which posited a fairly long list of ‘virtuous’ actions which would solve any country’s economic problems” (Mlambo-Ngcuka, 2006: 3).

The main objective of AsgiSA was to achieve a growth rate of about 5 percent between 2004 and 2014 that would provide opportunities for labour-absorbing economic activities, and ensure that poverty and income inequality would be considerably decreased.

AsgiSA’s interventions included an infrastructure programme where government set to increase public sector investment, as well as develop the country’s research and development infrastructure (Mlambo-Ngcuka, 2006: 4). AsgiSA identified specific sector strategies aimed at promoting private sector investment. The sectors identified were “labour intensive, rapidly growing sectors worldwide, suited to South African circumstances, and open to opportunities for Broad Based Black Economic Empowerment (BBBEE) and small business development” (Mlambo-Ngcuka, 2006: 6). The shortage of skills was identified by AsgiSA as the “single greatest impediment” to public infrastructure and private-sector programmes and was therefore, a key area for government involvement (Mlambo-Ngcuka, 2006: 7).

## 2. THE DEVELOPMENTAL STATE

THAT MACROECONOMIC POLICY IN SOUTH AFRICA has been conducted in a near exemplary manner over the past 15 years, is reflected in the fact that South Africa enjoys one of the lowest risk spreads of all emerging markets. While the democratically elected government of South Africa has introduced some innovative and costly social transfer programs to deal with established income and wealth inequalities, it has undertaken this task operating within a framework of cautious fiscal and monetary policies which have kept inflation, public debt and fiscal deficits at low levels. Also, the economy was significantly opened to international trade and competition as well as global capital flows. However, per capita GDP has grown at an average of 1.2 percent per annum since 1994, which has not had much of an impact on unemployment. South Africa’s unemployment rate is at approximately 23.6 percent according to the narrow definition of unemployment (excludes discouraged workers) (Stats SA, 2009: 1) which is barely changed from the estimates of around 25 percent in 1993. While employment has increased (approximately 1.5 million jobs have been created) this has only kept pace with the new entrants to the labour force. If “discouraged” workers are included the expanded definition of unemployment rises to some 32.2 percent. The composition of unemployment is made up predominantly by the young, black population, who are unskilled. According to Rodrik (2006: 2), “this poor record on employment represents not only an economic tragedy; it poses a significant threat to the stability and eventual health of the South African democracy.”

In the light of the poor success in job creation since 1994, three (3) alternative routes forward are possible. The first involves “fine-tuning” the current macroeconomic framework in order to achieve higher rates of growth and employment creation. This is essentially the path followed by AsgiSA. An alternative path would suggest that further deregulation, labour market liberalisation, privatisation and a reduced role of the state are necessary for faster growth and job creation. This is the route that would generally be supported by business. A third alternative is premised on the belief that the desired

outcomes are achievable only with an increased role for the state in the economy. It is against this last backdrop as well as the leadership changes in the ruling ANC that the concept of “The Developmental State” has surfaced once again in the discussion of the future for economic policy in South Africa.

In South Africa, the concept of “The Developmental State” is generally used to describe a state which drives development, rather than leaving it to the “free-market” approach. The African National Congress (ANC) has declared in its 2009 Manifesto that, there will be a “state-led industrial policy which will lead to the transformation of the economy. Adequate resources will be provided to strengthen the state-led industrial policy programme, which directs public and private investment to support decent work outcomes, including employment creation and broad economic transformation. The programme will target labour-intensive production sectors and encourage activities that have high employment effects” (ANC, 2009: 12).

## 2.1 WHAT IS THE DEVELOPMENTAL STATE?

The “developmental state” concept arose from the successful high growth experience of the industrializing states of Asia, especially Japan and Korea after 1945. According to Johnson (1999: 53), “the critical element of the developmental state in Asia was not its economic policy, but rather its ability to mobilise the nation around economic development within the capitalist system.” In terms of class structure, the developmental state was closely associated with business, but maintained the freedom it needed in order to drive the development of new industries (Woo-Cumings, 1999: 22). In terms of economic policy, the state got involved and catalysed the development of new industries, making use of a mixture of substantial amounts of subsidised credit, strong tariff protection, substantial training and infrastructure investment (Woo-Cumings, 1999: 22).

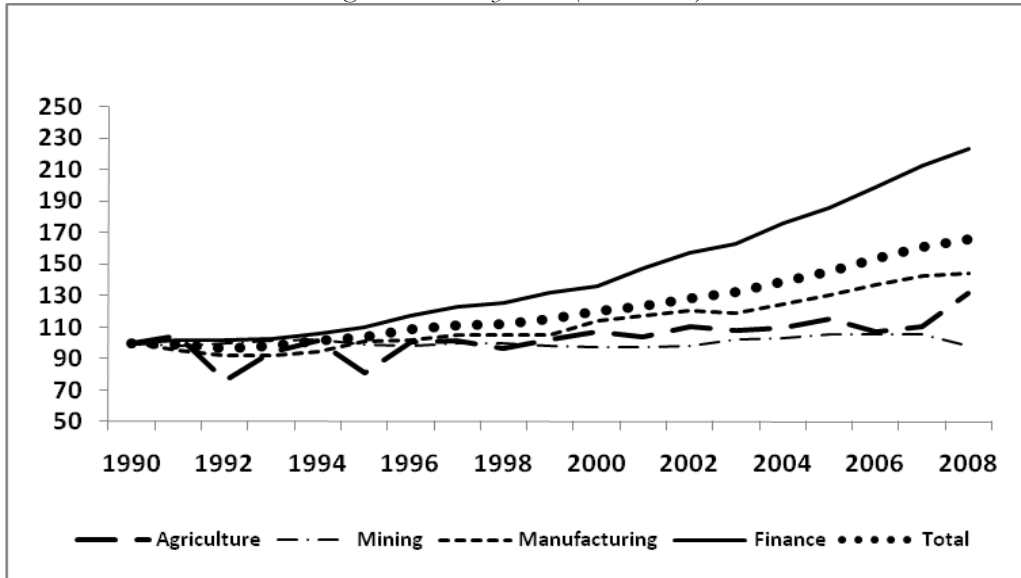
According to Wade and Veneroso (1998: 7), “high household savings, plus high corporate debt/equity ratios, plus bank-firm-state collaboration, plus national industrial strategy, plus investment incentives conditional on international competitiveness, equals the ‘developmental state.’” For Beeson (2003: 3), “the key is state capacity, or the ability to formulate and implement developmental policies. For a state to achieve such an outcome it not only needs a competent bureaucracy, it also needs an effective relationship with the domestic business class that will inevitably be at the centre of any successful developmental initiatives.” In order to achieve this, the state needs to be adequately embedded in society so that it can put into action, through its social infrastructure, its goals. The state should at the same time be autonomous so that it may formulate and implement its objectives and policies independently of specific interests and rather act in the wider national interest (Beeson, 2003: 3).

## 2.2 MANUFACTURING LED GROWTH

The South African economy has not been able to achieve sufficiently rapid and sustainable economic growth over the past 15 years so as to decrease the high unemployment which plagues South Africa (Rodrik, 2006: 3). One of the major causes of this problem is the contraction of the non-mineral tradable sector (including manufacturing) and the inability of South Africa to take advantage of the growth opportunities offered by export-oriented manufacturing. This is reflected in Figure 1

below which shows the increase in total GDP, as well as the contributions to GDP of agriculture, mining, manufacturing and the financial sector. It is notable that the financial sector rose much faster than the overall increase in GDP, but the contribution of agriculture, mining and manufacturing were all slower than overall GDP. This is ironic given the emphasis of early ANC policy thinking on restructuring the domestic economy in favour of labour-intensive goods demanded by the poor.

Figure 1: GDP by sector (1990=100)

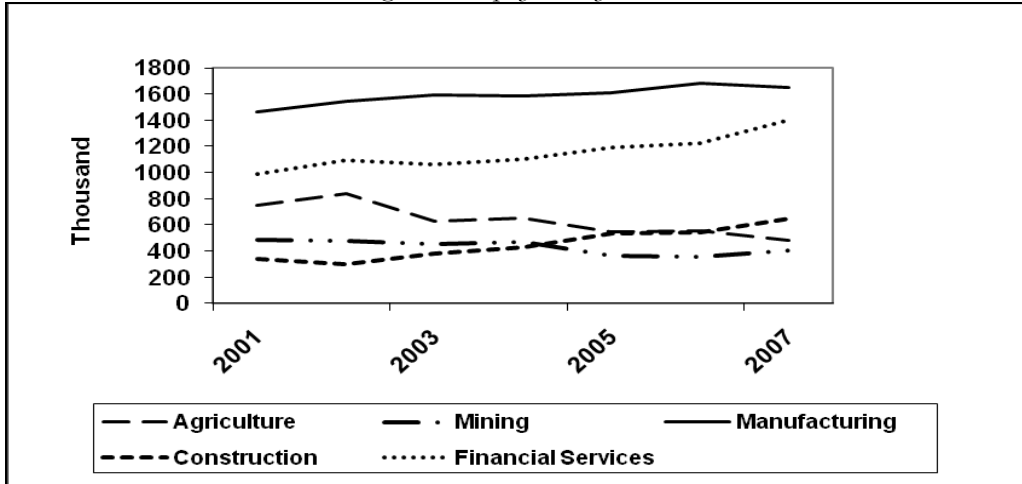


It is also a contributing factor to the slow pace of employment growth, depicted in Figure 2. Not only has the overall GDP growth been too slow to generate the number of jobs needed to substantially reduce unemployment, but the composition of the jobs created has been in favour of high skilled, low job creation sectors while low skilled, job intensive sectors have performed relatively poorly.

According to Rodrik (2006: 4) the manufacturing sector is more intensive in low skilled labour and is the sector which displays the highest productivity in an economy. Accordingly, “the expansion of non-mineral tradables— manufacturing in particular— will be good both for growth and employment.” Rodrik (2006: 4). It is in this light and the seeming failure of policies to date to encourage manufacturing growth that the South African government is now turning to a “state-led” industrial strategy in order to create employment and spur on economic growth. An export oriented strategy that increases the relative profitability of manufacturing tradables for global markets will generate economic growth by absorbing labour into productive activities where their marginal product is much higher. In view of the fact that the production of durable tradable goods require relatively low-skilled labour in South Africa compared to service activities, which are high-skill intensive, that have benefited as a result of recent patterns of structural change, such a strategy will bring about shared growth rather than trickle-down growth (Rodrik, 2006: 4).



Figure 2: Employment by sector



It should be noted that support for this greater emphasis on manufacturing production is not just the brainchild of the Cosatu leaders that form an important component of the new ANC leadership. It had already received support from the Panel of International Advisors (the “Harvard Group”) appointed previously by National Treasury to advise government on how best to achieve the AsgiSA objectives, and of which Harvard Economists Ricardo Hausman and Dani Rodrik were the principal authors. While the “Harvard Group” may differ from the Polokwane declarations and the 2009 ANC election manifesto in the envisaged leadership role of the state, the objective of boosting manufacturing production to increase employment creation is the same.

The pattern of structural change in South African formal employment is that there has been a remarkable increase in the share of private non-tradables employment with a parallel decline in employment within tradables. The result is a fall in the relative demand for low skilled labour due to the fact that the declining sectors make up the least skill intensive parts of the South African economy (Rodrik, 2006: 8). As most of South Africa’s unemployed are low skilled and there is an economy wide shortage of skilled workers the impact of this imbalance on employment creation is especially important. This pattern of structural change sheds some light on why the “skills shortage” is continuously at the centre of South African policy discussion. The observation that skills inhibit economic growth is commonly held, and is echoed in the government’s official policy document on the Accelerated and Shared Growth Initiative for South Africa (ASGI-SA). Therefore, there needs to be an increase in low-skill intensive manufacturing at the cost of skill-intensive non-tradables in order to generate higher levels of economic growth and employment creation (Rodrik, 2006: 9).

This shift in the demand for labour (particularly low-skill labour) makes it easier to recognise why employment creation has been disappointing and unemployment is so high in South Africa. There is the possibility that rising unemployment could have been averted by a corresponding decline in real wages for low-skilled workers. This however, would have been a political impossibility in view of the democratic transformation in South Africa and the role played by unions in the anti-Apartheid struggle and in supporting the election of the new democratic government.

In a study undertaken by Rodrik (2006: 20), it was found that the major reason for the decline in manufacturing employment was the decline in the relative price (profitability) of manufacturing. Skills-biased technical change and total factor productivity (TFP) growth contribute to the fall in manufacturing employment but to a much lesser extent than the fall in profitability experienced in the sector (Rodrik, 2006: 20). In his study on the manufacturing sector in South Africa, Rodrik (2006: 22) finds that the reasons for the decline the manufacturing sector's profitability are intensified import competition and an appreciation in the level of the real exchange rate. In the post-1994 period the real exchange rate has weakened, increasing manufacturing's profitability. This indicates that an even more depreciated real exchange rate would have been even more beneficial to the health of the manufacturing sector in South Africa. Rodrik (2006: 23) finds that manufacturing's profitability is also strongly connected to trade competition and performance. This is because "an increase in import penetration has a strong negative effect on a manufacturing sub-sector's relative price, while an increase in exports has a less strong but still statistically significant positive effect" (Rodrik, 2006: 23). Also, according to Rodrik (2006: 24), "import penetration has adverse effects on employment while exports have a positive effect" (Rodrik, 2006: 24). The outcome of the relative decline in profitability in the manufacturing sector is firstly that, an investor wishing to invest in South Africa in the period after 1994 would have rather committed resources to the banking, insurance and other services tailored towards the home market, than invest funds in the manufacturing sector (Rodrik, 2006: 20).

The manufacturing sector needs to be the centre of any strategy wanting to achieve shared growth. Rodrik (2006: 25) concludes that at the macro level monetary and fiscal policies need to ensure that the South African Reserve Bank (SARB) is able to "tweak" its inflation-targeting framework to allow for considerations of competitiveness to be made and influence its decision-making. Included here is a weaker real effective exchange rate. Hausman and Rodrik (2003) are sceptical about the role the state can play to enhance manufacturing performance in South Africa. Instead, according to Rodrik (2006: 25), "at the micro level there needs to be more coherent and better coordinated industrial policies targeted at "self-discovery". The objective here is to encourage private investment and entrepreneurship to come up with new activities in which South Africa can develop comparative advantage. In the absence of pro-active policies, such new investments do not necessarily materialise." Rodrik (2006: 25) identifies two things which are needed to ensure that such a strategy will be achieved. Firstly, there needs to be greater discipline in targeting policy interventions on reasonable, identified sources of market failures instead of on indistinguishable, and economically meaningless objectives (such as greater domestic "beneficiation" or higher value added). Secondly, a better institutional structure is required to ensure "(a) political leadership and coordination at the top and (b) strategic collaboration at the bottom with business and other stakeholders" (Rodrik, 2004).

An identification of the type of "pro-active" policies at the micro level that are required in necessitating the structural change in the economy needed to address unemployment and poverty is undertaken in the following section. The question of whether the South African government is in a position to provide the "better institutional structure" necessary to ensure the success of the above mentioned strategy is also asked.

## 2.3 MICRO-LEVEL POLICIES

Hausman and Rodrik (2003: 605), state that in order for a developing country to transform into a modern country it is essential that the country learns what it is good at producing. This process of “self-discovery” is an important determinant of structural change, but it is also, they suggest, a process that is unlikely to be effectively provided under the free market system. This is due to the fact that private firms undertake investments whose returns are below the socially optimal level needed in order to increase the returns from these investments (Huang, 2002: 547). Thus policies at the micro level are required to correct for this market failure. According to Hausman and Rodrik (2006: 629), “laissez-faire market actions lead to the underprovision of innovation and governments need to play a dual role in fostering industrial growth and transformation. They need to encourage entrepreneurship and investment in new activities *ex ante*, but push out unproductive firms and sectors *ex post*.”

The role of the state in achieving manufacturing success is therefore critical, but it is a role in the eyes of Rodrik and Hausman (2003) that is a facilitator of private investment and the correction of market failures.

The economic justification for such policies is that firms who would like to move into non-traditional industries in developing countries find it difficult to do so when faced with competition from producers in developed economies (Huang, 2002: 547). Therefore, according to theory, domestic firms which are protected can learn by doing and gain competitiveness against imports by raising productivity and by moving down the learning curve. According to Huang (2002: 547), “the infant industry argument is based on a notion of ‘dynamic comparative advantage’, i.e. nations can ‘create’ comparative advantages away from those determined by natural endowment of factors of production toward those in higher profit-margin industries or ones with greater technological externalities.” The role of government, through initiation and implementation of these policies, is to accelerate this shift more rapidly than the market would otherwise make possible. The additional mixture of the welfare-improving industrial policy is built on the idea of “big push.” The idea here is that singular investments are inadequate to launch industrialisation, because externalities associated with certain investment activities occur. This happens when an investment undertaken by one firm will create profits for other firms by altering the future composition of demand or by producing a product that decrease the costs of production for other firms (Huang, 2002: 548). Another reason why state intervention in industrial policy is advocated is because of the existence of scale economies - an individual investment can only become profitable if a large share of resources is invested in the sector. The role of government is to increase the private returns to investments equal to the social returns and/or directly organise investment activities across sectors so that investments are simultaneous (Huang, 2002: 548).

The way these policies can be implemented and managed is likely to differ significantly from country to country, depending on administrative capability, the existing incentive regime, the flexibility of the fiscal system, the degree of sophistication of the financial sector, and the underlying political economy. Some of the policies which have been used to promote industrial development are mentioned below.

In an effort to promote innovation, governments have historically used an assortment of instruments such as trade protection (import restrictions), public sector credit, tax holidays, and investment and export subsidies. The result which needs to be achieved is

that all suitable policy interventions need to increase the expected payoff to innovation. However, interventions normally create other distortions. For example, if the instrument does not effectively differentiate between innovators and imitators, it will promote early entry, thus limiting the benefits to innovators while increasing the social cost of the intervention since imitators will get part of the resources transferred (Hausman and Rodrik, 2006: 629). This happens when government fails to manage the entry of firms into the industry and results in 'excessive' entry relative to the size of the relevant markets and the unit costs remain high over a longer period of time. As we can see policies aimed at initiating the 'self discovery' process can lead to rent creation. If an industry has high import restrictions, this makes the domestic production of importable products artificially more profitable than other products. Subsidised credit or budgetary subsidies, which provides risk insurance against the 'informational' problem which exists in the financial market, makes access to financial resources easier and cheaper to firms (Huang, 2002: 549). To deal with the excessive entry as a result of rent creation government needs to limit entry on economic grounds, through policies encouraging joint R&D programmes, arranged mergers, and direct and indirect support to business conglomeration (Huang, 2002: 550). For such policies to be effective government needs to possess the 'right' capacity and discipline to prohibit entry, keeping in mind that enforcement costs are quite high. In the section that follows the institutional and governance requirements for effective industrial policy are discussed, as these are very demanding but are a must if industrial policy is to be a success and achieve its objectives. If the institutional foundation is weak then the risks of government failure and the wasting of public resources are considerably enhanced (Kaplan, 2007: 97).

### 3. INSTITUTIONAL AND GOVERNANCE REQUIREMENTS FOR EFFECTIVE INDUSTRIAL POLICY

Firstly, successful industrial policy requires coherence in terms of the goals and objectives set out to be achieved through industrial policy. This entails establishing clear criteria which are consistently applied to identify and select economic sectors or activities which are to be favoured or targeted (Kaplan, 2007: 97). If criteria are unclear and inconsistent in their application then the end result will be confusion and be a waste of time, effort and resources (Kaplan, 2007: 97). Secondly, there needs to be coherence in terms of the responsibility structure within government and its institutions to ensure that industrial policy is effectively administered and achieves the objectives it was intended to realize (Kaplan, 2007: 98). Kaplan (2007: 98) states that, "if there are multiple sites directing and implementing industrial policy, both the design and implementation of industrial policy will be sub-optimal." China displayed sub-optimal results in the 1970s and 1980s compared to Korea, because of its institutional framework. According to Huang (2002: 551), "trade policies and industry regulations in China were dispersed among several government agencies, making export contestation (which needs to be institutionally administered) harder to enforce. Also domestic competition was hampered by a weak central authority, which could not enforce market integration regulations effectively." Korea on the other hand had a bureaucracy which operated under a high degree of autonomy, which was partly derived from its technocratic expertise but mainly from the high level of integration across different policy functions and the central command over key economic resources. This institutional context enabled the Korean regime to oblige

firms to compete within the global economy, by facilitating entry restrictions and promoting economies of scale in the presence of high rents (Huang, 2002: 551). Huang (2002: 552) states that, “governments need to have the political and intellectual capacity to discipline the incumbent firms to increase scale and to impose restrictions on entry so that the rents created by the ‘micro level’ policies aimed at encouraging investment in innovative productive activities are conferred on one or a few efficient firms.”

The second important requirement necessary to ensure a successful design and implementation of industrial policy is strategic collaboration. There needs to be strategic collaboration between government, business and other stakeholders (such as research institutions). This collaboration is essential because investors in developing countries are beleaguered with problems of asymmetric information, especially regarding the cost functions of new ‘non-traditional’ activities. This is due to the fact that such information cannot be determined before the investment takes place, but only after it has been made (Kaplan, 2007: 99). These informational failures cause economies to stay the same course and not expand into new activities which have associated spillover effects. Industrial policy can be used to ascertain the underlying cost structure of an economy. Strategic collaboration will ensure the engagement between business and government to understand the opportunities and constraints that face investment and the objectives set out by government to achieve economic development, respectively (Kaplan, 2007: 99). Structured information exchange between government and business therefore seeks to identify what barriers to diversification exist and then how to overcome these barriers through policy design and implementation (Rodrik, 2004: 3). In this way the process of determining government policy is not a result of autonomous decision making by government. This is an important point – not telling business what to do but working with business towards more optimal outcomes.

Effective industrial policy requires a strong and competent state bureaucracy (Kaplan, 2007: 100). This point reverts back to the ‘embedded autonomy’ discussed in the second section of this paper. However, as discussed above, “embedded autonomy” is necessary but not sufficient. The developmental state also “depends on the existence of a project shared by a highly developed bureaucratic apparatus with interventive capacity built on historical experience and a relatively organized set of private actors who can provide useful intelligence and a possibility of decentralized implementation” (Evans, 1995).

The main aim of industrial policy is also to enhance productivity and the efficiency of firms, therefore effective industrial policy needs to provide for training and skills development (Kaplan, 2007: 102). It is important here to note the differences between the role envisaged here for the state and that identified in the ANC election manifesto (2009:) of a state that “leads” industrial policy, that “directs public and private investment to support decent work outcomes,” that will “target labour-intensive production sectors” and “encourage activities that have high employment effects” (Section 2 above).

## 4. INDUSTRIAL POLICY IN SOUTH AFRICA: INSTITUTIONAL AND GOVERNANCE CONSIDERATIONS

### 4.1 COHERENCE

There are a number of governmental policies in South Africa that selectively favour certain activities and sectors. They are not explicitly identified as industrial policy but display all the characteristics of industrial policy. The ‘selected and favoured’ activities and sectors include the following: Direct state support to Denel in the form of subsidies for armaments production; support to mineral processing by subsidising infrastructure and energy at Coega and Richards Bay; direct subsidies are provided to the Pebble Bed Modular Reactor (PBMR) for the development and production of nuclear energy plants; and finally the intervention in upstream fuel and chemicals production by proposing the ‘windfall’ tax on SASOL (this selectively disfavors investment and production in this area). The above mentioned policies comprise significant and very direct commitments of state resources towards or away from particular economic activities, notably impacting on the trajectory of growth and investment. They are also very research and high-technology intensive. The PBMR for example requires and attracts a large number of South Africa’s scientists and engineers. It seems to be that government is supporting an activity in which the factors of production are most scarce (Kaplan, 2007: 98). The Coega development which aims to attract mineral processing activities (like aluminum) is extremely capital intensive and therefore employment creation is minimal. These choices are clearly inconsistent with the objectives, of addressing the skills shortage and the high unemployment problem, set out in AsgiSA and the National Industrial Strategy (NIS). Accordingly, the OECD (2008: 12) finds that “the emphasis on industrial policies risks preserving the apartheid-era pattern of protected national champions insulated from foreign competition and enjoying high mark-ups. This runs counter to the acknowledged need to enhance the level of competition in the economy.”

South Africa has also openly targeted the textiles and motor vehicles and motor vehicle components sectors through exporters receiving support through earning rebates on imports that are relative to their exports. The Import Rebate Credit Certificates (IRCCs) applies in respect of motor vehicles and motor vehicle components and the Duty Credit Certificate Scheme (DCCs) applies in respect of clothing and textiles. The MIDP represents industrial policy that has been successful in assisting the motor vehicles and motor vehicle components industry in becoming globally competitive. However, international agreements by the WTO prohibit Subsidies and Countervailing Measures (SCM), from granting subsidies based on export performance which is what South African industrial policy has been built on (Kaplan, 2007: 96). Such policies, which were applied in Korea and Taiwan, are now prohibited. Therefore, the future of industrial policy for an industry like motor vehicles and motor vehicle components needs to be designed such that support must apply to all output and enhance local content. This move in policy will require major increases in expenditures from the fiscus and according to Kaplan (2007: 97), “a policy of support for all production whether it occurs in the highly competitive export market or in the protected domestic market, will be likely to result in less efficiency gains and make it more difficult to reward growing efficiency and competitiveness.”

The oversight and direction of these policy designs and implementation are not driven by the Department of Trade and Industry (dti) who should be the ministry overseeing industrial policy in totality. The Department of Public Enterprises administers support for armaments, the PBMR and Coega, while the National Treasury administers and controls the possible windfall tax on SASOL. Even though the dti may be consulted, the policy is initiated and managed by other departments with their own programmes.

The conclusion therefore is that inconsistent and inappropriate criteria are applied to the selection of activities that are supported by government; therefore there is lack of coherency in required policy goals and criteria. Secondly, there is no clear agency within government who directs the design and implementation of industrial policy on a whole.

#### 4.2 STRATEGIC COLLABORATION

Strategic collaboration between business and government has not been effectively managed and implemented to reap the benefits afforded by a successful engagement. There has been a structured engagement between business and government in the motor vehicles and motor vehicle components industry through the Motor Industry Development Council. Customised Sector Programmes (CSPs) are meant to provide a structure for engagement in each sector, however there has been no success in the implementation of these mechanisms (Kaplan, 2007: 100). There is currently a very limited institutional capacity for collaboration between business and government at the national level. The relationship between business and government is characterised by a high degree of ‘mutual suspicion’ (Kaplan, 2007: 100). This results in detachment and distrust between the two parties and a model whereby government makes decisions (often propped up by research) and then consults with business once it has already decided on its policy stance.

#### 4.3 GOVERNMENTAL CAPACITY

Governmental capacities in South Africa are very limited. According to Kaplan (2007: 101), “most of those who are currently responsible for government industrial policy are new recruits to their positions, who have a limited understanding of their sectors.” South Africa is not characterised by bureaucrats who are competent in the technical in-depth knowledge necessary to devise and execute significant large-scale interventions and support for business. This view is echoed by the OECD (2008: 12) who states that “the failures of government planning, coordination, and administrative capacity are recognised to be among the constraints holding back South Africa’s growth performance, therefore the emphasis on government programmes and initiatives is at odds with this recognition.”

#### 4.4 DISTRIBUTIONAL CONCERNS

Distributional concerns in South Africa challenge the notion of identifying specific firms to enjoy the benefits created by rents (Kaplan, 2007: 101). The presence of Broad-based Black Economic Empowerment (BBBEE) makes it difficult for government to support ‘white’ or ‘well-established’ enterprises at the perceived expense of ‘black’ or ‘emergent’ ones. This means that industrial policy in South Africa does not only need to enhance growth of identified sectors or activities but also needs to provide support for ‘black-

owned' or 'emergent' businesses within the designated activity (Kaplan, 2007: 102). This can weaken the impact on growth since exporting requires firms to generate economies of scale and a minimal scale of entry. Larger 'white-owned' or 'established' firms are inclined to have a higher export potential than smaller firms (Kaplan, 2007: 102). South African industrial policies are also constructed in such a way that they need to create employment. Therefore, incentives were redesigned such that support was conditional on and proportional to employment criteria. These types of incentives reduce their effectiveness as a support to investment and output because if the employment criteria were not met then the incentive could be withdrawn. This possibility of withdrawal reduces the appeal of such an incentive to investors (Kaplan, 2007: 102).

## 5. RECOMMENDATIONS

From the above discussion it is evident that the Developmental State requires:

1. Coherence with regard to objectives and goals identified for industrial strategy and overall macroeconomic strategy. Industrial strategy should be implemented from a central government department to ensure effective administration of policy prescriptions and the successful realization of policy objectives.
2. Strategic collaboration between government, business and other key stakeholders is needed, so that informational problems can be dealt with and opportunities and constraints within the economy can be identified.
3. A strong and competent state bureaucracy who will effectively promote and facilitate industrialisation.

In light of the above analysis, there is a need for the overall custodianship of industrial policy to be clearly demarcated within government and for such policy to be based on a realistic appraisal of the resources the state possesses rather than those it aspires to. The principal objective of industrial policy is to raise the productivity and efficiency of firms (Kaplan, 2007: 104). The direction and responsibility of industrial strategy taken as a whole should rest with the dti as the objectives of industrial policy are one with those of the dti. Therefore, there is a need for capacity building within the dti to ensure a successful direction of industrial policy. Lack of capacity within government requires intervention to be facilitative rather than prescriptive.

To ensure that growth policies are aimed at raising firm-level productivity and efficiency Hausman (2008: 16) identifies the central role that the Industrial Development Corporation (IDC) has to play to achieve this. "The activities of the IDC should be focussed on the financing and incubation of activities that explore the possibilities of new products, new processes, new geographical zones or new forms of organization and that can crowd in significant additional investment through imitation and replication of the identified business model" (Hausman, 2008: 16). The IDC should also consider particular infrastructure projects that can address industry-specific needs, such as industrial zones. The IDC should allocate part of its profits to funding substantial exploratory and pre-investment studies. According to Hausman (2008: 16), "the IDC should be evaluated not in terms of the returns it receives on old investments – it should not see itself as an asset management firm – but on its ability crowd in investment and structural transformation."

In terms of the coherence of industrial policy objectives, government needs to ensure that the objectives set out within the policy are consistent and in line with National



Government's objectives. In the 2009 Manifesto the ANC states that "adequate resources will be provided to strengthen the state-led industrial policy programme, which directs public and private investment to support decent work outcomes, including employment creation and broad economic transformation. The programme will target labour-intensive production sectors and encourage activities that have high employment effects. It will include systematic support for co-operatives by way of a dedicated support institution and small business development; supporting investment in productive sectors; and working together with our partners in Southern Africa to invest in our regional economy." However, the conundrum between whether labour-absorbing productive activities (low skill) are creating decent jobs or is it only in the private non-tradable sector that decent work can be obtained, needs to be clarified explicitly so that the implementation of policies are not misguided.

Finally, in order to ensure that the limited government capacities are overcome there needs to be a greater role played by business. This is due to the fact that where government does not have the capacity to identify constraints and opportunities for various sectors then business can play a leading role in assisting in the identification and policy design to deal with these. The institutional framework by which the microeconomic development strategy (MEDS) in the Western Cape ensures strategic collaboration between business and government is known as the programme of Special Purpose Vehicles (SPVs). According to Kaplan (2007: 107), the SPVs are represented by business stakeholders (members of a board) who govern the activities undertaken by the SPVs. There is also representation on the boards from the provincial, labour and academia arena. Most of the funding for the SPVs comes from government, however most SPVs raise funds from within their membership. The main aim of SPVs is to act as a sector or sub-sector development agency and encourage and facilitate collaboration between firms who fall within the same sector. Another objective of SPVs is to ensure that there is discussion between business and government on how government can support the development of particular sectors or sub-sectors. In this way government has access to information that it otherwise would not have had and can now make informed decisions when designing and implementing industrial policy to address opportunities and constraints facing different sectors. SPVs also allow for feedback mechanisms between firms and also between business and government, as well as structured monitoring and evaluation of industrial policies and programmes, which will ensure that capacities are enhanced and developed. It is therefore recommended that national government implement a programme of SPVs similar to that implemented by the microeconomic development strategy in the Western Cape.

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