South Africa's economic recovery plans: What are the missing pieces for a sustainable and inclusive drive towards industrialisation?

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Introduction

The impact of the COVID-19 pandemic on South Africa's economy has been severe and has exacerbated a number of pervasive and long-standing problems. The economy suffered a significant contraction as economic activity decreased by 7% in 2020 compared to 2019 while the unemployment rate increased to 32,5% by the end of the fourth quarter of 2020. This downward trend in performance is concerning and is largely due to the negative effects of the pandemic; however, it is important to highlight that, pre-pandemic, the economy was facing many challenges that have affected industrialisation and growth.

The Centre for Competition, Regulation, and Economic Development (CCRED) has, through its Industrial Development Think Tank research, identified some of these challenges in the economy. These include the presence of significant barriers to entry; premature deindustrialisation; lack of meaningful participation; poor support to small and medium enterprises (SMEs); and limited collaboration for export diversification and the development of capabilities. All of these combined with the existence of weak industrial linkages made the South African economy vulnerable to supply and demand shocks brought on by the COVID-19 pandemic. In other words, perhaps we should not be surprised by the outcomes.

As part of the response to the on-going economic and social challenges exacerbated by the COVID-19 pandemic, policymakers, political parties and other stakeholder groups including business released various proposals for economic recovery. These plans propose a range of interventions aimed at stimulating the economy and promoting increased investment and business.[3] But in their current state, the respective recovery plans are all missing key pieces of the puzzle necessary to properly transform the South African economy and set it on a more

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[2] The Industrial Development Think Tank (IDTT) is supported by the Department of Trade, Industry and Competition (the dtic) and is housed in the CCRED in partnership with the SARChI Chair in Industrial Development at the University of Johannesburg.
[3] The South Africa government has released its "Economic Reconstruction and Recovery Plan", which followed the publication of both the African National Congress (ANC) and Business for South Africa (B4SA) recovery plans.

sustainable and inclusive development path. This brief instead suggests that South Africa's economic recovery should focus on a few core tenets that are anchored on an industrialisation-focused agenda with an emphasis on sustainability, resilience, and effective inclusion in the economy while integrating and expanding into both regional and global value chains. This is essential in order to set the economy on a strong path towards growth, sustainable development, and inclusion.

Industrial policy hasn't won: A review of South Africa's economic recovery plans

Since the publishing of the *National Industrial Policy Framework in 2007* and the subsequent *National Development Plan 2030* in 2011, South Africa has been on a drive towards becoming the industrial powerhouse of the African continent. The subsequent iterations of the Industrial Policy Action Plan (IPAP) have focused on providing targeted support to high-value addition sectors with strong backward and forward linkages into the rest of the economy. However, the lack of an overarching industrial policy in South Africa in the 1990s and early 2000s, and poor coordination between government departments has undermined various industrial policy interventions and limited their economic impact. For example, the auto sector has been highly incentivised under successive industrial policies (see the Industrial Policy Action Plan) but there has not been a clear, central industrial policy thrust. The policies have tended to target too many economic sectors, neglecting the prevailing economic context in which there are serious fiscal constraints.

South Africa's recovery plans: More of the same?

In July 2020, Business for South Africa (B4SA)[4] and the African National Congress (ANC)[5] released economic recovery plans. These kick-started discussions around what shape South Africa's economic reconstruction and recovery strategy plan could take. This culminated in the South African Economic Reconstruction and Recovery Plan that was released in October 2020.[6] Since this government plan was informed by the two earlier recovery plans (B4SA and ANC), it is important to look carefully at the starting points of both business and the ANC. This allows one to assess more critically where the cracks lie. For instance, if the fundamental starting points of the parties are so vastly apart this can have a problem in reconciling these interests towards a productive developmental coalition.

While the recovery plans do speak to a wide array of issues in the South African economy, there are crucial missing pieces. There appears to be a divergence of views between the ANC and B4SA about their vision for the economy. We argue that their policies are a missed opportunity to achieve proper structural transformation, longer-term economic dynamism and inclusion. While the recovery plans emphasise the need to create a sustainable and resilient economy, in their current form, they lack crucial detail on how to achieve their targets and are vague on subsector-

[4] B4SA, 2020. *Post COVID-19. A New Inclusive Economic Future for South Africa. Delivering an Accelerated Economic Recovery Strategy,* s.l.: Business for SA.
[5] African National Congress,2020. Economic Reconstruction, Growth, and Transformation.
[6] The South African Economic Reconstruction and Recovery plan. https://www.gov.za/sites/default/files/gcis_document/202010/south-african-economic-reconstruction-and-recovery-plan.pdf

specific solutions to existing challenges that continue to hinder progress towards the objectives of the National Development Plan.

Table 1: ANC, B4SA and South Africa recovery plan policy focus

Policy Actions and Levers	ANC	B4SA	South Africa government recovery plan
Sources of funding			
Development Finance Institutions	✓	✓	
Utilisation or attracting of savings in social protection and retirement schemes more effectively, to finance infrastructure	✓	✓	
Sovereign wealth funds	✓	✓	
Infrastructure-related interventions			
Accelerate the completion of rail networks, transport infrastructure, ports, and transport corridors	✓	✓	✓
Electricity reforms (competitive supply)	✓	✓	✓
Manufacturing-related interventions			
Targeting high-value sectors with an import replacement focus (local content)	✓	✓	✓
Promotion and achievement of competitiveness through strategic value chains	✓	✓	✓
Social policies			
Promote objectives of Broad-based Black Economic Empowerment	✓	✓	✓
Protection of low-income workers, the unemployed and vulnerable groups	✓		✓
Regional market			
Strengthen regional market trade corridors and multifaceted partnerships with the rest of Africa	✓	✓	✓
Modernisation and skills development			
Support investments in ICT and digitalisation in manufacturing	✓		✓

Source: Authors, drawing from B4SA (2020), ANC (2020), and South African Government (2020)

The recovery plans broadly agree on the approaches for building an inclusive and equitable economy. For example, the recovery plans each called for increased infrastructure investment to drive the economic recovery; an emphasis on large-scale network projects such as energy, rail, and other transport corridors; investments in green infrastructure and technologies; and other high-level macroeconomic and structural reforms. In terms of the respective manufacturing-related interventions, the plans emphasise import replacement and targeting the continued development of high-value sectors. However, questions should be raised about whether these calls for localisation and other manufacturing-related interventions dovetail with the National Priority Sector Masterplan process that aims to develop sectoral action plans focusing on engagements with all stakeholders, and mechanisms to promote growth in the identified sectors of the economy. Masterplan processes, as evidenced in Thailand, are vital ways to build industrial coalitions that can result in strong developmental outcomes.

There are fundamental differences between the B4SA and ANC recovery plans. For example, B4SA's recovery plan is hinged on getting the economy to grow which in turn leads to more jobs with inclusion as a more secondary objective. In contrast, the ANC is eyeing an ambitious agenda aimed at resetting the structure of the economy by having interventions in many areas that are simultaneously inclusive, and growth-enhancing. However, questions must be asked if this is too wide in terms of scope to achieve any success. Indeed, effective industrial policies, for example, tend to focus on a narrow set of objectives with defined periods for action.

The plans also differ in areas such as on how to improve competitiveness in strategic value chains, and promoting policies that will realise extensive structural transformation and greater inclusion and participation in the economy. The differences and lack of detail pose a serious challenge to efforts to achieve an inclusive and transformative industrial policy agenda. How then do we correct this and chart a path to an economy that is fit for the 21st century? That is, an economy that embraces a new era of manufacturing and industrialisation while working to address the broader social and economic challenges to ensure the transition into a resilient, sustainable, and inclusive economy.

Prioritising structural transformation and developing medium and long-term dynamism

Since 1994, South Africa's economy has remained geared towards a few upstream sectors, and the country has not been able to achieve structural transformation. The country's exports are still dominated by primary and intermediate products such as minerals. Achieving structural transformation on the scale required to bring about meaningful economic and social change, necessitates a shift away from the resource-based, low value-adding activities towards more productive, high value-adding, and complex sectors. In this regard, manufacturing is crucial givens its strong association with sophisticated activities such as design, engineering services, as well as being a catalyst for technological and skills upgrading, including in labour-absorbing sectors.

For South Africa to achieve the type of structural transformation that will be instrumental in developing medium and long-term dynamism, priority needs to be on building an economy that is more competitive and sustainable. Investing in innovation and high value-adding manufacturing industries can lead to better jobs with higher wages and strong linkages throughout the economy. Building these industry linkages is essential for economic development. Along with this, the process of embracing and adapting to the latest technologies requires an environment that is focused on learning and investing in capabilities development and upgrading. The process of upgrading capabilities can be spearheaded through innovation by developing new and improved products and processes. Technological changes can also facilitate growth in the quality of output in different sectors through spillovers. Therefore, the accumulation of capabilities and technological change must be a core focus of South Africa's structural transformation endeavours.

An example from the agriculture sector showed gains from the application of industrial processes to move production to higher-value agricultural products such as apples and pears, berries, avocados, as well as stone fruit. This also helps to build new capabilities in processing and enables compliance to protocols and requirements in desirable international markets. Transformations of this type have already helped South African farmers by creating new jobs and facilitated the incorporation of smaller producers into global value chains and in the process improved their capabilities to deliver fresh goods to supermarket shelves around the world. Empirical research shows that if South Africa was to pursue the expansion of its export markets through the development and support of small and medium-sized growers, the fruit industry could create an additional 100 000 jobs by 2023. Selecting winning subsectors like this is key to the accomplishment of South Africa's goals of structurally transforming its economy.

Additionally, other important subsectors like plastics manufacturing, that have essentially been killed off by high upstream inputs prices, have significant latent potential which is largely not being considered. Plastic products are intermediate products into a number of industries with linkages that are a critical part of wider manufacturing capabilities. Because of this, the plastics sector has the capacity to help diversify the weak product space through migration of capabilities, and to create employment in a number of related industries.[7] Plastics is just one example of a sector with strong backward and forward linkages in the economy. Unlocking this potential, however, would require a number of decisive interventions including, but not limited to, a review of upstream pricing by Sasol, a partner of B4SA on COVID-19 initiatives. Interventions of this kind are vital if South Africa is to succeed in its plan to become a manufacturing hub for the African continent.

Inclusion, meaningful participation, and effective competition

The creation and nurturing of opportunities, jobs, and livelihoods in concentrated sectors must be a top priority of any economy faced with the threat of the unravelling and fragmentation of its social fabric. Currently, the South African economy is skewed towards the interests of incumbent firms and business interests that has come at the expense of social and economic development. Strategic behaviour by firms whether individually or collectively can reduce competition which can work against the goals of transformation, diversification, and the promotion of SMEs. Therefore, it is very important to identify practical steps that can be taken to ensure local businesses can compete through continued enforcement by the competition authorities, along with active ex-ante economic regulation in lowering barriers to entry in the economy.

In the same vein, to allow for inclusion and meaningful participation in the economy, South Africa must deal with concentration issues by promoting effective rivalry. Rivalry is crucial in fostering economic dynamism which could increase productivity and innovation in new products and business models, and spur incumbents to invest in improving their own offerings. That is, the issue of reducing barriers to entry is not only about fairness and inclusion, it is a long-term economic priority. To achieve this there is a need for a broader competition policy that is aligned to the aspirations of the industrial policy targets such as promoting dynamism, inclusion, and sustainable industrial development.

Yet, evidence from the milling, poultry and dairy value chains indicates that facilitating new entry requires an understanding of the entire value chain and the challenges that may arise from relying on larger competitors for access to key inputs, as well as the costs associated with accessing formal retail markets. An additional challenge, often experienced by fledgling black-owned businesses and SMEs generally, has been obtaining finance from both private and government sources. This drastically impacts on their ability to accumulate key capabilities. Furthermore, there is also a need for patient capital, rather than the crippling rescue loans that have been offered in

[7] The plastics industry has a strong multiplier effect of 3.7% for every job created and 3.5% for every Rand invested in growing the industry (Plastic & Chemical Trading, 2020)

the pandemic period. How you fund firms matters – patient capital gives challenger firms enough time to establish their customer base and build a brand and market presence.

Lastly, incentive programmes offered by government to larger firms should include conditionalities to ensure that there are wider benefits to the economy such as reducing consumer prices, reinvestments in localised capacity, and driving inclusion within organisations. Importantly, care needs to be taken to avoid (further) entrenching firm dominance through government support. These conditionalities should also be linked with firm performance, innovation, inclusivity, and productivity targets with clear, transparent milestones for major firms. Importantly, effective inclusion requires a coordinated and enabling policy and institutional environment where all spheres of government, as well as lead firms in the economy, are driving a common agenda. The fact that major firms were able to come together to ensure 30-day payment of SMEs suggests that even more can be done, and that recovery is not only about what the state can do.

The need for enabling and coordinated policies and institutions

Institutions are key components in any economy's success or failure. In the absence of an effective and coordinated policy and institutional space, South Africa's structural transformation project will surely fail. This will only serve to worsen the economic situation. Successful structural transformation requires a deliberate, enabling, and coordinated policy space across all sectors of the economy. This then requires that the state be disciplined and unwavering in its conviction for realising its policy goals.

A fragmented state is problematic and results in significant delays, inefficiencies, and very often, a complete failure of state-sponsored policies. For instance, research into South Africa's plastic auto components manufacturers emphasised the fragmentation of different government departments, a lack of coherent government policy, and institutional and association failures that have drastically impacted efforts to create a developmental coalition in the sector. In contrast, the Thai state for example, owing to its institutional discipline and efficacy, was instrumental in the tremendous growth and development of the Thai sector into a world-leading supplier of plastic automotive components. Similar issues are noted in South Africa's development finance space.

Research into the IDC's funding decisions in post-apartheid South Africa found that IDC funding has remained entrenched in capital-intensive upstream sectors. Because of this, there is currently limited concessional funding being provided to SMEs in high-value and labour-absorptive downstream sectors that are often dominated by large and lead firms. Evidence in the Black Industrialists programme indicated the key barriers to entry and challenges facing business development in South Africa range from access to capital, access to markets, achieving economies of scale, lack of coordination between government departments, to issues of skills and infrastructure. Some Black Industrialists have pointed out that state owned entities and other government agencies do not implement government policy pronouncements such as those relating to procurement. This weakens the effectiveness of adjacent policies. Therefore, any attempt by the state to create a developmental coalition requires that it adopts an enabling and coordinated policy space with the necessary institutions all working together to drive the structural transformation project. The capabilities do achieve this are present, and lessons should be drawn from the effective coordination that has surrounded the healthcare response to the pandemic as well as major projects such as the soccer world cup before that.

Rethinking the political settlement for a re-industrialisation agenda

The ANC and South African government's recovery plans call for forging a "new social pact" between government, business, and labour. This is envisaged to address South Africa's current political settlement which has largely benefited insiders in more resource-based upstream sectors, resulting in the lack of purposeful transformation; ineffective inclusion policies like BEE; and a limited and, in many cases, skewed redistribution of wealth favouring a few elites with the majority of the population suffering as a consequence. However, an evolution of a political settlement must be closely related to changes in the distribution of rents, and formal growth-enhancing institutions as well as the performance of these institutions. Yet, the ease at which evolution in the political settlement is reached depends on the original political settlement and the initial institutional space.

An effective political settlement should prioritise long-term investment in productive capacity and reward effort and creativity rather than incumbency. At present, the recovery plans do not mention any conditionalities or concessions by business to reach an effective compromise on some of the key issues highlighted in this brief. Instead, there is an underlying belief that the needs and interests of big business are more important given their control over several markets. This is evidenced by the influence of this group over the shaping of the economic recovery plan. Mushtaq Khan highlights the need for ensuring incentives are designed in such a way that all stakeholders see it in their individual interests to implement the policy. This then lessens the need for significant state capacity if business and labour take up and achieve their targets with little further intervention from the state.

South Africa's new political settlement should be structured around an industrialisation and development coalition. This must speak to, resonate with, and mobilise, among others, key constituencies, including industrial trade unions and youths. Moreover, it must prioritise effective skills upgrading, training, and productive investment in black entrepreneurs by opening up economic opportunities. Importantly too, the way government engages with large and entrenched firms needs to change with agreements around the expectations for large firms and rewarding long-term domestic fixed investment. There is a pressing need for the promotion of innovation, and dynamic competitive rivalry through effective government policies regarding infrastructure, procurement, skills development, technology, and opening regional and international markets. Changing the path for South Africa's economy requires a broad rethink rather than piecemeal initiatives, that places re-industrialisation and industrial policies at the centre of the country's development strategy.

Reimagining South Africa's economic destiny

The COVID-19 pandemic has exposed these weaknesses and vulnerabilities of the South African economy. Addressing these challenges is critical and has implications for South Africa's resilience to future shocks of this nature. These are issues that need to be addressed at the microeconomic level and require in-depth sector analysis to formulate coherent and targeted industrial policy. This brief has made the point that industrial policy also plays a vital role in increasing economic resilience and mitigating the vulnerabilities that exist in the economy. Well-designed industrial policy also plays a crucial role in bringing together stakeholders, both in the public and private sectors, to work together to realise a new economic future for the South African economy through targeted and sector-specific policies. However, industrial policy alone is ineffective without broad agreement on a number of conjunct issues.

Given the economic and socioeconomic conditions that underlie the South African economy, South Africa's agenda for re-industrialisation and inclusive growth needs to focuses on productive investment and widening economic participation. It needs to build on existing research and knowledge about how specific sectors of the economy have worked, some of which is drawn on throughout this brief. Along with this, there needs to be a coherent vision for re-industrialisation that prioritises long-term investment in productive capacity as well as rewarding innovation. This means engaging boldly and critically with big business. Progressive industrial policies are required while also ensuring there is a strong supporting institutional and policy landscape to create an inclusive, prosperous and sustainable society, including through actively undermining entrenched market positions. The adoption of such a policy agenda ultimately requires a strong, entrepreneurial and capable state to take the lead in building a developmental coalition.