

MAP TO A MILLION

Map to a Million New Jobs in a Decade

November 2017





WHO WE ARE:

The Manufacturing Circle is the voice of South African manufacturing and the platform off which manufacturers position the sector as the engine to grow the South African economy.

Established in 2008 as a corporate association of manufacturers, the Manufacturing Circle conducts research and engages with key stakeholders to promote the benefits of manufacturing growth for the economy, to influence policy and to highlight opportunities and priorities for manufacturing growth. In pursuit of these objectives, the Manufacturing Circle meets periodically with government ministers, heads of key state-owned entities, leaders of provincial and local government as well as with other business sector leaders.

We believe that in order to put South Africa on a higher job-rich growth path, to enable us to compete and succeed as a manufacturing destination in the global economy, we need to prioritise three clear goals to:

- Achieve a competitive manufacturing environment;
- Attain a supportive international trade position; and
- Advance the reputation of South African manufactured products.

We are committed to working with our policy makers and all other stakeholders to achieve these goals. For economic growth. For job creation. For the sake of a better life for all South Africans.



MAP TO A MILLION

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INTRODUCTION FROM OUR CHAIRMAN

South Africa is at a crossroads. After more than two decades of democracy and the failure of well-intentioned economic policy to lift the majority of our people out of poverty, something radical needs to be done to create jobs and grow the economy. We need to align the nation towards a common goal of creating jobs, and ensure that we don't expend our limited resources on unnecessary distractions. We need a focused war on unemployment to give those citizens still excluded from the economy the dignity and the security of a decent job.

Manufacturing, with its strong multiplier effects on value addition, job creation, export earnings and revenue generation, is the one sector in the economy that has the potential to create these jobs. But its positive contribution is under threat and declining. Since the 2008/9 financial crisis when almost 400 000 SA manufacturing jobs were lost, the industry has not been able to recover to those levels and we currently have 300 000 fewer manufacturing jobs than in 2008. Further, the contribution to GDP of the sector has declined from more than 15% in 2008/9 to just under 13% in 2017. In the early 1980s manufacturing contributed 24% to GDP. International experience shows that for SA's stage of economic development, manufacturing should contribute close to 30% of GDP, or more than double the current level. It's up to us to make it happen, and with the appropriate support framework we believe our targets are achievable.

There are many factors that have contributed to the de-industrialisation of our country. These include electricity supply constraints, rapid increases in administered prices, labour and political instability and competition from unfairly incentivised imported products. The attack on our democracy by the agents of state capture has also devastated business and consumer confidence.

While we believe in the resilience of SA's institutional and legal establishment, we cannot stand by and watch our country de-industrialise, unemployment grow and poverty deepen. Equally, SA still has a number of strong companies, many committed people and an infrastructure that if adequately enabled can drive growth, employment and equality.

In May 2017, and working in collaboration with a number of manufacturing sector associations, we launched our 'Map to a Million' new jobs initiative. Through workshops with our members and others, we identified the specific constraints that need to be addressed to incentivise investments in manufacturing and in so doing, create jobs. Trade and Industrial Policy Strategies (TIPS), a not-for-profit economic research institute, facilitated these discussions. We then embarked on a public-sector engagement process, including discussions with various ministers. We also engaged with organised labour, who expressed their support to create more jobs in manufacturing.

The launch of this document is the next step in our work. With it, we aim to inform the government's Industrial Policy Action Plan (IPAP) and encourage government, industry, labour and society at large to take the actions we have identified as being necessary to open the gates to meaningful, job-creating investment. The proposals that we make in this document are intentionally detailed and specific: for too long we have laboured under the generalities of inspiring but vague statements of noble intent, without addressing the detail. We don't intend to be unduly critical, nor do we want to be naïvely idealistic. Instead, we want to be realistic and constructive to identify real actionable steps that can create an environment in which manufacturing can thrive. In this way, together we can create at least a million new jobs in manufacturing in the next decade, and facilitate inclusive economic growth to the benefit of all.

This initiative does not intend to be exclusive or pretend to be exhaustive: we acknowledge how complex it is to agree on exactly what needs to be done to make SA work. We are also conscious that there are a number of other private sector efforts to spur economic growth. But as industry, we need to make bold choices about what we need to do to drive industrialisation and create jobs. Time is of the essence and we need to be decisive: there is no time for prevarication. We welcome much greater collaboration and conversation between all stakeholders in the months ahead.

Conscious of the responsibility of our generation to the next, we look to the future with confidence and resolve.

André de Ruyter

Chairman

Manufacturing Circle





FOREWORD BY MINISTER ROB DAVIES

Manufacturing must be at the forefront of efforts to grow the economy, create the much needed jobs in our country and support the effort of addressing inequality and transformation. As a lead sector, manufacturing contributes to job creation throughout the economy; and the efforts by the Manufacturing Circle and other industry groups to drive the creation of a million manufacturing jobs over the next decade are to be commended and supported.

There are many structural blockages to achieving faster economic growth and a robust manufacturing sector. It is through effective collaboration and communication between government, industry and workers that these blockages can be identified and where possible resolved. Some of the blockages and impediments to growth identified by the manufacturing sector have been listed in this document.

The Department of Trade and Industry supports the process to establish a structure to engage systematically and regularly with the manufacturing sector CEOs on these constraints in order to raise aggregate demand, unlock unused capacity, and ultimately expand the manufacturing sector. We will achieve this ambitious target of creating a million jobs through this collaboration and addressing the constraints in our economy, which will need to include a commitment by industry to increase the levels of investment, export growth, R&D activities, and local procurement, amongst others.

Dr Rob Davies

Minister of Trade and Industry



01 EXECUTIVE SUMMARY

South Africa's economy is in urgent need of initiatives that will create jobs and stimulate GDP growth. With unemployment at a 14-year high of 27.7%, business confidence at its lowest level in a quarter of a century, and more than half of the population living in poverty, delivering jobs and inclusive growth has to be highest priority for government, business and labour.

Our manufacturing sector has shed half a million jobs over the past two decades, and at less than 13% contributes less than half to GDP than is appropriate for SA's stage of development. If manufacturing can expand to 30% of GDP, it is estimated that between 800 000 and 1.1 million direct jobs can be created, with 5 to 8 times that number in indirect jobs. This document puts forward detailed proposals to create a roadmap to deliver a million jobs in the next decade.

The first priority is to prevent further de-industrialisation in rust belts like the Vaal Triangle, arrest further job losses and stabilise our industrial base. To increase utilisation of existing capacity, and the demand necessary to underpin new investment, additional demand for manufactured goods must be created. The Map to a Million proposes the following **demand-side interventions**:

Boost demand for goods manufactured in SA

Increase aggregate domestic demand

- A commitment by both business and government to visibly support Proudly South African, increasing the procurement of locally manufactured goods, provided their cost and quality are competitive. Retailers in particular should commit to clear labelling of products on shelf to ensure that consumers can make informed choices.
- Investigation by government of its options to invest in catalytic projects, such as a new pipeline to bring natural gas from Rovuma in Mozambique into SA, using SA steel and pipe, to lower the cost of natural gas.
- An increase in the renewables component of electricity procurement, with solar and wind generation equipment manufactured in SA.
- A reconsideration of administered prices to put more money back into the pockets of consumers. For example, fixing a maximum price for petrol (while retaining the ban on self-service) will encourage competition, lower fuel costs and could add up to R1.8 billion a year to disposable income, and reduce transport costs across value chains.

Actively pursue import substitution

- An actively pro-SA approach within WTO rules should characterise our trade policy. In particular, the International Trade Administration Commission's mandate should be altered explicitly to support SA industry. Detailed proposals to improve the efficacy of the ITAC process are contained in section 3.4 of the Map.
- Instead of reporting into the Economic Development Department, ITAC should report into dti, to align with industrial policy.
- In addition to policies currently in place, government and business should actively promote collaboration between producers across value chains to enhance in-country value addition, particularly in the agro-processing, platinum, manganese and steel value chains.



Enhance SA's export competitiveness

- Implement similar policies to SA's key competitors in manufacturing, such as India and China, in particular export incentives.
- Reduce Portnet tariffs, which are 88% higher than the world norm, which is a serious impediment to exports, and inflates import parity pricing. Improve port efficiency.
- Consider reinstating rail subsidies for containers destined for export to overcome the inland location disadvantage.
- Emulate the successful Motor Industry Development Programme for key industries, in particular secondary steel manufacturing.

Lower manufacturers' cost base to improve competitiveness

In addition to demand-boosting interventions, **supply** to the manufacturing sector should be enhanced by the following steps:

Reduce input cost for manufacturers

- Ensure effective energy price regulation of both natural gas and electricity by NERSA, failing which, the Competition Commission, to reduce energy cost and enable competitiveness.
- Regulate pricing of key inputs from sole suppliers, including monomers.
- Enable competition in electricity generation by deregulating this sector.
- Use the IDC's balance sheet to support industrialisation and lower the cost of capital to industry by liquidating long-standing investments actively to drive industrialisation, in particular black industrialists, at much bigger scale.

Fiscal policy

- The Income Tax Act already contains provisions that support manufacturing, which can be improved by loosening criteria for Section 11D (R&D) benefits, recapitalising the successful Section 12I incentive, and continuing the Section 12L incentive for energy efficiency, but with less onerous measurement and verification requirements.
- Implement the 15% tax rate allowed for in Section 12R to boost growth of existing SEZs, and also apply it to distressed industrial areas such as the Vaal Triangle to prevent further de-industrialisation.
- Allow accelerated depreciation for manufacturing, similar to the benefit extended to mining.
- Implement conditional tax holidays for investments with targets for job creation and value addition.
- Introduce recapitalisation allowances to enhance competitiveness of existing factories.
- Reconsider sugar, packaging and carbon taxes that have a negative impact on manufacturing.

Labour

- Support the dti's Intsimbi Future Production Technologies Initiative (an expansion of the successful pilot Intsimbi National Tooling Initiative Programme, which is a scalable model to resolve skills shortages).
- Implement transport subsidies to overcome spatial distortions and increase disposable income.
- Ease the work permit process for scarce foreign skills.
- Include labour in company governance structures to increase transparency and reduce adversarial labour relations.



Fix structural issues holding back growth and investment

In addition to the proposed improvements to both demand and supply, the following structural fixes will help to increase investment and job creation through manufacturing:

Reduce input cost for manufacturers

- To give priority to industrial development and job creation in a coordinated manner, a super-ministry along the lines of the Japanese MITI should be established, incorporating dti, EDD, DSBD and DPE, and aligned closely with National Treasury.
- Introduce significant private sector equity participation (in whole or in part) in SOEs, e.g. SAA, with governance to reduce waste and reduce the burden of non-functional and costly SOEs.
- Focus on education as an essential service, and promote high standards instead of high pass rates.
- Rescind and renegotiate the Mining Charter, as the Charter is detrimental to investor confidence across sectors, and has already reduced demand for manufactured goods.
- Greater policy certainty and reduced currency volatility will free up balance sheet capacity as fewer 'shock absorbers' will be required for foreign loan covenants.
- Support municipalities with the capacity to deliver and maintain infrastructure, as these are in the first line of service delivery.
- To mitigate the systemic risk of an Eskom default and avoid unaffordable tariff increases, split Eskom into independent generation, procurement and transmission entities, introduce private sector equity partners and enable the creation of a home-grown renewables sector instead of unaffordable nuclear energy.
- Abolish the costly and ineffective SETA system and rather give direct tax credits for training.
- Rethink concurrent jurisdiction to give the Competition Commission more power where regulators such as NERSA fail to regulate monopolies appropriately.

Manufacturing Working Group to drive Map to a Million

None of these interventions on its own will be enough to create economic growth and job creation through manufacturing. The Manufacturing Circle therefore proposes that a Manufacturing Working Group between business, labour and government be established under the leadership of the President or the Deputy President to coordinate the implementation of the Map to a Million.



The role of business

The Map to a Million proposals may seem disproportionately weighed towards government interventions, with little in the way of a *quid pro quo* by business. Given significant underutilised capacity, the first effect of the interventions will be to slow down the rate of job losses and de-industrialisation, before real growth is observed, and new jobs are created. In this ramp-up period, little new investment can be expected. It is only new demand that will create new factories and new jobs, and it is only through the more competitive supply of input costs, better skills and more coordinated policy interventions that manufacturing in turn can be competitive.

The Map to a Million strives to create structural conditions in the economy that are conducive to investment. For any actor in the private sector to expose assets to risk, as is inevitable when investing, there must be a reasonable prospect of achieving success. Thus, for business to play its part in response to recommended government actions, it is necessary for government to take the first step and create the conditions that will allow business to actively collaborate with government to create inclusive, tangible economic growth.

SA has fallen into a vicious cycle of de-industrialisation and spiralling unemployment rates, even when the balance sheet reflects the capacity to invest. To escape the trap of jobless stagflation, government must actively intervene for there to be any hope of establishing a virtuous cycle of inclusive growth. It is critically important that such action is taken now. SA is facing tough competition, contending with other nations on the continent in a way that it never has before, with lucrative and attractive investment incentives offered by countries with comparable risk profiles and higher growth rates. SA can no longer rely on being the default entry point for foreign investment into the African continent. Now, more than ever, there is a unique opportunity to secure significant economic transformation.



MAP TO A MILLION



02 OUR CONTEXT: SOUTH AFRICAN MANUFACTURING

2.1 UNDERSTANDING THE ROLE OF HISTORY

The history of SA's economy is well known, with mining at the heart of its development. The Gold Rush of the 1880s established Johannesburg as the centre of economic activity and transformed the economy into one dominated by mining and mineral processing. A strong manufacturing base then developed inland around the goldfields to support the mining industry.

World War II and the resulting global shortages saw the government supporting local industrial development and establishing institutions such as the Industrial Development Corporation to provide industry support.

The post-war apartheid state was able to draw on mineral rents and use the levers of the state to embark on massively ambitious projects in the energy and chemical sector, which saw the establishment and growth of Sasol and Mossgas (later PetroSA) as well as significant investment in electricity generation. The latter was necessary to unlock the vast mineral resources deep underground, support the energy-intensive synfuels process, and allowed significant capacity to be developed in processing minerals into steel and later aluminium.

Under apartheid, a siege economy with deep structural fault lines was established: one of government controls and tariff walls. Energy-intensive industry developed around the mining sector, using a system of cheap and unskilled race-based labour. Downstream manufacturing was not given priority, and although certain key capabilities developed in some sectors, generally the manufacturing base was uncompetitive, having not been exposed sufficiently to competition given SA's pariah status.

The isolation under apartheid and the need to replicate the lifestyle of the developed world for the white population saw unusual industrial patterns emerge in SA – for example multiple models of motor vehicles with small batch runs of each make. This pattern of small, usually uncompetitive, batch runs of multiple product lines was prevalent across many industries during the apartheid period.

Sanctions and the apartheid government's focus on defence spending created a manufacturing industry in pursuit of autarky. This, and the perverse protections perpetuated by sanctions, resulted in manufacturing's contribution to GDP peaking in the last decade of apartheid. The reforms adopted by the new government in the first decade of democracy then exposed industry to an intensity of competition which required a shift in its approach and for which many sectors were not ready. This coincided with the rise of manufacturing in China. As a result, SA manufacturing struggled, failing to achieve its potential.

The legacy of the past continues to plague the sector: suppliers of major inputs to industry including utilities are still dominated by large companies and inefficient state-owned enterprises, undermining competition. This, together with the recent approach of cost-reflective tariffs for utilities as well as uneven application of regulation, has led to high and escalating input costs, among them for steel, polymers, natural gas and electricity. The inland manufacturing base is an anomaly and a structural disadvantage for tapping into the export market: industry in most other parts of the world is concentrated at the coast, with the obvious benefits of easier access to export harbours, in turn facilitating trade. In SA, much of the output of manufacturing has to be transported at least 600 km to reach a seaport before it can be exported. Equally, the country's reliance on coal for the bulk of its electricity generation for energy-intensive users rather than renewable resources places a high burden on the environment.

Manufacturing is also still tied to the mining industry, depending to a large extent on the health of this sector for its own wellbeing. The impact then of the precipitous decline in the mining sector's contribution to GDP from above 20% in 1980 to 8% in 2016 is clear, alongside a global sourcing strategy by mining conglomerates as they became global players post 1994; as is the uncertainty created by the modern-day Mining Charter. The failure of the Charter to bring much-needed policy and regulatory certainty to the industry has had wide ramifications across the economy – it has dragged down business confidence and its negative impact has been felt across all sectors, including manufacturing.



Where we are today

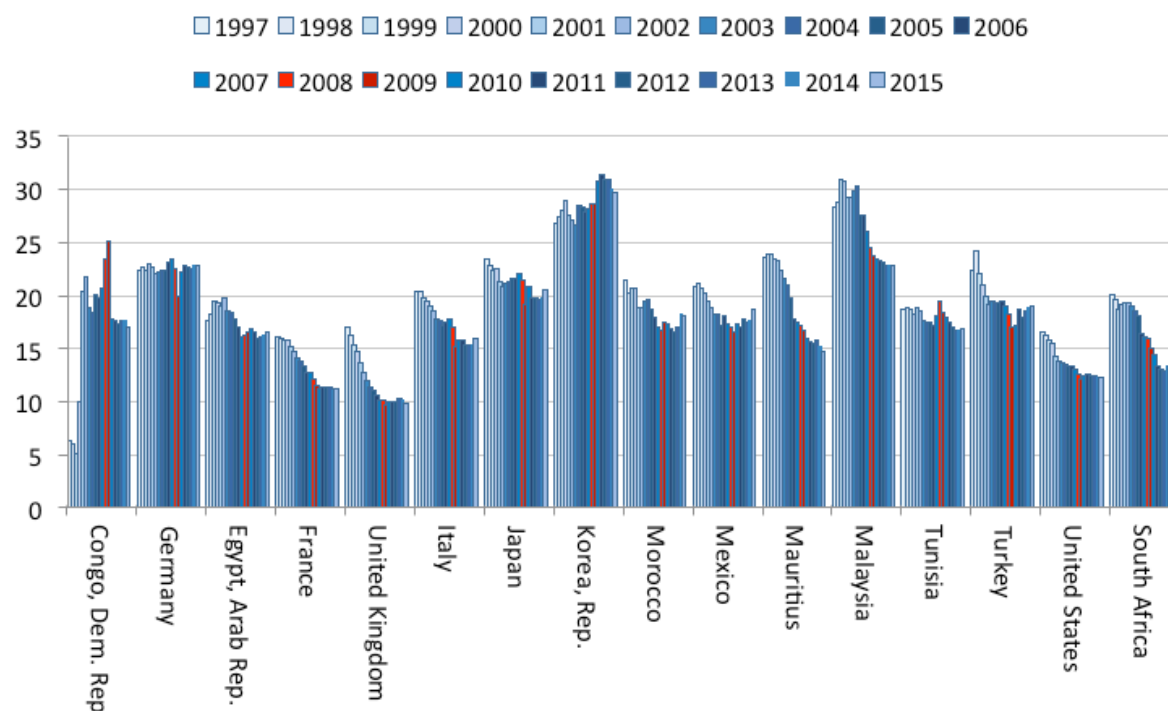
The many benefits of manufacturing to economic development, job creation and prosperity are widely accepted. In SA, it is a driver of tertiary education, and helps absorb people into the decent work the country has undertaken to promote as a key component of its national development¹.

Manufacturing also provides the base load and scale for key national infrastructure utilities such as electricity, rail and municipal services. Indeed, manufacturing possesses important multiplier effects in terms of value addition to the economy, job creation, export earnings, and tax-revenue generation. Moreover, the sector provides the scope to develop world-class mining equipment and capabilities, as well as the best means of processing SA's own natural resources and driving innovative activity².

Manufacturing's contribution to GDP has fallen from 24% in the early 1980s to less than 13% in 2017. Although there has been a general trend in global manufacturing toward declining contributions to GDP particularly as a result of the rise in financial services, SA manufacturing has fallen to the levels of the developed economies. This decline is out of keeping with its stage of economic development as successful services-based economies require a level of economic development that is first developed in manufacturing. This trend threatens prospects for continued economic upliftment, transformation and growth.

Moreover, this trend, although worsened by the global economic doldrums of the past eight years, reflects a more worrying decline in manufacturing capacity in the country. Indeed, SA manufacturing performance is lagging when compared to countries such as Malaysia, South Korea, and even the DRC. For its stage of economic development, SA manufacturing should be contributing at least 50% more to GDP than it currently does.

Manufacturing Value Added Share of GDP: Benchmarking South Africa

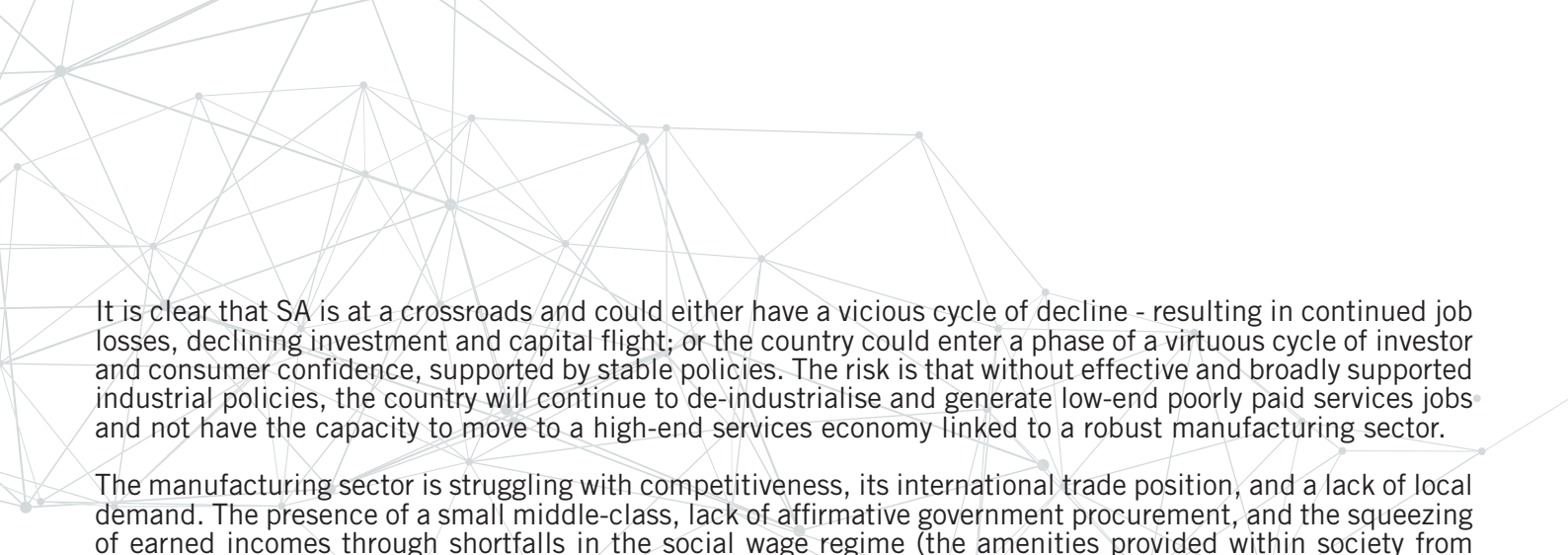


Source: (World Bank, 2017) Calculated from Electronic Database in July 2017.

¹Decent work and inclusive growth are among the goals of the United Nations' 2030 Sustainable Development Agenda and South Africa's own National Development Plan.

²Source: The World Bank





It is clear that SA is at a crossroads and could either have a vicious cycle of decline - resulting in continued job losses, declining investment and capital flight; or the country could enter a phase of a virtuous cycle of investor and consumer confidence, supported by stable policies. The risk is that without effective and broadly supported industrial policies, the country will continue to de-industrialise and generate low-end poorly paid services jobs and not have the capacity to move to a high-end services economy linked to a robust manufacturing sector.

The manufacturing sector is struggling with competitiveness, its international trade position, and a lack of local demand. The presence of a small middle-class, lack of affirmative government procurement, and the squeezing of earned incomes through shortfalls in the social wage regime (the amenities provided within society from public funds), reduce local demand. Many manufactures face concerns relating to the availability of technical and industry-specific skills, slow productivity growth, high input costs, the variable local availability of certain inputs, lack of investment, high electricity costs, poor infrastructure, and heavy regulatory burdens. These all reduce the competitiveness of many firms in the sector. Furthermore, the presence of cheaper substitutes from Europe and East Asia, overly liberalised trade terms and the volatile rand, place pressure on achieving a strong international trade position. Wild swings in the rand sparked by unpredictable government decisions mean that manufacturers have to build 'shock absorbers' into their balance sheets. They need to hold larger cash balances or inventory stocks to protect them against dramatic changes in the value of the currency.

It is clear from the many challenges that manufacturers face that without a virtuous cycle of investor and consumer confidence, supported by stable policies, SA will continue to de-industrialise, without the capacity to move to a services economy.

2.2 THE POTENTIAL OF SA MANUFACTURING

Creating additional demand for local goods is the key to a virtuous cycle that promotes economic growth. This includes stimulating local demand through state preferential procurement policies, protecting local industries through more assertive trade policies and the private sector supporting local industry in its own procurement practices. While domestic demand is not sufficient to sustain industry, it is a good base from which to build a dynamic export industry. Stimulating domestic demand will boost investor confidence, particularly when coupled with policy certainty, supportive regulation and competitive incentives, but to be effective would need to be accompanied by appropriate supply-side policies that build the skills base and support technological upgrading.

According to the Stats SA Quarterly Labour Force Survey, the manufacturing sector employed 1.8 million people in the second quarter of 2017 and was able to grow by 90 000 people when compared to the second quarter of 2016. Manufacturing makes up 12% of the country's 16.1 million total jobs, or 39% of the 4.6 million jobs in the real economy (being manufacturing, agriculture, utilities, mining and construction). Manufacturing has the highest job multiplier of any sector and an additional million jobs would result in significant growth across the economy, including the services sector.

In order to achieve an additional one million direct jobs in manufacturing over a 10-year period, an annual compounded growth rate of 4% on the existing number of 1.8 million jobs is required. This means that we should aim to create 72 000 jobs in year one – a target which we have already exceeded in 2017. However, to sustain the momentum of job creation for a decade to create a million jobs, we need policies that are stable and predictable, we need regulation that supports manufacturing, and we need to enable investment in new factories to create new jobs.

Given the current moribund local and global economy, achieving the million job target requires intervention by all social actors, and it will not be achieved without a shift in approach by all players and concerted effort to take a different path. In this document, we propose a map for this different path. Without the required step change in direction it will take almost a decade of growth at the current 2% rate merely to get to the employment levels before the financial crisis. The current levels of manufacturing employment or pedestrian levels of growth will not sufficiently address the social and political imperatives of job creation and economic transformation. The creation of a million jobs in manufacturing is our equivalent of an Apollo project. The difference is that it will not cost billions, but will rather create billions of rands of new revenue and wealth for SA and its people. The numbers are not overly demanding, and the multiplier effect renders the size of the prize highly desirable: decent work for a million South Africans should surely rate as one of the highest, if not the highest, priority for public policy.



03 WHAT NEEDS TO BE DONE

3.1 A COORDINATED APPROACH

SA's National Development Plan (NDP) seeks to create 11 million new jobs between 2012 and 2030, to bring down the unemployment rate to 6%. To achieve this target, 600 000 jobs must be created annually.

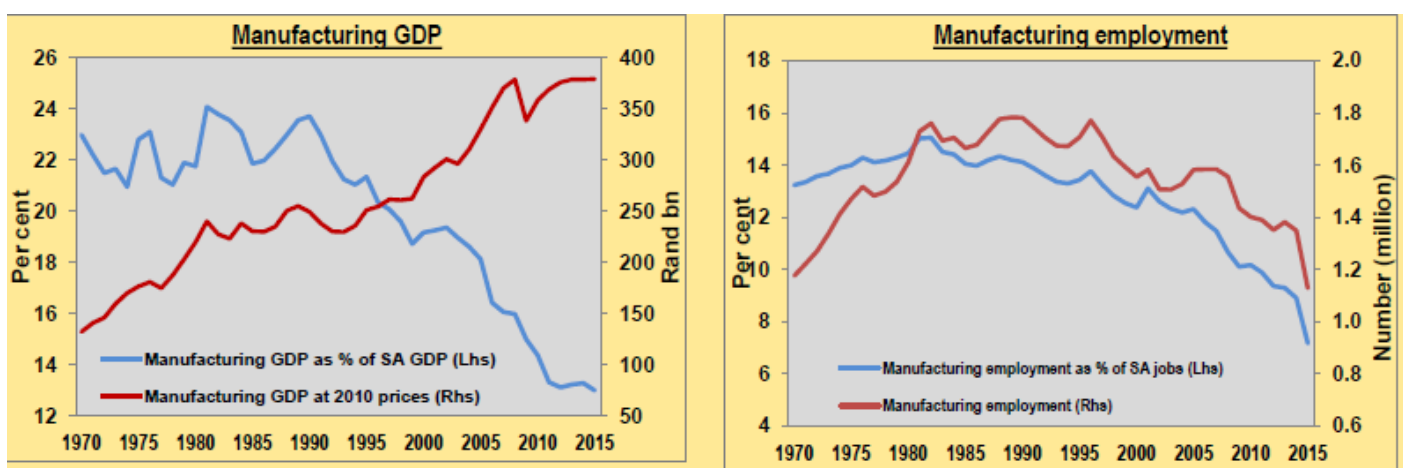
The National Industrial Policy Framework (NIPF) spells out the levers of the state to drive industrial development. It sets out a number of areas that require effort, including amongst other things sector strategies, industrial finance, trade policy, skills for industrialisation, leveraging public expenditure and industrial upgrading. The NIPF also is explicit in the need to address empowerment, transformation and support to the small business sector.

The Nine Point Plan, announced in 2015 as a means to galvanise the economy, has prioritised these issues with outcome 4 of the plan being "More effective implementation of a higher impact industrial policy action plan; and outcome 5 "Encouraging private sector investment".

The Industrial Policy Action Plan (IPAP) prioritises the manufacturing sector as a catalyst for creating inclusive growth and jobs. This is in recognition of the sector's high economic multipliers because of its value addition, linkages to the upstream production sectors of the economy such as mining and agriculture and the downstream sectors, including services.

IPAP provides the action steps that are required by the state to achieve these industrial development goals. However, despite industrial policy initiatives, unemployment continues its inexorable rise, and reached 27.7% during the second quarter of 2017, the highest in fourteen years. This shows that the SA economy is failing to create employment in line with the NDP policy objective.

In recent years, the manufacturing sector has continued to shed its share of GDP, while losing job opportunities at an alarming rate. According to the World Bank³, manufacturing has by far the largest indirect job creation component. For every job that is directly created in manufacturing sector, another 3.8 jobs are indirectly created, bringing down the fiscal cost of creating a job by 21%. Some economists calculate the indirect job multiplier to be as high as 5 – 8, making manufacturing by far the most attractive sector for job creation. It follows then that if the SA economy has a greater share of GDP from manufacturing, not only will more jobs be created in manufacturing but also in other upstream and downstream sectors.



Source: IPAP 2016/17 – 2017/18

³ World Bank – South African Economic Update: Focus on Private Investment for Job Creation





In order to accomplish the goal of growing the manufacturing sector and creating jobs, there must be a comprehensive and well-coordinated approach by government to bolster the industrial base in every aspect of its efforts. It must create an environment that unlocks private sector investment. It must introduce measures that address systemic challenges around the quality and price of infrastructure, education and training, industrial finance and market structures, as well as regulatory blockages. Such efforts would require the reciprocal commitment by the private sector to invest in the productive sectors of the economy.

However, given significant underutilised manufacturing capacity, the first effect of the policy interventions the Manufacturing Circle proposes will be to slow down the rate of job losses and de-industrialisation, before real growth is observed, and new jobs are created. In this ramp-up period, little new investment can be expected. It is only new demand that will create new factories and new jobs, and it is only through the more competitive supply of input costs, better skills and more coordinated policy interventions that manufacturing in turn can be competitive.

For any actor in the private sector to expose assets to risk, as is inevitable when investing, there must be a reasonable prospect of achieving success. Thus, for business to reciprocate government action, it is necessary for government to take the first step and create the conditions that will allow business to actively collaborate with government to create inclusive, tangible economic growth.

SA has fallen into a vicious cycle of de-industrialisation and spiralling unemployment rates, even when the balance sheet reflects the capacity to invest. To escape the trap of jobless growth, government must actively intervene for there to be any hope of establishing a virtuous cycle of inclusive growth. Harvard economist Dani Rodrik states: “Premature de-industrialisation has serious consequences...It reduces the economic growth potential and the possibilities for convergence with income levels of the advanced economies. De-industrialisation removes the main channel through which rapid growth has taken place in the past.” If we do not intervene soon, more factories will close, and more people will be out of a job.

There has to be a direct correlation between the industrial policies adopted by government and the resultant fiscal and trade policies implemented to achieve such objectives. In order to grow the manufacturing sector and create employment, the policy and regulatory environment, the education and tax system and the approach to infrastructure development cannot be divorced from the broader fiscal and macro-economic policy.

3.2 INDUSTRIAL POLICY

History has shown us that the most successful nations in terms of economic growth and development are those countries that have pro-actively supported and contributed to growing the industrial base of their economies. Even today, many of those developed economies that are thriving have strong industrial sectors. Indeed, the developing countries that have shown dramatic growth over the past few decades have been those that focused on building their industrial base – highlighting the link between growth in manufacturing output and growth in GDP.

The strategies adopted by these countries to attract, develop, support and grow the manufacturing sector form the basis for industrial policy and are key in support of economic development, including job creation.

SA, like its peer upper-middle-income economies in Central and Eastern Europe as well as Latin America (and excluding China), is facing the constant threat of a declining contribution of manufacturing to the economy. This challenge is further compounded by the negative impact of the commodity bust from 2011. Before this, the SA mining sector was a major contributor to demand for manufactured goods as well as providing significant resources to the economy as a whole, a decline accelerated by the unilateral imposition of the Mining Charter. Data show that the economy has never really regained its growth momentum since the Great Recession of 2008, unlike economies such as the US and Europe where aggressive pro-growth policies have revitalised economic activity and reduced unemployment.



Other key issues facing the SA economy include the following:

- A protracted period of slow growth, with the economy now regularly dipping into quarters of contracting economic activity. It has been on a downward trajectory since 2011, coinciding with the end of the commodity boom and tracking growth trends across the developing world excluding China. That said, key sectors of our economy such as agro-processing and automotives have shown remarkable resilience despite the moribund picture at home and abroad. However, at 22% contribution to GDP, the growth and employment prospects for financial services must surely be close to a ceiling.
- The decline in the rate of investment by both the private sector and state-owned companies. The rate of investment has dropped from a high of 23.5% of GDP in 2008 before the global financial crisis and the first domestic electricity crisis to below 20% in the last quarter of 2016⁴. Gross private-sector capital formation is lower than in other emerging economies, with at least 25% required to achieve the levels of growth required.
- Deep inequalities in terms of incomes, ownership and access to education and employment mean that economic policy tends to be contested and often poorly aligned. In a democracy, it is important that industrial policy visibly benefit the majority of voters as well as promote sustainable growth.

The measures adopted by the state, industry and workers to support industrial development and the effective implementation of those measures are therefore critical to the country and our economic development trajectory. SA is fortunate to have a National Industrial Policy Framework and regular iterations of the Industrial Policy Action Plan (IPAP) to drive our industrialisation ambitions, however, government has acknowledged the sub-optimal impact of its industrial policy path to date.

What is required for industrial policy to succeed


For industrial policy to be successful, it requires ongoing meaningful and decisive collaboration between industry, government and workers with a view to:

- Driving high rates of investment in productive capacity, including through re-investment of profits as well as the use of industrial finance and incentives.
- Supporting and enhancing the growth of domestic industry, particularly in countering dumped or subsidised imports that damage our own industry.
- Improving the use of and availability of technology as well as support for innovation.
- Supporting the development of skills that are relevant for the economy.
- Increasing the use of state resources to support market demand, particularly through the procurement of local content products.
- Increasing the disposable incomes of consumers through improved support for the social wage, including more effective public transport, health and education. In addition, deregulation of the price of petrol by imposing a maximum pump price, while maintaining the ban on self-service, is estimated to put back between R1.8 billion and R2.0 billion into the pockets of consumers, with no adverse impact on the fiscus.
- Contributing to expanding and developing new market opportunities.

Given the global conditions and international agreements, SA needs to take a speedy, decisive and strategic approach to how it takes forward its industrial policy.

⁴ TIPS Real Economy Bulletin, Q2 2017





One of the major problems bedevilling an effective industrial policy in SA is the plethora of government departments responsible for the economy. The Department of Trade and Industry, the Economic Development Department, the Department of Small Business Development and the Department of Public Enterprises all to a greater or lesser extent are tasked with a developmental agenda to deliver economic growth. As illustrated elsewhere in this document, National Treasury plays a difficult balancing act between budget allocations and revenue collection, sometimes to the detriment of industry. Against this backdrop, it is not surprising that industrial policy has not been able to deliver on its promise.

Chalmers Johnston, in his seminal book “MITI and the Japanese Miracle”, credits the Ministry of International Trade and Industry with delivering successive decades of superlative economic growth to the Japanese economy, until the Bubble Economy and demographics caught up with growth. The single-minded focus of MITI to grow Japanese industry enabled a country with virtually zero natural resources to rise from the ashes of World War II to become the world’s second-biggest economy, until it was overtaken by China. MITI illustrates the importance of focus and coordination in industrial policy. Incentives conceived in a vacuum, or administered by entities not interested in economic growth, are often ineffective, with the blame laid at the door of industry for not investing. By emulating the example of Japan, which created MITI in 1949, this super-ministry would be focused on building the industrial base, creating jobs, integrating conflicting policies and strengthening export competitiveness.

The Manufacturing Circle recommends that there will be great value in amalgamating the ministries responsible for economic growth into a SA MITI equivalent to drive industrialisation and job creation. Strong linkages should be established into other departments, in particular National Treasury, but also into Basic Education, Higher Education, Home Affairs (visas), Department of Agriculture, Forestry and Fisheries (phytosanitary regulations) and Department of Environment (EIA approvals, environmental taxes and levies). By coordinating government efforts, it will create an environment that would unlock private sector investment; promote job creation and address systemic challenges around the quality and price of infrastructure, education and training, industrial finance and market structures, as well as regulatory blockages.

It is imperative that this super-ministry be independent. It should be run by a body of highly competent administrators who are insulated from influence from both business and government. Elevating such a ministry into the Presidency, as some have suggested, would be unwise: it would create the potential for undue influence and political interference. An additional benefit of the creation of this super-ministry would be a reduction in the number of government ministries, significantly reducing the cost burden on the economy.

Another key area for clarification in the industrial policy environment is whether the driver for manufacturing growth should be small and medium-sized enterprises, or large industries. Both models have historically worked, for different structural reasons. Given our current skill and industrial base, the Manufacturing Circle believes that industrial policy should be focused on leveraging off manufacturing at large scale. The German Wirtschaftswunder in the 1950s was largely SME driven, but relied on a deconcentrated base of small family-owned businesses with access to a high skills base. SA does not have this infrastructure, and therefore will struggle to create investment at a scale sufficient to drive large-scale job creation. In the absence of a base from which SMEs can accelerate growth, the Far Eastern model of large enterprise-led growth is apposite: the chaebol in Korea and the keiretsu in Japan led to the creation of large, globally competitive enterprises, that in turn created a supplier base of SMEs. We therefore recommend that government focus on large-scale enterprises, first of all to arrest de-industrialisation and further job losses, but secondly, to act as the engines for growth of a vibrant SME sector as a supplier base to larger industries.



We recommend:

- Government should create a super-ministry with singular responsibility to promote industrial development and, in so doing, create jobs. Such a focused and properly resourced department would replace the at least four separate bodies of government that currently battle to coordinate trade and industrial policy and economic development.
- Government needs to acknowledge the importance of a flourishing large enterprise base which in turn creates opportunities for new small businesses. Business needs to apply enterprise development policies to enable entrepreneurs, particularly black industrialists, to benefit from enhanced demand in the economy. Black industrialists operating at scale will be a key element to growing the manufacturing sector in SA, and both government and business have a role to play in enabling the success of this policy.
- Business and government, particularly local and provincial government, should address some of the day-to-day challenges faced by industry and workers, such as shift workers falling victim to criminals, transport challenges and those related to day care. Industrial areas lend themselves to integrated efforts in this regard, and we acknowledge that business can do better at creating more worker-friendly environments.
- Government should publish its targets on industrialisation and its measurement of them. Based on the precept that 'you get the results you target', in this way the impact of industrial policy will be more transparent. By the same token, business should do the same thing – track the rand value of investments it makes in SA every year, and show how this correlates to output and jobs.
- Government should emulate the very successful Motor Industry Development Plan and apply this approach to other sectors, such as secondary steel manufacture and secondary polymer conversion, for example.
- By making available incentives and facilitating cooperation, government should accelerate the beneficiation of output of the mining sector, promoting both the upstream and downstream value chain.
- Further value chain facilitation, in particular in the agro-processing sphere, can be catalytic in import replacement and job creation. The time period for incentives for agro-processing should be extended from the current two years to correlate with the crop in question in order to allow time for projects to bear fruit.
- Government should review and where possible deregulate administered pricing in order to encourage competition. For example, if the retail price of petrol were to be set as a maximum rather than a fixed price, with the retention of a ban on self-service to retain forecourt attendant jobs, consumers would benefit from an estimated R1.8bn – R2.0bn in lower prices. This will inject money into consumers' pockets and in so doing increase aggregate demand, and possibly more importantly, reduce transport costs for workers and across value chains.
- Government should investigate the feasibility of investment in catalytic projects, such as building a new gas transmission pipeline to bring natural gas from Rovuma in Mozambique into SA, using SA steel and pipe, to lower the cost of natural gas. Government has already signed off in principle on a gas industrialisation strategy, based on vast regional resource discoveries. With its employment multiplier of $3x^5$, the gas industry could help address the critical problems of inequality and unemployment. The manufacturing sector, geared to supply local-content capital goods, could benefit from supplying the gas pipeline and distribution network, from local steel and pipes to machinery.
- Where monopoly suppliers of key inputs in the economy exist, and where there are significant discrepancies between prices charged to local manufacturers and export prices, government should consider regulating such prices in order to make downstream manufacturers more competitive against imports. It makes little sense that a Chinese manufacturer of buckets can obtain cheaper polymer from SA than a company based in Boksburg can.
- In two instances, the revised B-BBEE codes have unintended consequences which incentivise local companies to procure imports, and creates a free-rider problem where companies doing training in excess of their own requirement receive fewer points than companies not doing any training, but merely employing artisans trained by others. Government should review the codes to ensure that local procurement and training are adequately rewarded by the B-BBEE point scoring system.

⁵ the dti, "Towards a gas industrialisation strategy in South Africa", presentation by Garth Strachan, Deputy Director General, Industrial Development Division



3.3 FISCAL POLICY

A key tool in driving economic prosperity

As a government tool, fiscal policy has a very important role to play in influencing a country's economic conditions. By honing the tax incentives offered to manufacturing and enhancing the government spending in support of industrial development, government can help stimulate the re-industrialisation of SA and the creation of millions of jobs. This would then create a virtuous circle of value, as a revived manufacturing sector generates a wider tax base and greater personal tax receipts, helping to fund further government spending in support of the drive to end poverty and inequality.

The manufacturing sector is the second largest contributor to corporate income tax revenue after the financial sector. In the period 2012-2015, manufacturing accounted for on average 21% and the financial sector for 37% of the revenue. As manufacturing's contribution to GDP, currently at less than 13%, is lower than that of the financial service at 20% this shows the disproportionate burden of tax borne by manufacturing. Mining contributed on average 7% to corporate income taxes, while comprising 8% of GDP. It seems contradictory that the manufacturing sector, employing 1.8 million people, pays significantly more taxes than sectors with lower job creation potential. If we are to create a million jobs in manufacturing, fiscal policy needs to change to become more supportive of the sector.

Tax year	2012		2013		2014		2015	
Economic activity ¹	Tax assessed (R million)	Tax assessed (100%)	Tax assessed (R million)	Tax assessed (100%)	Tax assessed (R million)	Tax assessed (100%)	Tax assessed (R million)	Tax assessed (100%)
Agriculture, forestry and fishing	2 347	1%	2 930	2%	3 481	2%	2 403	2%
Mining and quarrying	14 096	9%	15 142	9%	11 582	7%	3 183	3%
Manufacturing ²	33 174	21%	37 659	22%	36 315	21%	19 221	18%
Electricity, gas and water	1 374	1%	1 863	1%	1 848	1%	1 200	1%
Construction	3 691	2%	4 439	3%	5 101	3%	3 978	4%
Wholesale and retail trade, catering and accommodation ³	23 913	15%	24 741	15%	26 858	16%	18 008	17%
Transport, storage and communication	14 034	9%	14 679	9%	14 563	9%	11 598	11%
Financial intermediation, insurance, real-estate and business services ⁴	58 512	37%	62 255	37%	64 307	38%	40 535	38%
Community, social and personal services ⁵	6 415	4%	6 001	4%	6 595	4%	5 244	5%
Other ⁶	21	0%	50	0%	114	0%	22	0%
Total	157 578	100%	169 760	100%	170 765	100%	105 392	100%

SARS – 2016 Tax Statistics ⁶

In its 2017 budget, government allocated R9.6 billion to tax and industrial incentives designed to boost investment and employment. It is currently reviewing these for their efficiency and contribution to inclusive growth, including whether they benefit capital-intensive production.⁷

In determining whether the current fiscal policies applicable to manufacturing are conducive to the growth and employment creation that the country so desires, the question is whether the tax regime creates an environment that is supportive of growth or whether it creates a burden on manufacturers and is therefore counterproductive.

⁶ <http://www.sars.gov.za/About/SATaxSystem/Pages/Tax-Statistics.aspx>

⁷ National Treasury – Budget Review (2017)



The evidence: a disconnect between industrial policy and fiscal policy

In reports commissioned by the Davis Tax Committee, the World Bank reviewed the SA tax system to determine the marginal effective tax rate (“METR”) across the different sectors and whether tax incentives effectively reduce the burden on capital investment.⁸ In its second report⁹, the World Bank investigated whether tax incentives reduce the cost of capital for businesses and whether a reduced cost of capital translates into more investments by these firms.

Compared to the statutory corporate tax rate in SA of 28%, the manufacturing sector has a METR of 19.6%, the second largest after the electricity sector. The METR measures the burden of tax on the marginal investments. The higher the METR for a specific sector, the less desirable it is to invest in such a sector due to reduced returns to investors.

Even though the manufacturing sector is more job intensive and has the highest job multiplier of all sectors, with an METR substantially higher than most other sectors, investments in manufacturing bear a relatively higher tax burden. Comparatively, the mining sector (which has a negative METR, implying subsidisation of investment) has a generous sector-specific tax regime.

It is then clear that, although from a policy perspective government has prioritised job-intensive sectors, in practice, there is a misalignment between fiscal policy and industrial policy. This is evident in the fact that greater industrial policy support is directed towards capital-intensive sectors such as mining, rather than labour-intensive ones such as manufacturing.

Even though the World Bank found that items such as wear and tear allowances and allowable interest deductions and tax incentives do substantially reduce the tax burden on investment in manufacturing, more work needs to be done to ensure that fiscal policy aligns adequately with industrial policy objectives. More initiatives must also be channelled to industry to further reduce the cost of investment in the sector and ensure sectoral growth.

Factors that have the effect of reducing the cost of investment in manufacturing include:

- An increase of tax allowances and incentives available to the sector;
- Additional cash grants for manufacturing.

It is worth noting that even though tax incentives and government support do positively influence the decision to invest in capex, this does not automatically make the business more competitive owing to market conditions unrelated to tax such as competition from subsidized government-owned Asian companies, lack of infrastructure, excessively high transport costs and limited capital investment by the local market. These are dealt with in more detail in other sections of this report.

We recommend that government:

- **Should have an all-inclusive approach towards industrial policy that not only includes incentives but also upgrades of infrastructure, improving labour relations as well as the issue of high-cost, low-skill labour.**
- **Ensures that fiscal policy aligns adequately with industrial policy objectives.**
- **Gives more consideration to reducing the tax burden on the manufacturing sector to make it more attractive to invest in.**
- **Reviews tax allowances to ensure that they are directed towards sectors that have a high job multiplier such as manufacturing.**
- **Substantially increases manufacturing sector allowances in line with generous mining allowances.**

⁸ The World Bank: Sector study of effective tax burden in South Africa - Part 1 (2015)

⁹ The World Bank: Sector study of effective tax burden in South Africa - Part 2 (2016)



A more detailed look at tax incentives available to manufacturing

It is clear that investment-linked tax incentives aim to reduce the cost of investment for businesses by providing reduced tax rates or tax breaks. In so doing, their goal is to encourage businesses to invest more, spurring economic activity and creating jobs. Although tax incentives differ from capital cash grants in that they do not have a direct cost to the fiscus, they do have cost implications in the form of revenue foregone as they result in reduced tax collections. More on this at the end of this section.

The Section 12L investment and training allowance

Section 12L is an investment and training allowance for industrial projects. It allows companies with a minimum investment of at least R30 million for brownfields or R50 million for greenfields industrial projects to claim additional allowances. Since 2011, this programme has allocated its budget of R20 billion, representing R5.6 billion in tax revenue foregone. While the incentive was extended to 2020, the budget has been fully utilised and no further budget has been allocated. Section 12L has been an example of a carefully administered and designed policy that has enabled investment linked to job creation. Although the administration of 12L could be simplified in terms of measurement and verification, it remains a case study in successful incentive design.

We recommend that:

- **The scope of the government's review of the impact of S12L must sufficiently review the link between the revenue foregone and the economic benefits of the incentives, including jobs.**
- **An additional budget of R5 billion is allocated as a matter of urgency as the current unfunded status creates policy, tax and investor uncertainty, and consequently slows down investment.**
- **Current regulations be amended to be aligned to the S12L legislation as it is creating compliance uncertainty for approved projects.**

The Section 12L energy efficiency allowance

This incentive is aimed at promoting the investment in energy-efficient equipment and process improvements. It is a notional additional tax allowance for energy savings achieved and verified by an accredited measurement and verification (M&V) body. Industry considers the M&V process to be complicated and onerous. Savings are those achieved compared to the prior year, rather than to before the relevant energy-efficiency project was implemented. As the tax legislation and the M&V standard are not aligned, there is uncertainty on how projects need to be measured. The legislation expires in 2020 and many energy projects in the development phase will only come on stream after the incentive ends.

We recommend that government:

- **Extends the period of the incentive to 2025 to create tax certainty.**
- **Amends the legislation to ensure the baseline is for before the energy-efficiency project was implemented rather than the prior year.**
- **Simplifies the M&V process.**

Section 12R – Special Economic Zones (SEZ)

Industrial Development Zones (IDZs), which started in 2000, were geared to attract foreign direct investment and enhance value-added exports. They have since been replaced by SEZs. Some of the special incentives associated with SEZs include: a reduced corporate tax rate of 15%; a special rate of capital building allowance deduction of 10% per annum; VAT and customs benefits; employment incentives for low-salaried employees; and additional section 12L benefits if located in an SEZ.



However, because the Minister of Finance is yet to sign the 15% tax rate into effect, there is a great deal of uncertainty surrounding the practical implementation of the incentive. None of the businesses that have set up operations within SEZs benefit from the reduced corporate tax rate.

The SEZ policy is focused on discrete industrial areas which are set up on a greenfields basis. This requires significant investment in new infrastructure, and potentially puts manufacturers outside the SEZ at a disadvantage, particularly if the 12R tax rate is allowed for SEZs only. Furthermore, in our view, the SEZ policy as currently formulated is eminently suitable to enhance an already burgeoning sector, as is evidenced by the success of similar policies internationally. SEZs internationally are typically established to encourage exports, to attract new investments and to decentralise industry to create jobs in hitherto poorly developed areas. However, in SA, the situation is rather different. Although there are clear gains to be had from a more equitable geographical distribution of economic activity, the World Bank¹⁰ says “there is also clear evidence that increasing urbanisation has strong, positive externalities through deeper and more extensive forward and backward linkages. In this context, the approach to spatial industrial policy in general, and to SEZs in particular, may benefit from being more attentive to exploiting the potential of urban agglomerations to deliver the large-scale job creation that is urgently needed”.

With manufacturers under stress, and with key industrial areas such as the Vaal Triangle de-industrialising, there are key elements that militate against the current policy, and support a wider application of its key tenets to prevent SA's current industrial base from turning into a rust belt.

- Existing industrial areas have a large infrastructure in place, which as de-industrialisation takes hold, is increasingly underutilised. Roads, electricity, water reticulation, railways and pipeline networks are largely in place in areas like the Vaal Triangle, Mobeni and Epping. Some infrastructural maintenance is required, since these date back to the 1960s, but replicating this investment elsewhere seems both costly and redundant.
- Owing to spatial distortions caused by apartheid planning, transport is one of the largest expense items for lower-income workers. Industrial areas were typically built in close proximity to major human settlements. For example, the Vaal Triangle industrial area is located in very close proximity to Sharpeville, Sebokeng and Boipatong. By safeguarding existing industrial areas from further decay, not only will jobs be preserved and located close to where people live, but transport cost will be a smaller expense for workers.
- Moving to new SEZs is in most cases prohibitively expensive for manufacturers operating in existing industrial areas, even if the benefit of incentives is taken into account. For example, a major pharmaceutical company operating in the Eastern Cape cannot justify moving to the newly established Coega IDZ. In any event, once an existing manufacturer has relocated to an SEZ, it will leave behind it a legacy of disinvestment, dislocation of its workforce and decay of the area that it has left.
- Failing to relocate will therefore put the incumbent manufacturer at a disadvantage to a new entrant, further increasing the risk of de-industrialisation if some form of corrective designation is not put in place.

Extending section 12R incentives, in particular the 15% corporate tax rate, to both SEZ investors as well as to manufacturers outside of SEZs, would soon pay for itself through increased PAYE contributions, as outlined later in this section.

We recommend that:

- **The Minister of Finance signs into effect the section 12R 15% corporate tax rate forthwith.**
- **Government publishes guidelines for claiming the reduced tax rates to ensure that businesses within SEZs are able to maximise the SEZ benefits.**
- **Government amends the legislation to include distressed industrial areas, including the Vaal Triangle, to pre-empt their further de-industrialisation.**

¹⁰ World Bank “South Africa Economic Update #9 – Focus on Private Investment for Job Creation”, p56



Section 11D – Research and development incentive

With this incentive, companies who conduct research and development can deduct up to 150% of their R&D expenditure. As a result, the 50% additional benefit at a tax rate of 28% derives a net 14% cash benefit. However, from an administrative perspective, this incentive has been plagued with delays and uncertainty. As a result, industry has lost confidence in the incentive's accessibility.

We recommend that government:

- **Achieves administrative efficiency by simplifying the process and improving turnaround times on final decisions, including creating an electronic submission platform; increasing the number of internal administrative staff and external experts; setting an application processing timeline; and removing the need for the Minister to sign off approvals.**
- **Introduces a retrospective approval of applications by allowing companies to pre-register an intention to do R&D in the coming period and then submit details at year-end, rather than needing to secure pre-approval of the project by the Department of Science & Technology before claiming the benefit.**
- **Clarifies the eligibility criteria by adopting a less-strict interpretation of qualifying criteria (which currently require that the R&D must contain some degree of novelty, not only for the applicant or within the Republic, but worldwide) to include projects that are novel for that particular taxpayer to increase its competitiveness.**

The Automotive Production and Development Programme (APDP)

The APDP is an incentive programme for automotive manufacturers / original equipment manufacturers (OEMs), component manufacturers and automotive tool manufacturers supplying the automotive OEM value chain. It comprises a customs incentive valued at R18bn-R20bn per annum, and a cash grant component managed through the Automotive Incentive Scheme (AIS) where for the 2016/17 financial year, government allocated R2 billion to the sector in the form of cash grants. The automotive sector contributes more than half of the whole manufacturing sector's contribution to GDP. This shows that if government truly puts its mind to stimulating manufacturing investment, it can create world-class, competitive products for export, with positive contributions to productivity, revenue and jobs.

We recommend that government, in collaboration with relevant industry players, emulates its approach to the APDP in other sectors, such as secondary steel manufacture and secondary polymer conversion, for example.

A more detailed look at grants available to manufacturing

The SA government offers numerous cash grants to the manufacturing industry. Cash grants differ from tax incentives in that they do have a direct cost to the fiscus, so they have to be budgeted for in each government department in their budget vote.

General incentive payouts

The most recent medium-term budget statement shows that the dti has only spent 27% of its budget for the six months of the year. In addition, on review of the contingent liability of the dti on current incentive contracts paid out, there is concern that the current allocated budget will not be spent on the manufacturing industry (apart from the automotive industry).

We recommend that the current budget underspend be analysed and ways to ensure that the challenges to spending be understood and rectified before year end close.



The Black Industrialist Scheme (BIS)

The BIS is a grant programme on projects with a minimum investment of at least R30 million which are to be majority owned by a black industrialist. The original policy objective was to create 100 new black industrialists. We are aware of concerns that some black industrialists as approved by the dti are struggling to get their projects to financial close.

We recommend:

- **The scope of the government's review of the impact of BIS must sufficiently review the link between the cash grant and the economic benefits of the incentives, including jobs.**
- **The current policy objective be reviewed to ensure that the incentive is reaching the intended recipients.**
- **Consider whether the entry point of R30 million is too high as many worthy projects are not able to access this incentive.**
- **The IDC be mandated to play a more active role in enabling black industrialists at scale, and in particular use long-held assets on its balance sheet to support industrial development.**
- **The financial close challenge be reviewed to ascertain challenges and to modify the dti process to ensure that approvals are not awarded to projects that have no chance of getting to financial close.**

The Agro Processing Support Scheme (APSS)

The APSS is a grant programme on agro-processing projects which are after the “farm gate”. The incentive has a requirement that applicants need to procure 30% from black-owned suppliers. There is concern that this hurdle is too high for certain parts of the agro-processing value chain or does not take the length of the growing cycle into account, as this incentive only extends for two years. Some crops take longer to bear fruit.

We recommend that the dti consults with the agro-processing industry association to ensure the industry concerns are adequately addressed.

Broad-Based Black Economic Empowerment requirements

The government grant programmes have different mandatory B-BBEE level requirements which result in inconsistent treatment amongst the various grant programmes. The general rule seems to be that a minimum B-BBEE level 4 is required for a grant to be successful. Ultimately grant programmes need to drive a change in behaviour in companies, so having a B-BBEE level 4 as an entry requirement precludes many worthy projects from receiving government support.

We recommend that:

- **Government review the B-BBEE rules in all the incentive grant programmes.**
- **Consideration should be given to having consistent mandatory entry rule (eg level 8), with additional incentive benefit levels for better B-BBEE performance.**



Taxes on production

Over and above the burden of taxes on income, and in spite of the various incentives outlined above, the manufacturing sector faces an additional tax burden in the form of proposed taxes on production. These include a proposed tax on sugary beverages, a carbon tax, a packaging tax, and a waste management tax. Not only do these proposals have the potential to increase the burden on the sector that has the second highest marginal effective tax rate of all sectors of the economy, but they also create investor uncertainty as they have not been implemented despite many years in policy formulation.

We recommend that government reviews the proposed additional taxes, some of which are regressive, to determine other non-tax initiatives to achieve the desired policy objectives.

SARS's delays in processing VAT refunds

Another source of industry concern is the undue delays in receiving VAT refunds from SARS, which have far-reaching cash flow implications for taxpayers. The Tax Ombudsman's report on VAT refunds supports the view that SARS employs tactics to unduly delay the payments of these refunds. Industry is also concerned about SARS's adversarial audit processes.

We recommend that SARS plays an enabling and proactive role, to administer taxes and duties fairly, including ensuring the timeous payment of VAT refunds.

The added benefits of creating jobs

In the event that government is indeed able to provide further clear and certain policy interventions to grow the manufacturing sector, such growth would likely come at the expense of revenue foregone as government would have to provide additional tax incentives. However, it is noteworthy that although government would collect less corporate income tax, the benefits of creating additional jobs – not only from a social and standard-of-living point of view – would clearly far outweigh the revenue foregone.

Illustratively, if government introduced more generous tax incentives in the manufacturing sector and as a result creates an additional one million jobs, the benefit to the fiscus is estimated at an additional R56 billion in tax revenue collectable from the additional one million taxpayers, calculated as follows:

Total PAYE / Total registered tax payers	R388 billion / 19 million
Average PAYE	R20 000
Average PAYE x 1 000 000 additional jobs	R20 000 x 1 000 000
Estimated PAYE revenue	R20 billion

As personal income tax contributes about 36% of total taxes, if the same ratio is applied to the R20 billion, an additional R36 billion in other taxes will be collected.

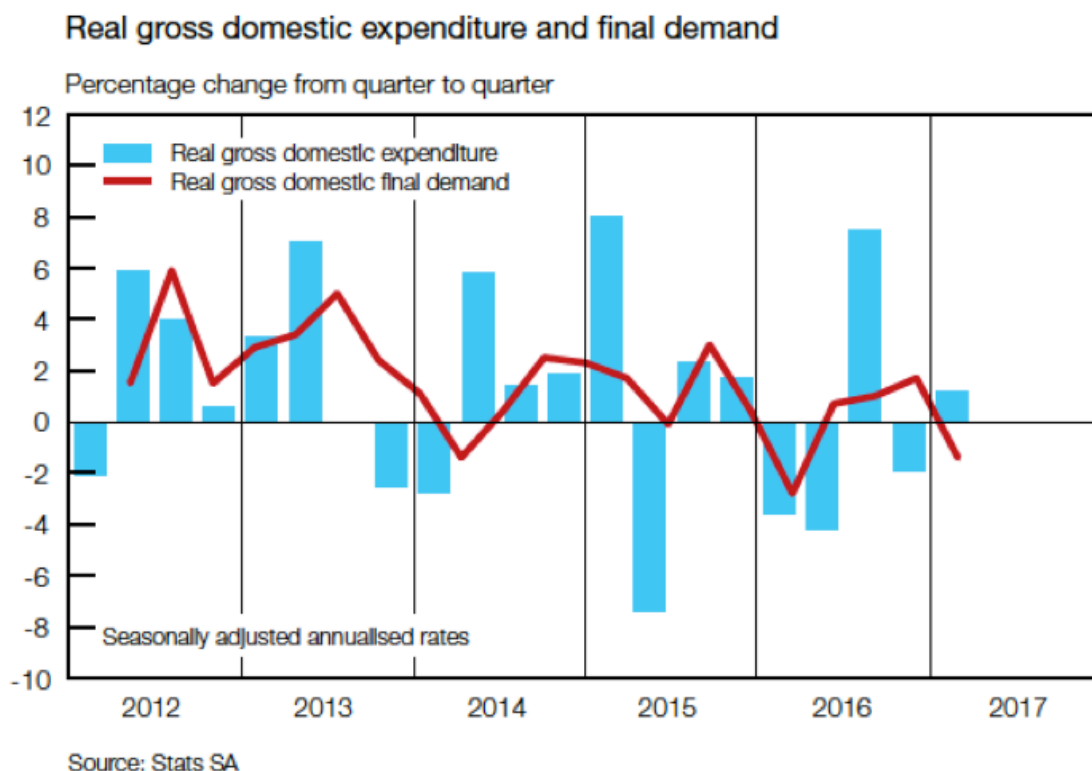
Estimated PAYE revenue at 36% of total taxes	R20 billion
Estimated other tax revenue at 64% of total taxes	R36 billion
Total tax revenue on 1 million additional jobs	R56 billion

This clearly shows the benefit to the economy as a whole of using fiscal measures to better support the manufacturing sector.



3.4 TRADE POLICY

Investments in manufacturing are fundamentally driven by demand for goods made in factories. Without demand, existing capacity will be under-utilised, and investments in new or replacement capacity will be deferred, sometimes indefinitely. Owing to low consumer and investor confidence in SA, current consumer demand in SA is at historically low levels. Business confidence is at its lowest ebb in a quarter of a century, and consumer demand has been declining with no indication of a revival, as shown in the following graph¹¹.



In order to augment a fragile and tepid aggregate domestic demand, two other sources of demand are available. We can either make more of the goods that we import, or we can export more of the goods that we manufacture. To make this a reality, a trade policy that deliberately encourages import substitution and supports exports is a prerequisite.

To be clear: the Manufacturing Circle does not advocate autarky as an economic policy, nor is it opposed to trade, and neither does it propose brute-force protectionism. On the contrary, we are strong advocates of international trade, provided that this takes place on an equal footing with our major trade partners.

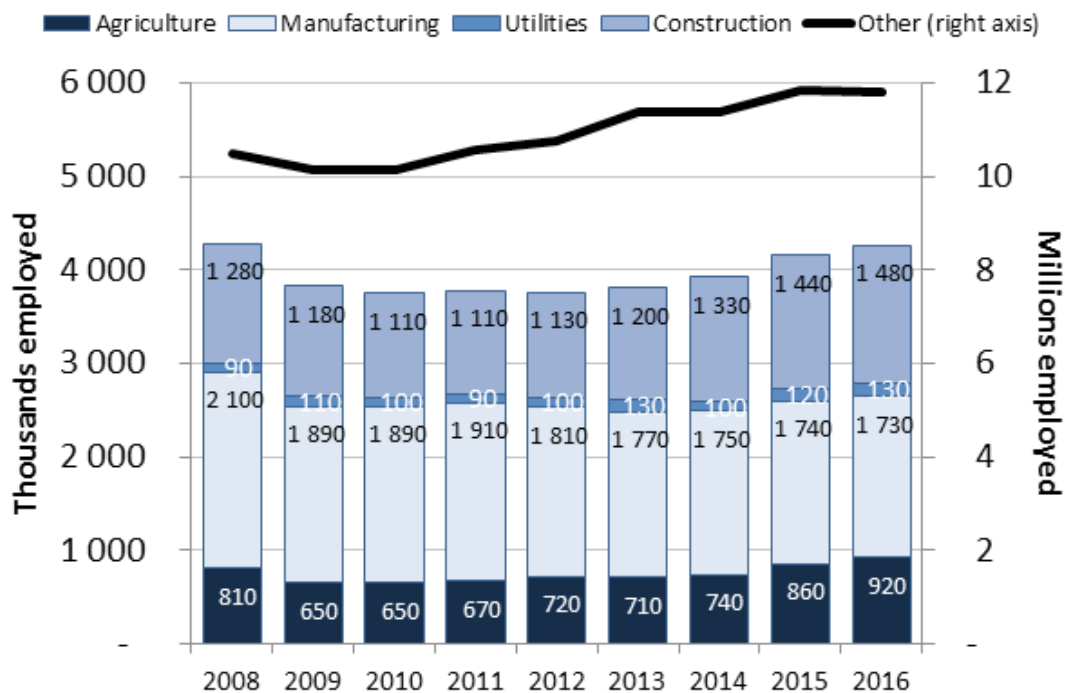
After the demise of apartheid, and the lifting of sanctions, government implemented trade policies that were remarkably aggressive in its deliberate free trade bias. The transition was arguably too drastic for sectors that had prospered behind the artificial protection of sanctions: many of our factories were sub-scale, with outdated technology and high cost structures, and could therefore not compete. SA's re-entry into the world economy was therefore characterised by the decimation of our manufacturing sector. Not only did the protective tide recede to reveal the lack of competitiveness of manufacturing, but our re-entry into the world economy coincided with the rise of China as the world's workshop.

¹¹ SA Reserve Bank, Quarterly Bulletin, June 2017



From its zenith of 24% of GDP, manufacturing has steadily contracted to its current nadir of less than 13%, with a commensurate loss of half a million jobs. Given the multiplier factor of manufacturing jobs of 5 – 8 indirect jobs created for every direct manufacturing job, it is no coincidence that unemployment has risen dramatically to a current high of 27.7%.

Employment by main sectors, South Africa



Source: StatsSA. QLFS trends 2008 - 2016 Q4. Downloaded from www.statssa.gov.za in February 2017

SA is a signatory to the World Trade Organisation, and has to comply with its international trade obligations. However, it seems to us that there is asymmetrical compliance with the WTO, and that the assertive use of both trade and non-trade barriers to imports, as well as support for their manufacturers characterise the trade policies of our major trade partners. We therefore think that there are opportunities for us to take a fresh approach to trade policy that will enable us to grow our economy and create jobs, while remaining compliant with our international treaty obligations.

Who is responsible for trade policy?

There are at least six bodies within government normally concerned with trade policy, being:

1. The International Trade Administration Commission (ITAC)
2. The Department of Trade and Industry (dti)
3. The Economic Development Department (EDD)
4. The National Treasury (Treasury)
5. The South African Revenue Services (SARS)
6. The Department of Agriculture, Forestry and Fisheries (DAFF) which only gets involved in agricultural matters



In addition, there are any number of peripheral agencies such as the National Ports Authority, the National Regulator for Compulsory Standards (NRCS) and the South African Bureau of Standards (SABS), to name just a few. The competing interests of these entities can create a bureaucratic quagmire in which the supposed beneficiary of trade policy quietly expires in the face of competition from imports as losses mount, and business becomes unsustainable.

The proliferation of government departments involved in trade policy creation and administration has exacerbated the complexity of using trade policy as a tool to assist manufacturing. When EDD was created, ITAC moved its reporting line from the dti to EDD and now reports to the Minister of Economic Development. ITAC was, however, created in 2003 when the International Trade Administration Act (Act No. 71 of 2002 - ITA Act) was passed. Until the creation of EDD in 2009, ITAC reported to the Minister of Trade and Industry. When EDD was created, the ITA Act was never amended, leaving ITAC officially needing the Minister of Trade and Industry to approve all of its decisions. This dichotomy is downplayed because the ITA Act establishes ITAC as an independent body, but it is clear that this split is fertile ground for problems to take root.

In addition to the potential for misalignment between dti and EDD, the role of SARS also varies considerably depending on the type of duty imposed. If a provisional duty is imposed, it is paid to SARS, but this will be refunded if the final decision is to not impose a duty, or to impose a lower duty.

Final duties are rather more complicated. The Customs and Excise Act (Act 91. of 1964) only permits the Minister of Finance to instruct SARS to make duty changes. When ITAC has made a decision to impose a duty, it makes a recommendation to the Minister of Trade and Industry, who, generally speaking, accepts the recommendation, and in turn recommends to the Minister of Finance to instruct SARS to change the duties. This should be a simple process taking less than six weeks; the reality is different, particularly in the case of duty increases. Applicants have no visibility on progress in the process, in particular when there is a delay at Treasury.

Although Treasury has oversight over all taxes, its role in trade-related duties and taxes is quite different. For all other taxes, Treasury is responsible for tax policy, but for trade taxes, this responsibility devolves to EDD and the dti because of the ITA Act. Although Treasury has a representative on the Commission, it has practically very little control over the development of trade policy (or certainly less influence than it perhaps would want). However, because final tariffs need to be approved by the Minister of Finance on the advice of Treasury, the result is that Treasury ends up exercising a *de facto* veto right over implementing duty changes after the change in tariff has been approved.

Duty increases, for example, which have been approved by ITAC, sometimes take over a year to be implemented by Treasury, if at all. The Minister of Finance can refuse to implement a recommendation he receives from the dti. He can also not make a decision: there is nothing in our current body of legislation that compels the Minister of Finance to implement a duty change.

While a duty application navigates its way through this complicated process, where different agencies have different powers and objectives, the applicant, who presumably is suffering real economic harm (without which the application would not have been approved in the first instance), is losing money, retrenching staff and slowly or – in most cases – quickly going out of business. An investigation into aluminium has taken more than two years to resolve – with no resolution in sight. No business can sustain losses for such an extended period of time.

A similar, but perhaps more serious issue arose with wheat, where Treasury again applied this unofficial veto right and stopped the increase of duties. This was litigated twice in 2016, with Treasury backing down in both cases.

This, however, moved in the opposite direction in the recent judgement in *Pioneer (Pty) Ltd v Minister of Finance and Others*. In this case, Pioneer attempted to compel the Minister of Finance to lower the duties on wheat in line with a recommendation from ITAC and the Minister of Trade and Industry. The Minister of Finance refused and the court supported his view. Importantly, it was made absolutely clear that tariff duty changes are not decided by ITAC or the Minister of Trade and Industry, but rather by the Minister of Finance.



It is crucial that a) the application process be expedited considerably by creating single point accountability in the organs of government for the imposition of duties and b) that duty decisions be driven by an agenda to promote economic growth and job creation, or the retention of capacity and jobs, rather than a focus on revenue generation. If the objective of duties is to generate revenue for the state, this can have completely contrary consequences to government's own trade policy. The veto of Treasury therefore is an important matter to be resolved.

Our recommendation is to explicitly require Treasury to give its input into duty applications before a recommendation is made by ITAC to the Minister of Trade and Industry, in order to prevent the second-guessing of the process. Secondly, expiry dates should be stipulated for all duty investigations.

Anti-dumping and countervailing investigations already have an 18-month deadline built in (counting from the day the matter is initiated), but safeguards and tariff investigations have no cut-off date. The initial perception, especially by manufacturers, may be that not having a cut-off is a good thing, but uncertainty benefits nobody. When the decision on wheat duties was delayed, the farmers could have missed a planting season. The current safeguard investigation on chicken from the EU has been running since February 2016, which again benefits neither local producers nor importers.

Ultimately, however, the creation of single-point accountability by establishing a super-ministry to enable economic growth and job creation, as proposed earlier in this report, will be the preferred structural fix to debottleneck bureaucracy.

The period in which duties remain in place

In all trade remedy matters, duties can only remain in place for five years (anti-dumping and countervailing) and three years for safeguards. At the end of the five-year periods for anti-dumping and countervailing actions, there is either a mandatory review, known as a sunset review, or the duty expires. In the case of safeguards, the duties reduce each year and must be completely removed at the end of three years.

Normal tariffs are, however, only assessed when there is a specific application or as part of an ITAC-initiated industry review. For modest duties, this is generally not a problem, but with higher duties, they can rapidly result in the development of uncompetitive industries. It should be borne in mind that the effect of imposing duties is to restrict competition, so excessively high duties can rapidly result in highly concentrated industries. This is exacerbated by the application process which is considerably more expensive when there is more than one applicant and so results in most applications being brought by highly concentrated or even monopoly industries.

We propose that all duties imposed be automatically reviewed after five years to ensure uncompetitive industries do not remain subsidised by consumers indefinitely.

Duty relief on products not produced locally

The recent spate of duty increases on various primary steel products has highlighted the need to have a mechanism that can be deployed swiftly, to give duty relief on materials not manufactured locally. At present the process generally sees the duty increase put through, followed by applications for the duty relief. By example, a duty increase was imposed on certain coated steel products, some of which are used in the manufacture of white kitchen goods. This particular variation of steel is not produced locally, with this confirmed in writing by ArcelorMittal. The duty increase was imposed on 22 September 2015.

Application for a rebate was published on 29 April 2016 and the rebate was finally granted on 2 December 2016. The rebate was not backdated, which means that importers paid duties of 10% on the imported goods for 15 months before any relief was available. No duties could be recovered for all the months the duties were paid. Clearly, this application of trade policy had no beneficial impact on SA manufacturing, although the fiscus garnered some incremental revenue. The manufacturer, however, was significantly disadvantaged by a protracted process which had an objectively unfair outcome.



We propose two solutions to this problem, which can both be implemented easily:

- 1. Duty relief, either in the form of a rebate or insertion of a new tariff code, should be implemented at the same time as the duty increase. There is no logical reason why relief cannot be given simultaneously with the imposition of duties. This is a process issue and requires no regulatory change.**
- 2. Amend the tariff regulations to allow for an expedited process of duty relief where evidence is presented that a product is not available locally.**

Duty relief on trade remedies

Rebates of duty or drawbacks are not allowed on any duties payable, besides normal customs duties. Likewise, ITAC published a similar restriction on rebating any trade remedy duties, except by specific permission, in order not to incentivise unfair trade. However, as is becoming apparent in the steel sector, very large duties are being locked in unfairly. The safeguard duties on hot rolled steel will have an increasingly negative effect on our exports because it is currently impossible to recover these duties in export projects. The safeguard also does not address unfair trade, but rather just a surge in imports threatening the industry, so the restriction would appear not to make sense.

ITAC can apply its discretion to allow an export rebate to still function, but export rebates cannot be backdated. However, drawbacks are available in terms of guidelines that are published by ITAC and not the Minister of Trade and Industry, so they can be rapidly amended. **We recommend that the drawbacks guidelines be changed to allow the recovery of all safeguard duties, particularly in order to protect the secondary steel sector.**

Increasing duties to the bound rate

When SA joined the WTO in 1995, we agreed not to increase our duties on certain products above a certain level, known as the bound rate. The bound rate is set at the level of a tariff code and ranges from zero for most of the tariff book, to unbound for a variety of agricultural products.

Increasing duties up to the bound rate is purely a policy decision and so can be implemented easily. Duties should obviously not simply be moved up to the maximum without due consideration, but certainly, there are no impediments imposed on SA by the WTO as long as the duties remain within the bound rate range.

Normal tariff investigations have no concept of provisional duties, so any duty increase has to follow a process which can take more than two years. If the challenges faced by the industry are really serious, it is crucial to expedite the imposition of duties, failing which the business in need of protection will go out of business. One attempt to deal with this problem was to introduce the concept of an “industry in distress”, but this has been problematic for two reasons:

1. The concept is undefined and it is at the discretion of the Minister of Trade and Industry to determine if an industry in distress. The lack of overt criteria renders this measure susceptible to challenge.
2. If an industry is distressed, an investigation is meant to move from initiation to finalisation in a shortened period, typically being three months. This three-month target has never been achieved, in large part because the actual investigation process is still the same, it's just that participants in the investigation (and ITAC) are expected to move faster. The only measurable outcome of this is that the response period is shortened by a week.



The existing policy implementation does not create an enabling environment to assist an industry in distress within three months. Proper definition of the broad characteristics of a distressed industry, similar to the safeguard regulations, will create clarity. **The process itself must be expedited, to produce an outcome within three months. We recommend the creation of provisional duties through an amendment of the ITA Act, again for similar timelines as for safeguard duties. Response times must be shortened, and the matter should be finalised by the date the provisional duty expires and should terminate automatically if not completed within this timeframe.**

The Manufacturing Circle does not propose a change to the existing tariff review process for normal applications, as it generally does work through a diligent process. However, business will benefit from a more predictable process. This, however, goes beyond describing the steps to industry, but should include timelines within which decisions will be made. Having firm timelines, clearly stated to the market, introduces a measure of accountability. **The processes that ITAC follows should not be shrouded in secrecy, and should be open to public scrutiny in the same way that Competition Commission investigations are transparent and open.** The Competition Commission processes are generally more accessible, with public hearings and an ability to engage counterparties in meetings. Our existing trade remedy regulations allow for what are called “adverse party hearings”, which are facilitated meetings between opposing parties. To our knowledge, there has only ever been one such meeting and it pre-dated the existence of ITAC.

Court proceedings are effective in large part because the opposing parties’ ideas can be meaningfully engaged. In trade investigations, this engagement is only possible through ITAC which applies no pressure to counterparties to, for instance, answer questions posed. ITAC itself does not allow its own ideas to be interrogated and so the process is often viewed with suspicion. The degree to which debate has been restricted to prevent proper ventilation of the issues has reached such a point that outcomes simply cannot be reconciled with the data and there is little transparency on the process leading to the outcomes. If the objective is ultimately to have more industry participation then the process needs to be considerably more approachable and the authority more accountable.

Recommended steps to improve this process include:

- 1. Hold public hearings on products which have a significant impact on consumers (such as basic foodstuffs).**
- 2. Allow adverse party hearings where requested, so that issues are properly ventilated before decisions are made.**
- 3. Oral hearings should be open by default and if there are confidential pieces of information, this can be dealt with in a closed part of the meeting, at the end of the presentation.**
- 4. Prepare investigation reports which actually meet the WTO’s requirements, so that decisions taken are properly understood. This is also crucial so that a body of precedent can be established.**

Aside from opening up oral hearings, all of the above proposals can be implemented without a change to the underlying legislation.

The importance of publishing regulations for all the available instruments

While the more common duty instruments have published regulations, a number of instruments do not have corresponding regulations. This effectively removes a number of important instruments from being accessed. The instruments of particular concern are those safeguard measures embedded in the various trade agreements we have signed. Most recently this problem has arisen in the bilateral safeguard investigation against chicken imports from the EU.

Regulations are important because they create a predictable environment. Anyone using the instrument will know how to access the benefits afforded by trade policy and investigations are far less likely to be disputed if the rules are clearly defined.



Every element of an investigation needs to be predictable. It is deeply problematic when parties involved in various trade investigations have no sense of how these investigations will unfold and when they can expect results. This of course applies to all investigation varieties, not just those with unpublished regulations.

Our recommended solution to the problem is for the Minister of Economic Development or the Minister of Trade and Industry to publish regulations for all ITAC investigations. ITAC can publish guidelines, but these are not binding and therefore lose much of the power of having rules.

Alternative dispute resolution

ITAC decisions cannot be challenged by any process other than by approaching the courts. This is a lengthy and expensive process, and because of the complexity of the issues involved, will not have predictable outcomes. Both SARS and the Competition Commission have appeal processes in place which create more accountability and hence confidence in the process. We propose the creation of an International Trade Tribunal, made up of trade experts, to adjudicate disputes over ITAC decisions.

Non-tariff barriers

While there are a number of improvements to be implemented in the ITAC process, the Manufacturing Circle acknowledges that it is in essence a reasonably predictable part of trade policy. Non-duty measures are less well defined, and will benefit from greater policy clarity.

Designation and localisation

Designation and localisation are processes designed primarily to drive government procurement to locally manufactured products. These processes are managed through the dti's Preferential Procurement Policy Framework Act. In theory, when government, or state-owned enterprises (SOEs) purchase goods, they should give preference to locally produced goods. In reality there is often pushback against this process because it seeks to interfere with existing supplier relationships and because it has the potential to inflate prices.

Designation and localisation have the potential to dramatically improve the state of the domestic manufacturing sector. The designation process is, however, not clear and is time-consuming, with current applications taking two or more years to be approved. This problem is further compounded by the lack of clarity on the criteria used to determine who will be designated and the absence of reasons for decisions, making it extremely challenging to learn lessons from prior applications (whether they succeeded or not).

If this process is to work, the following needs to be done:

- 1. The regulations need to be amended to include a proper application form, to provide better structure to the application process.**
- 2. Timeframes need to be inserted, with an automatic termination of the process after 18 months.**
- 3. All applications should be reviewed and published for comment in the Government Gazette, with a prescribed response period. Again, the norm of one month is not unreasonable.**
- 4. Interested parties should not only be able to respond in writing, but have an opportunity to present their views to the decision-making body.**
- 5. A report should be required spelling out the details of the decision and how it was reached. A good source for a minimum reporting requirement would be the Promotion of Administrative Justice Act, coupled with the WTO guidelines on reports in anti-dumping investigations.**

Business in SA should also play its part in local procurement, by giving overt preference to local suppliers, provided that price, quality and supply are all competitive. As part of business's contribution to supporting economic growth, business organisations such as BUSA and BLSA should make commitments to local procurement. Government can support this by **changing the B-BBEE Codes to remove the unintended disincentive on local procurement by including locally available imported goods in the denominator in calculating procurement spend.**



Specific agro-processing issues

Many agricultural products fall within the ambit of the DAFF, which is governed by a raft of legislation and regulation, in addition to the normal trade rules administered by ITAC and SARS. Agricultural products need to comply with the various food, animal and plant health legislation (collectively known as sanitary and phytosanitary measures). While trade rules apply to all products, the sanitary and phytosanitary requirements are unique to DAFF. However, decisions made by DAFF tend to lack transparency, and consequently, litigation against DAFF has been on the increase, with most of it related to administrative issues. The injudicious application of sanitary measures to restrict imports, has the potential to negatively impact trade relations between SA and our trading partners. In the short term, such actions may benefit the domestic industry, but in the long term, non-compliant sanitary measures are impossible to defend and may very well result in retaliation by trading partners.

It is essential that DAFF's phytosanitary and sanitary measures only be applied within the context of SA's overall trade policy, to avoid unintended consequences. Again, the structural remedy of coordinating all trade and industrial policy through a single ministry will significantly enhance the effectiveness of policy execution, and avoid scoring own goals with negative implications for a far wider range of industries. **Accordingly, we recommend that DAFF should improve the transparency and predictability of its processes, and that DAFF's jurisdiction be clearly delineated.**

Emerging industries

Although SA is not eligible for the trade policy type of infant industry protection, as we are considered an upper-middle-income country, there is scope for the state to support industries that are emerging. As an industry graduates from emerging to mature and competitive industry, rent-seeking behaviour is likely to manifest itself, as the former infant seeks to preserve its benefits, rather like a young adult reluctant to abandon the comforts of the parental home. Any consideration for protection of emerging industry would need to be coupled with two important concepts:

1. Clear definition for industries which are important rather than just uncompetitive. Picking winners is something government is generally bad at, but this would need to be clearly defined. These industries would need to show potential but be less developed than their international counterparts.
2. Limited time for protection. Those companies which have not become sustainable after a given period, need to be left to fend for themselves. If they face unfair competition, they can access instruments such as anti-dumping actions, but should not be allowed to benefit from the infinite largesse of the consumer (who always ultimately funds the shareholders of these companies, through higher local prices).

It is important to also distinguish between an emerging industry and a developed company making a new investment, although there are similarities. An emerging industry is the development of, for example, solar technology. A dominant chemical company opening a new polymer plant is not.

Providing protection for new investments to allow them time to reach sufficient capacity utilisation, competitiveness and effectiveness can be a beneficial policy if applied judiciously, particularly when the industry is far upstream. When investment is valued and encouraged through appropriate incentives, entrepreneurs can take bigger risks, in the knowledge that during their ramp-up period they will receive protection from scaled-up industries in the rest of the world. It should, however, be clear that the trade policy should not compensate for a lack of skill or excessively priced energy. Investments once operating at scale should be competitive against normal, unsubsidised imports.

We recommend that emerging industry protection should be developed as a new trade policy for SA, with clear guidelines to limit the duration and extent of protection, and to encourage new investments by emerging industries.



Export competitiveness

Leaving aside the fundamental competitiveness of SA and the volatility of our currency, there are two controllable variables which can have a material impact on our export competitiveness: the ability to recover VAT and embedded duties, and trade agreements.

Embedded duties

Embedded duties are duties levied on raw materials or intermediate goods which are processed or incorporated in exported products. In principle, if duties are payable on any product, this product should be produced somewhere in the SACU region. If this is not the case, then no duties should be paid. This principle is important to bear in mind to not end up with duties which only serve to inflate prices.

Embedded duties can reduce the competitiveness of manufacturers who import these materials or goods for processing into goods for export. Rebates of duty are exemptions from paying duty based on certain conditions being met. If these conditions are not met the duty still remains payable. Export, manufacturing and temporary rebates are in place and should be retained. A second type of rebate structure known as drawbacks, referred to earlier, work on a similar basis to export rebates, except that in the case of drawbacks, the duties have already been paid and are then claimed back by the importer, after the export has taken place. Drawbacks are thus very important, given the steady rise in duties across many industries. If these duties are paid on raw materials, then not getting the duty back will make exports less competitive.

The current administration of drawbacks leaves much to be desired. SARS not only takes an inordinately long time to refund duties, but reveals a negative approach to drawbacks through the types of queries, most of which indicate either deliberate intent to find reasons for rejection or incompetence at a worrying level. Since the recent duties on steel imports have been imposed, this has become a serious problem which needs to be resolved.

SARS appears to deal with drawbacks as if this is revenue it cannot forego, whereas this actually is an incentive designed to make our exporters more competitive (and pay more tax). The governing rules, while complex, are not unmanageable. **We recommend that the administration of drawbacks by SARS be significantly improved to encourage export competitiveness by accelerating the refund of qualifying duties.**

Trade agreements

A trade agreement can only be considered a success (from the perspective of SA), if it results in more exports to the other country than would have happened without the agreement's existence. Of course, this is difficult to measure perfectly, but there are a few principles which make success more likely.

If trade agreements are viewed as ways to improve market access for SA product into foreign markets, rather than a political tool, then they will yield much larger benefits. The current consultation process, which operates through NEDLAC in which BUSA represents business, does not always yield appropriate results. BUSA represents a broad range of businesses, and does not always successfully and comprehensively obtain input from industries that will be affected by the proposed trade agreements.

SA has started negotiating the Continental Free Trade Agreement and there does not appear to have been a call for input from industry. While BUSA is aware of the negotiations, there has not been a call for substantive input from manufacturers. Where substantive input is not obtained, undesirable outcomes may result.

We recommend that the process of obtaining input must be properly coordinated to ensure salient comments are solicited. At the same time, affected business must take responsibility for providing input into trade negotiations, and must be prepared to commit resources to ensure that SA's negotiators drive the best possible bargain.



Benefits contained in existing agreements

Government and industry should also collaborate to educate importers and exporters about the benefits contained within existing agreements. For example, SACU signed a preferential trade agreement with Mercosur (a number of South American countries) in 2005. That agreement was only implemented in 2016 and very few companies are even aware of the existence of the agreement. It covers only 1 000 tariff codes (of around 8 500 that make up the full tariff book), but there is some value contained in the agreement. It is now part of our law and can be accessed by SA manufacturers.

We have signed and implemented agreements with the EU, SADC, EFTA and Mercosur. **We recommend that, as a starting point, roadshows are put together by dti (accompanied by online content) to educate companies about these agreements.**

The Tripartite agreement is still under discussion (with Egypt currently being negotiated). Companies with an interest in these fast-growing markets need to be contacted and asked to participate. An immediate call for input on the Continental Free Trade Agreement should be put out to SA manufacturers, so that this opportunity is not lost.

Summary of recommendations regarding trade

1. Explicitly change the mandate of ITAC to use its powers to support local industry, enable economic growth and preserve and create jobs through the application of trade policy within the confines of WTO.
2. Merge the dti and EDD to bring trade and industrial policy together.
3. Publish regulations for all of the available trade remedies, including those contained in our various trade agreements.
4. Update existing tariff and safeguard regulations to include an expiry date.
5. Insert expiry dates into the regulations for all investigation varieties, to ensure timely decisions.
6. Ensure all decisions result in complete reports to establish a proper public precedent and to improve accountability.
7. Amend the tariff regulations to obtain the approval of the Minister of Finance within a set timeline not exceeding three months prior to a final recommendation being made by the Minister of Trade and Industry, and provide access to Treasury during the tariff application given its defining role in the implementation of duty changes. All considerations by Treasury in arriving at its conclusion need to form part of the report which is published. Treasury's mandate in considering tariff applications should be focused explicitly on economic growth and job creation, and not on direct revenue collection *per se*.
8. Ensure that SARS is properly capacitated not only to police imports at ports of entry, but also to prevent the abuse of tariff codes by importers to evade duties.
9. Create an expedited normal duty increase process for industries in distress, including an ability to impose provisional duties.
10. Create an expedited process for the removal of duties on products not produced locally, including the removal of the requirement that these companies provide reciprocal commitments.
11. Amend the tariff regulations to put all normal duties through a mandatory review after five years.
12. Amend the ITAC guidelines so that rebates and drawbacks can be automatically applied to safeguard duties.
13. Publish clear rules for designation and localisation.
14. Appoint ITAC to manage the designation assessment process.
15. Insert alternative dispute resolution processes into the ITA Act to make lodging a dispute cheaper and more accessible to smaller companies.
16. Clarify the mandate of DAFF to support industry, and clarify accountability between DAFF and dti to avoid trade disputes with trading partners.
17. Implement an emerging industry protection policy with restricted scope and duration to encourage investment and increase competitiveness of nascent industries up to global standard.
18. Instruct SARS to simplify and accelerate the drawback process.
19. Ensure broader participation in trade agreement negotiations and when finalised, spend more time educating industry on the benefits of the agreements.

3.5 REGULATORY ENVIRONMENT AND INFRASTRUCTURE

Inclusive economic growth and job creation require both a stable and predictable regulatory environment, which encourages business confidence and attracts investment, and reliable and competitive infrastructure.

Policy and regulation

SA's policy and regulatory environment is often mentioned as an obstacle to economic growth as it diminishes the country's attractiveness as a destination for sustained investment. Research commissioned by BLSA and BUSA¹² points to the difficulties industry and commerce face: "Business has seen substantial bouts of uncertainty in recent years, some of which have come from single departments, and some in pieces of legislation that have come from different departments with seemingly contradictory provisions and no coordination. Business has also had, from [its] perspective, increasing intervention in the business space often with little consideration...[of] practicability or the unintended consequences in terms of implementation. Many pieces of legislation in recent years have run into conflict with the constitution."¹³

Trust and certainty are fundamental to investment. In recent years, the level of trust between government and business has been eroded in processes leading up to the adoption of many legislative measures. Concerns have included: 1. the lengthy time delays in gaining clear policy direction from government; 2. inattentive drafting and a lack of alignment and coordination between different policies and regulations; and 3. the sheer quantum of regulatory reform proposed, with government in many instances being so ambitious in introducing leading-edge benchmarks that many consider them to be risky and 'bleeding edge'. Many pieces of legislation are in limbo, with processes yet to be concluded or pending signature by the President, or awaiting government's announcement of their date of commencement.

Examples abound: The Minerals and Petroleum Resources Development Act (MPRDA) and the Mineral and Petroleum Resources Development Amendment Bill; the Mining Charter; the Expropriation Bill; the Protection of Investment Act; the Draft Carbon Tax Bill and the proposed tax on sugar-sweetened beverages are just some that immediately come to mind. In the consumer goods sector, there are concerns about the Draft Regulations of Labelling and Advertising Foodstuff Regulation No R429 and the Liquor Licensing Regulations 2013 & National Liquor Norms and Standards. And with regards to environmental policies, laws and regulations, business considers many to have admirable ideals, but consider them extremely complicated and problematic to implement and administer. Based on members' experience in other jurisdictions, the regulatory burden on SA business is extraordinary, in particular having regard to the frequency of policy changes. Not only does this detract from SA's attractiveness as an investment destination for new investors, but puts a cost burden on existing business who have to engage with proposed regulations, often at very senior level.

The negative impact of the Mining Charter has been well-documented elsewhere. This impact is, however, not only limited to the mining industry, but also has a twofold negative effect on the manufacturing industry, by severe negative impacts on investor sentiment, which raises the cost of capital for SA firms, and also because demand for manufactured goods for the mining industry has slowed down due to uncertainty created by the Charter.

This is exacerbated by the fact that many of the laws and regulations governing environmental management fall to provincial and local authorities to enforce. The shortages of capacity, skills and financial resources at local government level are well known.

Business considers that in some cases, government does not appear to have taken into account the serious concerns of the investor community, with consultation taking place not in order to identify and address concerns, but rather to tick the box that stakeholders have been consulted. The absence of meaningful engagement has meant that there is an increasingly adversarial tone to business engagements with regulators, with legal action or the threat thereof being invoked more and more frequently. This is at odds with the ideals of participatory democracy and goes against the notion that we are all stakeholders in our economy, and have its long-term sustainability and prosperity at heart.

¹²"Report on regulatory challenges impeding investment & employment in SA"

¹³Ibid, p5



Lengthy time delays in gaining clear policy direction impacts on the ability of businesses to plan for and introduce changes to their operations. Furthermore, key regulatory changes often depend on the completion of others. As a consequence, capital is allocated to destinations with fewer regulatory barriers.

We recommend that there be much more meaningful engagement between government and business, and that government consults business timeously and substantively on regulatory interventions if it is serious about stimulating investment and economic growth. In turn, business should commit to supporting the objectives of economic growth and job creation, and not seek to find ways of frustrating policies that will support these objectives.

We further recommend that government ensures that its policy and regulatory reforms are backed by local empirical evidence to demonstrate and clearly define the problems it wishes to address and that reforms are applied in close consultation with business.

Overall, we recommend that government endeavours to provide a more predictable, stable and competitive policy and regulatory environment and a more effective problem-solving partnership between government, business and labour. To this effect, and until the crisis of unemployment has abated to more acceptable levels, regulatory interventions should be subjected to a binary test: does the proposed policy contribute to economic growth and job creation? If it doesn't, the regulation or policy should be deferred.

Infrastructure

A manufacturing economy can only thrive if raw materials, labour and goods can be connected with suppliers, manufacturers and consumers. Furthermore, utilities such as road and rail, electricity, natural gas, water and fuel should be both accessible and appropriately priced to allow manufacturers to compete. Properly functioning and affordable infrastructure is a prerequisite for growing employment in manufacturing. Without addressing reliability, availability and cost of infrastructure, investors will not have the confidence to invest, regardless of other supportive policies and objectives.

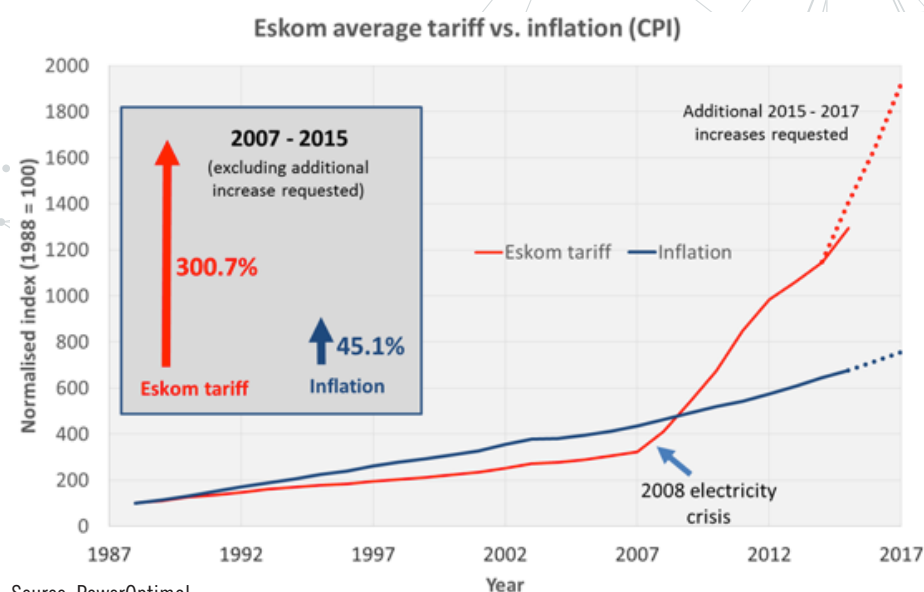
SA has a relatively well-developed infrastructure: in the World Economic Forum's Global Competitiveness Report for 2015-2016, it ranked 59 out of 140 countries in terms of its overall infrastructure quality. However, this infrastructure varies widely in both quality and cost. Since 2006, the grade awarded to SA infrastructure by the SA Institute of Civil Engineers (SAICE) has deteriorated from C- to D+ in its 2017 assessment. SAICE states that "although much of South Africa's built environment infrastructure is of high quality, the below-average grade reflects the continuing low maintenance levels, and even neglect in many areas, that is taking a toll on its resilience". This is in particular true of the infrastructure ecosystem within which manufacturing operates. Municipal infrastructure – including roads, water and electricity distribution – poses major risks to manufacturing. Having emerged from Eskom's regular load-shedding, factories now run their generators to compensate for unreliable municipal substations and electrical cables, and have to rely on fire water reservoirs to ensure continuous water supply. SAICE awards a failing grade of D- to these elements. Apart from the quality of infrastructure, the increasing cost of utilities is of particular concern.

The cost of infrastructure is very often a function of regulation: administered pricing is a major component of the input costs, as well as the distribution costs of manufactured goods. Ineffective regulation, or regulation that has a bias towards incumbent suppliers, rather than a supply-side growth-driven agenda, is a major constraint in increasing cost competitiveness, supporting investment and creating jobs.

Electricity

The cost of electricity, which historically has been a source of comparative advantage for SA manufacturers, is rapidly becoming one of the major disadvantages to growing our manufacturing base. The following graph shows the 300% tariff increase which Eskom has achieved since 2007.





Source: PowerOptimal

As a direct result, electricity sales to industry have declined precipitously since 2007, dropping by more than 17%. At the same time, Eskom's headcount has increased by 45% since 2007/08, and has remained between 47 000 and 48 000 for the last four years. In contrast, energy available for distribution has remained static, and has in fact decreased by 2%¹⁵. Electricity demand destruction is therefore a very real phenomenon. By some estimates, Eskom is likely to have 40 000 MW in surplus capacity in a decade. Against this alarming backdrop, Eskom's application for a 19.9% tariff increase shows a breath-taking ignorance of economics, and will surely only encourage paying customers to further reduce electricity consumption or to go off the grid using photovoltaic or other renewable sources. This will deprive Eskom of revenue, and lead to the so-called utility death spiral, of increasing tariffs and decreasing electricity sales.

Approving an above-inflation increase in electricity prices charged by a monopoly would be a negation of NERSA's regulatory role, and would provide further evidence of the failure of concurrent jurisdiction in regulating energy monopolies.

The moribund SA economy, in particular energy-intensive sectors like manufacturing, cannot absorb above-inflation increases. If approved, the 19.9% increase will precipitate a further round of factory closures, retrenchments and economic contraction. The economy, with unemployment levels that are alarmingly high, simply cannot absorb the proposed increases.

With Eskom's financial state now presenting a structural risk to the economy (according to Goldman Sachs) **the preferred solution would be to de-risk the utility by splitting it into three independent entities, viz. generation, transmission and procurement, in order to bring about a more efficient allocation of resources, and create opportunities for competition in the energy sector.**

Failure to address Eskom's structural issues will lead to an ever-increasing cost of electricity, ever-shrinking demand, and an ever-greater burden on the economy and ultimately on the taxpayer.

The high cost of electricity is exacerbated by the fact that municipalities augment their revenues by charging their customers a significant margin above Eskom tariffs. These surcharges are typically applied for general revenues, and not dedicated to the maintenance of electricity distribution infrastructure. In some instances, the entire electricity tariff is diverted to other uses, as in the case of the Emfuleni Municipality, home to the Vaal Triangle industrial heartland, where Eskom has threatened load-shedding due to non-payment by the municipality of electricity costs. For those Vaal Triangle manufacturers who have been paying their municipal utility bills, it is a serious concern to be confronted with load-shedding as a punishment for a sin which they did not commit. Exhortations to invest and employ hold little water when such administrative disincentives exist. **Capacity creation at municipal level to allow for secure and continuous service delivery to manufacturing hubs is essential to create investor confidence.**

¹⁵ The Eton Group | Eskom Financials Summary Report: 2017



Natural gas

The benefits to an economy of natural gas are well documented. In a 2015 study¹⁶, McKinsey estimated that the introduction into the SA economy of additional natural gas at more affordable prices could lead to the addition of R110 billion to GDP and the creation of 230 000 jobs. The reduction of natural gas pricing by 40% is estimated by McKinsey to enable investments in a variety of power generation and chemical opportunities such as polyethylene and methanol, important intermediate feedstocks for a variety of downstream manufacturers. These commodities are today the domain of one or two suppliers – with greater competition, the price of these raw materials should come down and enable more downstream investment. Affordable and competitive gas is therefore a key catalyst to unlocking economic growth and job creation.

Natural and methane-rich gas is currently supplied to SA by Sasol, which enjoys a monopoly in supplying gas sourced from Mozambique. While an initial ten-year regulatory dispensation from first gas enabled the complex cross-border project to proceed, the maximum gas prices determined by NERSA for the subsequent period are in fact higher than the initial, ostensibly more favourable dispensation. This is evidenced by the operating margins enjoyed by Sasol Gas. Although no longer separately disclosed, the gas distribution utility was historically able to record operating margins of 45%¹⁷. Backing out the volume of gas which Sasol supplies to its own plants, the operating margin on gas supplied to third party customers (predominantly in the manufacturing sector) is estimated to be in excess of 75%, while providing employment to a mere 318 people. The NERSA dispensation therefore clearly and disproportionately favours a monopoly player, at the expense of the manufacturing sector which employs 1.8 million people, and typically records operating margins of 8-12%. This disproportionate allocation of value across the gas chain is an inhibitor: for manufacturing to thrive, appropriate energy price regulation is required.

If NERSA does not regulate gas and electricity prices to favour investment, job creation and economic growth, we propose that the doctrine of concurrent jurisdiction (which prevents regulatory bodies from impinging on each other's territories) be reviewed in order to allow the Competition Commission to bring its scrutiny to bear on energy pricing.

Port and transport costs

SA ports are among the most expensive in the world. By the Ports Regulator of South Africa's own admission in its 2016/17 report, "In total, container costs including terminal handling charges are still 88% above the sample global average". These high costs are a significant barrier to trade, both import and export. The Manufacturing Circle cannot put it any better than the PRSA, the regulator responsible for this sector¹⁸: "Container cargo dues for 2016 are currently 182% above the global average...The data clearly indicates (sic) that South African cargo owners face significantly higher costs than that of the sample average, despite the shielding of the USD effect in this report. With the bulk of SA's manufactured goods arguably exported through containers, high costs are clearly contradictory to current industrial policy which aims to incentivise value addition, broadening of the manufacturing base, as well as increasing manufactured exports." High port costs therefore inhibit economic growth and job creation; surely an element which can and must be rectified.

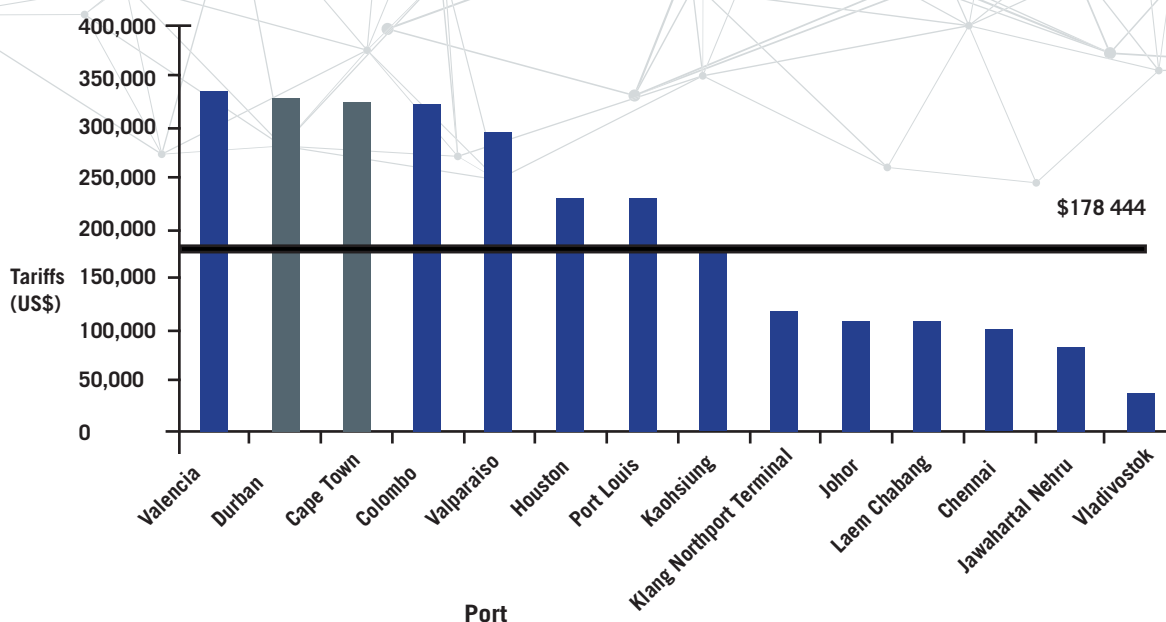
¹⁶ McKinsey Global Institute: South Africa's Big Five: Bold Priorities for Inclusive Growth

¹⁷ Source: Sasol AFS, investor disclosures, Manufacturing Circle analysis

¹⁸ Ports Regulator of South Africa (2016/17 report)



Total Port Costs including Terminal Handling Charges for Containers per Ship



Historically, ports have been the most profitable division of Transnet's operations. Profits generated from the ports have camouflaged poor performance at other divisions. Furthermore, the ports division has carried a significant share of Transnet's pension liability. However, the SA economy cannot afford to be penalized in terms of its global competitiveness in export and imports, particularly when import parity pricing is used to calculate a raft of administered and raw material (particularly fuel and polymer) pricing. Port charges are a significant component in the calculation of the Basic Fuel Price, which is a major portion in the price build-up that determines the regulated price of petrol and the price of diesel.

Lowering port tariffs to be globally competitive will not only act as an immediate boon to exporters, thereby stimulating local manufacturing, but will also reduce input cost into the economy, with positive impacts on disposable income, and raw material cost. The impact of these cost reductions will further contribute to a positive impact on other costs, such as wages and other inflation-related expenditure.

We propose that port tariffs in SA be investigated with a view to rapidly reducing them to international competitive rates, in order to support exporters, reduce the cost of intermediate goods and to reduce the import cost element of import parity priced commodities.



3.6 SKILLS AND LABOUR

Developing and sustaining a skilled workforce while managing higher labour costs and optimising productivity are essential to drive manufacturing competitiveness and growth. Limitations in skills supply as the Fourth Industrial Revolution takes hold, higher-than-inflation cost increases and below-par levels of productivity are blockages to enhanced job creation and economic growth.

Skills

A key to driving manufacturing competitiveness is a skilled workforce able to adapt to changing market and production conditions, and which can benefit from innovation and investments in new technologies.

A limited skills supply is one of the blockages to growth of the manufacturing sector. Shortages of suitably trained artisans and middle management are the result of a number of factors. These include poor output from the schooling system, limited uptake into the Technical and Vocational Education and Training (TVET) system and incoherence between the programmes offered through the TVET system and the skills demands of the manufacturing sector.

In basic and tertiary education, general skills are prioritised. Industry-specific or technical skills are in short supply. The shortage of skills and the ageing of the available skills are key cost factors affecting the medium-term sustainability and expansion of SA's industrial activity.

We recommend that the education system be realigned to focus on delivering skills that are required for further training in areas with the highest potential for job creation.

The Sector Education and Training Authority (SETA) system, mandated to develop and implement sector skills plans according to industry demand requirements, is not functioning effectively. With a combined allocation of more than R14 billion in ring-fenced funds per annum, and a history of SETAs having to be put in administration owing to poor management and governance issues, the value proposition to industry is on the whole more negative than positive. There are 21 SETAs that deliver a series of training programmes that are typically not suitably coordinated with industry.

As mandated by the SETA system, employers pay 1% of salary payroll to SARS on a monthly basis. Collections are applied to SETA administration costs (10%) and the National Skills Fund (20%), with the remaining 70% theoretically claimed back by companies, subject to the training programmes they have undertaken. Most companies are trying to maximise the amount of training done internally, in order to claim back SETA levies. However, the administration and collection cost of the SETAs still remain as an additional burden on business. Furthermore, given the misalignment between industry needs and the skills programmes offered, many companies are undertaking private initiatives on a separate basis, effectively paying twice for skills development, while the National Skills Fund currently has an available budget of some R3.4 billion, with R10 billion in accumulated surplus and reserves. Collection and administrative costs add up to R400 million per annum. This is an additional tax on business, with poor outcomes in terms of matching skills to the requirements of the economy.¹⁹

We recommend that the SETA system be abolished, but that the skills levy be retained for general revenue purposes, with deductions to be claimed by companies from SARS for training actually done. The accumulated surplus and reserves can be applied to reduce education and training costs through existing channels.

¹⁹ National Skills Fund Annual Performance Plan 2016/17



Compounding the issue is the requirement to contend with increased global competitiveness by remaining a player in advanced manufacturing. This demands a constant review of skills. The Fourth Industrial Revolution (also referred to as Industry 4.0 and which is based on the use of cyber-physical systems) will lead to disruptive changes to business models that will have a profound impact on the employment landscape.

An estimated 65% of children entering primary school today will ultimately end up working in job types that are completely new and do not yet exist, according to the World Economic Forum's 2016 Future of Jobs report ²⁰.

Core jobs in production will shift from manual- to tech-intensive activities, requiring different skills sets. Demand for customised products will raise demand for skills in design and R&D. Fourth Industrial Revolution trends will not only disrupt traditional manufacturing jobs, but also jobs in design, development, and related services.

This dynamic is resulting in an increasing skills gap, which is exacerbated by the emigration of highly skilled workers from SA shores alongside immigration restrictions for highly skilled foreigners. An additional challenge is that education is directed mostly at new entrants to the job market, rather than at existing workers.

We recommend that the visa system for scarce skills be revised with a view to enabling scarce skills to be deployed in SA, with requirements related to the duration of such visas and demonstration of skills transfer to SA citizens.

It is estimated that across the world, more than 5% of manufacturing jobs remain unfilled due to the ever-increasing skills gap. "Talent-driven innovation" is regarded as the number one ranked driver that impacts a country's ability to compete in manufacturing. SA industry faces increasing pressure to seek solutions to transform the manufacturing industry and close the increasing skills gap.

The systemic challenges in the skills pipeline for the manufacturing sector need to be addressed by assessing both the supply of skills and the effective alignment of skills supply with the demand for skills in the industry. In this regard, industry supports the following initiatives:

1. The Department of Planning, Monitoring and Evaluation (DPME) has launched a study to enhance education, training and skills outcomes in the manufacturing sector. The output of the study is intended to identify key elements for college reform to improve throughput and quality for TVET colleges, and ensure greater opportunities for labour market absorption of TVET graduates. Stakeholders comprise representatives from DPME, DHET, the dti, SARS, the Manufacturing Circle, TVET colleges and research advisors.
2. The Department of Trade and Industry: Industrial Development Division: Future Industrial Production & Technologies: Technical vocational youth development. This initiative has been designed to target talent-driven innovation while simultaneously reducing the skills gap. This new programme is an expansion of the successful pilot Intsimbi National Tooling Initiative Programme (NTIP). The public-private partnership is an integrated end-to-end industry system solution to address the increasing skills gap for technical training. NTIP is a successful, proven and fully scalable model that delivers internationally benchmarked workers ranging from entry level through artisan, technician and engineering skills requirements.

We recommend that the highly successful NTIP model be scaled up to accelerate the provision of skilled labour across all levels for the manufacturing sector.

The B-BBEE codes contain two provisions that seek to promote skills development. A company training previously disadvantaged people can qualify for a maximum of two points under the maximum of four points. An unintended consequence of this discrepancy is that companies are disincentivised from training more than their requirement, because companies that do not incur a training expense can take a free ride by getting double the credits by appointing people whom they did not train.

²⁰ World Economic Forum, 2016, "The Future of Jobs"



Labour

Unemployment in SA has grown consistently since 2013, and is currently at a crisis level of 27.7%. While the misery of poverty has to some extent been abated by an effective redistributive system of social grants, the economy ultimately needs to create jobs if the people of SA are to enjoy the dignity and fulfilment of work, and to alleviate the burden on the fiscus of ever-increasing social grants. Structural changes are required to our labour system if we are to create a million jobs. Doing more of the same will not deliver job-rich growth.

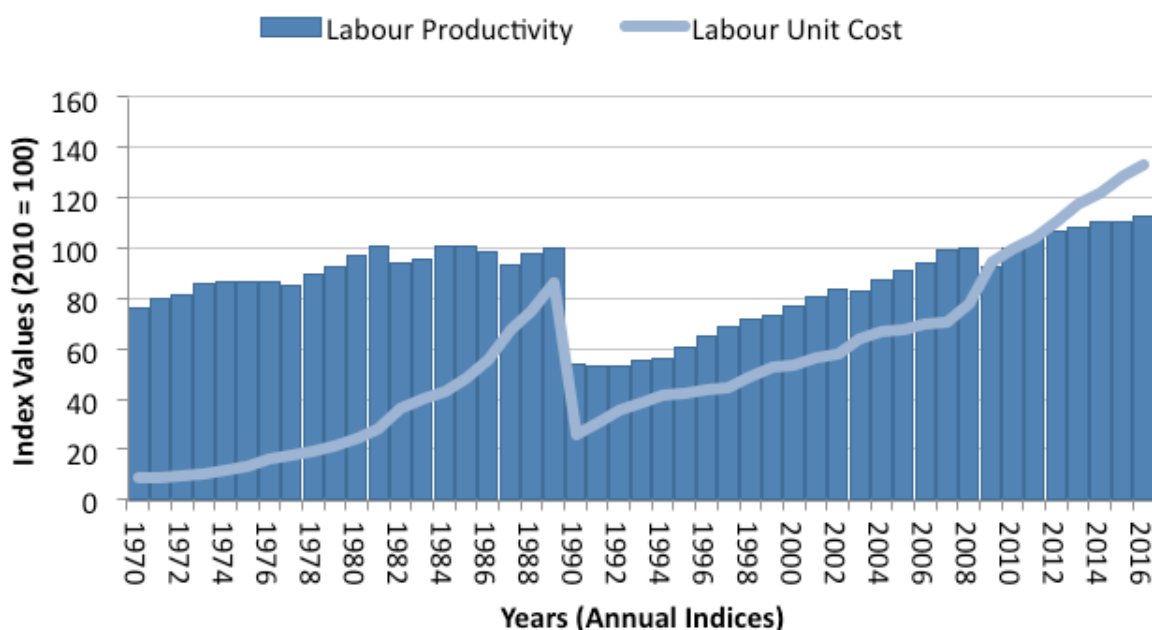
Increasing labour costs in SA influence decisions towards automation and mechanisation of operations, which has resulted in manufacturing shedding half a million jobs, even as productivity has grown. To address the unemployment crisis, we need labour-intensive growth, not capital-intensive growth. Two major factors play a role: labour cost, and labour flexibility.

The collective bargaining process contributes to driving up costs, as unions representing labour in larger companies generally enter negotiations from a higher starting value, well above the National Minimum Wage. Agreements for industry-wide percentage increases do not take affordability into account in terms of varying sub-sectors and company sizes.

When enacted, strike action also increases wage costs. Strikes are often accompanied by widespread intimidation and public violence, forcing employers to take costly security measures, or to suffer damage to property and equipment. Furthermore, productivity is impacted due to delays in output, and disruptions in the supply of labour. Labour costs are also being driven up due to skills shortages, where poaching of certain skills and trained personnel between companies has an inflationary effect.

Manufacturers are operating in an environment where wages are increasing and productivity is falling. This is a paradox because higher wages are needed to improve livelihoods and yet the poor state of human capital means that labour productivity gains are difficult to achieve. In relative terms, SA labour costs including wages and benefits are very high. Consequently, labour productivity and nominal unit labour costs are diverging, as is shown in the graph that follows. Indeed, between 2000 and 2011 nominal unit labour cost increased by 34% while productivity increased by less than half that at 13%.

Manufacturing labour productivity and labour unit cost



Source: (SARB, 2017) Calculated by TIPS from electronic database on manufacturing labour productivity and labour unit cost.



In negotiations, organised labour does not represent the unemployed and accessing employment opportunities for new entrants is therefore more difficult due to the relatively high entry-level wages that have been established. Labour is facing the same hurdles as business with regard to the lack of an effective social wage in SA in terms of public education, medical and transport systems, to name a few, as well as measures to address the impacts of crime.

Labour productivity needs to be addressed by improving poor management and first line supervision. Industry also needs to improve fundamental skills of running a factory, planning production and maintenance, optimising inventory and run lengths while meeting customer requirements. Better process management and production rationalisation will improve labour productivity.

We recommend that business improve collaboration to gain economies of scale in supervisory and management skills training in order to improve productivity in manufacturing by better management practices.

Increases in shop floor productivity are linked to workers acquiring the right skills, and functioning in well-managed systems. Shift systems could also be optimised, but are jeopardised by ineffective public transport systems and crime-related incidents.

Building on the acknowledgement by both business and labour, who came together for an unprecedented two-day meeting in June 2017, that business and labour together need to find solutions to SA's pressing socio-economic challenges, **we recommend that:**

- **Business and labour work together to get the economy going and don't just engage across picket lines. Greater and more meaningful collaboration is required to improve competitiveness, innovate, and create the growth opportunities needed to improve living standards.**
- **Business must consider alternative governance structures to enhance cooperation with, and transparency to, labour. Business needs to commit to facilitate better understanding within the workforce of the state of the economy and the issues facing business in sustaining operations.**
- **Labour must consider ways to introduce the excluded unemployed into the labour market in a way that is affordable and sustainable.**
- **Labour and business need to review the collective bargaining process. The exemption of small and medium enterprises from collective bargaining agreements should be considered.**
- **Business needs to improve training and accountability of middle management to improve shop-floor governance and productivity.**
- **Business also needs to introduce better process management and production rationalisation to improve labour productivity.**
- **Business needs to organise neighbourhood watches in certain factory zones and to assess the opportunities that clustering presents to improve support infrastructure and security for shift employees in the areas of production.**
- **Business and labour must collaborate to collectively motivate for improved education, health, transport and security services to upgrade the social wage in SA.**
- **Labour and business must stimulate aggregate domestic demand by actively supporting Proudly SA.**

Source: (SARB, 2017) Calculated by TIPS from electronic database on manufacturing labour productivity and labour unit cost.

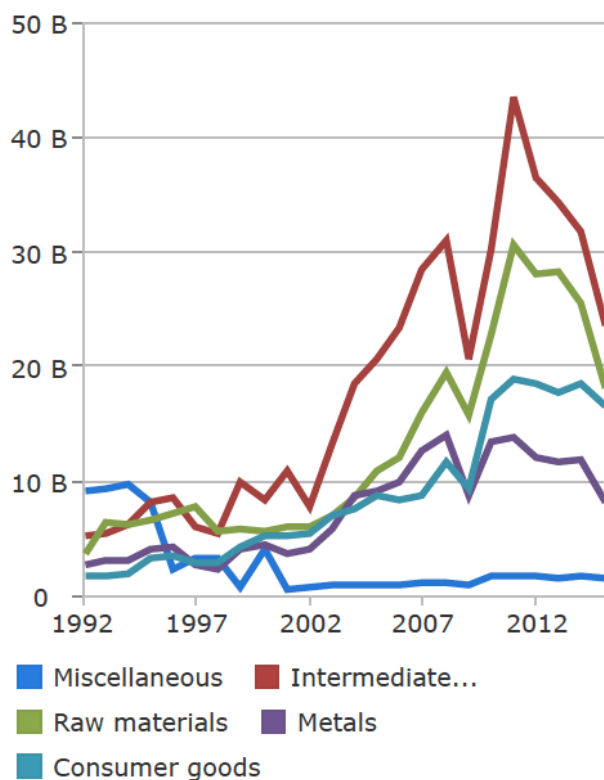


3.7 SUPPORTING LOCAL PROCUREMENT

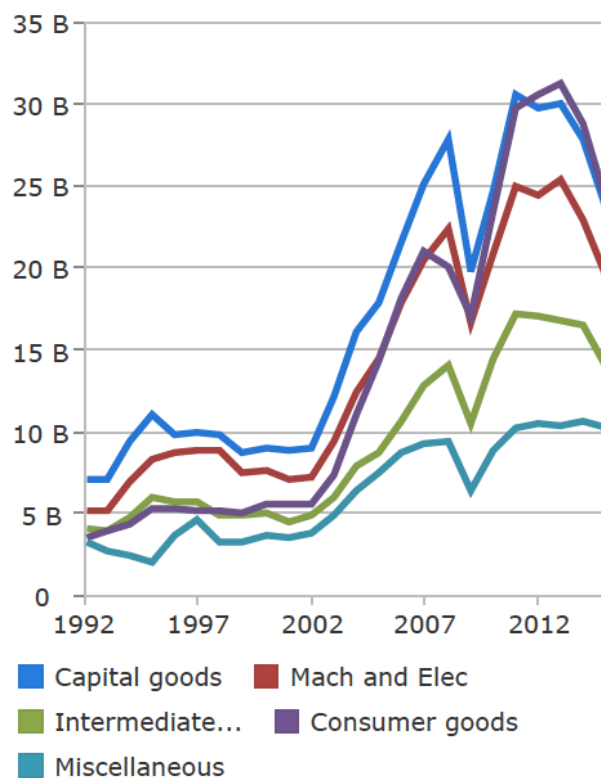
A commitment by South Africans to procure locally manufactured and beneficiated products, provided that they are competitively priced, increases aggregate demand and supply, thus supporting manufacturing, job creation and economic growth.

SA's economy is hugely reliant on exporting raw materials and intermediate goods. We import capital goods, consumer goods and machinery and electrical equipment, often made from the same raw materials that we exported. The value addition to raw materials by manufacturing processes is therefore lost to the economy, as are opportunities to create jobs and investment.

Exports (US\$ Thousand)

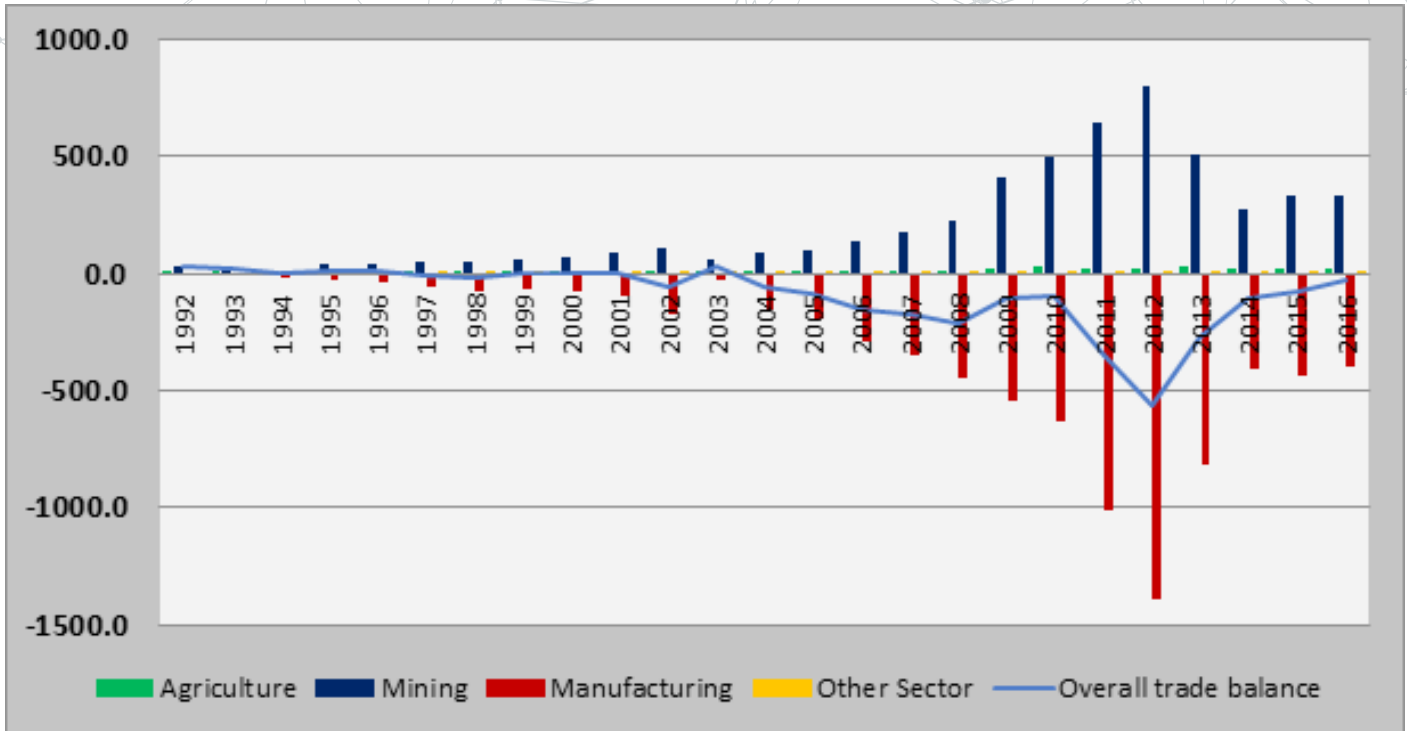


Imports (US\$ Thousand)



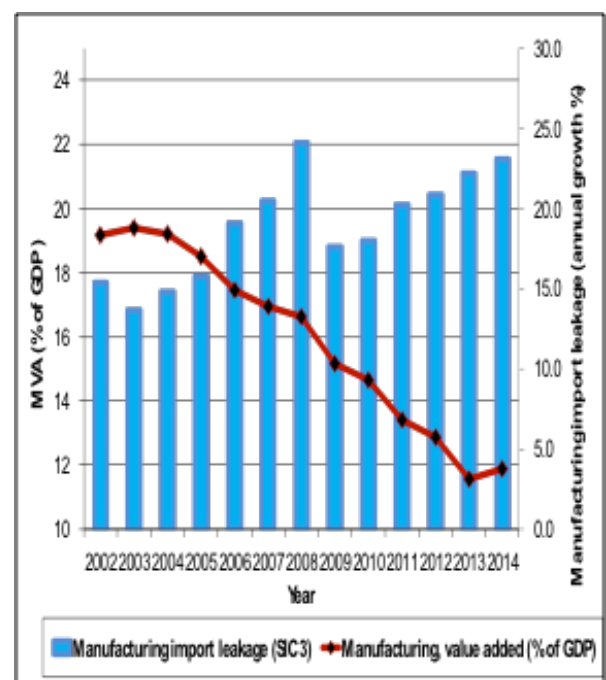
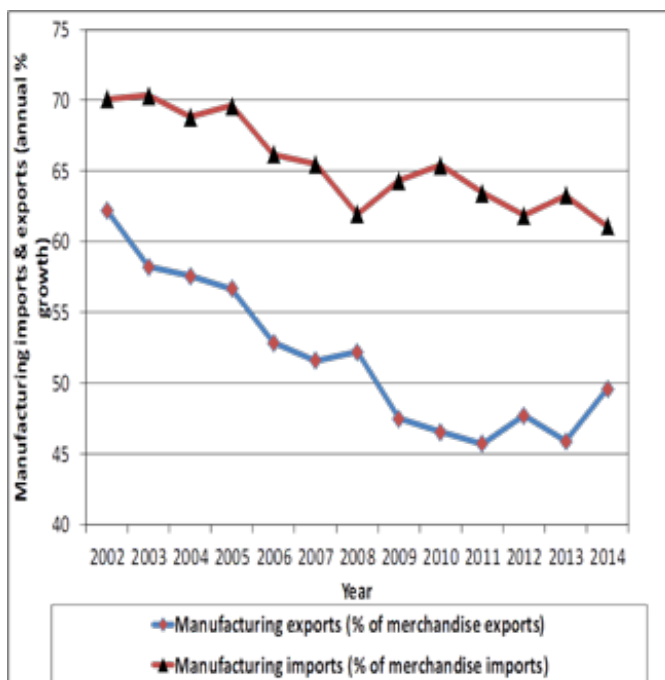
Even though SA currently has a trade surplus, our manufacturing sector is experiencing a trade deficit as evidenced in the graph that follows:

SA's trade balance according to broad sector (R bn) 1992-2016



Source: the dti, compiled from the StatsSA and SARB databases

This trend is further evidenced in the following graphs indicating how, since 2002, manufacturing imports have exceeded manufacturing exports, and manufacturing as a percentage contribution to GDP has declined as imports have increased.



Source: SARB, IDC, the dti



To reverse this trend, both business and government should increase their commitment to procure locally manufactured and beneficiated products that are competitively priced. The demand created by deliberately buying locally produced goods can be an important driver in creating economies of scale for locally manufactured goods, expanding local markets.

In the public sector, government purchasing power through public procurement contributes between 15% and 25% to GDP (on the value that is extracted from large-scale procurements). Therefore, preferential procurement by government is a lever to promote local industrial development. The Preferential Procurement Policy Framework Act (PPPFA) was enacted in 2000, and its Regulations promulgated in 2001. Local Content Regulations came into effect on 7 December 2011 through the 2011 PPPFA Amended Regulations. They are still applicable in the 2017 Public Procurement Regulations which stipulate that:

- the dti is empowered to designate specific industries/sectors, where only locally manufactured products that meet the stipulated minimum threshold for local content will be considered;
- organs of state must include local content requirements in their bid invites;
- National Treasury must inform organs of state via circular;
- organs of state can “self-designate” provided they consult with the dti and National Treasury; and
- bids that fail to meet the required local content are unacceptable.

Currently, 21 sectors/products have been designated with more to follow. Some challenges are being experienced in implementation, due to the large number of public procurement entities, not all of which have an understanding of the PPPFA and technical complexities in product specifications for certain projects. These issues are not, however, insurmountable.

We recommend that government continues to communicate the importance of local procurement to the wide range of public procurement entities (as currently undertaken by Proudly South African’s Public Sector Preferential Procurement Forums); and that designated products are specified in tenders (as currently undertaken by Proudly South African’s Tender Monitoring System). Also, non-compliance needs to be effectively dealt with (as is currently being considered in discussions with the Auditor General).

Effective implementation requires collaboration between the state and industry.

Furthermore, we cannot afford unintended consequences negatively impacting on local manufacture when advancing designated groups in terms of B-BBEE Status Level of contribution, EME or QSE levels. The 2017 Public Procurement Regulations provide that tenders may now contain a specific condition to advance designated groups. The new regulations allow a “set aside” of tenders for firms with a certain B-BBEE status and/or small- and medium-sized enterprises. A tender which fails to meet the prequalification criteria may be rejected upfront from consideration. This is an admirable policy objective, but susceptible to a species of fronting, which is to the disadvantage of local manufacturers. In some instances, products have been procured from B-BBEE accredited suppliers, who then import the products in question, while existing SA manufacturing businesses with a lower accreditation level but higher employment numbers have been compromised. In other cases, ‘set asides’ assigned to designated groups cannot be fulfilled and business is therefore not assigned.

We recommend that procurement designation policies and regulations be explicitly formulated to benefit local SA manufacturers, provided quality and commercial terms are competitive, and that suppliers who import products be awarded contracts only when no local supply is possible.

The importance of local procurement in the private sector is also critical, by industry and by end consumers. In industry, the critical nature of local procurement, particularly in the retail sector, needs to be clearly communicated and understood. For example, we have seen developments in the clothing and textiles sub-sector involving Proudly South African where a value chain approach has been applied starting with demand-pull initiated by clothing chains working all the way upstream to include locally based cotton growers in production.

Key to this argument is that consumers need to understand that the purchase of locally manufactured goods ultimately results in money flowing back into the country’s economy.



We also need to identify the top 100 imported products and where localisation can take place. This requires an assessment of manufacturing capacity and the ability to produce in SA through the analysis of the complete value chain of each product.

We therefore recommend that:

- **Government continues to communicate the importance of local procurement within its structures, and that designation of products is monitored and complied with.**
- **Government should increase the threshold applied to B-BBEE enterprise development (ED) beneficiaries to support real ED as well as the development of black industrialists at scale.**
- **Business needs to prioritise the importance of local procurement, both within industry and by end consumers by identifying opportunities in value chains for local procurement.**
- **Business must support Proudly South African in doing what some labour unions are achieving – tracking and raising the flag when tenders that should be filled locally are designed for imports.**
- **Business must work to help consumers understand the importance of buying locally, and provide the means to identify local manufactured product when making purchasing decisions.**
- **Business must identify key imported products and assess where localisation can take place by understanding manufacturing capacity through application of a value chain assessment.**
- **Business and government must formulate and communicate an economic analysis of the cost/benefit of a local manufacture approach.**

CONCLUSION

In many respects, SA appears to be at a tipping point. Record levels of unemployment, rising poverty levels, increasing political uncertainty and the large-scale diversion of resources away from inclusive growth to the beneficiaries of state capture have created an environment in which investors are understandably cautious, and are rather seeking investment opportunities abroad. If we continue on our current low road, the prospect of an IMF intervention beckons, with the associated loss of sovereignty in determining our own economic future. Against this backdrop, we run the risk of a toxic cocktail of continued further de-industrialisation and job losses.

Investor confidence cannot, however, be legislated by fiat. For investors to open new factories and employ more workers, they need to know that there will be demand for their products, and that they will be able to operate in a stable political, economic and fiscal environment.

As a nation, there has never been a greater need to coalesce around two complementary objectives: inclusive economic growth and job creation. Of all the sectors in the economy, manufacturing offers the greatest opportunity to deliver both. The Manufacturing Circle believes that the proposals made in this document are eminently doable. We do not require the equivalent of a moonshot; we need simple and effective interventions in how business, government and labour work together to grease the cogs of industry. Our proposals are modest, and can be achieved with ease if the necessary political will is applied. Our proposals are not costly to the fiscus: on the contrary, the additional tax revenue from a million new jobs will far exceed the cost of extending modest incentives to manufacturers.

We submit our proposals to our fellow manufacturers, to ministers and administrators, to regulators and policy writers, to labour and to business, but also to the public at large. If we succeed in catalysing a debate on how to grow the economy, and put more people to work, we will have achieved the first step on the road towards creating a million new jobs in manufacturing.





ACKNOWLEDGEMENTS AND CREDITS

Thanks

Trade and Industrial Policy Strategies (TIPS) provided much-appreciated advice and support in the formulation of this document. Executive Director Saul Levin facilitated industry workshops, advised on industrial policy and assisted with conversations between the Manufacturing Circle and policy makers. TIPS will continue to provide support as we implement plans and initiatives following the launch of this document.

We are also grateful to the dti for its tireless commitment to the industrialisation of our economy, as evidenced by a thorough body of work ranging from various iterations of the Industrial Policy Action Plan (IPAP), to specific strategies on areas such as gas industrialisation, local procurement and future industrial production and technologies. The Department of Planning, Monitoring and Evaluation will be instrumental in our work on skills development going forward.

As a member of Business Unity South Africa (BUSA), the Manufacturing Circle was fortunate to access research and discussion documents and communication platforms.

Understanding and navigating technicalities and formulating industry recommendations in the fiscal and trade policy environment would not have been possible without the support of Cova Advisory and XA International Trade Advisors. Proudly South African also generously shared their insights into local procurement.

Marek Hanusch, World Bank Senior Economist, Global Practice for Macroeconomics & Fiscal Management, also provided assistance, referring us to various sources of research.

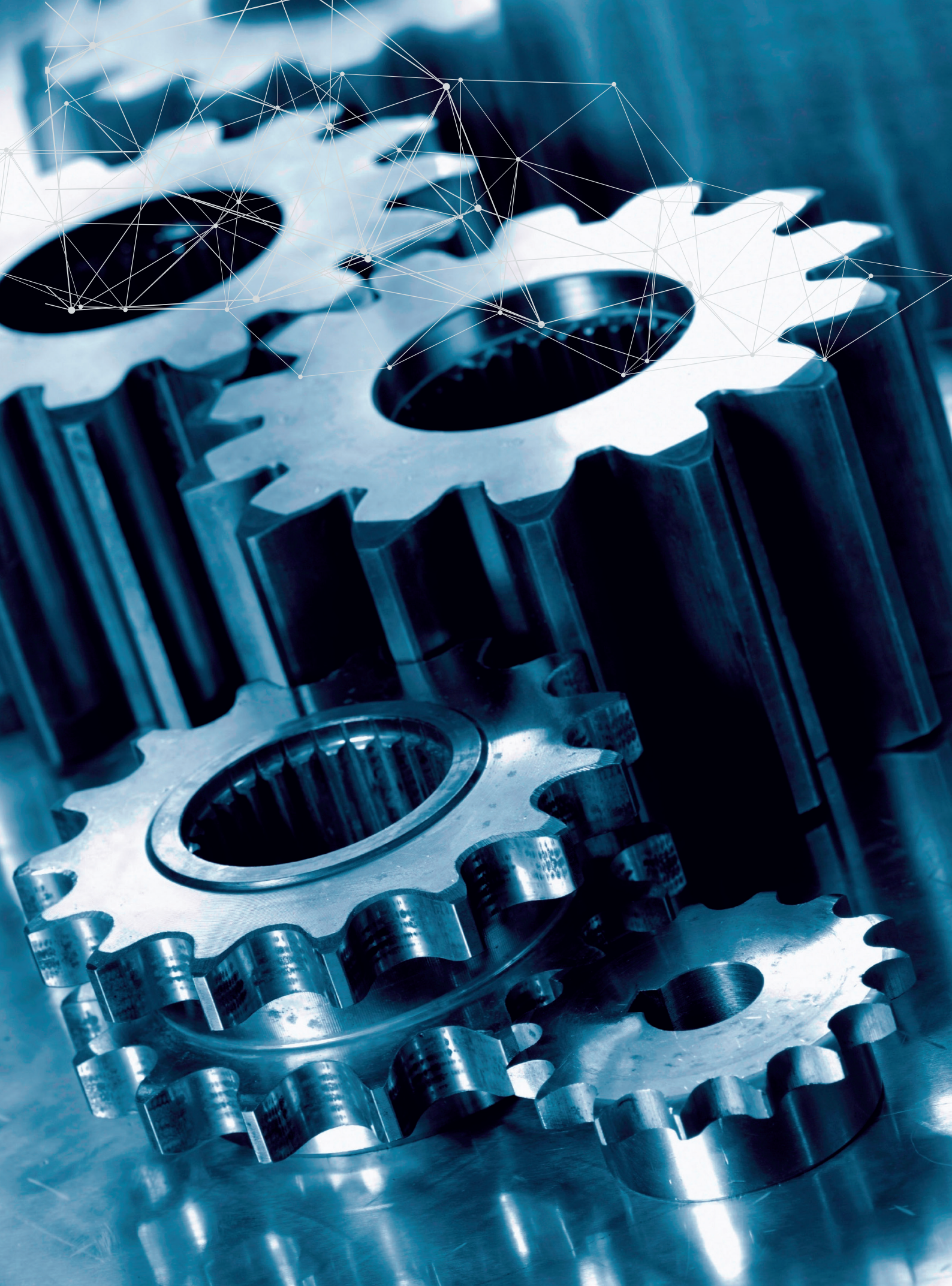
The formulation of recommendations would not have been possible without the support of a wide range of manufacturers who took the time to engage in workshops and participate in interviews. Our Manufacturing Circle members were key to this process. In addition, Packaging SA, Plastics SA and CAIA assisted in widening the engagement in various manufacturing sub-sectors.

The Map to a Million is a collaborative undertaking. We will continue to engage as many manufacturers as possible, and in so doing, continue to strengthen the voice of industry for the benefit of all.



MAP TO A MILLION

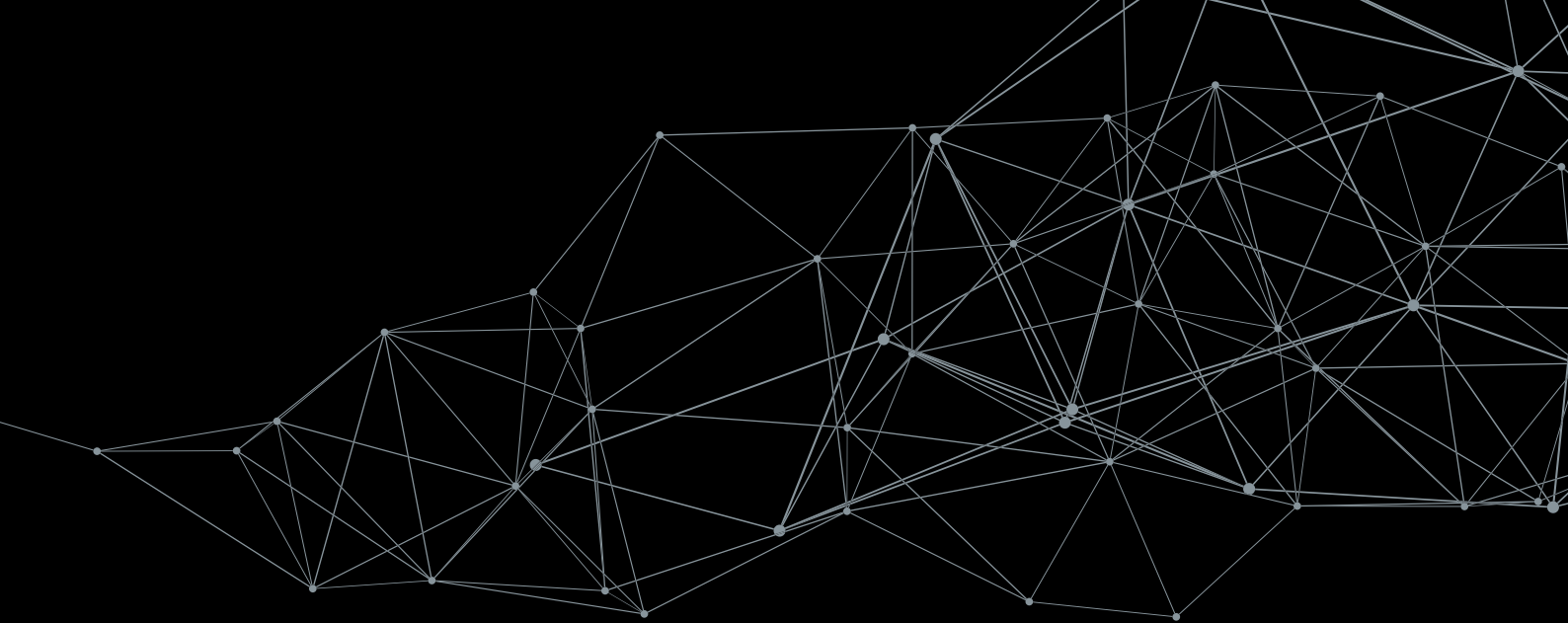




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