MANUFACTURING AS AN ENGINE OF JOB CREATION
PPGI FIVE YEAR SECTOR PLAN

29 JANUARY 2019

MANUFACTURING CIRCLE
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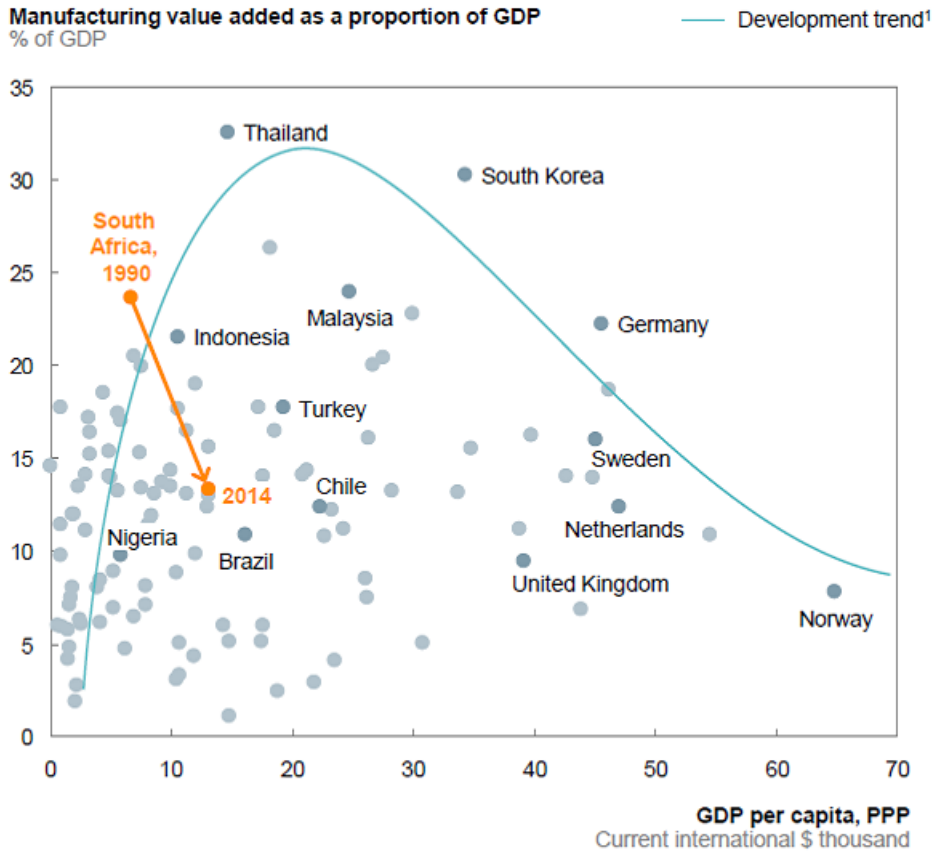
Manufacturing's contribution to GDP has fallen from 24% in early 1980s to less than 13% in 2017



1 Not a mathematical fit, but an observed trend that manufacturing peaks at 30–40% of GDP before gradually declining as a country's wealth grows.

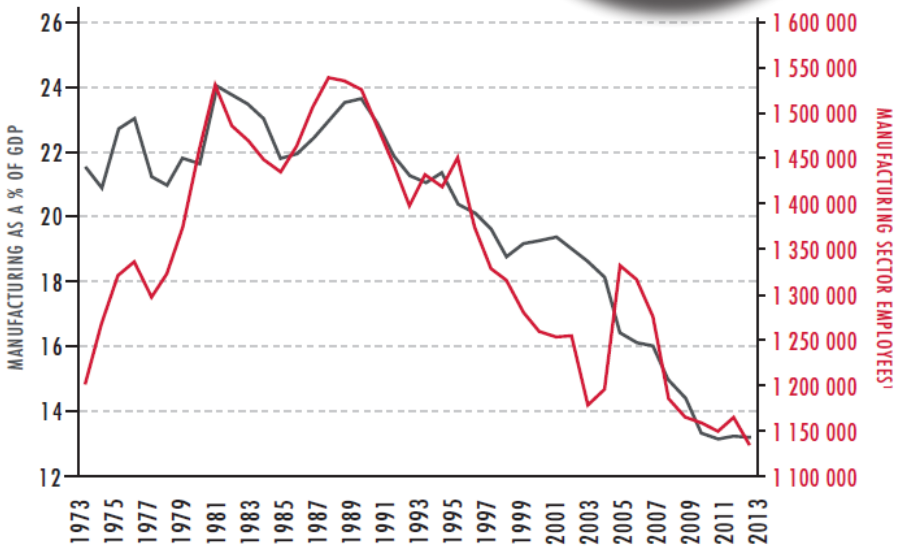
SOURCE: World Bank World Development Indicators; McKinsey Global Institute analysis

- South Africa's manufacturing growth is lagging other emerging markets
- Reasons are many:
  - Increased competition from imports
  - Increased labour costs
  - High energy costs
  - Infrastructure
  - Policy and regulatory uncertainty
  - Asymmetrical compliance with WTO rules
- For SA's stage of development, manufacturing should contribute double to GDP

Premature de-industrialisation is a fact in SA

Decline in manufacturing correlates closely with a drastic loss of jobs

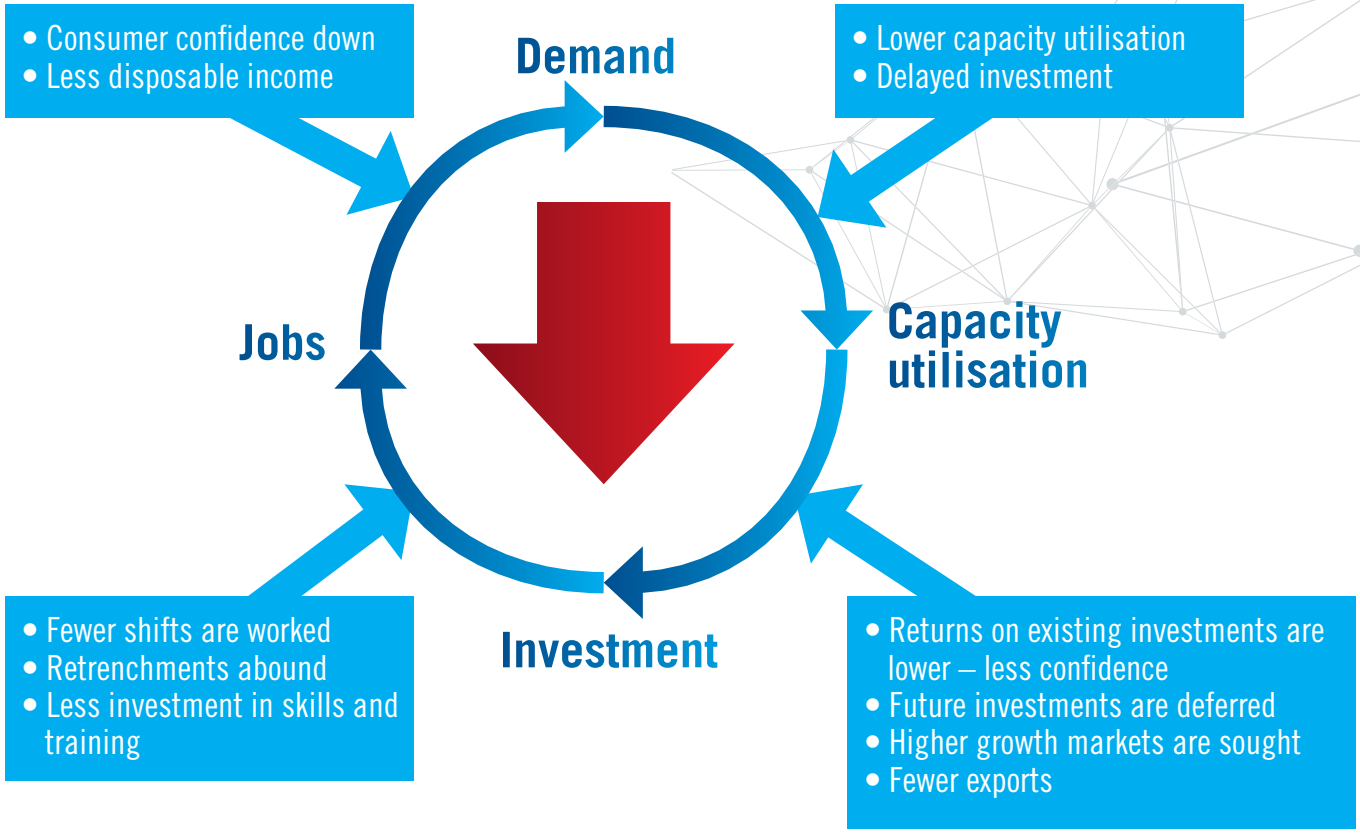
GRAPH 1 **SA MANUFACTURING**



Source: Stats SA, South African Reserve Bank

- **SA manufacturing has 300 000 fewer manufacturing jobs than in 2008**
- **For every manufacturing job impacted, an estimated three to five indirect jobs are affected**
- **Premature de-industrialisation is a key driver of unemployment in SA**
- **Unemployment at 27.5% in Q3 2018**

The vicious cycle of de-industrialisation



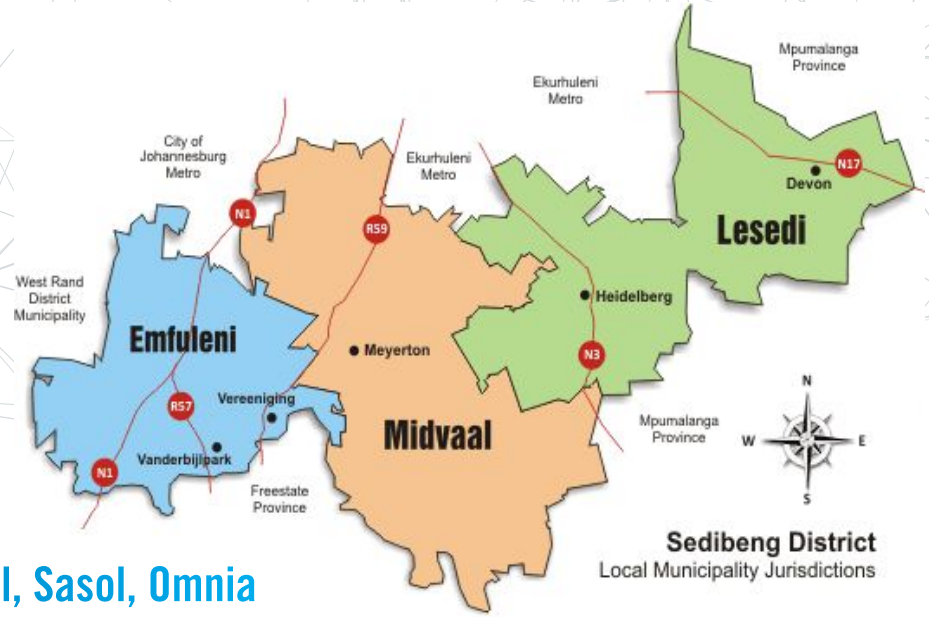
"Premature de-industrialisation has serious consequences ... It reduces the economic growth potential and the possibilities for convergence with income levels of the advanced economies."
– Dani Rodrik

"History teaches that a strong economy begins with a viable manufacturing base. Africa must find a viable path to prosperity without passing through an industrialisation phase [and jump to a services phase]. This is not likely to happen." – Jerry Jasinowski

Without a virtuous cycle of investor and consumer confidence, supported by stable policies, South Africa will continue to de-industrialise, without the capacity to move to a services economy

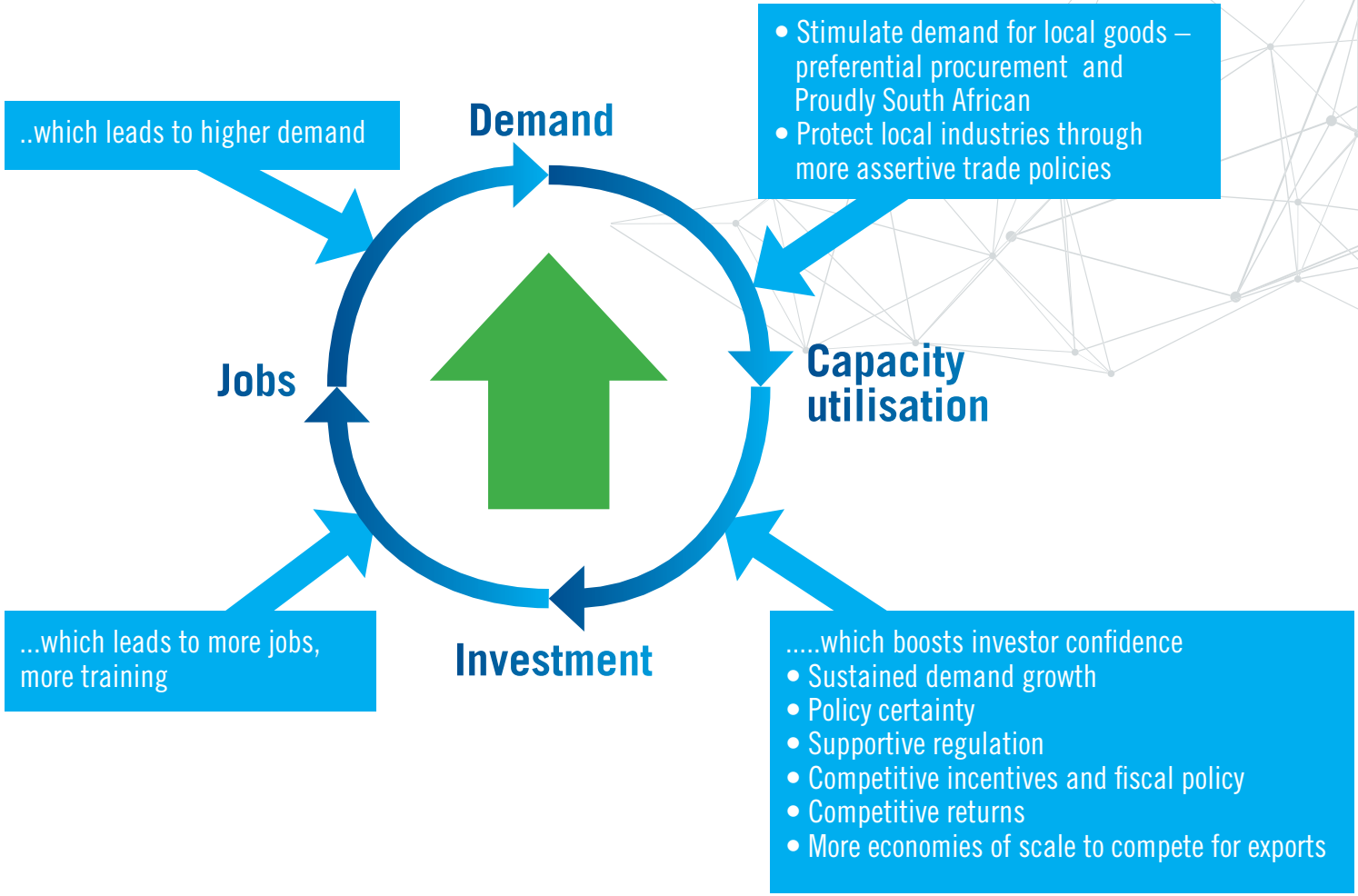
VAAL TRIANGLE AT A TIPPING POINT

- The Vaal Triangle is turning into SA's Rust Belt
  - Significant plant closures
  - Slow rate of investment
  - Major plants viability under threat
  - Negative social consequences
- Infrastructure exists
  - Road, rail, pipelines, water
  - Social: hospitals, housing,
  - Educational up to tertiary level
- Major raw material producers: Arcelor Mittal, Safripol, Sasol, Omnia
- Major converters: Nampak, Dorbyl, Hall Longmore
- Human capital: Boipatong, Zamdela, Bophelong, Sebokeng
- Access to markets in Gauteng
- Major export hub into Africa
- Unemployment rate of 47%
- Steady decrease in investment
- Growing populations
- Increasing number of discouraged job seekers
- Emfuleni municipality compromising industry



Report and recommendations submitted by the CEO Initiative to the President and Finance Minister, Nov 2018

Creating additional demand for local goods is the key to a virtuous cycle that promotes economic growth



Investment will not take place if demand-side policies do not dovetail with supply-side policies

Economic growth depends on demand growth

Demand growth strategies should be supplemented with supply growth strategies through industrialisation, otherwise imports and inflation will rise

- **Consumers need more disposable income to drive demand**
- **Fiscal constraints make tax relief unaffordable**
- **Lower repo rate by SARB will be inflationary**
- **Other levers are therefore required**
  - Review administered prices (fuel, gas, electricity, rail, port, data)
  - Reduce effective interest rates by applying the National Credit Act
  - Revisit industrial policy to nurture and grow existing base
  - Increase infrastructure appropriations that deliver (eg SANRAL)
  - Declare a War on Waste
    - > Enhance effectiveness of Auditor General
    - > Consequence management for non-compliance
    - > Inject private capital into SOEs to derisk fiscus and lower SA Inc's cost of capital

1. Put more money in to consumers' pockets to increase demand
2. Grease the wheels of industry to drive investment

Growth facilitates transformation

A growing manufacturing sector offers transformation opportunities in

- Skills development
- New jobs
- New businesses (range of size and geographic location)

Localisation of procurement spend is key

We are committed to advance the reputation of South African manufactured products by

- Promoting preferential procurement for locally manufactured and beneficiated products that are of competitive quality and price
- Supporting buy local campaigns
- Identifying the potential for increased expenditure from local producers
- Assessing opportunities in value chains to identify opportunities for import replacement and export led growth

Codes of Good Practice on Broad Based Black Economic Empowerment currently have the unintended consequence of incentivising the import of inputs when assessing procurement

RECOMMENDATIONS

Boost demand for goods manufactured in SA

Demand-side interventions

INCREASE AGGREGATE DOMESTIC DEMAND

- Commit to support local procurement, Proudly South African
- Consider government investment in catalytic projects (eg Rovuma gas to SA)
- Increase the renewables component of electricity procurement
- Reconsider administered prices (eg petrol) to put money back into consumers pockets

PURSUE IMPORT REPLACEMENT

- Alter ITAC mandate to support SA industry
- Align ITAC reporting into dti
- Actively promote collaboration between producers across value chains to enhance in-country value addition, eg agro-processing, platinum, manganese, steel

ENHANCE EXPORT COMPETITIVENESS

- Implement export incentives
- Reduce port tariffs and improve port efficiency
- Consider re-instating rail subsidies for containers destined for export
- Emulate MIDP programme for key industries

RECOMMENDATIONS

Lower manufacturers' cost base to improve competitiveness

Supply-side measures

REDUCE INPUT COSTS

- Ensure effective energy price regulation
- Regulate pricing of key inputs from sole suppliers, including monomers
- Enable competition in electricity generation
- Use IDC to support industrialisation and lower cost of capital – liquidate longstanding investments

FISCAL POLICY

- Recapitalise the successful Section 12I incentive
- Loosen criteria for Section 11D (R&D) tax incentive
- Continue Section 12L (energy efficiency), with less onerous M&V standards
- Implement 15% tax rate in SEZs, also apply it to distressed industrial areas
- Allow accelerated depreciation (similar to S12C) for manufacturing buildings
- Implement conditional tax holidays for investments
- Reconsider carbon, sugar and packaging taxes

LABOUR

- Extend National Tooling Initiative Programme to resolve skills shortages
- Implement transport subsidies to overcome spatial distortions
- Ease work permit process for scarce skills
- Include labour in company governance structures to increase transparency

RECOMMENDATIONS

Fix structural issues holding back growth and investment

- Create a MITI-style super-ministry
- Introduce private sector equity participation in SOEs, eg SAA, with governance to reduce waste
- Focus on education as an essential service
- Target policy certainty and reduced currency volatility to free up balance sheet capacity – fewer 'shock absorbers' needed for foreign loan covenants
- Support municipalities with capacity to deliver and maintain infrastructure
- Split Eskom into generation, procurement, transmission; introduce private sector equity partners; stop nuclear; support renewables
- Abolish SETA system, give direct tax credits for training
- Rethink concurrent jurisdiction to give Competition Commission more power

RECOMMENDATIONS

THE ROLE OF BUSINESS

- Current manufacturing capacity is underutilised
- Job losses and de-industrialisation need to be arrested before real growth is observed and new jobs are created
- Industry can commit to boosting demand for goods manufactured in SA by

  - buying local
  - identifying import substitution opportunities
  - enhancing export competitiveness.

- We can also consider alternative governance structures to enhance cooperation with, and transparency to, labour
- In this ramp-up period, little new investment can be expected.
- Concurrently, government needs to address structural conditions in the economy that are conducive to investment
- Industry needs a reasonable prospect of achieving success
- Government needs to create the conditions through policy certainty, co-ordination and alignment
- This will allow business to actively collaborate to create inclusive, tangible economic growth

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