



## Wits School of Governance

### **THE POLITICAL ECONOMY OF INDUSTRIAL POLICY – THE CASE OF IMPROVING MANUFACTURING THROUGH LOCALISATION**

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## **ABSTRACT**

The scope of the study is defined within the field of development economics specifically focusing on localisation industrial policy aimed at stimulating manufacturing. The primary objective of this paper is to deepen understanding of the link between economic development and localisation of the manufacturing value chain. Through analysis and examination, this research delves into debates surrounding South Africa's adoption of a localisation policy as an instrument for increasing domestic output levels. The study also investigated factors contributing to South Africa's de-industrialisation and declining manufacturing capacity. Through conversational semi-structured interviews, the researcher gained insights into the challenges facing manufacturing and the feasibility of localisation.

According to the findings of the study, the manufacturing sector faces significant obstacles to localisation, including manufacturing costs, policy instruments, poor infrastructure and logistics networks, and inadequate demand. Both global and domestic factors have had an impact on the manufacturing sector dynamics. Significantly enough for the successful implementation of localisation policies will be the political will and support. The research findings highlight the need for the implementation of effective monitoring and evaluation systems to improve policy execution. If implemented well, localisation will not only foster industrial development but may also promote an inclusive economy.

Keywords:

Localisation, industrial policy, manufacturing

## **DECLARATION**

I declare that this report is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Management (in the field of Economics and Development) at the University of the Witwatersrand, Johannesburg. It has not been submitted before for any degree or examination in any other university.

*KMochaki*

Koketso Michelle Mochaki

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## Abbreviations and Acronyms

AfCFTA	African Continental Free Trade Agreement
APDP	Automotive Production and Development Programme
ANC	African National Congress
CBAM	Carbon Border Adjustment Mechanism
BUSA	Business Unity South Africa
DTIC	Department of Trade, Industry, and Competition
ERAP	Economic Recovery Action Plan
ERRP	Economic Recovery and Reconstruction Plan
EU	European Union
GDP	Gross Domestic Product
IDC	Industrial Development Corporation
ILO	International Labour Organisation
IMF	International Monetary Fund
IPAP	Industrial Policy Action Plan
ITAC	International Trade Administration Commission of South Africa
NDP	National Development Plan
NIPF	National Industrial Policy Framework
OECD	Organisation for Economic Co-operation and Development
PPPFA	Preferential Procurement Policy Framework Act
RIS	Re-imagined Industrial Strategy
RSA	Republic of South Africa
SABS	South African Bureau of Standards
SARS	South African Revenue Service
SARB	South African Reserve Bank
SEDA	Small Enterprises Development Agency
SMME	Small, Medium, and Micro Enterprises
SOE	State-Owned Enterprises/Entities
SSA	Sub-Saharan Africa
STATS SA	Statistics South Africa
WTO	World Trade Organisation

## **Chapter 1: Introduction**

The development agenda of the country places significant importance on the manufacturing sector as a key contributor to economic growth, development, and job creation. This sector holds potential for driving economic activity and creating employment opportunities through its capacity to create linkages across different sectors of the economy. Crucial elements for driving industrialisation and employment opportunities include a strong political will and a sound industrial policy framework to encourage investment in manufacturing activities. Global business cycles, domestic macroeconomic policies, domestic politics, geopolitics, and education and training systems also play pivotal roles in industrialisation (Chang, 1997).

The manufacturing sector in South Africa has suffered an untimely decline in contribution to the economy (Edwards & Jenkins, 2015). Since 1990, manufacturing's contribution to GDP has declined sharply, and manufacturing output has grown slower relative to other upper-middle-income countries (Black, Craig, & Dunne, 2017). Production in the economy has been below optimal levels. Structural unemployment remains rampant, thus presenting a need for active industrial policy to boost growth in manufacturing and absorb more labour (Reinert, 2010). Despite efforts to boost growth through policy implementation, the domestic economy has deteriorated over the years (Moyo, 2016).

The impact of apartheid in South Africa caused pervasive racial divisions and marginalised a considerable portion of the population, therefore government needs to intervene in building an economy that creates job opportunities and wealth for all as a means towards achieving national unity. This ideal scenario involves the convergence of political and economic powers to fulfil the needs of society. However, there is a stark difference between the perceived "real" and "ideal" scenarios, which can be addressed through government help (Balkaran, 2017). According to Mufuruki, Mawji, Kasiga & Marwa (2017) and Munger (2022), it is for governments to implement policies to bridge the gap between the desired outcomes and current circumstances.

Industrial development, improving per capita living standards, and creating employment are a function of domestic history, expectations, values, beliefs, institutional structures, and power relations (Todaro & Smith, 2009). South Africa's economic and industrial policies are impacted by past colonial and apartheid legacies. The democratic government recognised that past methods of industrialisation and industrial policy are inadequate and needed to emphasise the significance of enhancing international competitiveness in promoting industrial development (Chang, 1997; Andreoni, Kaziboni, & Roberts, 2021).

In 2020, as a response to the impact of the COVID-19 pandemic, the government announced plans to re-industrialise the manufacturing sector through localisation initiatives. Since 2014, the South African government has included localisation in its policy agenda (DTIC, 2021), and it became a prominent aspect of industrial policy from 2020 onward (Fortunato, 2022). The rationale behind these initiatives is that they can be instrumental in fostering the development and innovation of local industries. However, these policies have been riddled with corruption and non-compliance in the past, reflective of fundamental difficulties in implementing industrial policies in South Africa (Andreoni et al., 2021). Improving local capabilities in the private and public sectors is essential for successful localisation and local content initiatives. This can be achieved through institutional support that emphasises training and technology investment (Transformation, S.S.E, 2018; Andreoni & Tregenna, 2018).

While the government has shown its ability to foster the growth of local firms in the automotive industry via the Automotive Production and Development Programme (APDP), there remains a prevalent sense of doubt surrounding ongoing industrialisation efforts through localisation initiatives. According to Kaplan (2007), South Africa's industrial policy is constrained by two major factors: the domestic macroeconomic framework and international agreements like the World Trade Organisation (WTO) that limit the policy choices, in particular, export promotion initiatives. Additionally, Kaplan also advises that institutional and governance issues should also be considered.

## 1.1. Background to the study

Industrial policy, development, and economic growth have been extensively debated, documented, and researched. Many studies have shown that the manufacturing sector stimulates sustained economic growth, enables greater labour absorption, and creates linkages across the economy (Kaldor, 1967, 1968; McCausland & Theodossiou, 2012; Kazan, 1959; Ocampo, 2017; Mufuruki et al., 2017). Kaldor's Growth Laws, particularly Kaldor's First Law, identified the manufacturing sector as the engine of growth, where growth in manufacturing output leads to a corresponding increase in GDP (Sule & Inedu, 2018).

The pandemic has highlighted that manufacturing remains the foundation of the economy. Simultaneously, the pandemic exposed the vulnerabilities of production value chains and underscored the adverse impact of globalisation and the importance of regionalisation and localisation on the domestic economy. The interruption in global supply chains led to demand and supply imbalances, which negatively affected domestic manufacturers' reliance on imported intermediate and capital goods (Industrial Development Corporation (IDC), 2020). As a result, production contracted, and there were significant job losses in the sector. In quarter four of 2021 alone, manufacturing lost up to 85 000 jobs compared to earlier quarters throughout that year.

The Department of Trade Industry and Competition (DTIC) attributes weak manufacturing output to increased competition from imported final goods and high dependence on imported inputs (DTIC, 2016). South African manufacturing output and exports do not exhibit the desired structural transformation. This means that there is not sufficient growth in domestic value-added and upward movement along the value chain (Andreoni & Tregenna, 2018). This aligns with Malan's (2015) assertion that the manufacturing sector is not fulfilling the industrial policy objectives of building a diverse, labour-intensive, and export-oriented economy.

Acknowledging this critical role of manufacturing in job creation and the overall expansion of the economy, multiple government policies, including the 2020 Economic Recovery and Reconstruction Plan (ERRP) and the 2019 Re-imagined Industrial Strategy (RIS), emphasise its significance. In 2020, during the height of the pandemic, the government, with the support of its social partners, declared the ERRP as a

response to the effects of the COVID-19 pandemic. A critical aspect of the ERRP is the re-industrialisation of manufacturing, which aims to revitalise the production economy and boost labour demand through localisation (National Treasury, 2020; IDC, 2020).

Localisation aims to minimise dependence on imported goods by channelling demand from foreign goods to domestically produced goods. This approach not only enhances domestic production but also encourages export-oriented manufacturing while integrating small and medium-sized enterprises (SMMEs) that were previously excluded from all levels of the manufacturing value chain. The fundamental goal of localisation is to support the local economy by absorbing local labour, using local resources, and fostering local entrepreneurship (Gruhn, 2019; Hartley, 2018). Andreoni et al. (2021) stated that localisation or local content policies need to be aligned with strategic trade policy because the country has not made efforts to protect final manufactured products.

There is a theoretical basis for the role of government in industrial policy theory and practice. However, there are significant practical challenges, including the possibility of government failure, the possibility of rent-seeking, and the possibility of using industrial policy tools for protectionist purposes (Warwick, 2013). Currently, the policy of localisation causes disagreements between policymakers and industry stakeholders.

## **1.2. Problem Statement**

South Africa's manufacturing industry has traditionally relied on the abundant supply of locally available natural resources and heavy state intervention through import-substitution policy tools. However, the current trend of, de-industrialisation, the uncertain outlook of the manufacturing sector, and the plateau in growth over the past decade suggest that industrial restructuring is necessary (Nel, Rogerson, & Marais, 2006). There is an apparent consensus on the need to build a diversified, labour-intensive, and export-oriented manufacturing sector since there has been evidence of early de-industrialisation that has been accompanied by unrelenting joblessness in recent years. This reinforces Chang's 1997 suggestion that South Africa needs major

industrial restructuring, which requires an active industrial policy. It is the opinion of the researcher that Chang's opinion still holds in the prevailing domestic and global environment.

The state has not been able to successfully pursue industrialisation, partly attributable to the ambiguity in industrial policy and the abstract nature of policies, thus failing to have the maximum impact (Chang, 1997). The history of the country, fragmented state, inadequate bureaucracy, and policy incoherence influence the political economy and pose a challenge to the successful implementation of industrial policy (Chang, 2013; Kaplan, 2007). Recently, these sentiments have been echoed about the localisation policy.

In 2018 the DTIC reported that the capacity, capabilities and competitiveness in the local manufacturing industry have not grown despite efforts to improve efforts to encourage improvement in the industry through the National Industrial Policy Framework (NIPF) and Preferential Procurement Policy Framework Act (PPPFA) (DTIC, 2018). According to van Wyk (2012), South Africa has the potential for localisation, but challenges lie in the lack of strong political will, negative public perception, and ambiguity in localisation policy. Lack of industry confidence is another concern since it is widely acknowledged that without stakeholder buy-in, the success of the policy hangs in the balance. Another contention is that such policies have had limited success in most industries and have previously been considered protectionist and distorted international trade. Nevertheless, local content requirements are making a comeback in current policymaking, particularly in developing countries (Rennkamp & Westin, 2013).

According to Makgetla (2023), the localisation approach to industrialisation remains relatively under-theorised and is often wrongly equated to import-substitution industrialisation. Moreover, there is a need for research on how best to achieve the aims of localisation while balancing various objectives and considering feasibility factors.

## **1.2. Purpose Statement**

The research explores various aspects of South Africa's manufacturing industry, particularly focusing on industrial policy and challenges related to localisation. It aims to explore perceptions of localisation as a policy and its feasibility in the current political and economic climate. The study seeks to identify contentious factors regarding localisation and its perceived implications on manufacturing and the broader economy.

- a) This research aims to analyse and investigate the debates on localisation as a policy in the South African context.
- b) The study also aims to explore the concept of localisation and its tools, identify challenges and opportunities, and formulate policy proposals.

### **1.3. Research Questions**

The study set out to answer the following questions:

What is the feasibility and potential impact of implementing a localisation policy in South Africa?

- i. How can localisation policies be effectively designed and implemented to maximize their positive impact on the manufacturing sector and the broader economy?
- ii. What are the main challenges and opportunities associated with implementing localisation policies in the current political and economic climate?
- iii. Are the objectives of localisation compatible with each other?

### **1.4. Structure of the research**

The dissertation consists of six chapters, which are as follows: Chapter 1 is an introductory chapter providing the context of the research, the statement of the research problem and the research objectives. Chapter 2 reflects and describes the prevailing dynamics and performance of the manufacturing sector and SMMEs. Then Chapter 3 provides a summary of the literature survey on localisation, the political economy of industrialisation, industrial policy evolution in South Africa, and the theoretical framework and empirical evidence. Chapter 4 outlines the design and

methodology followed in the study. It reflects on the research approach, design and method, the process of collecting data and the methods of data analysis. Chapter 5 discusses and analyses the findings, an in-depth interpretation and presentation of the key findings of the research. Finally, Chapter 6 gives the deductions drawn from the study, recommendations and concluding remarks.

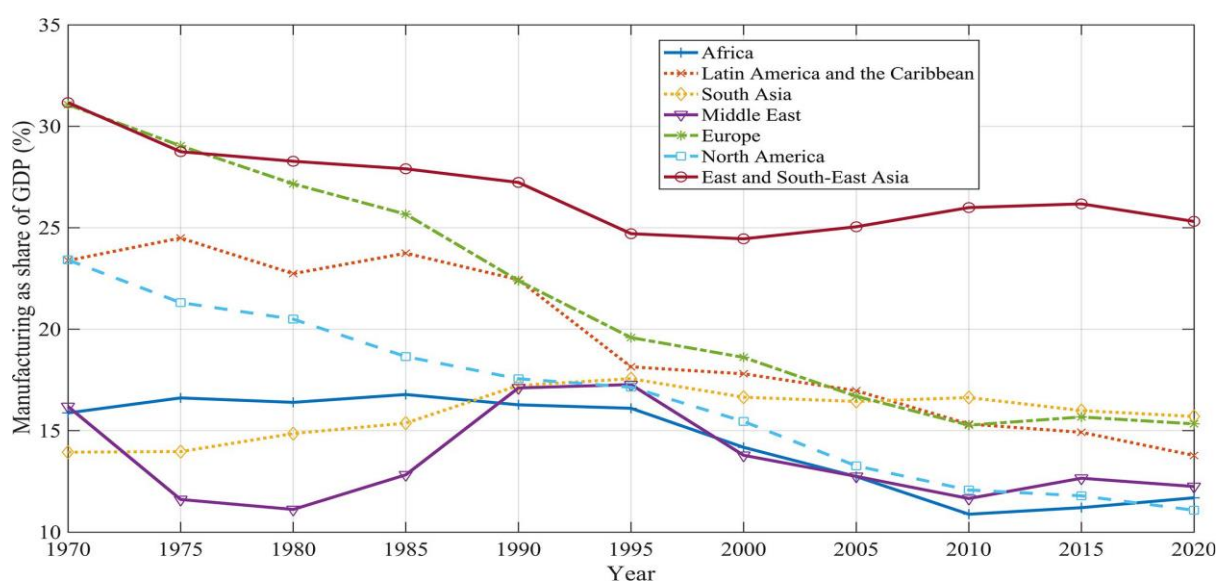
## **Chapter 2: Overview of the domestic manufacturing sector and SMMEs**

### **2.1. Introduction**

Compared to other global regions, Africa still trails behind in manufacturing production. The food and beverages industry are Africa's dominant manufacturing industry, followed by clothing and textiles. However, South Africa has succeeded in establishing a thriving automobile assembly and production industry. Between 2005 and 2014 manufacturing production across Sub-Saharan Africa (SSA) grew by an average of 3.5 per cent annually. This growth was more than twice the pace seen in global manufacturing growth and five times that observed in the European Union (EU). Although it should be noted that not all SSA countries were growing; Nigeria and South Africa have been facing declining production (Transformation, S.S.E, 2018).

Africa's lowest manufacturing value added (MVA) compared to other parts of the world dates back to the 1990s resulting from factors such as weak institutional capacity and poor implementation of policies related to issues of bureaucratic incompetence and fiscal constraints. The 1990s Structural Adjustment Programmes (SAPs) have been linked with de-industrialisation across Africa. The programmes were prescribed to developing nations as a precondition for receiving financial aid or loans. The idea behind SAPs was to help economies become more economically efficient and globally competitive. Yet, SAPs prematurely exposed vulnerable African economies to global competition with little to no government assistance as these programmes promoted market liberalisation and a minimalist approach towards government spending resulting in the lowest MVA during this period (Moyo, 2016).

Figure 1: Manufacturing as a share of gross domestic product (GDP) in world regions, 1970–2020.



Source: UNCTAD

### 2.1.1. South Africa's manufacturing sector

South Africa's manufacturing sector was established around infrastructure and mineral extraction activities which explains the dominance of metal products and petrochemical industries that made up most of the industrial sector (Andreoni et al., 2021). The industrial policy, therefore, was premised around the minerals-energy complex (MEC) and the beneficiation of mining commodities (Roberts & Rustumjee, 2010). The Department of Mineral Resources and Energy (DMRE) defines beneficiation as the value-added processing of primary materials (mining commodities) into more finished goods with higher export value. Currently, there are efforts to add even greater value-adding activities in the economy, particularly in the manufacturing sector through a localisation approach.

Driven by the desire for economic independence through local industries, the apartheid government engaged in selective interventions that led to the establishment of a robust industrial sector that was dominated by six conglomerates and state-owned entities (SOEs); the most notable ones being ISCOR, Transnet, Sasol, and ESKOM, (Zalk, 2014 as cited by Ngulube, 2014; Andreoni et al., 2021). The apartheid government relied heavily on SOEs to achieve their goals of industrialisation. The then-government ensured that SOEs and the related industries had strong linkages

with one another and there was significant emphasis on vertical integration, which is to say, that downstream industries fed into the upstream industries (Roberts & Rustomjee, 2010). The key to achieving dynamic and sustainable industrialisation is creating linkages within the local economy, in other words, localisation of value chains (Agarwal, Ismail, and Mkhabela, 2023). Export diversification, mineral beneficiation and localisation will underscore linkages within the value chain (Roberts & Rustomjee, 2010). Additionally, the state ensured that all the firms in the value chain received some form of support (Roberts & Rustomjee, 2010). Vertical integration among the state entities and the related industries reduced the cost of production, it enabled domestic firms to withstand global competition as well as economic sanctions that were instituted against the discriminatory government.

During apartheid the manufacturing sector peaked in line with a spike in investment in infrastructure and mining projects, however, industrial production has been on the decline over the past three decades, from accounting for 23.1 per cent of GDP in 1993 to 13.2 per cent in 2021. Industrial activities during apartheid were supported through incentives and tariff protection schemes under state-led efforts until at least the 1980s. SOEs' development and competitiveness were also nurtured by the support and protection provided by the government (Fortunato, 2022; Andreoni et al., 2021). The sector's decline over the years may be attributed to the failure to diversify as well as diminished support from the state (Ngulube, 2014, STATSSA, 2023).

Current industrial policy objectives include boosting local firms' competitiveness and export diversification. This can be achieved by strengthening capacity in energy and capital-intensive upstream activities while simultaneously supporting downstream activities of the value chain. According to Andreoni et al, (2021), structural transformation of the manufacturing sector requires enhancing and diversifying the downstream activities rather than focusing on upstream capital-energy industries. This forms a basis for the state to support infant industries as opposed to the prevailing support afforded to the upstream activities.

Trade policy reforms, competition policy, and supply-side support measures are crucial to realising these objectives effectively. In 2018 the DTIC reported that the capacity, capabilities and competitiveness in the local manufacturing industry have not grown despite efforts to encourage improvement in the industry through the

implementation of the National Industrial Policy Framework (NIPF) and Preferential Procurement Policy Framework Act (PPPFA) (DTIC, 2018). The government also noted that state-owned enterprises often neglect requirements for localisation set out in the PPPFA which hinders progress towards advancing the sector (RSA, 2019). Ideally, SOEs should align and support the country's developmental mandate however, over the years, structural and operational challenges have rendered SOEs inefficient in driving economic development and structural transformation (Fourie, 2014).

According to Roberts & Rustomjee (2010), policymakers must acknowledge the sector-specific historical and political economy such as evolving interests and power dynamics. Failure to account for the political economy in the sector may result in the larger businesses and monopolies continuing to abuse their dominance in the local market and continue to unduly benefit from state support at the expense of infant industries that need government assistance.

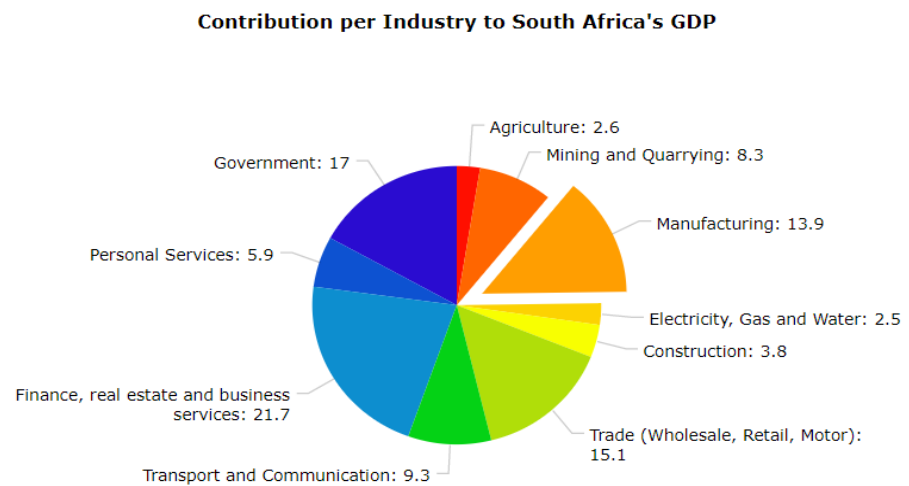
South Africa's manufacturing value add, and employment peaked from 1981 to 2008. However, when the global financial crisis hit in 2008/09, the industrial sector followed the global trend of premature de-industrialisation. Despite over ten years passing since the global financial crisis, the manufacturing sector has seen some of the worst contraction in both value-added and jobs created relative to other developing economies (Fortunato, 2022). Zalk (2014) and Fortunato (2022) observed that South Africa has been experiencing premature de-industrialisation like many other developing nations therefore re-industrialisation of the industrial sector may prove to be difficult given the challenges facing developing nations

South Africa is among 13 economies that have decreased their production by roughly 3.3 per cent over the past decade, along with Brazil and Russia. The industrial sector accounted for about 30 per cent of GDP from 1960 to 1980, while also being a significant source of employment opportunities (Fortunato, 2022). Bhorat & Rooney (2017) opined that the industrial sector has historically benefitted from relatively lower wages and uninterrupted electricity supply; however, these benefits have recently diminished. In recent times, manufacturing has been grappling with a challenge where wages are increasing faster than productivity, resulting in wage growth outpacing productivity growth. It has been reported that employee compensation in the

manufacturing sector saw an increase in 2022 compared to pre-pandemic levels, with an average growth rate of 6.4 per cent since then (STATSSA, 2023). Higher wages and salaries were found to be a financial burden for SMMEs. Furthermore, Bhorat & Rooney (2017) mentioned that deficiencies in skills and capabilities in the country make it difficult to absorb modern technologies that will enable the sector to move up in the manufacturing value chain.

Figure 2: Sectoral contribution to South African GDP

Note this figures represent total value added at basic prices (so this excludes the net effect from subsidies - taxes).



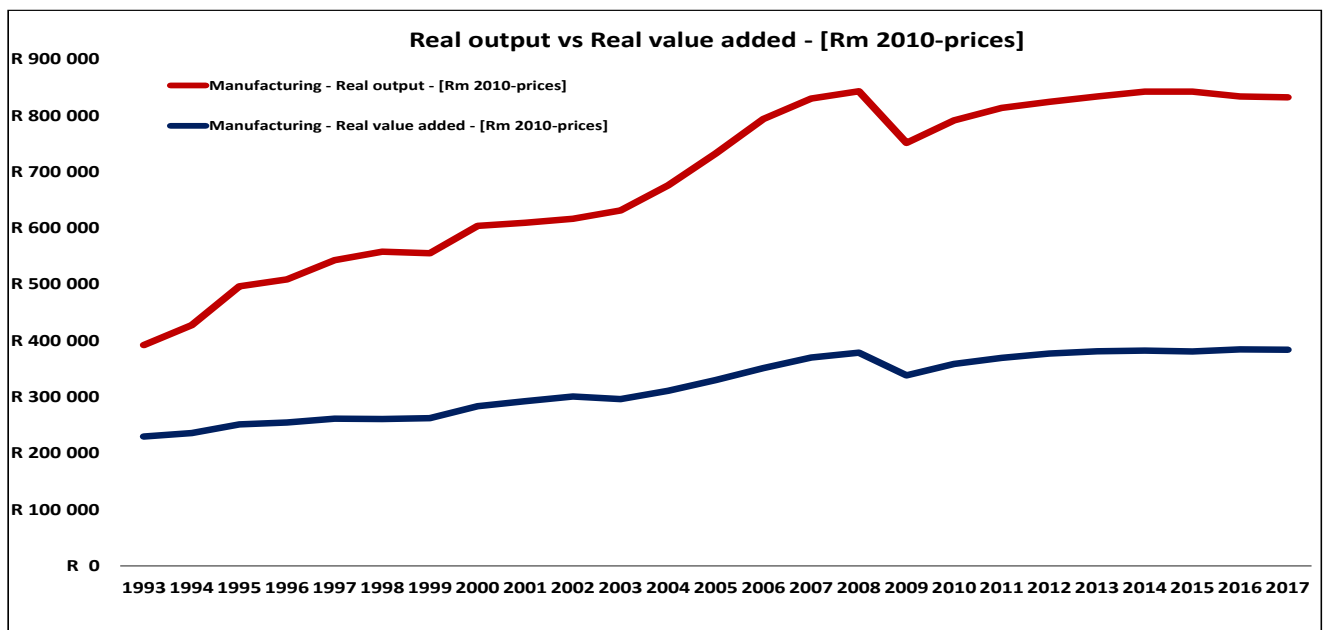
Source: South African Market Insights, 2021

The diagram above indicates that almost 70 per cent of the economy is driven by the tertiary sector, which is mainly made up of services, i.e., government, personal services, finance, transport, and trade industries. As part of its SMMEs-focused localisation policy framework, the Department of Small Business Development has begun implementing the manufacturing support scheme aimed at increasing the relative contribution of manufacturing to GDP by 2030 (DSBD, 2020).

South African Market Insights (14 January 2021) found that large manufacturers in South Africa are struggling, owing to a lack of demand for goods. Fortunato (2022) found domestic demand for manufactured products to have dropped by almost 18 per cent between 2008 and 2018. In addition, the continued preference for imported

products over locally manufactured goods adds to the downward pressure on the sector. Evidence also suggests that demand has shifted from domestic supply to imported goods. Furthermore, foreign demand for South African manufactured goods has declined (South African Market Insight, 2021). Hence, the government aims to achieve localisation and revitalise manufacturing by reducing imports. The localisation strategy seeks to channel demand away from foreign goods to locally produced goods.

Figure 3: Manufacturing production output and value-added (1993 – 2017)



Source: Department of Trade, Industry, and Competition (DTIC)

The manufacturing sector's gross value added fell sharply by 5.9 per cent in the second quarter of 2022. The closure of oil refineries, electricity constraints, rising input costs, challenges related to transport and logistic infrastructure, geopolitical tensions, and severe flooding in KwaZulu Natal adversely affected production. Political instability and lack of access to financing were some of main the binding issues facing manufacturers however severely constrained power supply was the key constraint (SARB, 2022; STATSSA, 2022).

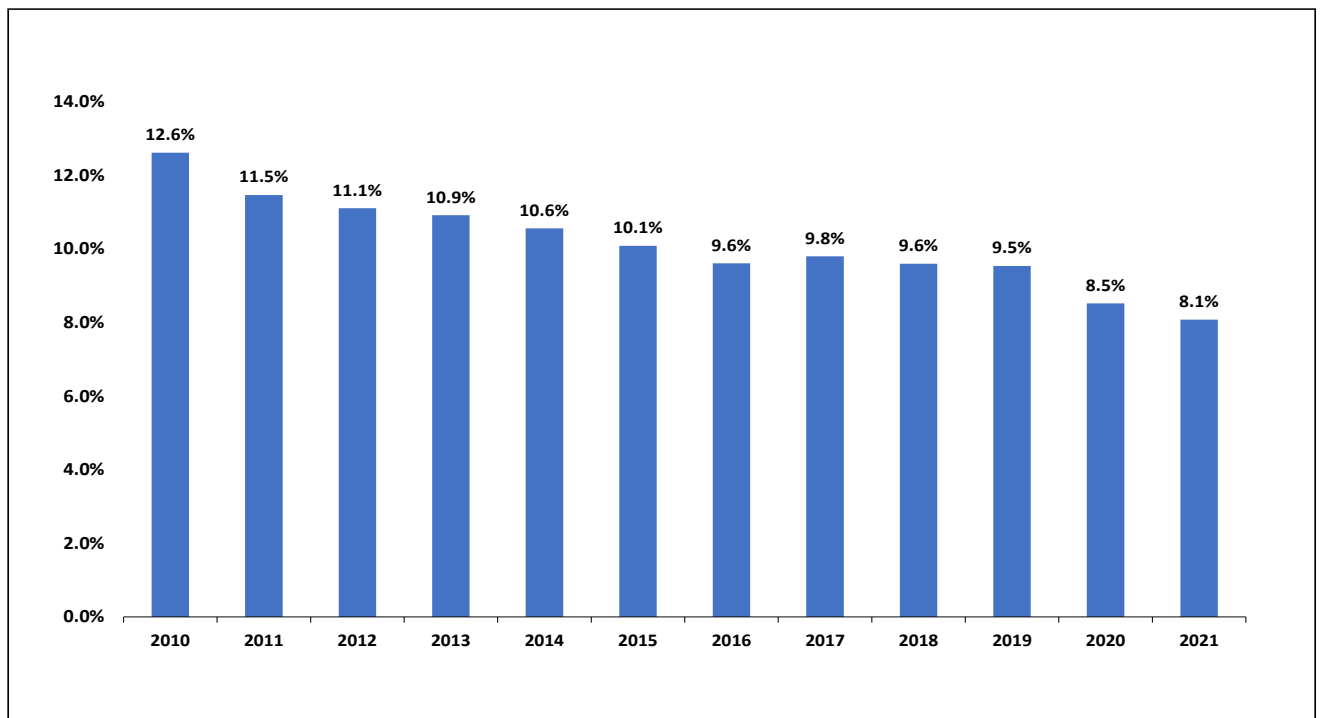
The decrease in manufacturing output is evident in the drop in production capacity utilization from 78.2 per cent in February 2022 to 77.6 per cent by May 2022 (SARB, 2022). South African manufacturers are said to be using less and less of their full capacity. In 2019 the level of capacity underutilisation was sitting under 20 per cent,

implying that a fifth of South Africa's manufacturing capacity was not being used (South African Market Insights, 2021). The main cause of underutilised capacity was a lack of demand, which was followed by a lack of raw materials and insufficient skilled labour. According to Fortunato (2022), due to local constraints, after 2008 South Africa's productive capabilities became inadequate, which also posed as a hindrance in attempts to diversify the sector. As such, one of the localisation priority areas is restoring inactive industrial production infrastructure.

### **2.1.2. Employment in the manufacturing sector**

Manufacturing is an important source of employment, employing one out of every ten people. Nimrod Zalk, Industrial Development Policy and Strategy Advisor at the DTIC is of the view that manufacturing creates opportunities to increase the share of non-agriculture employment, hence it is critical to prioritise its development (as cited by Ngulube, 2014). If manufacturing gains traction, it will bode well for employment prospects. Although recent employment statistics from STATSSA showed that the manufacturing sector added about 123 000 jobs in quarter three of 2022, the sector also shed 308 845 jobs between 2005 and 2021. Job losses were most severe in the textiles and clothes subsector (STATSSA, 2022). Available data from the International Labour Organisation (ILO) indicate that manufacturing employment as a proportion of total employment in the country has been on the decline since 2010, following global trends.

Figure 4: Manufacturing employment as a proportion of total employment (%)



Source: International Labour Organization (ILO)

## 2.2. Brief overview of the Small, Medium and Micro Enterprises (SMMEs)

Government recognised the importance of SMMEs in the development of economies so much so that in 2014 the Department of Business Development (DBSD) is launched to facilitate the development and growth of small businesses (Seda, 2016). Furthermore, to contribute towards localisation, the department launched a small enterprises manufacturing support programme to improve the industrial base for both the domestic and external markets. In the spirit of radical economic transformation, government further committed to encouraging the participation of Black entrepreneurs, especially women and youth in the economy (Balkaran, 2017). Promoting the growth and development of SMMEs is also purposed to foster the National Development (NDP) goals of among others creating employment opportunities. Moyo (2016) also draws on Naude (2013) and makes an argument for entrepreneurship and innovation in the quest for industrial development hence industrial policies should support innovation and entrepreneurship.

### 2.2.1. South African SMMEs landscape

Peterson, Albaum & Kozmetsky (1986) (in Amboise & Muldowney, 1988) defined “*small business is independently owned and operated, and which is not dominant in its field of operation.*” (as quoted by Balkaran, 2017). SMMEs embody a wide range of businesses, both formal and informal. Stats SA defined the informal business as one that does not have any employees and is not registered for taxation or any licensing board. The informal sector consists almost exclusively of survivalist entities, with limited growth potential and established solely for survival. These enterprises are mostly concentrated in rural areas due to the large numbers of hawkers and informal traders and are made up almost exclusively of Black people. The formal segment of SMMEs is dominated by white people. In 2015, it was found that whites owned and operated 51 per cent of formal SMMEs, which reflects a decrease from 57 per cent in 2008. The share of Black-owned SMMEs improved from 30 per cent in 2008 to 34 per cent in 2015 (SEDA, 2016).

DSBD (2020) estimates that there are between 2.4 million and 3.5 million SMMEs in South Africa, the majority of which operate informally at a micro level with an emphasis on black survivalist businesses. Some entrepreneurs cite difficulty navigating bureaucratic red tape and regulations as reasons for slow growth (Tambo & Maponyane, 2020). Despite their potential to create job opportunities and promote human capital development within the country, SMMEs' contribution to employment and economic growth remains lacklustre due to disparities resulting from past governance (Berry et al., 2002; Tambo & Maponyane, 2020). Berry et al. (2002) also recommended that any policies pertaining to SMMEs need accurate market information and data which is needed to inform a more targeted approach to SMME growth because the needs of these enterprises vary vastly.

SMMEs make up more than 90 per cent of businesses and almost 8 per cent of employment in African economies, according to the African Development Bank (Mparutsa, 2021). While this business segment is the largest contributor of employment opportunities in South Africa, employment created by the business segment contracted by 4 per cent or roughly 10.4 million in quarter one of 2020. The bulk of the job losses occurred in the formal sector for several reasons (DSBD, 2022). SMME employment in South Africa is also said to trail the averages in developing and

developed economies. Available data suggests that small businesses in South Africa contribute roughly 65 per cent of employment compared to the global average of 95 per cent.

SMME development and integrating informal enterprises into the mainstream economy are major opportunities to achieve the employment and growth objectives of the National Development Plan (BUSA, 2015). Employment in both the formal and informal SMMEs was gradually growing however, disruption caused by the COVID-19 pandemic has since reversed this trend marked by some recovery in 2021 (Makgetla, 2023).

About 9 per cent of the SMMEs operate in the manufacturing sector while most of the small enterprises are found in the domestic trade (wholesale and retail) and accommodation sector, followed by the community sector. In 2015, Small Enterprises Development Agency (SEDA) found that small businesses in the manufacturing sector reported the second-highest turnover behind the SMMEs in the domestic trade sector. Subsequently, the two sectors are also the highest tax revenue contributors in the business segment (SEDA, 2016). Another important feature of South Africa's manufacturing sector is that it tends to be concentrated in the rich or high-income parts of the country like Gauteng, Western Cape, and KwaZulu Natal (Fortunato, 2022).

The challenges and needs of South Africa's SMMEs have been extensively recorded. The expansion of this business segment has encountered obstacles due to many factors, including but not limited to:

SMMEs are deemed to be risky as they lack available collateral and cash flow (iAfrica, 2024). Access to finance is a major obstacle as lenders are predisposed to put resources in well-established SMMEs. As a result, start-up SMMEs are often overlooked from lending opportunities, according to the Financial Services Regulatory Task Group (2007). Lenders also tend to discriminate against SMMEs based on their geographic location. SMMEs operating in Gauteng, the economic hub of the country, enjoy greater access to finance which partly explains why the province is home to about 48 per cent of formal SMMEs. On the other hand, SMMEs in rural areas find it difficult to get funding (DTIC, 2008).

South Africa's deteriorating physical infrastructure is another major obstacle to business expansion and often results in higher operating costs. The availability of

affordable communication, transportation, utilities, land or space can play a crucial role in supporting new businesses (Finmark Trust, 2010). Inadequate infrastructure makes it difficult for SMMEs to access markets for their inputs and customers (iAfrica, 2024).

Insufficient investment in research and development (R&D). According to Maas, De Coning and Smit (1999), South African SMMEs are less innovative than their counterparts in developed countries. Investing in R&D can help businesses generate creative solutions through discovery methods.

South African SMMEs tend to be subjected to relatively high labour costs, which can be attributed to the country's well-intentioned but costly labour laws aimed at worker welfare. South Africa's relatively high minimum wages, however, are proving costly for small businesses (Berry et al (2002).

The abovementioned constraints are not unique to South Africa. Dinh & Monga (2013) found that among Tanzania's small businesses in the manufacturing sector, key constraints are access to finance, entrepreneurial skills, skilled labour and availability of inputs.

### **2.3. Conclusion**

In recognition of the significant role that SMMEs and manufacturing can play in bolstering economic growth and employment, the DSBD has created a policy framework that prioritizes SMME-focused localisation. Similar to apartheid's industrialisation, the goal is to industrialise through local industries. The SMME-focused localisation aims to expedite SMME participation, particularly those in rural and township areas, in the localisation of the manufacturing value chain. Essential measures will include establishing funding protocols for these businesses, enhancing their capacity for creating products and services, as well as providing guidance on how to access export markets (DSBD, 2020). The following chapter covers relevant literature on the topic at hand.

## **Chapter 3: Literature Review**

### **3.1. Introduction**

This chapter evaluates and analyses literature on dominant discourses and debates on the question of political economy and industrial policy. The literature examines four primary areas of discussion. Firstly, it delves into the political economy of developing countries' industrialisation processes, acknowledging how institutional factors coupled with politics play a significant part in economic development hence promoting government intervention to encourage growth via industries is essential. Secondly, South Africa has fashioned itself as a developmental state due to interventionist industrial policies. Developmentalism or developmental state is the theoretical framework underpinning the research. Thirdly, the literature reviewed South Africa's industrial and trade policy evolution, its successes and shortcomings. Lastly, a review of international localisation experiences and recommendations to serve as the foundation for developing a localisation strategy for South Africa.

According to Todaro & Smith (2009), domestic history, expectations, values, beliefs, institutional structures and power relations contribute to industrial development as well as the elevation of per capita living standards while creating employment opportunities. Hence in South Africa's case, economic and industrial policies are heavily influenced by colonial and apartheid legacies. Policies are designed to redress these legacies towards building a more equitable and inclusive economy through the Industrial Policy Action Plan (IPAP) and National Industrial Policy Framework (NIPF).

More than two decades since apartheid ended and more than a decade since the inception of IPAP and NIPF, South Africa continues to face high structural unemployment rates, persistent poverty, income inequality issues, and low productivity across undiversified production sectors. Fortunato (2022) has suggested that doubts are arising regarding the effectiveness of industrial policy amid a decade-long decline in the country's industrial activity.

President Cyril Ramaphosa has emphasised industrial development as a crucial part of South Africa's economic policy, as stated in the ERRP. The outbreak of the COVID-19 pandemic found the domestic economy already weak and with low levels of capacity utilisation in various sectors, including the manufacturing sector (National

Treasury, 2020). The pandemic presented an opportunity to restructure and transform the economic landscape while considering global and local factors that contribute to the South African manufacturing dynamics. Criticism from Makgetla (2022) is that there is an absence of extensive analysis of the factors that perpetuate the country's socioeconomic ills and mechanisms to address them in the ERRP. A thorough understanding of these dynamics is crucial for policymakers to formulate effective strategies that promote sustainable industrial growth, elevate living standards, and create employment opportunities effectively.

### **3.2. Political economy of industrialisation and industrial policy**

The political economy of industrial policy refers to the influence of politics on economic outcomes resulting from policies implemented. It emphasises how political decisions affect society's economic choices. The role of the state in pursuing industrialisation heavily relies on political economy issues involving the formulation of relevant policy that considers industrial development objectives (Storm, 2017; Morris, 2010). The dominant position in the literature is that, in the context of a developing country, government should actively promote industrialisation because it is widely recognised that institutional and political factors play a vital role in economic development. It is also acknowledged that public policies are informed by socio-economic ideologies, although politics tend to undermine these ideas (Acemoglu, 2010; Piech, 2015).

Industrialisation can be defined as value-addition in the production of final goods by transforming primary products into finished products using modern production methods. Sheffrin (2007) defined industrialisation as the socio-cultural and economic transformation that shifts individuals from low productivity and low-income agricultural sector to higher productivity to an industrial sector (Sule & Inedu, 2018; Dinh & Monga, 2013). South Africa is characterised by low levels of productivity, socio-economic disparities, structural unemployment, hence lower levels of industrialisation, underutilised capacity, and undiversified manufactured exports. The extent of these socio-economic issues set the tone for public policy priorities of any developing nation (Todaro & Smith, 2009).

Policy choices reflect existing power relations in any country with a history such as that in South Africa. Before 1994 the apartheid government acted in the interests of the minority White population and neglected Black communities. The minority population enjoyed access to quality healthcare services, education, and job opportunities while the Black population was marginalised, excluded from the mainstream economy, and subjected to sub-standard services (Eberhard, 2003; Moyo, 2016).

Prior to the rise of power by Idi Amin, the Ugandan economy displayed the potential to become one of Sub-Saharan Africa's (SSA) most prosperous economies. At that time, economic policies were sound and price stability was strong - leading to a 6 per cent annual growth rate. Although the economy was thriving, it was not inclusive. It was mostly Asians who dominated the private sector, relegating Ugandan natives to informal economic activities. Under Amin's leadership from 1971 to 1985, Uganda experienced a severe economic downturn that resulted from unstable policies and political turmoil. As such, there was extensive damage done to Uganda's industrial sector with manufacturing capability plummeting down to just ten per cent capacity. When economic restructuring began in 1986/87 the reduction of macro-economic distortions and liberalisation of markets resulted in the share of industrial output to total GDP rise (Mbabazi & Mokhawa, 2005).

Martin (2014) cites Fine and Rustomjee's (1996) assertion that industrial policy decisions ought to take into account the socio-political-economic context upon which industrialisation relies. The political economy of such policies is driven by power dynamics in society, determining resource allocation, prioritized sectors and beneficiaries of intervention efforts according to Pillay (1990). Thus most, if not all South Africa's policies since the democratic dispensation have been trying to remedy the apartheid injustices although their impact has been minimal.

Moyo (2016) holds the view that industrialisation is more than an economic issue, it is ideological and political. It is ideological in the sense that as demonstrated by historical experiences, such as colonial exploitation left most African and Latin American countries still dependent on primary commodities, causing social and economic imbalances. Even though South Africa is considered relatively industrialised within sub-Saharan Africa, the government remains committed to promoting further

development due to market failures necessitating intervention through policies like industrial policy (Mufuruki, Mawji, Kasiga & Marwa, 2017).

South Africa continues to have the highest income inequality in Southern Africa with a Gini coefficient of 0.63 (UNECA, 2023). The continued marginalisation and frustration experienced by countless South Africans can be attributed to government's failure to align its political ideals with appropriate economic policies. There is prejudice towards the political elite at the expense of economically vulnerable groups. These economic orders established during the colonial era and apartheid continue to be in place hence exacerbating poverty and inequality (Balkaran, 2017).

The current administration is still confronted with a very fragmented and highly politicised public administration that was inherited from the apartheid government. Bureaucracy is not appointed based on merit and recently there have been calls all around to professionalise the public service as the incompetence of the public servants serves as a hindrance in the successful implementation and execution of policy initiatives (Chipkin, 2022).

For the economy to grow in a way that has the potential to maximise the ideal social benefits and efficiency, the economy needs dependable and composed control with the deliberate direction of investments to breed a conducive environment for growth. As it was pointed out in the 1960s public choice theory that market failures and below average social outcomes are reasons enough to warrant government intervention (Munger (2022)).

*“To realise the vision of the Constitution, South Africa needs transformation that opens a path to inclusive economic growth and development. Growth without transformation would only reinforce the inequitable patterns of wealth inherited from the past. Transformation without economic growth would be narrow and unsustainable.”* – Professor Brain Kantor (as quoted by Balkaran, 2017).

The ruling party, the African National Congress (ANC) is mindful that although economic growth is necessary, it will not be sufficient for adequate economic transformation. Ultimately economic transformation is about restructuring South Africa's economy *“from an exploitative exporter of raw materials, to one which is based*

*on beneficiation and manufacturing.*” (ANC, (2017, pp. 2-5) as cited by Balkaran, 2017).

When former President Jacob Zuma assumed power in 2007, there was an emphasis on the economic and social reforms that would benefit the interests of the majority and an enthusiastic desire to shift from neoliberal policies. The Zuma administration viewed the neoliberal policies as detrimental to development. The government went on to adopt interventionist strategies in key industries such as mining (Ramantsima, 2015).

The recurring issue with industrialisation is how to coordinate structural transformation towards manufacturing in an efficient, equitable, socially efficient, and politically feasible manner (Storm, 2017). Overall, it must be in the interest of the nation. East Asian nations’ industrialisation was largely influenced and guided by the state rather than liberal economic principles. The Asian governments directed private industries about what amount and type of products would produce optimal social outcomes. On the other hand, Latin America and Africa’s industrial development has not reached its full potential, not necessarily because of poor policy choices but more from governments lacking in autonomy to act on their will, in that they failed to *‘impose’* their vision on investors and private sector and eventually yield to the market to determine outcomes (Storm, 2017). According to the literature, industrialisation requires visionary leadership and a concerted effort to redress ideologies that continue to shape the political economy that restrains industrialisation. Industrial policy is a way to correct market failures.

### **3.3. The need for industrial policy?**

#### **3.3.1. The relationship between manufacturing and growth**

A wealth of studies established a robust industrial base as a driver for sustained economic growth, development, labour demand, creating linkages and spillovers across the wider economy. The industrial sector is assumed to experience faster productivity growth than any other economic activity as well as capital accumulation

(Kaldor, 1967, 1968; McCausland & Theodossiou, 2012; Kuznet, 1959; Ocampo, 2017; Mufuruki et al., 2017, Bell, 2018).

Between 1967 and 1968 Kaldor studied the relationship between manufacturing productivity and economic growth. The Kaldor study found a positive correlation between production and growth. McCausland & Theodossiou, (2012) tested the Kaldor theory and found it to hold, especially in developing economies (cited by Bell, 2018).

Neoclassical economist Kuznets (1959) also noted that modern economic development is characterised by periods of robust output growth that overlap with structural transformation (cited by Bell, 2018). Ocampo (2017) argued that in developing countries economic growth is associated with the dynamics of production structures and the policies aimed at supporting them. Although the path to industrialisation has become more intricate, the argument in favour of manufacturing as the driver of growth and development still stands (Martin, 2014).

Overall, manufacturing-led development is justified by its ability to generate positive externalities through the accumulation of skills, innovation, technology and investments. Additionally, because manufacturing activities necessitate well-coordinated supply chains, a further argument for this approach can be made. Furthermore, the relatively higher productivity in the sector when compared with other sectors in the economy is another key argument for pursuing manufacturing-led development (Weiss (1985, 2003) cited by Martin, 2014).

### **3.3.2. Premature de-industrialisation in South Africa**

During development, there is a point where manufacturing output and employment's contribution to the economy starts to decline, in favour of tertiary sector growth as seen in most developed economies (Palma, 2005 cited in Metileni, 2015), this is termed de-industrialisation. In the case of South Africa however, there has been evidence of early de-industrialisation where manufacturing is on a downward trajectory and the composition of the economy has shifted from tradable sectors such as mining, agriculture, and manufacturing towards services sectors (Black et al., 2017; Reinert, 2010; Bhorat & Rooney, 2017).

The shift in the composition of the economy was also accompanied by a corresponding trend in employment dynamics (Bhorat & Rooney, 2017; Andreoni & Tregenna, 2018). As such, over the years, labour-intensive manufacturers such as clothing and textile have contracted (Black et al., 2017). Bell (2018) on the other hand, warned that a lack of technological advancements in manufacturing will stall economic performance.

Bhorat & Rooney (2017) attributed the mediocre performance of the manufacturing sector in South Africa to competition from foreign goods, particularly imports from Asia. Some have attributed the country's lagging industrial development to a lack of productive capacity in intermediate and capital goods and the absence of linkages across sectors (Fine, 1997; Bhorat & Rooney, 2017). Trade and tax data indicate that the manufacturing sector has the second highest propensity to import, particularly the importation of intermediate and capital goods. Fortunato (2022) found South Africa's largest industries to be highly capital-intensive with low demand for labour. Black et al. (2017) also found that the manufacturing sector has become capital and energy-intensive attributable to technological advancements hence jobs in the sector have not grown. Hence the manufacturing sector is failing to achieve the set objectives of creating jobs, reversing inequality, and eradicating poverty as envisioned in the National Development Plan (NDP) and IPAP.

The disappointing performance of industrial activities in South Africa especially after the 2008/09 global financial crisis suggests that industrial policy objectives need to be re-evaluated to account for the constraints confronting the manufacturing sector. To an extent global factors such as diminished demand for South Africa's manufacturing goods partially explain the country's de-industrialisation and manufacturing dynamics. In light of this premature de-industrialisation, government is faced with the challenges of finding alternative ways to create jobs and inclusive growth (Fortunato, 2022). South Africa's premature de-industrialisation is also indicative of the failure to transform. Chang (1997) noted that global business cycles, domestic macroeconomic policies, domestic political environment, geopolitics and the education and training system also play a pivotal role in the sector's performance. Gruhn (2019) advises that good industrial policy should be cognisant of the prevailing structural dynamics.

### 3.3.3. Defining industrial policy

There are varied definitions of industrial policy and there is no universally agreed upon definition. Stiglitz et al. (2013), Warwick & Nolan (2014), and Chang (1997) established broad and narrow definitions of industrial policy. The broad definition, on the one hand, encompasses macroeconomic policies aimed at supporting industrialisation. The narrow definition addresses sectoral prioritisation and sector-specific strategies, often driven by constrained fiscal resources, capability, and capacity.

Selective industrial policy is aimed at chosen sectors to bring about outcomes that are desired by the state and all relevant stakeholders (Chang, 1997). Chang's definition of industrial policy arises from his analysis of South Korea's profitable selective state intervention to support and promote specific sectors and industries (Martin, 2014). Munger (2022) and Strachan (2017) define industrial policy as a set of government interventions directly aimed at the expansion of selected priority economic sectors. In essence, industrial policy encompasses any policy that affects industry.

When pursuing selective or sector-specific industrial policy, policymakers should be cautious not to target 'too many' or 'intricate' sectors given the limited financial resources and bureaucratic capacity that tend to persist in developing countries like South Africa (Kaplan, 2003). Kaplan further advised that sectoral targeting should be more focused, limited in number and scope while Stiglitz et al., (2013) advised that it is important to maintain "*economic rationality*" and avoid being overzealous in the quest for industrialisation.

Verhoef (1998) cited by Bell (2018) said that industrial development is a macroeconomic phenomenon, comprising various microeconomic aspects, therefore establishing the ideal policy mix may require trial-and-error exercises, a "process of self-discovery". This requires industrial policy to have a degree of flexibility that allows for changing conditions and failures as advised by Chang (1994) (as cited by Martin, 2014).

Those in opposition to selective industrial policy do so because such interventionism designed to assist '*priority sectors*' distorts competition, stifles innovation, and creates opportunities for rent-seeking. Another key argument against the use of industrial policy is the state's inability to execute policies that may potentially benefit the

economy. This argument is relevant in the South African context where public servants' competencies are being questioned (Martin, 2014).

This study focuses on the manufacturing sector, advocating for a selective or targeted industrial policy that tackles the challenges facing the sector and maximises the sector's potential. The following section reflects on state intervention in the economy vis a vis market-led industrialisation.

#### **3.3.4. The age-old Market versus State-led industrialisation debate**

As argued by orthodox or free market economic theory, industrialisation is more likely to take place if countries specialise according to their respective comparative advantages ((Imbs and Romain Wacziarg 2003, Klinger and Lederman 2004, cited by Martin, 2014). The orthodox theory is based on the Ricardian concept of comparative advantage and forms the basis for targeted intervention. In this context, when industrial policy is properly targeted at specific industries, ideally a country should move past the comparative advantage specialisation phase and create a competitive edge (Morris, 2010), yet most of Africa, including South Africa, has not experienced that. Zalk (2014), orthodox reforms have not produced substantial and sustainable investments, growth or employment prospects. As such, in the context of Africa, the continent specialises in the production and export of primary commodities due to the continent's abundant endowment in natural resources, leaving these countries severely dependent on imported industrial goods (Moyo, 2016). South Africa is no exception, the country's comparative advantage lies in the primary industries and is heavily reliant on the mining sector thus the country has an inadequately developed and undiversified manufacturing base (Jourdan, 2011).

The juxtaposition is the heterodox theory which advocates for economic structural change as a requirement for developing countries to transition away from primary industries toward diversified output and manufacturing through government intervention. This theory emphasizes diversification as the key factor for promoting economic growth instead of specialisation (as cited by Imbs & Romain Wacziarg, 2003; Klinger & Lederman, 2004). In support of this notion, Hausmann and Rodrik (2002) argue that governments should provide greater assistance toward non-primary

sector activities because they have a more significant impact on both employment opportunities and overall growth within developing nations.

The role of industrial policy in development has proponents and opponents. Most advanced economies have relied on industrial policy to promote growth and development, markets were not exclusively responsible for industrialisation in those economies. Economic history indicates that the now-developed countries industrialised using protectionism and interventionist industrial policy. Consider the United States (US), which began promoting free trade after 1940 whereas, before that, most of its policies were protectionist. The American steel industry growth was supported by high tariffs imposed on steel imports from Britain. The US government also nurtured its key industries through investment in research and development as well as public procurement (Mufuruki et al., 2017). Another recent example of the US's protectionism is the 2018 imposition of excessive tariffs on steel imports from China. These actions by the US perpetuated rivalry between the two countries where the two economic giants were engaged in trade battles. Similarly, Rodrik (2004) emphasises that industrial development in Asia and Latin America occurred due to massive industrial policy interventions (as cited by Rennkamp & Westin, 2013). The now-developed countries then shifted towards neoliberal policies and also moved away from localised production (Rodrik, 2010; Bell, 2018; Mufuruki et al., 2017; Anderson, 2013).

State intervention is one of the most debated issues when it comes to industrial policy and has been well documented (Martin, 2014). Economic liberals advocate for minimal state intervention in the economy because state intervention is perceived to crowd out private sector investment and distort economic activity (Anderson, 2013), while others may argue that private investment follows public investment. Despite this, recently industrial policy has become acknowledged as the tool for creating jobs, building an inclusive economy, and equitable society (Stiglitz et al., 2013). UNCTAD (2018) has pointed out that in developing nations, industrial policies should seek to grow the manufacturing base and export-oriented growth. However, Rodrik proposes that industrial policy should not be restricted to the manufacturing sector, especially in developing economies (as cited by Kaplan, 2008).

The case against industrial policy stems from two issues. The first one is that government does not have sufficient data required to inform as to which sectors and firms need to be supported most. The second is that industrial policy inherently chooses winners and losers therefore suppressing competition and innovation while opening opportunities for rent-seeking and lobbying (Rodrik, 2014 as cited by Munger, 2022).

There is evidence that indicates that the *laissez-faire* or orthodox approach in some countries has resulted in a premature shift towards the tertiary industries at the expense of tradeable sectors that are the key drivers of growth and development (Aghion, Boulanger, & Cohen, 2011). Proponents of active industrial policy point to Japan and Germany as prime examples of countries that still maintain the production of intermediate goods through active industrial policy. Industrialisation in these countries is driven by structural transformation and diversified production.

Free market and trade liberalisation ideologies are slowly losing support upon reflection on how the East Asian Newly Industrialised Countries (NICs) managed to successfully develop through heavy government intervention (Fine, 1997). The failure of open market strategies has made way for developmentalism (Anderson, 2013). Developmentalism is politically driven in that the political agenda defines a nation's long-term developmental and industrialisation priorities (Mbabazi & Mokhawa, 2005).

### **3.3.5. Conclusion**

Targeted interventionist industrial policies are necessary to reindustrialise the manufacturing sector in South Africa and protect domestic firms through incentives, subsidies, tax breaks, and education and training. The country has experienced a premature de-industrialisation partially attributable to neoliberal policies. Neoliberal policies are believed to delay development in developing countries. As a result, it would be difficult to create a developmental state within a neoliberal economic framework since there will be limited capacity for government control and influence (Bolesta, 2007). Therefore, industrial policy remains a critical part of the developmental strategy in the country. The current industrial policy approach in South Africa is a combination of targeted state intervention and open market strategies.

(Coetzee, Daniel & Woolfrey, 2012). The following section will briefly reflect on South Africa's history with industrial policy.

### **3.4. Brief history of South Africa with industrial policy**

South Africa's industrial policy trends follow other post-independence nations where domestic production activities were protected through subsidies, incentives, industry support, and import restrictions. During the mid-1800s South Africa's manufacturing was still in its initial stages. There were two main strategies in place to boost manufacturing. First, was the issuing of the sole right to operate an industry as a businessperson. The second strategy was the imposition of high import tariffs to protect local industries (Malan, 2015, DSBD, 2020). Despite these efforts, South Africa's industrialisation and development failed to reach their full potential as there was no mass production of manufactured goods while the benefits were enjoyed by one racial group (DSBD, 2020).

The South African government has been actively pursuing industrialisation since the 1970s and 1980s and efforts were mostly centred around investment in infrastructure development and establishment of industrial development zones (IDZs). Historically, South Africa has made extensive use of active industrial policy to support and create an industrial base (Black et al., 2018; Malan, 2015). The aftermath of the Second World War motivated South Africa to embark on import substitution industrialisation (ISI). For a brief period, ISI policy managed to increase the share of heavy industry manufacturing value added supported through direct intervention and protection of domestic industries against big foreign competitors (Chinembiri, 2010). However, the import substitution strategy was not sustainable and its contribution towards growth started to decline. As a result, there was an increase in application for protection by businesses in the form of customs duties surcharges when the economy took a downturn. (Edwards et al., 2009). In the late 1980s, South Africa's policy shifted away from import substitution to export promotion. The main objective was to bring about higher levels of specialisation and exports, as a result allowing for increasing economies of scale and efficiency in productivity (Kaplan, 2003).

The apartheid government engaged in strict protectionism as part of the support for industrialisation policy. The most prominent examples are the steel and automotive industries. The success of South Africa's auto industry is a result of targeted industrial policy interventions over decades. The incentives and protective measures such as tariff protection that were afforded to the automotive industry were part of the local content requirements that successfully propelled the automotive industry to become South Africa's top manufacturing exporter (Kaplan, 2003; Zalk, 2014; Malan, 2015).

According to TIPS (2019), between 1994 and 2017 the share of auto industry exports increased from 1 per cent to 10 per cent of total exports and created around 110 000 direct jobs (RSA, 2019). However, despite the tariff protection in place, the importation of vehicles and vehicle components remains high. Available trade data reveals that in 2021, roughly 16 per cent of total imports were attributed to imports of vehicles and vehicle components, with this pattern remaining unchanged since the 1960s (Kaplan, 2003; Zalk, 2014; Malan, 2015, Barnes, 2000).

Policies shifted alongside changes in the political landscape (Takala, 2008). After 1994, South Africa's development strategy shifted from export promotion with import restrictions to trade openness. Trade liberalisation was accompanied by other economic policies that were designed to reintegrate the South African economy into the global community. Export subsidies, incentives, and import surcharges were phased out thereby reducing protection for the domestic industries (Edwards, Cassim and van Seventer, 2009).

### **3.5. Current Policy Framework: From IPAP to Re-imagined Industrial Strategy (RIS)**

In the past decade, government has introduced various policy initiatives which created the framework for the nation's industrial policy. Policy objectives have remained unchanged over this period, which is to reduce unemployment through infrastructure development and development of labour-intensive sectors such as mining, manufacturing, agriculture, tourism, and a 'green' economy (Zarenda, 2013). IPAP targets economic growth by improving manufacturing productivity to more and with greater efficiency (Gruhn, 2019). However, after more than ten years since its inception, minimal improvement was observed since production output remains

undiversified which leads to continued importation of higher-value goods - hence making it crucial for policymakers to review this plan.

During 2019, in the face of weak economic performance and a deteriorating manufacturing industry, Cabinet Lekgotla adopted the Re-imagined Industrial Strategy (RIS) to address existing industrial policy initiatives that have failed to curb declining manufacturing and employment rates while also diversifying South Africa's export basket (Makgetla, 2022). Additionally, one of RIS' priorities is building an economy that benefits all citizens and provides employment opportunities. The objectives of the industrial strategy align with and amplify the National Development Plan's (NDP) medium-term strategic framework (MTSF) which runs from 2019 to 2024. The NDP emphasizes moving away from heavy dependence on primary industries towards establishing a diversified economy through increased participation in high value-added global supply chains and greater integration within domestic value chains.

IPAP provided actions required to achieve industrial policy objectives while RIS which replaced IPAP emphasises action-oriented private-public partnership. The new focus of RIS centres on developing comprehensive sector-focused plans, or masterplans which are designed to be executed jointly by government, business and labour for optimal socio-economic impact. RIS promotes localisation and emphasises the local content requirement in public procurement as one of the critical policy levers. Moreover, this industrialisation strategy strives to transform the economy into an inclusive one through BBBEE, nurturing SMMEs in depressed areas of the country, and empowering the vulnerable groups of the population.

## **3.6. Merchandise Trade and Trade Policy**

### **3.6.1. Trade Patterns**

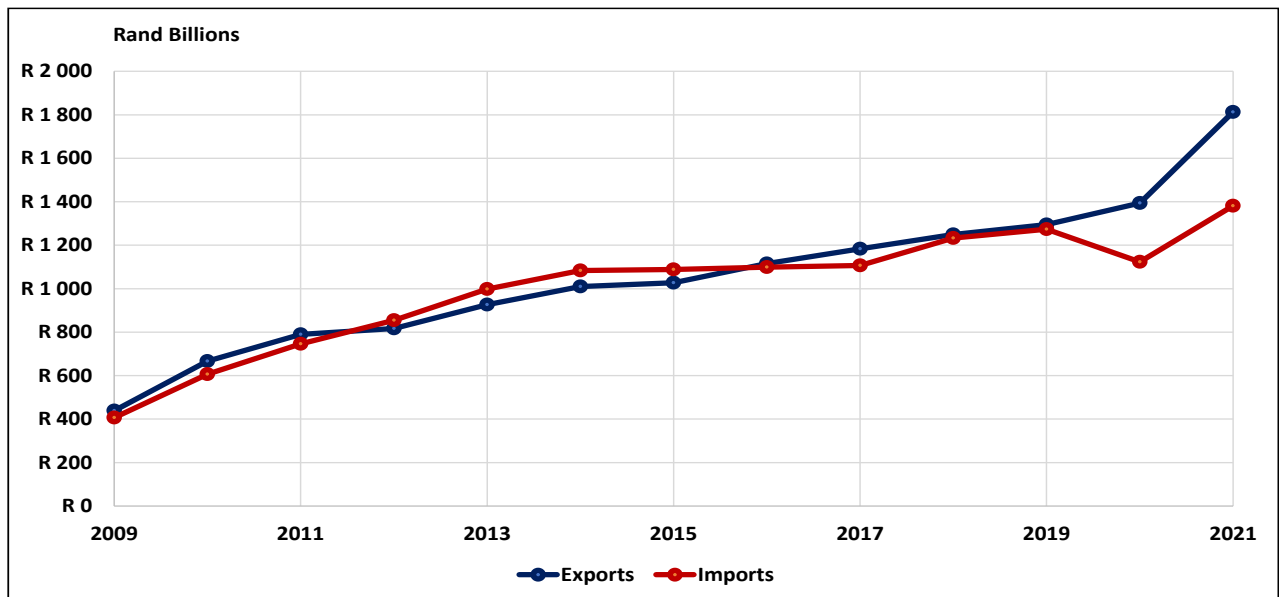
Many developing nations, including South Africa, rely heavily on primary sectors for export sales. In fact, over half of South Africa's export basket consists of primary goods, such as coal, ores, gold, and Platinum Group Metals. This undiversified portfolio leaves exports vulnerable to fluctuations in global commodity prices. For instance, the primary commodities exporting economies were adversely affected by the 2008/09 global financial crisis as demand for commodities fell resulting in declining export sales of primary commodities. Conversely, the COVID-19 pandemic created economic uncertainties subsequently resulting in a commodities price boom to the benefit of the resource-dependent countries. As such, South Africa's trade account was buoyed by elevated commodity prices (Makgetla, 2023). However, the World Bank (2022) reported that commodity prices were seen to be retreating from their March 2022 highs. This trend may have negative implications on the trade accounts of the resource-exporting countries thus further stressing the vulnerability to external shocks for resource-dependent countries.

South Africa's economy, though relatively small, is highly integrated with the global market and accounts for 0.53 per cent of world merchandise trade and about 0.28 per cent of world services trade. The country's international trade in goods and services is 60.4 per cent of national GDP (DTIC, 2021). Manufactured exports to the rest of the world are driven by the automotive industry, while manufactured exports to other African countries, are more diversified and include machinery, electronics, pharmaceuticals, food, and beverages which characterises most of the manufacturing sector's composition.

South Africa's reliance on imported high-tech machinery and electronics persists as they are crucial intermediate and capital goods for manufacturing. This can be attributed to the country's ISI policy in the 1960s, which allowed for the importation of intermediate and capital goods. Consequently, this policy created a highly capital-intensive manufacturing base (Chinembiri, 2010). Subsequently, the sector has

performed poorly concerning export growth and competing with foreign goods (Black et al, 2017, Chinembiri, 2010).

Figure 5: Trade Flows (2009 – 2021)



Source: South African Revenue Service (SARS)

South Africa has been registering a trade surplus since 2017, which means that the country is exporting more than it is importing. The largest trade region for South Africa is Asia with China being the biggest contributor. China alone accounts for about 20 per cent of South Africa's total imports and 11 per cent of total exports.

In 2021, precious metals and mineral products made for 28 per cent and 24 per cent of total exports, respectively, together making up for 52 per cent of exports, reflecting a significant increase from their contribution in 2019 owing to the commodity price boom that resulted from the COVID-19 disruptions. This shows that South Africa's exports are highly vulnerable to economic downturns in major trade partners and fluctuations in commodity prices. Vehicle exports, on the other hand, as a percentage of total exports declined to 9 per cent in 2021 from 14 per cent in 2019 as production slowed during the pandemic (2020 and 2021) because of a global part shortage (semiconductors) and other global supply chain disruptions.

The failure to fully industrialise is the reason South Africa and many other African countries are still predominately exporting primary goods and importing manufactured goods (Moyo, 2016). Szirmai (2009) and Naude's (2013) main argument is that due to the manufacturing sector's ability to transform the economy into a diversified one,

industrialisation is key to limiting the impact of adverse external shocks. However, focusing on rebuilding the manufacturing sector does not mean that the mining and agriculture sectors should be neglected as these sectors are the core of South Africa's economic foundation (Makgetla, 2023). Nonetheless, Primi and Peres-Nunez (2009) argue that industry protection should be limited to the high-value adding activities and production linkages as opposed to the agricultural and mining activities that add little to no value.

### **3.6.2. Trade Policy**

Trade policy in South Africa has generally been neoliberal, resulting in limited use of protectionism (Berry, von Blottnitz, Cassim, Kesper, Rajaratnam, & van Seventer, 2002). Since joining the World Trade Organisation (WTO) in 1995, South Africa has reduced tariffs and engaged in free trade agreements. Trade liberalisation has exposed domestic industries to global competition (Intellidex, 2021). Some are of the view that the exposure of local firms to global competition was premature and that domestic firms could have benefited from government support and protection for a bit longer (Malefane, 2018, Intellidex, 2021). The liberation of trade follows decades of inward-looking policies including import substitution, high tariffs, and import quotas (Chinembiri, 2010). Although import replacement measures were instrumental in creating competitive industries, they were unsustainable and failed to diversify of the economy while the benefits accrued to the white population (Bell, 2018, Intellidex, 2021).

Extensive research has been conducted on the impact of trade openness on economic growth. While some studies have supported open trade, others have advocated for minimal trade openness or a degree of protectionism (Malefane, 2018). The Heckscher-Ohlin (H-O) theory suggests that given South Africa's high level of unemployment and abundance of labour gives the country a comparative advantage in labour-intensive industries. The theory further suggests that trade openness would stimulate demand for labour. However, that has not been the case in the country given the country's persistent structural unemployment problem that was partly caused by the decline of labour-intensive industries.

It is worth noting that trade liberalisation has had adverse effects on growth, development, and employment (Chinembiri, 2010). Rodrik (2006) argues that opening markets has not favoured the manufacturing sector because it has allowed significant import penetration and has negatively impacted domestic production. Firms in developing nations tend to become less competitive and lose market share as the developing countries engage more in the global markets through international trade. Thus, Rodrik (2015) placed most of the blame for premature de-industrialisation in developing nations on prematurely engaging in international trade.

A study by Edwards and Jenkins (2015) found this to be true, particularly in the clothing and textile subsector. They found that cheaper imports particularly from China overwhelmed domestic production therefore leading to the gradual contraction of the subsector. Fundira (2016) also found that import penetration has harmed domestic production. The late Julius Nyerere, former Tanzanian leader once said that it is nonsensical to open markets to big competitors when you have no power to compete with them. In other words, how do small firms compete with big international firms while the domestic market is still underdeveloped? (Mufuruki et al., 2017). Prematurely increasing foreign competition is never welcomed by the domestic industrial sector, which may experience higher costs of production compared to their international counterparts and may in turn result in the “dumping” of cheaper imports.

Export-led growth hypothesis assumes that the increasing exports of manufactured products is an important determinant of growth in the long run, however, this hypothesis remains debatable. Proponents of export-led growth point to the economic success of the East Asian countries that were seen to be correlated to growth in labour-intensive manufactured exports (Torayeh, 2011). A study by Torayeh (2011) found that in Egypt there is a bi-directional causality between manufactured exports and economic expansion. Kilavuz and Topcu (2015) also argue that whether increased exports benefit economic expansion depends on the demand and supply elasticity of export goods. The higher the elasticity of the goods the more it will add to the economy. Torayeh (2011) further concluded that vigorous export-led policies that emphasises the composition of manufactured exports seem like a logical step towards sustained growth.

Accordingly, domestic manufacturers require a period of active government support and some degree of protection as they build up their productive capacity and capabilities to compete with foreign goods (Mufuruki et al., 2017). The Department of Small Business Development (DSBD) acknowledges that localisation can be effective with some level of domestic industry protection (DSBD, 2020). Localisation involves efforts to enhance local self-sufficiency and reduce dependence on foreign goods which ideally should lead to a diversified production of goods and services. However, localisation does not mean that everything must be produced locally, nor does it mean the end of trade or complete seclusion from the world markets. Instead, it seeks a balance between domestic production and international trade (Frankova & Johanisova, 2012), requiring strategic trade policy as part of the broader industrial policy.

### **3.6.3. Conclusion**

The role trade policy plays in industrial policy is widely debated among economists and policymakers. The DTIC believes that trade policy should serve as a catalyst for job creation and the advancement of industrialisation (Business Tech, 2021). This section examined both proponents and opponents of free trade and protectionist trade policies were considered. With regards to South Africa specifically, major points raised include scepticism towards liberal trade policies being ideal for its economic growth strategy. The literature showed that the influx of cheaper imports inundated domestic markets leading to a need for tariff support for the local firms so that they can build up their productive capacity and capability.

### **3.7. Literature and evidence on localisation**

#### **3.7.1. Introduction – Industrialisation through localisation**

Loosely defined localisation is the steps taken to ensure that goods and services are predominately produced and sourced from domestic markets rather than abroad. In the case where the goods and services cannot be sourced locally, *“localisation would involve investing strategically in domestic markets to create and grow capabilities, which would encompass industrialisation.”* (Hartley, 2018).

The ERRP identifies localisation as a critical intervention for industrialisation, aiming to decrease reliance on imports, enhance domestic productivity and encourage export-oriented sectors. The aim of adopting the localisation strategy is to revive production in the economy, expand the domestic value chain, and generate employment opportunities while promoting the transformation of ownership patterns (DSBD 2020). The effects of the pandemic on the global value chain forced the government to fast-track efforts to deepen local supply chains that are open to goods manufactured locally.

The policy objectives, which focus on labour-intensive and export-oriented growth, place the manufacturing sector at the heart of localisation efforts. These goals are strongly tied to and amplify the 2019 Re-imagined Industrial Strategy. Organised labour has identified localisation as a critical role in achieving deliverables outlined within the Economic Recovery Action Plan (ERAP).

Business Unity South Africa (BUSA) (2015) highlights that during a challenging period for manufacturing and primary economic sectors, where few hold significant sway over the economy, there is immense potential for small to medium-sized businesses in local townships to drive growth and create an inclusive economy. As such, BUSA advocates for greater emphasis on developing SMMEs as a means of achieving economic transformation. Localisation initiatives also include a targeted manufacturing program aimed at integrating SMMEs into the value chain, ultimately changing ownership patterns (National Treasury, 2020).

In recognition of the significant role that SMMEs can play in bolstering economic growth and employment, the DSBD has created a policy framework that prioritizes SMME-focused localisation. The goal is to expedite SMME participation, particularly those in rural and township areas, in the localisation of the manufacturing value chain. Essential measures will include establishing funding protocols for these businesses, enhancing their capacity for creating products and services, as well as providing guidance on how to access export markets (DSBD, 2020).

Localisation is not new nor unique to South Africa. Many developed countries have been using some form of localisation as part of their industrial policies to safeguard their domestic industries. In contrast, developing nations tend to aim industrial policies at developing new industrial capabilities so that they may be able to compete in the global markets rather than protecting infant industries (Roth (2017) as quoted by Hartley (2018)).

China serves as a prime example of a developing country that has successfully developed its local industries through localisation. The Chinese localisation programme was anchored by encouraging mass participation of rural SMMEs despite their underdeveloped technologies (DSBD, 2020). Rennkamp & Westin (2013) are of the view that supporting local industries requires more than just restrictive measures such as content requirements, research and development (R&D) and capacitation of local industries are just as crucial. Emerging from the pandemic, SMMEs require all the necessary support to restructure and thrive. Awosusi & Shaib (2020) suggested investment in the development of local industries and restricting unnecessary importation to save domestic economies amid and post-pandemic. In addition, they suggested support for SMMEs through aids that will lead to higher productivity and industrialisation.

The most common reason for pursuing localisation is to build capacity, supply chain development, and partnerships with local businesses (Deloitte, 2015). Localisation may result in proximity to markets, reliable supply chains, and the accumulation of adequate economic infrastructure that is essential for inclusive economic growth (DTI, 2016). Reliable and localised supply chains have become increasingly essential since the COVID-19 pandemic and geopolitical tensions continue to unsettle global value

chains. For example, the global shortage of semiconductors at the time of writing affected automotive manufacturers worldwide. The war between Russia and Ukraine has impacted on food prices as the two countries are major suppliers of wheat and vegetable oils thereby threatening food security. These global events have inspired the West to consider diversifying their supply chains in the most vulnerable industries. The US has offered subsidies to encourage domestic production of electric vehicles and renewable energy technologies (LinkedIn source, 23 Jan. 23).

According to Douthwaite (2004), globalisation is inclined to widen inequality, and has a degree of unpredictability and unsustainability. Douthwaite also claims that there is a close relationship between re-establishing internal economic self-sufficiency and sustainability. Although globalisation has made it easier for emerging countries to export their goods, these countries do not have the whole value chain in their backyards and are therefore open to external shocks (Whitfield, Marslev, & Staritz, 2021; Douthwaite, 2004). In some cases, globalisation has created a power imbalance between the state and the market. In South Africa, globalisation has to an extent taken power from the government in favour of the market (Ramantsima, 2015). Consequently, the state must adhere to global rules such as the World Trade Organisation (WTO) agreement that limits the space to exercise their autonomy with respect to certain aspects of industrial and trade policies.

Belousova, Walsh, & Groen (2021) indicate that in the wake of the COVID-19 crisis countries have started engaging in diversification activities that rely more on the local environments and less so on global markets. The World Economic Forum (WEF) has also recommended shorter supply chains and increased proximity to the client base and inputs (Elia, Fratocchi, Barbieri, Boffellid, & Kalchschmidt, 2021).

### **3.7.2. The political economy of localisation – Global experiences and lessons**

Abraham Lincoln is known to have said, *“I do not know much about the tariff. But I know this much. When we buy manufactured goods abroad, we get the goods and the foreigner get the money. When we buy the manufactured goods at home, we get both the goods and the money.”* – Mufuruki et al., (2017)

The implementation of localisation or local content policies has been instrumental in advancing economic growth in many countries including China, Korea, Thailand, Vietnam, Brazil, and the United States (US) (DSBD, 2020). Industrialisation in the 1980s in the US, Germany, and Japan entailed creating the whole value chain at home. There needed to be proximity to inputs, inter-related industries, and the necessary competencies (Baldwin, 2013).

The US embraced the advantages of trade protection for their economy and employment prospects therefore between 1776 and 1940, the US was protectionist and to an extent continues to be to this day. The American government imposed significant tariffs on imported British rails which resulted in costly railroad expansion within the US, but this in turn allowed the US steel industry to participate in production. Their steel industry then grew and became efficient (Mufuruki et al., 2017). According to Chang, the leading industries in the US were influenced and guided by the government through public funding of R&D activities and procurement (as cited by Mufuruki et al., 2017).

In 1933 the US passed the 'Buy American' act to help the economy overcome the Great Depression. The Act required the public sector to procure all their finished goods and services domestically and only intermediate goods were allowed to be sourced from the international markets. Non-compliance and contravention of the act resulted in extensive sections and penalties (Roth, 2017 as cited by Hartley, 2018).

In the 1940s Brazil introduced its import substitution industrialisation (ISI) policy. The policy aimed at expanding domestic production of goods that were being imported at the time. Government and business collaborated to fund the implementation of the policy. The ISI policy bore impressive growth rates and manufacturing became the engine of growth until the country started experiencing capital shortages, especially for intermediate goods that were used in the manufacturing process. This was a major shortfall of the policy which eventually led to the policy being phased out and the country gradually implemented liberalisation reforms (Intellidex, 2021). To develop its motor vehicle industry, Korea adopted an ISI approach through which it used all industrial policy tools such as subsidised loans, tax policy, import duties and quotas to support the industry (Baldwin, 2013).

Whitfield et al., (2021) cite Mauritius as the first sub-Saharan African (SSA) country to successfully localise its clothing and textile sector. Mauritius achieved this through strategic investment in local firms. In the 1990s local firms invested in fabric production leading to a peak in clothing and textile exports and by 2019, 97 per cent of the clothing and textile firms were locally owned. Mauritius's export-oriented strategy entailed the establishment of export processing zones (EPZ) where the government subsidised export companies through duty-free importation of inputs used in manufacturing, tax incentives, and conducive labour laws (Moyo, 2016).

In the context of Ethiopia, attempts to localisation the clothing and textile sector were unsuccessful despite government helping local manufacturers through subsidised financing. The Ethiopian government provided subsidised financing through the Development Bank of Ethiopia as well as export promotion as part of the industrial policy tools. However, no linkages were created among pioneer firms that failed to become competitive or profitable enough to afford loan repayments. This failure was also due to industries lacking basic knowledge about manufacturing, i.e., lack of capability. As a result, only a handful of firms were able to enter the export market, while most diverted to supply the more profitable domestic market while others failed. The Ethiopian government understood the importance of supporting local firms in the clothing and textile sector, but political instability added to the challenges of executing industrial policy projects (Whitfield et al., 2021). Mufuruki et al. (2017) advised that if African states wish to develop, there is much need to capacitate firms and individuals with productive capabilities, more specifically enhance technological and organisational capabilities. Developing capabilities in the manufacturing sector will attract investments.

Local content policy tool offers an opportunity to achieve higher levels of productivity and to create local supply chains. Case in point, in the 1980s local-content requirements in China resulted in productive supplier industries in technologically advanced goods such as automobiles and electronic goods consequently pushing China to become the world's largest manufacturer (Rodrik, 2008; Gruhn, 2019). The Chinese built a cost-effective manufacturing sector and highly integrated supply chains. The success of China's localisation efforts was also due to strict socialist regimes because industrialisation was driven by political sentiments rather than market conditions (Hartley, 2018).

Whitfield et al., (2021) found that there is immense potential to drive industrialisation if it involves extensive localisation through the presence of local enterprises and sectoral linkages to create local supply chains. According to ESI-Africa (2022), localisation strategies are currently still being used in China, in the wind value chain as part of efforts to be 'carbon neutral' by 2060. Wind value chain industrial policy in China has resulted in the creation of linkages and spill overs across sectors, from the raw material suppliers to the intermediate goods producers, and the wind turbine producers. Today, China dominates the manufacturing of renewable technologies due to generous government assistance in the form of subsidies, access to infrastructure and an abundance of factors of production (cheap labour and land). In Brazil, localisation contributed to establishing a components industry for medium technology content in the wind energy industry and created at least 4000 jobs (Rennkamp & Westin, 2013).

It is worth noting that successful localisation in the past has been driven by competent and dedicated political leadership as well as a clearly defined strategy, according to international experiences. The core principles of the Korean successful localisation were extensive human capital development and focused government leadership and determination. This allowed Korea to build their competencies, and supply chain, introduce new original models and gain competitiveness in the auto industry (Van Wyk, 2012; Baldwin, 2013).

In the South African context however, the domestic original equipment manufacturers (OEMs) were able to develop and dominate the industry on the back of government's intervention through tariff protection and import permits to protect against foreign competition. These OEMs were also required to adhere to the local content requirement otherwise there were penalties for non-compliance (Barnes, 2000). Hence the auto industry has succeeded and grown over the years.

In essence, localisation is the political and practical support to localise as many aspects as possible of production and consumption (Frankova & Johannisova, 2012). According to Van Wyk's (2012) findings, South Africa has the potential for successful localisation provided it adequately addresses challenges of poor political commitment and negative public opinion. Hence the political economy of industrial policy and the manufacturing value chain will play a critical role in the localisation process.

The idea of utilising localisation to advance industrialisation has been met with contestation among various stakeholders. Some of the debates on localisation are because it is perceived to be misaligned with industrial policy and its mechanisms (Rolfstam, 2015 cited by Gruhn, 2019). Some critics argue that the costs related to localisation, such as the possible imposition of higher costs, inferior standard goods, stifling innovation, and competition may be understated (Bernstein, 2021; Altebeker, 2021). However, some perceive localisation as a good initiative to address the decline manufacturing sector (Gruhn, 2019).

ESI-Africa (2022) believes that the limited success of localisation in various industries is linked to market instability arising from uncertain demand, poor coordination and incoherence between key departments, and inadequate monitoring, and enforcement of local content requirements. Furthermore, there appears to be ambiguity in the current local content rules thus leaving room for interpretation.

### **3.8. Theoretical framework**

The overarching theoretical framework for the proposed study is premised on development economics, that is, a combination of traditional economics and the political economy. Industrialisation through localisation may be located in the economic theory of developmental state, supply-side economic policies, and endogenous development.

Theoretically, developmental states or developmentalism should balance state-led intervention and market economy (Razvija, 2007). Developmentalism recognises that left to their own devices markets do not always yield to pareto efficiency therefore government intervention is required to correct for market failures. According to Bishop et al. (2018), developmentalism aims to create markets that are purposefully engineered through incentives, subsidies, and trade remedies to achieve a set of national development objectives. According to Wikipedia, developmentalism positions economic development as the primary focus of political activities and institutions. It also legitimises political leadership, especially in developing countries. As an economic principle, developmentalism holds the belief that economic progress in developing countries can be fostered by promoting a dynamic and diversified domestic

market by using trade policy tools to restrict imported goods, which is similar to what localisation seeks to accomplish. Developmentalism primarily revolves around the production sector.

Japan, South Korea, and China are states that are considered developmental states and are often associated with elevated levels of economic growth (Fourie & Malan, 2020). Developmentalism had remarkable success before the introduction of neoliberal structural adjustment programmes however the failure of these neoliberal economic strategies favoured developmentalism (Anderson, 2013). The goal of a developmental state is to drive industrialisation; and diversify the economy while balancing economic growth and social development. In a developmental state, the government derives support by actively pursuing inclusive economic growth and improving living standards (Gumede, 2011; Reinert, 2010).

Razvija (2007) asserts that it may be difficult to achieve developmental goals in an environment where the state has restricted authority to direct resource allocation, as in the case of a free market economy. Amsden 1989 (cited by Bell, 2018) argues that industrialisation occurs when the state has authority and acts on it. According to Mufuruki et al. (2017), if industrial policy is to be successful, there needs to be a government with 'embedded autonomy', in other words, a government that has its roots in society and has the power to act on its will. Developmentalism emphasizes competent leadership and bureaucracy as key ingredients in building a developmental state (Ngqebe, 2017; Bishop et al., 2018). The absence of political will and competent leadership is detrimental to the success of any public policy (Koma, 2013; Anderson, 2013).

There are debates on whether developmentalism is possible in a democratic state. Although developmentalism indeed took place in somewhat authoritarian countries of East Asia, Gumede (2011; 2009) argued that development and democracy are complementary. Japan is a leading example of a democratic developmental state. Japan's developmental state success lies in the fact state bureaucracy is recruited based on merit and is unaffected by democratically elected politicians (Razvija, 2007). Bishop et al. (2018) mention Mauritius as another example of a democratic developmental state where the state engaged in selective industrial policy and used sector-wide subsidies and incentives to boost manufacturing. The bureaucracy that is

involved in the implementation of public policy is independent, qualified, and continuously upskilled. Munger (2022) argued that government failure is a bigger problem that confronts 'good' industrial policies. Munger (2022) further points out that politically, good industrial policies are not deemed feasible and that industrial policies cannot be successful in a democracy.

Active industrial policy such as the localisation programme may be classified as an interventionist supply-side policy. Supply-side economic policies are initiated to enhance productive capacity in the economy. The interventionist supply-side policies include among others, investment in human capital, infrastructure, and research and development (Gruhn, 2019). Market Business News (2022) defined supply-side policies as economic policies aimed at enhancing markets and industries operations so that they can contribute more effectively towards economic growth. As such, localisation is designed to increase the country's productive capacity, and capability. Supply-side policies suggest that if implemented effectively, prices will fall as the supply of goods and services increases thereby benefitting consumers and may also boost competitiveness of exports. In addition, as businesses grow there will be an increase in the demand for labour. It has been pointed out that supply-side policies on their own may result in a skewed distribution of income and widening inequality. Therefore, a more sustainable approach is to use a combination of demand-side and supply-side economic policies.

Betancourt (2020) states that the current global affairs, i.e., the COVID-19 pandemic, and global supply chain blockages present an opportune time for countries to restructure their economies in a way that the local markets are the key drivers of economic development. According to Awosusi and Shaib (2020), African countries should develop their policies at 'home' so that they effectively address local difficulties. In the 1850s for the most part, manufacturing in South Africa was fixed around the local market, ensuring that the local Cape economy produced most of its own basic needs (Malan, 2015).

Localisation also offers an endogenous approach or inward-looking approach to development as it aims to benefit the local economy by absorbing local labour, using local resources, and creating local supply chains. An endogenous approach to development is determined by local and internal factors and tends to be highly

beneficial for local economies. An endogenous approach to development can then be used to effectively integrate previously marginalised groups into the mainstream economy (Slee, 1993). Developmental state theory, supply-side economics, and endogenous development guided the research.

## **Chapter 4: Research Methods and Methodology**

### **4.1. Introduction**

This chapter outlines and describes the research methodology followed to answer the research question. This section discusses the approach, sampling, data collection, and analysis.

The objective of this research is to explore the factors that are perceived to be contentious regarding this policy and the perceived implications of localisation on manufacturing and the wider economy.

- a) This research aims to analyse and investigate debates on localisation as a policy in the South African context.
- b) The study also aims to explore the concept of localisation and its tools, identify challenges and opportunities, and formulate policy proposals.

### **4.2. Research Approach**

The research method for the study was qualitative, as it aimed to explore the opinions and perceptions of participants. This research intends to thoroughly understand individuals' opinions, views, and attitudes about localisation and industrial policy. This exploratory qualitative study explored issues associated with premature de-industrialisation, declining manufacturing, and the anticipated impact of localisation on industrialisation from the participants' perspective.

A qualitative approach allowed the researcher to cross-reference facts and opinions expressed in the primary and secondary data (Ngqebe, 2017). The explorative nature of the study was designed to generate new insights and a deeper understanding of the controversies surrounding the localisation policy. Semi-structured or open-ended interviews were conducted to investigate the research question (see Annexure B for the research instrument).

Researcher aimed to understand the meanings and interpretations that individuals give to their experiences thus employed the interpretivist research paradigm guided this study. Interpretivism requires that subject matter be understood "through the eyes

of the participants rather than the researcher.” This study aimed to provide a glance at other people’s perceptions (Cohen et al., 2007; Rehman, 2016; Burnard, 1991). Industrial and economic policies are shaped by social, political, and economic factors. The study also draws on the critical theory research paradigm, as the study questions institutions and social and power relations (McCandless, 2007). Due to the nature of the data collection method and the awareness of potential bias in participants’ opinions, the researcher made every attempt to remain unbiased.

### **4.3. Data Collection and Analysis**

The research used both primary and secondary data and included pre-existing literature on the topic at hand. Primary qualitative data were collected through semi-structured interviews to capture respondents’ opinions and understanding. Semi-structured interviews allowed the researcher to probe and deepen the discussion of the research question. The interview process was conversational and aimed at engaging in a meaningful dialogue with participants. Due to the fact the study was exploratory the questions in the interview guide often raised more questions rather than providing solid answers. The semi-structured offered flexibility to ask follow-up questions as needed (see Annexure B for the research instrument).

Quantitative data on the demographics of the manufacturing sector, trade patterns, and economic development were sourced from multiple data sources such as SARS, the South African Reserve Bank (SARB), STATSSA, and the Department of Trade, Industry, and Competition (DTIC). Other indicators were sourced from the World Bank, the International Labour Organisation (ILO), and the Organisation for Economic Co-operation and Development (OECD).

#### **4.3.1. Sampling**

The sampling for the study was deliberate and purposive. The objective of purposive sampling is to gain comprehensive insights into the research question by deliberately selecting participants who possess expertise and intimate knowledge of the subject matter (Kothari, 2020).

Fourteen individuals were selected to participate in the study. Participants were individuals in middle and senior management roles in key government departments, agencies, and industry experts. The participants in the study included individuals who had first-hand experience in industrial and economic policy formulation, implementation, and monitoring or had intimate knowledge of the topic. For this study, participants shared their subjective opinions without affiliation with their respective organisations. Before commencing the interviews, the participants were asked to provide a brief background about their professional experiences and expertise to help the interviewer discern if the respondents did indeed fit the population description.

Additional data were collected from newspaper opinion pieces, blogs, and media releases from stakeholders. Mare (2015) advised that collecting data from a variety of sources helps obtain realistic views of opinions and perceptions ( Gruhn, 2019).

#### **4.3.2. Data Analysis**

The research applied content and discourse analysis that allowed for a careful examination of words, figures, and literature. The researcher engaged in subjective writing to articulate their evaluation and interpretation of content (Leedy & Ormrod, 2010, as cited by Metileni, 2015).

The interviews were conducted online using Microsoft Teams, as it was convenient for both the researcher and participants. The interviews were recorded and transcribed with the consent of the participants. The interviews were transcribed using the Microsoft Teams record and transcribe function. The transcripts were read and re-read to allow the researcher to engage in the data.

At the end of the interviews, high-level findings were summarised to identify emerging themes to help with the analysis. The transcripts were then summarised and coded according to the emerging themes and issues addressed in the interviews (Saunders et al., 2009). Intelligent verbatim transcription was used to create print-ready transcripts that were modified to represent responses accurately and completely (Indian Scribes, 2023).

Thematic analysis allowed the researcher to examine commonalities, differences, and relationships under the emerging themes that emerged from the interviews and literature. The process of analysis was rather manual, as the researcher did not have access to thematic analysis software. Thematic analysis can be used by anyone to transform and organize open-ended responses. Thematic analysis coding is a method that aids in categorizing data extracts and deriving themes and patterns for qualitative analysis, facilitating the identification of themes revolving around a particular concept (Get Thematic, n.d).

The exploratory nature of the study called for inductive content analysis to produce the meaning of the data collected through semi-structured interviews. Thematic analysis of the data allowed the researcher to identify patterns of meaning across a set of data to seek answers to the questions. The analysis of the data was inductive because the themes were not predetermined and were generated from the actual data collected. Similar to Gruhn (2019), coding with the actual interview responses enhanced the researcher's understanding of the participants' perspectives on localisation and industrial policy. Coding is appropriate for qualitative studies, but particularly for studies that prioritise the participant's response.

#### **4.4. Limitations**

The researcher recognised that there may be potential flaws in the research process. To begin with, a key factor that impacted the success and credibility of the study was to involve participants who were deemed to be knowledgeable about the subject matter and those who were directly impacted by the localisation policy. The sample was not reflective of all relevant stakeholders who may be impacted by the implementation of the localisation policy. The sample was homogenous and representative of the population, based on the selection criteria.

Second, the researcher's lack of professional training in conducting interviews could have influenced the data collection and outcomes (Owen, 2015, as cited by Gruhn, 2019). Additionally, manually coding qualitative data means that the researcher's biases may have influenced the coding process (Get Thematic, n.d).

Third, the researcher was cognisant of the fact that secondary literature was produced for several reasons, such as political, economic, and cultural, so there may be bias in the existing literature, leading to a biased analysis of the literature (Mensah, 2020). Similarly, because qualitative research is subjective and participants were speaking from their own experiences and viewpoints, bias may have occurred in the data collected.

To reduce bias, the researcher followed Gruhn (2019). According to Gruhn, (2019), semi-structured interviews can help reduce biases, particularly subject biases, by using standardised questions for each interviewee. This ensures that each participant is asked the same questions in the same manner, which helps maintain consistency and fairness across all interviews. Therefore perceptions of the participants can be compared directly, because the information in the questionnaire and the questions are similar or identical. This standardisation allows the researcher to use the interview guide as a framework, which can reduce the impact of any particular bias a participant might have concerning specific questions. Moreover, semi-structured interviews allowed the researcher to probe further and explore interesting or relevant topics that arise during the conversation while maintaining a consistent structure. This balance between standardisation and flexibility helps mitigate individual biases' influence on the overall results, ensuring that the findings are more reliable and valid.

Finally, due to time constraints and conflicting schedules between the fifteenth prospective respondent and the researcher, it was difficult to conduct an interview. In addition, the researcher was unable to find another eligible subject. It should be mentioned that by the time the tenth interview was conducted, data saturation had occurred.

## **Chapter 5: Results and Insights**

### **5.1. Introduction**

This chapter presents the research findings of the data collected through semi-structured interviews on the perceptions of experts, stakeholders, and policymakers on localisation as a policy and its feasibility in the current domestic political and economic landscape. The chapter aims to provide insights and an understanding of the data collected. There is further discussion on various perceptions of localisation as an industrial policy tool.

The research was exploratory, and a qualitative approach was used to answer the research question. To enhance the findings in the literature, semi-structured interviews were conducted to provide a wide range of perspectives. Fourteen individuals were selected to participate in the interviews. Additional data was collected from newspaper opinion pieces, blogs, and media releases from stakeholders.

### **5.2. Presentation of Results**

To analyse the data, one concept was applied to each short phrase or complete sentence answered. After then, the data was sorted into coding groups relationships and similarities. Following Sinclair's (2017) recommendation, the researcher immersed themselves in the data to gain a deep understanding and identify significant themes related to the research questions and the literature review. This required reading or examining the data several times, in-depth. Relationships were then created from individual codes to code groups. To ensure consistency, descriptors were created for these code groups, which were then grouped together under each relevant sub-research question by sub-code groups. Descriptors helped in maintaining a clear definition and understanding of what each code group represents. This approach helped in ensuring that the findings are both comprehensive and aligned with the research objectives. The table below highlights the main themes which are discussed in the rest of the chapter.

Figure 6: Sub-research questions linking to code groups

Sub-Research Questions	Theme	Sub-Theme
What are the main challenges and opportunities associated with implementing localisation policies in the current political and economic climate?	Market Conditions	Lack of economies of scale
		Lack of demand
		Quality of local products
	Structural constraints facing the sector	Weak infrastructure and poor service delivery
	Skills gap	Mismatch between skills demanded and supplied Education and Training deficit
How can localisation policies be effectively designed and implemented to maximize their positive impact on the manufacturing sector and the broader economy?	Government Support and Policy Framework	Policy Framework
		Implementation, Monitoring and Evaluation
	Trade and Industrial Policy	Localisation equivalent to import substitution
		Tariffs an important industrial policy tool Regional integration
Are the objectives of localisation compatible with each other?	Developmental tool	Localisation can be a catalyst for jobs and linkages in the economy
		Spilt focus in terms of competing policy objectives
	Support for SMMEs	Incentives and Funding
		Non-Financial Support
		Market Formation

Source: Researcher's Compilation

### 5.3. Discussion of results

**Research Question:** Are the objectives of localisation compatible with each other?

#### 5.3.1. Localisation is an important developmental tool

In cases where goods and services are not available domestically and are sourced elsewhere, strategic investment to create and enhance domestic capabilities and capacities would be industrialisation through localisation (Hartley, 2018). The DTIC (2021) defined localisation as *“building local industrial capacity for the domestic and export markets.”*

*“The process of organising a business or industry so that its main activities happen in local areas rather than internationally” (Cambridge Dictionary, 2018).*

Respondent Fourteen defined localisation as producing goods domestically and reducing the level of imports. For Respondent Thirteen, localisation is not only about producing locally but there must also be an appetite to consume locally made products.

*“It (localisation) is about being made in South Africa and majority consumed locally” – Respondent Thirteen.*

### **a. Localisation as a growth and developmental tool**

*“...every local transaction has a ripple effect that extends beyond our comprehension. By purchasing locally produced food and other goods, consumers support their local economy, families, communities, and promote the culture of entrepreneurship.”* — Paul Mashatile (March 28, 2023) [tralac Daily News - tralac trade law centre](#)

Twelve of the Fourteen respondents indicated that localisation would be beneficial as a vehicle for economic growth and development. However, the conditions need to be right to successfully localise the production value chains. Two respondents were not in favour of localisation and thought that government should focus their efforts on other reforms that build competitiveness in the domestic and global markets.

*“The localisation obligations are intended to benefit local communities which generally have high unemployment rates, widespread poverty, low education qualifications and which communities are rural or peri-urban in nature,”* said Shardanand Seeth, Business Development Executive of John Thompson Division.”

*“In terms of our trade policy, we have strong support to encourage localisation, but we need to encourage localisation in a way that it creates employment by localising those labour-intensive production processes.”* – Respondent Eleven

Although localisation, preferential procurement and local content policies have been central parts of the ERRP, these policies have been met with contention from various stakeholders and the media. Several critiques cite South Africa’s constrained production capacity, which may make localisation in some sectors impractical and not feasible. Respondents One and Three noted how manufacturing constraints are reflected by the types of products imported into the country.

*“Richard Wainwright similarly warned that in certain sectors “requests for local content are impractical”* and Business Leadership SA CEO Busisiwe Mavuso noted that *“there is not nearly enough production capacity in South Africa to meet the requirement for solar energy components.” Imports are urgently needed”* - Bernstein & Schirmer (2020)

*“Businesses are sceptical of existing localisation policy and worry about capacity, price and quality as well as the ‘usual’ constraints of electricity, regulations (including labour)” – Manufacturing Circle (2019)*

Stratchan (2022) believes that localisation should be a secondary developmental mandate and an in-depth cost-benefit is required because localisation carries a cost. Despite this contention, government and its social partners remain committed to the idea of localisation as a developmental tool.

All but two respondents thought that localisation was crucial in boosting the manufacturing sector.

*“We still need the manufacturing sector so much so I think the discussions on localisation are quite critical as it relates to how the manufacturing sector can contribute to fit the augmentation of the development aspects of South Africa because of its huge forward and backward linkages” – Respondent Nine*

*“The point is this, localisation is not for its own sake, right? It is about expanding industrial capacity so we cannot talk about localisation without talking about industrialisation broadly”- Respondent Six*

Respondent One echoed the sentiments of Alterbeker and the Intellidex report. Alterbeker (2021) argued that the case of localisation is flawed, unconvincing, and economically biased. Bernstein & Schirmer (2022) contend that by protecting local firms from foreign competition and giving them exclusive access to the local market, there is a risk of promoting highly inefficient businesses. Agarwal et al. (2023) also warn of the downside of “picking winners” or national champions which involves the risk of inefficient allocation of resources, may lead to concentration of economic power, and stifling innovation, ultimately stunting growth and development.

According to Respondent One, industrial policy is another name that governments use to select winners where the market fails to do so. Additionally, the respondent warns that this might be dangerous because it obscures resource allocation. The points raised by respondents remain a concern for some economists. The optimal scenario for industrial policy is to support winners rather than choose them. This can only occur if the government has adequate knowledge and data about which industries and products are worth backing (Dinh & Monga, 2013).

*“There are lots of approaches to industrial policy. And if you are going to pick winners, then you should pick winners. But in South Africa, because so many sectors are under pressure, the DTIC then tends to want to say they are picking winners, but they still want to support all sectors” - Respondent Fourteen*

According to Respondent Twelve, localisation does not make economic or business sense. He is of the view that the aim of running a business is to maximise profit; therefore, it makes sense to source goods and inputs wherever it is cost-effective for the business, especially in this globalised village. For this respondent, localisation will only make sense if it increases the profitability of local businesses. Bernstein & Schirmer (2022) argue that the localisation policy would not serve any purpose if choosing a domestic product instead of an imported one did not involve additional expenses. Overall, for businesses to localise, local goods need to be significantly lower than imported goods.

An Intellidex report (2021) found that businesses would prefer to purchase from local markets as long as their needs are met, and they receive sufficient support for localisation. However, they expressed lack of confidence in the government's ability to execute it properly. Businesses remain sceptical and have concerns about the capacity to localise, price, and quality of locally produced products. Additionally, the report found that local manufacturers were burdened by the typical constraints of electricity and regulations.

The deputy minister of finance pointed out that it is crucial to meet localisation objectives in order to reverse the trend of de-industrialisation that the country had experienced in the last two decades (NAACAM, 2023). In conclusion, a strong emphasis on localisation efforts and intentional investment, resulting in increased manufacturing activity, will significantly positively impact various other sectors such as services, construction, trade, transport, communications, and finance by generating thousands of employment opportunities in the process (Dludla, 2022).

#### **b. Localisation as a tool for building a secure supply chain**

Agarwal et al. (2023) posit that creating backward linkages in the local economy is the key to dynamic and sustainable industrialisation. Before the COVID-19 pandemic

outbreak, global value chains served as shock absorbers against changes in domestic demand. Supply chain disruptions that emerged during the pandemic have changed this narrative. The pandemic and escalating geopolitical tensions have threatened and continue to pose risks to global trade and supply chains.

Supply chain disruptions adversely impact domestic production, as businesses experience difficulties sourcing raw materials and inputs which will result in higher costs of production and ultimately increased consumer prices; in other words, disruptions in the global value chains have inflationary effects which may result in tighter monetary policies.

Two respondents discussed the importance of shorter and integrated domestic supply value networks. Respondent Seven highlighted a growing trend towards 'de-globalisation' among some Western nations who aimed to boost their own domestic supply chain. This trend emerged after the COVID-19 pandemic disrupted global value chains and hampered manufacturing and economic activities in countries with a high reliance on imported inputs.

*“You will notice there is a trend towards de-globalisation led by the USA after what happened during the pandemic how supply chains were disrupted” – Respondent Seven*

A 2019 survey by the Manufacturing Circle found that businesses are supportive and eager to localise their supply chains where possible, provided that the environment is conducive for localisation.

*“Government may be the single largest procurer in the country with a responsibility to buy local, but businesses must also look at their supply chains and buy whatever raw materials and everyday supplies that they need to run their operation from other local businesses.”- Proudly SA*

Respondent Four who has more than 20 years' experience in industrial policy development confirmed that in the clothing and textiles industry, they found it beneficial to have local suppliers that are responsive to the changes in the domestic market instead of long supply chains. This was possible through a sector-specific masterplan.

The aftermath of the COVID-19 pandemic has resurfaced the significance of industrial policy debate. The use of industrial policy has been gaining momentum in some

countries as they rebuild their economies after the COVID-19 crisis. The disruptions have encouraged countries to develop inward-looking economic policies in the form of reshoring and near-shoring (Nodari & Rungcharoenkitkul, 2022). Localisation implies a reduction in reliance on global supply chains to avoid disruption while simultaneously promoting economic growth (Tagg, 2022).

### **c. The cost of localisation**

Van Wyk (2012) commented that to start the localisation process, especially in manufacturing, government funding is required. According to Strachan (2022), there is a cost associated with localisation; therefore, it must be properly financed. The CEO of Actom, Mervin Naidoo (2022) was quoted saying *“What is important is that you need government spending to localise.”* Three respondents in the study echoed similar sentiments.

*“We might not have the financial means to heavily subsidise certain sectors, but there are other means that we can use that also support localisation”-*  
Respondent Three

*“These strategies need resourcing. They need funding. Concessional funding. Economic incentives of various kinds that are managed, that come from the fiscus or development banks, or IDC.” – Respondent Six*

Respondents Six also mentioned that there is a need for judicious use of government business incentives. Respondent Two also pointed out that although in the short-run the implementation of import replacement for designated products may lead to a loss of trade tax revenue in the country. However, over time this forgone revenue from imports will be replaced by domestic taxes generated through employment and income taxes collected from the manufacturing sector which benefits from localisation efforts.

*“We might get a little bit of more of the tax revenue from them (manufacturers). We will lose some from imports, but we will gain some from the other taxes as well” – Respondent Two*

The Manufacturing Circle and Proudly South Africa pointed out that long-run multiplier effects will outstrip the short-term costs of localisation. In 2017, Andre de Ruyter urged

government to align its fiscal policy with industrial policy objectives by reducing the tax burden on the manufacturing sector so it can attract more investment. Governments around the world are using incentives and subsidies as part of their efforts to build and protect their industries.

**Research Question:** What are the main challenges and opportunities associated with implementing localisation policies in the current political and economic climate?

### 5.3.2. Domestic structural constraints

Currently, the country grapples with a challenging economic environment marked by subdued demand and weak manufacturing production output. The manufacturing sector is dealing with intensified electricity shortages, increasing production costs, and logistical and infrastructure inefficiencies. During apartheid, the manufacturing base was robust and had the potential to be globally competitive. For example, ISCOR succeeded by relying on inexpensive iron ore, affordable and readily available electricity supplied by Eskom, and an efficient freight rail network (Makgetla, 2023).

Excessive input costs, weak infrastructure, poor service delivery, penetration of cheap imports, skill shortages, and policy uncertainty have all contributed to the sector's decline over the years. As a result, the sector has failed to remain competitive in global markets and has shed a considerable number of jobs. All of the respondents in the study agreed on the abovementioned factors as binding constraints facing the manufacturing sector.

*“Power cuts, logistics and infrastructure, those are the key concerns that can potentially affect the investment or the growth of the sector” – Respondent Eleven*

*“So I think that's why for me, the manufacturing sector remains a critical sector and the discussions on localisation are quite critical.” – Respondent Nine*

Respondents Nine and Fourteen attributed the declining domestic manufacturing predominately to de-industrialisation. As covered in the literature review, de-industrialisation occurs when there is a shift in the composition of the economy and a premature shift in tertiary industries. Respondent Nine believes that localisation of the

manufacturing sector is an acknowledgement of de-industrialisation in the sense that we have seen sectors like the services sectors dominate while the manufacturing sector has been declining since 1994. Thus, the DTIC wants to reindustrialise and localise production to reverse de-industrialisation, according to Respondent Fourteen. The respondent added that de-industrialisation is likely to continue until structural constraints are resolved.

According to the National Treasury (2019), despite several policy interventions to support the manufacturing sector, the capital stock has shrunk and, as such, found the country to be de-industrialising. The NDP and IPAP acknowledge that structural transformations characterised by high-value-adding manufacturing are needed to sustain economic growth and generate jobs (Sako et al., 2016). Insufficient industrial policy support has left the manufacturing sector inadequately prepared to withstand and thrive amid increasing global competition, prompting its deterioration.

The South African economy is still attempting to recover from the effects of the COVID-19 pandemic. Recent findings from the SARB 2023-Q3 Quarterly Bulletin paint a bleak picture, with production declines in eight out of ten manufacturing subsectors, pointing to weakened demand both domestically and abroad. Unfortunately, in South Africa, economic and industrial policies are not designed to readily adapt to sudden economic downturns such as global recession or pandemics; therefore, policy is unable to readily accommodate such external shocks effectively. Meanwhile, data from Productivity South Africa reveals a significant drop in productivity from 2010 to 2021.

#### **a. Infrastructure shortfalls**

Economic theory suggests that capital stock accumulation, labour, and technology are the three major sources of long-term economic growth. Productivity South Africa (2022) found that there has been negative growth in the capital stock. All the participants in the study identified inadequate infrastructure as a key obstacle to industrialisation. The country's deteriorating infrastructure has created an unsupportive environment for industrialisation.

*"...the physical environment is not supportive of industrialisation"* – Respondent Six

Respondent One claims that inefficient infrastructure has reduced production capacity in the manufacturing sector, forcing the country to import goods that could potentially be produced locally.

*“...we are importing someone’s working infrastructure, electricity, ports working efficiently...”* – Respondent One

Proudly South Africa and BUSA noted that inadequate infrastructure particularly in areas where SMMEs operate is a big burden and serves as a hindrance to the development of the business segment. Inefficient freight and rail networks have resulted in increased volumes of goods being transported by road, which is more costly, particularly for smaller firms. Although revitalising and upgrading the railway network system is already on the government’s to-do list, tangible results are yet to be realised.

*“Then there are infrastructure challenges in the places where many small businesses are located – how to transport products in and out, to expand premises and establish a secure and safe operating environment. Infrastructure challenges include of course the provision of essential services such as reliable water and electricity supplies, which is not always the case in some locations.”*  
– Proudly SA

Uncertain electricity supply is flagged as one of the biggest binding constraints to economic growth and development. The ailing electricity infrastructure and electricity generation capacity over the past fourteen-plus years have resulted in severe electricity supply uncertainty in the country. In addition to the power shortages, electricity costs have increased considerably, placing an undue burden on local businesses and private households.

*“Look at electricity. Just unacceptable that such an input cost has been abused by various interest groups the most influential outside the State.”* – Respondent Seven

The World Bank Enterprise Surveys conducted in 2007 and 2020 found the following: there has been a significant increase from 19 per cent to 62 per cent of manufacturing firms that consider electricity as their primary obstacle; there is an increasing number of companies reporting losses due to power outages; and South Africa now falls under

the category of nations with severe electricity constraints such as Liberia, Lebanon, and Nigeria.

According to the Daily Investor (2023), the former Eskom CEO Andre de Ruyter said, *“the maintenance at Eskom is pathetic. There are maintenance agreements which have not been done for two years.”* The stabilisation of electricity supply would require massive investment in upgrading the electricity generation and distribution infrastructure; thus far, government and Eskom have failed to present workable solutions to the energy crisis in the country. The government has also debated the extent to which they should support the development of renewable energy solutions. There is no denying that the industry needs urgent public sector involvement in resource mobilisation and investment in implementing renewable energy solutions (Martin, 2014).

#### **b. Poor service delivery**

Intricately linked to inadequate infrastructure is service delivery, or the lack thereof. One of the respondents provided an example of a chicken manufacturer, Astral, based in a small town in Mpumalanga. Inefficient basic service delivery in that small town necessitated that the poultry farmer makes alternative means of having an uninterrupted water supply thereby increasing production costs for the poultry farm to produce chickens. This validates the comments by BUSA and Proudly SA that poor service delivery and failing infrastructure increases production costs.

According to Roberts & Rustomjee (2010), there is significance in aligning transport and logistics infrastructure with the country’s development agenda along with reasonably priced and readily available electricity. Otherwise, localisation efforts will be limited by the poor state of the country’s infrastructure, according to Respondent Four.

Despite these challenges, Respondent Eleven who participated in conducting research to identify investment and export opportunities within the manufacturing sector in KwaZulu-Natal found that investors are still interested in South Africa and that investors still considered South Africa a favourable investment destination.

*“Despite the challenges that we have in South Africa in general, there are still some positive sentiments... I am sure you have noticed that at the investment conference, there were pledges that we made...”*- Respondent Eleven

### **5.3.3. Market Conditions – Lack of economies of scale**

The cost of production was a universal issue among all participants in this study. Local production was deemed expensive and left manufacturers uncompetitive internationally. The competitiveness of domestic firms largely relies on their capability to achieve economies of scale (Sako et al., 2021; Obinyeluaku, 2017).

*“It's very hard to see how localisation ever gets off the ground and works because your local alternatives have to bake in the extra costs that government places on them”* – Respondent One

*“Many areas of economic activity that can be done domestically but bring the costs of manufacturing down.”* – Respondent Seven

Water scarcity, electricity shortages, and high municipal rates are at the core of the production costs. Electricity prices have risen by about 500 per cent over the last decade, as reported by the government in the Re-imagined Strategy (RIS). According to the Manufacturing Circle (2019), the availability of water and energy at cost-effective rates is important in the production of quality goods.

*“Look at electricity. Just unacceptable that such an input cost has been abused by various interest groups the most influential outside the State. The same is true for water and property rates. We need well-functioning municipalities here.”*  
– Respondent Seven

Similar to Dinh & Monga (2013) sentiments, Respondent Eleven believes that manufacturing costs are a measure of the competitiveness and sustainability of the sector. Other participants mentioned that high wages in the country are the reason the country is importing goods that could be produced domestically simply because *“It might be cheaper to produce elsewhere because labour in South Africa is one of the more expensive... we do not have cheap labour like other countries...”* – Respondent Eleven.

In addition, the respondent raised concerns about deteriorating labour relations, as evidenced by labour unrest and sporadic strikes in various industries. To expand business operations, the manufacturing sector needs affordable and stable labour. Berry et al. (2002) found that South African businesses are faced with relatively high labour costs, which in South Africa is the result of labour laws which are well-intentioned to benefit workers.

It is general knowledge that some countries can manufacture goods at a cheaper and faster rate. The Localisation Support Fund argues that a significant influx of cheaper and substandard imported products continues to undermine and affect local manufacturers, who have the capability and capacity to manufacture. For this reason, it is important for domestic manufacturers to be able to achieve economies of scale.

*“If something comes in much cheaper from a country that already has economies of scale, then it is not worth it to produce it locally.”* – Respondent Ten

*“Yes, there are instances where we can get products cheaper, but at the same time, we also want to support and grow our local industries because it also has a rippling effect. You are creating jobs.”* – Respondent Three

Respondent Ten is of the view that it may be difficult for South Africa to achieve economies of scale because of the size of the population of which a majority have low incomes. Furthermore, the respondent alluded to the proximity to markets as a constraint. Martin (2014) found that a comparative advantage lies in proximity to markets, and a small population may not be able to sustain output. The finding by Martin (2014) supports the comments made by Respondent Ten. Distance from key markets affects the prospects of export-led industrialisation (Makgetla, 2022).

#### **a. Lack of demand**

*“You cannot produce without a market”* – Respondent Thirteen

Lack of demand, as one of the key constraints of localising the industrial sector, came up repeatedly in the interviews as well as in media opinion pieces. To boost demand for local goods, the government along with Proudly SA have embarked on a “Proudly

SA campaign” where Proudly SA hosts an annual Buy Local Summit and Expo. The Expo offers SMME-focused workshops, lessons in local procurement, legislation, compliance issues, and an impressive exhibition of local goods and services. However, the manufacturing base should be strengthened enough to not solely rely on government procurement. Respondents Nine and Fourteen have expressed that stimulating aggregate demand should be a top priority to revive the sector to its former glory. Respondent Nine also acknowledges that demand cannot be stimulated outside of a growing economy. This presents a predicament to policymakers.

*“So I think, it creates a spiral effect that promotes growth in the economy. By stimulating the economy and increasing aggregate demand, positive implications arise which further influence the economy.”* – Respondent Nine

In addition, the participants argued that if we had sufficient local demand, then it would reduce reliance on export markets because it would also serve as protection against external shocks of weakening global demand.

*“You will reduce reliance on exports so much that if there is a decline in exports, you still have got sufficient demand to carry local production.”* – Respondent Nine

Respondent Ten highlighted low demand but argued that addressing inequality and poverty in the country is necessary to create local demand.

*“We're not going to be able to create local demand if we don't solve for just inequality for broadly, but also income inequality”* – Respondent Ten

Makgetla (2023) emphasized that the condensed South African middle class has limited domestic and regional demand and well as constrains the country’s light manufacturing. Ayabonga Cawe, the commissioner of ITAC stated that weak demand in the economy has resulted in capacity underutilisation in manufacturing. Furthermore, the commissioner noted that the country is facing both supply- and demand-side constraints that hamper manufacturing; therefore, this would require a combination of social and industrial policies to address this issue. Demand cannot be created in an environment with low and constrained income. The issue of inadequate demand raises the debate on social and industrial policy measures (Cawe, 2023).

Thus, the researcher asks that in industrial policymaking which takes precedence, strategic industrialisation objectives, or addressing the country's social injustices?

*“Achieving economies of scale if you only have South African demand is challenging, so we need the region and the continent, which is why the AfCFTA is important and policies like localisation should be implemented in a way that they do not affect our ability to then leverage those opportunities, right?”-*  
Respondent Fourteen

African regional economic integration may be a way to create access to a larger market (Obinyeluaku 2017). On the other hand, Africa is relatively underdeveloped and may be unable to provide a larger regional market (Makgetla, 2022).

#### **b. The quality of locally produced goods**

The quality of locally produced goods in comparison to imported goods is one of the media's main criticisms of localisation. Local products must meet quality and price expectations to gain consumer acceptance.

*“If they have to be designated, it means they were not the buyer's first choice. There must be a reason for that. Are they more expensive? Are they inferior in some way?”-* Bernstein and Schirmer (2020)

Respondent Three, an economic analyst at SABS pointed out that the point of localisation is to encourage citizens to choose South African products over foreign products based on standards and quality of the local products. Although we are bound by the World Trade Organisation (WTO) Agreement, there is a clause in the agreement that allows developing countries such as South Africa to deviate to suit the local economy and assist local industries to grow.

*“We want citizens to choose South African products over international products based on standards. So even though we are obligated to firstly use international standards there is a clause within the WTO that gives us the mandate to actually personalize standards, so to say, to suit our local economy and also to assist our local industries to grow.” – Respondent Three*

Another respondent said the concerns for quality need to be qualified. He expressed that producers must maintain their standards even when selling locally and are aiming to supply foreign markets. Local manufacturers cannot compromise on quality in either case.

*“The certain standards that have to be met in the inspections being conducted to ensure that goods that are sold locally remain of the required and international standards” – Respondent Nine*

*“South Africa produces quality; we have various organisations that ensure that the products that we make here are of quality we have the SABS and Proudly South African...” - Respondent Eleven*

Respondent Eleven also alluded to the fact that imported goods are not always of superior standards to locally manufactured goods.

*“South Africa imports a lot of water meters, even though we have manufacturers locally and some of the imported goods are of poor quality.” - Respondent Eleven*

The Localisation Support Fund expressed concern over how cheaper foreign products with inferior quality can stifle local manufacturing. The SABS in collaboration with the government assists local producers to meet required standards. These services are also extended to SMMEs at low cost to assist them in accessing international markets.

*“We would offer SMMEs assistance in terms of the application of the standards in the, for example, production methods... Giving them preferential rates or lower rates in terms of testing their products and getting them certified so that when they are presented in the market, consumers can choose local products over international products based on the quality that they were produced.”- Respondent Three*

*“Many South African vehicles manufactured in our country are preferred in overseas markets due to the high quality of our goods” - Dlodla (2022)*

SABS has a local content grading scheme that was launched in October 2021. The scheme is designed for manufacturers wanting to leverage the fact that their products are manufactured locally. The local content scheme can provide data to support

localisation efforts; assist in the implementation of preferential procurement policies; that can be used to promote locally produced goods; and assist local manufacturing in acquiring Made in Africa certification. This local content verification service is a critical industrial policy tool which opens up new business opportunities therefore contributing to industrialisation initiatives (SABS, 2023). Hence National Treasury has highlighted the need to ensure that SABS is well-capacitated for the verification function as part of efforts to create support for demand-side industrial policy interventions (National Treasury, 2019).

### **c. Domestic skills shortage and high labour costs**

Another concern identified by all the participants in the study was the local shortage of appropriate skills, specifically in technical competencies within the manufacturing industry.

*“Another complaint here is of skills. No capacity because there are no skills involved”* – Respondent Eight

A respondent from SABS lamented that a lack of skills makes it difficult to keep up with technological advancements; therefore, local manufacturing techniques do not evolve as technology advances. With inadequate skills, the quality of the local products will be questioned.

*“We get stuck in doing things the old way because we are unable to upgrade our systems concerning technology... skilled labour keeps up with technology”* – Respondent Three

Kruger (2016) noted that manufacturers in South Africa have difficulty sourcing trained graduates with critical thinking, problem-solving, and cognitive flexibility. Skill shortages are exacerbated by skilled labour leaving the country. Martin (2014) found that manufacturing firms in the Eastern Cape mentioned that finding relevant skills is a sore point and in short supply.

The Department of Higher Education and Training (DHET) (2016) identified insufficient education and training, specifically in engineering and artisan skills as the root cause

of technical skill shortages. Although there are Further Education and Training (FET) institutions that produce engineers and artisans every year, these graduates often struggle to find employment as they are deemed not to meet “industry standards.” In 2019 the Manufacturing Circle recommended that government facilitate skills transfer training programmes that are designed to meet the relevant skills demand in the sector.

Respondent Thirteen recommended that all departments including the education department need to be aligned with industrial policy objectives. For example, if the economy or industrialisation requires a certain set of skills, the education system should be adjusted accordingly, starting at the basic education level. The growth and development of the manufacturing sector and the broader economy will remain stunted if the issue of skills shortages is not addressed.

*“The economy is not competitive in labour-intensive manufacturing because the cost structure is too high, labour laws are not conducive to such industries, and the country lacks the management acumen to manage large, labour-intensive firms.”* – Respondent Eleven

The skills shortage in the manufacturing sector is further exacerbated by wage rigidity. According to Berry et al., (2002) South Africa’s relatively high minimum wages are costly for small businesses. Codera Analytics (2023) observed that wages grew faster than profit in most sectors including manufacturing while the finance and business services and community and personal services sectors net profits outpaced wages. STATSSA (2023), reported that the compensation of employees in the manufacturing sector saw an increase in 2022 compared to pre-pandemic levels, with an average growth rate of 6.4 per cent since then.

Insufficient and inadequate skills in manufacturing may lead to doubts regarding the quality of domestically produced products, further stunting the global competitiveness of the sector. Skills shortages require a long-term policy intervention.

**Research Question:** How can localisation policies be effectively designed and implemented to maximize their positive impact on the manufacturing sector and the broader economy?

#### **5.3.4. Localisation and its implication on trade policy**

*“Imports are not bad at all, but importing what we can produce locally is “bad” because it does not support local employment, income generation, etc. So, it is not about banning imports, but rather about maximising local benefits on a sustainable basis.” - Dr Iraj Abedian (2023)*

*“Firstly, there is an assumption that imports are bad and exports and domestic production are good.” – Respondent One*

The World Economic Forum (2021) highlights the importance of international trade in promoting economic growth, development and employment opportunities globally. Trade is a potential driver of structural change through both supply-side and demand-side effects (Obinyeluaka, 2015). Despite this vital role, global trade is vulnerable to changes in economic, political and environmental factors which is evident in how global trade patterns were adversely affected and indefinitely restructured by the COVID-19 pandemic. The pandemic crisis compelled countries to consider the adoption of inward-looking, near-shoring and offshoring strategies (Nodari & Rungcharoenkitkul, 2022).

Through localisation, government wishes to reduce non-oil or petroleum products imports by 20 per cent over the next five-year period. In addition, Minister Patel announced that government would increase exports through trade (Business Tech, 2021; RSA, 2021). The Re-imagined Industrial Strategy (RIS) proposes supporting export growth, especially exports to the rest of Africa to cushion the limitations of South Africa’s small domestic market. This reform requires regional integration that can be facilitated through the AfCFTA while increasing manufacturing output to maximise opportunities and fully capitalise on the “new market.” International trade can foster job creation if existing markets are maintained while pursuing expansion into untapped ones (BUSA, 2017).

*“Ultimately, I believe that localisation is a deviation from our export-led growth strategy” – Respondent Fourteen*

Export-led growth is argued to compel local production to be more efficient and of higher quality to gain a competitive edge in the global market. Competing on the global market exposes local producers to technological spillovers and higher product quality (Makgetla, 2023).

Respondent Three also thinks that it is important to control imports and the fact that we are not means that we leave the country fully dependent on international markets.

*“We ship all our raw materials and import them as finished products and that has therefore robbed us of developing manufacturing value chain” - Respondent Eight*

South Africa is still predominantly a primary producer and not a secondary producer that can absorb the idle labour force. The country’s exports are still concentrated in seven primary commodities namely coal, PGMs, gold, iron ore, manganese, chromium and diamonds.

Five of the respondents think that the AfCFTA will be one of the main ways South Africa reduces imports as envisioned in the localisation approach to industrialisation.

*“Trade will improve within the continent, and we will probably change some tariffs to make sure that certain products that come out of, let's say, Europe, they probably have a higher duty and unlike when you source it within the continent, which would be free of duty” – Respondent Thirteen*

Respondent Three thinks that the country is importing goods that can be produced locally. Furthermore, the participant referenced the import substitution policy that was implemented during the apartheid due to international economic sanctions and aftermath of the World War II. The apartheid government was able to implement import substitution because their industrial policies fostered vertical integration of industries through extensive incentives and investment schemes (Roberts & Rustomjee, 2010).

On the other hand, Respondent Seven believes that in terms of localisation, which implies import substitution, the government should weigh the potential gains from newly established manufacturing companies against any losses in the import sector.

The Respondent suggested that resistance from organised businesses in the import sector might be due to this factor as well.

*“Balancing act between job losses in import sector and job gains in newly manufactured entities. This transition needs to be managed carefully. The obvious benefit is saving foreign exchange reserves. Will strengthen our currency.*

*“Not good for exports but inflation will be kept in check and the domestic market will thrive as more money will be circulated and capital could be used to expand the nascent sectors.”* – Respondent Seven

As much as global trade plays a significant role in economic development for most economies across the world, geopolitical tensions and the increased use of “green” industrial policies threaten to change or even reduce global trade (OECD, 2023). Localisation policy tools will have to balance export promotion while restricting imports that threaten the domestic markets.

#### **a. Tariffs are an important trade policy tool**

*“We need to make sure that in terms of trade policy, the use of duties or tariffs to protect local industry is maintained.”* – Respondent Four

The minister of the DTIC emphasised that *“trade policy needs to be a source of new jobs and expansion of the industrial economy”* (Business Tech, 2021). Most of the respondents agreed that although tariffs and other trade policy instruments are a critical component of industrial policy, it is important to carefully consider the choice of policy instruments because South Africa must adhere to the WTO and other multilateral organisations' commitments.

As a member of the WTO, South Africa may adjust their tariffs up to an agreed level known as the bound rate per the Customs and Excise Act no. 91 of 1964 ; however, there is also flexibility given under certain clauses within the agreement that allows for customization in order benefit local economies while assisting emerging industries. In the early 1990s, the WTO removed the use of tariff protection or support to infant industries. However, the WTO rules still permit governments and large businesses to

support local suppliers and have not prohibited supply-side actions to aid producers in becoming more competitive (Makgetla, 2023).

As per the National Growth Path (NGP), trade policy instruments should be designed in a way that promotes value-adding and labour-intensive manufacturing to expand the economy and employment opportunities (ITAC, 2016). An appropriate measure of the effectiveness of trade policy instruments would be to observe whether the desired changes in trade flows were affected (Sako et al., 2021).

Respondent Nine argues that *“it's not necessarily an issue of trying to protect the local economy as such, but it is trying to strengthen the capability of local industries.”* Makgetla (2023) advises that tariffs must be used strategically and not as standard practice.

Respondent Eleven who previously worked at ITAC believes that various rebate facilities do promote localisation as he has witnessed while working with the automotive sector's APDP.

*“So we were responsible for imposing various tariffs on certain products, and when you looked at their financials, you could see a company failing. However, after we implemented the tariffs, things significantly improved, allowing them to keep both their investment and the jobs that they were providing.”* –

Respondent Eleven

Government uses barriers to imports through customs duties, import permits, subsidies, and incentives. These “localisation barriers” measures are applied to support domestic firms and to suppress the dominance of foreign firms (Stone, Messent and Flaig, 2015). In the mid-1990s automotive industry in South Africa was mainly concentrated by local firms, and this was as a result of government support through significant levels of tariff protection from foreign competition. In return for this protection, firms had to adhere to the local content requirements by sourcing much of their inputs from domestic emerging OEMs (Barnes, 2000). However, with the reduction of most of the duty protection, the OEM and automotive industry value chains must battle the surge in imports that depress local sales.

In a 2017 Impact Evaluation Report on the performance of the poultry industry, ITAC found that in one case, tariff protection resulted in marginal gains in the domestic value

chain but reduced imports. In another case, increased customs duties boosted the firm in increasing production, profits and job retention. However, the overall domestic value chain continued to decline due to rising imported input costs. In summary, following this analysis of the two firms' experiences, it was concluded that tariffs support neither select winners nor losers.

There are cases where ITAC observed export growth, job retention, recovery in domestic recovery, and improved domestic value chain after tariff protection while in some cases or industries, higher customs duties did not halt the influx of imports, one particular case is that of the aluminium extrusion industry (ITAC, 2016). Ideally, tariffs should protect domestic markets against cheaper imports as well as lower the cost of imported inputs. Similar to the automotive sectors, ADPD tariffs can be reduced or eliminated for inputs that are used in manufacturing exports.

In East Asian countries high tariffs successfully laid the foundation for export industries. As argued in import-substitution industrialisation theories, the use of tariffs is anticipated to secure domestic demand for local producers as tariff support is expected to increase domestic manufacturing and become internationally competitive, increase investment and create jobs (Makgetla, 2023, ITAC, 2016).

*“The choice of instrument can result in other countries retaliating...”* – Respondent Nine

*“Trade politics will always exist, and we may receive a bit of backlash in terms of some of the initiatives that we may want to take, but this type of policy is not unique to South Africa.”* – Respondent Three

#### **b. Import replacements through tariffs may impede growth in some sectors**

Makgetla (2023) contends that local procurement regulations may impede industrialisation by delaying infrastructure projects.

*“Then RMB CEO James Formby made it clear that localisation requirements were holding back our ability to produce alternative energy. In April, Formby complained about local content rules increasing the cost of wind and solar energy installations.”*

*He went on to argue that tariffs on imported steel have a similar effect.*” – Bernstein and Schirmer (2021).

*“Cost pressure on imported inputs worsened”*- The Manufacturing Circle (2018)

In 2019, the Manufacturing Circle suggested that identifying opportunities for import replacement, and growing exports would boost industrial output.

*“We are not against trade. We just want a competitive advantage.”*- De Ruyter (2017)

*“South Africa is importing more intermediate products than it exports, but exports more consumer products than it imports, suggesting that the latter are relatively internationally competitive, though with less policy space.”* – ITAC (2017)

In 2017, ITAC recommended reduced tariffs on imported intermediate goods that go into the production of goods, to avoid raising the cost of production. The National Treasury also emphasised that since some of the exporting firms are import-intensive in terms of their intermediate inputs means that trade policy cannot exclusively focus on export promotion.

During the third quarter of 2023, South Africa experienced a further decline in its terms of trade as imports became more expensive due to a weaker rand price and inflation while exports decreased alongside global commodity prices (SARB, 2023). The deteriorating terms of trade mean that manufacturers would incur higher costs when sourcing their inputs from foreign markets. This can harm domestic production. There must be a balance between export promotion and ensuring that the importation of intermediate goods is adequately considered in trade policy (National Treasury, 2019).

It is imperative to support exporting firms since evidence suggests that they are prone to be more productive, have higher labour productivity, and have higher wages (Matthee et al., 2016; Edwards et al., 2018). In addition, export growth is also an important aspect of structural transformation that the country is in dire need of (National Treasury, 2019).

Policy support is lacking in many industries while those industries that have strong policy support like the automotive sector have done reasonably well in comparison. It

could be suggested that the government adopt similar tariff structures and industrial rebates as seen within the APDP used by this industry. As stated by Dinh & Monga (2013), only exporters should be granted duty-free access to inputs, whereas non-exporter's inputs are subject to and duties on all inputs used in final goods. This proposal is backed up by ITAC's observations of elevated production and employment through implementing rebate facilities for intermediate goods in some cases.

### **c. Localisation offers an opportunity to fast-track regional integration**

Two of the participants alluded to “regionalism” as a means to expand trade and development.

*“We need to be in a position to see what we should produce domestically, what should be produced in the region, what we can trade with people in the region. Long term there is no country that has ever grown on its own right like the Asian tigers grew together. You need your neighbours and unfortunately, our immediate neighbours are small, which then makes the continent important.”* – Respondent Fourteen

*“You got the AfCFTA now. There is room to work on developing that market, but part of it then goes back to fixing some of the infrastructure bottlenecks and if we can get around some of these issues within the region, which certainly could create a big enough market for some locally produced goods.”* - Respondent Ten

*“So I mean with the coming of the AfCFTA we are going to see more countries opening up, meaning that also provides a new market, potentially new markets for countries to diverge. I think the timing of it is perfect now that all countries are now embracing the AfCFTA agreement.”* – Respondent Three.

Agarwal et al. (2023) argued that an approach to the AfCFTA rules of origin known as “developmental regionalism” can assist in diversifying African economies by promoting a “Made in Africa” strategy. This will lead to higher-value production and facilitate the creation of regional value chains. By utilising this method, large internal markets can be formed through AfCFTA regulations, which have the potential for attracting domestic, regional and international investments towards increased production and exports from African countries. This argument stems from the fact that rules of origin

aim to establish the threshold for local content and value-added before goods are traded. Furthermore, it is argued that the AfCFTA needs to facilitate the creation of a regional value chain to support the industrialisation and development goals of members. The development of an integrated regional value chain will shift Africa from suppliers of raw inputs or low-value assembly that have restricted development to high value-added production (Agarwal et al., 2023).

To a certain degree, some of the participants in the study are of the view that localisation and regional integration will propel countries to elevate their production supporting Agarwal et al.'s assertions.

*“We're talking about AfCFTA now. Would not localisation mean that if it is within the continent, whatever we are producing as long as it is produced within the continent, that's localisation”* – Respondent Thirteen

*“The types of goods that we are importing from the international market and international in the sense I am referring to outside Africa is because our local industries have not been pressured to actually develop and produce at a certain standard. So maybe this is also the pressure that is required not only for South Africa but within the region.”* – Respondent Three

According to Respondent Eleven industrial policy creation needs to leverage the symbiotic relationship between trade, investment, and tourism. Though there is a correlation between the three elements, causation has not been established. Through the AfCFTA, policymakers have an opportunity to develop trade and industrial policy instruments to incentivise investment in production (Agarwal et al., 2023). Sako et al. (2021) found that creating and gaining access to larger markets not only depends on foreign direct investment (FDI) but also on local firms growing as a result of expanding the domestic market and integration into regional and global value chains. Overall there is a need for trade policy to closely align with industrial policies.

Two of the respondents who are sustainable development economists alluded that climate change is expected to have an impact on global trade. Europe is set to implement a climate-friendly industrial policy which presents an opportune time to fast-track regional integration to expand the export market within the African continent. The European Union's (EU) Carbon Border Adjustment Mechanism (CBAM) will make it difficult to access the EU markets which may impact African exports and ultimately

growth (Worley, 2023). The African Development Bank's president has warned that Africa may lose up to 25 billion US Dollars annually owing to the EU's implementation of the CBAM. In addition, he argued that the mechanism has the potential to impede Africa's developments in trade and industrialisation as it imposes higher taxes on value-added exports such as steel, cement, iron, aluminium and fertilizers (Thomas, 2023). Hence AfCFTA may cushion the possible loss of export revenue.

### **5.3.5. Government Support and Policy Framework**

Concerning policy formulation, implementation, and coherence the occurring themes presented in the data were that policy goals were clear; there were fundamental failures to implement policies; and that policy formulation is mostly a political project with little stakeholder engagement and bias, in other words, some respondents believe that policy formulation is arbitrary. Furthermore, research findings revealed that South Africa battles with weak policy coordination, a lack of well-established monitoring and evaluation systems, and skills deficiencies in the state bureaucracy.

#### **a. Good policy framework**

Policy goals or objectives were considered clear enough by most of the participants. When responding to the proclamation of localisation policy BUSA and SACCI agreed that the ideas presented are good.

To ensure the most efficient use of limited government resources, it is crucial that policy objectives are unambiguously communicated to relevant stakeholders with clear directions and without any confusion or ambiguity. The first step to setting clear objectives and goals is to extensively study and identify the problem. In this regard, the government has done well to identify relevant problems that continue to pester society and the economy (Roux, 2002).

*“We have more plans than we need. That is how clear we are about the problems and diagnostics is on point.” – Respondent Six*

*“Policy objectives are clear. Clear enough. From where I am standing it is clear in terms of what we need to do to support localisation. It is for the implementing parties to decide.”* - Respondent Three.

*“Good policies. The intention is particularly good. The Champions, sometimes they are the problems”*- Respondent Eight

Public policies have not been successful in effecting the desired change in society therefore the issues remain unresolved due to a myriad of issues including political interference and implementation shortfalls. Policy development and analysis continue to be two crucial elements in addressing various socio-economic issues (Prinsloo, n.d.). In its paper on economic transformation, inclusive growth, and competitiveness, the National Treasury (2019) suggested that there is room for improving industrial policy through continuous, independent monitoring and evaluation, flexible intervention measures, experimental implementation of policies and streamlining industrial policy to optimise its effectiveness (National Treasury, 2019). One of the observations noted in the RIS is that there is a need for an evidence-based approach when formulating policies where there is a regular review of policies. Morris (2010) advises that when designing industrial policy, government should engage in continuous learning and innovation.

The Washington Consensus (1997) argued that limited information is the biggest challenge facing the government in policy development. Government needs to access sector-specific information to identify opportunities and risks that firms are confronted with (Morris, 2010; Roberts & Rustomjee, 2010). The issue of limited information is a key limitation in policy development and implementation, according to Respondent One quoting Munger (2022).

#### **b. Arbitrary policy formulation and rent-seeking**

In terms of policy development, three of the respondents highlighted that political factors tend to hold greater importance in the process.

*“Policy development in the country is mostly a political project. Engagement and consultation with stakeholders are not robust enough. The ruling party is chasing what will sound good to the public” – Respondent Six.*

*“Policy starts off a political project and then becomes a government project and then it's an attempt in various ways to insert it into the private sector”- Respondent One*

Respondents One, Three, Six and Fourteen emphasised that it may be important for the government to engage in robust consultations with relevant stakeholders in the policy formulation process.

*“It is not something that a government on its own should just decide upon. It should be backed up with research because we may also find ourselves wanting where we choose an industry which is not futuristic, which will not be as important in the next 5 to 10 years.”- Respondent Three*

Respondent Six also highlighted that policy should not be developed arbitrarily because ideally policy should be designed to address a specific issue or a range of issues. Respondent Eight also echoed the issue that policy should be designed to solve certain issues. Hence it is important to engage with all relevant stakeholders.

*“Localisation and industrial policy as a whole need to make sense in relation to the business models of the lead companies... There needs to be buy-in from workforce, labour unions...crafting a strategy that must make economic sense for major participants in the value chain.”- Respondent Four*

*“Any initiative, any project that you have to do, it has to at least solve one or two or all of them. All of those issues, right?” – Respondent Eight*

Respondent Two, on the other hand, does not believe the actions of the government are void of some degree of research and consultation but went on to indicate that perhaps the research and consultation might not have been robust enough.

*“You mean like now as we are sitting here, those guys (policymakers), they do not do your research. They are... And do a little bit of research... Yes, the research you have is not that deep” – Respondent Two*

Munger (2022) argued that industrial policy inherently chooses winners and losers because industrial policy assumes that the government can allocate resources better than the market. However, there is often an information gap in the sense that government officials and bureaucrats have no access to full industrial or sectorial data that would be required to make accurate evaluations of industry players, and therefore be able to direct resources more efficiently towards the “good and futuristic” industries (Munger, 2022).

On the other hand, while policy formulation may in some instances be arbitrary there is also an issue of lobbying and rent-seeking. Respondent Thirteen raised the issue that policy formulation in the country tends to favour big corporations, in most cases multinational corporations. The respondent believes that investors have unwarranted influence on the industrial policies of the country thereby robbing the state of its autonomy. The prevalence of lobbying and rent-seeking can lead to the diversion of resources from productive activities to unproductive activities. In turn, productivity and potential for growth may be restricted (Chang, 1993).

There needs to be clear boundaries between public officials’ private interests and political interests. The lack of clear boundaries may result in the exploitation of these official by specific groups to advance their mutual private interests at the expense of the interest of society at large. The fact that the political elite have conflicting business and economic interests is a plausible reason policy fail and are therefore constantly reviewed and revised resulting in delays in implementation and realisation of set objectives (Ramantsima, 2015).

Another concern raised by Respondent Thirteen is that SMMEs are an afterthought in policy formulation. The respondent can be quoted as follows:

*“Do we, as the South African government have power, or do they (investors and large businesses) have the power? So that is why we are not moving forward because the people who own the capital, the resources, they have the power to influence policies.”* – Respondent Thirteen

Such industrial policy capture may worsen inequality and increase the concentration of wealth and capital in the hands of the elite few (Research Network, 2023). Two respondents mentioned that the state’s lack of autonomy is one of the main reasons why industrial policy in the country has not had the desired impact for which it was

designed. It could be argued that policy goals often do not align with the socio-economic needs of a country, as various stakeholders hold different expectations. Therefore, both private and public sector interests should be taken into consideration when formulating public policy. It is crucial that public policy addresses economic, social, and political issues that impact both the public and private sectors (Prinsloo, n.d.)

Respondent One alluded to the information gap that exists in South Africa's policy formulation process that often leads to policy failure. According to Martin (2014), good policymaking requires rigorous and meaningful consultations between the private and public sectors to identify prevailing constraints and new opportunities. Government and business are necessary for economic transformation. Accordingly, the government has begun cultivating this relationship through various sector masterplans and close engagements with various stakeholders such as investors and unions (RSA, 2019). According to Prinsloo (n.d.), stakeholder involvement in policy formulation and execution is essential as common goals are cultivated. The head of enterprise and supply chain development at Absa Regional Operations (2021) commented that *"support of this critical economic sector requires multi-stakeholder involvement from the public and private sectors."*

### **c. Execution and implementation shortcomings**

Policy implementation is the practical aspect of policy formulation and is crucial in achieving economic, social, and political goals therefore cannot afford to be neglected (Prinsloo, n.d.). The research found that there is a need for clearly defined implementation action plans and guidelines. According to the Manufacturing Circle (2017) *"implementation with clear action plans, budgets and timelines will be key."* Former chair of the Manufacturing Circle Andre de Ruyter (2017) recommended that a manufacturing working group between business, labour and government be set up to co-ordinate the implementation of policy, referring particularly to localisation.

Lack of coordination between intra and inter-departments is a major obstacle in policy implementation. According to Respondent Six, the slow implementation of policy creates uncertainty and as a result, creates an inconducive investment environment which is reflected in declining gross fixed capital formation. Thus the country has

experienced a decline in manufacturing because both policy and physical environment are not supportive.

*“We have been very slow in implementation of our policies so that by itself creates uncertainty”* – Respondent Six

Respondent Two emphasised that although government has clear policy goals and objectives, the actual implementation thereof to achieve certain goals has not been clearly defined.

Respondent Six also highlighted the lack of large-scale monitoring and evaluation as a major constraint on the outcomes of government policies. He also believes that the Presidency's institutionalising monitoring was an expert move however government failed to institutionalise it in all the relevant departments responsible for implementing government policies. Hence, the respondent recommends a decentralised monitoring and evaluation function.

*“M&E (monitoring and evaluation) as a discipline is not well entrenched in the departments themselves, we have not been able to find each other. I am talking about the Presidency and the sector department, so in other words, sector departments look at the Presidency as a centre of government”* – Respondent Six.

National Treasury noted that as part of implementing focused and flexible industrial policy, there needs to be constant monitoring and evaluation to ensure that accurate and timely data is collected throughout the life cycle of programmes.

Respondent Eleven thinks our policies are brilliant however the enforcement aspect needs to be tightened particularly referencing the Preferential Procurement Policy that has been central to localisation initiatives. According to the RIS, other departments and SOEs are often seen to be ignoring localisation requirements, leaving the DTIC being the only department concerned about localisation targets (RSA, 2019). Makgetla (2023) also claims that often local content procurement policies are solely left to the individual departments which is indicative of lack of inter-department coordination. State-owned entities and state agencies are often expected to meet localisation targets from their budgets, even if their mandates are not tied to fostering industrialisation (Makgetla, 2023).

Gruhn (2019) found that there appears to be a lack of incoherence between local and national industrial policy frameworks. Related to this, respondents Three and Thirteen are of the view that there is policy misalignment among departments where we see different departments working in silos whereas they should be working together to align their respective policies to industrial policy objectives. The aforementioned lack of coordination across government and macroeconomic instability is making it difficult to successfully roll out public policies that will support value-adding manufacturing activities.

*“I think what the government policy is trying to do right now, is to actually coordinate the different initiatives that different departments were taking in silos but fails or does not go as smoothly because of lack of coordination between the different entities. But the coordination of what needs to happen, who needs to act and when to act, that becomes a great obstacle.” – Respondent Three*

According to one of the participants in the study, another hindrance to rolling out of policy is the need for resources. This again reinforces the recommendations made by Andre de Ruyter in 2017 for the government to align fiscal policy to industrial policy objectives. The success of policy response reflected an age-old inability of the state to coordinate government actions and resources to support industrialisation. Policy choices are directly influenced by the state's fiscal capacity.

*“I think because they are so the focus is so broad, you need resources. You need resources to be able to achieve everything... even moving from IPAP and now the masterplans, we still have way too broad a focus.”- Respondent Fourteen*

#### **d. Inadequate human capital and bureaucratic capabilities within government**

Capacity and resources, both human and financial are vital for successful implementation of policy. Unfortunately, South Africa is facing acute human capital and financial constraints. Respondent Eight mentions that policy champions are also an obstacle in policy rollout.

*“These plans will depend on the ability of the state to execute. Planning alone will not be adequate. In our view, many of the ideas proposed by the President are good, but will be constrained in taking off, without fixing the human capital equation.” – BUSA (2020)*

The South African Chamber of Commerce and Industry (SACCI, 2020) called upon the government to build a meritocracy and argued that the plan (ERRP) rests on the ability to execute therefore there is a need to investigate the human capital.

*“The South African Chamber of Commerce and Industry calls upon the President to take the bold step of commissioning an independent, professional and deep audit, assessment and evaluation of the current skills-set in the public sector managerial cohort.” – SACCI (2020)*

Furthermore, SACCI referenced Japan, Taiwan, South Korea, Singapore, old Hong Kong, Russia, Australia, and Israel, the eight non-western countries that did not compromise on bureaucratic capabilities and in so doing successfully developed their countries. Respondent Four is of the view that localisation in rail manufacturing has failed to achieve the desired outcomes due to a lack of commitment of real intent by SOEs to localisation. The respondent also referred to the Zondo Commission that found unethical practices in the procurement of rolling stocks which is indicative of the lack of commitment from SOEs. In addition, localisation is hampered by inadequate capacity in the procurement and supply chain officials (Makgetla, 2023).

Other participants made a point that an *“overly layered and rigid bureaucracy”* hinders policy development and execution.

*“...overly layered and rigid bureaucracy that is why the processes of policy development are rather slow. And if we are slow in policy development, be rest assured, we will be slow in policy implementation too.”- Respondent Six*

In 2017 the Manufacturing Circle lamented that there should be *“an improvement in the personnel skills base, in terms of project management and financial administration.”*

*“I certainly do not assume that “states possess a well-informed, effective bureaucracy”- World Bank economist Justin Lin*

Kaplan (2007) cautioned that considering the limited governmental capabilities, industrial policy should be modest, and the private sector should play a prominent role. Establishing institutional frameworks is necessary to enable businesses to take the lead in determining the opportunities and challenges that a sector faces, as well as the policies that are intended to address these. On the other hand, Morris (2010) advocates for the establishment of sustainable public-private partnerships while maintaining integrity in the institutions involved supported by a strong political will to resist any form of lobbying and rent-seeking from various interest groups. It is worth noting that continued support for certain groups increases their power in shaping policy (Roberts & Rustomjee, 2010) potentially, leading to the prioritisation of the agendas of interest groups at the expense of the national development goals.

The South African government in its 2019 Reimagined Industrial Strategy (RIS) acknowledged the skills deficit within the public sector. *“We need to rebuild the capacity and skills that have been eroded across the public sector and state-owned companies.”* (RSA, 2019). According to Gumede (2011), a developmental state is one with an active industrial policy, competent state bureaucracy, and efficient coordination between key national governments. As well as a government that prioritises national development goals. *“Successful developmental states boast high levels of policy coordination, linked to a well-established monitoring and evaluation system.”* The Research Network (2023) also states that the success of policies depends on the implementation capacity within the state’s bureaucracy. The quality of the bureaucrats is of high importance.

**Research Question:** Are the objectives of localisation compatible with each other?

### **5.3.6. Financial and non-financial support for SMMEs is critical**

*“SMMEs need policy support to enhance resilience...”* – Mparutsa, head of enterprise & supply chain development at Absa regional operations (2021)

The effects of the pandemic have left SMMEs more vulnerable than before. As Makgetla (2023) pointed out employment in the SMME segments fell as the pandemic affected economic activity. Therefore additional state and private sector intervention

is required to encourage economic activity in SMMEs. Debbie Tagg, chief operating officer of Smart Procurement noted that for localisation to make an impactful and sustainable contribution to the economy, the “SMME trifecta” is a necessity. That is *“SMMEs need unique business development support, funding and market access,”* she says. This is the SMME trifecta required for localisation to be successful.

#### **a. Market formation and resource mobilisation in SMMEs**

Industrial policy can provide access to capital for local businesses and link suppliers with buyers (Whitfield, 2021). The South African government does have policies that are designed to offer both financial and non-financial support to SMMEs. There are also institutions such as SEDA which provides non-financial support to small enterprises and cooperatives. The IDC and the DTIC have various programmes that offer financial support to small enterprises.

According to Proudly South African CEO, only 37 per cent of SMMEs survive to their fourth year while a staggering 70 to 80 per cent do not make it past the first year of business. Access to funding, infrastructure, and proximity to markets are some of the key factors upsetting SMMEs' development and growth (Mashimbye, 2021).

Three of the respondents made mention of the market setting as a factor in SMMEs' growth. Respondent Six and BUSA (2023) discussed issue of concentration. The main issue is that the economy remains concentrated in the hands of the elite few, oftentimes the politically connected elite. The argument advocates for the inclusion of the development of SMMEs business segment as an important yardstick in the government's socio-economic impact assessment. One of the strategic objectives of the industrial sector's masterplans is to increase SMME participation through the Black Supplier Development programme and localisation of the value chain. Without appropriate measures to adequately address the prevalence of inequality in production, ownership and wealth will remain in the hands of the few (Makgetla, 2022). Thus, economic transformation will continue to elude South Africa.

Respondent Six also mentioned that market dominance and monopolies make it difficult for smaller players in the value chain to gain competitiveness since these monopolies are inclined to exert their pricing powers. Respondent Seven also alluded

to the tendencies of large businesses to assert their market dominance through higher prices.

According to Respondent Eleven in terms of support for SMMEs, there is collaboration between government and large businesses. Government also supports the establishment of clusters that will bring all local players together through the Department of Small Business Development.

*“So you find that some companies like Toyota for example, they provide incubations... they are supporting small businesses... it's the same with Ford and BMW in Pretoria” – Respondent Eleven*

This respondent also believes that both the public and private sectors are working hard towards the integration of small businesses into the entire value chain of the manufacturing sector.

*“We need to collaborate as corporate South Africa to contribute towards the sustainable growth of SMMEs. We need to approach SMME growth holistically and partner with all stakeholders if we are to address the multiple challenges of sluggish economic growth, widespread and high unemployment, and thus accelerate socio-economic inclusion.”* comments Vusi Fele, Chief Procurement Officer, Absa.

In February 2021, Ford Motor Company shared its plan to invest R16 billion in expanding its manufacturing facility situated in Tshwane. The primary objective of this investment is the production of the next-generation model for its popular vehicle, namely the Ford Ranger bakkie while also facilitating growth opportunities for twelve small and medium-sized automotive component manufacturers. During this project phase, approximately half of all procurement expenses designated towards bulk earthwork construction and top structures within the Tshwane Special Economic Zone are projected to be allocated towards SMMEs resulting in up to R1.7 billion worth of contracted opportunities (RSA, 2021).

Respondent Thirteen believes that if all large enterprises embarked on such initiatives there would be notable development of SMMEs. According to the respondent, SMMEs need mentorship – a Big Brother or incubation relationship with large businesses

because this will improve their production capability and expose their products to a larger market.

*“If we consider the number of SMMEs. There are so many. However, only a handful of big companies actually invest in supplier or SMME development; not all companies do so” – Respondent Thirteen*

The reason is that based on the respondent’s experience, large businesses are capitalists by nature who give little to no consideration for giving back or corporate social responsibility.

*“...Only a few (large businesses) commit to really SMME involvement, expansion, growth and development...” - Respondent Thirteen*

Chris Hattighn, a policy analyst asserted that if support continues to be given to larger enterprises and after many years of protection, they are still not competitive on the global market then there is no reason to believe they ever will be..

*“In this country (South Africa) the firms receiving state protection are mostly not new entrants trying to find their feet...” - Chris Hattighn, policy analyst.*

Roberts & Rustomjee (2010), rightfully point out that there appears to be a failure to monitor and enforce conditions agreed upon for state support. Furthermore, the terms and conditions for receiving such support are unclear. Chang (1993) warned that this kind of state-created rents are difficult to eradicate due to political pressure from rent seekers. He illustrated this with an instance of infant industries and businesses that persistently fail to outgrow infancy while continuing to unjustifiably benefit from government protection and incentives. The economic rationale behind localisation is based on the concept of infant industry, which posits that offering adequate support can help boost competitiveness among emerging or existing producers at both national and international levels (Makgetla, 2023).

## **b. Incentives and funding**

*“Make funding of SMMEs simpler and more accessible. From my own experience, it requires a sum of money to fund expansion and create jobs. Funding will also*

*give my companies more stability and look for more opportunities and create jobs. The end goal is not capital accumulation but create jobs” – Respondent Seven*

The media, government social partners and six of the participants in the study have explicitly said that incentives and funding mechanisms are biased towards larger industries. Often funding is inaccessible for SMMEs.

*“Those guys up there (government and large business) do not necessarily have an incentive to allow small players to enter the space and that’s why you have monopolies being entrenched and sustained over time” – Respondent Six*

*“More protection is likely to further strengthen the dominance of large, incumbent firms, leading to an even more concentrated economy with low levels of competition.” - Chris Hattighn, policy analyst.*

Based on this observation business incentive structure of the government must be evaluated in a manner that will aid greater participation of SMMEs in the broader economy. BUSA believes that the current support structures and incentives are not designed optimally to encourage businesses of all sizes to participate competitively.

*“The government will still have a responsibility to continue playing its role regulatory role. So in playing its regulatory role like in this case, issues of competition, is still is to dismantle issues of cartels and monopolies” – Respondent Nine*

It is well known that SMMEs tend to have no long-term financial plans and are therefore deemed a considerable risk to lenders (iAfrica, 2024). Based on this, Respondent Six thinks that there is a need for a well-crafted funding mechanism for SMMEs. The DTIC has made available industrial financing options to small enterprises such as loans, grants or tax allowances. SMMEs need to be registered and tax compliant to access these funding options. In light of the energy crisis facing the country, the IDC has reduced barriers for small enterprises to access funding for energy solutions by offering concessionary funding to Energy Services Companies (IDC, 2023).

### **c. Non-financial support**

Drawing from his professional experience, Respondent Twelve has deduced that as much financing is needed for SMMEs, particularly Black-owned, there is a lack of critical skills that are required to nurture and grow a business. According to the respondent, Black-owned SMMEs lack governance structures and innovation and have limited access to technology and marketing.

*“Yeah, the crux of the matter is from my side, they always need money but honestly speaking it’s not money it’s governance.”* – Respondent Twelve

The respondent also argued that without proper governance structures, these small businesses do not follow procedures and therefore may not fully account for the funding and other forms of assistance that they receive. What is lacking is consequence management for failure to account for resources and opportunities afforded to small enterprises, this is according to Respondent Twelve.

Small businesses need to be held accountable for how they used the support offered to them and there needs to be consequences for non-compliance. The respondent’s assertion highlights the skills and education deficit that small business owners and emerging entrepreneurs face. Therefore, developing entrepreneurial skills is a critical step (Makgetla, 2023). Hence, the government needs to afford small enterprises with mentorship, business viability and incubation programmes which are available through SEDA and other economic development agencies across the country.

*“Education to support the SMME sector will be crucial, and this is where corporates play such a critical role through enterprise supply chain development programmes and supporting initiatives”* – Mparutsa (2021)

### **5.3.7. Competing socio-economic and industrial policy objectives**

*“The marginalised people that are not very active in the economic sectors of our society, so policy creation leans more towards addressing our social ills as opposed to strategic industrial development ”* – Respondent Eleven

To maintain their political power, political leaders must successfully promote economic growth that generates job opportunities and wealth for all. Failure to do so increases the likelihood of social unrest caused by rising unemployment rates and inadequate

social service assistance. When implementing industrial policies, countries often encounter conflicting objectives (Agarwal, 2023). Ramantsima (2015) and Roberts & Rustomjee (2010) argued that the ANC government previously prioritised ownership transformation through BEE and BBBEE relegated strategic national industrialisation as a secondary developmental mandate. Nevertheless, government has since adjusted its course slightly by intensifying its focus on increased local beneficiation minerals and localisation initiatives which are aimed at increasing value-adding economic activities for job creation and socio-economic development. These initiatives also include efforts to integrate SMMEs in deprived areas in the value chain.

Respondent Nine revealed that an evaluation of a government incentive showed it had multiple goals which made focusing on the incentives alone ineffective in achieving desired outcomes.

*“The moment you try to encroach with the number of objectives you are dividing focus across the different areas” – Respondent Nine.*

The respondent also advised that government should limit or streamline the objectives so that efforts are more impactful rather than spreading focus and limited resources over many areas. Likewise, Respondent Thirteen asserted that the government has a split focus which diminishes any impact of efforts.

*“In the process of attaining its main objective, it must not be overcrowded by so many objectives. We understand that there are social objectives that are there, issues of social transformation...” – Respondent Thirteen*

Concerning whether the country has been strategic or not when it comes to industrial policy, Respondent Fourteen pointed out South Africa has not been strategic in its approach to industrial policy. The participant alluded that the broad focus is due to a multitude of social ills that the government is trying to resolve.

*“I do not think we are (South Africa) very strategic because we try to save every single sector... some of the masterplans are for industries that I am not sure we really should be focusing on...” - Respondent Fourteen*

Makgetla (2023) suggested that if policymakers wish to transform the economy, they have to identify industries, subsectors or value chains that government should support. However, South Africa is confronted with lingering socio-economic deficiencies

therefore government's focus appears to be too broad. For example, the country is facing an unemployment problem, particularly excessive youth unemployment therefore the DTIC focuses on too many sectors in an attempt to address the unemployment issue.

*"I think because we have such a huge unemployment problem, we then try to design policy around making sure that we do not lose any jobs and that we do not let any sectors die... you know the reaction is to say let us try and save as many jobs there as we can... I do not want to say we have made policy through survival, but I think that essentially, that is probably what we have been doing"*

- Respondent Fourteen

With a growing population, the South African economy is struggling to keep up with the growing labour force. Consequently, unemployment rates have soared, and social welfare spending has increased significantly diverting funds from potential investments in productive activities. To address this issue, the government must establish an environment that fosters economic expansion and job creation. By doing so, social welfare spending can be reduced, freeing up funds for investment purposes. After all, economic growth is a function of investment, higher investment levels are likely to stimulate the economy.

The challenge with industrial policy is determining the cost and benefits of specific initiatives, factoring in South Africa's socio-economic objectives. Therefore industrial policy initiatives need to support projects that promote employment opportunities, and development as well as advancing manufacturing and services industries (Makgetla, 2023). Notwithstanding this point, Fourie (2023) has argued that the country's industrial policy primarily emphasises empowerment promotion as well as wealth redistribution undermining the advancement of export-oriented sectors. According to Fourie (2023), South Africa has prioritised political expediency over economic growth. Furthermore, Fourie (2023) believes that perhaps empowerment and redistribution can be achieved through labour and education policies instead of industrial policy. Fourie however, fails to acknowledge the persistently prominent levels of inequality in the country, which underscores the continued necessity for redistributive policies. Apartheid and colonialism produced enduring mechanisms that continue to sustain entrenched inequalities, reinforcing the relevance of redistributive policies today.

*“The State must empower the marginalised as the constitution spells out. Unfortunately, some judges high up do not concur. We need strong advocates for this of its necessity.” – Respondent Seven*

According to Respondent Eight, the integration of gender issues and inclusivity is crucial throughout the process of localisation rollout.

*“Once we start speaking about localisation then we start speaking about inclusion. Black people need to be included in the localisation aspects of certain industries.” - Respondent Eight*

Overall, in South Africa, the government policies have had varying effects on different economic classes which has made it challenging to achieve a national consensus and often delayed implementation (Makgetla, 2022). Therefore transformation and redistribution should be a focus area of the overall development agenda, but it must not take priority over industrialisation.

The next and concluding chapter will provide deductions drawn from the discussion of the research findings and make possible policy recommendations for overcoming obstacles to localisation and realizing its full potential for economic development.

## **Chapter 6: Recommendations and Concluding remarks**

### **6.1 Introduction**

The main goal of the research was to explore the feasibility and implications of localising the manufacturing sector and SMMEs. The desired outcome of the study was to develop an in-depth understanding of localisation and its role in economic development. The problem statement pointed out that South Africa has not been as successful as envisioned in the pursuit of industrial development. The proclamation of localisation as an industrial policy aimed at reviving the manufacturing sector was met with a lot of contentions about whether this kind of industrial policy will indeed reindustrialise the manufacturing sector, create jobs, and build an inclusive economy and solid domestic supply chain.

The study revealed and analysed factors that were deemed contentious concerning localising domestic manufacturing and pointed out a range of factors from participants' vantage points and media opinions that may serve as a hindrance to successful localisation. For this study, localisation refers to manufacturing value chain activities taking place domestically while industrial policy entails any form of government intervention that is designed to influence industrialisation.

This chapter presents the overall conclusions and deductions drawn from the study on the use of localisation for reindustrialising manufacturing while enhancing the participation of SMMEs in the production value chain. Additionally, based on the findings presented in chapter five, this chapter puts forward recommendations to facilitate the successful implementation of localisation.

## **6.2. Recommendations**

The manufacturing sector is critical for the economy's prosperity due to its cross-cutting nature throughout the economy. As per the AU's Agenda 2063 (2015), industrialisation and manufacturing are fundamental for economies to create growth through entrepreneurship. Therefore, the growth of the sector has a direct impact on the economic growth and development of the country. Evidence suggests that manufacturing plays a significant role in driving structural transformation, where labour and capital are mobilised from traditional sectors into manufacturing and then later into more sophisticated economic activities. This study deduces that manufacturing is still critical for the economy and localisation has immense potential to develop, deepen and expand the sector's production value chain.

### **6.2.1. Recommendations on localisation interventions to drive development**

South Africa has adopted a targeted industrial policy that involves sector-specific masterplans, which are developed through collaboration between government and the private sector. The success of some industries and firms has revealed how collaboration between government and business could support industrialisation in South Africa. Morris (2010) has suggested that unless businesses get actively involved with this policy framework, achieving success may remain an elusive goal. However, private sector involvement presents the possibility that industrial policies can become captured by powerful interest groups, leading to crony capitalism and the exclusion of SMMEs.

The study revealed that the country should focus on localising the production of goods in which the country has a comparative advantage because it should be easier for South Africa to develop these products as they are more closely aligned with the country's current capabilities (Fortunato, 2022) and therefore that would make strategic sense. Moreover, the levels and composition of imports should be extensively studied so that the policymakers may get the sense where domestic production is feasible and may be justified (Makgetla, 2023). After all, focusing on a limited number of manufactured products would accelerate transformation efforts in the nation (Sako et al., 2021).

In most economies, public procurement is an important source of demand hence it is a main tool for localisation and can be an excellent lever for promoting local industry development, innovation, and technological advancement (Edler and Georghiou, 2007; Georghiou et al., 2014; Lember et al., 2014; Tiryakiolu and Yülek, 2015 as cited by Andreoni et al., 2021). Nonetheless authorities must address implementation gaps if they are hoping to promote localisation efforts through public procurement policies.

### **6.2.2. Recommendations on trade policy reforms**

The study recommends that South Africa adopt both export promotion and import substitution strategies simultaneously to achieve its goals of industrialisation through the prudent use of tariffs. The Centre of Development (CDE) (2021) cautions against industrialisation through localisation and import substitution approaches based on the historical performance of such policies and strongly advocates for export promotion as a vehicle for fostering development. On the other hand, the National Treasury cautioned against neglecting the import-dependent manufacturing industry by overemphasising export promotion through excessive tariff protection.

Moreover, Makgetla (2023) has highlighted the potential risks of import substitution for certain industries, so it is crucial to carefully evaluate imports that are to be replaced on a case-by-case basis. This approach will not only guarantee that tariff support is tailored towards achieving localisation goals but also prevent an increase in imported intermediate goods costs.

Tariffs remain an important trade policy tool but should be used cautiously. While selected industries such as the automotive sector, have seen benefits from tariff support in the past, it is imperative to exercise caution as industry protection should not be provided in perpetuity, especially at elevated levels to avoid distorting competition and harming imported inputs dependent industries. One added benefit of decreasing reliance on imports is that it will improve trade account and strengthen the currency.

### **6.2.3. Recommendations on excessive cost of production and structural constraints**

An important deduction from the study is that localisation efforts will be limited by the poor state of the country's infrastructure, specifically inefficient transport network and ports bottlenecks as well as unreliable electricity supply. The study concludes that manufacturing costs are a measure of the competitiveness and sustainability of the sector. The uncompetitive state of South Africa's manufacturing sector requires significant restructuring. The OECD found that certain emerging countries offer manufacturers opportunities for low-cost production such as labour laws that allow for lower wages, land availability, and supportive government policies (McCord, 2023). It is crucial to increase accessibility of these key inputs because they will improve competitiveness, productivity and growth.

Businesses in all sectors of the economy have found electricity constraints and the associated inflated costs to be a significant burden. Government has debated the extent to which they should support the development of renewable energy solutions, resulting in the development of the South African Renewable Energy Masterplan (SAREM). While there have been several new projects related to renewable energy nationwide recently, infrastructure needed for these initiatives is still limited, and the cost of renewables is too great to bear for some businesses. Therefore the state should incentivise and subsidise these projects as highlighted in the SAREM while Eskom finds a workable solution to the country's electricity shortages.

The upgrading of roads, railways, and modernising port systems needs to be expedited. South Africa's urban road networks are well-maintained however roads in the rural areas and townships still need rehabilitation. By improving the transportation and logistics infrastructure will reduce cost and delays associated with trade and transport. Government has committed to restructuring Transnet and Eskom to resolve its key inefficiencies.

### **6.2.4. Recommendations on ensuring adequate demand for local goods**

Localisation will be feasible and make economic sense for local firms if there is a stable market, that is, stable demand and lower cost of production. The study recommends

that there should be interventions in place to create stable demand for local goods, protect the domestic market and enhance domestic manufacturing competitiveness.

Theoretically, it is beneficial to purchase domestic products instead of imported products as long as the benefits from increased aggregate demand outweigh possibly inflated prices for government purchases (Makgetla, 2023). The whole of the government sphere as the largest consumer is central to the local content policies through the PPPFA. SOEs and government departments need to adhere to public procurement policies and source their goods and services locally where possible. Stringent enforcement measures must take place for non-compliance.

Currently, government along with Proudly SA have embarked on a “Proudly SA campaign” and offers SMME-focused workshops, lessons in local procurement, regulations, compliance issues, and an impressive exhibition of local goods and services. Perhaps, government should intensify efforts on this campaign.

Local demand will be secured and sustained as long the quality of the locally produced goods is not compromised and can compete with foreign goods. The SABS has programmes that are offered to SMMEs and local producers at a low cost to ensure that they meet the required standards. SMMEs and local producers need to be educated about these programs and how to access them. Additionally, there is a need to explore niche markets and export opportunities to increase demand for locally manufactured products and achieve economies of scale.

Regional integration will create and expand the market for domestic producers to cushion for the limited domestic market (ITAC, 2017). The findings suggests that AfCFTA will facilitate expansion of markets and export diversification.

#### **6.2.5. Recommendation on skills shortage**

The study found that the economy is not competitive in labour-intensive manufacturing because of the skills shortages and relatively high wages in the sector. To address the skill deficits, the study recommends that the education system needs to be aligned with industrial policy objectives. Makgetla (2023) recommended that industrial policy must prioritise initiatives for accelerating realistic educational reforms to ensure that

school leavers with or without matric have the relevant competencies to enter the job market and/or embark on entrepreneurship. In other words, school leavers to be able to meet economic needs of the country. Moreover, Makgetla (2023) suggests that the mandates of industrial policy should extensively engage with programmes to expand workplace training and apprenticeships.

The remedy to the lack of skills in manufacturing is to increase the skill base by developing education and vocational training programs to build a skilled workforce capable of supporting advanced manufacturing activities. South Africa has an abundance of labour as evidenced by high youth unemployment. Government, government agencies like SETA and National Youth Development Agency and businesses need to partner to fill the skills gap and invest in the continuous skilling and upskilling of employees.

#### **6.2.6. Recommendations on policy formulation and execution**

The study found that although South Africa has an arsenal of well-crafted policies, conflicting interests of public officials and bureaucratic failure are great impediments to the execution of policies. The Presidency has committed to building a professional and competent public service which will improve the execution of policies. Creating a meritocracy is a long-term solution in the meantime, the current public service must commit to continuously “learn, unlearn, and relearn.”

South Africa lacks in the monitoring and execution function therefore tracking and monitoring systems need to be in place, to measure the impact and outcomes of policies. This will create a platform to revise and clarify targets and commitments timeously while promoting a culture of accountability and transparency in the public sector (Prinsloo, n.d.). Consistent monitoring and evaluation of policies will allow policymakers to make necessary modifications to objectives based on changes in influencing factors. By doing so, policymakers can ensure that their policies remain effective and relevant in achieving their desired outcomes. As Roux (2002) pointed out policy needs to be flexible to accommodate changes in the operating environment. Successful localisation depends on the creation of a supportive environment that encourages investment in local manufacturing and the development of SMMEs.

As the findings and the literature pointed out the lack of competent bureaucracy and well-crafted monitoring and evaluation systems may prevent South Africa from achieving its developmental agenda. South Africa can learn from South Korea where the state closely monitored priority industries through compulsory reporting and enforcement systems. As a result, the state was well-informed about the industrial development and in a better position to identify futuristic industries (Chang, 1993).

### **6.2.7. Recommendations on supporting SMMEs**

The study echoes the findings by Hlongwane & Jordaan findings (2017) and Makgetla (2023), that skills development is a key step to enabling entrepreneurship. Industrial policy needs to create platforms for skills development for entrepreneurs and ensure alignment between industrial policy and the education system. Along with the conventional industrial policy tools such as incentives, tax breaks, and protection extended to SMMEs, these tools should be complemented with competitiveness-enhancing policy tools such as vocational training, technical advice, sponsorship, incubations and networking platforms be extended to SMMEs. This is in the hopes that these initiatives will help businesses grow and create jobs while enhancing their competitiveness (Ketels & Duch, 2022). Dinh & Monga (2013) proposed incubation schemes to facilitate the entry of private sector local firms into mainstream economy.

Along with enhancing skills and capabilities in the SMME sector, it is also important to simplify access to funding mechanisms. Accessing funding remains a thorny issue for SMMEs, government should continue to remedy this issue by reducing red tapes as well as educating SMMEs about the funding mechanisms available.

Furthermore, government and businesses should continue to work together to create an enabling environment that is supportive of increased participation of SMMEs in the manufacturing value chain, particularly those in depressed and historically disadvantaged areas of society, as highlighted in the ERRP.

### **6.2.8. Recommendations on balancing socio-economic objectives and industrialisation objectives**

The study found South Africa has not been strategic in its approach to industrial policy due to the many socio-economic ills that government is trying to overcome. Government should limit or streamline the objectives so that efforts are more impactful rather than spreading focus and limited resources over many areas. Localisation has the potential to contribute to more equitable economic development by including the marginalised parts of society, however, there is a risk that benefits may not be evenly distributed, potentially exacerbating existing inequalities if the elite and large corporations dominate the localisation efforts.

### **6.3. Concluding remarks**

Undoubtedly, the manufacturing sector in South Africa is vital to the nation's development plan and has a lot of potential. The Presidency and DTIC have realised the importance of revitalising this sector and, to ensure its viability and sustainability, the sector has been designated a priority sector in ERRP and RIS. Unfortunately, localisation initiatives aimed at boosting the sector have been undermined by other government departments and SOEs.

Despite its growth potential, the industry continues to face several significant issues. Perpetual institutional weakness in South Africa is still impeding the sector's potential for expansion. Meanwhile, successful localisation strategies in countries like Korea and China were driven by extensive human capital development and focused government leadership and determination. Accordingly, politics will play a pivotal role in achieving localisation in South Africa.

The findings supported industrialisation through localisation, although there were concerns and constraints raised that need to be addressed for successful localisation. According to the findings of the study, government needs to urgently attend to the deteriorating infrastructure, particularly transport network, port infrastructure and the unstable electricity supply.

To establish a globally integrated and competitive market, it is essential to complement demand-side interventions with adequate supply-side support. The supply and availability of key inputs, such as infrastructure, basic services, skills, and finance, need to be secured (Makgetla, 2023; Dinh & Monga, 2013).

In conclusion, while South Africa aims to strengthen its manufacturing base through localisation policies, addressing policy ambiguity, bureaucratic inefficiencies, and stakeholder engagement remains crucial for its success. Increasing localisation will increase the economy's manufacturing output. However, how well the obstacles are overcome will determine if localisation will be followed by a notable uptick in employment and general development. Effective collaboration between the government and business sector is necessary to address the problems associated with localisation of the manufacturing sector. The successful implementation of localisation will help to achieve the country's socio-economic objectives. Effective localisation policies can contribute to more equitable economic development by supporting SMMEs and disadvantaged communities.

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## Annexure A: Participant list

<b>Participants</b>	<b>Position</b>	<b>Organisation and experience</b>
Participant 1	Trade policy and Industry expert	CEO and Founder of XA Global International Trade Advisors.
Participant 2	Economic Analyst	South African Bureau of Standards (SABS) - assisting the country in meeting its WTO obligations.
Participant 3	Data Analyst – Trade Statistics	South African Revenue Service (SARS).
Participant 4	Deputy Director - Sector and Industry Development: Manufacturing	Gauteng Economic Development Department.
Participant 5	Senior Economist – Trade Statistics	Economist at South African Revenue Service (SARS) Monitoring the implementation of economic policy in the Presidency.
Participant 6	Industrial Development Policy and Strategy Advisor	Department of Trade, Industry and Competition (DTIC).
Participant 7	Political Economics commentator. Semi-retired Accountant with business interests	Political Economics commentator with an undergraduate degree in economics and accounting.
Participant 8	Economist – Sustainable Growth	Trade & Industrial Policy Strategies (TIPS).
Participant 9	Director – National Treasury	National Treasury works closely with DTIC. Engages in policy discussions with the DTIC to give effect to their mandates.
Participant 10	Senior Economist – Sustainable Growth	Trade & Industrial Policy Strategies (TIPS). Has previously worked as a Budget Analyst at the National Treasury and as an Assistant

		Director at the Economic Development Department (EDD) focused on industrial policy.
Participant 11	Sector Specialist - Manufacturing	Trade and Investment KwaZulu-Natal. Conducts research to identify investment and export opportunities within the manufacturing sector in the KZN.
Participant 12	Deputy Director -	Experience as an industry analyst and legislative analyst. Works closely with Productivity South Africa.
Participant 13	Economist - Trade and Industrial Policy	Researcher at South African Revenue Service with experience as an industrial policy analyst for the automotive sector at DTIC.
Participant 14	Director – National Treasury	PhD in Economics. Economic Policy - Manufacturing, Trade and Industry.

Source: Researcher's compilation

## **Annexure B: Interview Guide**

### **Demographics**

- I. What is your job description?
  - II. Name and role of your organisation
- 
1. What is the current state and outlook of the manufacturing sector and SMMEs? Which areas are of the greatest concern and deserve the most attention?
  2. In your opinion, are there clear policy goals for the development of the local manufacturing industry?
  3. Localisation is an important aspect of the Economic Reconstruction and Recovery Plan. How do you understand localisation in the context of SMMEs and manufacturing?
  4. What are the challenges faced by SMMEs in the manufacturing sector and how can they be addressed to support their growth?
  5. How do you anticipate that this policy will affect the business community, investment, competition, and ultimately the economy?
  6. The COVID-19 pandemic has had an impact on merchandise trade and ultimately production. How do you anticipate localisation to affect trading partners and trade patterns?
  7. Do you think the localisation of manufacturing is viable in the current state of the domestic economy and political climate, as well as the global economy?
  8. How should the localisation strategy be drafted in South Africa's manufacturing sector to maximise the potential benefits to the domestic socio-economic context?
  9. What government regulations, legislation, and policies have had an impact on manufacturing?
  10. What are the challenges that must be overcome, and the possible policy interventions needed to effect localisation successfully?
  11. In your opinion, is the state capable of implementing this policy successfully, and what should the role of the government be in implementing such a localisation strategy?

12. How has interest group advocacy or lobbying impacted the implementation of policies in your experience?
13. The state aspires to build a developmental state, in which there is a balance between sustainable economic growth and social development. Do social objectives (such as women's empowerment, BEE, etc.) take precedence over strategic industrial development when formulating policies? How can these objectives be balanced?