MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

GROWING THE ECONOMY AND CREATING JOBS THROUGH ACCELERATING INDUSTRIALISATION AND BENEFICIATION IN SOUTH AFRICA AND REGIONAL INTEGRATION FOR BROADER DEVELOPMENT IN AFRICA

SPEECH TO THE CEEF ANNUAL DINNER

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Fellow Cabinet Ministers,
MEC's,
The Commissioner of the Competition Commission,
Directors and corporate executives,
Honoured guests,
Ladies and gentlemen

Government places greater emphasis on industrialisation, the addition of value on basic resources, and regional integration to facilitate broader development, both locally and across the continent.

Although an often difficult task and one that requires reversing certain long entrenched economic and social practices, we have embarked on this path of reform and policy re-alignment for a number of sound reasons.

One critical reason is the overwhelming evidence that industrialisation and structural economic change enables a country to fast-track its development. Virtually all cases of rapid and sustained economic growth in modern economic development have been associated with industrialisation, and particularly growth in manufacturing production.

Conversely, those countries that remained focused only on the extractive industries - usually minerals and basic agricultural commodities - and did not move up the so-called value chain, have often seen economic benefits concentrated amongst a small segment of society, and have not experienced the same strong sustainable economic (or GDP) growth of their peers. They may have experienced short bursts of growth, especially during times of commodity booms, but never the kind of relentless growth that persists over decades.

It is growth that persists over decades that transforms an entire economy and its structure, spreads economic benefits widely and engenders innovation and brings about the creation of new industries. It's only growth that is sustained over long periods of time that results in intergenerational wealth creation and the reduction in many social ills such as poverty, inequality and unemployment.

Whilst we wish to emulate those countries that have successfully transformed their economies, by undertaking reforms to promote industrialisation and structural change, we acknowledge that no country has ever walked this path alone. Rather, countries have integrated their efforts with those of their neighbours and often adopted a regional approach. They have plugged their productive capacity into global value chains. They have analysed the needs and demands of other nations, and utilised or complemented, the strengths or deficiencies, and the resources and endowments of others.

Why is industrialisation important?

Industrialisation has, for most countries, been the precursor to periods of accelerated growth for the following reasons. Firstly - as alluded to - manufacturing drives productivity and structural change, moving the economy from low to high productivity activities. But it also drives technological progress and is, globally, the main driver of innovation.

Secondly, these innovations and technologies emerging from industrialisation, and the benefits they provide to efficiency and productivity also benefit other sectors. This is because backward and forward linkages and spill-over effects tend to be stronger in manufacturing than in other sectors. Combined with productivity and innovation, manufacturing is able to “pull” along economic growth in ways that growth in other sectors do not.

Thirdly, this pull factor can also stimulate employment growth in other sectors – particularly the services sector, but also potentially the agricultural sector. Thus, the manufacturing sector results in economy-wide inclusive growth and employment creation. Fourthly, the manufacturing sector offers special opportunities for capital accumulation and investment in developing countries – which in turn drives growth. Capital accumulation and clustering effects can be more easily realised in spatially concentrated manufacturing than in spatially dispersed agriculture or services.

Fifthly, industrialisation enables economies of scale because manufactured items are generally traded goods; companies are driven by competitive pressures of increasingly global industries. This benefits downstream industries and consumers through lower prices and improved quality and performance.

Lastly, from a macroeconomic perspective, manufacturing exports in many countries provide an anchor for the current account, the currency, the balance of payments and sovereign or currency risk ratings.

During normal business cycles it can prove an invaluable source of foreign currency, and for stability of the balance of payments. Over the longer term, the economic activity, jobs and exports created by the sector become increasingly important in the context of a finite exhaustible endowment of resources. And this brings us on to beneficiation.

So why is Beneficiation important?

It is important to recognise that South Africa has a vast source of comparative and competitive advantage through our massive natural endowments of minerals that are not being leveraged sufficiently. In fact we have the highest value of non-energy natural resources in the world, valued in excess of US$2.5 trillion. And we might shortly add significant oil and gas reserves to that mix, as exploration efforts intensify over the next few years, both offshore and in the Karoo basin.

The Beneficiation Strategy approved by Cabinet provides a framework for transforming mineral resources into higher value products, which could in turn be exported or used in the domestic economy. The ultimate aim is to promote employment and the diversification of economic activity. The targeted commodities are gold, platinum, diamonds, iron-ore, chromium, manganese, vanadium, nickel and titanium, with coal and uranium grouped together. The strategy identified five pilot value chains, namely, energy, steel and stainless steel, pigment production, auto catalyst and diesel particulate filters, diamond processing and jewellery.

The Mineral and Petroleum Resources Development Act amendment bill, which has been passed by Parliament, will once signed into law create the enabling framework which will be further detailed through regulations. One critical section (section 26) requires a certain proportion of mineral output to be reserved for use in local value adding activities. To give a competitive advantage to local downstream producers, these minerals must be sold locally at a developmental price.

In addition, there are a number of other policy initiatives including special economic zones, various Research & Development programmes and incentives, various tax incentives, international trade agreements to name a few – aimed at encouraging downstream value addition and investment. We also have committed to large infrastructure provision - especially transport, electricity, and water projects that should enable and facilitate greater growth in this area.

While the basic objective of the broad beneficiation strategy is sound, we have to be cautious when designing policy to ensure that the mining sector's contribution to GDP, investment and employment is not destroyed or deterred. The contribution of the mining sector to national GDP might be declining, currently at around 8 to 9 per cent, but it still makes an indirect contribution to GDP of about 18 per cent and employs around 514,000 workers (6 per cent of total employment).

Also, almost 50 per cent of South African exports are mining commodities, and mining companies account for a large portion of JSE capitalisation and attract significant amount of foreign inflows which help to finance the current account.

Thus, we need to ensure we have a balanced approach to the development of the downstream sectors, taking into account the availability of electricity, low levels of investor confidence, the capabilities that exist in the South African economy and the need for South Africa to remain a premium mining investment destination. .

Why is Regional integration important?

This brings me to the third leg of my talk – regional integration. Regional integration offers an opportunity for industrialisation by increasing the market size, allowing firms to improve economies of scale, specialise, pool resources, grow organically along with growing markets (rather than outcompete for existing market share), and develop regional value chains. This can lower input costs, by reducing the high costs of sourcing goods from afar, especially where markets are too small to justify local production of those goods.

Greater regional integration also allows firms to make use of different skills and endowments of each country (e.g. gas in Mozambique, oil in Angola, minerals and agriculture in Zambia, water in the DRC and so on). It is critical to use these skills and endowments effectively and where they are best suited.

The IMF estimates that Sub Saharan Africa will grow at an average rate of 5.5 per cent over the next two years and projects that Sub Saharan Africa's growth rates will remain in the top 30 per cent in the world. GDP per capita in current US dollars has tripled from US$530 in 1995 to US$1569 in 2012 (World Bank Development Indicators). As GDP has risen, so too has expenditure on goods. As growth has prospered, private companies have increasingly taken the lead in finding ways to collaborate and innovate.

As a result, regional integration is gaining momentum. Between 2009 and 2013, the share of cross border greenfield investment projects originating from within Africa increased to 18 per cent, from less than 10 per cent in the early 2000s.

According to the UN's World Investment Report, total FDI flowing into the African continent in 2013 totalled US$ 57 billion in 2013. US$13 billion of this flowed into Southern Africa. South Africa, Kenyan, Nigeria and Angola are heavy investors. According to the UNCTAD World Investment Report 2014, South Africa remains the largest investor in Africa in the world. The total stock of South African investments in the continent stood at US$23.6 billion, compared to China's US$21.7 billion.

South African firms are already benefitting from regional growth and greater integration, with exports to SADC, excluding SACU countries, forming 13.7 per cent of total exports last year, up from 8.8 per cent in 2007. SADC now forms the second biggest market for South African manufactured goods and is also the fastest growing.

As demonstrated by the latest World Bank country report on South Africa, from earlier in the year, the majority of new exporting firms from South Africa first accessed foreign markets through ventures in Africa. This is because conditions and markets are more favourable, and because the specific goods and services, and the attributes thereof, offered by our firms where more closely aligned with that being demanded in the region.

Challenges with regional integration and industrialisation

Whilst private investments are forging ahead, often the pace of Government negotiations is criticised. But the terrain that must be covered is complex. For example, whilst regional integration is about accessing the bigger regional market, it also requires opening up the local market to firms in the region.

And this has implications for many of the domestic industrialisation interventions in each of the countries, including preferential procurement, tariffs, provision of infrastructure and sector specific interventions – where interventions are interested in promoting local firms.

Successful regional integration therefore requires the integration of industrial policies, between countries, and the identification of different sectors or parts of the value chain where specific country endowments, resources or initiatives, are best suited. This may mean restructuring certain policies or programmes to reduce overlap. This is tricky ground in which we are negotiating with our regional neighbours. But trade-offs are required, and both parties must agree.

To further illustrate this point, consider that the benefits of a common market and the execution of various industrial and other policies depend critically on enforcement of certain rules, tariffs, quotas, non-tariff barriers, standards, taxes and other measures.

Where borders are porous allowing for illicit trade, transfer pricing, or any other ways of circumventing the system – the purpose of the original policy is defeated, and indeed many private businesses could stand to lose out greatly. The ability of countries to monitor imports and stop illegal imports is thus a major risk of regional integration. This is another area in which we continue to engage with our peer country neighbours.

But there are other areas which are often over-looked: for example sanitary and phytosanitary regulations to protect plant and animal health, carbon taxes/fuel levies and other environmental levies, health and safety legislation, or decent wage conditions - which may not be shared across borders and which may disadvantage firms based on location. Hence broader standardised and aligned regulation is critical. Another area of further engagement

Regional integration also has implications for tax revenue. Many smaller countries are dependent on tariffs or revenue sharing formulae. Regional integration might also require greater movement of capital and financial flows, which would require changes to financial regulation.

National Treasury has developed tax and exchange control incentives to promote trade and investment. These are focused on local companies seeking to benefit from African growth and positioning SA as a conduit for investment into Africa, in particular, multinationals that seek to establish a regional office in Africa. The greater movement of labour and individuals that would come with regional integration would have implications for employment and would make it difficult to control wages and employment standards.

There are various “ease of doing business” type initiatives and infrastructure developments that we, as Government, are actively working on. These include the “one-stop-shop” currently being investigated by the economic cluster departments (to assist with visas, time to set up a company, labour issues etc.), or the efforts of the Development Bank of Southern Africa which have been refocused on infrastructure projects (specifically roads, energy, ICT, transport and water).

However even here there can be geo-political issues/sensitivities. For example ensuring the provision of energy is important, yet there are significant differences in the region around individual countries' energy security needs.

Conclusion

We hope that the current package of policy and funding initiatives is sufficient to realise the beneficiation idea and diversify the economy from an over-reliance on commodities towards industrial sectors with stronger economic links, sustainable growth and job creation potential. But we acknowledge, however, that to successfully industrialise and create greater value addition for mineral downstream industries, we require greater market access and a pool of resources that we alone, as a single country, can achieve.

Regional integration and a large common market might offer us these opportunities for greater economies of scale and degrees of specialisation. And indeed we have already seen rapid growth in trade and investment within the region, and particularly for new exporting firms.

But we would be naive to imagine that we could use our African neighbours as a dumping ground for our excess products in order to achieve our growth ambitions indefinitely. At some point they will resist or resent any one sided relationship, and if our neighbours development is retarded in any way it ultimately affects us too.

Regions grow together. The literature has shown this often. Thus we believe that we need to follow a path that looks at both our needs and theirs, and develops them co-jointly. This may mean re-examining our industrial and beneficiation policies so that our neighbours are part of our envisaged value chains. This may take time and careful negotiation. In the meantime, however, we would encourage the private sector to continue forging links in the region and investing in a stronger joint future. And if you have any ideas in which we can hasten agreement on solutions – please let us know – we are always open to new ideas.

Ultimately we are confident that together we can move in the right direction, and that the key to the development of our nation lies in the industrialisation and beneficiation but also in the joint development with our regional neighbours.

Thank you.