MINISTRY OF FINANCE
REPUBLIC OF SOUTH AFRICA

POLICY CHALLENGES OF ECONOMIC DEVELOPMENT IN SOUTH AFRICA.

KEYNOTE ADDRESS BY THE MINISTER OF FINANCE, ENOCH GODONGWANA, ON THE OCCASION OF THE LAUNCH OF THE BOOK: STRUCTURAL TRANSFORMATION IN SOUTH AFRICA: THE CHALLENGES OF INCLUSIVE INDUSTRIAL DEVELOPMENT IN A MIDDLE-INCOME COUNTRY.

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Director of the Programme

The contributors and editors of the book, in particular Pamela Mondliwa, Antonio Andreoni, Simon Roberts and Fiona Tregenna

Distinguished Ladies and Gentlemen:

INTRODUCTION

Thank you for the opportunity to share my thoughts on this special occasion where we are launching ground-breaking academic work by some of our country's finest researchers and economic thought leaders. As a government that strives to make decisions on the basis of evidence, and decisions informed by results of rigorous scientific enquiry, we value high quality research that helps us respond to the pressing challenges of poverty, unemployment and inequality.

Our reality is that the current state of the South African economy is unsustainable. Real GDP per capita has been declining since 2015. Productivity growth has been slow and appears to be slowing down further; and the unemployment rate has recently increased to record highs of 34.4 %.
Part of our policy response requires that we place emphasis on fundamentally transforming the structure of our economy – to move from low growth and low labor absorbing sectors, to sectors of high growth, high productivity and greater labor absorption.

Our focus must also be on how do we upgrade to higher value-added activities within sectors. If we can do this we stand a greater chance of catapulting our economy onto a path of inclusive growth, sustainability and global competitiveness.

The body of work we are launching today will no doubt strengthen our response, in particular, to the challenges we face in our quest for greater and inclusive industrial development.

WHY INDUSTRIAL DEVELOPMENT?

Over the years, South Africa has made some progress towards attaining structural transformation in pursuit of faster, inclusive and sustainable growth. However, as it is asserted in the book, this progress has been discontinuous and uneven.

We know from economic literature that industrialization – in the structural sense of shifting resources into industry and particularly into manufacturing – has come to be closely identified with persistently faster levels of economic growth and development.

Until well into the 20th century those countries that were "industrialized" would also be those countries with relatively high proportions of output and work-force attributable to industry and in particular manufacturing.

From this we learn that countries that succeed in making the structural shift to industry and manufacturing would have met the necessary and sufficient condition for higher and sustained levels of growth and development.

Put differently, development is intimately linked to industrial production!
I am raising all of this background, which you all know, because for me one of the outstanding features of the volume of work we are launching today, is that it is putting industrial policy and the quest for industrialization back at the center of the development agenda – where I think it belongs.

Over the years, South Africa has experienced significant de-industrialization. From a high of around 22% of GDP in the late 1980s to the early 1990s, manufacturing now contributes around 12% of GDP. In addition, the manufacturing sector's capital base has shrunk – from R677.7 billion in 2008 to the current R545.9 billion in real terms.

These numbers speak of the decimation of our industrial base. They also speak to significant job losses, widening income inequality and poverty. The decline in manufacturing has been matched by a rapid and significant growth across a range of service sectors.

As from the 1900s, while the contribution of other key economic sectors such as mining, agriculture and manufacturing were either declining or flat, the services sector became the main source of growth.
The sector now makes up about 65% of GDP, 63% of employment and 74% of capital formation.
The growth of the services sector is driven in the main by credit fueled consumption and import-intensity.
Talking of the import intensity of our economy, I often make the point that even in an environment of growth – however minute it may be – our economy continues to suck-in imports.
This is in part because of a weak industrial base.
This is also a reflection of an imbalanced growth model, which is unsustainable and keeps our economy vulnerable.

For instance, during the commodity boom of the late 1990's and early 2000s, we were unable to optimize the opportunity presented by the boom to effect structural changes, which would have allowed us to translate the boom into sustainable growth and development.

Manufacturing has strong backward and forward linkages to the rest of the economy which make it a significant driver of demand across the economy.

Equally, the sector's ability to interface between agrarian and resource extracting economies and introduce new products and technologies allows it to move the economy forward – from low to high productivity activities.

Further, in an environment, such as ours, where structural unemployment remains stubbornly high, manufacturing has a critical role to play in expanding our skills base and helping us deal with unemployment.

Ultimately, the point we are making is that industrial development is critical for our aspirations, as a nation, for higher levels of economic growth, job creation, transformation, and development.

Structural transformation also has development implications, in that it contributes to promoting and maintaining a competitive economic environment that helps firms to grow and produce profitably.

ENSURING ALIGNMENT BETWEEN INDUSTRIAL AND FISCAL POLICY

There is an argument in the book that macro-economic policy has not been supportive of industrial policy. Our point of departure is that macro-economic policy can never be passive in relation to industrial policy. To us, fiscal policy is a powerful instrument, capable of influencing and shaping the orientation and structure of the economy. It is not just the allocation of resources that matters, but also the market structures, institutions and sectors that are enforced or transformed as a result of the deployment of fiscal resources. In addition, the composition of government spending matters for both the pace and the quality of growth.

We are of the view that government expenditure should complement and enable rather than substitute for production in the private economy.
Essentially, structural transformation is about building a competitive economy that participates effectively in global and regional value chains.
Fiscal policy has a feed-back loop that can drive competitiveness – making it an enabler of competitiveness.

For instance, the pace and scale of infrastructure roll out – which is an outcome of the effectiveness of the use of fiscal resources – has a significant impact on the competitiveness of local firms and the ability of their products to access global value and supply chains.
Equally, investments in new technologies, innovation, health, education, training and up-skilling of the workforce – all of which are linked to the outcomes of fiscal policy – also have a direct bearing on competitiveness and inclusion.

Another example is that the pace of the vaccine rollout programme has profound implications on the ability of our economy and industries to operate at full capacity.
Further proof that the conduct or the deployment of fiscal resources cannot be detached from the goal of enhancing the economy's production capabilities, is the work we are doing through Operation Vulindlela.
Through Operation Vulindlela we are implementing microeconomic interventions which we deem as building blocks towards structural transformation.
Ultimately, these interventions are aimed at boosting investment, trade, innovation, skills development, breaking barriers to entry, as well as enhancing competitiveness and economic inclusion.

SOME PROPOSALS GOING FORWARD

On export diversification

Part of what industrial policy seeks to achieve is greater trade and export diversification – especially diversification to higher, value-added exports.
Linked to this is the fact that as a country we have always placed increased trade or export-led growth at the heart of our industrial and economic policies.
Accordingly, the kind of export intensity we must pursue should include greater integration of our manufactured products into global value chains with particular emphasis on value chains within SADC and the broader African continent.
This we must do in order to take advantage of the African Continental Free Trade Agreement as well as economic linkages and flows between sectors, firms and geographic locations on our continent.

Ensuring Policy coherence and certainty

Also, of importance is need to strive for policy coherence and certainty across the economy.
In this regard, significant progress is being made to towards ensuring greater policy and regulatory certainty in important economic sectors such as water and sanitation, energy and telecommunications.

Linked to this is the work we are doing to strengthen the capacity of the state not only to implement policy, but also to intervene in the economy in a manner that does not hinder but enhances industrial growth and development.
Strengthening the capacity of the state to implement policies draws particular significance since South Africa does not suffer a paucity of policy documents, policy positions and pronouncements. We often say that our problem is not the absence of policies but rather it is the implementation of policies. Emphasis must also be placed on ensuring alignment of policies.

On growing the productive economy
Currently, our government working together with social partners at NEDLAC is implementing the Economic Reconstruction and Recovery Plan, announced by President Ramaphosa in

October last year. One of the pillars of this Plan is industrialization and growing the productive economy. Through this pillar we are intervening decisively to drive strategic localization, repurpose South Africa's manufacturing as well as strengthen regional and global trade.
Ultimately our goal is to significantly increase South Africa's manufacturing output, reduce the proportion of imported intermediary and finished goods and expand the capacity of local suppliers.

As we do this work we are aware that over time our manufacturing firms have been struggling to build their productive capabilities, to diversify their production activities, embrace new technology and develop their domestic supply chains. This has contributed to many of our manufacturing firms remaining uncompetitive and thus unable to be part of the global value chains. This is an area that required ongoing attention.

CONCLUSION

As I conclude I wish to quote from the book: *"Countries that have attained middle-income status, like South Africa, face a number of challenges – in particular, linking up to global value chains while linking back into their domestic economies, and keeping pace with technological change. These, and developing countries more generally, are looking at industrialization and industrial policy as ways of addressing these challenges, escaping premature deindustrialization and changing the structural and institutional configuration of their economies towards higher productivity activities. Indeed, structural transformation and industrial policy are returning to the forefront of national policy debates."*

We welcome this development.

We believe that structural transformation should be placed at the heart of the economic development agenda. We, therefore, welcome the publication of this body of work which we also see as a timely intervention; presenting new ideas and strategies required to unblock long standing economic challenges which have gripped the South African economy for decades.
To the team we say: well done!

Thank you.