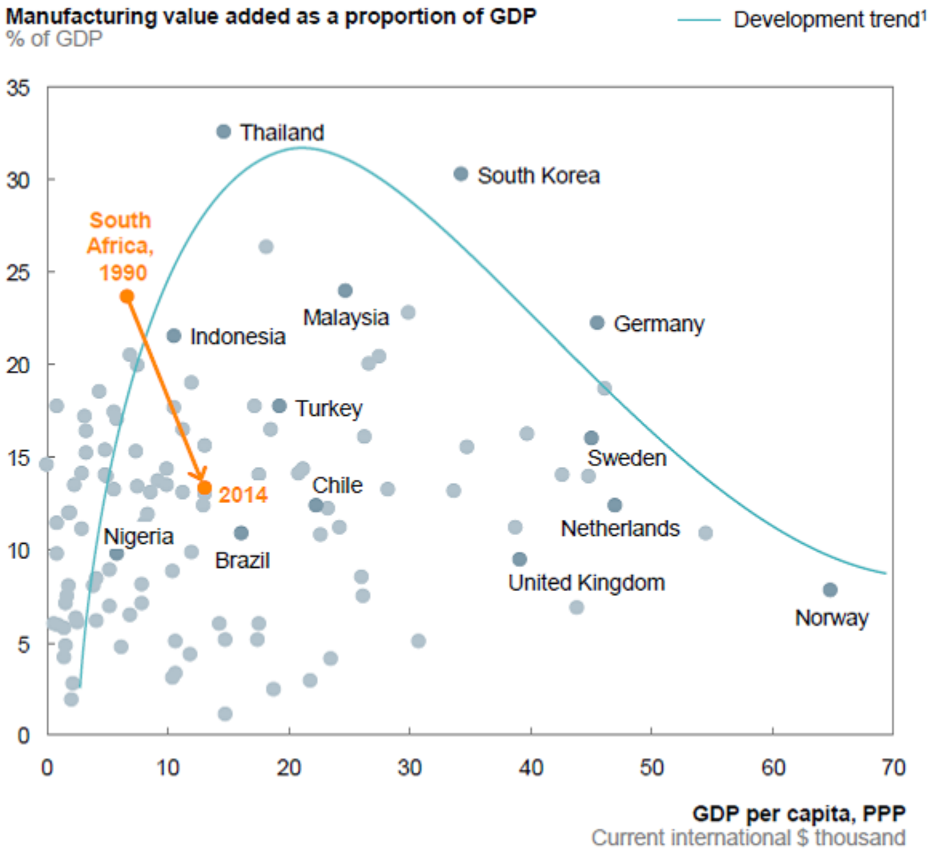
MAP TO A MILLION

June 2018

MANUFACTURING CIRCLE
EMPLOY. PRODUCE. PROSPER.

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



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

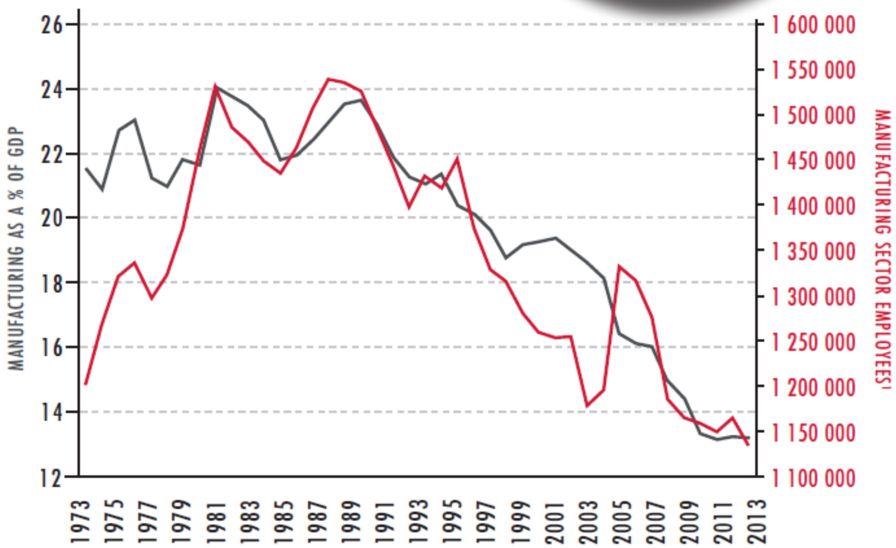
SOURCE: World Bank World Development Indicators; McKinsey Global Institute analysis

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

Premature de-industrialisation is a fact in SA

Decline in manufacturing correlates closely with a dramatic loss of jobs

GRAPH 1 **SA MANUFACTURING**



Source: Stats SA, South African Reserve Bank

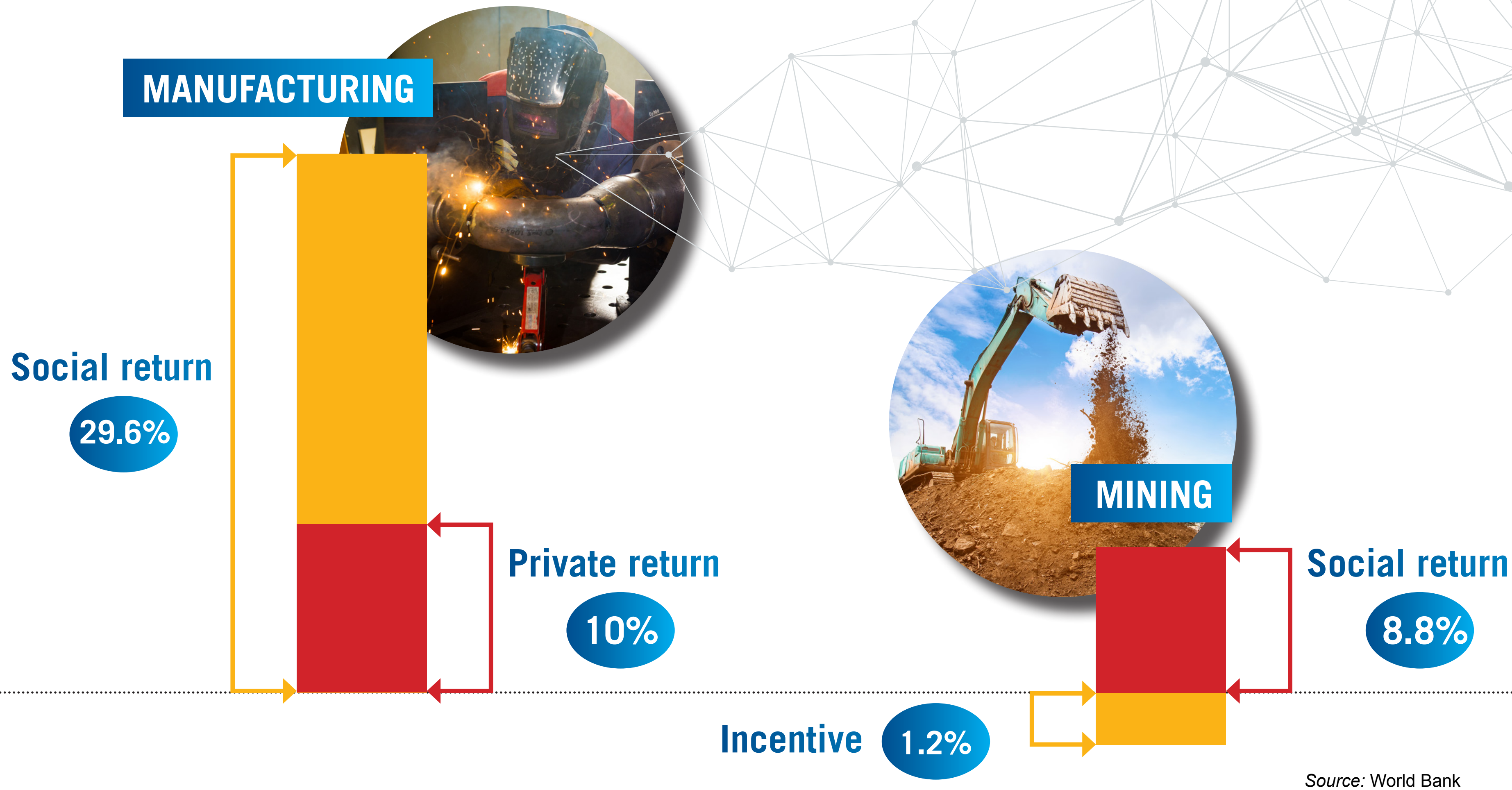
- **Since 1989, SA manufacturing has shed half a million jobs, as its share of GDP has shrunk**
- **If manufacturing were to have an appropriate share of GDP for SA's developmental stage (28 – 32%), a theoretical 800 000 to 1,1 million jobs could be created**

Unemployment at 27.7%, highest in 14 years

Manufacturing output decreased 1.6% y-o-y in September

Business confidence is at its lowest in 25 years

Manufacturing has the highest job multiplier of any sector, so job losses have an outsize negative impact



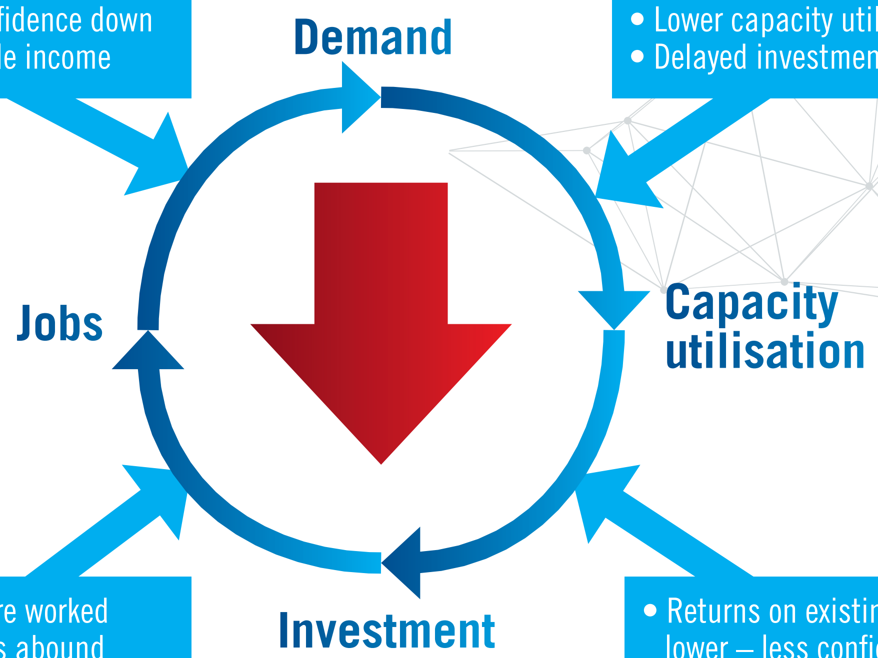
Source: World Bank

Manufacturing has a 5 – 8 x job multiplier effect

The vicious cycle of de-industrialisation

- Consumer confidence down
- Less disposable income

- Lower capacity utilisation
- Delayed investment



- Fewer shifts are worked
- Retrenchments abound
- Less investment in skills and training

- Returns on existing investments are lower – less confidence
- Future investments are deferred
- Higher growth markets are sought
- Fewer exports

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

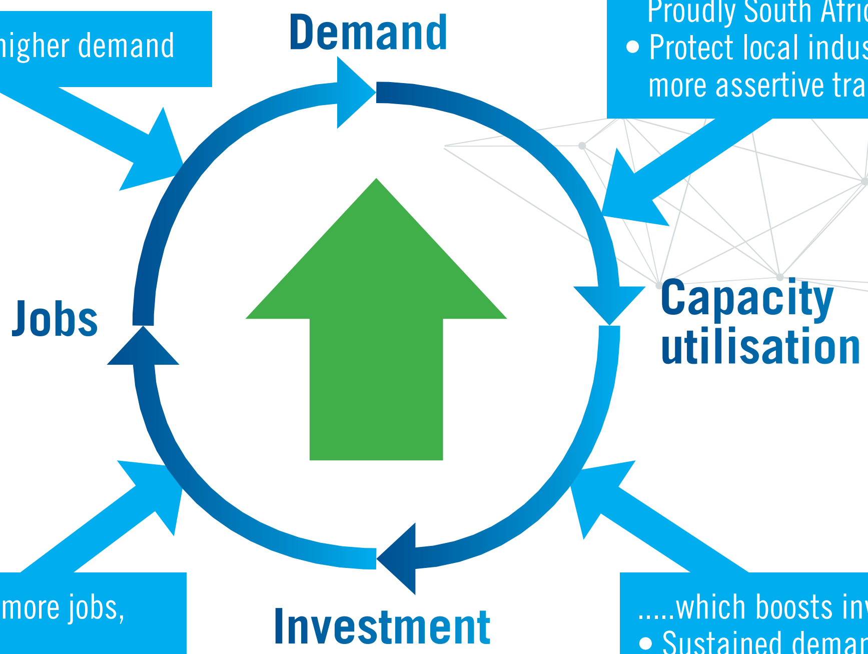
"History teaches that a strong economy begins with a viable manufacturing base. Africa must find a viable path to prosperity without passing through an industrialisation phase [and jump to a services phase]. This is not likely to happen." – Jerry Jasinowski

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

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

- Stimulate demand for local goods – preferential procurement and Proudly South African
- Protect local industries through more assertive trade policies

..which leads to higher demand



.....which boosts investor confidence

- Sustained demand growth
- Policy certainty
- Supportive regulation
- Competitive incentives and fiscal policy
- Competitive returns
- More economies of scale to compete for exports

...which leads to more jobs, more training

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

RECOMMENDATIONS

Boost demand for goods manufactured in SA

Demand-side interventions

INCREASE AGGREGATE DOMESTIC DEMAND

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

PURSUE IMPORT SUBSTITUTION

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

ENHANCE EXPORT COMPETITIVENESS

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

RECOMMENDATIONS

Lower manufacturers' cost base to improve competitiveness

Supply-side measures

REDUCE INPUT COSTS

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

FISCAL POLICY

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

LABOUR

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

RECOMMENDATIONS

Fix structural issues holding back growth and investment

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

RECOMMENDATIONS

THE ROLE OF BUSINESS

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

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

RECOMMENDATIONS

MANUFACTURING WORKING GROUPS

- Required to co-ordinate the implementation of recommendations
- Priority areas to be identified to include

  - Trade
  - Skills
  - Fiscal Interventions
  - Local Procurement
  - Infrastructure

- Stakeholders to include business, labour and government
- Timelines and deliverables to be established

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