Geekonomics: Industrial Policy: Local Lessons

The Ministers of Finance and of Trade and Industry have started a surprisingly and refreshingly public discussion about trade and industrial policy.

In his budget presentation to Parliament the Minister of Finance cut to the heart of the issue by posing the key question: how can trade and industrial policies best promote the global competitiveness of South African companies, thereby increasing overall economic growth and job creation?

The Minister of Trade and Industry replied by repeating the DTI's emphasis on the need for strategic and selective trade and industrial policy interventions to nurture domestic industries and assist them to overcome disadvantages in the local and international markets.

Both Ministers claim to draw on international experience. This is certainly useful; but this experience needs to be interpreted carefully and correctly. Rather than continuing the debate the international experience, let's consider the more obvious and immediate evidence from South Africa itself.

Trade Liberalization in South Africa:

The Minister of Trade and Industry feels that trade liberalization will not improve the competitiveness of domestic firms.

Economic analysis of South Africa's immediate post-Apartheid experience reaches a very different conclusion – trade liberalization and deregulation led to across-the-board improvements in competitiveness in virtually all industries. Significant increases in export and import intensities showed that the economy can adjust through selective shrinking and expansion of firms and activities according to their competitive abilities; that South Africa can compete globally; and that an effective way to achieve this is to remove unnecessary shackles of protection and bad regulation. To deny any of this is to fly in the face of overwhelming economic evidence.

The Trade Minister also claims that South Africa's trade is already substantially liberalized. He quotes low average tariff rates, but ignores the many high rates in key sectors. Measured by the number of rates above, say, 15 percent, South Africa has liberalized far less than is apparent from the averages. Furthermore, selective tariff rate decreases have not always reduced *effective* protection. In fact, the government policy of leaving high rates on anything produced domestically and eliminating tariffs on inputs, has *increased* effective protection and perpetuated the inward looking bias of South African manufacturing.

Strategic, Sector-Specific Policies:

The Trade Minister continues the mantra about the importance of carefully crafted, selective and strategic policies tailored to the needs of particular sectors. He supports this view by mistakenly identifying many well-known policy failures in Asian countries as reasons for their success.

Instead of searching for mystic solutions from abroad, let's look at the hard evidence at home. Have selective and strategic sectoral interventions helped South African firms to achieve global competitiveness?

The Motor Industry Development Programme (MIDP) continues to be held up as the paragon of our industrial policy. No matter that, by our estimates, it has resulted in subsidies from South African consumers and taxpayers to a handful of foreign car makers of well over R 100 billion over the past 10 years. No matter that it has created no new jobs in manufacturing and has certainly constrained job creation in downstream sales and servicing. No matter that it is scheduled to go on at least until 2012, possibly 2020, and that most of the industry admits that it will never be globally competitive in South Africa. No matter that after three years and studies commissioned from two sets of consultants, the government has not yet completed a promised and supposedly urgent review of the programme.

The story does not end with the MIDP.

As an ad hoc addition to its long-promised but not yet delivered strategy for the textile and garment industry, the government decided to "protect" the industry by imposing quotas on imports from China. The immediate results were to penalize garment retailers and poor consumers, and, most perversely, to harm garment makers by denying them access to key fabric inputs. In response to the rising cost of this ill-conceived intervention the government relaxed the import quotas, but has given a veto over all quota allocations to the unions.

Propping-up uncompetitive firms doesn't end with the private sector. As part of its promotion of high tech and strategic industries, the government continues to subsidize Denel Corporation, the state-owned arms and aerospace company. For what? Primarily, it seems, to sequester some of the country's most talented scientists and engineers in a state enterprise that specializes in commercially and economically unviable projects.

South Africa's strategic, sector-specific industrial policies have been very costly. There is no evidence that they have increased the global competitiveness and economic sustainability of the protected sectors and firms. In fact the overwhelming evidence is that these interventions breed, not competitiveness, but rather requests for more subsidies – demands that the government finds difficult to assess or resist. Meanwhile, taxpayers, workers and consumers suffer while more competitive activities get discouraged and/or crowded out by incentives that promote inward-looking rather than outward-looking investments.

We hope that the Finance Minister's well-spoken words about global competitiveness continue to resonate in Cabinet.

Matthew Stern and Frank Flatters are from Development Network Africa, a private economic and development consulting firm. Visit our blog and let us know your thoughts on trade and industrial policy in South Africa: http://www.dnafrica.com/blog.php

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