Policy Implementation and Legislative Review Summit

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PARLIAMENT OF THE REPUBLIC OF SOUTH AFRICA

Outline

- Introduction
- Industrial policy and legislative background
- Dysfunctional structure of the South African economy
- Key consideration for functional industrial policies and legislation

Introduction

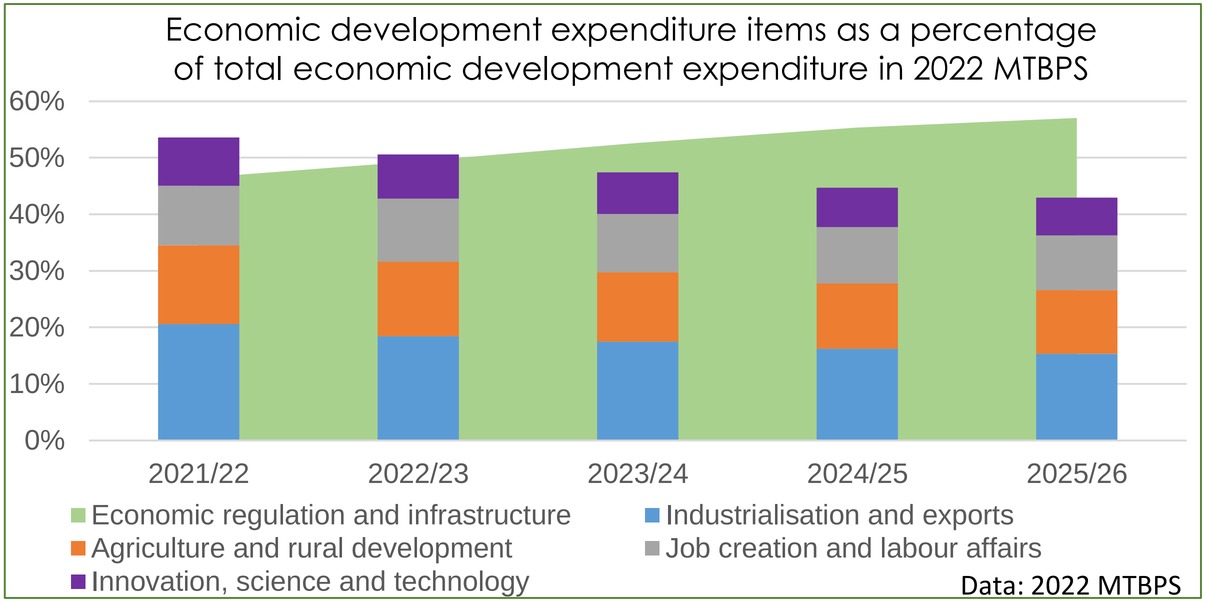
- The Parliamentary Budget Office is a juristic entity of Parliament and headed by a Director as an Accounting Officer
- The Office is established in terms of section 15 of the Money Bills and Related Matters Act 2009 (Money Bills Act), as amended. To support the implementation of the Money Bills Act; in particular support to Finance and Appropriations Committees in both Houses; but other Committees and Members of Parliament (MPs) subject to the availability of capacity
- The purpose of this presentation is to provide Members of Parliament with the understanding of issues facing South Africa economy within the context of industrial policy and legislative provisions

Global outlook: A poorer outlook due to a contractionary fiscal and monetary policies

- The United Nations Conference on Trade and Development warns in its Trade and Development Report 2022 that tighter monetary and fiscal policy choices in advanced economies increases the risk of a global recession and prolonged stagnation
- They warn that these actions may inflict worse damage than the financial crisis in 2008 and the COVID-19 shock in 2020
- These constraints on growth are in addition to the ongoing problems caused by the continued Covid-19 pandemic, the ongoing war in Ukraine, global supply chain problems and high energy, freight and fertilizer costs
- There has been widespread implementation of higher interest rates to fight inflation by curbing demand, decreasing investment levels and increasing unemployment
- At the same time there has also been a widespread return to fiscal austerity across the globe
- The increased interest rates have caused massive outflows of capital from developing countries, including South Africa
- According to SARB Monthly Reports, SA has had cumulative negative non-resident total net purchases of shares and bonds up to Aug. 2022

South African growth outlook

GDP growth outlook - calender year*	2022	2023	2024
National Treasury - Budget 2022	2,1%	1,6%	1,7%
National Treasury - MTBPS 2022	1,9%	1,4%	1,7%
South African Reserve Bank - January 2022	1,7%	1,8%	2,0%
South African Reserve Bank - September 2022	1,9%	1,4%	1,7%
IMF - World Economic Outlook - January 2022	1,9%	1,4%	-
IMF - World Economic Outlook - October 2022	2,1%	1,1%	
Reuters Consensus Forecast - January 2022	2,0%	1,8%	2,0%
Reuters Consensus Forecast - September 2022	1,9%	1,5%	1,8%
*Growth projections correspond to publication date and not forecast date			
Data: National Treasury, South African Reserve Bank, International Monetary Fund			



- South Africa's economic outlook over the medium term is relatively poor
- There is little support for economic development in the 2022 MTBPS
- The increase in infrastructure expenditure is offset by declining shares for the rest
- Aggregate demand and investment will in all likelihood remain low
- Econ. structure will remain highly concentrated and inadequately diversified
- Therefore, efforts to fight inflation and reduce government debt levels will likely hurt small businesses and the poorest households much more than they help

Background

- Two aspects of economic development that act as important constraints to well-being and ultimately the ability of the economy to achieve sustainable economic growth are discussed:
    - Human development
    - Economic development and the need for industrial structural transformation
- These aspects of economic development are interrelated because human and industrial development impact on one another through employment and income
- The ability of an economy to create adequate levels of employment and income will affect levels of poverty and human development
- Food and energy security and infrastructure are crucial for human and economic development
- The adequacy and quality of food, energy and infrastructure affect the quality of life and productive capacity of the economy
- Overall, there are large constraints on economic development and growth due to the inadequacy of human development, economic and industrial transformation and food and energy security and infrastructure

Background

Progress with regards to development and implementation of industrial policy in post apartheid South Africa;

- Pre-and post 1994 economic planning
  - Aimed at general improvement in the functioning of markets rather than promoting structural transformation. These measures included:
  - Rapid trade liberalisation
  - Which contributed to de-industralisation by destroying manufacturing industries and causing job losses at the same time
  - Promotion and entrenchment of the economic dominance of highly concentrated, resource-based industries and capital-intensive sectors (argue that this was a "*hidden industrial policy*")
- Emergence of Industrial Policy post-2007
  - Formal industrialization planning took effect
  - National Industrial Policy Framework (NIPF) and related IPAPs have been implemented
  - Progress in development of transversal instruments and sectoral strategies
  - Limited effect due to in part, poor economic planning and coordination
  - E.g. poor investment, resources-based goods and lack of jobs and growing inequality
  - But also three(4 or 5 now) major economic shocks
    - On-going currency overvaluation and volatility
    - Global financial crisis and great depression
    - Energy insecurities and price shocks
    - Now Covid-19 and Russian –Ukraine conflict

Background

National Industrial Policy Framework and IPAP set four strategic industrialisation objectives:

- *To facilitate diversification beyond [the] current reliance on traditional commodities and non-tradable services. This requires the promotion of increased value-addition per capita characterised particularly by movement into non-traditional tradable goods and services that compete in export markets as well as against imports*

- *The long-term intensification of South Africa's industrialisation process and movement towards a knowledge economy*

- *The promotion of a more labour-absorbing industrialisation path with a particular emphasis on tradable labour-absorbing goods and services and economic linkages that catalyse employment creation*

- *The promotion of a broader-based industrialisation path characterised by greater levels of participation of historically disadvantaged people and marginalised regions in the mainstream of the industrial economy*

Background

Overarching themes in understanding Industrial Policy outcomes in South Africa

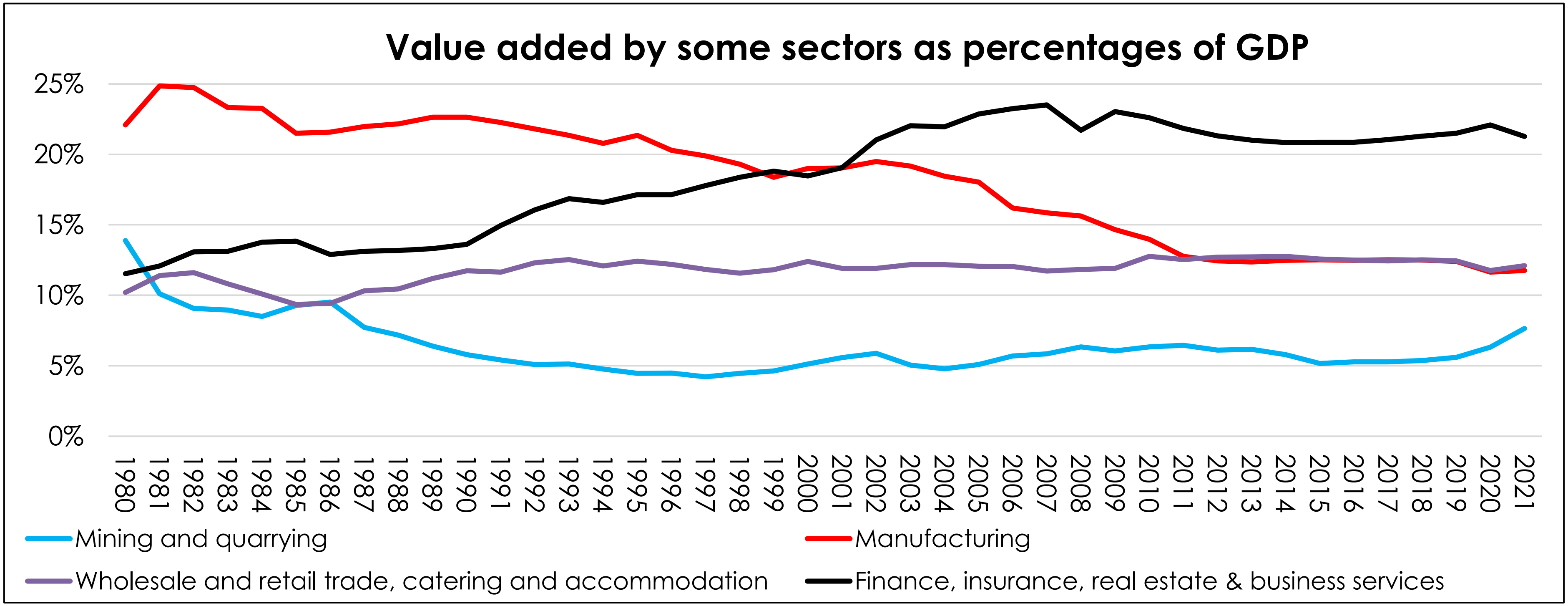
- Is there coherence between industrial policy and other macroeconomic and other policies? E.g. Fiscal policy or monetary policy
- Given the structure of the economy (concentration and few dominance by few large, oligopolistic corp), have industrial policies been able to incentivise productive rents and change the distribution of economic power?
- Has the industrial policy been seen as a critical component of broader goals of development and inclusion?
- How has the public procurement policy or framework interfaced with the industrial policy?

What has been the structure of the South African economy?

the dysfunctional structure of the South African economy

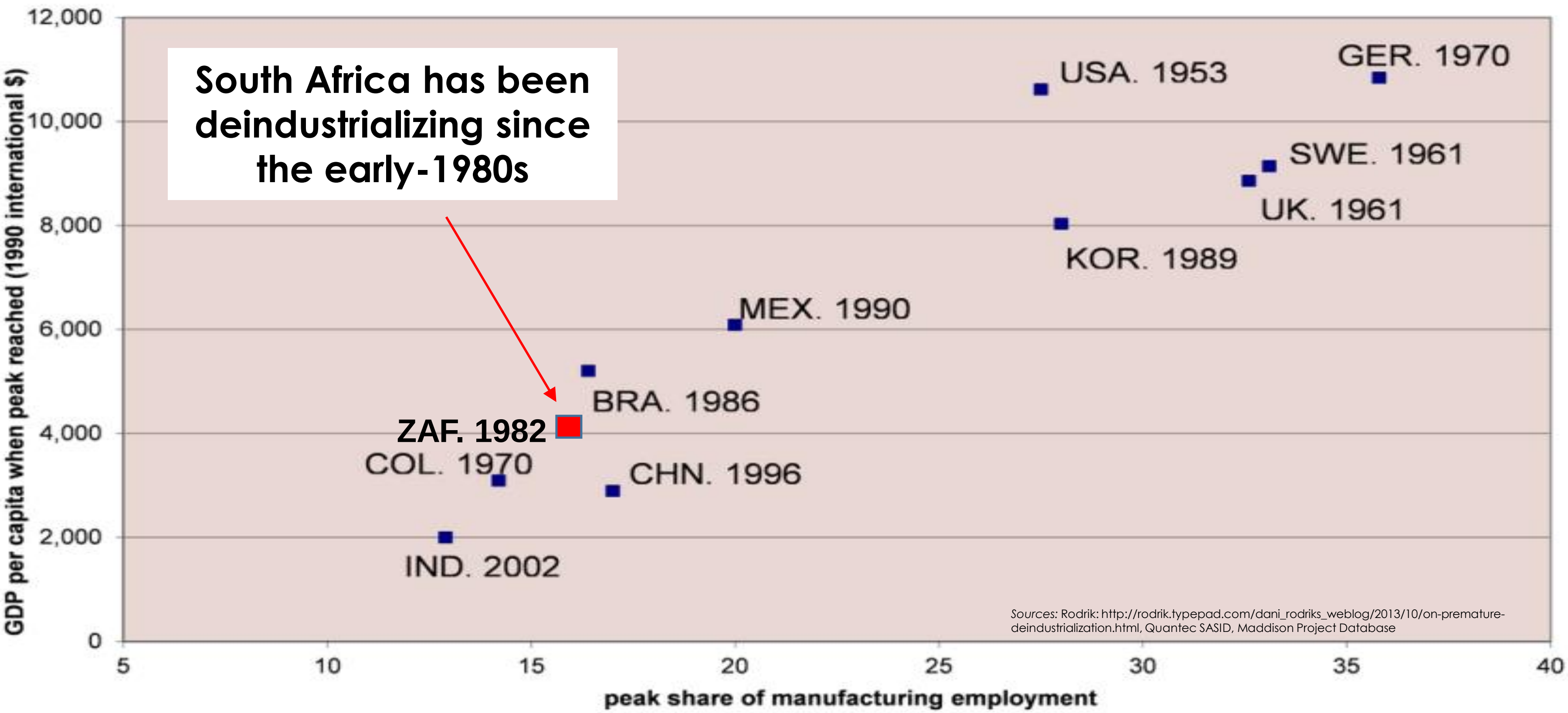
The structure of the SA economy since the 1980s

- The contribution to GDP of high value adding sectors of manufacturing (particularly that of manufacturing sectors not closely linked to mining and minerals processing) has declined since the late 1980s
- Economic diversification outside of the core mining and minerals related industrial sectors has not taken place
- Firms in domestic supply chains have not developed requisite capabilities in manufacturing to drive structural economic transformation (Andreoni et al., 2021)
- Market power of large firms within value chains such as food processing, metals and machinery, and chemicals and plastics, remains entrenched (Comp. Commsn, 2021)



Premature deindustrialisation and growth

Peak shares of manufacturing employment as a share of total employment relative to per capita income



Role of manufacturing in economic development

- Producing proportionately more output relative to input- increase return at the firm level
- Productivity improvements due to economies of proximity of related supplier and competitor firms and institution- increasing returns at the sector level
- Draws in inputs from primary sectors, manufacturing itself and services, as well as generating forward linkages to the rest of the economy- economy wider linkages and multipliers

The South African economy is very concentrated: The Top 100 firms by JSE Mkt Capitalisation

	1990	2000	2010	2020
Top 100 market cap (billions, Rands)	317	1 495	5 779	15 151
Percentage of total JSE market cap	83%	91%	94%	97%

- The top 100 have made up a very high proportion of total JSE market capitalisation
- The largest 10 companies accounted for 38% of the total capitalisation of the top 100 companies in 1990 and had extraordinary growth to 70% in 2020
- A pattern of accumulation of non-fixed assets (which can include financial portfolios) has been rewarded by the market through higher valuation of company shares, without corresponding increases in productive fixed investments
- Ownership diversified away from the major groups that formed the core of the of the mining and minerals and closely linked sectors (MEC sectors)
- However, the subsidiaries over which these MEC groups exercised control and influence have in many cases remained as lead firms
- The factors that underpinned and entrenched their dominance in sectors have not been eroded, partly because arrangements have remained in place after 1994 (such as long term rights to key mineral resources, or the regulatory favour still enjoyed by lead firms such as Sasol (Mondliwa and Roberts, 2019)

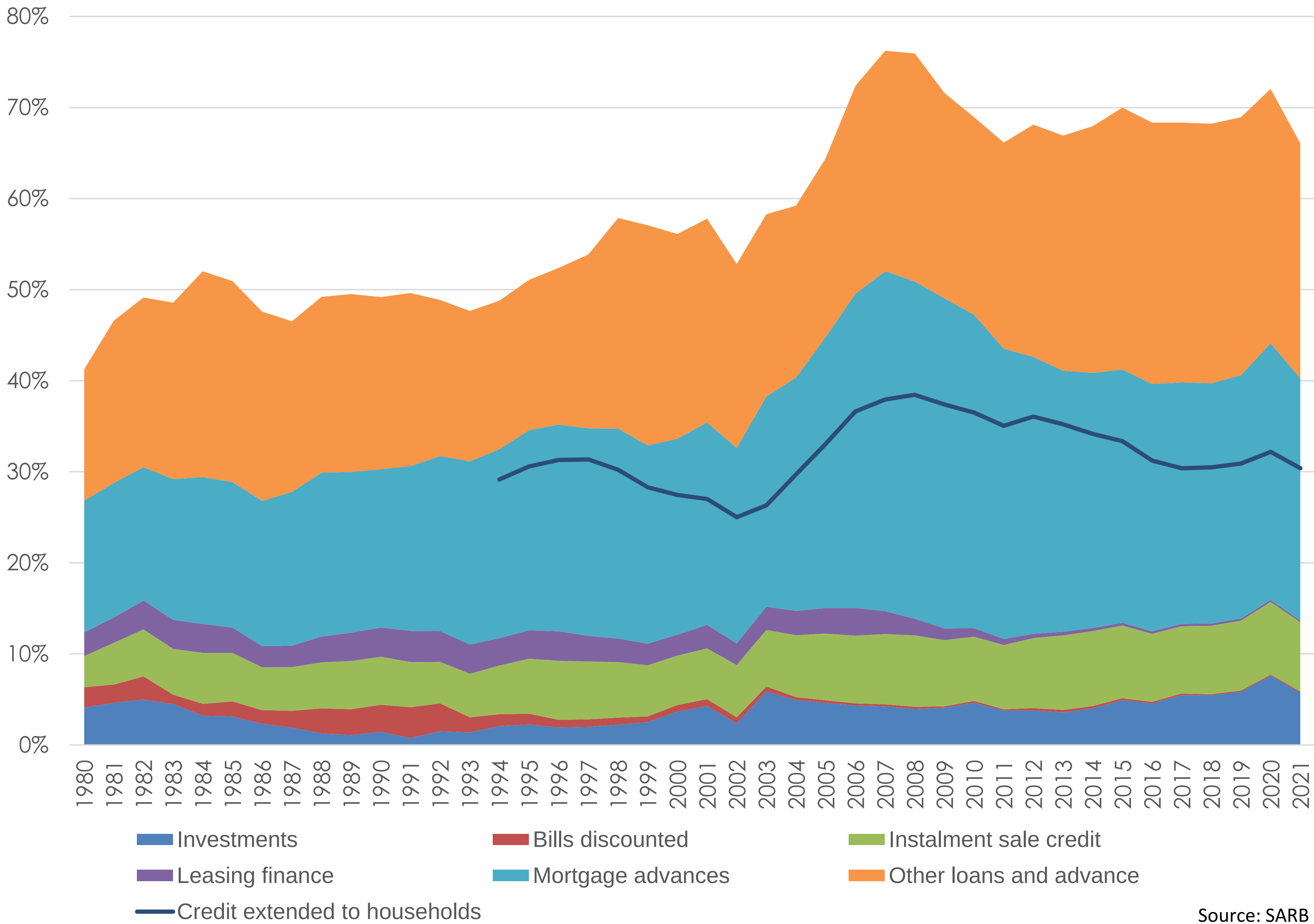
Financialisation & the large corpns since the 1990s

- The global economy and South Africa have become increasingly financialised
- In 2021, the JSE top 100 group consisted of 43 cross/dual listed companies
- Despite high levels of corporate profitability by international standards, the SA economy is trapped in a cycle of low fixed investment and growth, suggesting lack of reinvestment of profits in the real economy (Bosiu et al., 2017a; Zalk, 2021)
- There has been significant stagnation of private sector GFCF from the period after the global financial crisis in the late 2000s,
- Investments of lead firms (top 100 by JSE market cap) have increased but these have been in the form of:
  - Large-scale merger activity and international listings
  - 130 transactions recorded since 2010 valued at about R280 billion (in real terms) involving the JSE top 100 firms acquiring foreign companies (Who Owns Whom)
  - External acquisitions and new investments consistent with a pattern of internationalisation of South African capital
- The implication is that lead firms raise capital from the domestic economy to fund more international investments rather than local productive investments
- In 2020, 15 of the 17 real estate companies in the JSE top 100 (by assets) had most of their assets outside South Africa

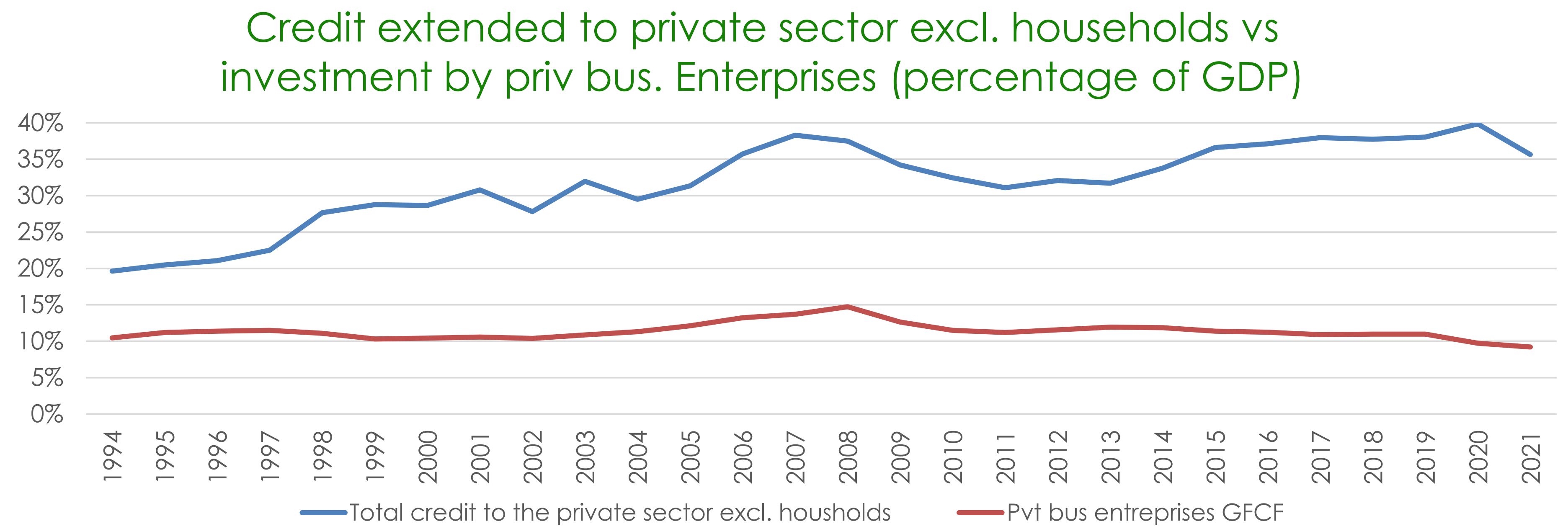
Financialisation & large corpns since the 1990s

- There has been a ‘delinking’ of investments in the financial markets and the real economy
- Financial markets have been leveraged to fund speculation rather than productive investment (Karwowski, 2015; Bowman, 2018).
- The stock of debt of the top 100 JSE firms has remained high over the past three decades – it increased much from 56% of total assets in 1990 to 83% in 2020
- In other words, an increasingly large share of returns is used in service of debt
- Firms have invested significantly in short-term liquid assets
- Dividend payments have increased substantially relative to capital expenditure since the mid-2000s (to 82% of the value of capital expenditure in 2019)
- The value of financial assets (including debt and equity held) has far exceeded real economy productive investment in South Africa and across the world
- The growth in value in stock markets is in stark contrast to stagnant domestic investment in productive assets

Total credit extended to the private sector by all monetary institutions



Source: SARB


Credit extended to private sector excl. households vs investment by priv bus. Enterprises (percentage of GDP)
40%
35%
30%
25%
20%
15%
10%
5%
0%
1994
1995
1996
1997
1998
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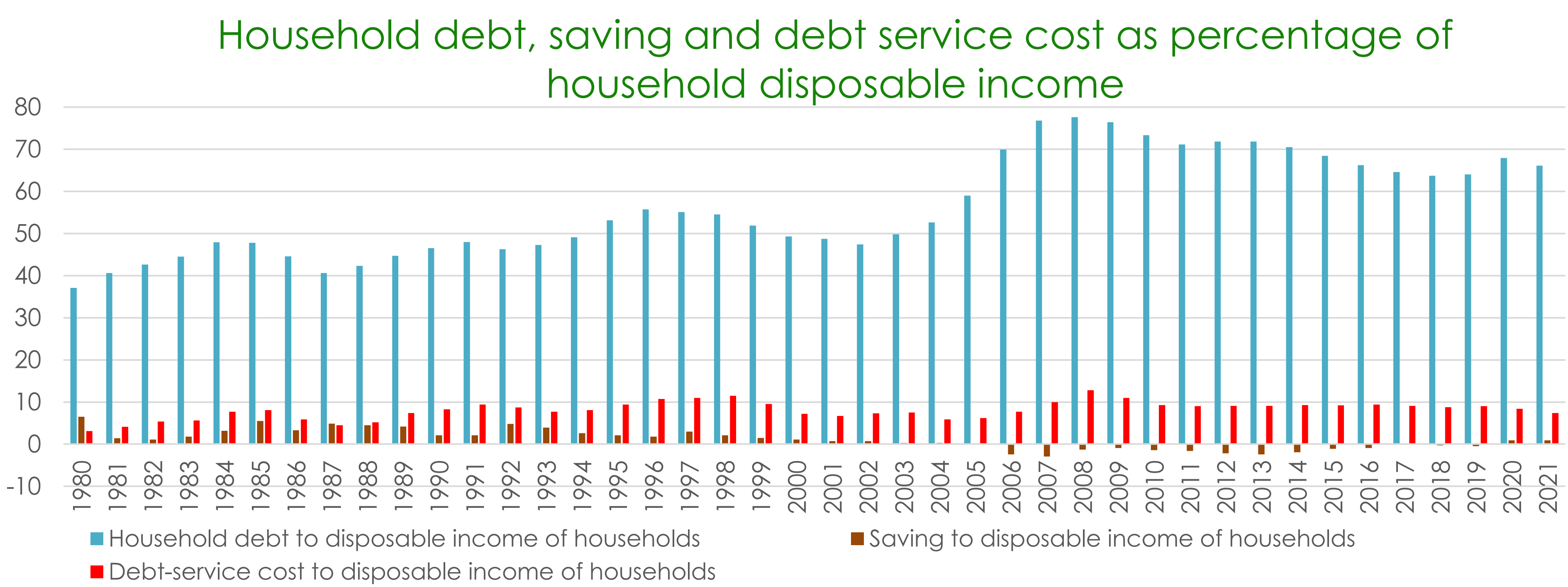
2021
Total credit to the private sector excl. housholds
Pvt bus entreprises GFCF


Household debt, saving and debt service cost as percentage of household disposable income
80
70
60
50
40
30
20
10
0
-10
1980
1981
1982
1983
1984
1985
1986
1987
1988
1989
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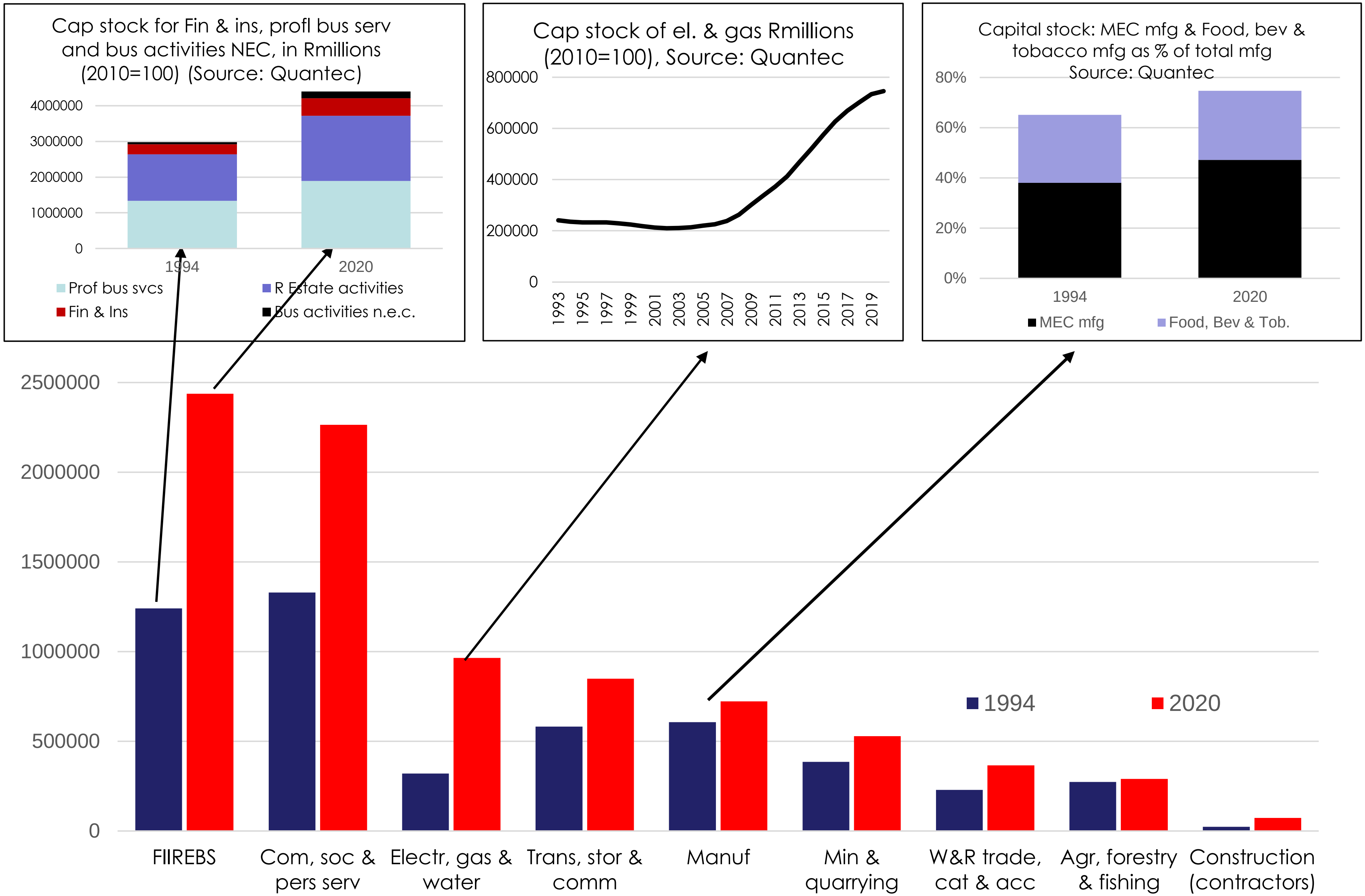
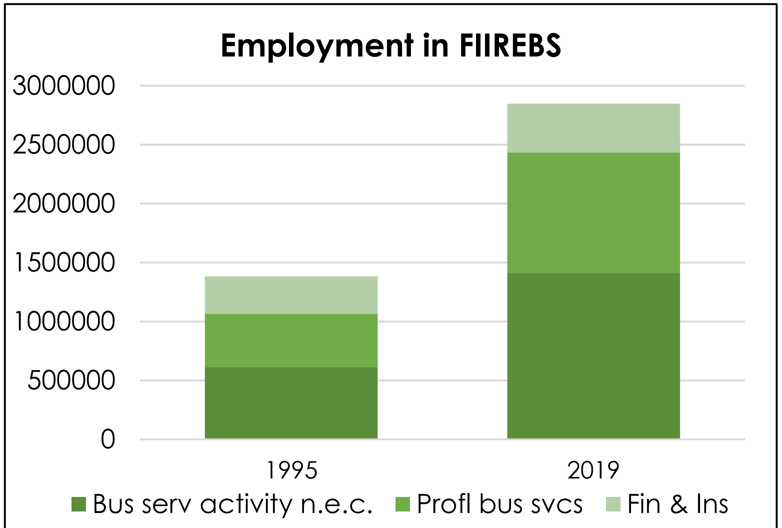
2021
Household debt to disposable income of households
Saving to disposable income of households
Debt-service cost to disposable income of households

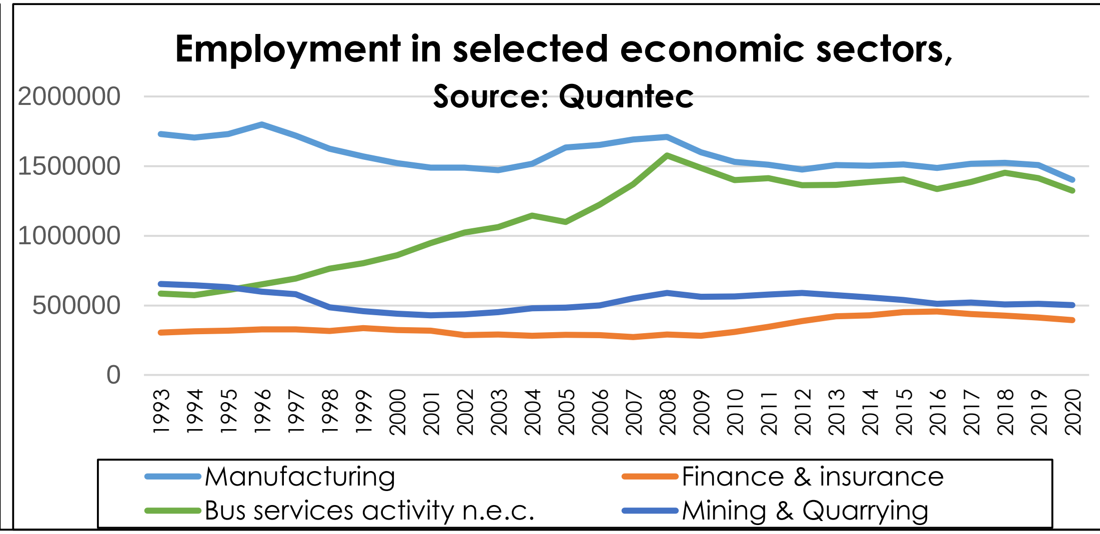
Capital stock of different sectors, 1994 & 2020

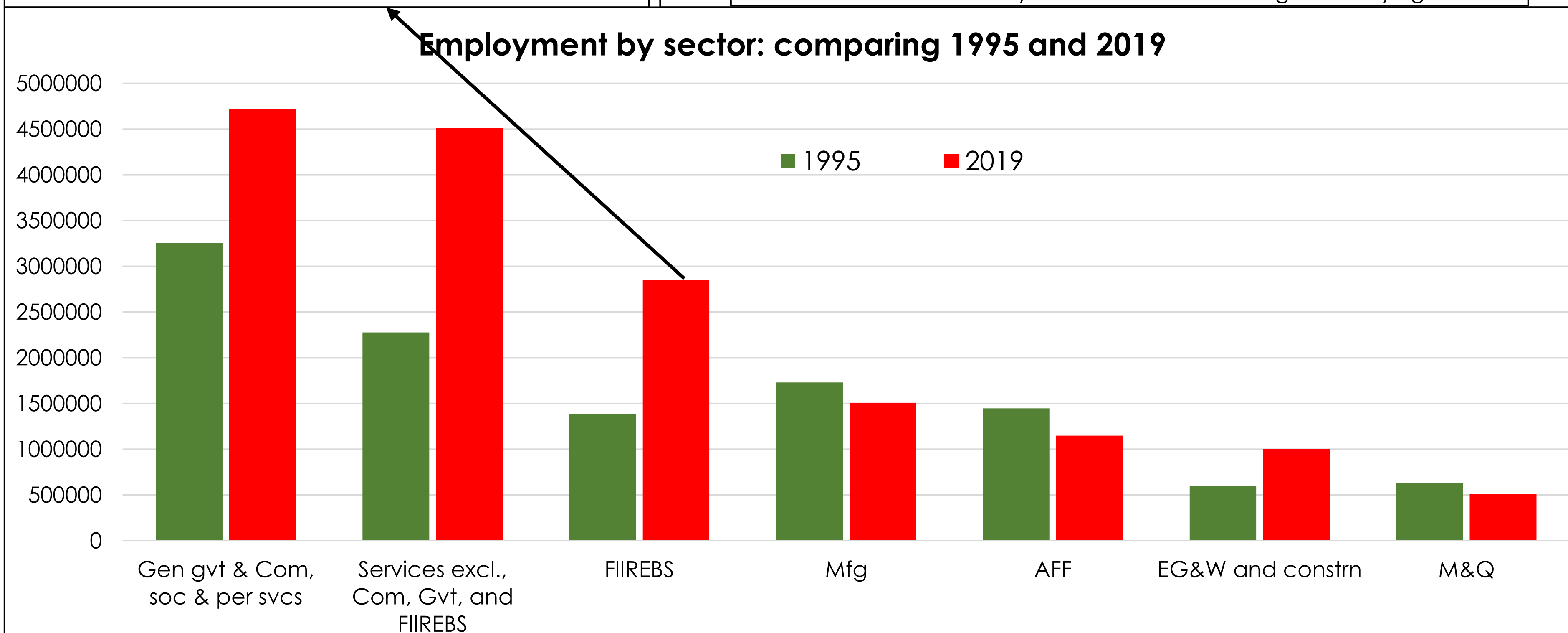


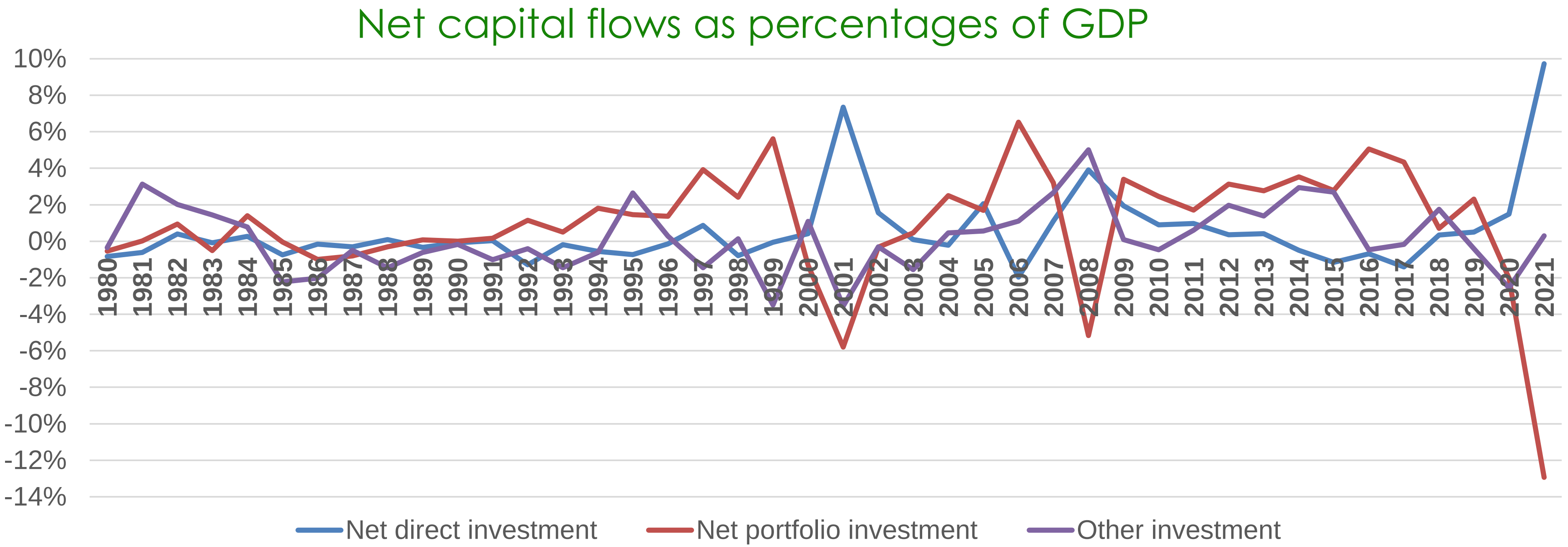
Capital stock of different economic sectors, Rmillions, 2015=100, Source: SARB

Employment for different sectors



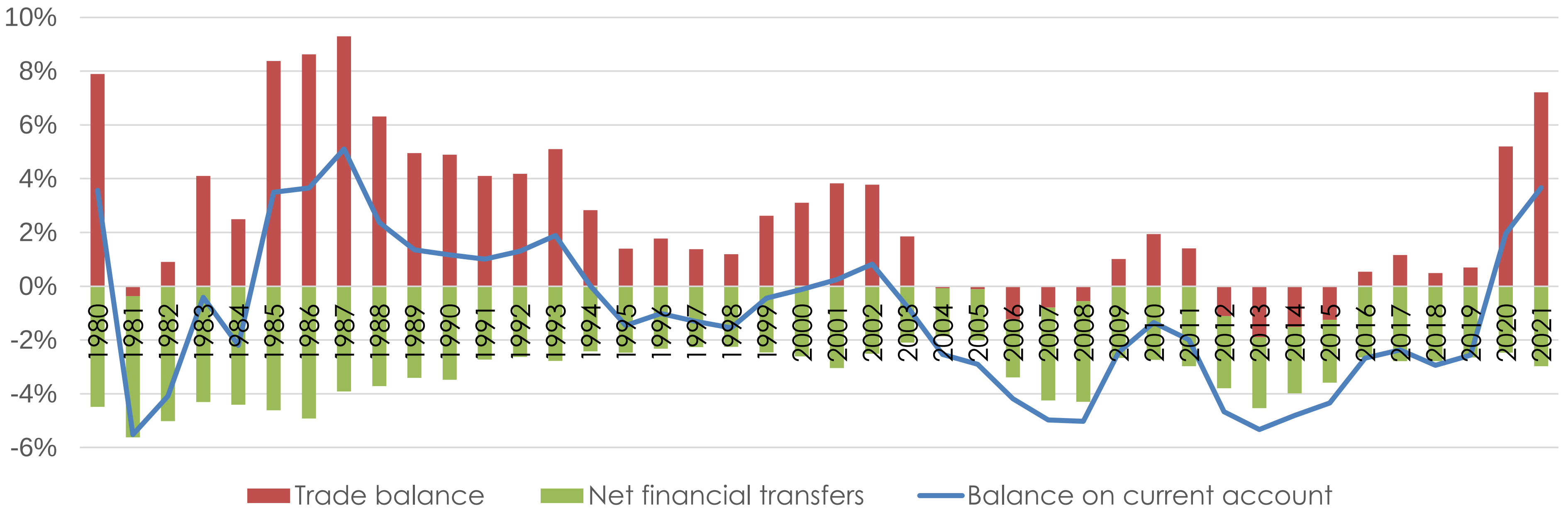






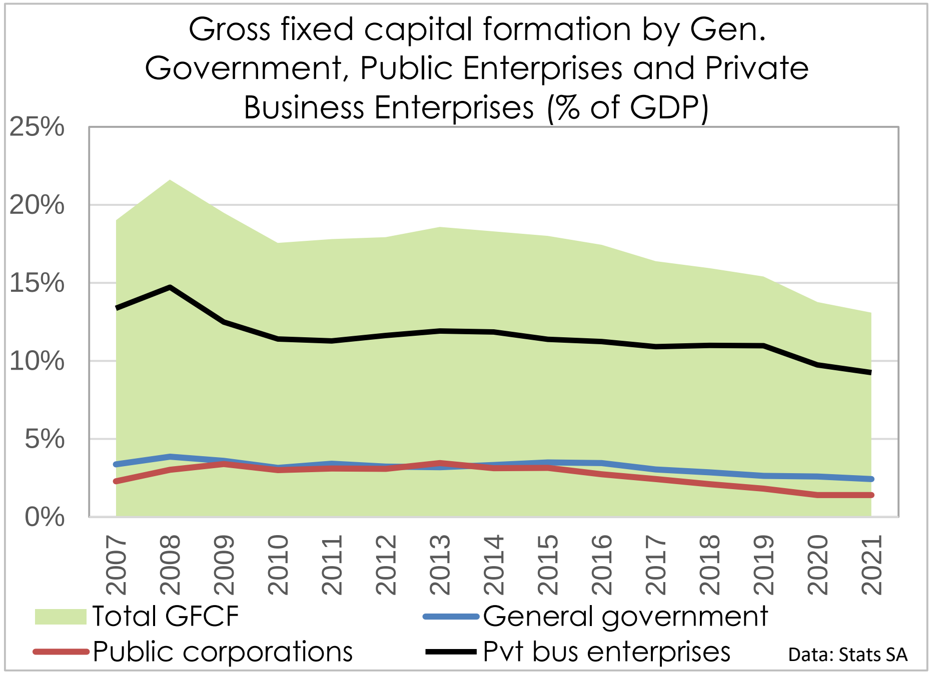
- The capital flows is the financial side of the balance of payments
- It is volatile and very much related to liquidity in developed countries and their speculataive capital movements and efforts to benefit from interest rate differential in developed and developing countries
- We see that net FDI is low or negative as a percentage of GDP for much of the period – the short-term flows associated with more speculative capital movements – portfolio and other flows are high but volatile
- Also, note that long term investment will not come for increased short-term flows – there is a huge maturity mismatch risk – so short term inflows leads to more speculative domestic activity as well. This happened before the GFC – from 2003 there is an increase in portfolio flows – foreign money into the stock exchange this drives up share prices – which leads to more stock buying by locals that then leads to more buying by foreigners until the GFC and then it crashes – the same pattern happned from 1993 to 2000
- The other flows is mostly short-term bank lending and a lot of that is driven by carry trade – where foreigners borrow in developed countries at low rates to make short term returns on higher rates in developing countries

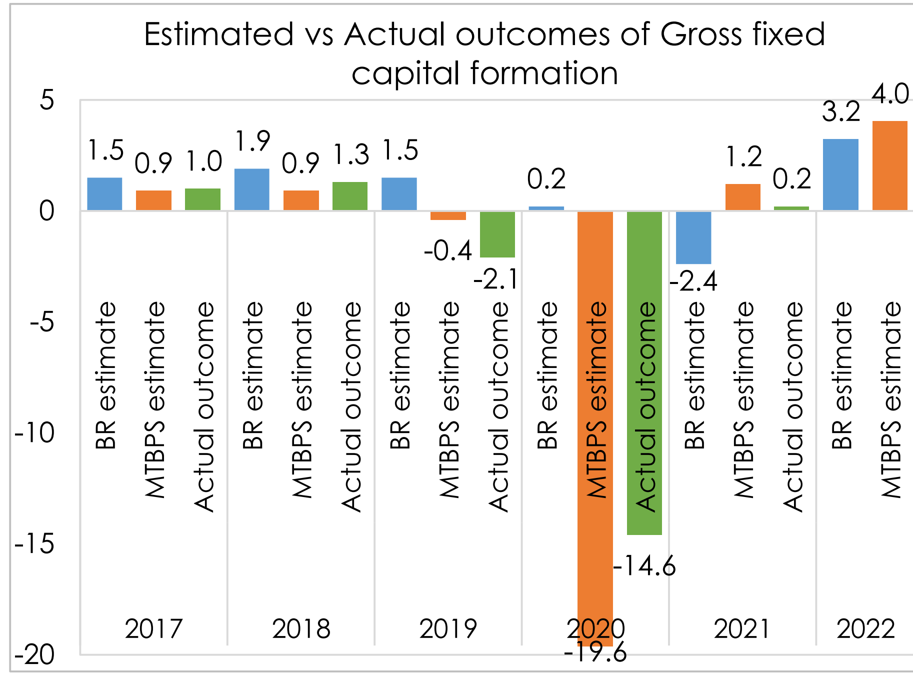
Current account dynamics (percentages of GDP)



- The impact of capital outflows on developing countries induce them to increase interest rates not only out of fear of inflation but also to attract foreign capital inflows
- South Africa has generally attracted short-term capital inflows rather than FDI
- The combination of higher interest rates and volatile cross-border capital flows poses serious risks to macroeconomic stability in developing countries
- South Africa is at risk because it has had annual current account deficits since 2003, except for 2020 and 2021
- This current account deficit has predominantly been due to net financial transfers on the current account and not the trade balance
- Maintaining a primary fiscal surplus and reducing government debt will not improve South Africa's current account situation and prospects for growth because of the overwhelming impact and vulnerability to destabilizing, volatile short-term foreign capital flows and the high interest rate regime it requires

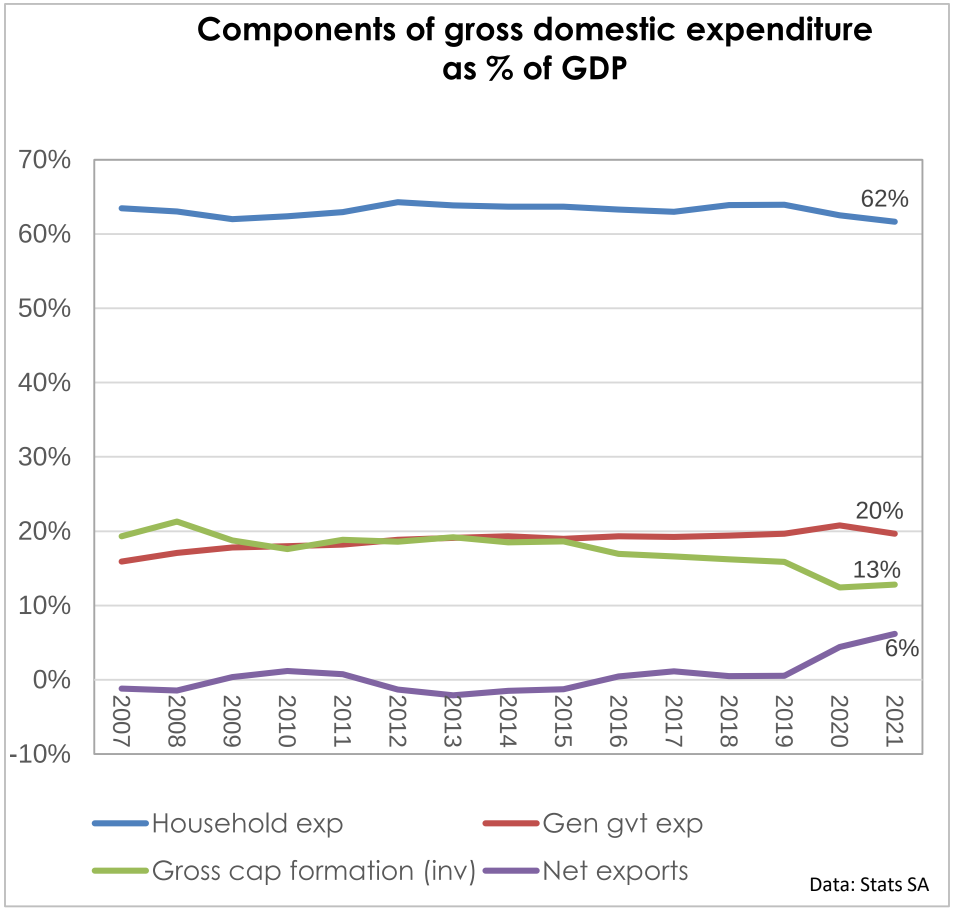
Investment landscape in South Africa

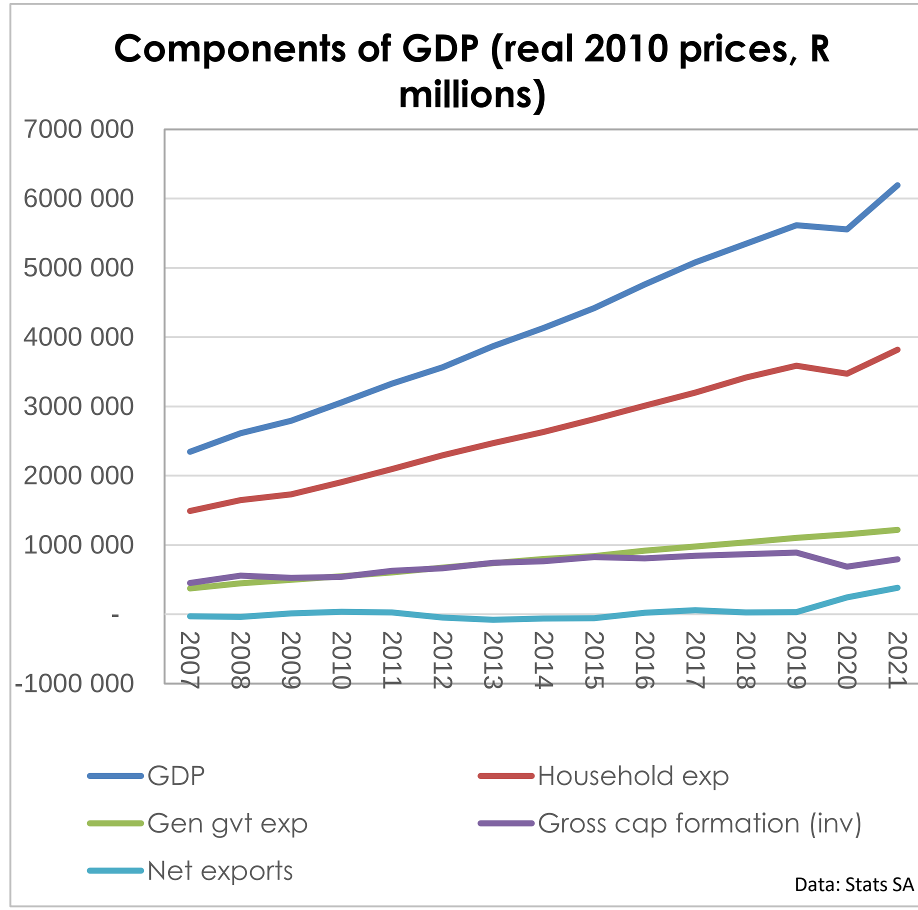




- The NT bases much of its GDP growth forecast over the MTEF on higher investment
- Infrastructure spend is expected to increase from R66.7bn in 2022/23 to R112.5bn in 2025/26
- However, NT's track record on forecasting investment growth has been poor (e.g., in each of the 3 years before Covid-19, investment growth was overestimated in the Budget Reviews)
- Private investment has been below 12% of GDP since 2015 and, despite the infrastructure fund launched in Aug. 2020, not a single mega infrastructure project has occurred
- Public investment remains weak at below 5% of GDP each for general government and public enterprises, while private investment declined to below 10 per cent of GDP in 2021 (well below the NDP target of 10% and 20% of GDP, respectively)
- A lack of state capacity to deliver infrastructure projects as well as the insufficient progress in addressing structural constraints do not bode well for the fixed investment outlook

GDP growth requires government support for more consumption by struggling households and expenditure on investment in infrastructure





- Expanded government expenditure in support of poor households, improving service delivery and upgrading services infrastructure can support structural economic transformation and increase growth

Structural reforms vs structural transformation: Government's structural reforms

- Main interventions
  - fixing network industries,
  - reducing red tape,
  - increasing labour market deregulation for flexibility and
  - use of competition policy to increase competition.
  - mention industrial policy
- These structural reforms do not aim to transform the structure of the economy
- They are based on a simplistic calculus that actions within certain sectors and reducing red tape will cumulatively add several points to GDP growth
- The aim of the NT's microeconomic, supply-side approach is to improve conditions and reduce costs to business for more economic activity
- The government's definition of structural economic concerns has deliberately been interpreted in a narrow sense where the problems are identified as related to government actions and regulations, red tape and worker organisation
- Somehow, the intensification of competition policies was not seen as adding to red tape
- The supply-side focus of the structural reforms is a policy choice that are in line with contractionary fiscal framework

What is the cost of not understanding the problem?

- The result has been low investment, declining levels of productive capital stock, growing unemployment and more precariousness of employment
- Macroeconomic policies – fiscal conservatism and inflation targeting – supports rentiers and financialisation and undermines long-term productive investment and employment – **it disempowers “value creators”**
- Government’s solution to these economic difficulties is to focus on business and to improve business confidence
- This is the losers game related to some particular version of new classical rational expectations theory where they want to prove that government policies are credible and that they will cut expenditure and reduce debt
- Government offer supply-side structural reforms
- However, given the structural problems and financialisation of the economy government’ efforts to show credibility exacerbates the structural problems
- The government proposed structural reforms will reinforce the status quo and possibly make things worse – **it further empowers “value destroyers”**
- Poor GDP performance and pressure to spend more (given the ,multitude of risks facing the world – climate change disasters, social unrest because of hunger and poverty and generally related to inequality, health crises/pandemics etc) – so governments attempts to appear credible end up making them miss targets and look not credible

The need for structural transformation

- Structural transformation of an economy requires industrial change that:
  - Builds and increases economic activity from sectors of low to high productivity and complexity, and
  - Deepens industrialisation though upgrading from low to high productivity activities within economic sectors
  - For example, transforming an economy with most value-added in primary sectors such as mining and agriculture towards increasing value added from manufacturing and then on to advanced industries that combine high value services, increased research and development and manufacturing
- Evidence shows that economic development is associated with increasing the size of the economy
- GDP growth leads to a larger tax base that in turn could support increased provision and quality of social services
- It is also associated with increased employment and incentives that promote higher levels of education and skills development

The need for structural transformation

- Manufacturing is considered key to structural economic transformation because it has strong linkages across entire value chains from primary sectors such as mining and agriculture through to advanced services like engineering and design.
- Historical evidence shows that development of manufacturing has the ability to drive technology dependent productivity of other economic sectors within value chains
  - For e.g., productivity has increased in agriculture with advances in manufacturing of agricultural machinery, chemical fertilisers and even genetic engineering
- South Africa has not achieved significant transformation and has in fact prematurely deindustrialised
- There have been large losses of employment in manufacturing, particularly due to declining diversity in sectors that would support faster employment growth directly and in associated services sectors
- While certain services sectors, particularly finance, have grown, South Africa's role in global value chains has generally remained that of providing low value-added primary products and raw materials
- South Africa continues to remain dependent on mining and minerals for much of its export earnings

Key consideration for Implementing South Africa's Functional Industrial Policies and Legislation for the Seventh Dispensation

Macroeconomic Policy Reform

- Government and public corporations increase their investment in economic infrastructure, social infrastructure and economic services in line with the NDP targets
- The Reserve Bank reverting back to its "flexible inflation targeting" regime and upgraded to a dual mandate of both targeting inflation and economic growth at 6%
- Monetary authorities adopt the necessary measures to raise the annual growth of credit extension to the private sector productive sectors and SMME at a consistent rate annually (set lending targets?)
- The role of FDIs and a developmental allocation of capital away from speculation in financial and real estate markets towards fixed investment in the real sector - particularly value added manufacturing sectors - in line with the NIPF and IPAPs.
- The need to reform the private financial sector so that financialisation of the economy can be reversed somewhat and more investment goes into the real sector. Address the power of large corporations and concentration of most markets also has to be addressed in a developmental way and not just legalistically through competition law and the Competition Commission
- There is need to divert money to SMMEs and entrepreneurs willing to help diversify and transform the economy and to creating jobs

Trade and Industrial Policy Reforms

- Industrial financing incentives that will directly and indirectly increase total annual investment in the manufacturing sector
- Regional industrialisation integration and regional value chains- Special Economic Zones and African integration programmes to increase total exports
- Localisation policies to gradually reduce import dependency ratios of some sectors by setting targets for a particular period
- Local content requirements to provide clarity on the; extent of local ownership, market structure, and requirements to build technology capabilities
- Digitalisation (4IR and digital platform) and industrial policy
- Climate change and green economy strategies and industrial policy, e.g. addressing adverse impact of climate change on productive sector like agriculture
- Consideration for greater coherence and better coordination between industrialisation goals and macroeconomic and other economy wide policies, e.g. fiscal policy and industrialisations strategies or public procurement framework and industrialisation objectives
- How to ensure medium to long-term energy security and provide support to productive sectors and SMMEs in particular

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Thank you

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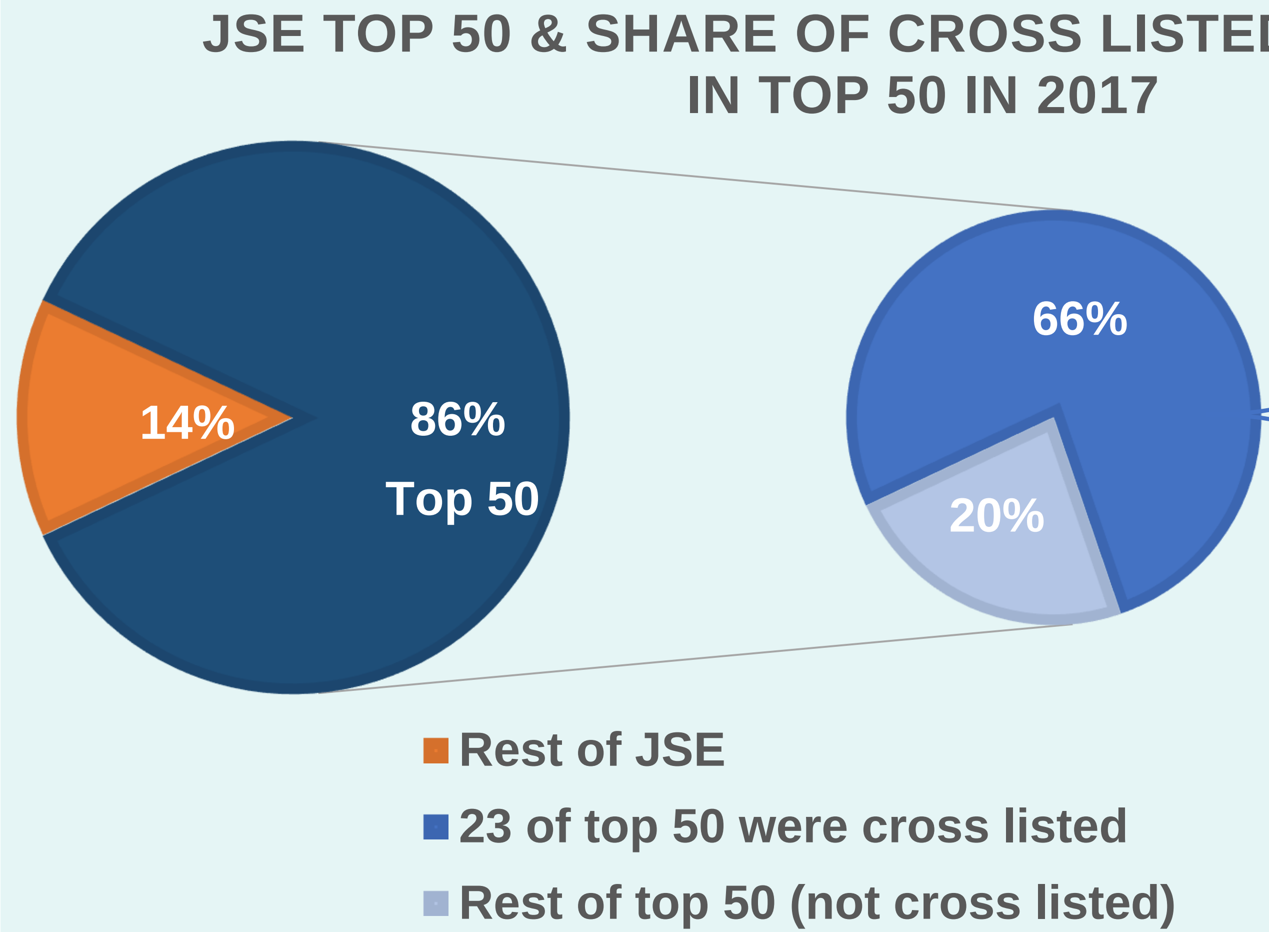
ADDITIONAL SLIDES

Background

- The context for this presentation is that evidence shows that inequality is negatively correlated with growth and development
- There is concern about the rise of network industries, data collection and privacy as well as global market dominance of a few corporations. These problems raise important questions about the capacity of individual states and the need for more international coordination
- There is an emerging consensus that these problems cannot be solved without a much larger role for the state and some reversal of the widespread economic and financial deregulation that occurred since the 1980s
- The measures taken by the state to address poverty and inequality and redressing historic injustices will affect human and economic development
- Expenditure on state social support and infrastructure investment is necessary for economic and industrial development and will affect the size and performance of the economy
- In turn, the size and performance of the economy affects the well-being and capabilities available for increased productivity and economic growth

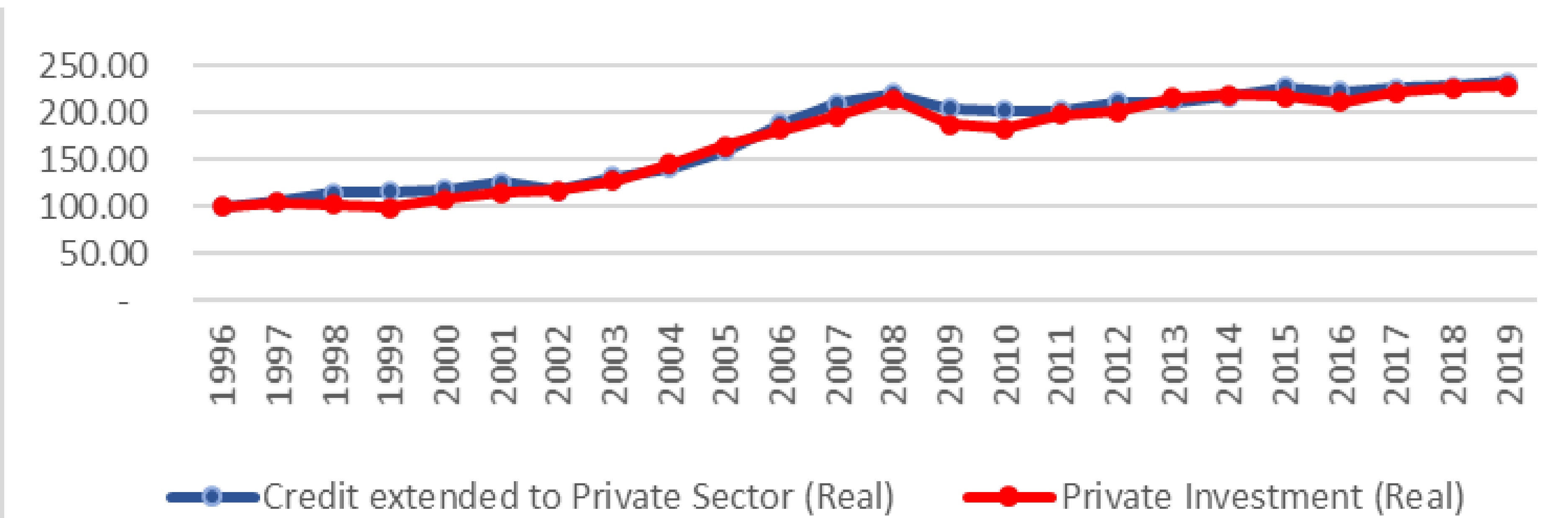
Disconnect between financial markets and real economy in SA



SA operations small part of global operations, 2017	
Naspers	5,5%
Richemont	8,0%
BAT	18,0%
South32	10,0%
Anglo American PLC	7,0%

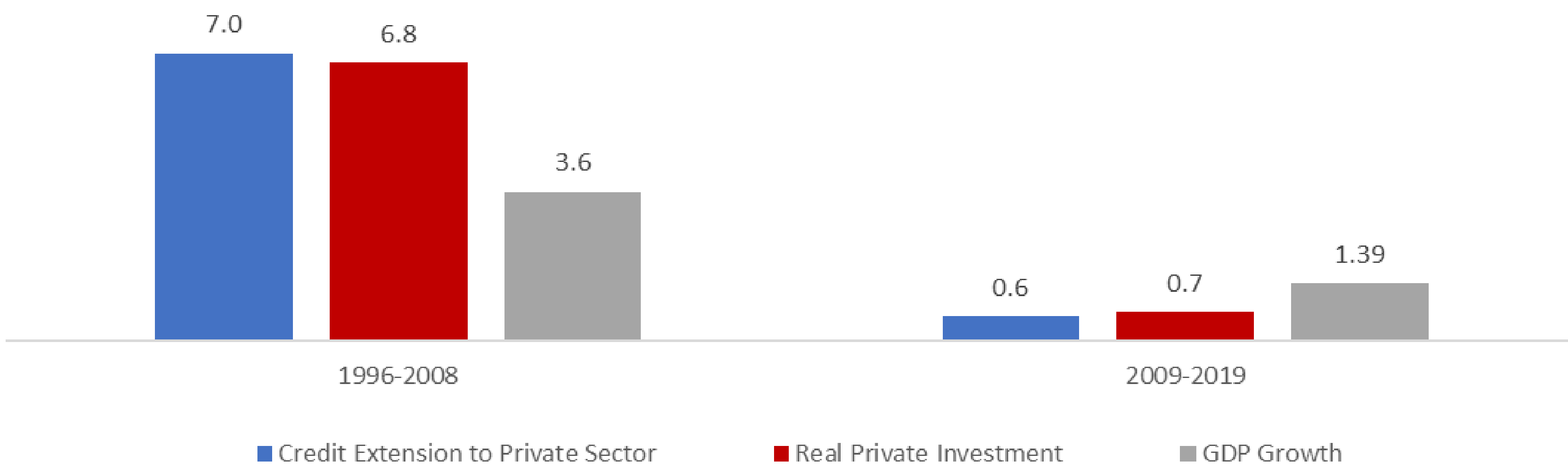
Access to credit (i.e., borrowing) is another important determinant of private investment

- Close positive relationship between the private sector's ability to borrow (i.e., access to credit) and private real investment in South Africa during the last 25 years
- Despite its potential to support private investment and economic growth, data on the credit extensions highlight another restrictive dimension of monetary policy in South Africa
- There is huge misallocation of capital in the economy and that low interest rates could support even more misallocation. Even if there is some increase in investment. late we look at investment and capital stock - the other issues is whether the investment going and is it helping of hurting prospects for economic transformation



Access to credit (i.e borrowing) is another important determinant of private investment

- During the period of 1996–2007, the real value of credit extension to private sector grew at an average annual rate of 7%. Private sector investment grew in parallel with the credit extension at an average annual rate of 6.8%. And average GDP growth of around 3.6%
- Post global financial crisis (2008–2009), due to a highly restrictive lending policy, the average annual growth of credit to the private sector significantly dropped to almost half a per cent (0.6%) in real terms.
- This had direct impact the private investment growth, which dropped spectacularly to an average of 0.7% per year. And consequently, the average GDP growth recorded was 1.39%
- The large corporations that do most of the investing in the economy do not borrow from the monetary sector - the credit extension here is to households and fueled the housing bubble and debt driven consumption - that then translated into debt fueled unsustainable economic growth. As the graph above shows less than 10% of GDP of credit extended to the private sector was to investment - the bulk is mortgage and credit card,(There was a real estate bubble not only in residential but also in commercial real estate)



Structural reforms vs structural transformation

- Widespread consensus that the extraordinarily high levels of unemployment, poverty and inequality are unsustainable
- There are also longstanding views that there is a need for structural transformation of the South African economy but not agreement on what that entails.
- Too much of the discussion does not adequately take into account
  - macroeconomic factors and
  - finance, cross-border financial flows and financialisation
- The National Treasury (Government), most mainstream academics and media commentators in SA use neoliberal economic ideology:
  - supply-side policies,
  - a reduced role for the state,
  - monetary policy administered by an independent central bank solely aimed at keeping inflation low and
  - a view that fiscal policy is ineffective, inflationary and growing government debt that crowds out private sector investment
- The observance of orthodox economic thinking means that they:
  - believe in a dichotomy between financial and real markets
  - make an overly artificial separation of microeconomics and macroeconomics
  - treat economics and economic policies as if history does not matter, and
  - Treat uncertainty as not important when it is in reality
- Therefore, they explain economic outcomes and develop policies without examining broader social issues that impact on the evolution of institutions and the related path dependence of the economy
- Makes them unable to understand the macroeconomic, financial and other structural factors that impact on investment and employment