# Manufacturing
# a new economic future

## Introduction

Manufacturing is key catalyst and multiplier for job creation, GDP growth and development in a country. In South Africa, manufacturing as a percentage of GDP has been declining rapidly. In this press briefing, the reasons behind this decline are explored, looking at ANC policies and legislation, the political environment and the tools used by the Department of Trade and Industry (DTI) to stimulate manufacturing.

From the research it becomes abundantly clear that there is no consistency, validity or sustainability in a number of the policies and legislation in the manufacturing space.

The tools used by the DTI including incentives, trade relations and tariff measures have had some impact but need to be enhanced and realigned in a number of areas.

There are also a number of gaps in the suite of tools used by the DTI. The DA's ***'Manufacturing a new economic future'*** full document further expounds on aims to fill these gaps by exploring amendments to visa requirements, skills shortages, the 4th industrial revolution, trade relations, incentives, local content procurement and tariffs amongst others.

With these amendments and additions, we conclude that SA can be an attractive environment for Investment from the manufacturing industry.

## Importance of manufacturing

According to the World Bank, manufacturing has the highest job multiplier out of any sector.

The multiplier effect of manufacturing according to a Manufacturing Circle SA report is R0.35 for the fiscus, three additional jobs and R1.13 for output. Thus, for every rand invested in manufacturing, fiscal revenue will increase by R0.35, output will increase by R1.13 while for every R1 million invested, jobs will increase by 3 employees.

The role of the government is not to pick winning sectors, favouring one sector over another; but there are measures that can be taken to improve the broader economic environment that will make a big difference to the viability of not only manufacturing but other sectors in the economy too.

## Current political context

The climate of political volatility with the factional battle within the ANC, the land debate and the populist drive by the ANC and EFF towards Expropriation without Compensation (EWC) and state capture allegations has created an unstable manufacturing environment where investment in the sector is drying up.

We now know from Trade Envoy, Trevor Manual that EWC has made South Africa a 'hard sell' towards foreign investors which is a big threat to the manufacturing sector.

The policy environment has been littered with poorly drafted legislation that has been challenged by opposition parties, non-governmental organisations (NGOs) and society leading to numerous court battles. The "Protection of Investment Act" is one such Act that does not provide adequate protection for foreign investors, and will be an added reason for investors to look elsewhere or disinvest from South Africa, especially around manufacturing. This has created an uncertain environment which is putting off investors and manufacturers from long-term investment plans

The bottom line is that businesses are weary to invest in an economy with weak growth and are increasingly looking to invest offshore where better returns can be found.

## SA's manufacturing performance

Seasonally adjusted manufacturing production decreased by 1.5% in the three months ended May 2018 compared with the previous three months.

Manufacturing decline has correlated strongly with the loss of jobs and increased unemployment in SA. In 1994, manufacturing made up between 16% and 17% of the workforce. In 2002, manufacturing employment constituted 16% of the workforce. While in Q2 2018, it had fallen to 10.7% of the work force with 1.74 million people.

The latest QLFS survey indicates that manufacturing employment has contracted by 3.1% from June 2017 to June 2018, resulting in a loss of 105,000 jobs.

## South Africa's Trade Statistics

Manufacturing in SA is dominated by a few key industries:

- Agri-processing
- Automotive
- Chemicals
- ICT and Electronics
- Metals
- Textiles

As at 30 June 2018, South Africa's trade statistics are highlighted below:

- Total Exports: R 110.1 billion
- Total Imports: R 98.1 billion
- Trade Surplus: R 11.9 billion

## Why is manufacturing struggling?

South Africa's manufacturing growth is lagging behind other emerging markets.

Other than the political reasons mentioned above, increased labour costs, high energy costs, poor infrastructure development, misaligned policy, regulatory uncertainty and asymmetrical compliance with World Trade Organisation (WTO) rules. The combination of the above has put a significant handbrake on manufacturing.

From 2007 to 2017, Eskom tariffs have increased by 500% against inflation of 111%, while investment levels have fallen from 20.6% to 19% of GDP.

Structural challenges remain in the country. These are: management shortcomings, labour inflexibility, collective bargaining issues, skills shortages exacerbated by visa challenges and infrastructure inefficiency.

Fiscal challenges have added to the pressure on manufacturing. These include: the potential carbon tax, the newly implemented sugar tax, the waste management tax and the generally slow response to competition from highly subsidised imports

The expropriation of land without compensation, the concentration of the Ministers power in terms of the Competition Commission and investor-averse legislation such as the Protection of Investment Act are also raising alarms.

## DTI's response

Currently the DTI's response is to incentivise everything. From textiles to agro-processing and automotives; the DTI has set up incentive schemes often using tax rebates or cash to encourage investment and growth.

The DTI also employs policy levers such as the Special Economic Zones that encourage investors to plough money into designated areas that receive tax and infrastructure incentives.

Six incubation centres in the manufacturing sector have been created to stimulate start-ups Government has identified the development of small enterprises in this sector as essential to the recovery of the country's economy and ensuring employment creation.

However, with only a projected 250,000 SMEs creating less than 30% of the jobs in SA, these interventions seem to have failed. Unemployment has reached a new high of 9.6 million people and 105,000 jobs in manufacturing have been lost in Q2 2018.

## DA's position

It is clear that an effective trade policy trumps industrial policy. Our position is strongly in favour of increasing free trade while recognising that some measures from time to time must be deployed to protect local industries against dumping in line with WTO regulations. Free trade maximises competition and consumer choice, and helps to keep down prices.

Our focus is not on interventionist regulatory measures and fiscal incentives but rather on facilitating higher value addition through improving skills and public-private sector collaboration. This methodology has also assisted in moving Malaysia from a low-growth to high growth path.

A World Bank report (2014) remarked "by opening local markets to domestic and foreign entry, South Africa would enable new productive firms to enter and place downward pressure on high mark-ups. This would lower input costs and tip incentives in favour of exporting by reducing excess returns in domestic markets. Competition would also stimulate investment and innovation and, over time, condition the market to ensure that firms entering competitive global markets have reached the productivity threshold to support their survival and growth." Thus increased competition is vital.

## DA's Proposals

### 1. Reduce red tape

Red tape removal will unlock numerous opportunities for new manufacturers to move into the market by making it easier to do business. The DA has launched a Red Tape Impact Assessment Bill which has been gazetted aimed at assessing legislation in order to reduce the regulatory burden it places on small business.

### 2. Policy Certainty

Policy certainty can be achieved by removing problematic policies e.g. the Promotion of Investment Act which seeks to limit foreign investor's rights to justice and gives no clear certainty on expropriation. The Expropriation Bill, The Land Holdings Bill, the Mineral & Petroleum Resources

Development Act (MPRDA) and the Mining Charter are all examples of legislation which creates uncertainty and confusion for investors and needs to be amended.

### 3. Prepare skills base for a modern economy: 4th Industrial Revolution

Innovation can be enhanced by allowing easier access for foreign skilled workers to attain visas in SA and offering focused DTI incentives coupled with skill visas and skill transfers. This will require visiting the current regulations on visas and raising the strategic importance of visas linked to scarce skills.

### 4. Increase Trade

The DA would look to pursue new markets and step up innovation and productivity in SA by creating a new manufacturing innovation and export task team. South Africa should be looking overseas for growth in regions such as Asia, South America and Africa and increasing exporting partners. The DA would look at enhancing and expanding SA's existing trade deals. The Southern African Customs Union relationship would need to be investigated to create a mutually beneficial arrangement. The DA would also look to replicate successful trade promotion agencies such as Wesgro in the Western Cape across South Africa. .

### 5. Reduce energy costs

Energy costs need to be drastically reduced. Renewable energy should be directly sourced from manufacturers to reduce energy costs. The DA would ensure that manufacturing has access to cheap and reliable power suppliers in order to lower the cost of manufacturing. This would include bulk and long-term deals with heavy industries. The break-up of the energy sector with the Private Members Bill that the DA is drafting will go a long way to reducing the cost of energy.

### 6. Steel Tariffs

There needs to be a review of tariffs on imported steel to keep prices competitive to local suppliers and build the competitive downstream sector. The DTI has protected monopolies like Arcelormittal South Africa (AMSA), driving up the local price of steel while the downstream sector has received no support, lost jobs and had to pass on price increases to consumers.

### 7. Comparative Advantage

Focusing on industries where we have competitive, comparative and absolute advantages. SA has a large resource base. The DA would focus on using this resource base to build a strong value chain in South Africa which could be used to export and use for local demand. South Africa needs to develop a skilled labour supply to grow into a globally competitive manufacturing hub focused on high-value added categories such as automotive, processed metals, industrial machinery and equipment, and chemicals. SA's high technology exports need to be a focus. A review will be conducted to look at gaps in the value chain for these strategic industries and how SA can develop them. With a multiplier of 10.5 jobs for every R1 million invested and output increase of R1.79 for every R1, agriculture and hence agri-processing will be a key priority area in incentives and incubation as one of the strategic industries.

### 8. Local Demand

Stimulate a greater demand for SA products by driving a 'Made in South Africa' campaign which will require the State, as the largest spender on goods and services, to show that no local bidder met the criteria before selecting a foreign supplier. This will be enforced through a 'purchasing audit' that each government department, sphere of government and entity will be audited by the Auditor General. They will also have to provide 'source of origin' certificates to indicate where the good originate from to stop 'fronting' through local companies simply importing goods. Recognising in this, that a local premium will have to be accepted for goods to be made in SA, up to a maximum of 20%. Exceptions will be made for special condition procurements. In this, the DA will ensure that South African Bureau of Standards (SABS) is funded and able to fully assess local content in manufactured goods sold to the state.

### 9. Incentives

Incentivising investment in manufacturing through sector specific manufacturing incentives (SSMI). These would be based on the ability to improve production efficiencies, lowering of manufacturing costs and ability to create new jobs. Reviewing current incentives programmes to make sure there is no administrative blockages and that it is efficient and effective in creating value. In this, DA would advocate unfreezing the budget for the Manufacturing Enhancement Programme. Lowering corporation taxes for manufactures to 15% conditional on re-investment in capacity to expand production, skills training and Corporate Social Investment (CSI).

### 10. Infrastructure

There is massive backlog in infrastructure development with the country's roads being overused and collapsing under the strain of transportation. The rail network can be improved through public-private partnerships that will unlock areas earmarked for manufacturing in the Special Economic Zones. In line with this, state capture has torpedoed the national rail build programme and a clean-up of these contracts as well as recoupment of overspend is needed urgently. Budgeted money needs to be ring fenced for specific infrastructure improvements especially amongst ports, terminals and manufacturing nodes. A railway indaba is required to discuss the future prospects and plans for rail in South Africa.

## Conclusion

In conclusion, the DA believes that the current suite of tools from the ANC including policies and legislation is extensively inadequate to address the economic challenges and infrastructure backlog required to stimulate sectors such as manufacturing and to stimulate jobs. The DA's proposal provide the basic building blocks required for all sectors to thrive. Manufacturing in particular has the capacity to be a job multiplier within our country and catapult the country to a new level of development. It is thus vital that the government applies the correct set of tools to encourage this sector.

In government the DA would implement the set of policies necessary to encourage investors and provide confidence in the long-term sustainability and security of their investment. In this, the DA would need to work hand in hand with the Department of Labour and Education to ensure co-operation and mutual realisation of growth in this sector with increased labour flexibility and skills development.

The DA would look to address the challenges faced by sectors such as manufacturing by focusing on growth in intra-regional trade, improving infrastructure, reducing visa requirements for skilled workers, increasing local content auditing, reducing red tape, adjusting tariffs/taxes and reviewing the high-technology value chain.

With these adjustments, the DA believe that SA can become a major hub for manufacturing across the continent.