

Déjà Vu?

The Department of Trade and
Industry's National Industrial
Policy Framework



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Peter Draper and
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7 Introductory note

Business Leadership South Africa (BLSA) commissioned Peter Draper and Phil Alves, as authoritative commentators on trade and industrial policy, to write a short critique of the National Industrial Policy Framework (NIPF) and its associated Implementation Action Plan (IPAP), released recently by the Department of Trade and Industry. BLSA believes that this paper makes an important contribution to the debate on issues central to South Africa's economic policy. However, since BLSA is not a mandated business body, the views contained in this paper are those of the authors, and should not be attributed to BLSA.

7 About the authors

Peter Draper is a research fellow of the South African Institute of International Affairs (SAIIA), and head of its Development Through Trade programme. His areas of expertise are trade and investment policy and trade negotiations, with particular reference to the World Trade Organisation; the Southern African region; and South Africa's bilateral ties with key trading partners. He has published widely on these subjects, and is an established trade policy commentator.

Phil Alves is an economist for SAIIA's Development Through Trade programme. His research interests include trade, productivity, and competitiveness; trade and technology; the WTO and global economic governance; South Africa's regional and bilateral trade agreements; and the political economy of international trade.

7 Executive summary

WHILE THE ECONOMIC and social imperatives that gave rise to the Department of Trade and Industry's National Industrial Policy Framework (NIPF) and its associated Implementation Action Plan (IPAP) are entirely legitimate, we believe these initiatives are inadequate in their present form. There are legitimate concerns over the policy directions charted, the capacity of the DTI and the government to implement them, and their possible impact on policy-making as well as the economy. Much could be gained by reducing the state's ambitions, incorporating effective transparency mechanisms in the DTI's policy planning processes, and underpinning those processes with a robust cost-benefit analysis. Given the absence of such trends in the DTI's thinking, as reflected in the NIPF and IPAP, we believe the government should rather continue to prioritise the Accelerated and Shared Growth Initiative for South Africa (AsgiSA), and focus on implementing it fully, rather than privilege the NIPF and IPAP.

7 Acronyms and abbreviations

AsgiSA	Accelerated and Shared Growth Initiative for South Africa
BPO&O	business process outsourcing and 'offshoring'
DTI	Department of Trade and Industry
EIEC	Economic, Investment and Employment Cluster
GEAR	Growth, Employment and Redistribution
IAP	Implementation Action Plan
KAP	Key Action Plans
MIDP	Motor Industry Development Programme
NIPF	National Industrial Policy Framework
WTO	World Trade Organisation

7 Main report

Background

ANALYSTS AND OTHERS have commented at length on the state's plans to play a more active role in the economy, as envisaged in the National Industrial Policy Framework (NIPF) and its associated Implementation Action Plan (IPAP) released by the Department of Trade and Industry (DTI) on 6 August 2007,¹ and many concerns have been raised. Is it wise for the state to intervene in the economy? Do the planned interventions focus on the right areas? Could greater state involvement in the economy not have some unfortunate unintended consequences? And is the state actually capable of playing this role?

The two documents need to be located in the broader context of the government's economic policy, both current and potential. Its most important current economic policy statement is the Accelerated and Shared Growth Initiative for South Africa (AsgiSA). This programme addresses 'cross-cutting' constraints on economic growth in South Africa, particularly those involving the availability, quality, and cost of economic infrastructure and 'priority skills'. It strongly emphasises improving the competitiveness of the economy, and building on the stability achieved via the government's prudent macroeconomic policies over the past 10 years, notably its Growth, Employment and Redistribution (GEAR) policy. It also provides for sector-specific interventions, and identifies three: business process outsourcing and offshoring; biofuels; and tourism. It makes a case for the development of more sector strategies in the context of an industrial policy framework to be produced (which has now occurred) by the DTI. Furthermore, this broad approach seems to have been endorsed by the team of economists at Harvard University advising the National Treasury and the Deputy President on AsgiSA's implementation.²

Pursuing a more active industrial policy is a long-standing goal of the left wing of the ruling tripartite alliance,³ and has been the subject of at least two recent position papers emanating from the ANC (2007) and COSATU (2006). Given the broader debate about leadership succession in the ANC, it is clear that industrial policy, or what passes for it, has become a key element of the struggle to define a post-Mbeki economic policy.

So what kind of policy thrust does the NIPF and its IPAP imply? In our view, these documents do not really enter uncharted territory, nor are they particularly alarming. For the most part they capture current and previously announced processes, and draw them together. Overall, they clearly

have a more interventionist thrust, in keeping with the ‘developmental state’ paradigm which the government now favours. This is confirmed by the select bibliography in the NIPF base document: all the academic sources cited fall in the ‘pro-industrial policy’ camp, and not one dissenting source is cited (and there are many).⁴ This apparent lack of objectivity by a key policy-making department is cause for concern, and manifests itself at various points in the document. Its intentions are clear even if the discourse is sometimes muddled.⁵

In the analysis that follows, we first examine the NIPF’s perspective on South Africa’s ‘development path’, which underpins the DTI’s case for greater state intervention in the economy via sector strategies. Next, we assess the document’s perspective on trade policy, which it presents as an extension of industrial policy. Next, we briefly assess the battery of sector-specific interventions proposed in the IPAP. Finally, we briefly assess some process issues at the heart of the NIPF’s implementation, including intra-government co-ordination and the capacity of key government departments.

The NIPF’s perspective on South Africa’s ‘development path’

The NIPF is underpinned by the DTI’s perceptions of the shortcomings of South Africa’s development trajectory. Briefly, the document argues that South Africa cannot continue to rely on commodity exports and hence, in line with newly industrialised countries in East Asia in particular, needs to diversify its economic structure and export basket. Manufacturing is identified as the key driver of diversification. This argument is broadly supported in the economics literature, with many economists arguing that only manufacturing has the potential to promote the economy-wide gains in productivity necessary to fuel higher rates of economic growth, and consequent diversification and employment. The document then sets out four ‘necessary conditions for industrialisation’:

- a stable and supportive macroeconomic and regulatory environment;
- skills and education for industrialisation;
- traditional and modern infrastructure; and
- innovation and technology.

Of these, the last three are appropriately specified, and the second and third are the particular focus of AsgiSA. The document then argues that an active industrial policy is required to promote diversification, and that this interventionist thrust should be supported by ‘appropriate’ macroeconomic and exchange rate policies. We regard this stance as a particular cause for concern.

The East Asian and other development experiences show that the most common and effective tool in the industrial policy-maker’s toolkit is exchange rate manipulation. If one can control the side-effects of an artificially weak currency, manufacturing exports will respond, as has happened all over East Asia – a lesson thoroughly absorbed by China’s leaders, for example. In the past the DTI has agitated for exchange rate targeting, a perspective endorsed by Dani Rodrik, one of the leading members of the Harvard team. However, what effect would this have on our

hard-won macroeconomic credibility? Can the South African Reserve Bank actually target a competitive exchange rate, given South Africa's relatively low levels of foreign exchange, its high levels of liquidity, and consequently its volatile currency? If it were to attempt this, the market consequences would probably be far-reaching. Therefore, we are concerned about the NIPF's assertions that our monetary policy needs to be brought in line with industrial policy. Fortunately, due to inflation targeting and inadequate foreign reserves, this option does not seem to be available at present.

Furthermore, some commodity exporters have done well, diversifying into services and/or agricultural processing – not necessarily manufacturing – on the basis of proceeds from resource exports reinvested in economy-wide productivity-enhancing areas. Assuming that the policy environment remains supportive, our commodity exports will continue to earn foreign exchange and contribute to economic growth and domestic employment for some time to come. However, as the NIPF rightly suggests, we need to manage the proceeds well and reinvest them in infrastructure, skills, and technology development. AsgiSA is the key policy platform that supports this objective.

Similarly, the document asserts that South Africa cannot rely on increased consumption to sustain its economic growth; hence the need to promote industrial diversification and exports. Clearly, consumption is a problem from an inflationary perspective, but it is not clear why it should inhibit industrial diversification, as more consumption means a growing domestic market. Our domestic market is too small to sustain import substitution, and we do need to export more to global markets. However, it turns out that the DTI's real problem with the consumption growth path lies in the corresponding increase in imports, or what the NIPF describes as 'import leakage' (DTI 2007b: 5). This terminology harks back to old import replacement ideologies, which are incompatible with a modern economy linked to the global trading system and aspiring to emulate East Asian economies based on the export of manufactured goods.

So what would it take to boost industrial development in South Africa? Our manufacturing sector operates under major constraints, many caused by inadequate or misguided state policies (in the telecoms and transport sectors in particular), but, more importantly and strategically, by our location in the global division of labour. This is where the document is weakest. As it points out, we are squeezed between rich countries (marked by high levels of control over advanced technologies) and 'Chindia' (marked by cheap and labour-intensive production). Yet the document says it will focus on 'low-skill, non-traditional, non-tradable' manufactures (see the Minister's overview), and try to move these sectors up the value chain. We don't know what this phrase really means, and wonder whether it contradicts the goal of breaking into global markets (after all, the sectors are 'non-tradable' by definition). Regardless, we don't see much scope for a massive expansion of manufactured exports, especially labour-intensive ones, given that South Africa is:

- far from major markets, and transport costs to them are very high (shouldn't we free up our airways, like Dubai, for instance?); and
- not plugged into global divisions of labour centred on multinational corporations, in which supply chain management and competition play a key role. Research into big South African

corporates' understanding of their supply chains reveals that we are well behind international norms (Barloworld Logistics (2006). We doubt that the DTI could play a useful role in this respect, but the NIPF's silence on this aspect of international competition is disturbing.

In addition, we have plenty of labour market challenges – including rigidities, low productivity, and skills shortages – that militate against travelling down this path. The NIPF is coy on this score, merely stating that the problem is complex. Yet some clothing retailers argue that the department is beholden to domestic trade unions in respect of Chinese clothing import quotas (see Bisseker 2007), although the reality is more complex.

Given all this, we are not sure that a sector focus is entirely appropriate. A company focus and a sectoral approach to identifying promising targets for support may be, but thereafter supply chain management and horizontal interventions as specified in AsgiSA are the keys to our development path.

The NIPF's perspective on trade policy

In the 1990s the government knew what it needed to do in respect of trade policy. The legacy of almost a century of protectionism, inward orientation, and apartheid policies had brought our brittle, diseased economy to the brink of ruin. It needed competition, in large doses, and the new ANC government did not fail on this score. The tariff regime was substantially liberalised, quantitative restrictions were eliminated, and the system of agricultural marketing controls dismantled. In short, the entire trade regime was overhauled. Much of this was done unilaterally, albeit in line with South Africa's obligations under the Uruguay Round of trade talks under the aegis of the World Trade Organisation (WTO).

While entrenched interests and gross productive and allocative inefficiencies have since been exposed, plenty of problems remain. The required adjustment has been slow, and in some instances very painful. And many now believe that our export performance has been inadequate, that the liberalisation of the 1990s has helped to generate our high current levels of unemployment, and that trade reform will not drive South Africa's economic miracle without the firm hand of government. This, in very crude terms, is why we are now standing at the foot of the industrial policy mountain.

A certain reading of history, which the NIPF document agrees with, argues that the selective, strategic, and temporary protection of certain industries or even specific companies – combined with clever incentives, creative financing, and strong cooperation between government and business – is the most important strategy employed by countries which 'caught up' during the 20th century. As noted earlier, this is a highly contested view. But regardless of the argument's historical or contemporary validity, it implies a specific role for trade policy.

The approach adopted by the NIPF is marked by three important assumptions. First, trade policy can only be an effective developmental tool if it is underpinned by a robust industrial policy.

That is, trade policy lacking direction from industrial policy is not 'strategic'. Second, tariff policy must serve the goal of improving 'non-traditional' export performance. Tariffs must therefore be decided on a sector-by-sector basis, 'dictated by the needs of imperatives of sector strategies' (*sic*). Third, tariff policy must increase effective rates of protection (protection of value addition) in the domestic economy. This means reducing tariffs on upstream inputs not produced in South Africa (including capital equipment), and treating downstream tariffs 'more carefully, particularly those that are strategic from an employment or value-addition perspective'.

These all suggest the same thing: the use of protection in 'strategic' ways (read, on a sectoral basis) to advance diversification and industrialisation, and presumably reduce 'import leakages'. This is reminiscent of India's (long since abandoned) post-independence approach to trade policy in terms of which the state maintained tight control over all tariffs, deciding the fortunes of each on the basis of a five-year 'development plan'. A crucial difference though is that South Africa starts from a relatively liberal (by developing country standards) trade regime, whereas India's tariffs were prohibitive.

One obvious cross-cutting challenge is our WTO tariff bindings, which are both low on average and often very close to the rates we currently apply at the border.⁶ Since we are not considering cancelling our WTO membership, we must accept that lack of 'wiggle room' is potentially a big problem, especially if the Doha Round of WTO negotiations deliver an actual outcome.⁷

But let us assume that we can do what we like with our tariffs. What would the wise approach be? Reviewing tariffs in terms of an effective-rates-of-protection calculus is rational in principle, especially in sectors competing against subsidised imports.⁸ But, in reality, conducting trade policy in this way has a mixed international record, as it is nearly impossible to get right. Tariff decisions aimed at protecting preferred parts of value chains are always based on analyses of current activity, which doesn't help at all if the aim is to foster growth in new activities. Besides, what is 'current' changes rapidly – just ask Indian telecommunications firms.

And there are obvious conflicts within value and supply chains between those who depend on imports to remain in business and hence prefer lower protection levels, and those who depend on domestic markets and therefore prefer more protection. Clothing and textiles are obvious 'candidates', and are two of the sectors targeted by the DTI. We all know that textiles are the principal upstream input for clothing, which is the main value-adding downstream activity, employs more low-skilled labour, and is less capital-intensive. How would one design a tariff structure to protect both simultaneously? The IPAP specifically calls for 'a review of input costs into the clothing sector'. But if textiles receive more protection, clothing manufacturers will be forced to accept higher costs, and any scheme rewarding clothing exporters with tariff rebates on imported inputs will erode the protection of textile manufacturers. Subsidies seem to be the only option (if liberalisation is off the table), but these are generally prohibited under WTO rules. Ultimately, those firms that are best organised and funded are likely to receive state backing that those that are not. The danger therefore is that the 'strategic trade policy' gives way to 'state capture' by rent-seeking firms.

Furthermore, local and international literature shows clearly that the trade liberalisation of the 1990s is providing important economy-wide benefits. Export performance and productivity have improved in a range of non-traditional industries – vital achievements in an economy that was isolated for a long time, and has re-entered a hostile global environment. Despite what one reads in the media about manufacturing, non-commodity exports have grown much faster than they did prior to 1994, implying that a good degree of diversification has taken place. Reduced trade protection has also been pro-poor, reducing the costs of basic consumption, and – contrary to conventional wisdom – has also been employment-neutral (Edwards and Lawrence 2006).

But no one has ever argued that this is a panacea. Efforts to overcome persisting market and government failures should be pursued aggressively. This includes a hard look at domestic issues such as an over-regulated and inefficient telecommunications sector, inefficient labour markets (including skills and health constraints), poor technology policy, unhealthy levels of industrial concentration, and so on. Arguably, much of this is already addressed in AsgiSA. Yet the prevailing ‘climate of ideas’ is pushing towards a more interventionist, less liberal approach to trade policy.

Proposed interventions: assessing the IPAP

The IPAP restates the government’s approach to industrial policy, noting past successes and current projects. The former include, in the DTI’s view, the Motor Industry Development Plan; the latter include tourism, and the chemicals, carbon, aluminium, and stainless steel industries. It then prioritises the government’s interventions based on which are ready for immediate implementation (the ‘low-hanging fruit’), and which must wait for further research and the completion of ‘self-discovery’ processes (see below). For all planned interventions, however, IPAP details Key Action Plans (KAPs) – lists of actions to be led generally by the DTI, and which identify the government departments and agencies that must be brought on board.

Immediate actions include:

- Fast-tracking the implementation of KAPs in four sector clusters:
 - capital/transport equipment and metal fabrication
 - automotives and components
 - chemicals, plastics fabrication, and pharmaceuticals
 - forestry, pulp and paper, and furniture
- Cross-cutting actions:
 - Designing and implementing an Industrial Upgrading Programme
 - Revising the range of industrial financing instruments available to government and its agencies
 - Reducing input costs through:
 - competition policy
 - reviewing import duties on intermediate inputs into manufacturing
- Improving organisation, co-ordination, and capacity in government.

IPAP then discusses the AsgiSA sector priorities not included in the four clusters, namely business process outsourcing and 'offshoring' (BPO&O); tourism; biofuels; clothing and textiles; diamond beneficiation and jewellery; agro-processing; film and television; and crafts.

Altogether this is an extremely broad focus, exposing the DTI to criticism over where exactly the government's priorities lie. It is also surprising, given that the IPAP document itself recognises that because the state faces capacity constraints, it must prioritise its interventions and be strategic in doing so. Indeed, Hausmann (another key member of the Harvard team) and Klinger (2006) observe the following:

The DTI's National Industrial Strategy identifies 14 priority sectors. The first point of note is that even though this strategy is prioritized in terms of sectors, the strategy is not highly focused at the product level, as 854 products out of a total of 1241 in the HS-4 digit system are targeted ... With almost 70% of export goods potentially targeted under this strategy, the first question is whether it is wise to omit the other 30% of products (p 34). ... What policy implications emerge from our analysis? In principle, the ideal approach would imply the adoption of a sector-neutral promotion strategy that is concentrated on overcoming market and government failures, wherever they may be, and would thus not choose specific sectors (p 44).

Moreover, the IPAP states that there are other sectors which require 'substantial sector strategy development and perspectives', including two huge ones: mining and minerals beneficiation; and information and communications technologies (ICT, including services and products). Can the government really intervene effectively in all these areas? Concerns over state capacity come to the fore here, and are discussed next.

Process issues

Most countries (perhaps all) offer the kinds of support (finance, technology, dedicated infrastructure, and training) the IPAP document talks about. So all the tools which the state (not just the DTI) has available to it do need to be better aligned, more disciplined, and more focused.

However, the notion of 'self-discovery' in terms of which the state, in collaboration with 'stakeholders', is meant to identify the obstacles to economic growth is problematic.⁹ While such a process would be in keeping with our history and traditions of social dialogue, it could also be open to abuse. Specifically, in areas where the state is weak in terms of capacity (as is the DTI), it is vulnerable to capture. For example, many people – the present authors included – worry that it has been captured by the multinational motor vehicle manufacturing companies, to the detriment of poor township commuters. What is to stop this from happening in other sectors?

At the very least, this points to the importance of introducing transparency mechanisms and sunset clauses into sector policies, along the lines of Australia's Productivity Commission. This would oblige the government to publicise requests by business for support, and introduce review mechanisms open to public scrutiny.¹⁰ More importantly, it would require the government

to conduct cost-benefit analyses before introducing any policy interventions – an approach seemingly lacking in the Motor Industry Development Programme (MIDP) review process.

Furthermore, if these sorts of interactions are mediated in preconceived sector ‘boxes’, what about promising emerging companies that don’t ‘belong’ to a given sector but may offer far greater potential from the standpoint of employment creation, forex earnings, and so on? In other words, there is a danger of exclusion, yet it is taxpayers’ money that is at stake, not the state’s as such. This concern is also voiced by Hausmann and Klinger (2006: 45), who argue that rather than targeting specific sectors and companies, the DTI should open a ‘general window’ of support and discipline it in terms of objective criteria and transparency processes as outlined above.

Finally, we have some questions about ‘co-ordination’. We don’t think anyone will disagree with this notion, or the urgent need for it. Duplication is a problem at many levels, and better co-ordination mechanisms are clearly needed. But should the private sector wait around until the state makes up its mind?

This points to the politics of the issue. Government departments the world over are notorious for protecting their turf. This means that a strong central actor with real authority is required to bang heads together and mediate these interests. In our view, the National Treasury is best placed to play this role.¹¹ Yet the IPAP document argues, not unreasonably, that such authority should reside in the Economic, Investment and Employment Cluster (EIEC). This cluster and others like it are at the heart of the Presidency’s attempt to co-ordinate the policy interventions of various government departments. But, given the nature of government, if the EIEC is given the role of driving the NIPF’s ambitious agenda, its recommendations will still be contested in cabinet. This is the reality of government everywhere; no bureaucrats or politicians like to have their prerogatives second-guessed, or taken away from them. Our concern is that so much is already riding on AsgiSA, with government capacity and co-ordination already recognised as a major constraint. The NIPF’s complex set of interventions, flawed in several respects as outlined above, will only add to the implementation problems of an already overstretched state.

Finally, it is not clear that a business-friendly view would emerge from such a process. The evolution of industrial policy in East Asia has been dominated by government–business interactions; however, our bureaucracy is ideologically more diffuse, which will probably make for more confusion and, possibly, paralysis. Unfortunately, if the clothing and textiles quota saga is anything to go by, our industrial policy is more likely to be driven by COSATU and the South African Communist Party, both of which have agitated for years for an interventionist approach.

Endnotes

- 1 Both these documents are available at www.thedti.gov.za/nipf/nipf.htm.
- 2 Their papers are available at www.cid.harvard.edu/cidwp.
- 3 We would argue that South Africa's industrial history is littered with examples of state intervention, from old-fashioned import substitution beginning in the 1920s; via the creation of 'strategic industries' in the 1950s to 1970s with major financial support from the Industrial Development Corporation and fiscus (tax incentives); to those approaches tried since 1994: clusters à la Michael Porter; Spatial Development Initiatives; innovation support via a proliferation of financial incentives; and sector-specific policies in the cases of the automotive and clothing/textiles sectors. Therefore, the NIPF does not start from scratch.
- 4 See, for example, Martin Wolfe's Economists' Forum in the *Financial Times*, available at <http://blogs.ft.com/wolfforum/2007/07/the-growth-of-n.html#comments>. He recently reviewed two books by two advocates of import substitution industrialisation and interventionist industrial strategy, one of whom, Professor Ha-Joon Chang of Cambridge University, served on the DTI's industrial policy advisory group. The ensuing debate is wide-ranging, robust, and intelligible to the lay person. Unfortunately, a subscription to the FT website is required.
- 5 The NIPF contains some terminological confusions; for example, finance is deemed to be a 'non-tradable' service and, given the expansion of South African banks into the continent and other emerging markets, we think this is not the case. But this is a minor point.
- 6 A tariff binding is a tariff ceiling; most countries apply actual tariffs lower than their permitted ceiling levels. The difference between the two is referred to as 'water in the tariff'.
- 7 South Africa (and its customs union partners) would have to make substantial cuts to actual tariffs under even the least ambitious scenario currently on the table. Hence the DTI is arguing – with some justification, given the presence within SACU of one least developed country (Lesotho) and three 'small, vulnerable economies' (Botswana, Namibia and Swaziland) – that SACU is a special case deserving unique treatment when it comes to industrial tariff reductions. WTO members may accept this argument.
- 8 Mainly in agriculture, but in principle one might also include imports from countries with significantly undervalued exchange rates, such as China. However, the latter is fiendishly difficult to measure, let alone prove, and there is no WTO precedent for it that we are aware of.
- 9 Interestingly, the NIPF uses the notion of 'self-discovery' in a very different way from the original Hausmann-Rodrik definition. In the former, government 'discovers', along with business and labour, all sorts of binding constraints, and the best sector-based policy approach to removing them. By contrast, Rodrik (2004) notes: 'Diversification of the productive structure requires "discovery" of an economy's cost structure – ie, discovery of which new activities can be produced at low enough cost to be profitable. Entrepreneurs must experiment with new product lines. They must tinker with technologies from established producers abroad and adapt them to local conditions. This is the process that Ricardo Hausmann and I called "self-discovery".'
- 10 By contrast, the Motor Industry Development Programme (MIDP) review has been conducted in secrecy, and has apparently been driven by consultants to the motor assemblers. To the extent that this is true, it raises serious questions about whose interests it is serving. See Flatters 2005.
- 11 Interestingly, an unnamed senior National Treasury official has been quoted as saying: 'The DTI can pretend to have an industrial policy, and we'll pretend to fund it' (Joffe 2007).

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