PARLIAMENT
OF THE REPUBLIC OF SOUTH AFRICA

The costs and outcomes of industrial development initiatives 1994/95 -2014/15

Executive summary

Parliamentary Budget Office

August 2016

The Parliamentary Budget Office (PBO) has been established in terms of the Money Bills Amendment Procedure and Related Matters Act, 2009 (Act no. 9 of 2009). The PBO provides independent, objective and professional advice and analysis to Parliament on matters related to the budget and other money bills. The PBO supports the implementation of the Act by undertaking research and analysis for the finance and appropriations committees.

This report has been compiled in response to a request from the Chairperson of the Standing Committee on Appropriations in Parliament. The Committee asked the PBO to investigate the costs and outcomes of industrial development initiatives. The final terms of reference also included the Select Committee on Appropriations and the Portfolio Committee on Trade and Industry.

Please note that this is an executive summary of the full report. For a more detailed analysis including data, methodology, limitations and references, please refer to the full report.

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1 Introduction

South Africa has actively attempted since 1994 to promote industrial development through a range of policies and programmes covering numerous sectors. These policies and programmes entail the allocation of limited state resources for particular ends. As these resources could have been used to promote other social and economic objectives, it is important to evaluate the efficiency and effectiveness of the programmes and policies. This is especially important in the context of National Treasury imposing spending ceilings to reduce the budget deficit, resulting in fewer resources available to fund competing priorities.

This report estimates the direct financial costs of the state's industrial policy initiatives since 1994. These costs are compared to a range of economic outcomes for the economy. It is not possible to attribute the specific outcomes in terms of investment, job creation or growth to specific policies and incentives, as there are a range of factors affecting the performance of the economy. It is nonetheless useful to compare outcomes and performance of the targeted sectors relative to the opportunity cost.

Given the allocation of public resources to fund a range of programmes, it is important for the legislature to determine:

1. If the outcomes of the programmes have met their stated objectives – programme effectiveness
2. The cost of the programmes relative to outcomes – programme efficiency

Determining this will allow the legislature to decide:

1. If the programme should continue, or have its scale altered
2. If the objectives of a particular programme can be realised through less costly (more efficient) means
3. If an alternate programme should be funded instead, allowing for better prioritisation

South Africa's approach to industrial development since 1994

With the transition to democracy, South Africa developed and implemented numerous policies directed at increasing growth, development, and creating employment. The objectives of these policies have been varied, and have included growth, employment, small business promotion, empowerment, regional and spatial development, and export promotion. Table 1 in the full report summarises the key industrial policies – or broader growth policies with industrial policy components – implemented since 1994:

2 Resources dedicated to industrial development initiatives

Total expenditure on industrial development initiatives consist of direct expenditure that is allocated in the budget and fiscal revenues foregone due to tax incentives.

Expenditure

South Africa directly spent R84.3 billion (nominal Rands)[1] on industrial support and development initiatives between 1994/95 and 2014/15. Three sectors account for more than half this spending. **The manufacturing sector received the largest share of this allocation, receiving R32.1 billion (38%) over the 21 year period.**

Significant expenditure was allocated to a range of other sector-specific initiatives including, business process outsourcing, film production, agriculture and tourism. This totalled R17.8 billion, about 21 per cent of total expenditure.

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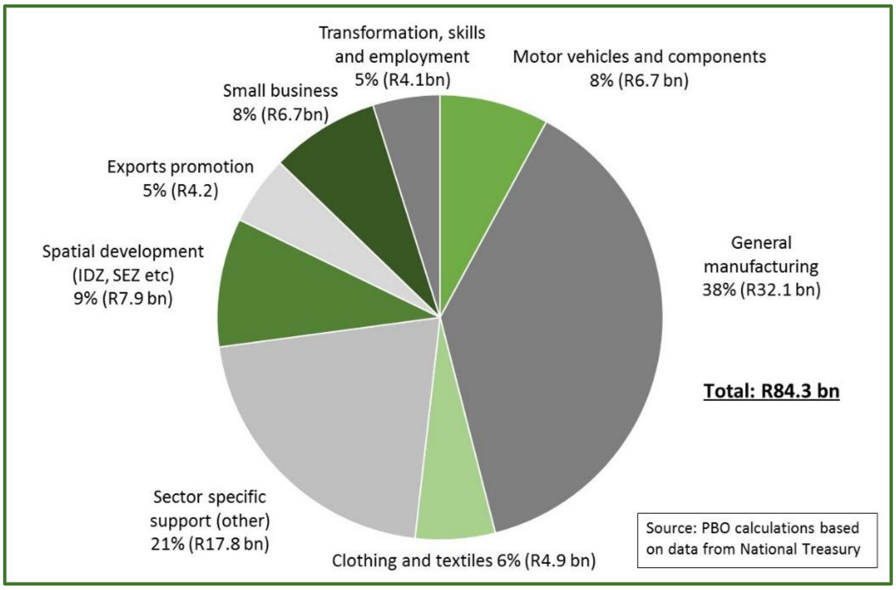
[1] This report includes Rand amounts in both nominal and real terms. Nominal figures are the Rand amounts reported at a specific period in time. Real figures reflect Rand amounts from different periods in time expressed in the Rand value of a specific point in time (e.g. fiscal year 2015/16), this allows for comparison across time. . It does this using a fiscal-year GDP deflator.

The average share of the main budget dedicated to industrial development increased from an average of 0.5 per cent between 1994/95 – 2004/05, to over 0.9 per cent since 2005/06. This increase is, in part, due to the increased focus and funding for industrial policy since the launch of the DTI's National Industrial Policy Framework in 2007, and the subsequent Industrial Policy Action Plans (IPAPs). Similarly, support for small business development has also grown strongly from around 2007.

Expressed in constant prices in 2015/16 Rands, South Africa dedicated R122 billion of expenditure to industrial development initiatives from 1994/95 to 2014/15. This amounts to 9.8 per cent of the 2015/16 budget.

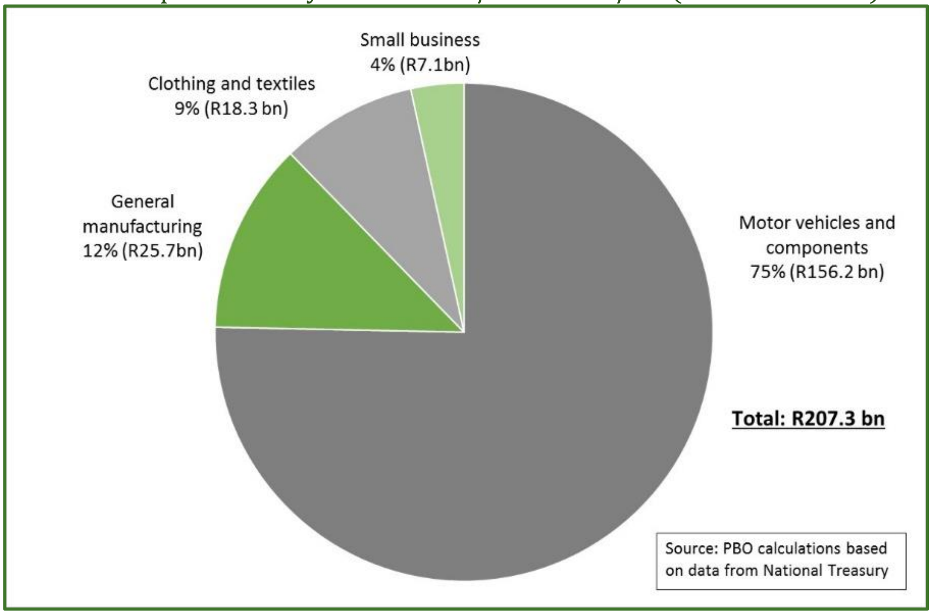
Figure 1: Total expenditure by sector/function 1994/95 – 2014/15 (nominal Rands)



Tax expenditure

In contrast to on-budget expenditure, **tax expenditure incurred by government is dedicated to only a few sectors, namely motor vehicles, manufacturing, clothing and textiles, and small business**. Tax expenditure incurred for industrial development purposes between 1994/95 to 2014/16 amounted to R207.3 billion. **Expressed in constant prices in 2015/16 Rands, South Africa incurred R393.15 billion of tax expenditure to support industrial development initiatives. This amounts to 36.8 per cent of tax revenue in 2015/16.**

Figure 2: Total tax expenditure by sector 1994/95 – 2014/15 (nominal Rands)



Total resources dedicated

Adding direct expenditure and tax expenditure presents an estimate of the total resources dedicated to industrial development. **Since 1994 South Africa has dedicated R291.73 billion to industrial policy initiatives.** Expressed in 2015/16 Rands, South Africa dedicated R476.65 billion to support industrial development initiatives. **This amounts to 36.8 per cent of tax revenue in 2015/16.**

On-budget support for industrial development only represents about 29 per cent of resources dedicated to industrial development. The larger share of support for industrial development is from tax expenditure (71%). However, in recent years the share of support of expenditure has increased relative to tax expenditure. This is, in part due to the NIPF.

Manufacturing

The manufacturing sector has been a consistent focus of South African industrial and economic policy pre and post 1994. There have been several programmes, policies, initiatives and incentives directed towards the development of this sector.

During the period 1994 – 2015 South Africa dedicated R85 billion in 2015/16 Rands for the promotion and development of the manufacturing sector. About 60 per cent of this was through expenditure and about 40 per cent through tax expenditure.

The manufacturing sector has grown considerably since the transition to democracy in 1994. The sector is now 1.6 times the size it was in 1994. The sector's contribution to GDP averaged around 15 per cent between 1994 and 2008. Since 2008, the sectors contribution to GDP declined, and now averages around 13.5 per cent of GDP. This indicates that the sector has grown slower than the economy since the 2008 financial crisis.

Manufacturing exports have performed particularly well since South Africa's reintroduction into the global economy in 1994. It took the country less than six years to double its volume of manufacturing exports. This suggests the success of the country's policies to ensure successful reintegration into the global economy. Manufacturing exports fell by over 25 per cent between 2008 and 2009 as the effects of global financial crisis reduced demand. It has taken over five years for manufacturing exports to return to pre-financial crisis levels. **Manufacturing exports have grown from under 30 per cent of total exports in 1994 to about 65 per cent today. This reflects both an increase in the volume of exports, as well as the shift in the composition of exports - higher value goods.**

Employment in the manufacturing sector has been in consistent decline since the transition to democracy. The sector used to employ 1.43 million people in 1994 – 14 per cent of total formal employment. This fell to about 1.1 by 2014 – 10 per cent of total formal employment. With employment creation as a stated objective of several of the manufacturing-oriented programmes and incentives, it should be noted that the sector has become less reliant on labour. Despite consistent increases to manufacturing output and exports since 1994, the sector has in fact decreased its employment levels.

Motor vehicles sector

Following the transition to democracy in 1994, the motor industry needed to adjust to the liberalisation of the domestic market. In 1995 South Africa introduced the Motor Industry Development Programme (MIDP). The MIDP was a set of incentives and subsidies targeting the South African automotive sector. It later was modified and extended on several occasions. In 2012 it was replaced by the Automotive Production and Development Programme (APDP).

The automotive sector has received about R324.2 billion in 2015/16 Rands in government support over the period 1994/95 – 2014/15 through both the MIDP and APDP. This accounts for about 60 per cent of the total industrial support covered in this report. This is in part due to the limited role of industrial policy in the first decade of democracy.

The significantly larger share dedicated to the sector has been in the form of tax expenditure. Of the R316 billion of revenue foregone by government, 52 per cent has been via the duty free allowance and 46 per cent through import duty credit certificates. Both were incentives under the MIDP.

The South African automotive sector has grown steadily since 1994, but has become less labour-intensive. The latest data suggests that growth may have stagnated. This is in part due to the poor and uneven global recovery following the financial crisis. **The industry is approximately two and a half times the size of what it was in 1994 when measured by its gross value-add.**

Clothing and textiles sector

Government support for the clothing and textiles sector has amounted to at least R40.8 billion in 2015/16 Rands over the period 1994/95 – 2014/15. This accounts for 7.3 per cent of overall industrial support expenditure covered in this report. While the sector receives a relatively small proportion of overall government support, it is not insignificant. Over the period, the clothing and textiles sector has received the third highest financial support from government on a sector basis.

Tax expenditure accounts for 86 per cent of the total support for the sector. The remaining 14 per cent is made up of the Clothing and Textile Production Incentive Programme (8.8%) and the Clothing and Textile Competitiveness Improvement Programme (5.1%).

The trend analysis suggests that other factors may have played a larger role in the real growth in sector output rather than the introduction and uptake of incentives. This can be inferred from comparing the growth trends in the sector with the introduction of various incentives. **It should however be noted that it is often difficult to precisely measure the impact on growth of a particular incentive.** It would therefore be inaccurate to make definitive statements regarding the efficacy of the sector's incentives based exclusively on the above trend analysis.