

**BUSINESS SOUTH AFRICA RESPONSE TO THE  
DEPARTMENT OF TRADE AND INDUSTRY  
DOCUMENT ENTITLED:**

*“ACCELERATING GROWTH AND DEVELOPMENT: THE  
CONTRIBUTION OF AN INTEGRATED MANUFACTURING  
STRATEGY”*

**PRESENTATION TO THE TRADE AND INDUSTRY  
PORTFOLIO COMMITTEE AND SELECT COMMITTEE  
ON ECONOMIC & FOREIGN AFFAIRS, 25 APRIL 2002**



# SOUTH AFRICA STANDS AT A *CRITICAL ECONOMIC THRESHOLD*

The economic growth trajectory of the economy needs to be raised to a significantly higher level through a massive expansion in the growth of economic opportunity and investment.

Failure to raise the growth trajectory from the current 2.5% per annum rate, given South Africa's 7.8 million unemployed people, may result in the likelihood of social and political turmoil in South Africa in the future.

BSA rejects the latter scenario as unacceptable. But we must understand the dangers of not raising the economic growth trajectory.



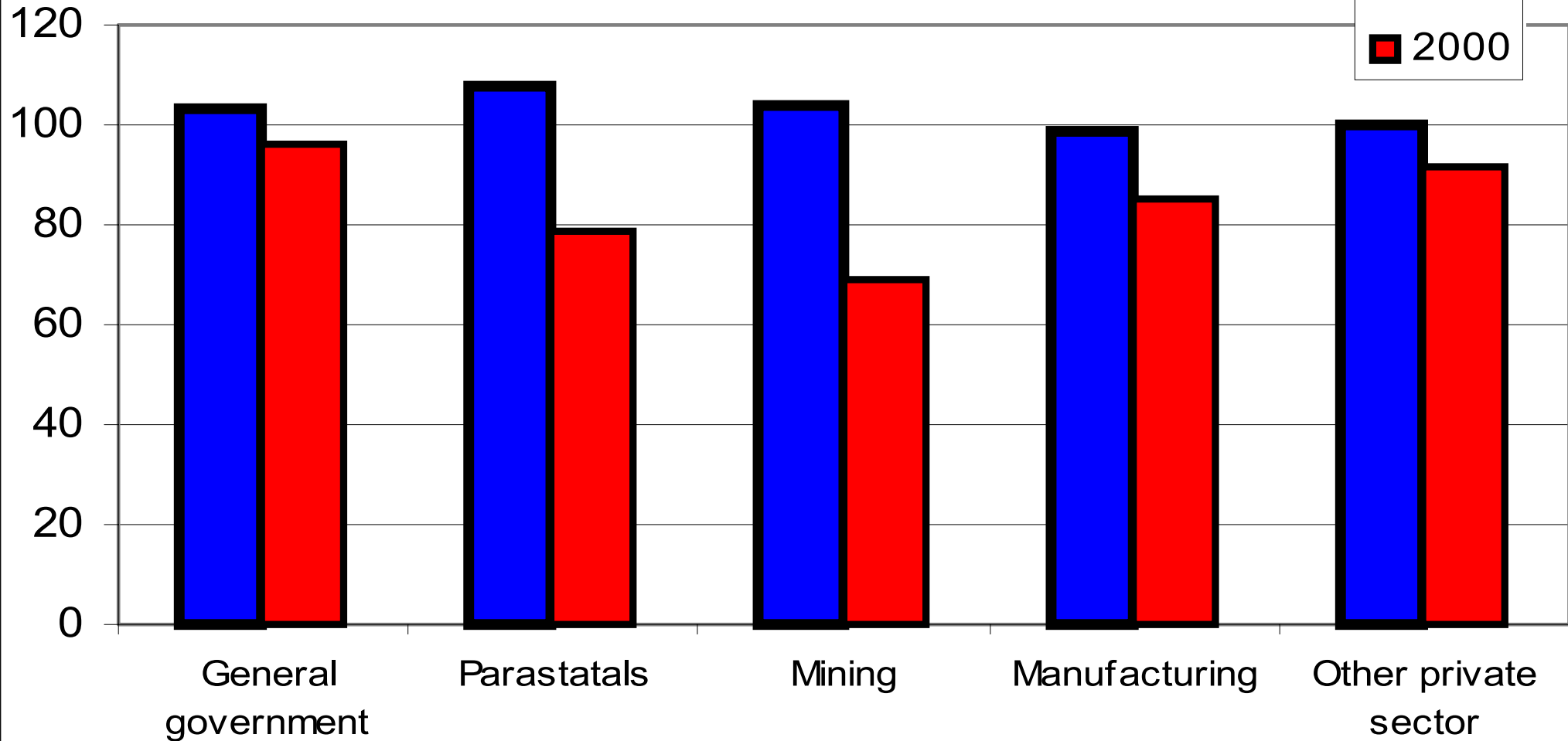
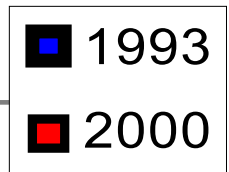
# **SOUTH AFRICA'S ECONOMIC PERFORMANCE:**

- Yes good progress has been made in stabilising the macro-economy, reducing inflation, reducing the budget deficit, stabilising the fiscal situation, relaxing exchange controls and liberalising international trade.
- But, South Africa's investment and growth rates remain far too low to tackle high unemployment and living standards.

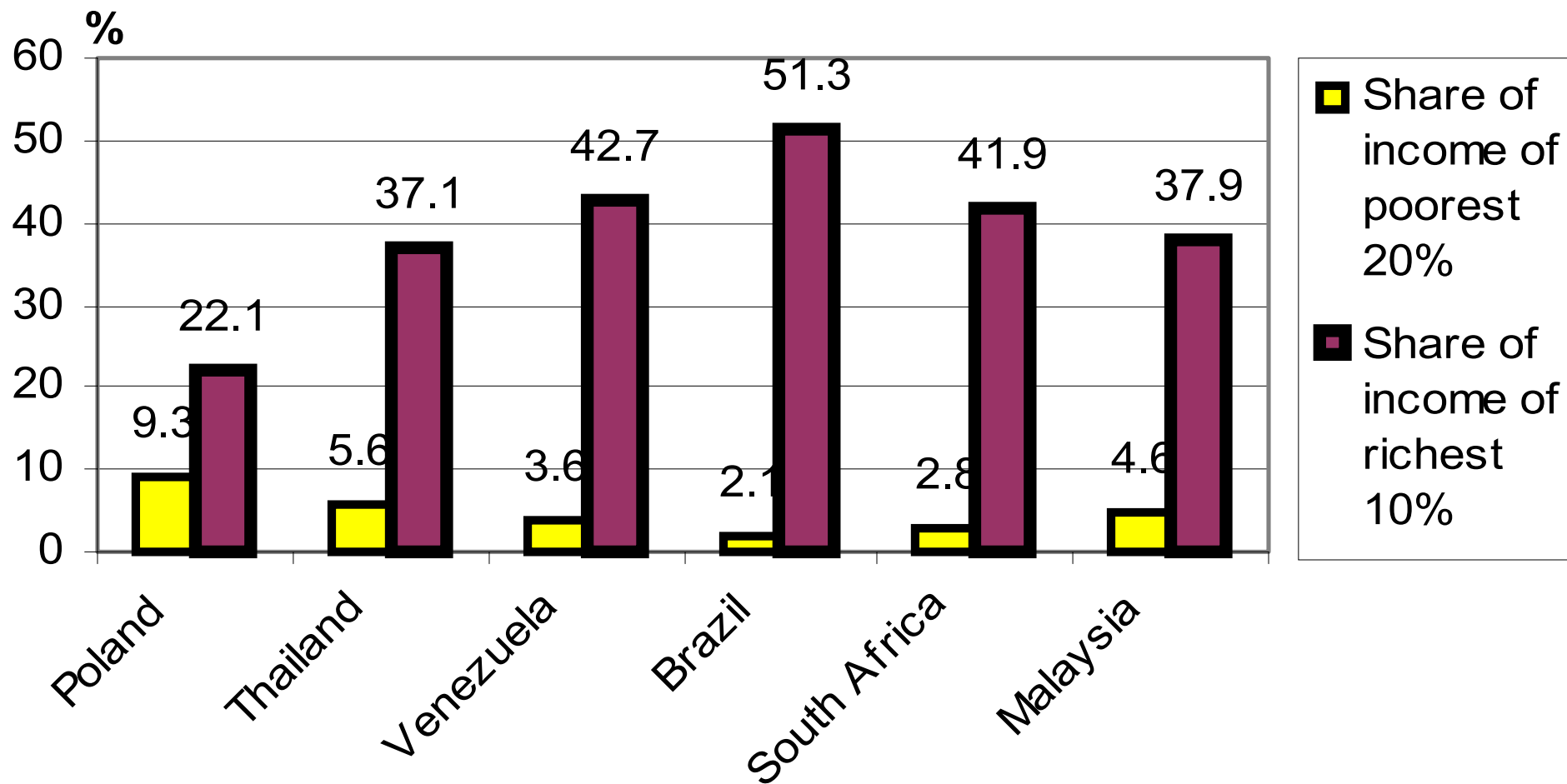


# Non-agricultural employment, 1993 and 2000 (1995=100)

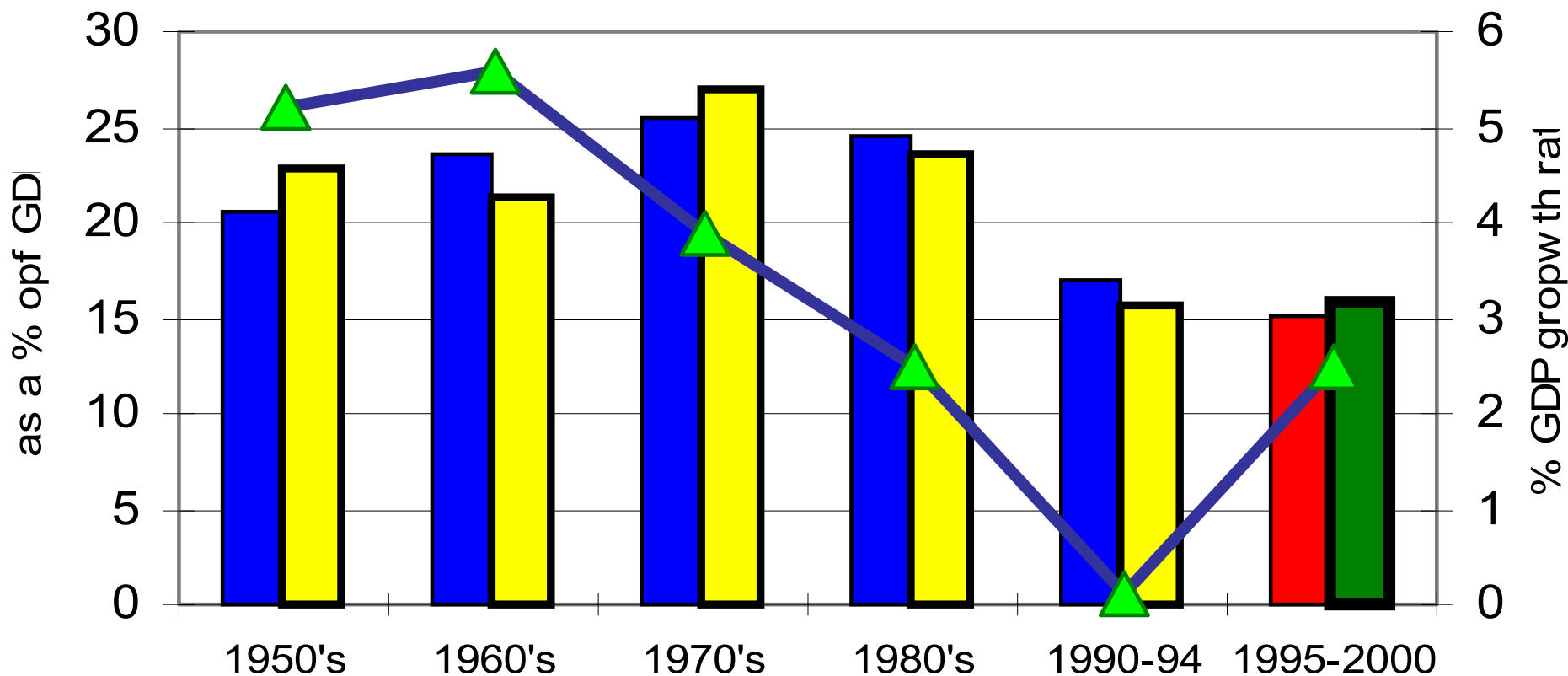
1995=100



# Comparison of the share of income for poor households and rich households



# South Africa, savings and gross fixed capital formation to GDP ratios and GDP growth rates for the decades 1950 to present



■ GDS/GDP   
 ■ GFCF/GDP   
 ▲ Real GDP growth

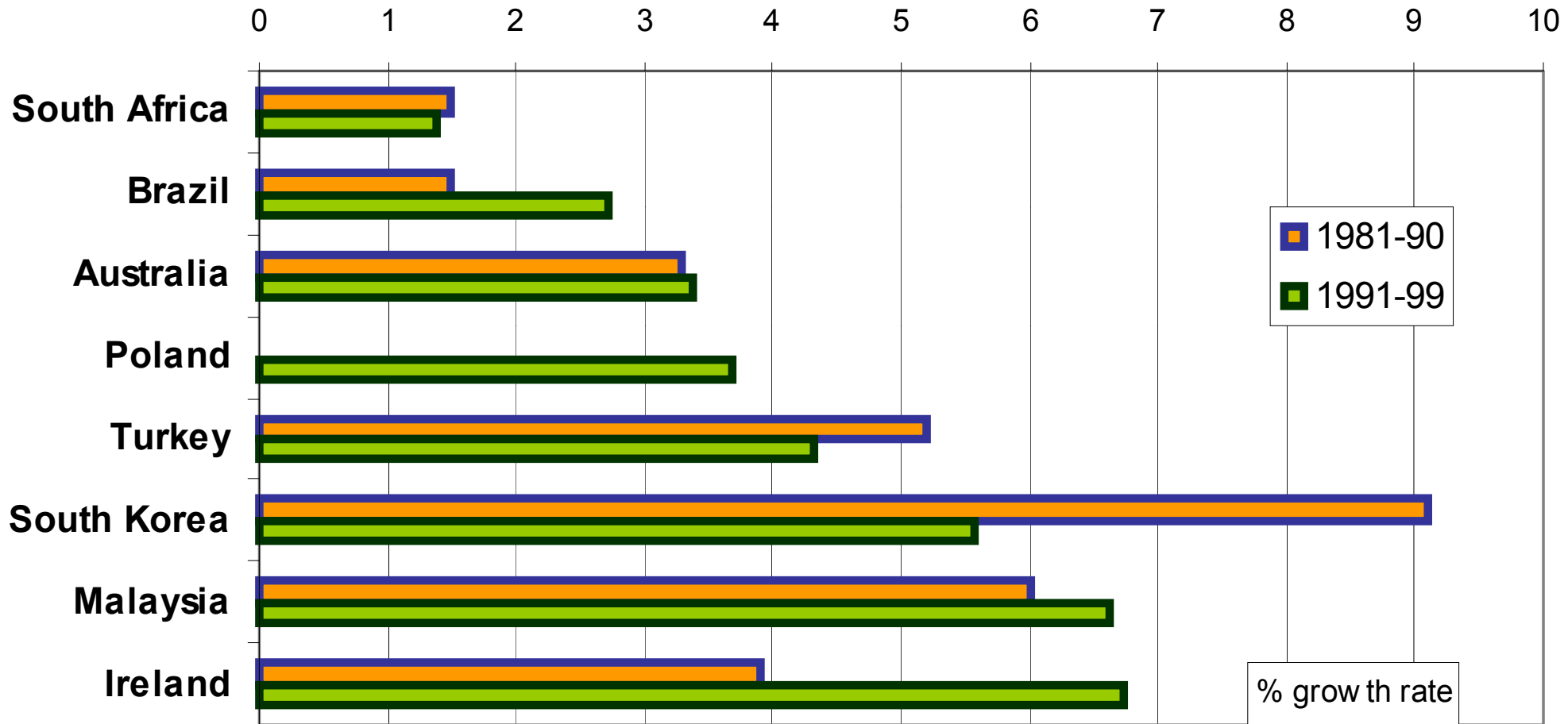


# **SOUTH AFRICA'S ECONOMIC PERFORMANCE RELATIVE TO COMPETITORS:**

- Low economic growth rates.
- Low savings and investment rates.
- Little foreign direct investment.
- High unemployment.

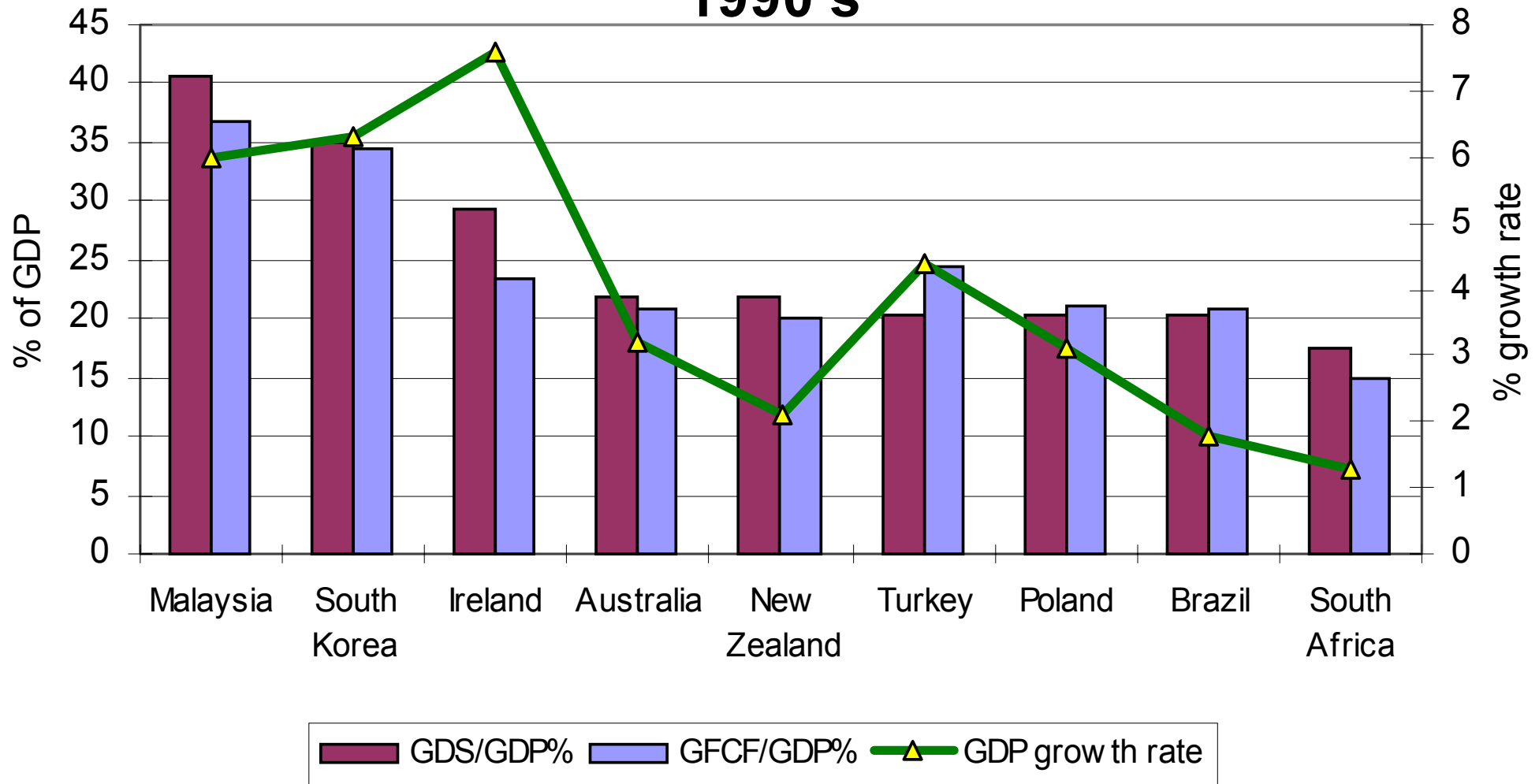


# Economic growth rates in key developed and emerging market economies, average 1981-90 and 1991-99



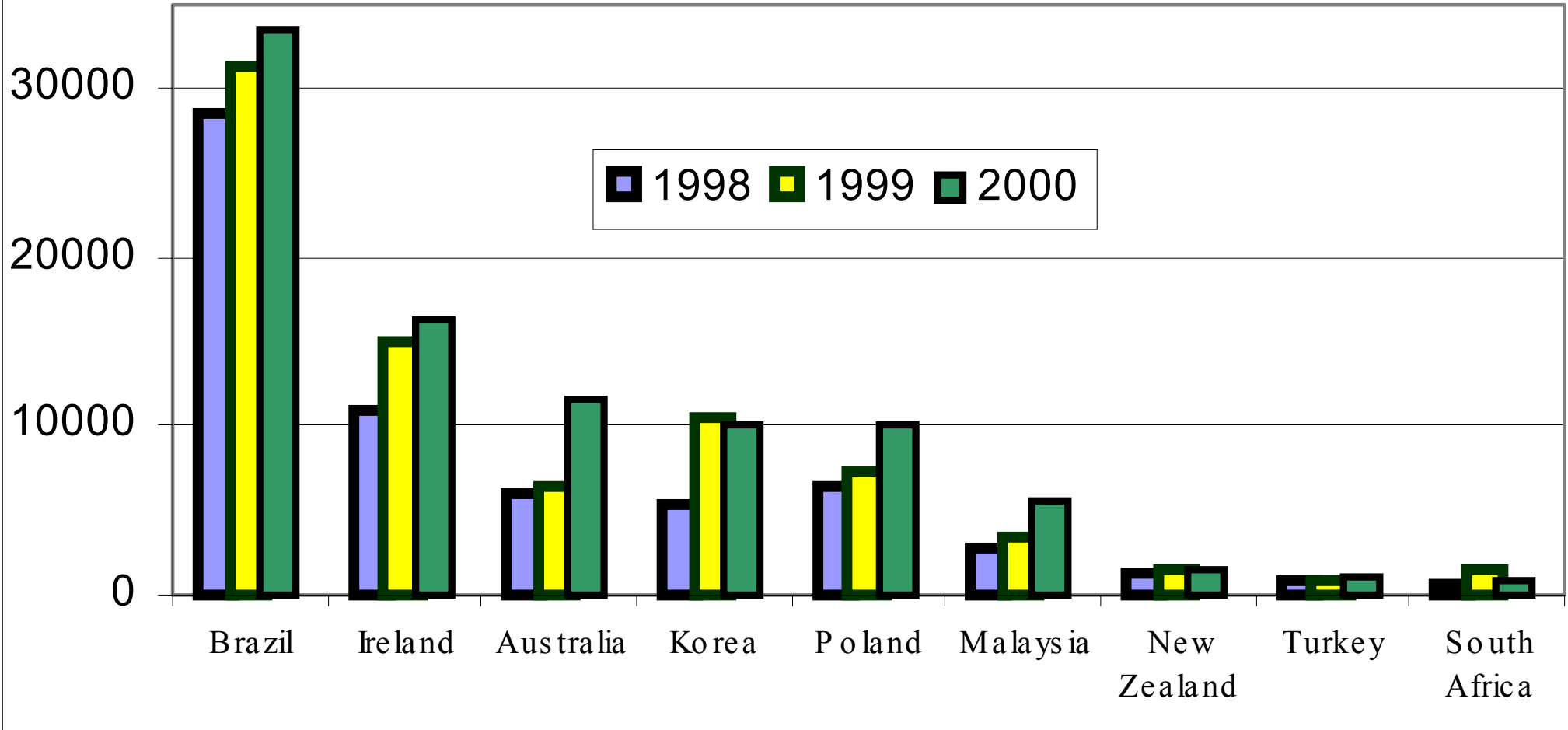


# Gross domestic savings and capital formation rates as a % of GDP for the decade of the 1990's

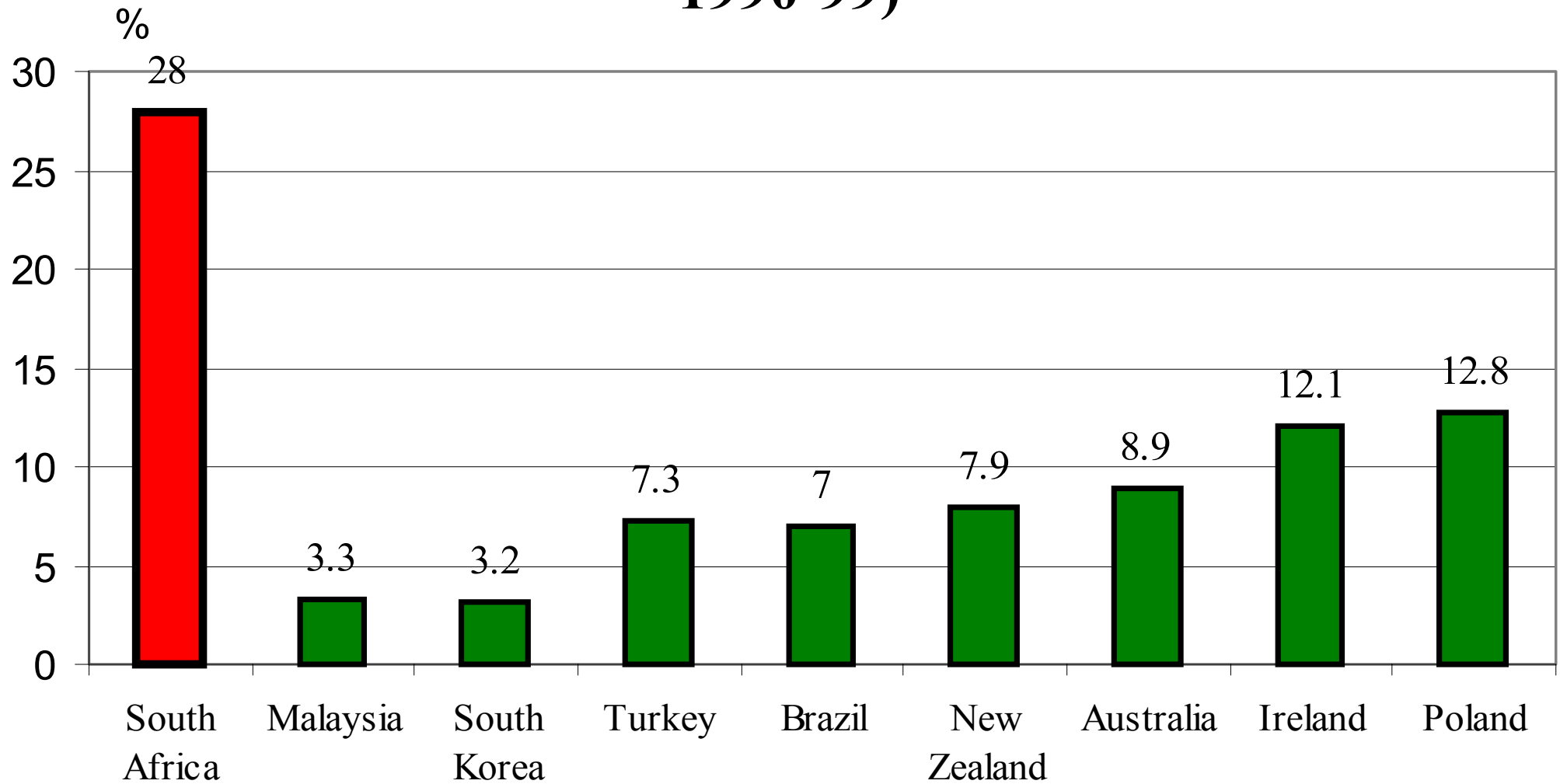


# Foreign direct investment into key emerging and developed economies, 1998-2000

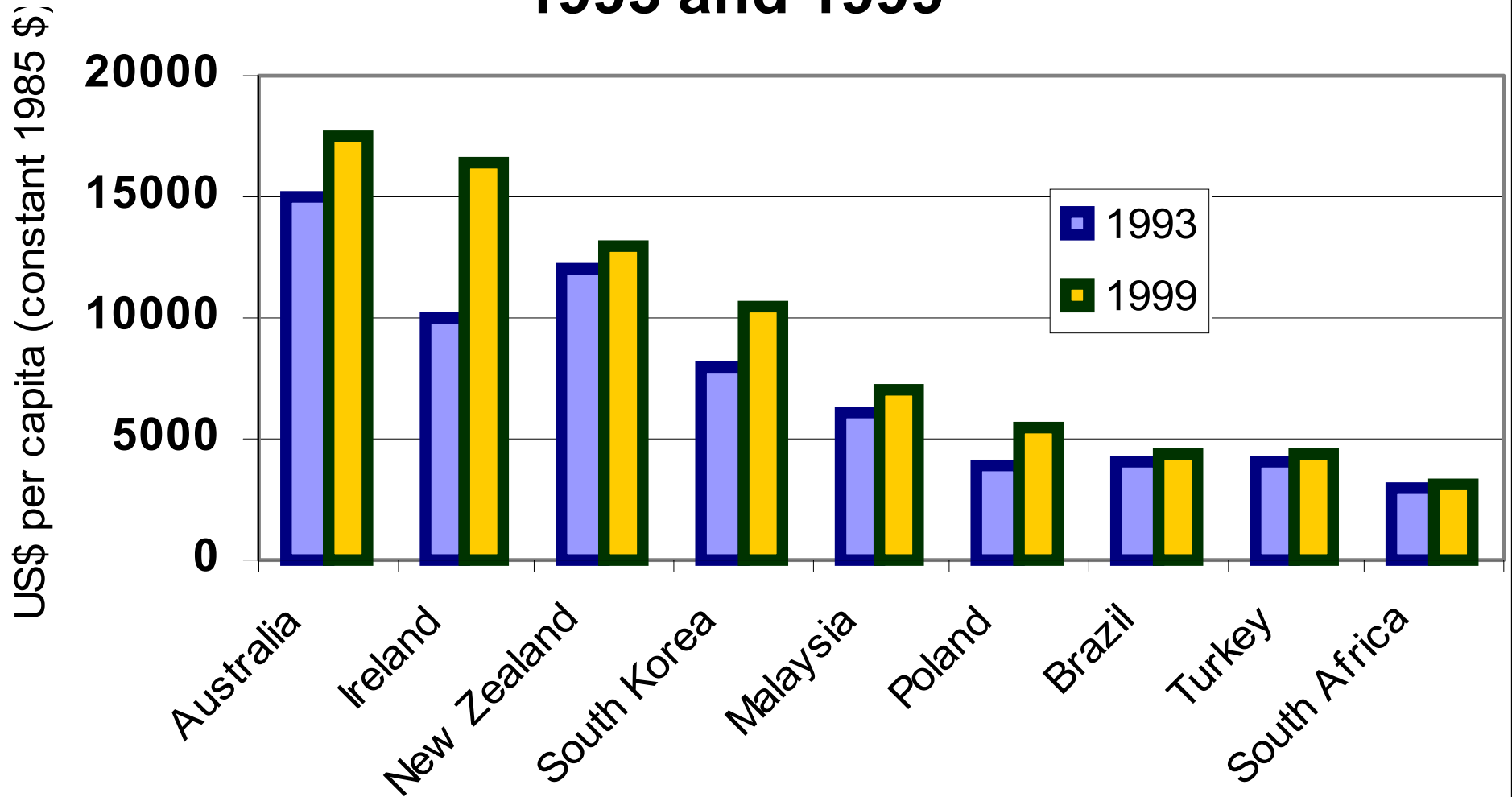
US\$ mns



# Unemployment (as a % of labour force average 1990-99)



# Real GDP per capita in 1985 US\$ terms, 1993 and 1999



# **SOUTH AFRICA NEEDS TO RAISE THE ECONOMIC GROWTH TRAJECTORY TO A HIGHER LEVEL THROUGH:**

- A massive expansion in the growth of economic opportunity and investment.
- A massive expansion in the skills base of the broad population to ensure all people participate in the growth of opportunity.



**In general, for an economy at South Africa's stage of development the key driver of economic growth will be supply-side investment.**

- That fuels an export boom.
- Raises employment and disposable incomes.
- That allows steady growth in the size of the domestic market.
- That encourages foreign participation in our economy (FDI and portfolio investment).



# THE CRITICAL LITMUS TEST FOR THE INTEGRATED MANUFACTURING STRATEGY:

- Does the IMS address issues which affect investment decisions at the firm level?
- Does the IMS contribute to the debate on building capacity for all South Africans to participate in the economy?



# GENERAL COMMENT:

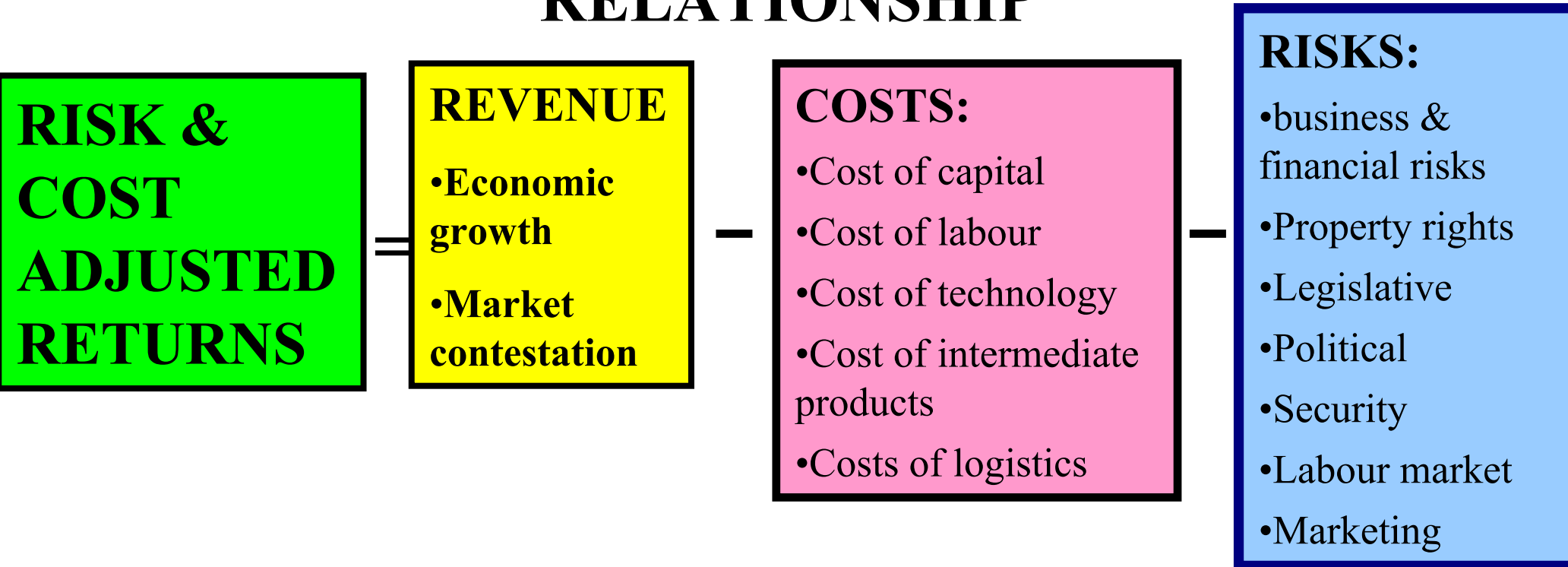
## What factors drive investment?

- The availability of investment projects (which are currently closed in the telecom, energy, rail, port arenas!)
- The size of the domestic market and access to other markets.
- The availability of the factors of production (skills, capital) at world competitive prices.
- Ultimately investment decisions are driven by risk and cost adjusted rates of return criteria.
- If the costs and risks of investing in South Africa are too high – investment will not take place





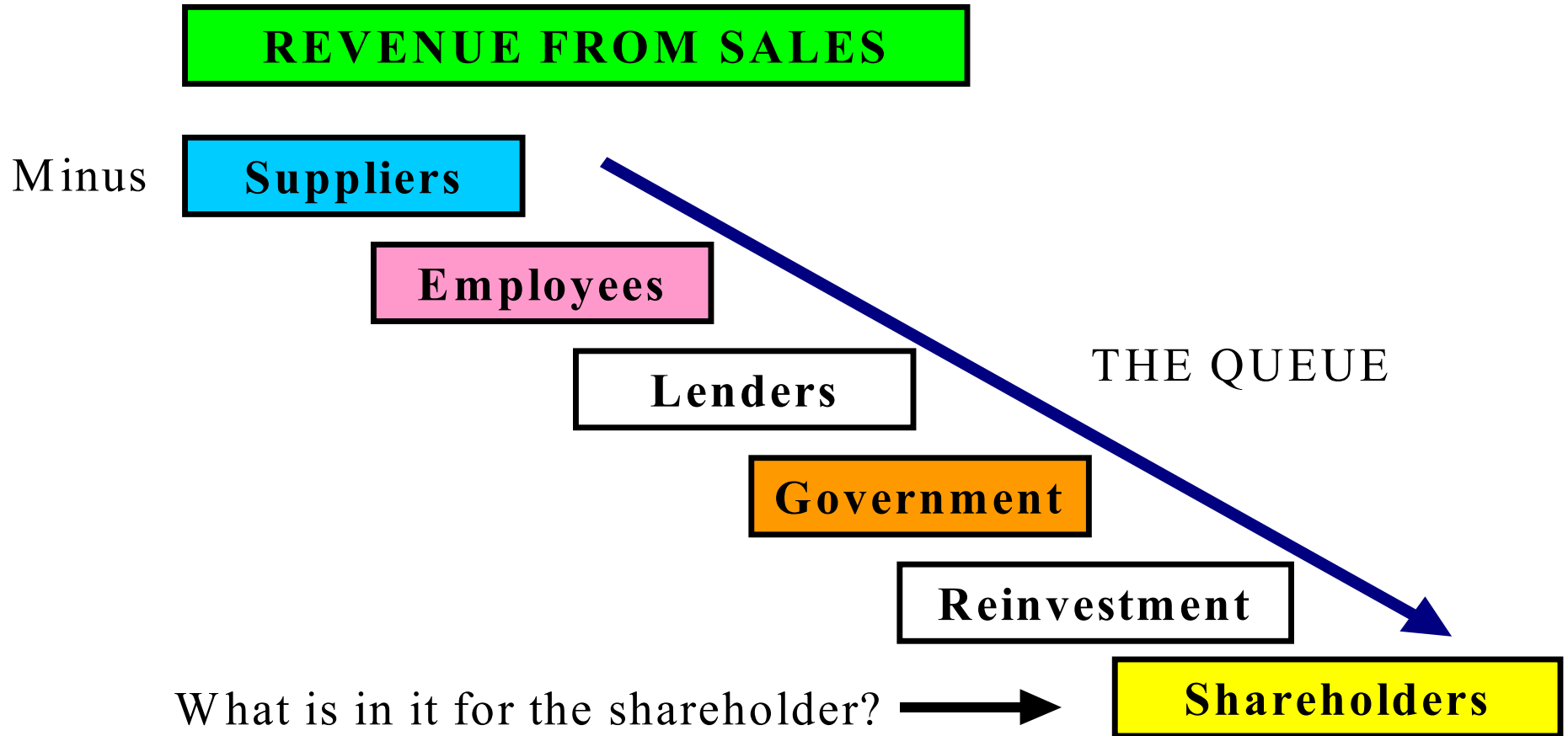
# INVESTMENT DECISIONS ARE DRIVEN BY THE RISK AND COST ADJUSTED RATE OF RETURN RELATIONSHIP



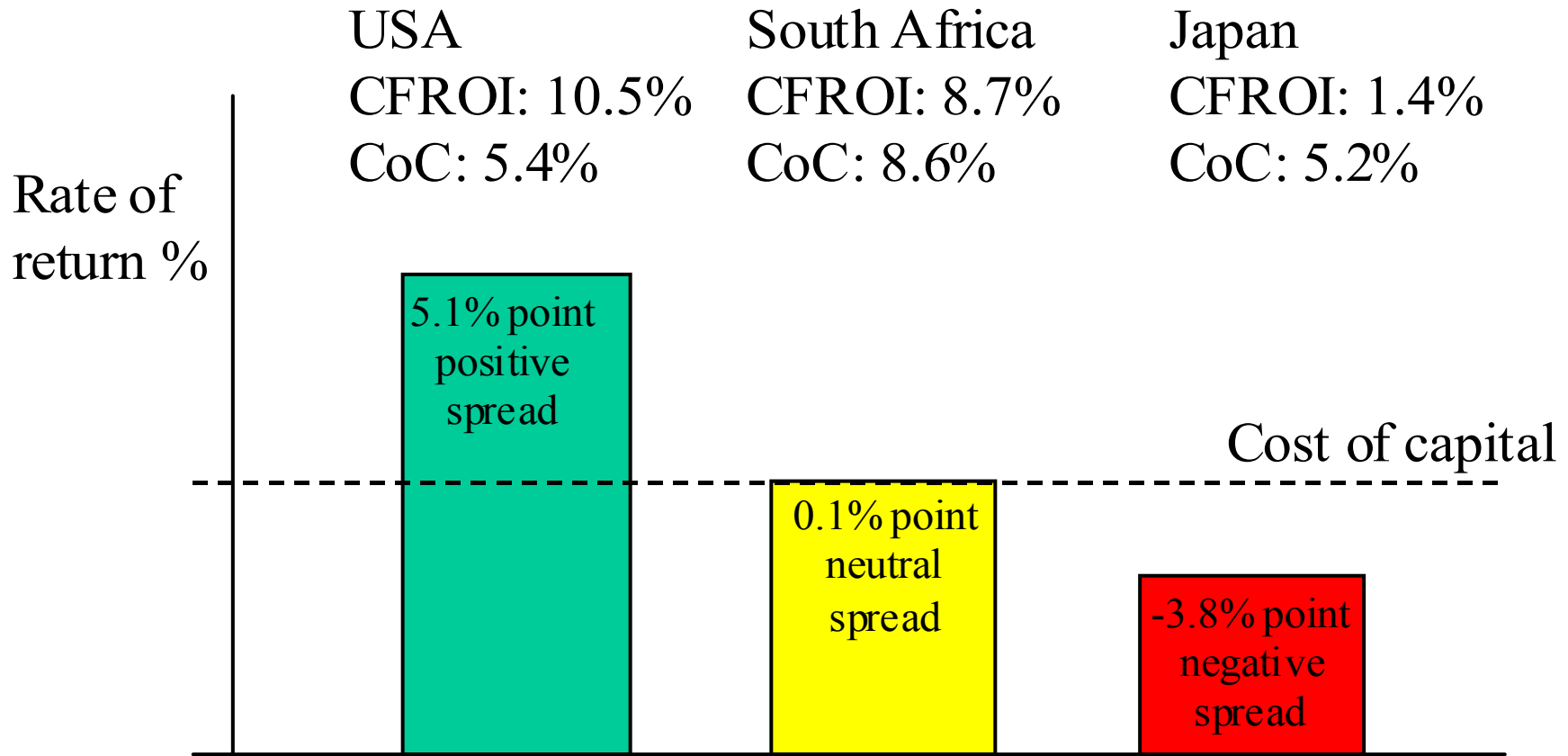
The investment hurdle rate = rate of return required by an investor after covering the risks and costs of a project over the long-term.



# THE CASH RECEIPT QUEUE, WHAT IS IN IT FOR THE INVESTOR?



# EVALUATING INVESTMENT DESTINATIONS



## Comments:

Excellent risk & cost adjusted rate of return which will encourage expansion and further investment

Neutral risk & cost adjusted rate of return which results in a focus on cost cutting and minimal investment

Negative risk & cost adjusted rate of return which will result in severe restructuring and disinvestment

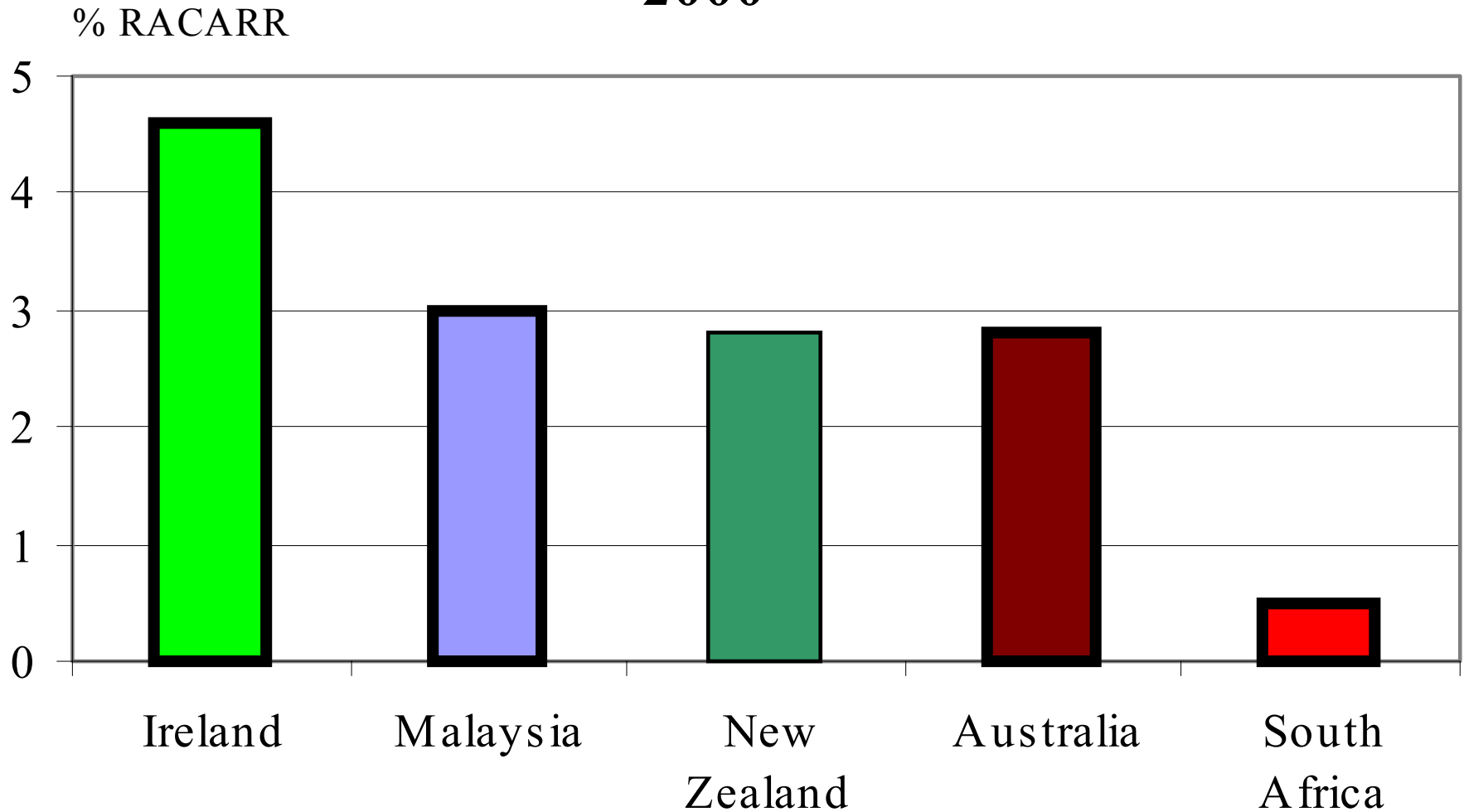


# HOW DOES SOUTH AFRICA PERFORM ON THE COST/RISK SIDE OF THE INVESTMENT EQUATION?

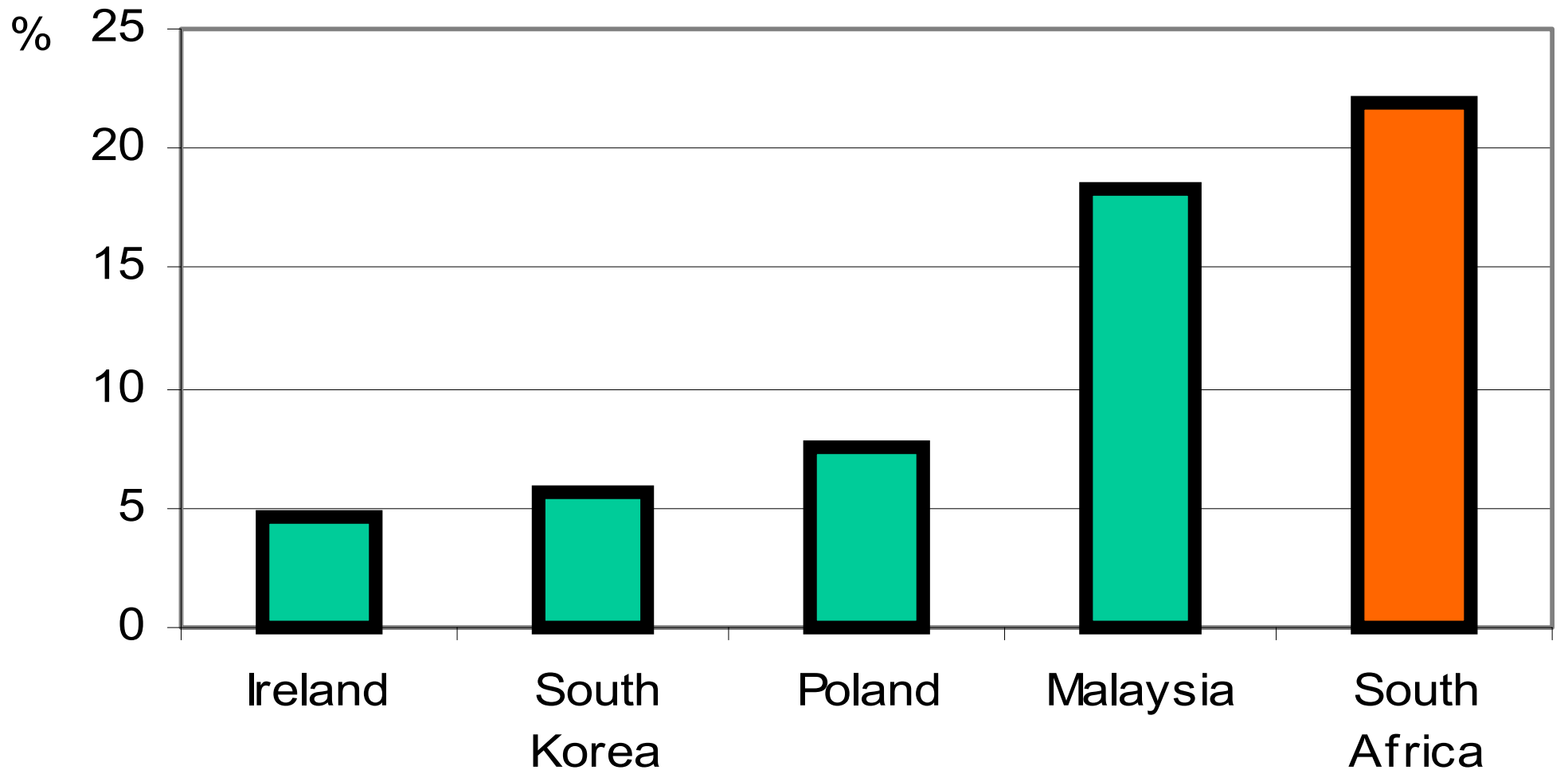
- The real cost of capital is too high (interest rates, tax rates, currency volatility).
- The cost of labour per unit of output is very high (apartheid education, labour laws, poor management practices).
- The costs of logistics are too high (the lack of competition in service provision results in high prices which disadvantage exporters).



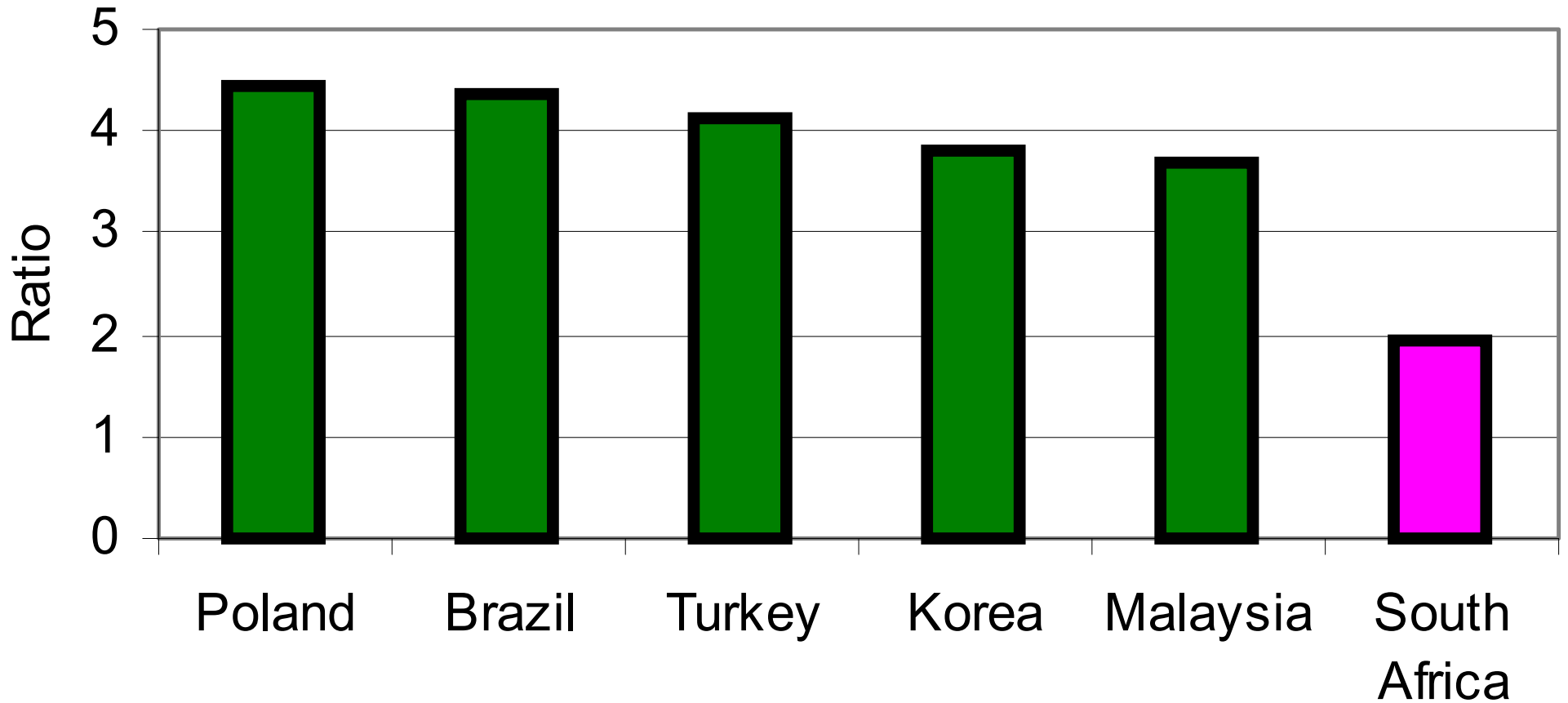
# Real cost and risk adjusted rates of return for 2000



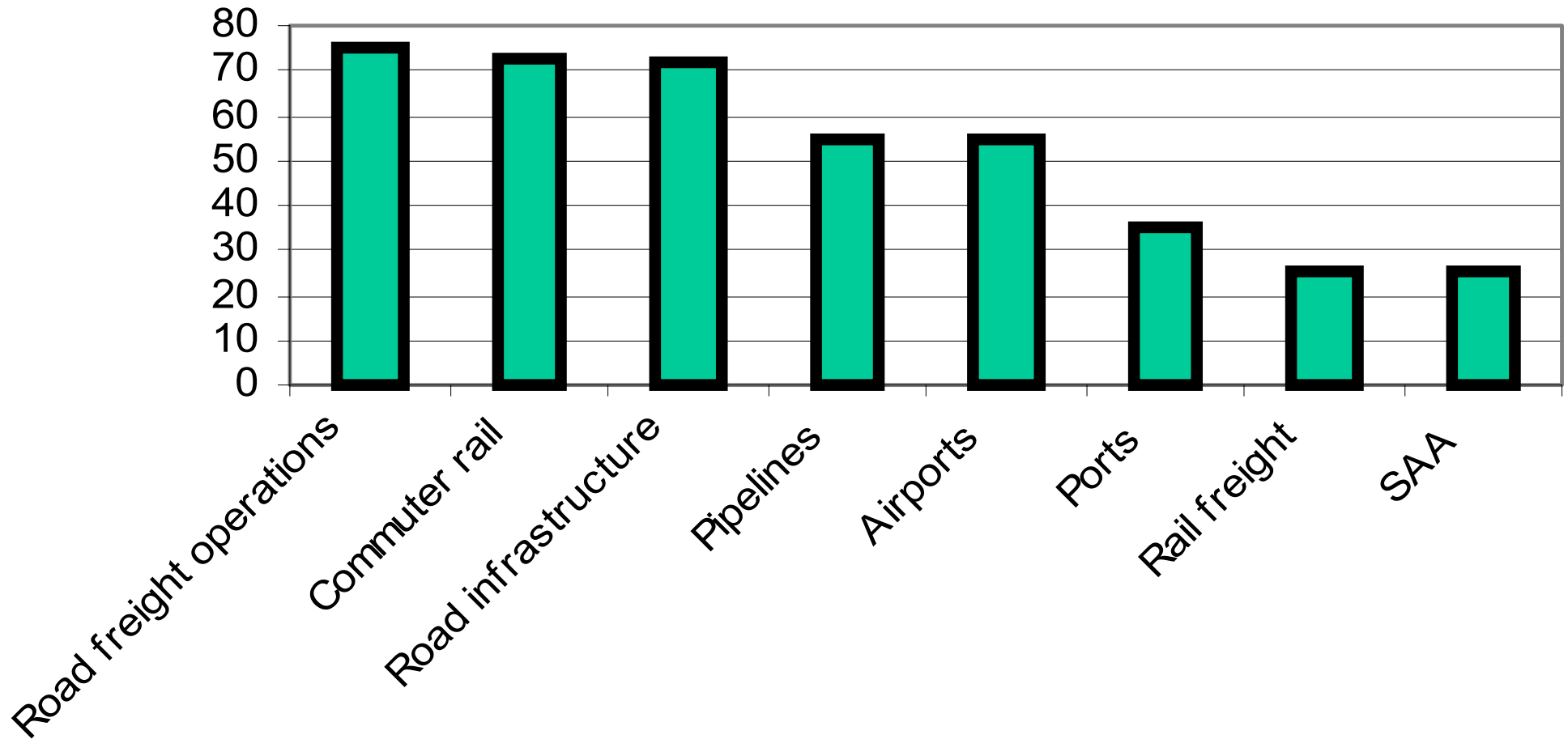
# Effective company tax rates, 1998



# Ratio of labour output to labour cost in manufacturing, 1999 data, source: World Bank database



# Estimated capital spending as a % of LT capital requirements





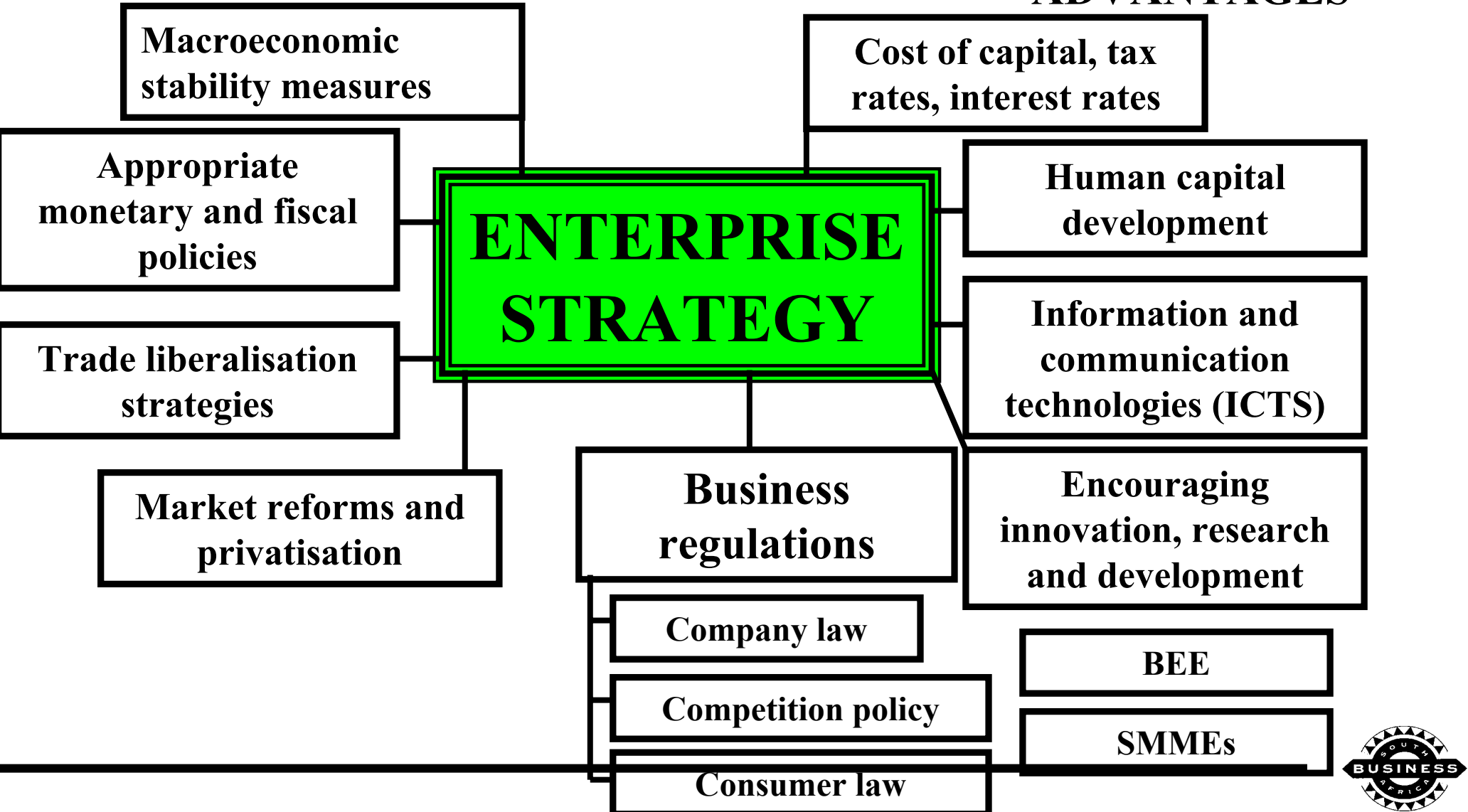
# GENERAL COMMENTS

- Government's continued focus on Economic Policy co-ordination through the Economic, Investment and Employment Cluster in government is strongly supported.
- BSA supports the contention that the traditional comparative advantage and dynamic comparative advantages are no longer the key drivers of investment and growth in the international context. Increasing focus is being placed on competitive advantages which relate to the ability of firms to really compete in the global market place. This is not to say that traditional/dynamic comparative advantages are unimportant, and that a lot can be done to use these as a foundation for investment and growth - but the location of investment is increasingly being determined by competitive advantage factors.



# TRADITIONAL POLICY MEASURES

# NEW POLICY MEASURES DESIGNED TO FACILITATE THE CREATION OF COMPETITIVE ADVANTAGES



## **GENERAL COMMENTS cont.**

•BSA welcomes the DTI's view of benchmarking and performance assessment. BSA proposes the establishment of an independent "**Cost Benefit Analysis Unit**". Such a unit would not only look at industrial strategy but all government policy with the critical "litmus test" as the impact of such policy on investment, employment and economic growth.

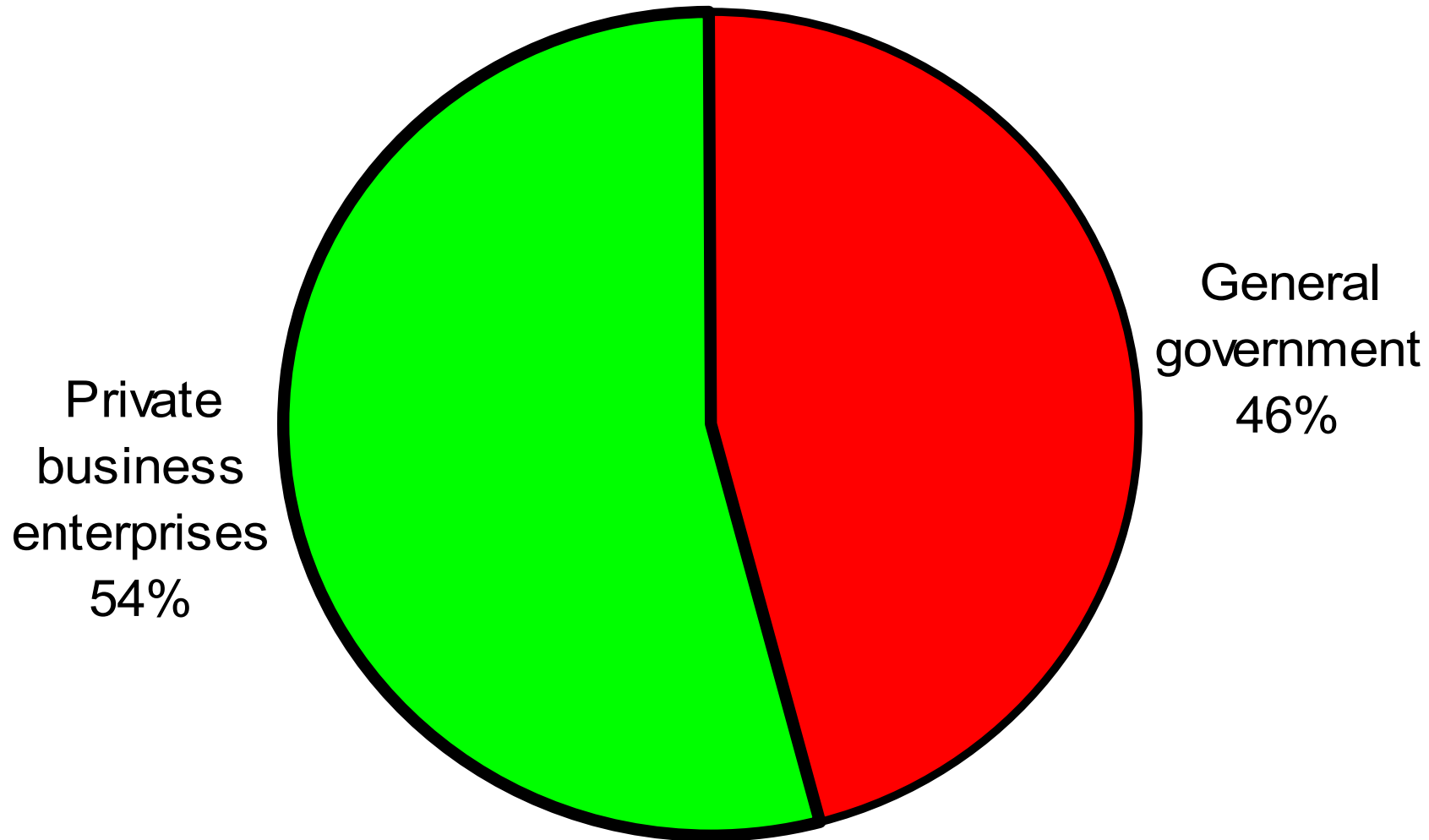


## **GENERAL COMMENTS cont.**

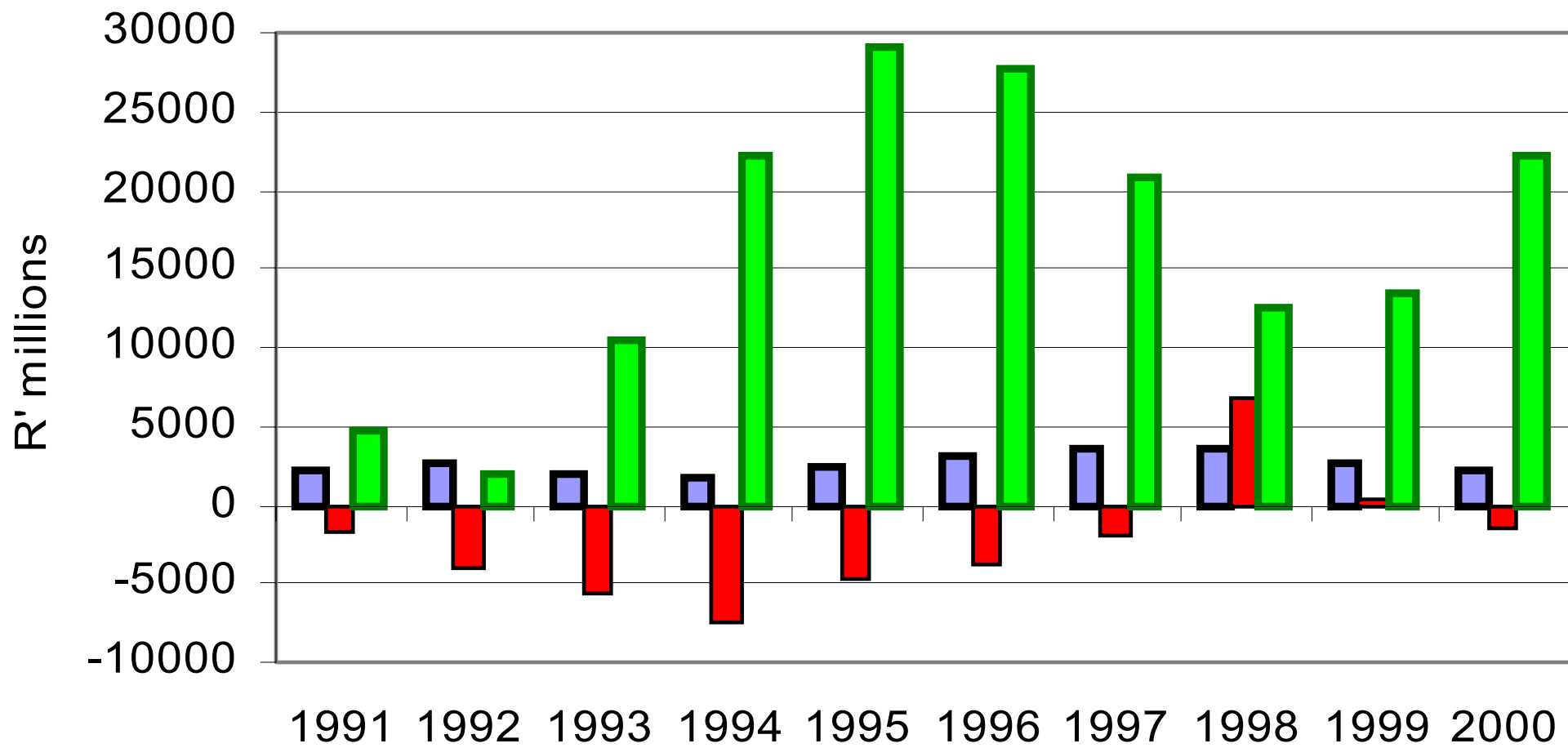
- BSA welcomes the focus in the document on the input cost and service efficiency factors affecting the competitiveness of South African business. But a recurring theme of BSA's input is the negative impact of state owned assets (particularly parastatals) on:
  - Administrative price setting, which raises inflation, raises interest rates, raises the cost of capital to the detriment of investment and growth.
  - The investment performance of the economy.
  - Competition in the economy.
  - The reliable supply of goods and services to all consumers.



# Total fixed capital stock in South Africa, government versus the private sector



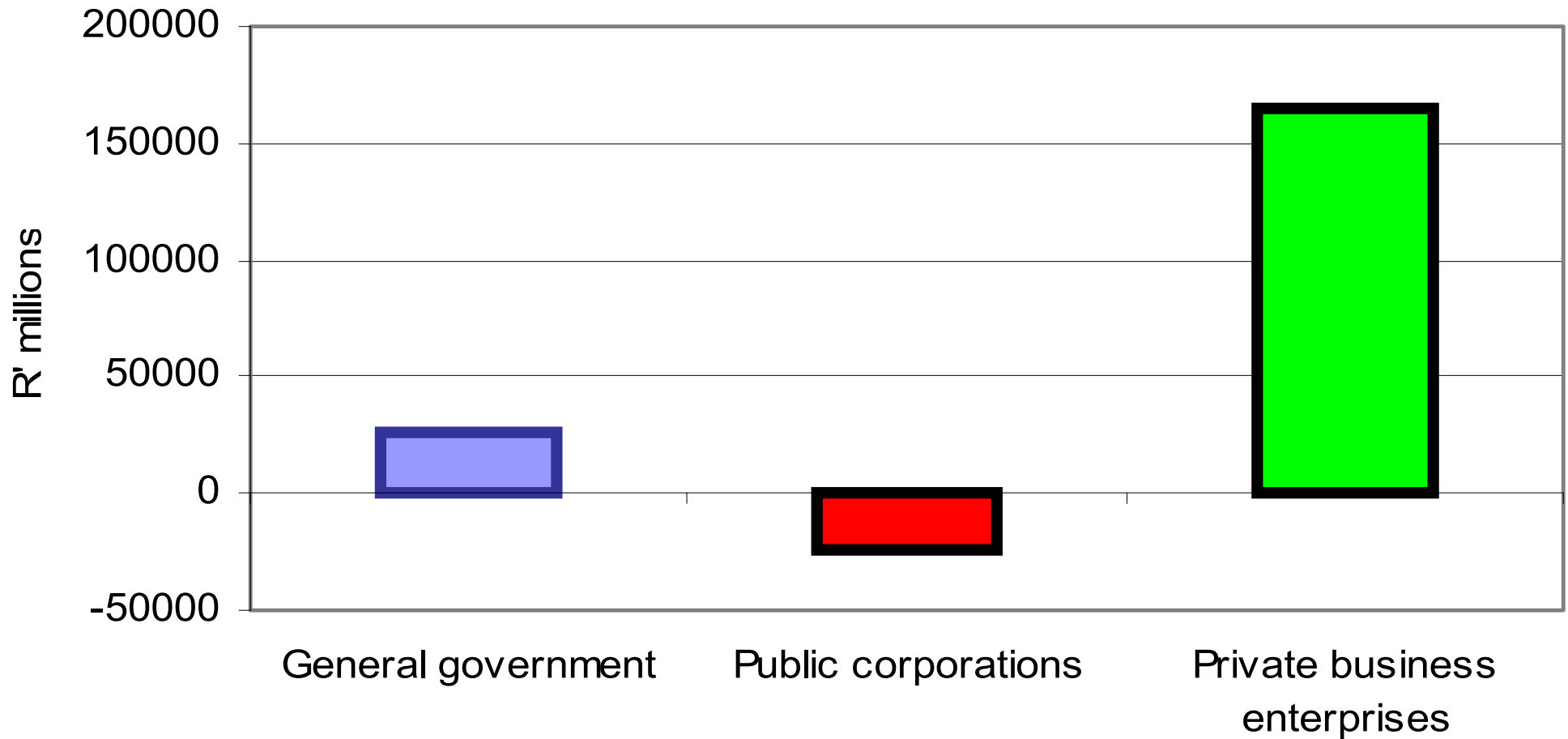
# Total net capital formation for South Africa by organisation, nominal terms



■ General government ■ Public corporations ■ Private business enterprises



# Total net capital formation for South Africa by organisation 1991 to 2000, nominal terms



## **GENERAL COMMENTS cont.**

- BSA is concerned that not enough attention is placed on the institutional performance of government. Delays in applications to the courts, the Masters office, the Registrar of Companies, the Deeds Office, not to mention compliance with tax and labour market legislation place a huge compliance cost and burden on business.
- The institutional performance of government in these areas requires constant assessment and evaluation. The establishment of a Cost Benefit Assessment Unit could conduct such assessment. At the end of the day what is required is good efficient institutional performance from government.





# KEY SPECIFIC COMMENTS

- P. 2, under the heading “Introduction” BSA is of the view that what SA requires is a massive expansion in the growth of economic opportunity and investment (I.e. break the shackles constraining investment).
- The negative effects of state owned enterprises on pricing, inflation, investment, the scope of goods and services offered and the efficiency of service are captured in specific comments on p. 16 1st paragraph, p. 22 under the heading new sources of competitiveness, p. 24 top paragraph, p. 27 top paragraph, p. 29 penultimate paragraph, p. 31 top paragraph, p. 32 top paragraph, etc.
- The document fails to capture significant progress made in certain sectors on the BEE and transformation front in the areas of ownership, management, employment equity, procurement, and rural development.



## KEY SPECIFIC COMMENTS cont.

- Page 25, top paragraph, sentence starting "the economy has become more attractive for direct investment..." can be construed untrue in a relative sense. Whilst SA has made significant progress at the macroeconomic level, on a microeconomic and investment level, the pace of reform in South Africa has been slower than our major international competitors.
- Page 31 second paragraph starting “Five sectors of the economy that have considerable potential....will receive focused attention from the state.” A significant body of research points to the fact that governments are notoriously bad “pickers of winners”. BSA recommends a broad approach whereby the overall investment environment is improved for all sectors so that no unsustainable distortions creep in to investment decision making.



## KEY SPECIFIC COMMENTS cont.

•Page 43 last bullet point regarding creating policy certainty and stability. Whilst the objective of policy certainty and stability are crucial to investment decision making – the reality is that the business regulatory environment has been in constant turmoil and change with over 500 changes to regulation and legislation in the past six years. Businesses and investors require a degree of certainty and stability that ensures that the distribution of the benefits of an investment is guaranteed. Any factors which impinge on the distribution of the benefits will raise the risk profile, raise investment hurdle rates to the detriment of investment, growth and employment. South Africa's current low investment and foreign direct investment rates is indicative of a poor investment environment which raises the risks and costs of investment.



# CONCLUSION.

- BSA welcomes the publication of the most recent IMS document which captures a number of areas of discussion from NEDLAC.
  - Organised business is committed to facilitating the move of the economy onto a higher growth trajectory - but all the social partners have a crucial common destiny in this regard.
  - Yes the IMS does start to address the key issues that affect investment but at a broad level. What is required is a much deeper analysis of the constraints to investment and growth.
  - Yes the IMS does start looking at the types of skills that will be required but again the analysis is broad.
  - Lets work together to get growth and investment high.
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# SOUTH AFRICA CAN LEVERAGE THE BENEFITS OF GLOBALISATION

## GLOBALISATION AND THE INTEGRATION OF MARKETS

