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The Political Economy of Structural Transformation

Political Settlements and Industrial Policy in South Africa

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14.1 Introduction

Despite multiple policy interventions, South Africa has not made significant progress in achieving growth-enhancing structural transformation over the period 1994 to 2019. In terms of sectoral transitioning, the economy has prematurely deindustrialized, with manufacturing's contribution to gross domestic product (GDP) declining from 21 per cent in 1994 to 12 per cent in 2019 in favour of services (Chapter 11). The increase in the contribution of services to GDP over the period 1994 to 2019 has been accompanied by the increasing importance of lower-value, lower-productivity services overall (Chapter 1). At the same time, the growth of financial services has not been accompanied by significant growth in employment in the sector, nor by higher levels of savings and investment in the real economy.

Within manufacturing, growth in value added has continued to be biased towards mineral- and resource-based industries that were at the industrial core of the economy in 1994, reflecting limited sectoral deepening (Chapter 2). The slow progress of transformation of the industrial structure is reflected in South Africa's undiversified exports. Mineral and resource-based industries continue to dominate the export basket—accounting for approximately 60 per cent of merchandise exports in 2019—and South Africa is thus missing out on the gains from international integration in improved competitiveness and 'learning through exporting' in diversified manufacturing industries (Bell et al., 2018).

The failure to achieve growth-enhancing structural transformation has also had implications for socioeconomic outcomes, including increasing unemployment, worsening inequality (Chapter 8), and limited success in increasing participation by the previously disadvantaged black population (Chapter 9).

So why has South Africa had such a poor record, particularly as the economic-policy objectives of successive African National Congress (ANC) governments

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under democracy have been to change the structure of the economy to more diversified and labour-absorbing industries? To answer this question, it is necessary to understand the power of different interests and how they have influenced policy choices, design, and implementation (Khan and Jomo, 2000; Khan and Blankenburg, 2009; Gray, 2018).

As a salient case study on structural transformation and economic development, the South African experience offers key lessons for middle-income countries more generally. The analysis draws on the contributions in this book, reflecting on the differences and similarities observed in the detailed industry studies, including the coalitions of interests that underpin the outcomes. This is complemented by engagement with the contestation of interests at the macro level and how these conflicts influence both industrial and broader economic policies.

Section 14.2 starts with a discussion of the political settlements framework and how it assists in understanding different trajectories of industrial development. Section 14.3 then presents the observed patterns of structural change in selected industries, drawing on the in-depth industry chapters, and considers how the liberalization of the economy and the configuration of economic power influenced these patterns. Section 14.4 reflects on the shifting coalitions of interests that have underpinned the policy agendas under former presidents Mandela, Mbeki, Motlanthe and Zuma. Section 14.5 concludes the analysis by drawing out the main observations regarding South Africa's evolving political settlement, its influence on industrial development, and the wider lessons for other middle-income countries.

14.2 Political Settlements and Industrial Development

The success or failure of structural transformation, in terms of processes of production upgrading, necessarily depends on changes in the distribution and configuration of power among different organizations, that is, in the 'political settlement' (Khan, 2018). A given settlement depends on the distribution of power within countries and, for industrial development, whether the ruling coalition supports the design and implementation of policies with incentives for, and conditions on, firms to ensure high levels of investment and effort in learning and technological upgrading (Khan, 2018).

As such, successful industrial production relies on the ability of the state to create and manage rents, which are important for technological learning, which is necessary for driving structural change. The political settlements framework is a useful lens through which to examine how states' capabilities to manage these rents, including monitoring and disciplining rent recipients to ensure productive investment for growth, are influenced by the distribution of power within a society (Gray, 2018).

The political settlements framework emerged as a critique of New Institutional Economics (NIE), which focused on the adoption of institutions that enforce the rule of law, a democratic political election system, low levels of corruption, transparency of the state, and limited restrictions on the private sector, which ultimately became the 'good governance agenda' (Gray, 2019). However, the NIE struggled to explain huge differences in the development trajectories of countries despite them adopting this good governance agenda (Khan, 2018). The political settlements framework assesses how regimes work in practice and explains that the economic outcomes of an institutional dispensation is heavily reliant on the distribution of power in the environment in which they operate (Khan 2018, Gray 2019).

For example, let us consider the relationship between competition and economic development. NIE emphasizes competition with liberalized markets and independent institutions as the primary requirement for economic development and moving countries to what North et al. (2009) term 'open access orders'. However, this supposes that competition simply arises in the absence of obstacles, and fails to recognize the need to address entrenched inequality and economic power (Makhaya and Roberts, 2013). And, it does not properly explain the underlying power arrangements and configuration of interests that shapes markets and influence a given institutional configuration and framing of laws (Khan, 2010).

The new institutionalism also does not engage with the 'path-dependent' nature of development—meaning that firms which have developed productive strengths are able to re-invest, further develop capabilities, and grow their businesses. Thus, inclusion requires productive rents to induce investments in capabilities outside the initial industrial core to support structural change. NIE is primarily focused on static efficiency rather than the dynamic efficiency that is necessary for long term growth.

By comparison, in the political settlements framework, rents are pivotal in shaping the structural change required for economic development and power is held in both formal and informal institutions (Khan, 2018; Gray, 2018). The implication is that political settlements analysis entails a broader mapping of groups that hold power in society, including the elite and non-elite (Behuria et al., 2017). It is necessary to consider how powerful elites organize through formal and informal institutions, especially during development transitions, to sustain economic benefits for groups that would otherwise have lost out (Khan, 2010). The organizations which are formed are thus the mechanism through which social and political stability is maintained, helping to generate distributions of economic benefits in line with distributions of power.

The approach to political settlements adopted in this chapter draws on the contributions of Khan (2010 and 2018), together with developments by Behuria et al. (2017), and Gray (2013, 2018, and 2019). These contributions all note the importance of 'holding power', which refers to the capacity to engage and survive conflicts—in other words, the ability to inflict costs and absorb costs inflicted by opposing groups (Behuria et al. 2017). The sources of holding power include economic structure, violence rights, rents and ideology (Behuria et al., 2017; Gray, 2018).

The following section looks at some of the industry experiences in the context of the political economy and political settlement dynamics described above.

14.3 Structural Transformation in South Africa: A Review of Industry Experiences

The political settlements underlying South Africa's structural change dynamics can be observed by reflecting on the conflicts over value capture in the industrial groupings that form the core of the economy, which have been analysed from different perspectives in the book. These include metals and machinery, chemicals and plastic products, food and beverages,[1] fruit, and automotive industries (Bell et al., 2018; and Chapter 1).

The ongoing better performance of upstream resource-based industries compared with the more diversified downstream sub-sectors, into which these resource-based basic products are inputs, is reflected in the studies of metals and machinery, and chemicals and plastic products (Chapters 3 and 4). The two industry groupings show common features and interesting contrasts. Importantly, both show the failure to diversify and build stronger capabilities. Indeed, there has been a hollowing out of capabilities as the downstream more diversified parts of the value chains have performed far more poorly than the upstream resource-based basic metals, refineries, and chemicals parts of the chain.

Within each industry, however, there are pointers to the potential for growth. For example, there are segments within the machinery and equipment sub-sector linked to meeting the specialist requirements of different types of mining operations, in which South Africa has developed world-leading capabilities. While there have been such niches of advanced capabilities, the country failed to build on these capabilities through supporting broader local clusters. In the plastic products industry, for the period from 1994 to 2002 during which tariffs

[1] As there is no separate chapter on food and beverages, see Bell et al. (2018) for background research on this sub-sector.

were liberalized, the local firms competed effectively with imports and grew output and employment. Crucially, during this period the monopoly input supplier, Sasol, was constrained in its pricing to local customers. This changed as the regulatory regime altered, and Sasol's[2] strategy towards the local value chain moved to maximize prices (Mondliwa and Roberts, 2019).

Various forms of continued support for the upstream basic metals and chemicals sub-sectors have contributed to the outcomes. This is a puzzling question from the political economy perspective: why have capital-intensive resource-based industries continued to receive so much attention and different forms of support, while downstream, labour-absorbing, industries have in most cases not been supported by effective strategies for building capabilities? Part of the answer lies in what has been the dominant paradigm of economic policy in general, part lies in the challenges of competitiveness in these sub-sectors within the global context, and part lies in the ongoing influence of the large upstream firms, which are well entrenched and effective at lobbying.

Different factors have driven the performance of the automotive and the food industries. These are both large industries in South Africa, accounting for 7.2 per cent and 14.8 per cent of manufacturing value added respectively in 2019.[3] The automotive sector has been assisted by a targeted industrial policy, which has evolved through a series of phases (Chapter 5). Outside of resource-based sectors, it has recorded by far the best growth in manufacturing, yet the capabilities remain shallow and focused at the assembly level. The automotive industry has continued to run a significant trade deficit, while the record in growing local content has been relatively poor. South Africa has not developed the capabilities of more sophisticated automotive hubs in countries such as Thailand and Mexico. The automotive industry reflects a skewed arrangement that favours the original equipment manufacturers (OEMs). The successful lobbying of the large OEMs for ongoing support is one factor explaining the outcomes observed in South Africa. This is perhaps unsurprising as the threat of the loss of high-profile jobs in unionized factories has had a greater influence than the potential employment that could be generated by better policy support.

The food and beverage industries consist of a range of value chains extending from agriculture and agroprocessing to retail. The industries include some success stories, notably the rapid growth of fresh fruit production based on export markets (Chapter 6), and wine exports (Chapter 7). During apartheid, in the agriculture to food value chains there had been extensive regulation and support for cooperatives in processing, such as milling and dairy. The widespread

[2] Sasol is the upstream supplier of chemical inputs including polymers used to produce plastic products.

[3] This only counts the narrowly defined sub-sectors and not the related areas, such as automotive components classified under other sub-sectors, and agricultural production and packaging in the case of food.

liberalization of markets in the 1990s brought far-reaching restructuring with large employment losses in many segments. In this changing context, the cooperatives became privately owned with many acquired by multinational conglomerate groupings.

The fresh-fruit industry has emerged as a strong export generator and has built considerable capabilities to export fruit into international markets. A key factor in its success is coordination along the value chain to deliver higher-value products to meet the preferences of export markets. This has combined the farming of new varieties requiring advanced capabilities with the appropriate logistics and marketing operations to place the products on supermarket shelves. The successes have resulted from effective producer strategies, in the absence of a targeted government strategy, though there have been some attempts to rectify this.[4] South Africa has realized the 'industrialization of freshness' in important fruit groupings, while in other groupings the industry has not achieved the coordination and long-term investments required (Chapter 6).

14.3.1 South Africa Has an Open Economy but There Have Been Signs of Structural Regression

With the liberalization of the economy starting in the 1990s, South Africa has become extremely open and internationalized in terms of trade, capital flows, and ownership. While these changes brought far-reaching restructuring in industry, the changes have not resulted in diversification or sustained higher levels of investment (see also Black and Roberts, 2009). The experience points to the challenges of managing international integration to ensure that the linkages are built into local production systems (Chapter 13).

In terms of international trade, the liberalization in the 1990s heralded much higher levels of exports and imports (Chapter 1; and Figure 14.1). Over the period 1994–2002 the real exchange rate had weakened, as was appropriate under reduced protection. While import penetration increased so did the ratio of merchandise exports to GDP, from 18 per cent in 1994 to 25 per cent in 2000, opening up a trade surplus. This included increased exports in diversified manufacturing industries including machinery and equipment and motor vehicles (see Chapters 3 and 5). In these and other manufacturing sub-sectors, imports also grew substantially.

From 2002, however, the strengthening exchange rate underpinned by the focus on inflation targeting meant imports increased strongly, to reach 27 per cent of gross domestic expenditure (GDE) in 2008 (Figure 14.1). As reflected in the

[4] This seemed to be changing, when in 2019 a process began for developing a master plan to support fruit alongside other selected agricultural products.

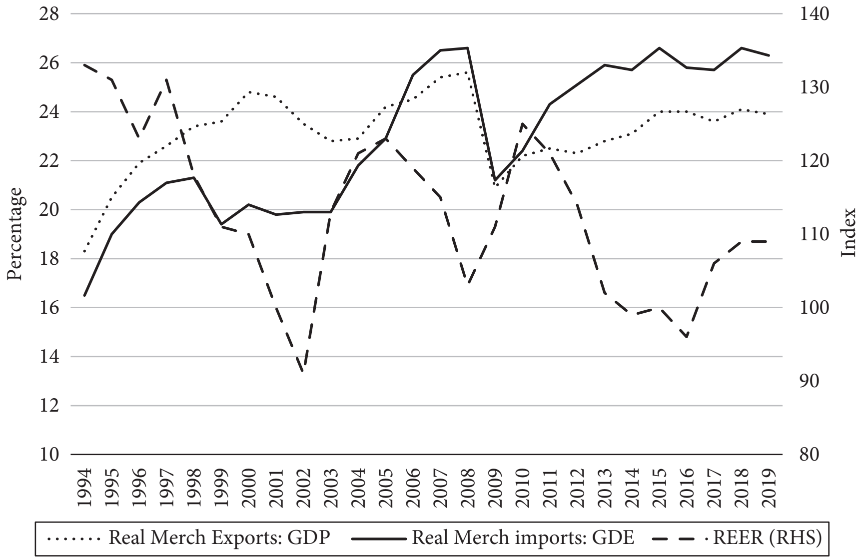

Figure 14.1 Trade and the real effective exchange rate
Note: the real effective exchange rate is indexed at 2015 = 100.
Source: South African Reserve Bank data.

industry studies, these increased imports were largely of diversified manufactured products and undermined local producers who could not compete with cheap imports. The increase in imports in fact exceeded the higher earnings from minerals exports and the country went into a trade deficit during the international resources boom to 2008. The end of the boom saw much poorer export earnings, while the hollowing-out of diversified productive capabilities meant a widening trade deficit once again from 2011.

Instead of the hoped-for export-led growth, the far-reaching liberalization and international integration led South Africa to prematurely deindustrialize, with the contribution of manufacturing to GDP declining from 21 per cent in 1994 to 12 per cent in 2019.[5] Moreover, within manufacturing, the structural change has in fact been regressive in nature, as growth in value added has continued to be biased towards mineral and resource-based sub-sectors (Chapters 1 and 2). The share of diversified manufacturing (including metal products, plastic products, and food and beverages) in total manufacturing value added in fact declined between 1994 and 2019 (Chapter 1). There has been a decrease in manufacturing employment across the board, but the largest losses have been borne by exactly those diversified manufacturing industries where strong growth would create jobs, both directly and in related industries. As noted above and in Chapters 1 to 6,

[5] Statistics South Africa (2019). Statistical Release P0441 Gross domestic product Quarter 4, 2019, https://www.statssa.gov.za/publications/P0441/P04414thQuarter2019.pdf.

there have been 'islands' of strong export capabilities in manufacturing, such as in mining machinery, but these have not been built upon to be replicated in other parts of the economy.

Its openness to the global economy has further meant that South Africa has been exposed to global commodity price volatility. This is evident in the huge swings in steel prices (Chapter 3). The effects of downturns have been for the local producer to lobby for support, while in years of high prices the profits have been taken out of the business.

South Africa's liberalization of capital flows has seen large volumes of portfolio and foreign direct investment (FDI) inflows and outflows (Figure 14.2). As South African companies such as SABMiller and Naspers have become part of huge transnational corporations (TNCs), the capitalization of the Johannesburg Stock Exchange (JSE) has increased to an equivalent of more than 300 per cent of the country's gross domestic product (GDP). This has not meant higher levels of fixed investment in South Africa, however. Capital account liberalization has also allowed South African corporations to move capital abroad on a grand scale, both legally and illegally (see Ashman et al., 2011).

The rise in portfolio and FDI inflows has been matched by an increase in foreign ownership of the JSE. Measured in terms of control of companies listed on the JSE by their capitalization, foreign ownership increased from 4 per cent in

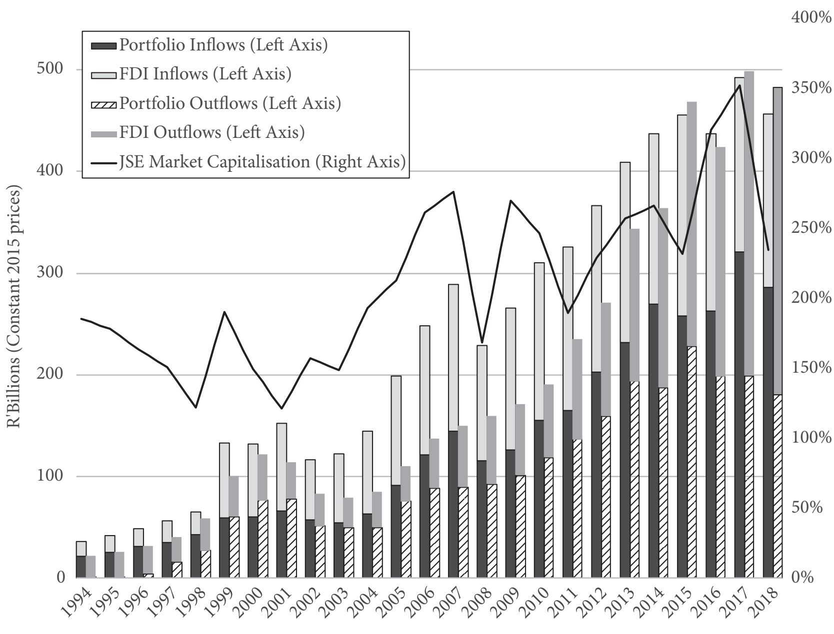

Figure 14.2 Portfolio and FDI inflows, outflows, and JSE capitalization
Source: Authors' calculations using South African Reserve Bank data.

the late 1990s to 25 per cent in 2018.[6] The significance of TNCs in South Africa's economy is in line with global trends, which show individual corporations controlling resources (at least in monetary terms) and having security, intelligence, and public relations operations larger than many states, as well as significant lobbying capabilities, such as through donations to political campaigns (Zingales, 2017; UNCTAD, 2018).[7]

The international ownership of key businesses in South Africa has in some industries been part of a deliberate government strategy. In the case of basic steel, the government strategy was for Iscor to have an international steel equity partner to enable access to technology and investment (Chapter 4).[8] Ultimately, the company became absorbed into ArcelorMittal, the largest steel transnational corporation in the world. The local business became peripheral to the parent, given the relatively small domestic demand and low levels of growth, and the parent company did not invest in the R&D in the South African business required for learning higher-tier capabilities. The weakening of historical cost advantages meant it was vulnerable to commodity price swings, while subject to transfer pricing and profit shifting by the parent company, and weakening local linkages and technology collaboration (see also Lee, 2015).

14.3.2 Key Insights from the Industry Experiences

Political settlements are stable when the distribution of rents is in line with the distribution of power in the economy. This suggests that powerful groups can be identified by studying the patterns of rents or benefits of economic policy. The key insight to be drawn from the discussion of industry experiences is the strong continuity of better performance by upstream industries and poor progress in diversifying the economy. There have also been sustained high profit levels in some sub-sectors of services (OECD, 2013; World Bank, 2018; and Chapter 2). These outcomes point to the weight of path dependency that needs to be addressed for a change in direction, in which industrial policy and broader economic policy should play a key role. However, the degree of success or failure

[6] The largest South African conglomerates, led by Anglo American and Richemont/Rembrandt (now Remgro) had always been internationalized, even while being identified as South African, in part because of their origins and in part because of their response to economic sanctions during apartheid. However, these were still family-controlled conglomerate groups with a very substantial part of their business based in South Africa (Chabane et al., 2006). Remgro has remained family-controlled and Anglo American has unbundled; the huge growth in foreign ownership was boosted by AB Inbev's acquisition of SABMiller (the biggest listed company in recent years in terms of its market capitalization).

[7] The significance of large global corporations is not new of course (Zingales, 2017).

[8] Iscor was the state-owned and vertically integrated steel producer with interests in iron ore and steel production. When it was privatized, it was split into Kumba Iron Ore and Arcelor Mittal South Africa ("AMSA").

in effecting this change is dependent on the extent to which the powerful interests or groups support this diversification. Three important observations from the industry experience can be made. These are discussed briefly below and are developed further in the discussion on the evolving political settlement underpinning South Africa's industrial development, in section 14.4.

First, the patterns of performance were reinforced by the adoption of the liberalization policy paradigm, which mainly benefited the established large and competitive firms in the economy. The analysis of the evolving political settlement must engage with the extent to which different organizations influenced the policy decisions taken, as well as the underlying ideological conflicts in the policies that were adopted. The ideology and dominant policy paradigms have implications for policy choices and influence the relative holding power of different groups (Gray, 2018). In this regard, free market economic orthodoxy, together with the liberalization agenda, have privileged the interests of existing capitalists at the expense of a model to support the entry and growth of challenger firms that would bring greater economic dynamism.

Second, the industry experiences point to the continued government support of the large incumbents, despite the industrial policies apparently being aimed at improving productive capabilities and investing in the diversification of certain industries. Our [?] analysis examines the economic power of large firms and the extent to which these firms have influenced the evolution of the political settlement. This is based on the assumptions that industrial support creates rents and the distribution of these rents has largely followed the existing economic structure; and the prevailing economic structure reflects a country's economic history, including the construction of markets and the main participants, as well as the large incumbent businesses.

Third, the lack of industrial diversification also reflects the problems with coordination across policy areas that include energy, minerals, and infrastructure. Understanding the underlying factors in the poor policy coordination is important, particularly if this failing is a result of conflicts of interests—as appears to have been the case.

It is important to understand the makeup of the main groups or interests that have been engaged in conflicts over policies, rents, and policy coordination. These are essentially established businesses, previously excluded black capitalists and black entrepreneurs, industry associations, trade unions, and the government and its constituencies. Many of the established businesses have also had interests in extractive industries with favourable dispensations governing inputs, energy, and infrastructure provision, and in which profits did not necessarily depend on investment in upgrading capabilities. The previously excluded black capitalists have been fragmented into two main groups, the black elites that often had ties with the ruling political party, and independent black entrepreneurs. Industry associations have provided important platforms for engaging on policy and have generally been made up of different combinations of entrenched firms, black capitalists, black entrepreneurs, and entrepreneurs more generally. The trade unions representing workers have focused on the interests of the existing workforce, meaning that these have been largely aligned with the existing economic structure, and chiefly focused on worker issues within this context. The unemployed and market entrants have not been sufficiently organized to counteract the influence of entrenched firms on economic policy, and government has been the arena where conflicts of interests play out rather than a strong voice for the former groups. What is evident is that the interplay between these groups has been dynamic and fluid: in certain periods, some have managed to organize their power better and control rents, while in other periods different groups have been more successful.

14.4 The Evolution of the Political Settlement and Economic Policy for Industrial Development

South Africa's democratic economic policy can be assessed in three phases that roughly coincide with the presidential tenure of Presidents Nelson Mandela (May 1994 to June 1999), Thabo Mbeki (June 1999 to September 2008), and Jacob Zuma (May 2009 to February 2018). The period under President Cyril Ramaphosa (from February 2018 and continuing at the time of writing) is too short to properly assess, while President Kgalema Motlanthe (September 2008 to May 2009) was an interim president for less than a year. As the chapter is concerned with structural change, the analysis considers the distribution of rents or flow of income between the initial industrial core (as at 1994) and more diversified and labour-absorbing industries. This section also considers broader economic policy beyond industrial policy, as the rent management systems of a country are strongly influenced by ideological commitments and dominant policy paradigms (Gray, 2018).

14.4.1 The 1994 Compromises: A Political Settlement to End Apartheid

The compromises reached in 1994 meant that the economic structure was left intact, in effect continuing to protect white ownership of wealth and privileged employment positions of the existing workforce for at least five years in exchange for improvements in labour rights. The compromises were premised on the growth that was expected on the part of established businesses. The major changes adopted were the liberalization of trade and capital flows, the deregulation of agricultural markets, and moves towards privatization. These choices effectively de-prioritized redistribution and inclusion.

The compromises reflected the relative power of big business interests. Business had invested heavily in influencing the economic policy-thinking for the democratic era. This included engaging with all the stakeholders leading up to and during the Convention for a Democratic South Africa (CODESA) negotiations in 1991, providing technical support and data for scenario-planning exercises, punting a market-friendly environment that informed both the ANC and the National Party in the coalition 'Government of National Unity' (Padayachee and Van Niekerk, 2019). The holding power that was leveraged was a combination of ideology and economic structure. Big business was at the helm of the country's industrial core and this placed it in a privileged position, as it was understood that without businesses' support, the economy would underperform. Big business's position was further buttressed by the appointment of former banker Chris Liebenberg as the Finance Minister of democratic South Africa, following the resignation of Derek Keys, who was also a businessman. Chris Stals, who had close ties with the existing business establishment, was retained as governor of the Reserve Bank. Big business, recognizing the potential power of black entrepreneurs, initiated the principles and practice of black economic empowerment (BEE), with its emphasis on ownership transfers to influential individuals (linked to the ANC), to secure buy-in for orthodox reforms, particularly capital account liberalization (Zalk, 2016). These BEE deals started long before the actual legislation came into effect, and as such, served to significantly shape it.

Big business sought to mould institutions and set the rules of the game, to protect their interests over time. This continuity that has been observed over the democratic period confirms that the structure of power in the 1990s has effectively shaped the institutions in its favour.

In the period from 1994 to 1999, there was no overarching industrial policy. The Industrial Strategy Project (ISP), which guided microeconomic policy in the period mischaracterized South Africa's economic challenge as having a high degree of industrial diversification from import substitution along with inefficiencies associated with protection from imports (Joffe et al., 1995: 45). As a result, the policy recommendations focused on facilitating specialization with three elements: fostering the role of market incentives, strengthening underlying capabilities in human resources and technology, and providing an appropriate institutional environment to facilitate industrial restructuring (Joffe et al., 1995: 45). This was very much aligned with the orthodox economic ideology that prevailed at the time, where emphasis was placed on fixing the fundamentals and allowing market forces to do the rest, rather than adopting targeted industrial policy to shape the development path.

The high levels of concentration and lack of competition in many sub-sectors were acknowledged as a challenge for a growing economy (Joffe et al., 1995). However, the Competition Act of 1998, which was negotiated by government, labour, and business, emphasized market efficiency and did not directly tackle the extreme concentration of control by dominant firms in many markets. The issues of inclusion specified in the preamble of the Act were only really given effect in mergers and acquisitions in the form of a public interest provision. As such, it was a reflection of the balance of power between the key constituencies and the strength of big business in particular (see Roberts, 2000: 124–42 for a detailed description of the negotiations). Many of the firms in the big business grouping were already dominant in the markets in which they operated and thus were more concerned about the implications of abuse of dominance provisions rather than merger regulation. The choices made mattered for structural transformation, as the strategic conduct of incumbents can raise entry barriers, exclude smaller businesses, and undermine capability development and diversification (Mondliwa et al., 2020; Mondliwa et al., 2021).

The 'holding power' of big business in the negotiations reflected the fact that government at the time of the legislation was very concerned about investment levels in the economy, which, given the economic structure, depended in large part on the decisions of big businesses. Indeed, the implicit threat of not investing if the commercial environment was not 'friendly' or conducive to 'business certainty' played a part in determining the outcomes of the negotiations. This was reflected in the significant changes made between the government's initial draft and the final provisions (Roberts, 2000: 138). As a result, even though the Competition Act acknowledges the objective of wealth redistribution, the orthodox provisions meant to deal with abuse of a dominant position have proven to be limited (Roberts, 2020).[9]

At the same time, macroeconomic policy emphasized 'stability' and cutting the fiscal deficit, with monetary policy attempting to target the money supply to control inflation. This was despite alternatives that were on the table, including the 'framework for macroeconomic policy in South Africa' put forward by the ANC's Macroeconomic Research Group (MERG). The MERG framework emphasized an initial public investment-led approach for the 1990s and sustained growth in 2000s underpinned by supply-side industrial policy interventions to alter the development trajectory (MERG, 1993). The rejection of the MERG proposals by President Mandela and Deputy President Mbeki followed the critique by the white business community which labelled them as 'macroeconomic populism' (Gumede, 2007). The final negotiated economic policy focused on reassurances to local and international business, and the developmental state ideas were abandoned. Subsequent assessments of economic performance found strong path dependency effects, with the benefits of trade liberalization being realized by those firms that were already internationally competitive in 1994 (Aghion et al., 2013; Bell et al., 2018; Mondliwa et al., 2021). Industrial financing, including by development finance institutions, continued to flow towards the upstream industries (Black and Roberts, 2009).

[9] The Competition Act was amended in 2018 and the amendments seek to address questions of increased participation.

14.4.2 The More Things Change the More They Stay the Same: 2000–8

In the 2000s, under President Mbeki, there were strong elements of continuity from the compromises of the Government of National Unity. In effect, the political settlement reached in 1994 remained largely intact in terms of the balance of power and the institutional arrangements, albeit with some important additions. The benefits of liberalization, open markets, and macroeconomic stability continued to be proclaimed, reflecting the ascendance of free markets as the dominant policy paradigm. This was supplemented by expanded 'market friendly' incentives to encourage 'knowledge-intensive' activities and advanced manufacturing technologies (Machaka and Roberts, 2003). Higher levels of investment were expected from business in response. However, there was no understanding of the relationship between the economic structure and investment in capabilities and, instead, deindustrialization continued as downstream and diversified manufacturing performed poorly. In addition, the incentive programmes, in practice, tended to support the capital-intensive upstream industries (see Black et al., 2016; Mondliwa and Roberts, 2019). By the mid-2000s there was still no overall policy that aligned all the different interventions and there was no one agency coordinating government interventions to ensure wider benefits (Rustomjee, 2013).

Though there was a range of incentives to promote investment, exports, and technological improvements, and to support small firms, these were largely soft-touch measures targeted at the same industries that received support from the apartheid government, doing very little to change the structure of the economy. The three manufacturing and tradable sub-sectors that were specifically supported by government between 1994 and 2007 were automotive, resource-processing industries (steel, chemicals, and aluminium), and clothing and textiles. Examples of these incentives include the accelerated depreciation allowance (37E incentive), and the Strategic Industrial Projects (SIP) programme. Both incentives were made available to large capital-intensive projects, mostly in resource-related sub-sectors such as steel, ferro-alloys, aluminium, and basic chemicals (see Black and Roberts, 2009). The rationale for continuing to support upstream industries was based on opportunities for development through linkages to the downstream industries. However, there were no conditions placed on these incentives and there have been limited benefits for linked industries (Bell et al., 2018; and Chapters 3 and 4).

With the commodities boom driven by Chinese demand, coupled with domestic consumer credit extension and investment for the World Cup in 2010, the economy grew even while cheap imports on the back of the strong currency were hollowing out local manufacturing. At the same time, the need to bridge the gap between South Africa's 'two economies' meant social grants were increased along with greater spending by government and parastatals on extending basic services.

The approach to BEE reflected this attempt to straddle divergent realities as business committed to voluntary charters with weak monitoring and an absence of enforcement (Ponte et al., 2007; Mondliwa and Roberts, 2020). BEE effectively reinforced the existing economic structure and left black shareholders in debt to their white business partners and needing to ensure the flow of profits was maintained (Chapter 9). Large businesses successfully lobbied the government not to implement structural changes that would create opportunities for entrants, including black entrepreneurs, in exchange for firms creating BEE initiatives that effectively reinforced their position as gate keepers in the economy (Mondliwa and Roberts, 2020). This was despite the BEE Commission[10] having developed a detailed programme for BEE that aimed to bring empowerment and structural transformation, together with an emphasis on increased productive investment (BEE Commission, 2001; Mondliwa and Roberts, 2020). Again, big business was able to use economic resources to accommodate a small black elite.

Many of the BEE Commissioners later became beneficiaries of the ownership transfers and have become multimillionaires. This weakened the holding power of the remaining black entrepreneurs as there was now a policy in place with the objective of addressing their concerns, even if the instruments were weak. By 2015, the distribution of the value of BEE deals was largely in line with the economic structure in 1994. Mining attracted the highest share (32 per cent of the total value), followed by industrials representing 18 per cent of the total value (Theobald et al., 2015). The implication is that in relation to economic structure, the incentives of the new black elites connected to BEE were aligned with the status quo. The strategies of the emerging black elite were also to establish BEE holding companies that took minority shares in multiple existing companies to spread risk rather than deepening ownership and control and making new net investments. There are very few examples of BEE beneficiaries that have moved into diversified manufacturing activities; and those that have diversified their portfolios have tended to move into financial services.

The poor design of BEE also undermined the use of public procurement to drive diversification and productive inclusion. The application in practice meant that empowered importers could be prioritized over domestic producers. This came at the cost of domestic production and jobs.

The international listing of South African firms was taking place at the same time as the rise of the shareholder value movement, which saw the growing influence of institutional investors demanding intensive corporate restructuring to unlock larger and more rapid flows of cash to shareholders (Chapter 10). This underpinned the wide-scale corporate and industrial restructuring, which was in fact associated with a hollowing out of capabilities (Zalk, 2016). The impact of the

[10] The BEE Commission was established in 1998.

commodities boom and strong currency meant that imported goods became cheaper and that salaries were higher in international currency terms, further fuelling consumption but undermining companies' competitiveness.

On the labour front, much semi-skilled and unskilled labour, and many of the informally employed and unemployed, were progressively excluded. While popular protests grew, these were suppressed by policing, and social grants were substantially expanded to mitigate the short-term effects of deindustrialization (Runciman, 2017).

Overall, the development of industries in South Africa in the 1990s and early 2000s reflects path dependency, compromises, and continuities in the absence of a concerted and coordinated industrial strategy across the government to change the trajectory. Individual ministries did develop strategies that aimed to support advanced manufacturing and create employment, such as the Integrated Manufacturing Strategy (Department of Trade, Industry, and Competition, 2002) and the Advanced Manufacturing and Technology Strategy (Department of Science and Technology, 2003). However, there was little coordination between these policies to ensure wider benefits.

Towards the end of this period it became apparent that structural change towards more diversified industries was necessary to drive growth and to address the high levels of unemployment and curb increasing levels of inequality. As part of the Accelerated and Shared Growth Initiative of South Africa (ASGI-SA), which replaced the Growth, Employment, and Redistribution (GEAR) policy as the country's macroeconomic policy, the National Industrial Policy Framework (NIPF) was introduced in 2007. The NIPF identified the need to coordinate interventions and target sub-sectors for industrial development. The focus of the strategy was on diversifying the economy towards downstream labour-absorbing industries. However, the industrial policy did not reflect the prevailing distribution of power within the economy. As such, it has not been successful and is considered a project of the Department of Trade, Industry, and Competition (DTIC) rather than part of a government-wide coordinated strategy.

14.4.3 Shifts in the Political Settlement: Populism and State Capture, 2008–18

Growing popular sentiment against the Mbeki government was made evident when President Jacob Zuma won the leadership of the ANC in 2007 and effectively removed President Mbeki in 2008 (with President Motlanthe holding office for a short period). This was with the support of the Congress of South African Trade Unions (COSATU) and other groupings on the left inside the ANC. However, instead of a progressive economic policy agenda to engage with the country's development challenges, under President Zuma an increasingly clientelistic political settlement emerged. This included vertical fragmentation of control within the ANC as extractive rents were competed over from local to national levels of government and in state-owned corporations (Makhaya and Roberts, 2013; Public Protector, 2016; Bhorat et al., 2017). The message was that the market economy was rigged against the majority and that the only way to accumulate was through leveraging state influence.

For a time, public sector trade unions were kept onside by higher public wage settlements for government employees, while industrial unions fractured and ultimately left COSATU. The public wage premium increased during this period, and this, together with the expansion of public sector employment, increased the public wage bill, diverting funds away from other expenditure items such as investment in public infrastructure (Bhorat et al., 2016). This was the case even while the delivery of services by the state deteriorated and protests increased across the country (Runciman, 2017).

The impact of the political settlement of this period on industrial policy was profound, as conflictual stances were taken across government on a host of policy areas of central importance for industrialization, such as energy, mining, and procurement policies. Levers such as local procurement were employed for short-term rent capture across government. As a result, there were missed opportunities for building local capabilities in a number of areas, including machinery component manufacturing from the Transnet procurement process (Crompton and Kaziboni, 2020).[11]

The main strategy that President Zuma had used to gain leadership within the ANC was to divide the party and the Tripartite Alliance to alienate President Mbeki and his supporters.[12] Once he was in power, it became important to bring in wider interests, reflected in a larger and more fragmented Cabinet, with the number of ministries growing from twenty-six to thirty-six. This proliferation of government departments made coordination of policy almost impossible.

President Zuma and his alliances often made public announcements about the need to displace 'white monopoly capital', which was allegedly growing at the expense of the accumulation of black wealth. This narrative was used to remove ministers that were labelled 'puppets of white monopoly capital' and replace them with others, many of whom were to emerge later as having connections to the Gupta family associates linked to state capture.[13] The clientelism gained legitimacy even with the continued exclusion of the majority, and this narrative

[11] Transnet is the state-owned monopoly in rail, ports, and pipelines. In 2012, Transnet embarked on its largest-ever single order of 1,064 locomotives with local content requirements. However, the project was later found to be corrupt and the local-content requirements were bypassed in a number of instances.

[12] This is an alliance between the ANC (ruling political party), the Congress of South African Trade Unions (COSATU), and the South African Communist Party (SACP).

[13] The Gupta family is alleged to be at the centre of the large-scale corruption that characterized Zuma's presidency. See Bhorat et al. (2017).

became a source of holding power. It also weakened the stance of big business, which was seen as representing 'white monopoly capital'. Despite the rhetoric on 'radical economic transformation' and fighting South Africa's triple challenges of high unemployment, inequality, and poverty, there were very few interventions to trigger structural change or address real impacts of monopoly power on the economy. The most significant was the black industrialist programme, involving financing by the Industrial Development Corporation (IDC) and the DTIC, as well as public procurement, to address the challenges of access to markets, which has also had many challenges (Chapter 9).

The remaining industrial policy rents continued to flow towards established businesses. The incentive programme for the automotive industry was also updated in this period, but it continued to disproportionately benefit the multinational OEMs and there was limited upgrading through linkages to the automotive industry (Chapter 5). Import tariffs were introduced to support the struggling upstream steel industry at a significant cost to downstream industries (Rustomjee et al., 2018; and Chapter 8). Though the tariff support to AMSA came with conditionalities this time around, the design of the conditionalities undermined their effectiveness (Chapter 8). Incentives to support recovery from the 2008 financial crisis and the ensuing recession, such as the Manufacturing Competitiveness Enhancement Programme, also flowed to established firms, often financing investments that would have taken place without it (Beare et al., 2014). The programme's design, whereby firms had to finance the investment and claim back from government later, privileged firms that already had access to funding. Programmes that were targeted at the upgrading of collective capabilities for diversified industries were not prioritized for funding. In 2014, a cluster programme was developed to assist firms to overcome challenges with competitiveness. The programme, which involved financing and policy support for groups of firms seeking to collectively resolve challenges, was later shelved due to lack of funding (Beare et al., 2014).

While firms broadly maintained profit levels in this period (Driver, 2019), there was limited investment in expanded productive capacity in South Africa (Bosiu et al., 2017). When challenged on this, business argued that the low levels of investment were a result of political uncertainty associated with Zuma's presidency. However, the comparison of investment levels among comparable middle-income countries indicates the relatively lower investment levels in South Africa throughout the whole post-apartheid period (Chapter 1).

Zuma's presidency has often been framed as the 'nine wasted years'[14] or 'the corrupt years'. The implication of this position is that the removal of the 'bad apples', coupled with a return to the 'good governance' agenda that characterized

[14] In 2019, in a speech given at the World Economic Forum, President Ramaphosa referred to President Zuma's time in office as the 'nine wasted years'. See Haffajee, 2019.

the Mbeki presidency, would resolve South Africa's problems. It is argued strongly here that this is not the case. A point often missed in debates about this period is that South Africa's failure generally to mobilize higher levels of investment in productive industries of the economy materially contributed to the conditions that enabled the brazen clientelism, patronage, and corruption that characterized the Zuma presidency (Zalk, 2016; Mondliwa and Roberts, 2018).

14.5 The Political Economy of Structural Transformation in Middle-Income Countries: Lessons from the South African Case

The success or failure of countries to drive structural change can be understood in terms of whether the political economy dynamics, and the governing coalition of interests, support the growth of diversified manufacturing sub-sectors with higher levels of productivity (Khan and Blankenburg, 2009; Gray, 2018). This chapter has assessed the contestation of interests and the power balance that underpin South Africa's structural change dynamics. It contributes to the growing evidence of political economy analyses of structural change in middle income countries by engaging both with the conflicts at the micro level (in specific industries) and interaction with the meso and macro dynamics. So, what does the South African experience tell us about the political economy of structural change?

South Africa's political settlement has evolved but not in ways that have led to significant changes to the productive structure of the economy. Instead of the upgrading coalitions critical for successful industrialization, the coalitions have effectively been of incumbent firms with limited sharing with a small group of the black elite. This deal has meant the firms have retained their economic position and been able to internationalize. In South Africa's case, the large and lead firms are concentrated in commodities (linked to minerals), and regulated industries including telecommunications, healthcare, construction, and the financial sector. In commodities, the primary focus has been on extraction and export of minerals. This does not require substantial investments in capabilities within the economy. The rationalization of the activities of mining houses in the 1980s and 1990s meant that the non-core assets, including in mining machinery and equipment, which requires investment in technological capabilities to be competitive, were sold off to less funded domestic capitalists and international firms, implying an exit of capabilities and/or lower investments.

The regulated industries are mostly natural oligopolies, where high barriers to entry limit the levels of rivalry that would lead firms to invest in capabilities in order to increase market shares. The incumbent firms can also raise strategic barriers to entry to ensure the exclusion of other firms. The relative importance of both the commodities and the regulated industries in the economy also means that they have power to influence policies—what Zingales (2017) has termed the 'Medici vicious circle'. The economic power that comes with establishing dominant positions in markets readily translates into the capture of political power that reinforces those positions. This exemplifies economic structure as a source of holding power.

The implication is that there is no influential constituency backing structural change. The commodity sub-sectors have also been producing intermediate inputs for more diversified downstream firms. These upstream firms at times have charged exploitative prices that have undermined the competitiveness of downstream firms (Chapters 3 and 4). The vertical distribution of power within the South African value chains has typically been skewed towards the upstream input suppliers. The holding power of these upstream firms has not only been derived from dyadic relationships between the upstream and downstream firms, but also from the orientation of institutions towards the upstream sub-sectors—what Dallas et al. (2019) refer to as institutional power.

The levers which could have been used by the South African government, including energy and minerals policies, have been undermined by the fragmentation of the state. The division of responsibilities into many different departments under different ministers, particularly during the Zuma administration, meant that corporate interests could lobby them separately and make a coordinated approach unlikely. The separation from trade and industrial policy of initially technology policy in the 1990s followed by development finance and competition (from 2009) put further strain on the coordination requirements across government. Through the political settlements lens, however, what initially presented as an incoherent policy approach actually reflects an arrangement emerging from the need to keep the ruling coalition together.

In the agenda and actions of the state, the interests of workers and businesses in diversified industries have not been given importance, while the lobbying of the industries which prospered under apartheid have meant they have been able to continue to hold sway. Contests have largely been over the division of existing rents rather than how to create new rents. This has been true of the framing of BEE in terms of ownership in existing businesses. The issues of 'state capture' have also focused on existing rents.

Without crafting a new political settlement in which the interests of longer-term investment in capabilities have a prime position, it is difficult to see a different path being taken. Breaking down barriers to entry and growth is one side of such a settlement; new investment is the other.

South Africa's post-apartheid experience is an extreme version of factors facing upper middle-income countries struggling to enter high-incomes status in the context of liberalization, globalization, and high levels of inequality. Four key observations provide rich material for wider political economy debates.

First, the state is not monolithic but rather an arena where conflicts between powerful groups take place. The industry case studies in the book and the discussion above have shown how different interests are able to shape economic policymaking and regulation in their favour. In addition, the state's ability to monitor and enforce conditionalities on state-provided incentives is dependent on the balance of power.

Second, the constitutive power of international norms that are not necessarily associated with particular institutions can shape development outcomes (Dallas et al., 2019). The rationalizing of South African conglomerates, combined with the internationalization of businesses and a narrower focus on protecting profits and paying out dividends, undermined longer-term productive investments in South Africa.

Third, inequality makes politics prone to populism, understood in economic terms as personalized leadership that addresses broad but unorganized discontent. The rise of former President Zuma was in response to the growing discontent with outcomes for the majority of South Africans. The liberalization reforms have largely ensured the continuation of the economic status quo including inequality. As such, the variable relationship between political stability and economic transformation during the period of analysis has underpinned the accommodation of particular interests.

And fourth, institutional analysis alone does not explain the paths of economic transformation. Post-apartheid South Africa has developed world-class institutions, which on paper should have ensured that the transformation of the economy would be more inclusive. However, the way institutions work in practice depends on the responses of the organizations operating under these institutions (Gray, 2018). The state capture years have been indicative of how power lies outside formal institutions, with the Gupta family alleged to have used a web of informal networks that operate within and outside formal institutions to facilitate clientelism.

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