Could the Emperor's New Clothes be Made in the Coega Special Economic Zone?[46]

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The South African economy needs to become more employment intensive. In the New Growth Path document there is a diagram which illustrates how the growth rate required to create 500 000 jobs per annum hugely depends on the employment intensity of growth. It's an obvious point - South Africa (SA) needs growth, however, each unit of Gross Domestic Product (GDP) growth needs to generate more employment opportunities than has hitherto been the case.

In spite of massive unemployment and a poverty rate more reminiscent of low middle income rather than upper middle income countries, SA does very badly in labour intensive manufacturing. Why is it that other upper middle income countries with much lower poverty levels that SA (e.g. Mexico, Malaysia, Turkey and Thailand), have large labour intensive sectors and SA does not?

Special Economic Zones (SEZs) can aim at establishing industry competitiveness via improved infrastructure, establishing clusters or dealing with economic distortions. They can also be used to experiment with reform - the Shenzhen SEZ founded in China in 1980 is a classic example. The actual rationale in SA is not very clear. The stated objectives of the SEZ programme are wide-ranging and include stimulating regional growth, attracting foreign and domestic investment and developing strategic industrial capabilities. While the objective of reducing spatial inequalities can be understood in terms of SA's history, this may be in conflict with growth objectives. The location of SEZs in backward regions will impact negatively on their ability to attract investment because of limited infrastructure, skill constraints and weak linkages to supply chains.

Asian manufacturing development offers many lessons. Let me cite two. The first is the opening of the aforementioned Shenzhen SEZ in 1980. As is well known, Shenzhen was at the time a fishing village in southern China. China was an orthodox communist country not at all open to foreign investment. The location for this experiment was chosen partly because it was a long way from Beijing, where there was considerable opposition to the opening up being proposed by Deng Xiaoping. China was able to mobilise its latent comparative advantage in low-cost labour on an unprecedented scale. Justin Lin argues that China went from being a comparative advantage defying (CAD) to a comparative advantage following (CAF) economy and this explains China's massive economic success. In 1980, per capita income in China was just $194 (i.e. 7% of the SA level of $2788). Now China has a per capita income of $9580 compared to SA's $6354. In 1980, manufacturing wages in China were a tiny fraction of those in SA. Garment sector wages in China are now a third higher than in SA ($326 vs $244 per month[47]).

The second lesson is from Korea – or at least from a Korean academic from Cambridge University. Ha-Joon Chang is a well-known heterodox economist and exponent of interventionist industrial policy who argues that countries should pursue dynamic comparative advantage. He was in Cape Town about 10 years ago and I asked him what would be an appropriate industrial policy in a very high unemployment economy such as SA. Industrial policy is generally concerned with moving up the value chain and structural change of the sort successfully undertaken by Korea itself. So his answer surprised me.

[46] This is a play on the book title *Why the Emperor's New Clothes Are Not Made in Colombia: A Case Study in Latin American and East Asian Manufactured Exports* by David Morawetz, published by the World Bank in 1981.

[47] Barrett, P. and Bauman-Pauly, D. (2019) Made in Ethiopia: Challenges in the garment industry's new frontier. NYU Stern Centre for Business and Human Rights. May. https://bhr.stern.nyu.edu/made-in-ethiopia-res

He said something to the effect that SA should "mobilise the unemployed as a leading sector". What does that mean? My take on his response is that industrial policy has to deal with mobilising our greatest unemployed resource, unskilled and semi-skilled labour. This it has manifestly failed to do.

Let's now come back to Coega. If you drive out of Port Elizabeth (Nelson Mandela Bay) heading east along the N2 highway, you will soon come to a huge area (it's almost the size of Port Elizabeth itself) of laid out industrial land which contains a few dozen scattered factories. This is a SEZ almost on a Chinese scale with good infrastructure, which includes a fully equipped container port. The difference compared to most Chinese zones is that Coega is almost empty.

Let's imagine what would happen if the zone was able to create 100 000 jobs in the next five years. Currently, after more than a decade in operation, it has less than 10 000 operations jobs (although many more have been created through construction). 100 000 new industrial jobs would transform the economy of the Eastern Cape. The city of Port Elizabeth would gain new life. Remittances would flow back to the villages and densely populated areas of the Eastern Cape. The multiplier effect would create hundreds of thousands of additional jobs in services, agriculture, construction and the informal sector.

But how could this happen? How could SA compete? This is the challenge for industrial policy. Instead of being fixated on moving up the value chain and high productivity jobs, it has to "mobilise the unemployed as a leading sector". One could even argue that SA has to move down the value chain. This means providing worker flats close to factories, subsidising training and factory buildings to create an environment attractive for light manufacturing in the zone on a huge scale. There also has to be some modification of labour regulation. At the same time, the President's investment team and the President himself should head to China, Japan and other countries to speak to investors.

This is not a new idea. It has been posed in a different format by David Kaplan and the Centre for Development and Enterprise.[48] Their proposal suggested competing with very low wage countries such as Cambodia in the garment sector. I am suggesting something different, labour intensive light manufacturing but of products such as consumer durables and electronics, not competing directly with very low-wage countries such as Bangladesh, Ethiopia and Cambodia in low-end garment manufacturing. The emphasis is on industrial policy support rather than labour deregulation, although labour regulation would need to be seriously looked at.

But what about comparative advantage? It is not being argued that SA can suddenly compete with China, but we can do a lot better in light manufacturing. Mobilising the unemployed as a leading sector means that a prime focus for industrial policy must be to equip the unemployed with skills. Yet the SA government cannot do that. Firms can – the best way to create skills is to create large scale employment within firms. This would have the greatest effect on economy-wide productivity.

In the past, SA has subsidised heavy industry (and the automotive sector) and continues to do so. The favourable power supply agreement between Eskom and the Australian owned South32 Hillside Aluminium smelters is a case in point. Electricity subsidies to South32 probably amount to well over more than R1 million per annum for each of the thousand-odd employees. And of course, this is electricity SA does not have; these smelters gobble up about 3% of SA's electricity supply. Aluminium is then exported or sold to domestic fabricators at import parity prices. This electricity supply contract is up for renewal. What will the government do?

Much smaller levels of assistance could be used to build competitive advantage in light manufacturing at zones such as Coega. The Nelson Mandela metropole has huge advantages - an experienced labour force and a very large labour pool, under-utilised infrastructure including two ports and an attractive living environment. When combined with SA's sophisticated financial system and long industrial history, it is surely quite straightforward to build a compelling investment case.

[48] Centre for Development and Enterprise (2016) An EPZ for the Nelson Mandela Metro. *Growth Series Report 7*. Johannesburg. Centre for Development and Enterprise.