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Inward industrialisation: How do we get it going?

South Africa finds itself in an unenviable position at present. Economic is low and erratic, and appears unable to keep up with population, resulting in declining per capita income. Unemployment is high and rising, and formal-sector employment has lagged far behind population growth for the last fifteen years. Despite this, inflation remains stubbornly high and far in excess of that experienced by our main trading partners. Tax rates are perceived to be too high, and personal savings too low, having been on a declining trend for many years. Rural poverty and high population growth rates have meant a high rate of urbanisation which has accelerated significantly since the abolition of influx control. The consequence has been a huge and growing backlog of formal housing accompanied by mushrooming squatter/shack settlements on the peripheries of cities, as well as within many existing formal black residential areas.

It is trite to say that the only long-term solution is economic growth with the creation of jobs on a massive scale. Once employment has grown to the point where labour shortages are being felt, competition will see to it that wage levels rise and productivity improvement takes place.

Industrial development in any country may be generated by one or more of three processes:

- a growing domestic market;
- export promotion; and
- import substitution.

The term "inward industrialisation" was used in the Organisation of African Unity's 'Lagos Plan of Action' in 1980, and was then applied to South Africa by Lombard et al (1985). Zarenda (1989) has attempted to define it and place it within its theoretical context. Lee (1987) defines it as "domestically generated growth, based upon supplying basic consumer products (e.g., clothing shoes, furniture, basic foodstuffs) and facilities (e.g., low-cost housing) to the rapidly urbanising Black population, with the increasing labour force coming from the rural areas simultaneously finding employment in these existing industries". Inward industrialisation therefore is a variant of the first category above and, as such, is nothing new. What is new, apart from the term itself, is the realisation in various influential quarters (including government) that there is a large potential African consumer market and that the exploitation of this potential offers a tremendous opportunity for further industrial growth. This point has been made frequently over the years, but with little effect in the face of government policies of the day.

The political and social influences on the economy in the past have been such that only a relatively small portion of the African population has been able to join the mass consumer society. As a consequence, this market is, for many products, probably limited to no more than about 25 per cent of all households. The possibility of incorporating the rmeaining 75 per cent is what gives South Africa an advantage in terms of its industrial growth potential over many developed countries which face virtually stagnant domestic markets and whose industrial expansion is necessarily dependent on export markets.

POTENTIAL

Thus, there is a huge potential market for basic goods together with the labour force required to meet it. The key question is how to actualise this potential. A study of market processes in a free-market economy would suggest that this would happen spontaneously, along the lines of Say's Law, with supply creating its own demand. However, this is patently not happening, with soaring unemployment, poverty and the accompanying crime, as people struggle to survive.

Ideally, with no foreign economic threats or pressures and no internal tension, investor confidence would be high, rapid economic growth would create jobs, and the shortage of Whites to fill skilled posts would necessitate further African advancement up the occupational ladder. This would all lead to an increase in African spending power and hence to growth in domestic demand for goods and services. Further industrialisation would occur as a result of the operation of all of the processes listed earlier.

However, given the current international and internal political climate, there are difficulties:

- The worldwide trend towards increased protectionism together with the imposition of trade sanctions and consumer boycotts against South Africa, limits the scope for export-led growth despite the low exchange rate.

- Import substitution has tended to be highly capital intensive, and the country's imports in any case consist mainly of machinery, transport equipment and industrial chemicals, local production of which would be uneconomic given the size of local demand and the consequent absence of economies of scale.

- Private (local and foreign) investor confidence is at a low level.

In addition there are numerous rules, regulations and standards, as well as institutional structures, which inhibit the operation of the free market, and it is difficult for budding entrepreneurs to gain a foothold.

MARKET DEREGULATION

While free marketeers maintain that all that is necessary is to deregulate the market, it is by no means clear that this is readily achievable. It is undoubtedly true that the regulatory institutional framework would be streamlined, but it must be borne in mind that every regulation/institution was put in place for a reason, and even if one discounts the argument that they serve the public good (which many undoubtedly do), behind most of them lie vested interests which would have to be ignored or won over before changes could be effected. Even if it were possible to free up the market effectively, it is by no means clear that this would produce the desired results except in the extremely long run, given the situation in world markets, lack of investor confidence, etc. as already mentioned.

Where then is the impetus to inward industrialisation, and hence growth, to come from? The key to this is rapid urbanisation which, far from being an insoluble problem, provides a signal opportunity. The African population has experienced rapid urbanisation since World War II, and there is little doubt that this expanding urban market has had much to do with South Africa's manufacturing development. Some 40 per cent of the African population resided in urban areas (defined to include informal settlements) in 1980, and various projections indicate that this should increase to 60-65 per cent by 2000. This implies that the urban African population will grow at a mean annual rate of about 4,4 per cent and that it will more than double in absolute numbers between 1980-2000.

The market potential among urban Africans could therefore more than double over this period. However, the incremental population cannot become consumers unless they are in receipt of incomes, and this means having jobs. The country has experienced low rates of economic growth for most of the last 12 years, and manufacturing employed fewer people at the end of 1985 than in 1976.

COLOMBIA

Examination of the situation in which Colombia found itself in the 1960's and the solution it tried in the next decade is instructive in suggesting a way in which the process of inward industrialisation can be triggered. Smith (1990) points out that Colombia shared many of South Africa's current problems:

- high population growth with a rapidly-growing economically-active population;
- wide income discrepancies between an impoverished rural sector and a wealthier urban sector, which resulted in high rates of urbanisation, and a concomitant shortage of housing;
- high and rising unemployment accompanied by high inflation, low economic growth and periodic balance-of-payment crises;
- a policy of growth through import substitution which had run out of steam owing to the exhaustion of 'easy' opportunities;
- a low propensity to save.

Since 1971, Colombia has implemented a unique development strategy. This has used rapid urbanisation as the tool of development p lanning and has been based on the idea of construction as the "leading sector" for economic growth (Currie 1974). There was a large housing backlog in urban areas, and the satisfaction of this demand, it was argued, could have significant multiplier effects in the economy.

The advantages of using the construction sector as the linchpin of economic growth in Colombia were:

- it served internal demand and therefore made the economy less vulnerable to external forces (such as fluctuating world commodity prices);
- it used domestic raw materials and therefore put no pressure on scarce foreign-exchange resources;
- spillover benefits or urbanisation included increased pressure for land consolidation and for large-scale farming using modern technology; and
- construction was labour intensive and created new urban jobs which required little skill or education.

In order to satisfy the latent mass demand for housing in Colombia, a system was designed to encourage personal savings and to channel those savings into mortgages and construction. The system was based on cost-of-living adjustments in terms of which savings linked to construction were inflation-indexed and thus yielded a positive real return unmatched by other financial assets (personal savings previously had been discouraged by negative interest rates). Special private institutions were established for this purpose, and were required by statute to devote at least 50 per cent of their funds to middle- and lower-income groups.

EFFECTS AND WEAKNESSES

The Colombian strategy had immediate effects:

- Housing finance expanded rapidly, new building loans doubling in two years.
- New building activity boomed.
- Employment in the construction sector expanded by 44 per cent in two years, while the employment multiplier effects were such that 1 million new jobs were created in four years with a concomitant decline (of almost 50 per cent) in the unemployment rate.
- The national economic growth rate reached 7-8 per cent per annum.

The programme, however, also had a number of weaknesses.

- It appeared to have contributed to inflationary pressures.
- It benefited mainly the middle- and upper-income groups rather than the poor. This was largely because the planners, assuming that incomes would rise sufficiently to enable the poor to live in conventional housing excluded site-and-service and self-help housing. It is now conceded that this was a mistake and that site-and-service schemes, together with State provision of infrastructure and community services, would have been more beneficial to the poor.

- Although it reduced unemployment to the extent that this was no longer a significant urban problem, many of the jobs were low-income and low-productivity ones centred on the informal sector, handicrafts and domestic service. This criticism would appear to be unfair in that key aspects of the policy were reversed only four years after implementation (see Smith 1990), resulting in a significant drop in real growth. Had this not happened, it could have been expected that the continuing high growth rate would have resulted in labour shortages, with the ensuing competition leading to wage rises which would then have forced employers to introduce productivity improvements to justify the new level of wages and so on. Thus, the real criticism should be directed at the premature reversal of key aspects of the policy.

"LEADING SECTOR"

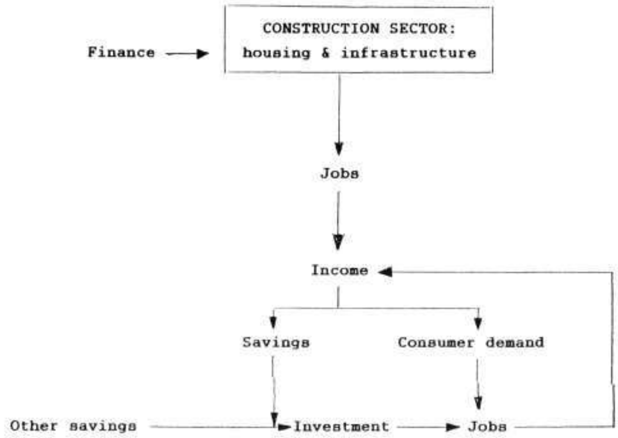
It appears that the "leading sector" concept, using rapid urbanisation and the construction industry as a trigger (as illustrated in the diagram), could be applied in South Africa with the same advantages as those listed above. The construction sector has a low propensity to import; the possibility of improving homeland agriculture along similar lines as mentioned above is apparent; the production of basic goods is less import intensive and more labour-intensive than that of more sophisticated goods; and sectors such as building and clothing are competitive and offer considerable scope for small firms and African entrepreneurs with consequent favourable effects on income distribution.

The idea is that housing and physical infrastructure (streets, water, sanitation, power, schools, clinics, recreation and other social services) would be provided to meet the needs of the rapidly urbanising African population. A number of issues arise out of this proposition.

How is the expenditure necessary to set the process in motion to be funded? Higher government spending can be financed by raising taxes, increased borrowing or printing money. Lee (1987) appears correct in advocating a policy of higher brorrowing but this of course implies a higher rate of deficit financing than at present. Recent Budgets have been based on a borrowing requirement of no more than 3 per cent of GDP, but Rees (1986) regards this as ultra-conservative; at the current rate of inflation the nominal deficit is, in fact, a real surplus, and the consequences of this policy is that the balance of revenue has to be derived from very high taxation rates. Presumably the private sector, notably financial institutions, would assist in the funding and participate in housing development.

What is the job-creation potential within the construction sector itself of alternative housing strategies? For example, the eight housing-delivery systems examined by the NBRI for the Private Sector Council need to be compared. How many jobs could each generate given the number of dwellings required, and what are the funding implications? Would the construction be undertaken by large firms, small African builders, etc., and is there any scope for sub-contracting from large to small firms? What average incomes would be earned under each scheme? This is an important point as the multiplier effects will depend on elasticity of demand for individual goods, and this elasticity in turn will depend on income earned.

As the diagram illustrates, the provision of housing and infrastructure generates additional jobs and hence additional income in the economy. We may hypothesise that some of this income will be saved and some will be spent.



CONSUMER EXPENDITURE

With regard to consumer expenditure, it is important to assess the likely pattern so as to obtain an idea of the sectoral breakdown of manufacturing and other (primary and tertiary) jobs which might be created, i.e., what is the elasticity of demand for what items? Lombard et al (1985) mention that there would be a growing demand for foodstuffs, clothing, textiles, footwear and building materials, but presumably the demand for more sophisticated goods would also increase. The Bureau of Market Research reports would provide a guide. Is the pattern of consumer expenditure such as to be able to sustain rapid industrialisation? And will this be in large, medium or small firms or in the informal sector?

With regard to savings, what is the propensity to save of the new income earners? Their savings, together with savings elsewhere in the economy, would have to provide the investment funds required to expand output to meet these new consumer demands. It is important that the investment requirements should be met as far as possible by new savings rather than by diversion of existing savings from other avenues of investment. Leaving aside the question of efficiency of investment, the only way ultimately to increase growth is to increase investment at the expense of consumption. Lee (1987) argues that low-income earners have a high propensity to consume, and that therefore little personal savings will accrue and the financing problem in the economy will be exacerbated. Improved overall incentives to saving thus appear critical. It seems important to stimulate new savings at the expense of consumption by middle- and higher-income groups, and ways of encouraging such savings require attention.

The Colombian experience cited earlier suggests that the interest- rate elasticity of private savings may be surprisingly large, and that the creation of special savings instruments which give a positive real rate of return **after tax** may generate substantial sums. Even though real interest rates in South Africa are currently positive and likely to remain so, after-tax returns are negative for middle- and upper-income earners. This has been so for many years, and is no doubt one of the major contributors to the decline in personal savings.

INVESTMENT

With regard to investment, how much excess capacity exists in manufacturing industry at present and how much new capital investment would be required, and would such investment be diverted from other activities and with what net effect on employment, e.g., if investment is diverted from the armaments industry, what would be the overall result?

The expansion of manufacturing output to satisfy consumer demand would, of course, itself result in increased employment in these industries. These new jobs would imply additional income (as per diagram) and again some would be spent and some saved, and so on.

CYCLE

If the cycle outlined in the diagram works, it should provide an impetus to growth in existing import-substituting industries and to the establishment of new ones as economies of scale become possible. Whether export industries would be stimulated would depend on political factors; in the normal course of events the existence of a larger local market should enable manufacturers to develop and adapt products and technology to Third World conditions and therefore improve their position in foreign markets.

In particular, the country's comparative advantage probably lies in exporting basic consumer goods to other Southern African states, where potentially large markets exist. The question may be raised as to how these countries, which are generally extremely short of foreign exhchange, should pay for such imports. Most of these countries have, or can produce, basic commodities which this country needs, e.g., hydroelectric power, water, basic minerals and raw materials, and counter-trade deals could be arranged in many cases.

In conclusion, inward industrialisation offers South Africa the chance to reorient its growth path, and through a rapidly expanding consumer market, to open up new avenues for both import substitution and export promotion. However, it should not be seen as THE answer, and there are many potential pitfalls. Above all, concentration on inward industrialisation should not detract from the more mundane tasks of productivity improvement and the maintenance and extension of existing export markets, streamlining of the regulatory/institutional environment, etc. Further, the opportunities to improve rural conditions provided by rapid urbanisation should be firmly grasped. Indeed, it is essential that an urban-based strategy should be accompanied by an appropriate rural-based one. □

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*This is a slightly extended version of a paper prepared by the authors for the Private Sector Council in 1987.

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