

# **Industrial Policy, Politics and State Capacity Building**

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This is a discussion note rather than a polished paper. I have kept references down to a minimum. It is written with the intent of setting out some of the basic issues and is meant to stimulate debate and discussion around the political issues of industrial policy. It draws heavily on my personal experience in formulating and implementing industrial strategies in South Africa in two areas: a) at a regional level with the Western Cape government and b) and at a national level through attempting to organise firms in the various components of the clothing and textile value chain and negotiate a sector policy on their behalf with national government.

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(My thanks to David Kaplan for very helpful comments. I remain solely responsible for the content.)

## SETTING THE CONCEPTUAL SCENE

### Some of the issues to consider

In this note on stimulating a discussion around building state capacity, I try to raise a number of questions/issues derived from my own experiences around both industrial policy and the politics of growth that impact on the ability to translate industrial policy into implementable strategy. This is a discussion which pivots around the alignments and conflicts of interests within the state, as well as between state, private sector, and unions.

The politics of growth is wider than the issue of how industrial policy is designed. However we often engage in the discussion as if it was simply a question of policy, leaving out a crucial political component of the equation – i.e. the manner in which politics plays itself out within the domain of the formulation of policy and its translation into strategy.

Let me start by asserting four key questions at issue in discussion of industrial policy:

- Can industrial policy lead to economic growth? This most often turns on the state versus market debate.
- Can one attain economic growth through big jumps or does one make do with what one's existent capacities. This is essentially a debate around creating competitive advantage or operating on the basis of ones existing comparative advantage.
- How can capacity in government be built such that it is able to formulate and particularly implement policies more effectively? This is essentially a discussion around the role and limits of upgrading and skill building? In other words the role of learning and adapting as opposed to an all knowing state.
- Who leads the process? This is a discussion around the politics of growth and the role of government and/or business.

I start from the premise that industrial policy has to tackle the problem through the following three framing issues:

- Direct versus indirect policy and strategy – some state interventions are directly designed as industrial policy whilst others are not intended as industrial policy but have an important indirect impact on industry.

- There are different levels of state and economic activity – i.e. macro, meso, and micro interventions
- Policy coherence versus policy (i.e. political) will.

Although this discussion note deals more or less with all of these areas, the major point in the note is to outline the centrality of policy coherence and political will and stress the key differences between them. In other words bringing politics back into the discussion of industrial policy

### **The dominance of two conventional orthodoxies**

Industrial policy has critically been polarised into those who favour the market over the state (free market advocates), and those who argue for major state intervention to overcome market failure (developmental state advocates). The former are classically represented by the World Bank/IMF through the Washington Consensus, whilst Ha-Joon Chang has been the most vociferous advocate of the latter position.

Those sympathetic to the Washington consensus (World Bank 1997) argue for the primacy of the market and are sceptical of government intervention aimed at shaping the pattern of industrialisation. They argue that the biggest single challenge for government in its development of policies for different economic sectors and cross-cutting themes is one of limited information. In order to identify appropriate policies, government has to identify the myriad of opportunities and constraints that firms face and to understand firm responses. As the World Bank report (1993) into the determinants of industrial success in eight “highly performing Asian economies” (Hong Kong, Indonesia, Japan, Korea, Malaysia, Singapore, Taiwan and Thailand) concluded this is obviously a daunting task, and beyond the scope of most developing country administrations. “The prerequisites for success were so rigorous that policymakers seeking to follow similar paths in other developing countries have often met with failure” (World Bank 1993: 6).

It concluded, in summary, that the only positive role which these governments had played was to promote generic economy-wide incentives (e.g. education and research and development) to compensate for market failures. The Report explicitly argued that targeted industrial policies had been a failure, even though it acknowledged that providing unambiguous “proof” was difficult. There were two central conclusions that arose from this study: Firstly, it was argued that targeted industrial policies cannot be

shown to have had a net positive impact on industrial performance; and secondly, even if it were true that targeted policies might be effective in some environments, the call on administrative expertise was so significant that few developing economies could hope to benefit from their use.

For this reason many orthodox economists stress the enormity of the task confronting government while simultaneously emphasising the limitations on government capacities and resources. For them, the probability that such policy interventions will fail is very high. Indeed, government failure is likely to be ubiquitous<sup>1</sup>. Consequently they argue against the need for state governed interventions, instead asserting the pre-eminence of the market over the state as the appropriate mechanism to resolve problems and ensure economic growth. Hence they privilege trade policy liberalisation, deregulation, Foreign Direct Investment (FDI) and the dismantling of policy and administrative regimes designed to promote industrial development.

In this perspective, there is seemingly no politics of growth because the concept of state intervention is frowned on. The underlying concept is one of static allocative efficiency so upgrading is not an issue, and capacity building in government becomes downplayed. Comparative advantage rules because fundamentally the market knows best.

This view of eschewing state intervention in favour of the market has come to be accepted as the dominant orthodoxy in economics, and hence in the minds of conventional economists, industrial policies have been considered to be jettisoned into history's trash bin. However as Rodrik (2007) points out:

The reality is that industrial policies have run rampant during the last two decades - and nowhere more than in those steadfastly adopted the agenda of orthodox reform. If this fact has escaped attention, it is only because the preferential policies in question have privileged *exports* and *investment* - the two fetishes of the Washington Consensus era - and because their advocates have called them strategies of "outward orientation" and other similar sounding names instead of industrial policies. Anytime a government consciously favours some economic activities over others, it is conducting industrial policy. And by this standard the recent past has seen more than its share of industrial policies. (pg. 119)

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<sup>1</sup> Pack and Saggi (2006) argue that the "range and depth of knowledge that policy makers would have to master to implement a successful industrial policy is extraordinary. They would have to understand the relevance of , and be accurately informed about, a huge range of complex questions and have the ability to accurately evaluate very subtle differences" (pg 21).

The issue therefore in reality becomes not one of whether to engage in industrial policy, but rather *how*, in *what form*, and *under whose direction*, one should do so.

A vocal proponent of what we may term 'orthodox industrial policy' is Ha-Joon Chang work (1996, 1998, 2002). His definition of industrial policy is narrow, identifying selective policies to target particular sectors and firms, regarded as "national champions". Thus, he cautions against a wide perspective which comprise a 'catch-all term for all policies affecting industrial performance'. Instead he defines 'industrial policy as a policy aimed at *particular industries* (and firms as their components) to achieve the outcomes that are *perceived by the state* to be *efficient for the economy as a whole* (emphasis in the original) (Chang, 1994 :59-60).

In this framework industrial policy is targeted at protecting and facilitating particular sectors, utilising efficient far sighted state institutions, to 'defy a countries comparative advantage' and create competitive advantages<sup>2</sup>. This all takes place at the national level. Consequently one struggles to find a detailed discussion of the role of industrial policy at the level of the firm, region, cluster, or value chain in this work.

A key problem for this conceptualisation of industrial policy however lies in the issue of state capacity - who knows and who decides? Empirically the favoured example brought to bear to demonstrate the success of this model is the role played by the state in South Korea (or sometimes the other NICS are also cited). But this begs the question of its applicability to most developing countries whether they be low or even middle income ones, where:

- the state's institutional capacity is low and disorganised,
- human resource capability is poor,
- corruption is often endemic and targeting industries facilitates political capture,
- even if government could pick winners developing countries government bureaucracies are generally incompetent,
- officials have little experience of industry and its needs, and
- hence are incapable of leading, and the major problem lies in implementing industrial policy no matter how sophisticated its formulation might be.

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<sup>2</sup> A phrase used in his debate with Justin Lin in Development Policy Review, 2009, 27 (5): 483-502

The problem with the orthodox industrial policy advocates, is that the stress on targeted interventions implicitly assumes that the state 'knows' or has access to pre-determined 'knowledge' with respect to what to target, both generally as well as within the selected sector. In other words the issue of government 'learning' is relegated from the discourse. Knowledge is rather a result of sound information provided by research institutions within government or through contracting external consultants to assist in the formulation of appropriate policy. This is peculiar given the current stress in business circles on the importance of knowledge intensive activities and the process of learning in attaining manufacturing excellence.

Furthermore, the discourse of world class manufacturing stresses that attaining knowledge and appropriately applying this knowledge is a relational, rather than self contained, endogenous activity. It is not only that government has to engage in ongoing learning and innovation, it also needs to be aware of who it has to learn from. Industrial policy is all too often premised on the notion, and unfortunately also believed too literally by government bureaucrats, that the state conceptualises the issues, provides the strategies, and then business receives the benefits. In other words, there are at least two parties in any industrial policy/strategy and intervention – government and industry stakeholders – and the process of filling in the details of industrial policy involves them in a mutual, relational, 'learning' activity.

Whilst there is some discussion about building capabilities, the issue of achieving systemic competitiveness between firms is neglected in Chang's focus on targeted sectors as the essence of national industrial policy/strategy. The role of clusters and value chain alignment producing systemic efficiency between the links of the chain, as well as reaping collective efficiency gains through cooperative clustering is hardly discussed.

Then there is the question of which level of the state is best placed to engage and intervene? Most discussion of industrial policy operates from the perspective of the central, national government and national sectors. But firms, even if they operate within national and transnational markets, exist and are embedded within defined localities. Central government is often too far away and distant from firms to be sectorally embedded in their needs, problems, requirements, and cluster activities. As a result central government finds that it lacks the *institutional intimacy* to appropriately monitor

and appreciate successes, and track the enterprises movement towards international competitiveness. Central government's tendency to concentrate resources and set up bureaucratically obstructive accessing mechanisms can also have a major debilitating impact on the ability of firms to gain from industrial policy arrangements. Distant and unresponsive centralised bureaucratic structures do little to enhance the building of relations essential to the uptake of programmes deemed national priorities<sup>3</sup>.

In short, space barriers, distance and limited contact between firms and central government officials limit trust, mutual learning and effective implementation. Often, but not always, this can be overcome by provincial and local governments, which are more embedded in the industries under their purview, assuming greater authority. Provided of course that provincial governments are held accountable for provincial economic development. Being able to create greater institutional intimacy with industry they are in a position to jointly formulate more appropriately designed industrial policies, set more realistic priorities for the areas they exercise governance over, and implement realisable industrial strategies. We stress that this is not always the case, since incompetent or corrupt administrations can also simply use their closeness to local enterprises to engage in rent seeking behaviour.

This issue of implementation failure is the fourth dimension that orthodox industrial policy/strategy proponents have to consider. Government learning in respect of industrial policy is not confined to formulating policy about formulation *what* is required to be done; it is also fundamentally an implementation issue – i.e. *where* to intervene and *how* to go about doing so.

This requires institutionalising a learning process between government and industry. Furthermore there is little point in setting out an industrial policy requiring a variety of interventions if the implementation capacity in government does not match the requirements. But all too often available capacity is not the realistic starting point. Instead elaborate, elegant and sophisticated industrial policy measures are formulated with no realistic prioritisation based on existing capacity and the necessary institutional arrangements to implement them.

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<sup>3</sup> Helmsing goes so far as to claim that "... *the only justifiable form of industrial (trade) policy is in fact regional industrial development policy.*" Helmsing (2001)

## An alternative to the orthodoxy

Essentially, in setting up the duality between industrial policy and the market, both sides<sup>4</sup> of this debate have also set up a polarity of government intervention versus business activity. One seemingly has to choose - either the state is paramount or business is left alone to go about its business.

In contrast, Dani Rodrik has attempted to escape this polarity and provide a very different approach to industrial policy<sup>5</sup>. This approach stresses the importance of the relational interdependency between state and business, the necessity but uncertainty of any state directed interventions, and hence the crucial role of learning in the process. Indeed the essence of industrial policy is not to treat it as a fixed static state but rather as an institutionally embedded process.

For Rodrik (2007), industrial policy is first and foremost about getting the appropriate information and establishing a relational process of learning:

industrial policy is .. a discovery process .. where firms and .. government learn about underlying costs and opportunities and engage in strategic coordination... I start also from generic market failures, but then I take it as a given that the location and magnitude of these market failures is highly uncertain. .... the task of industrial policy is as much about eliciting information from the private sector on significant externalities and their remedies as it is about implementing appropriate policies.

Hence the importance of understanding that the state cannot achieve its industrial policy aims on its own and requires a reciprocal relationship with business. Government does not have the capacity to 'know' a priori what is required:

"The right model for industrial policy is not that of an autonomous government applying Pigovian taxes or subsidies, but of strategic collaboration between the private sector and the government with the aim of uncovering where the most significant obstacles to restructuring lie and what type of interventions are most likely to remove them.

The consequence of this model is that industrial policy has to shift its traditional focus away from prior known targets and towards a process of mutual learning and reciprocal determination of problems as well as solutions:

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<sup>4</sup> Justin Lin (2009), attempts to marry these two positions with his concept of the state as a 'facilitating midwife' rather than a 'defying nursemaid'. His view is firmly anchored in a comparative advantage perspective with marginal state interventions based on existing endowments with the private sector playing a major role. The problem is that instead of Korea the empirical reference becomes China.

<sup>5</sup> There are other authors that have also attempted to escape the dichotomous terms of this industrial policy debate - e.g. Evans with the concept of embedded autonomy to name just one. I use Rodrik because in my opinion his is the most clearly articulated policy framework.



industrial policy needs to focus not on the policy *outcomes*—which are inherently unknowable *ex ante*—but on **getting the policy process right**. .... how we design a setting in which private and public actors come together to solve problems in the productive sphere, each side learning about the opportunities and constraints faced by the other.

With this emphasis on process, learning, and strategic collaboration, it is not surprising that Rodrik therefore also stresses the importance of picking the right parts and levels of the government in implementing appropriate industrial policy:

Typically, you have to look for parts of the government where there is bureaucratic competence, where there is professional expertise with certain amount of autonomy. And I think, where you have those, programs like these can be undertaken. It will never look the same way from one country to another. .... Particularly, this will depend a lot on where the capacity in the system, in the public sector, is really located..

So in summary, Rodrik argues that there are a wide range of generic market failures and externalities – indeed a wider range with a more constraining impact on development than has hitherto been recognised. The location and magnitude of these failures is highly uncertain. Hence the argument for an active role for government is precisely because of the wide ranging extent of market failure. But Rodrick also recognises the possibility of government failure is very real. Nevertheless, he argues that the limitations on government in accessing the necessary information can be very considerably alleviated through the development of appropriate processes and institutions. Thus, the considerable emphasis on institutional design in his theoretical framework, part of which is precisely built around the importance of creating the conditions for learning and accessing information between private and public sector.

The private sector has far better, albeit also imperfect, knowledge than the government. The key issue that institutional design has to grapple with is how to ensure that government can access and learn from the information possessed by the private sector. Simultaneously, the private sector needs to be well-informed about government policies and limitations since government has an important impact on their behaviour. This is why institutional design which facilitates learning and information flow is so important for effective industrial policy and strategy. Organisations and processes which bring government and business into a dialogue have to be designed so that government can access information and to act effectively on it, and, reciprocally so that business can have knowledge of governmental policies and capacities. Finally the ultimate aim of industrial

policy is international competitiveness - to build firm level capability and value chain alignment in order to create individual and systemic competitiveness.

## **PART 2: TWO PRACTICAL EXAMPLES**

In this next section I sketch out in summary form two practical examples of building state and private sector capacity around what I have termed an alternative (relational or embedded) form of industrial policy. The first is a regional/local industrial policy formulated and implemented by the Western Cape province government from 2005 onwards. The second example is a national sector policy for the clothing and textile industry. Notwithstanding their undoubted success as exercises in industrial policy formation I also raise a number of *political problems* that threaten their long term viability and ultimate success.

### **The Western Cape Micro-Economic Development Policy**

This provincial industrial policy (called the MEDS)<sup>6</sup> was formulated by a combination of a small committee of external experts<sup>7</sup> working with government bureaucrats in the provincial department of economic development. It explicitly rejected the top-down old approach. The MEDS was premised on the recognition of the existence of both market failure and institutional failure, and hence the need to create specific institutional instruments to deliver public goods, coordinate network alignment, and meet market needs. It accorded primary importance to establishing an institutional environment between government and industry, which prioritized the needs of firms as well as creating an enabling environment for the co-evolution of policy and instruments for support.

In line with the principles governing its industrial policy - creating public/private linkages, learning from the private sector, and acknowledging the capacity limitations of government – the MEDS conceived of the private sector rather than government as best situated to identify constraints, obstacles and opportunities. Hence it was accorded the leading role in developing the specifics of the implementation of the industrial strategy. The institutional framework was structured so that government should work very closely

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<sup>6</sup> For detail on the MEDS see the Kaplan et al 2010.

<sup>7</sup> I was one of four experts called the Oversight Committee of the MEDS. From 2005 - 2010

with, and take the lead from, the private sector in various key sectors, designing policies to address the short and long term sectoral needs of industry, without this entailing that government was simply doing the bidding of business.

The first goal and task was to attempt to identify sectors where growth can be significantly enhanced through government assistance. The explicit rationale was that without industry buy-in industrial policy/strategy is unlikely to work. The private sector therefore, rather than government, should play the leading role in this process, without relegating government to the back burner. For, the rationale was that the identification of new opportunities and the design and implementation of specific sectoral strategies should be a joint endeavour of the provincial government working together with the private sector. Furthermore, the process of implementation was understood as an iterative one, involving an ongoing process of learning as the strategy unfolded. Rather than assuming a priori answers to all issues, it explicitly attempted to avoid producing a comprehensive directory of possible policies which, like the 'yellow pages', eager civil servants can thumb through to find this or that detailed intervention.

This process of 'working together' was effected through specially set up institutions embodying a public-private partnership - 'sector forums' or independent 'special purpose vehicles' (SPVs) - to bring together government and industry. These institutional arrangements were intended to ensure learning and transfer of knowledge about the needs of the stakeholders in the specific sectors identified for support, maintain continuous buy-in from the key stakeholders as the process unfolded, allow for flexibility in the identification of key areas of intervention as conditions altered, and finally avoid the funding bottlenecks associated with overly bureaucratic government procedures.

These SPVs were the institutional mechanisms enabling provincial government to assist industry meet specific sectoral needs and achieve firm competitiveness. They did this through facilitating the alignment between sector firms and provincial government, as well as assisting firm/enterprises to cooperate with each other. SPVs were constituted to include industry and government department stakeholders on their boards, to which they were jointly accountable. They were required to consult broadly and frequently among member firms and then report on their needs and design support mechanisms to address these needs. The SPVs became the focal point of learning, dialogue and information

exchange between the private sector and government, led by the former, in formulating policy plans. SPVs therefore allowed for the co-evolution of policy and industrial support initiatives. In addition they were also the knowledge point for ensuring that implementation plans were grounded in, and backed by, a public/private partnership to raise the chances of their success. Given the limitations of government capacity, SPVs were expected to carry much of the burden of industrial policy – its evolution as well as strategic implementation. The SPVs are in effect development councils for their industry. They are the most important mechanism for ensuring that industrial policy remains relevant and responsive to the needs of the firms and sectors it is designed to support.

Many government industrial policies are devised in the abstract based on first principles, and conceptualised as if the capacity issues to implement them were someone else's problem. Rather than adopting this approach, the MEDS started from the principle that a policy or strategy has to take into account the existing and likely institutional arrangements available to implement it. There is no point in devising an elegant, academically advanced industrial policy/strategy which requires an unattainable level of expertise and/or large numbers of civil servants in government to make it operational. Provincial government has a limited budget, a defined civil service salary budget that makes it hard to attract skilled staff particularly from the business sector, and exhibits high staff turnover. Hence in reality it often operates with severe skill shortages and insufficient capacity. The MEDS therefore operated on the principle of 'cutting your coat according to your cloth'. It consciously tried to avoid formulating industrial policy based on the political 'wish lists' of government or the sophisticated policy programmes of consultants. Instead it purposively limited its scope and breadth, and tailored its government interventions in line with the actual capacity of government to implement its proposals.

Hence a few priority sectors meriting particular attention were identified based on specific goals of potential growth and equity criteria. The key issue here was to avoid the all encompassing wish list syndrome and to take account of limited capacity, all of which would simply result in a dilution of priorities, dissipation of focus, and an inability to act effectively with limited resources. What followed from the latter was implementing the principle of 'achieving the greatest bang of the buck' to decide on which sectors would be prioritised. Sectors that had high potential, that were susceptible to policy and where

resource costs were likely to be limited, would qualify as potential priorities. Finally the presence of existing forms of private sector organisation (industry associations, sector forums, sector based development organisations) with significant representation and embeddedness, which could embody a sector strategy, provide legitimacy and act as a driver, was a key basis for making a decision to prioritise a particular sector.

In the policy framework those sectors selected were categorised in terms of levels of priority with differentials types of designated support. The highest level were a small number of 'flagship sectors' which were earmarked to receive multi-faceted government support – finance, training, infrastructure, promotion etc. - over a number of years. Government was committed to building and providing capacity in the form of a designated "desk", staffed by knowledgeable personnel that were specifically dedicated to providing consistent and continuous support for that particular sector. The rationale was that the continuous interaction would build on and provide the necessary institutional intimacy to ensure confidence and sustained interactive learning between the private and the public sector. If one accepts the limitations of government's capacity as one of the starting points of industrial policy, then an important role of such interventions must be to also grow this capacity in terms of resources, people and capabilities. The expansion of government capacity, through an iterative learning process, which also grew sectoral capabilities was thus an important goal of MEDS.

This was regarded as a critical objective to create a stable and credible policy environment, providing firms with considerable certainty regarding the availability of resources and personnel. Without such stability, embodied in a focused, consistent policy environment, and an appropriate institutional form, government personnel could not learn, develop their industry analytic capacities in any sustainable form. This is particularly important given the general tendency to swap government personnel about, within and between departments.

Having 'flagship desks' heavily backed by high level political support was also regarded as a way to overcome the dislocated nature of government operations. The problems that firms face do not exhibit themselves in the neatly packaged silos of government departments. They cut across the spheres and competencies of departments and ministries, and addressing constraints often requires policy changes and interventions in

a wide variety of ministries – e.g. education, labour, police and criminal justice, home affairs and transport, to name only the most obvious. For example the operational performance of these firms may be disadvantaged by inadequate public transport or energy malfunction or targeted criminal activity, all of which require rapid response but which is difficult to get action on because of the silo nature of government. The concept of a dedicated ‘desk’ with high level political backing was intended to overcome such problems, allowing knowledgeable personnel to move seamlessly between departments, rapidly intervening to solve particular problems and overcome constraints. Being familiar with the key participants in the selected industry and able to pick up issues easily, such personnel should immediately be in a position to take constraints and obstacles to a higher level in order to get them dealt with.

In turn the SPVs understood the industrial policy/strategy not as a fixed ‘plan’ but as embodying process, engagement and learning. Rather than viewing the MEDS as a set of codified policy prescriptions, they saw it as the mechanism to establish relationships between government and the private sector. Likewise their own obligation and responsibility lay in providing the institutional nexus where this process of learning, policy reformulation and strategic intervention by government and industry could occur.

In summary these institutional arrangements for an alternative industrial policy strategy in the province were able to meet a number of critical industrial policy goals:

- Because of their institutional intimacy, they ensured the *institutionalisation of learning and transfer of knowledge* about the needs of the stakeholders in the specific sectors identified for support.
- They maintained *continuous buy-in from the key industry stakeholders* as the industrial policy process unfolds and private sector participants are always able to feel relevant and consulted.
- From an implementation perspective, their independence of government red tape and procedures allowed for *flexibility in the identification of key areas of intervention* as conditions alter. The presence of representative private sector actors in the institutions meant that these special purpose vehicles should be able to rapidly learn what areas to intervene in, tackle potential obstacles flexibly, and act to take advantage of opportunities.
- They were able to *avoid the funding bottlenecks* associated with overly bureaucratic central government procedures. Using the core funds provided by

provincial government they were able to leverage additional funding from a broad range of other private and public sector bodies to significantly ramp up their range, scope and spread of activities.

- Designated *lower tier government officials were closer to the firms* in a particular targeted sector and hence were better positioned to manage and address their issues and provide rapid action.
- This structurally helped to *build internal capacity in government* through specialised ‘desks’.

Obviously all this could only work if these ‘sector bodies’ (e.g. Special Purpose Vehicles) - the focal point of information, learning, and dialogue between the private sector and government - formed a central plank of the industrial policy and its implementation strategy. Provincial government was able to feel confident in granting them funding support, since it also became the sector bodies task to ensure that the programme was carried out according to the criteria set out and that monies were being spent effectively. Given the limitations of government capacity, in this way the sector bodies, comprising a public/private partnership, but led by the private sector carried much of the burden of regional industrial policy – its design as well as implementation – in a variety of different sectors in the province.

### ***Politics and the MEDS***

Generally speaking the MEDS has been a relatively successful piece of industrial policy design and implementation<sup>8</sup>. However there have been a number of problems. Apart from the usual and expected teething problems most of these these lay in institutional issues of alignment between the regional government and the SPVs. Many of these can be analysed in terms of institutional blockages, capacity problems, difficulty in attracting and holding good SPV managers, some poor functioning SPVs, or lack of resources etc. It is not my intention to lay these out here. They have been covered in a number of reports to the provincial government and many of the pertinent issues are published in the MEDS Composite Report (2010). Some however pertain directly to the influence, or interference, of directly political processes. It is to these issues of the politics of implementation that we now turn.

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<sup>8</sup> In March 2010 an International Peer Review Panel produced a very favourable evaluation of the MEDS as an industrial policy framework – its formulation and design rather than implementation. The principal reports by Raphie Kaplinsky and Hubert Schmitz are available as an appendix to the Composite Report.

The politics of industrial policy tends to be seen by economists as equivalent to issues of policy formulation and design – for example where one stands in respect of the limited intervention, free market friendly, state versus the interventionist, developmental state. My concern here is rather to summarise some of the issues around the influence of politics on the implementation of the MEDS as an accepted industrial policy. In my descriptive discussion and analysis that follows I have tried to group the numerous issues of empirical detail into two broad categories of ‘politics’ in order to make them more generalisable. These are politics in a broad sense deriving from ideological frameworks, and politics of the small derived from administrative institutional conflicts and interests. I also discuss these in terms of two separate periods under different political party regimes in the life of the MEDS.

The alternative model of industrial policy outlined and put into practice in the MEDS requires a particular brand of politics on the part of those bureaucrats exercising power over the implementation of the MEDS. The period within which the structure of the MEDS was put into place occurred under an ANC dominated provincial government (2004 to the March 2009). The upper echelons of the department of economic development – both politically appointed civil servants and politicians – expressed wholehearted support for the particular brand of industrial policy characterising the MEDS. Without this support the MEDS would never have seen the light of day and been allowed to grow into a successful industrial strategy. They seemingly bought into this idea of a relational industrial policy, as opposed to a more commandist role of orthodox industrial policy or a limited intervention (free market) model. This was in spite of the dominant, more commandist ideological framework within which the ANC was historically steeped. However, at critical moments, many of the old politico-ideological instincts of this upper echelon came to the fore.

The ANC, like most nationalist movements in Africa had a deeply ingrained, ideologically rooted, suspicion of capital which played itself in myriad ways. This manifested itself in a direct way in the Department of Trade and Industry (or provincial department of economic development) which struggled to understand that their main client/customer was actually ‘business’ rather than an amorphous ‘the people’. They found it very difficult to accept in practice the maxim that ‘business proposes and government disposes’ – an underlying rationale of the MEDS industrial policy framework.



This dovetailed with the general problem applicable to most ordinary bureaucrats, an inherent unwillingness to let go of direct control of the relationship between themselves and industry. They clearly saw the point that the essence of industrial policy requires long term vision and plans, and should not be subject to the vicissitudes of short term individual business decisions, but they struggled to take the corresponding step of the MEDS that this did not mean they were in full control of the long term process.

This was compounded by the intra government struggles with the provincial treasury. The latter, as seems to be the case with all finance ministries, was inherently well disposed to a limited state interventionist modus operandi, seeking short term measurables and immediate returns to justify fiscal expenditure. Short term measurables makes sense if one is dealing with a defined and determinate outcome – e.g. a bridge or a road – but it makes little sense for evaluating industrial policy investment where the outcomes are necessarily longer term and much more diffuse. It is simply not possible, for example, to measure the number of jobs created by a manufacturing excellence training program for firms to make them more internationally competitive. The end result of this intra governmental political struggle was that the SPVs were subjected to filling in an overly complex set of unrealistic check boxes to meet the short term, measurable outcomes agenda.

The impact of these two sets of political process interplaying with the implementation of the MEDS policy design was manifested in a number of ways. I cite a few.

- *Ceding real control over financial resources given to the SPVs:* The HOD during the latter part of this ANC dominated period tried to implement a system which would have substantially increased centralised control at the very top of the department.
- *Listening to industry:* Despite numerous recommendations, it took an extremely long time to get the department to consider redesigning a monitoring and evaluation system of the effectiveness of SPV programs based on the usefulness to industry of programs rather than ticking government check boxes.
- *Learning from industry:* When feeling threatened by new ideas, there was a tendency to fall back on the all knowing bureaucrat – e.g. ‘we have enough people in government to know what is good for industry in this or that sector’ – despite a

commitment at other times to the concept of industrial policy as a 'learning', capability building process.

- *A tension in dealing with the Oversight Committee driving the MEDS:* Whilst the OC mostly and generally had support from the provincial department its peculiar status, as independent and outside the remit of government but paid on contract by government to act as oversight of the MEDS, resulted in conflict when it pursued agendas not fully supported by the upper echelons. This was often when the OC felt the need to assert the interests of the independence of the SPVs against bureaucratic control.
- *Defensiveness in respect of government decision making:* The upper echelons of the department clearly felt that decision making in respect of SPVs and priority sectors fell under their sole remit.

For most of the life span of the MEDS under the ANC government, politics was manifested in the above ways, subtly influencing the manner in which this industrial policy/strategy was implemented. However the impact of party politics was felt in a much more direct manner when the April 2009 elections resulted in a change of provincial government in the Western Cape. The ANC lost comprehensively and the Democratic Alliance (DA) a party which was explicitly business friendly took control of the provincial government with an absolute majority. This seismic shift in the politics of power has had a significant impact on the implementation of the MEDS as an industrial policy over the past year.

This change in political party control manifested itself in two ways: Firstly, an ideological struggle for the heart and soul of the MEDS. Secondly, departmental paralysis as a direct effect of a new administration coming into power.

It became clear in the first few months that there were distinct tendencies within some quarters of the new government which expressed a clear partiality for free marketeerism and limited state intervention. The fact that the DA was business friendly meant that they were sympathetic to a business driven industrial policy, but at the same time many in the party and government struggled to overcome an instinctive tendency to want to retreat from the state intervention that any industrial policy requires. The ideological issue here was the exact opposite of that prevalent in the previous period under the ANC government. Suddenly the very concept of industrial policy and the MEDS had to be

justified. The OC and those civil servants in the department found themselves now having to fight a rearguard action defending and justifying the importance of, and need for, industrial policy in various forums set up to re-evaluate policies and programs inherited from the previous administration.

The fact that this transition coincided with the financial crisis and the need for budget cuts only made this covert political struggle more difficult. For the financial crisis also gave immense power to the provincial treasury which was demanding budget cuts all round. This reinforced the ever present demand for short term immediate results as the criteria for expenditure justification. Industrial policy and the MEDS became an easy target for those wanting cut budgets. Hence the demand for substantial evidence of 'performance measurables' in order to justify allocation of budget to the MEDS industrial policy measures escalated. The whispered refrains, seldom explicitly articulated, that had to be countered drifted around the corridors: 'Why shouldn't we just give money directly to business? Why do we actually need an industrial policy? What are these SPVs and why give them money if they are neither government nor the private sector? And indeed, why do we need all these people in the department of economic development?'

There was a certain irony in this hidden, intra governmental, process of political struggle over the MEDS. For the MEDS never really fitted comfortably with the general ideological framework of the ANC., The DA, which was much closer to business, should have been much more at home with it, and more easily able to accommodate it, as a more business friendly framework. After all one of the MEDS's fundamental rationales was the need for an industrial policy led by industry.

The other impact of the change in political regime was an administrative one stemming from a new government. This would not have had a political effect on the administration of the department if the bureaucracy had remained stable. However the departmental head of economic development inherited from the new regime was also simultaneously shifted sideways within a few months. In itself this was not a bad thing, for he lacked a power base within the staff, and this move was generally welcomed by most people associated with the implementation of industrial policy in the province.. However, the cumbersome process of appointing a new Head took a further 9 months. Some of the reasons for this delay can be put down to individual naivety and administrative

inexperience. However a substantial part also derived from the impact of the broader political terrain. The new administration wished to both ensure it got the 'right' person for the job and also cover its political tracks in doing so, and not be seen to be hastily bringing in their own political appointee. The net effect however has been an inability on the part of the upper echelons of the department to exercise the necessary leadership to provide consistent and continuous support for the implementation of the MEDS industrial policy measures.

In effect the department of economic development spent the first year of a new political administration, where it was fighting for its lifeblood and that of the MEDS, without any real effective, stable and strong leadership. The impact on the internal coherence of the department of economic development (and hence the MEDS also) was severe. In some respects it paralysed activity, in others it allowed for little control over wayward activities of individuals. Not only did this disrupt the internal administrative mechanisms of the organisation, but it also meant the department has been a sitting duck for the provincial treasury to take pot shots at.

The legitimacy of industrial policy requires consistent application, both in terms of policies and people who implement them. Apart from the difficulties in attracting and retaining the right skills, the department was not able to consistently do that for the following reasons:

- Politics and political struggles (not just between ANC and DA but within the political parties) interfered with the process.
- Pressures from a treasury that was inherently well disposed to the ideological framework of limited state intervention and suspicious of industrial policy.
- The intra government political pressure imposed on the department to be financially accountable in terms of short term measurables skewing policy and ultimately reducing the resources available.

In summary then, although the Western Cape provincial industrial policy is in many ways still vibrant through the flourishing activities of a number of SPVs on the ground, and the MEDS is presented in public forums as a success, the story of the MEDS illustrates how the vicissitudes of politics, and the dominance of Treasury, in the large and the small, constantly came in the way of defining a clear and consistent trajectory for policy.

## Industrial Policy for Clothing and Textiles

As is obvious from Chang's position, targeted sectoral state strategy is the heart of the orthodox industrial policy advocates. In 2004 the South African state initiated a series of sectoral policy interventions in a number of selected sectors. These were called Customised Sector Plans (CSP). The sector directorate of the DTI at this stage was exceptionally weak having undergone a process of attrition on the part of the Minister and Director General since 1994. In effect, by 2004, the Ministry had only one or two people (depending on how one counted) working in the C&T division. The industrial policy formulation process of the CSP for the clothing and textile (C&T) sector was outsourced to Justin Barnes who had extensive service provider experience in creating clusters and value chain alignment in a number of sectors, but especially the automobile and C&T industries<sup>9</sup>. Based on his experience he adopted an approach which was very similar to that outlined as the alternative industrial policy framework outlined above.<sup>10</sup>

Traditionally these two sectors comprising the C&T industry had been in major conflict and unable to agree on a common platform to take to the state. Barnes had however been working with both the clothing and textile sectors in incipient clusters and was able to move seamlessly between them. He therefore canvassed the associations and firms in the two sectors on their views, needs, requirements, conflicts etc. He attempted to engage with the dominant union but despite numerous phone calls and emails received no positive response. By mid 2005 a draft CSP brokered between the various segments of the C&T value chain was ready to be presented to various stakeholders in government – departments and quasi parastatals. At this stage I was formally asked to chair and facilitate a series of workshops between industry stakeholders and national government. The union refused to attend these workshops. In mid June, at the final workshop, the various components were finally agreed between all parties and the CSP was sent to the DTI for formal ratification.

At the heart of the new CSP was a public private partnership institution – the Textile and Clothing Development Council - bringing together all industry and government stakeholders to develop, manage and implement a series of proposed interventions. It

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<sup>9</sup> See for example Morris and Barnes 2007. Barnes was also responsible for creating the major SPV in the Western Cape for the clothing and textile sector – the Cape Clothing and Textile Cluster.

<sup>10</sup> Although Barnes was the primary professional driving the process I was informally involved at an early stage.

was a seemingly major achievement for industrial policy and government. The industry looked forward to a new era.

The process brought to the fore a major policy/strategy weakness however. The drivers of the C&T value chain – the seven major clothing retail chain stores who controlled 70% of domestic sales - were only weakly represented in the CSP process. This was a crucial flaw since the entire orientation of the industry had shifted toward the domestic market. In order to rectify this each of the major retailers were therefore visited by Barnes and their buy in to the process was secured. They agreed to co-fund a major workshop to discuss a coherent approach on the part of the entire C&T value chain.

By October 2005 a major workshop for the entire industry – retailers, clothing manufacturers and textile mills - was held. This *Imbizo* – a Zulu name for a major coming together of parties to thrash out differences – was hosted by the Cape Clothing and Textile Cluster<sup>11</sup>. It had the explicit aim to develop value chain alignment between the various links in the chain. Only issues of value chain alignment were allowed in the discussion. In other words whingeing about labour issues or lobbying for state support was banned from the discussion and participants were forced to focus on blockages and opportunities for systemic competitiveness and cooperation along the value chain. Apart from the stimulus of the CSP, the key issue driving the discussion was a crisis in the industry occasioned by a major increase in Chinese clothing and fabric imports, and the possibility of creating cooperation along the value chain to take advantage of local production. This required a compact along the chain to produce the speed and flexibility in production that the retailers required and which would result in a competitive advantage over Chinese.

At the end of two days the retailers, clothing manufacturers and textile mills committed themselves to a strategic vision for the industry and initial steps to implement it. A few months later all the major retailers joined the Cape and KZN Clothing and Textile Clusters, paying not only special membership fees but also creating a new fund for achieving alignment in the supply chain and upgrading the C&T manufacturers. Subsequent *Imbizos* began to put flesh on the value chain alignment skeleton, with major

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<sup>11</sup> This *Imbizo*, and subsequent ones, was chaired by myself, with Barnes providing key strategic inputs.

strategic and operational interventions planned and implemented to achieve systemic competitiveness. Seemingly a new era was born.

Out of this was also born a new private sector driven loose organisational framework for the industry, encompassing the three sectoral associations in the value chain – the *C&T Business Alliance* - with an explicit mandate to coordinate policy cooperation, and present a coherent policy/strategic front in dealings with government. I was appointed the convenor and chief negotiator of the Business Alliance.

From the perspective of industrial policy these events and organisation consequences were a remarkable achievement. Two parallel policy processes – one state driven and one private sector driven - were seemingly coming together to produce a significantly powerful and coherent industrial policy/strategy for the C&T sector. This encompassed all the major components required - direct and indirect policy, policy design, macro/meso/micro aspects, and also critically, an appropriate institutional framework at the national and local levels.

#### ***Politics trumps industry cooperation and value chain alignment***

It seemed that a new era was inaugurated. However, instead of receiving major political backing and accolades, this process came under huge political pressure and was derailed in the end through the impact of political conflicts and a lack of policy will.

Firstly, the trade union, which had been given all the opportunities for engagement but had steadfastly refused to participate in the process of drawing up the CSP, used its membership of the Congress Alliance (ANC, SACP and COSATU) to initiate a behind the scenes lobbying process. The formal signing off of the C&T CSP by the DTI somehow never occurred, and to the surprise of the entire C&T value chain, in late 2005 the DTI suddenly re-opened discussions around the CSP. Industry went to these meetings, now represented by the Business Alliance of the C&T sector, and presented coherent and more sophisticated industrial policy positions. The union demanded a clause-by-clause re-negotiation of the entire CSP, presenting positions which were not only utterly unacceptable to the Business Alliance, but also threatened the policy and institutional coherence of the CSP. In effect they were designed to allow the union to be the prime driver of industrial policy. The DTI dithered, reverted to commandist policy positions, tried to bully the Business Alliance, and attempted to steamroll through changes to the

CSP in order to satisfy the ANC's alliance partner. It appeared that the object of the exercise from the perspective of the union and the DTI was to break the newly achieved alliance welding together the industry along the value chain, and the primary target they aimed at were the retailers. This was ironic since even a cursory knowledge of the dynamics of the industry would have told them that retail drove the value chain and without their cooperation no coherent and sustainable industrial policy was possible.

Meeting followed meeting, and eventually, by mid 2006, an incoherent document containing a variety of compromises which the Business Alliance, disillusioned by the process, said they could live with but were less than enthusiastic about, emerged from the process. However, to all intents and purposes, many of the key members of the Business Alliance had by this stage abandoned the CSP ship. Their attitude at this stage was that the CSP was a government document and there was no compunction on their part to sign it. The retailers, who were absolutely key to achieving any coherent strategic interventions, especially in respect of value chain alignment, withdrew from any institutional involvement in this government led process. The textile and clothing development council – now renamed with a politically correct appellation – would not see the light of day in any form acceptable to industry. The DTI and the union felt they had asserted their political authority, but they did so at the expense of the massive policy gains that had been made previously and the destruction of any trust that had been built up between the industry and the government. The CSP was named and christened, but in actual fact the industrial policy for the sector was stillborn.

What about the other C&T industrial policy initiative? The private sector driven<sup>12</sup> process of value chain alignment driven by the clothing and textile clusters which had made a quantum leap in securing major buy in from the retailers and developing operational programmes. This was still a major industrial policy/strategy achievement based on building trust and cooperation along the value chain, albeit operating outside of, and in spite of, national government activities. Unfortunately government conspired to significantly undermine, but not destroy, this industrial policy initiative also.

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<sup>12</sup> Although the initiative was driven by the SPV clothing clusters the industrial policy was to all intents and purposes so dependent on the private sector involvement that it was effectively 'private sector driven'.



South African C&T manufacturers were struggling to compete with Chinese imports. This was impacting on local production and employment, and both the manufacturers and the union were extremely concerned about the consequences. Despite pleas from around 2004 to government for some form of protective action at the expiry of the Multifibre Agreement (MFA) on Dec 31 2004, their voices fell on deaf ears. By late 2006 the clothing manufacturers had realised that their major hope lay in an alliance with the retailers to achieve value chain alignment in order to raise their competitiveness and capabilities rather than seeking tariff or quota protection against legal imports.<sup>13</sup> A month after the CSP discussions were concluded, in late August 2006, the DTI announced that they had agreed to a two year voluntary restraint agreement with China imposing clothing import quotas on selected items. They made it clear that this was a strategic intervention aimed at the retailers and supposedly in the interests of the clothing and textile manufacturers and workers and would take effect in October 2006. The union was named as the primary proposer of the initiative with support from the clothing manufacturers.

The industry was shocked and in an uproar. The retailers denounced the measures as causing sales chaos and likely to be ineffectual in assisting the clothing manufacturers to become more competitive. It was pointed out that the result would simply be import diversion. The retailers now also looked with some suspicion at the clothing and textile manufacturers with whom they were discussing initiatives to deepen cooperation and achieve value chain alignment. For their part the clothing manufacturers denounced the whole Chinese quota initiative as coming too late to be useful. Furthermore they said they had not been consulted by government, and did not feel the quotas were in their interests. Indeed, mindful of the suspicious eye of the retailers, they distanced themselves publicly from the entire initiative. The textile association sat on the fence but it was clear to all concerned that they were willing to provide covert backing to the initiative, even if they were reluctant to say so publicly.

In the end the imposition of quotas was delayed until Jan 2007. The process of enforcement was chaotic in many respects and a special committee was set up by the DTI to administer it including obvious mistakes and application for exemption. This committee was supposedly broadly based but real power resided in the union, which the

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<sup>13</sup> Illegal imports was a major problem but all major players in the industry agreed on the need for action to be taken in this regard.

DTI claimed had been the proposer and hence had the final say in signing off on any amendment etc. The result was a fairly shameless abuse of power on the part of the union, and a number of covert horse-trading deals took place behind the scenes. Suffice to say that at the end of the two year period none of the stated aims of the quota initiative were achieved. The industry carried on bleeding, firm competitiveness did not increase, major investment did not take place, and import diversion from other Asian suppliers was the order of the day. Indeed one could argue that the initiative simply alerted the retailers to other sources of supply which they could take advantage of after the end of the quota restrictions.

However the major consequence of this ill intentioned industrial policy initiative not its immediate impact in respect of quotas, but rather the destructive impact of undermining the foundations of the private sector driven industrial policy. It palpably eroded the hard earned trust that had been built up between the various players in the C&T value chain. The massive enthusiasm displayed at the early *Imbizos* gradually dissipated. The value chain alignment process has continued but in a more restricted fashion. The clothing and textile clusters still operate successfully but retail involvement is less engaged and more perfunctory. In short a significant industrial policy/strategy opportunity has been dissipated.

## **CONCLUSION**

Building industrial policy capability and strategic capacity involves setting into play a mutually reinforcing relationship between a number of key institutional processes. These involve direct and indirect strategic initiatives, revolve around getting the macro, meso and micro levels of intervention in place, and making sure that the policy design is inclusive. It requires recognising that without industry involvement and buy-in success is likely to be evasive.

However, the key conclusion from this discussion note is that this is not simply an issue of policy formulation. At its heart it is also one of ensuring sufficient political will is present to overcome obstacles, resist countervailing pressures from groupings pursuing only sectarian ends, and maintaining the integrity of the institutional form to build sustainable public-private partnerships. This is very hard to do, much harder than formulating an industrial policy on paper.

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