

Manufacturing in the PGDP: steps to supporting employment generation and relatively labour-intensive activities in the Eastern Cape

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1. Background

The paper was commissioned to feed into the process of developing the PGDP being undertaken by the Project Management Unit. The consolidation, development and diversification of the manufacturing base is one of the main planks of the PGDP. While manufacturing is relatively small in the Province, there are major concentrations of activity. In addition to the direct employment in manufacturing, the jobs created in service sector activities including transport, communications, construction and financial services as a result of growth of manufacturing need to be recognised. Increased manufacturing activity also generates government revenue.

The objectives are to:

- Establish the base-line from existing data on manufacturing
- Identify sectors with growth potential
- Identify sectors with potential for relatively labour-intensive activities
- Outline the roles for Provincial Government and public institutions

The industrial policy framework as captured in the DTI's *Integrated Manufacturing Strategy* will also be reviewed to ensure that the Province's strategy is consistent with approach of national policy.

The point of a PGDP is taken to be the articulation of clear choices at the Provincial level embodying economic analysis and prioritisation. It only has an effect in so far as it feeds through to co-ordinated actions by public institutions.

Section 2 examines the recent performance of manufacturing at the national level and industrial policies followed by analysis of the performance of manufacturing in the Eastern Cape in section 3. The role of institutions in the Province is then reviewed in section 4. Section 5 concludes by identifying key elements in a strategy to encourage labour-intensive manufacturing in the Province.

2. Introduction: manufacturing performance and policies

A new industrial policy framework was outlined by the South African Department of Trade and Industry (DTI) in 2002. This *Integrated Manufacturing Strategy* (IMS) will 'constitute a collective government position and co-ordinate a set of actions across government' (DTI, 2002: 3). It is primarily focused on improving competitiveness. A range of factors are identified as important for firms' competitiveness, including the prices of inputs, infrastructure price and provision, technology and innovation, skills, and effective regulation. Integration with the international economy and increased knowledge-intensity in production are key features of the new competitiveness approach of the DTI, as opposed to the natural resource and unskilled-labour bases of earlier phases of industrialisation. The IMS proposes a 'value-matrix' framework to understand vertical and horizontal relationships affecting production.

The IMS proceeds from the government's Microeconomic Reform Strategy which sets out a vision for 'a restructured and adaptive economy characterised by growth, employment and equity, built on the full potential of all persons, communities and geographic areas.' The Strategy specifies that this requires:

- A geographic spread of social and productive investment
- An integrated manufacturing economy capable of high degrees of value-added
- An extensive ICT and logistics system capable of speed and flexibility
- A high degree of knowledge and technology capacity
- Greater diversity of enterprise type and size
- Skilled, informed and adaptable citizens
- An efficient, strong and responsive state structure

At present the IMS is more of a vision, articulating an approach rather than specific steps and actions in concrete terms. There is also no identification of the roles of different institutions which fall within the DTI sphere. Many of the potential areas for government action suggested by the IMS are at the local government level.

The IMS identifies five focus sectors:

- Agriculture and food production
- Tourism
- Information and Communication Technologies
- Cultural industries
- Export sectors (within which different manufacturing activities are identified).

In other words, manufacturing sectors are not identified in their own right, but only in so far as they have export potential. However, under the DTI's development of customised programmes eight sectors are identified including clothing & textiles, metals & minerals, automotive & transport, and chemical and biotechnology.

The DTI recently announced that it is taking the IMS forward through two strategies:

- Customised Sector Programme (CSP)
- Sector Support Network (SSN)

These two involve sector strategies for the eight sectors (for which customised programmes are being developed) and mechanisms for regular interaction between industry and government at the sector level to discuss strategic issues. This will flow through to policies, regulations and incentives. The Motor Industry Development Council, through which the industry meets the Minister and/or high ranking DTI officials on a monthly basis, is the model being used.

The IMS is founded on the key thrusts of knowledge-intensity, beneficiation and integrated value-matrices which cut across the development of competitive capabilities. These are not elaborated in any detail but are certainly broad enough to ensure that the Provincial strategy is expressed in ways which are consistent with the national framework.

Implications

Industrial policy at the national level is firmly based on international competitiveness in a liberalised trading environment. This limits the possible direct support for industrial development by national government and places greater onus on sub-national levels of government.

The areas of knowledge-intensity, beneficiation and value-chains require local information, analysis and negotiation. The findings from such a local analysis also need to be represented to the various appropriate institutions. In other words, the manufacturing strategy of DTI relies upon smart and effective local government if it is to be successful. The development of production capabilities which underpin a broad-based growth path requires co-ordinated action around skills development, investment and infrastructure.

Patterns in national manufacturing development

There has been a high degree of variation between manufacturing sub-sectors in terms of value-added, employment and trade performance. In terms of value-added, the best six performers from 1996-2001 have been plastics, leather products, other chemicals, TV, radio & communications, basic chemicals and motor vehicles (Appendix Table 1). Using 2002 data available at a more aggregated level, there has been strong growth of more than five per cent from 2001 to 2002 in the groupings:

- metal products, machinery & equipment
- petroleum, chemicals, rubber & plastic products
- textiles, clothing and leather products
- furniture and other manufacturing

Manufacturing employment performance has generally been poor, as even sectors recording strong growth in production have been cutting employment, such as the auto sector. From 1996 to the end of 2002 only seven sectors have recorded net increases in employment led by plastic products with an average growth in employment of 3.4 per cent per annum, followed by printing & publishing at 2.9 per cent and wood & wood products at 2.7 per cent. But, from 2001 to the end of 2002

there have been major improvements in some sectors reflecting a quite different manufacturing trajectory. Of potential importance for the Eastern Cape, employment in the furniture sector was 15.1 per cent higher at the end of 2002 compared with the average for 2001. The radio, TV & communications equipment sector also saw a massive 27.0 per cent jump over 2001. There were also signs of regeneration in textiles and clothing which both saw increases in employment after many years of contraction. To an extent the improved performance in 2002 reflects the depreciation of the Rand with manufacturing firms being more competitive against imports and in export markets. There are already signs that some of these gains have been reversed in 2003 with the strengthening of the Rand. Higher interest rates have also choked-off investment spending having knock-on effects on demand in many sectors such as machinery and metal products which had grown both production and employment strongly in 2002.

Some of these sectors such as printing & publishing are concentrated in the major urban centres in Gauteng, Cape Town and Durban. Other chemicals includes a range of products mainly for local consumption such as soaps & detergents and paint. Location decisions are driven largely by proximity to the main markets. This sector, however, also includes pharmaceuticals in which the Eastern Cape has had a significant presence. Plastic products has historically been located mainly in Gauteng, with the main uses being for packaging. However, there is an increasing shift by firms to export part of their output, which favours a coastal location. Plastics are also being increasingly used to replace other materials across industries. It is a relatively labour-intensive sub-sector but requires investment in machinery, availability of basic skills, and good transport infrastructure.

Over the medium terms there have been major reductions in employment in many subsectors with contractions in excess of five percent per year on average in: footwear, non-metallic minerals, basic iron & steel, textiles, rubber products, other manufacturing, and tobacco products. While several of these sectors, such as footwear and professional equipment have experienced increased import penetration and lower tariffs, the links with trade performance are by no means clear. Many of the sectors with large employment losses are in heavy industries such as basic iron & steel and non-metallic minerals. These industries may export a significant proportion of their output but domestic demand is also important, for example, for non-metallic minerals (which includes cement). These sectors have been severely affected by weak domestic investment and construction activity.

International trade

With trade liberalisation there has been a reorientation within many sectors, with higher levels of both imports and exports. This implies a shift in the centre of gravity for much of manufacturing which originally located in Gauteng due to the concentration of domestic demand. Now, for firms which may be importing increasing proportions of their inputs and exporting a proportion of output, a coastal location makes sense. This impetus is hampered by domestic overland transport costs, which remain high, and problems with the efficiency of rail freight in particular.

Several sectors with a large proportion of exports in output are large-scale activities where minimum efficient scale exceeds local demand. These include basic iron & steel, basic chemicals, and non-ferrous metals (see Appendix Table 1). Such sectors are generally extremely capital intensive and production sites are already well established. In other sectors in which tradability has increased there are much more opportunities for quite labour-intensive growth. Furniture, leather products, machinery & equipment, TV & communications equipment, professional equipment and other transport equipment all export more than 30 per cent of their output. The export orientation of these sectors (except for leather products) has also increased significantly in recent years.

The increased tradability of these products has not translated into better performance in terms of output and employment in the 1996 to 2001 period. But, the recent data for 2002 reported above indicate a quite dramatic turnaround in furniture manufacturing and TV & communications equipment.

On the input side, firms operating in niches often require grades of input materials (such as steel or polymer plastics) not made in South Africa. Interviews indicated that this was an important motivation for several firms in choosing a coastal location.

Expected future trends?

While national policies have tended to emphasise high-value hi-tech industries, one of the major influences on industry is the move to macroeconomic neutrality and a resumption of government investment which will favour the core industries of iron & steel, metal products and non-metallic minerals (which includes cement). Signs of this were already evident in 2002. These sectors will also benefit from infrastructure investment in other African countries in line with NEPAD initiatives. Big investments in mining in South Africa (especially platinum) and other African countries, generate demand for related machinery & equipment in addition to metal products. But, after a big increase in mining activity in 2002 several projects have now been postponed due to the strengthening of the Rand.

Also on the demand-side, the rise of earnings of the middle-income group will benefit spending on various goods such as motor vehicles and consumer durables (notwithstanding short-term interest rate effects), TV & communications and leisure items. By comparison weak employment performance is consistent with the poor performance of the food and beverages sector. Other consumer goods such as household chemicals, soaps and detergents appear to have been performing better, partly due to exports.

Supply-side conditions related to production costs and conditions will continue to favour the plastics industry as plastic continues to replace metals. The increasing international trade flows will also continue to favour coastal locations. Continuing growth in forestry favours growth of wood products and paper. The ongoing practice of import-parity pricing by major producers of material inputs including iron & steel, stainless steel, aluminium and basic chemicals means there is little if no cost advantages to domestic downstream industry. This is one area to be tackled by

government and has led to export-parity pricing being offered by several firms (including Iscor and Sasol) to downstream users for the proportion of output which is exported. This trend is reflected in recent proposals to establish a wire manufacturers export cluster in Durban.

Government emphasis on promoting competitiveness in downstream manufacturing would ideally lead to growth across a range of sectors. However, the outcomes are uncertain given (weak) demand considerations and the volatility of the currency. Recent studies of investment¹ found exchange rate instability to be an important deterrent to investors.

¹ For example, Gelb 2002.

3. Manufacturing in the Eastern Cape

The auto and transport equipment sector is the biggest manufacturing grouping in the Eastern Cape in terms of both output and employment, followed by the chemicals & rubber, and the textile & clothing groupings.² Food & beverages is also important. These data even understate the significance of the auto industry as products such as tyres, seat leather and auto plastics fall within other groupings but are effectively part of the auto industry. Taken together this industry probably accounts for more than half of all manufacturing value-added in the Eastern Cape. But, the auto industry is not generally labour-intensive, and has been shedding jobs while growing output.

In terms of employment (and taking labour-intensity into account), the more important sectors (although they still account for less employment in absolute terms than auto) are food products, clothing and textiles, plastic products, and wood products.

Of these sectors, the Province is under-represented in clothing and plastic products (on a comparison of the shares of the Province in national manufacturing activity). This position may reflect inherent reasons for the lack of competitiveness of the Province, or it may indicate an opportunity. If the performance of these sectors is influenced by factors such as infrastructure, training institutions, access to finance or investment incentives, then government can play an important role.

In leather products the Eastern Cape is well established and accounts for more than a quarter of national production (although a smaller share of employment, due to the focus on auto leather in the Province). In wood products, the Province's share does not reflect the great forestry potential, suggesting this is a major area for attention. Downstream linkages in both of these sectors are an important challenge. In leather, this relates to development of leather furniture and possibly a revival of the footwear industry (although focused on more niche production, as in clothing). In wood products, the opportunities again link to furniture.³

Recent developments

Data on manufacturing at the Provincial level are drawn from DRI-Wefa. These data are only available in more aggregate manufacturing groupings. For value-added the data extend to 2002, while for employment the data only extend to 2001. Assuming similar employment patterns in the Eastern Cape as nationally, we can infer likely 2002 employment levels.

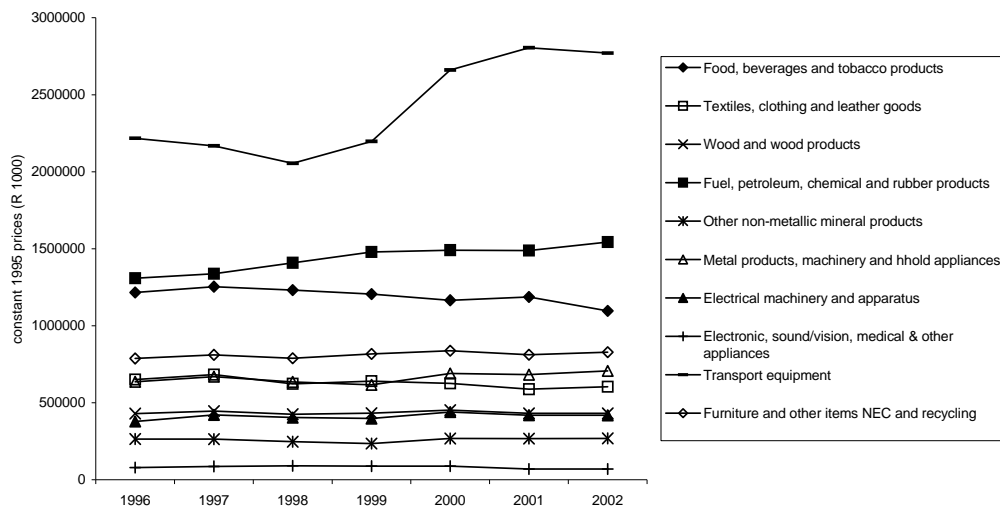
The sub-sectors with the best performance in the Province in terms of value-added is the transport equipment grouping (including motor vehicles) (Figure 1). But, this

² The previous paper, 'Assessing industrial development in the Eastern Cape and the role for Provincial Government – A Preliminary Analysis', 2002, contained a more detailed discussion of the Province's manufacturing industry based on the 1996 Manufacturing Census.

³ The main new entrant and investor in each of these sectors in recent years is Claas Daun, who owns furniture manufacturer Steinhoff, as well as Kolosus tanneries (although these operations are not necessarily in the Eastern Cape).

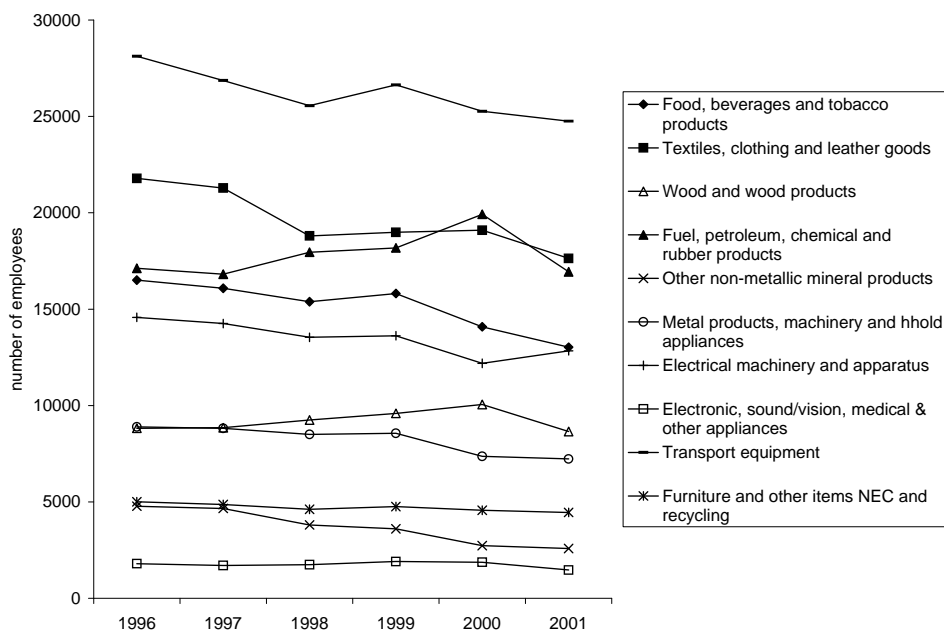
sector has continued to shed employment from 1996 to 2002 in the Province (Figure 2). The petroleum, chemical & rubber product grouping has increased production and employment (until a sharp reduction in 2001). Other sectors with positive or stable production are furniture, metal products and wood products. Of these, furniture and wood products have both maintained relatively stable employment (Figure 2). Assuming that employment patterns in 2002 in the Eastern Cape are in line with those at the national level then these would both be expected to have created jobs.

Figure 1. Eastern Cape: Value-added of major manufacturing groupings



Source: DRI-Wefa

Figure 2. Eastern Cape: Employment of major manufacturing groupings



Source: DRI-Wefa

The majority of sectors, however, have seen large employment losses with the largest being in: textiles, clothing & leather; food, beverages & tobacco; and transport equipment. There have also been very large reductions of employment in relative terms in the other non-metallic mineral products grouping where 2001 employment levels were approximately half the number in 1996. This sector largely consists of activities such as cement and brick-making which depend on local demand. They would be expected to pick-up as capital spending on major projects such as Coega kicks-in.

Influences on sectoral development and their implications

There is a diverse range of influences on the development of manufacturing in the Province. The main ones to be taken account of in the coming five to ten years are:

- sources of local demand, especially linkages with major spending on infrastructure in Coega;
- increased local income associated with growth in tourism and employment in the development phases of Coega;
- the ongoing development of the auto sector and linkages into components beyond catalytic converters and seat-leather;
- increasing emphasis on international trade and firms able to service both local and export markets, requiring being able to deal with uncertainty associated with exchange rate movements and foreign markets, and effective logistics;
- the leveraging of capabilities developed for established sectors, especially auto into other activities;
- the growth of forestry and agricultural produce requiring links with processing/beneficiation; and
- continued concentration of activity in NMM and East London with the need for a spatial strategy to regenerate industrial locations in the wider Buffalo City area and the hinterland as a result of congestion in East London.

These influences all represent the evolution of tendencies already evident. The challenge is to anticipate bottlenecks, realise economies of agglomeration and linkages, and orient the development path to ensure more broad-based growth and a more rational longer-term spatial location of activity.

The patterns are consistent with the picture painted 18 months ago.⁴ Follow-up interviews with many of the firms previously interviewed confirmed the patterns, which have meant that the Eastern Cape is one of the better performing Provinces. But, the performance is clearly inadequate relative to the development needs of the Province. In the Province interviews suggest:

- The *auto sector* continues to grow, with signs of greater linkages into components, such as those made of plastic. These activities require supporting institutions and should be a major focus to both increase the labour-intensity of auto related activities and build wider and deeper linkages. The cap on

⁴ The report 'Assessing industrial development in the Eastern Cape and the role for Provincial Government – A Preliminary Analysis' was prepared for the ECDC in January 2002.

catalytic converters under the MIDP and the sliding scale meaning more exports (with local content) each year to earn the necessary import-permits encourages these linkages.

- There is a regeneration of *textiles activity*, and some clothing, partly stimulated by AGOA. The ending of the provision in the next two years that allows countries (other than South Africa and Mauritius) to import fabric means that there will be a need for textiles to supply the more than 35 clothing factories established in Lesotho. Recent investments in the Free State indicate these effects already materialising. The Eastern Cape is well situated to exploit such opportunities, as recent investment announcements confirm.
- Important successes have been achieved in *agro-processing and food products*. The Peddie pineapple growers' initiative is literally bearing fruit. Small firms are also growing in production linked to aloes and essential oils, as well as dried flowers (for export).⁵
- Firms making *plastic products* continue to grow. These include products such as plastic bottles (of PET sourced from SANS in Cape Town), flooring and pipes. The diversity in plastics indicates the need to examine linkages with the different markets, such as of flooring and pipes into housing.
- Established firms such as First National Battery and Kohler (now a division of Nampak) are benefiting from their Eastern Cape location and growing output and employment.

Key considerations which were emphasised for the roles of Provincial and local government are:

- *Infrastructure and skills development* – a major source of collective benefits from local agglomerations of economic activity is in skills and experience. Firms typically under-invest in training as they cannot reap the full returns (assuming people move between firms). There are also cumulative causation effects that reinforce vicious or virtuous circles. The existence of a local industrial base means there is a network of skills and support services. The absence of such a base means firms are unlikely to locate meaning the skills and support services do not develop. For example, the scarcity of 'loom tuners' was a constraint on a local textile firm. The availability of engineers to service plastics moulding machinery was cited as a consideration for a blow-moulding firm.
- *Information and expectations* – investors based their decisions partly on what they expect other agents to be doing as this will impact on their own operations. Government can play a lead role if it invests in collecting, analysing and disseminating information in a process of 'indicative planning'. Recent experience suggests that government is not playing this role effectively

⁵ Possible investment in a can manufacturing operation would further link with agro-processing.

at present. The diversification of auto components and regeneration of textiles has occurred largely in spite of rather than in consort with government.

- ***Market failures in access to finance.*** Several firms interviewed whose rate of growth depended on finance had experienced little support or understanding from public institutions charged with lending to manufacturing and had instead resorted to commercial banks. Given the weaknesses of South African banks in extending credit to small and medium manufacturing this is to some extent an indictment of development finance in the Province, unless a decision has been taken to be very selective in channelling finance to certain sectors.
- ***Effective liaison*** with other branches of government and public institutions. The need for ease of communication with DTI, IDC, ECDC etc in a more 'one-stop' form was highlighted. The Province can play an important facilitating role here.
- ***Logistics*** are crucial for firms in sourcing inputs and delivering products. This cuts across infrastructure provision. Public transport services for employees getting to and from work was an additional area that several firms raised. Obviously, improvements of public transport will also benefit the mass of the population in urban areas.

Coega is discussed in more detail below under the role of institutions, however, the impact it is going to have on local demand does not appear to have been taken into account. In 2003 it is projected that 20 000 people will be employed at the height of construction activity. If we were to assume that these are low paid construction workers earning R1000 per month this translates to additional disposable incomes in the area of R20mn per month. This extremely crude estimate demonstrates that there will be direct effects on demand for food and beverages, consumer durables such as fridges, TVs and cookers, and housing materials assuming that some of the income is spent on improvements to dwellings. Added to the increased income already in the NMM area as a result from tourism this means there is scope for growth of manufacturing to serve local demand. This would be particularly attractive for firms looking for some local demand to support exports. Without a co-ordinated response much of the potential demand-pull from this income will be lost.

4. The role of institutions

This study does not attempt to comprehensively cover the institutions responsible for supporting manufacturing in the Province. I briefly comment on the roles of institutions under three main headings: development finance; business support; and SDIs/IDZs. I then discuss the key challenges and choices for appropriate institutional development in relation to manufacturing and the PGDP.

There is a host of institutions and initiatives engaged in supporting manufacturing in different ways. But, it is not clear that there is coherent way of co-ordinating or even keeping track of them. In addition, there needs to be a clear identification of the lead agency/institution(s). At present there is not one site where basic information is collected and disseminated. For example, an investor looking for information on chemicals in the Province would have to search even to identify the organisations working in the sector. The CD recently released by ECDC goes some way to addressing this need, but much more needs to be done.

Development finance – IDC and ECDC

IDC

IDC finance starts with loans from R1mn upwards. In the last year reported on (2001/02) 26 projects were financed, with a value of R418mn creating 2995 direct jobs. In addition, the share of the Eastern Cape in IDC financing has been increasing in number and direct employment creation, from fewer than 5 per cent of the value of IDC finance in 1999/2000 to 13 per cent in 2001/02. Jobs created in the Eastern Cape amounted to 35 per cent of the IDC's national contribution.

The large projects financed were mainly in agro-processing, reflecting the IDC's role in the sugar beet project still to get underway. With other projects in metal products (auto related), textiles, forestry, clothing and rubber products (auto related). Financing classified as empowerment covered 13 projects (two of which were also included in the large projects list). These included significant financing of enterprises engaged machinery & metals products and chemicals products.

In SME approvals the Eastern Cape falls behind other Provinces with a share of less than 5 per cent of the national total (by both number and value of approvals). Of the 19 SME projects financed, the largest number were in the metal, transport and machinery products sector, followed by chemical & allied industries and tourism.

The IDC is aiming to further extend its financing of agricultural and agro-processing activities, including food processing. It is also closely engaged in support for Coega.

As such, there is some overlap with ECDC and a clear designation of roles is necessary. The IDC has a much longer approval process and higher transactions costs associated with their main focus on larger projects. Its procedures are therefore not necessarily well suited for smaller-scale lending.

ECDC

Information provided for financial year 2002/03 indicates that that three quarters of ECDC's loans are to the 'contractor' sector and only three per cent are to manufacturing. The total amount of finance extended amounted to R76.2mn. This appears to represent a major decline in finance extended over previous years and a major shift away from manufacturing. Several firms interviewed indicated that they would not consider ECDC any longer for finance as the rates charged were no better than commercial banks and the time to approve a loan was longer and more time consuming. (One example was of a nine-month period for approval of a relatively small loan.)

It is not clear what the reason for this is, but it suggests a major problem with development finance and/or the extent of investment activity in the Province.

While ECDC has moved to more commercial rates for finance, the principle of development finance, that there are wider benefits to the economy from an investment than to just the private investor, suggests a role for concessional finance subject to specified criteria. The effective subsidy to large-scale capital-intensive investments in the anchor projects sought by Coega is a further reason to ensure that concessional finance is available to smaller and more labour-intensive enterprises for whom access to finance through commercial banks is a greater barrier than for larger firms. The lack of effective development finance therefore represents a bias in financing against smaller firms and also those entering new product areas or niches to whom banks will be less willing to lend.

Business support, including training and technology support

ECMAC

The main business support institution is the Eastern Cape Manufacturing Advisory Centre. This began as the Port Elizabeth MAC and has grown to by a national network, representing an initiative pioneered by the Province.

The core function of ECMAC is to provide business advisory services to SMMEs (defined as firms with up to 200 employees). In the initial phases only manufacturing businesses were targeted but this has since been extended to other firms. For example, a major target area is envisaged to be construction companies. The ECMAC centres work through industrial advisors who respond to the needs of SMMEs. They provide a diagnostic service to identify the problems facing firms, and follow through with actions identified to address these problems. They also provide a range of basic information required by firms and links to other organisations. The top five areas of assistance are in access to finance, productivity improvements, quality systems, marketing, and human resources.

From its inception in 1997 until 31 March 2003 ECMAC has worked with 1093 enterprises with the largest number (36 per cent) being in the broad chemicals grouping which includes brick-making, soap-making and plastics. The second largest

grouping with 20 per cent of the total are in clothing & textiles, followed by footwear and leather. 68 per cent of the SMMEs are HDI-owned and 38 per cent are female-owned. Jobs sustained in the SMMEs worked with are 9926 and ECMAC has facilitated the employment of a further 1201 people.

The ECMAC therefore focuses on more labour-intensive activities and is also actively engaged in supporting firms aiming to diversify out of the auto sector. For example, 16 plastics convertors are being worked with, most in the auto sector but with the potential to move into other areas. There has also been support for a plastic pipe manufacturer and a small boat manufacturer, both with great potential.

In textiles, a consortium of nine clothing and textiles firms has been formed to develop into European markets using the local Breathetex fabric as the base. A manufacturer of rugby jerseys has also been supported in exports to the USA.

ECMAC has built up links with the partnering programmes of European agencies. These seek to link European firms with South African partners both to support investment in South Africa and to facilitate exports.

Chemin

The Eastern Cape is also home to a national incubator and technical support initiative for the chemicals industry, Chemin, which is funded under the Godisa programme of the Department of Science and Technology. It is based at the PE Technikon. The initiative is at a relatively early stage with ten Chemin projects underway or in development in the Province:

- Aloe processing and exporting
- Mixing of water purification chemicals
- Diesel additives
- Conversion of citrus waste
- Essential oils
- Moss control agent
- Mosquito repellent
- Black hair care products
- Pectin manufacture
- Establishment of centre of excellence for analytical chemistry

Chemin provides lab and testing facilities and support with the commercialisation of a product. The incubator facilities provide an initial location for firms while they are in the development phase. Chemin is also linked with the Technology Stations Programme also supported by the Department of Science and Technology.

While the aim of Chemin is to target high value niches within the chemicals sector there is also potential for large-scale job creation such as in the harvesting of aloe and in consumer chemicals such as hair care products. These should not be ignored in favour of 'hi-tech' projects.

Industrial Development Zones

Coega IDZ

Handover of the port is scheduled for September 2005, with first ship to dock in September 2004 with materials for the port and the proposed Pechney aluminium smelter. The main focus has continued to be on large anchor tenants in the metallurgical sector due to the aim to facilitate investments by Pechiney and Ferrostaal. Agreements have been negotiated with Portnet and Eskom.

The majority of employment creation for these are in the construction phase with a peak of 20000 direct jobs in 2004 (for both the port and Pechiney site). There will be an estimated direct employment of 800 in the Pechiney smelter itself.

This is already having a major impact on the NMMM economy and the impact will grow considerably in 2004 with increased demand for accommodation, transport, services, tourism, and consumer goods as a result. But, the major concern must be about the need to attract broader-based industry. The attention to the large-scale anchor projects has to an extent meant a lack of emphasis on manufacturing activities suited to the site. These are different from downstream opportunities in benefiting the aluminium to be produced. Indeed, the experience of other areas such as Richards Bay suggests that producing aluminium and beneficiation are totally different. Import-parity pricing means there is not necessarily any competitive advantage in being located close to production of raw material inputs.

As the targets of auto, electronics and metal products clusters suggest, the IDZ strategy needs to be viewed as a subset of the Province's strategy to attract investments which are suited to coastal locations.

It is also of concern that the linkages and multiplier effects of Coega do not appear to have been closely examined. As mentioned above, these include simple demand multipliers due to the increased incomes in the NMMM area which will impact on demand for consumer durables. This provides an added incentive for the location of firms producing such products assuming that there is anticipation of the demand stimulus.

East London IDZ

Phases 1A and 1B of the ELIDZ will be fully serviced by July 2004 and the IDZ has embarked on a major marketing initiative to investors in their targeted sectors of:

- Agro-processing
- Pharmaceuticals
- Automotive
- Wood products
- Minerals

Interest has also been expressed in a number of areas such as textiles (blankets, denim), pharmaceuticals and paprika processing. The IDZ is therefore at a crucial

stage in establishing its rationale within industrial development of the Buffalo City areas as a whole. In this regard, it is not clear that the IDZ strategy is part of a wider location plan which would seek to locate larger and ‘dirtier’ industries outside East London.

DTI

Information on use of DTI programmes by firms in the Province was promised but not provided by the time of writing

Institutional roles

Clarification of the roles requires at minimum covering:

- ***Information gathering and analysis*** (linked to some kind of annual report on manufacturing along the lines of the ‘Economic Overview’ contained in the ECDC Annual Report). This should cover the activities and offerings of all the major institutions working with industry in the Province.
- ***Leadership and co-ordination function***. This is most naturally linked with information and analysis but needs to be situated in an institution with the authority to review the activities of different institutions and monitor performance. This authority derives most easily from provision of funding linked with political leadership and therefore would reside most effectively in a further strengthened ECDC as the Province’s core agency responsible for industry.
- ***Development finance*** – several institutions operate here. The need is to identify how they relate to different segments of the market for finance.
- ***Business support services*** – such as provided by ECMAC.
- ***Training and skills development*** – this includes the roles of the SETAs in the Province and tertiary education institutions.
- ***Sector co-ordination*** – for all priority sectors.
- ***Spatial development*** – this cuts across the plans of the NMM and Buffalo city and the IDZ’s. For the IDZ to be sustainable and realise their full potential they need to be situated within strategies for development of the wider locations and to build local linkages with businesses outside the IDZs. At present this does not seem to be well articulated.

5. Key elements of a strategy to expand labour-intensive manufacturing in the Province

After outlining the role of manufacturing in the Provincial economy, and the role of Provincial government, key priorities are proposed. These priorities are at a relatively general level and are to indicate directions for effort in the Province. The auto sector and issues of skills development and finance are then discussed in more detail. The section concludes with tentative steps for the second half of 2003.

How is manufacturing understood?

Manufacturing, as the processing of material inputs into intermediate and final products, is an integral part of economic development. The key question is of the nature and core drivers of manufacturing in the Province. In this regard the Provincial dynamic should emphasise two strands:

- the advantage of a coastal location for firms exporting a proportion of their output and/or importing a proportion of their inputs;
- linkages with local materials (agriculture and forestry), and with local consumption.

Within each, more labour-intensive activities should be promoted. These are not necessarily activities which are competitive on a pure labour-cost basis, but those which depend on a combination of infrastructure, access to inputs, labour availability and low to mid-level skills, and markets. Recent performance and investment announcements indicate the potential here, in sectors such as plastics and wood products.

The importance of associated activities in logistics, services and transport, and the Province's determination to develop them should also be emphasised. It is in these areas that much of the job creation can take place.

Role of Provincial government

The DTI's IMS makes it clear that provincial and local government has a very important role to play. The IMS framework allows for a whole range of factors to be taken into account such as vertical and horizontal linkages, and has programmes to be drawn upon. But, it places a major responsibility on the Province to develop coherent strategies based on the economy of the Province.

This 'indicative planning' role for government requires capacity to analyse, anticipate change, and to map a way forward. It also requires co-ordination of the different institutions impacting on the development of manufacturing. This involves the effective interaction with national institutions and the identification of the roles to be played by provincial and local/metro agencies.

Institutional development

Effective mechanisms for co-ordinating the roles of national agencies with local institutions are obviously important. In several other Provinces an economic development agency has been created by government to perform the overall lead role in economic development. This is one option for the Eastern Cape, however, alternatives include increasing the role of ECDC together with improving the working of agencies responsible for other sectors of the economy (such as tourism). Provincial government has an important role in monitoring the performance of these institutions and holding them to account on the priorities identified by government.

At present there is no clear lead agency for manufacturing development, which encompasses the analysis and co-ordination of measures. The most appropriate place for such an agency is within ECDC given that the assessment of lending opportunities requires analysis of manufacturing sectors. It requires devoting significant resources to building capacity. In recent years significant capacity has been developed in the IDZs, and mechanisms need to be found to draw on this expertise at the Provincial level.

Such an agency or unit would dovetail with providers of services across the Province, such as ECMAC. Such business development or support services are distinct from the analysis and strategic direction roles and it probably makes sense to keep them separate in terms of institutional responsibilities. Provincial funding for ECMAC would also imply closer monitoring of its activities and performance.

A major part of the leadership role would require the hosting of the proposed Forums for manufacturing clusters in the Province. Such an initiative for the deepening of sector plans would link in with the DTI's approach at the national level.

Clear prioritisation

- Labour-intensive manufacturing: The relatively labour-intensive activities and sectors in which the Province has potential are now clear. What is lacking is co-ordinated plan for each. This requires interaction with firms and the various institutions.
- Linkages with IDZs and the wider economy: The role of IDZs as catalysts for manufacturing growth rather than stand-alone initiatives needs to follow-through to investment strategies. Despite some analysis of opportunities it appears that the search for large anchor-type investments for Coega and East London appears to have distracted attention from the more employment-generating activities such as identified for electronics, auto, plastics and similar manufacturing activities. The IDZs also need to be part of a wider location plan for manufacturing to attract activities such as textiles to locations such as Fort Jackson and Dimbaza. Such a plan also needs to take into account expansion by existing firms. The infrastructural investments which are part of the IDZs should be to the benefit of all firms looking to supply products through the ports.

- Broadening the auto industry (see below): a co-ordinated plan to grow and increase the linkages from auto into other sectors has been slow to emerge. Given the concentration in the Province, and the relative success of the sector, this is concerning. While the often highlighted lack of employment creation in the narrower auto assembly gives cause for caution, the development of capabilities by firms in areas such as batteries and plastic mouldings should be built upon. There are other linkages such as leveraging the training and skills development impetus of the sector for other manufacturing activities requiring similar skills.
- Participation of SMMEs: relates to skills development and access to finance (see below). Small and medium enterprises are not a separate sector in the sense that they are engaged in different types of economic activity – in manufacturing, transport, service provision etc. The important feature is therefore the barriers that exist to their growth. These barriers may be generic (such as access to finance) but still require an understanding of the different economic sector if finance is to be extended by an organisation such as ECDC. Barriers also exist in access to markets, packaging and in processing of agricultural products. These activities all lend themselves to co-operative operations.
- Participation of the historically disadvantaged persons: There is a need to distinguish between factors such as access to finance which is a key element of access and participation and direct measures such as procurement. Given the apartheid legacy, direct measures have a crucial role to play in meaningful empowerment. In addition, there is a need to monitor employment equity plans of firms and the links (or lack thereof) with skills development plans.
- Location of industry: as discussed above in regard to IDZs, there is a risk of over concentration without a plan (and incentives?) to encourage industries to locate in areas of high unemployment and available land. For example, at present the main industrial areas of East London are booming, raising potential problems of congestion, while firms are far from residential areas where their workforce lives. Waiting for rising land prices in East London to induce firms to move further afield will not ensure the most appropriate location of different types of manufacturing activities.

Strategy for the auto sector

The auto sector needs to be addressed separately, if only due to its size and significance in the Province. There are other important reasons. The nature of auto manufacturing means that it links with a wide range of other sectors and it can be a catalyst for capabilities in these related activities to increase production for other markets. The presence of the auto industry can also be used to support wider skills development. For example, many firms in Uitenhage make use of VW's training facility even where they are unrelated to the auto sector.

The evolution of the MIDP means there is increasing pressure on the main auto assemblers to increase locally made components outside of the seat-leather and catalytic convertors which have dominated investments in the earlier period. There are a range of obvious opportunities in auto components, including:

- Airbags (a textile product)
- Plastic interior and bumpers
- Air-conditioners
- Auto-related electronics
- Auto paint

In addition, niche manufacturers that are presently importing fully built-up models and have not developed component exports to generate import permits could be aggressively targeted. For example, this would include a firm such as Subaru.

The *horizontal migration* of capabilities into other areas, such as moves by auto leather manufacturers into furniture leather, should be a key thrust. The fact that this is already happening to a limited extent serves to illustrate what might be achieved through more targeted actions.

Measures to address skills development and finance

While these areas are almost always raised in development strategies, skills development requires a systematic drive to link firms' projected needs, the operations of the SETAs, and education and training institutions. For example, the lack of any serious university or technikon research group working on the auto industry is only one of the more obvious gaps. Training of machine operators for the plastics industry requires linking with the Plastics Federation in Midrand.

Interviews suggested that there was a 'missing middle' in the provision of development finance between the small-scale activities supported by ECDC and the larger scale activities of IDC. This may just require facilitation of the IDC's stated aim of greater allocation of finance to smaller-scale firms but the procedures of the IDC militate against such a move. The importance of local knowledge in assessing loan requests suggests ECDC is the more appropriate institution. It is therefore recommended that ECDC should expand its lending activities and offer subsidised finance to targeted sectors and firms that meet criteria (including ownership, employment generation and location).

Priorities and action plan for manufacturing

Please note this is very tentative, for the purposes of making choices more transparent. It overlaps with initiatives already underway (such as moves to develop the Provincial AIDC).

July – December 2003

The most urgent priority is to make the PGDP a meaningful framework by which interventions and institutional activities will be shaped and co-ordinated. At present,

discussions on manufacturing suggest it runs the risk of being a re-packaging/restating of priorities at a fairly general level without any real ownership of it by the main institutions in the Province. Almost all of the firms and institutions interviewed set little store by it, especially when compared with the major initiatives such as Coega. Acceptance of this lesser role for the PGDP implies quite a different approach to the one set out here.

Major steps suggested for the second half of 2003 are as follows.

- Establish industrial development unit capable of leadership in terms of both analysis and co-ordination of activities of different institutions. Recommend that locate in ECDC.
- Provincial development strategies for selected clusters and hold initial *industry forums*. Suggested initial clusters:
 - Plastics and chemicals
 - Textiles and clothing
 - Wood products
 - Furniture
 - Agro-processing
 - Food and beverages (partly because of local demand stimulus and also because the Province does not even produce enough for its own needs)

An important part of this process is the identification of sub-sectors for specialist industry studies, such as sub-groupings of plastics for particular markets. In addition there needs to be a mechanism to identify niches with potential (which may partly fall within above sectors) such as leisure products, natural healthcare products etc.

- Establish Provincial grouping for the auto industry and link with a plan for evolution of components production.
- Extension of business support services – recommend through extension of ECMAC’s activities. Regular monitoring mechanism of ECMAC activities to accompany Provincial funding.
- Establish multiplier effects of Coega and responses required from government – analysis which can be updated on an annual basis.
- Develop more detailed Coega plan for attraction of investment beyond anchor projects and within a location plan for NMMM.
- Skills development plan for manufacturing – approach SETAs for funding at least one training initiative per priority manufacturing grouping. Require all tertiary education institution to set out five year plan for their evolution of courses in relation to changing demands.
- Establish ‘best-practice’ procurement framework for large firms – to include mechanisms by which they are going to increase their spend on black SMMEs.

- Location plans for industry, integrated with IDZs.
- Identification of medium-term priorities (next four years)
- Implement effective monitoring of actual, potential and lost investments

January 2004: Launch Provincial Manufacturing Strategy

Appendix Table 1. Manufacturing performance, by subsector, 1996-2001

Sector	Avg ann VA gr, %	Avg ann empl gr, %	X:Q ratio 2001, %	X:Q ratio 1996, %	M:Cons 2001, %	M:Cons 1996, %	% skilled labour	K:L (Rth/empl)	RCA 2001	Nom tariff 1993, %	Nom tariff 1999, %	Nom tariff 2001, %
Food	-1.1	-3.8	10	11	9	9	45.4	157	0.10	13.4	14.5	8.2
Beverages	2.7	-3.4	13	10	3	5	46.6	605	0.69	14.3	10.0	18.1
Tobacco	-2.5	-5.3	14	7	1	2	46.6	207	0.92	27.8	31.3	42.0
Textiles	-2.3	-7.2	15	17	22	24	20.6	72	-0.22	49.1	25.7	15.7
Wearing apparel	-0.9	-2.4	18	7	14	9	17.5	11	0.15	81.0	50.2	20.2
Leather products	7.1	0.5	32	38	27	37	20.5	55	0.12	24.0	28.3	15.4
Footwear	-13.3	-12.7	4	5	38	26	9.3	31	-0.86	38.0	28.9	27.5
Wood & wood prod	3.7	2.5	14	10	10	11	39.4	34	0.17	10.9	3.3	3.3
Paper & paper prod	-1.0	-2.6	21	23	10	14	37.9	284	0.43	5.6	5.9	7.4
Printing, publishing	1.1	2.9	3	3	16	23	75.3	54	-0.70	9.8	2.1	1.0
Coke & refineries	-8.8	-5.7	26	22	11	13	59.3	5 249	0.49	9.3	7.2	3.7
Basic chemicals	5.0	-0.8	41	49	43	51	45.6	824	-0.04	1.9	1.4	2.2
Other chemicals	5.8	0.5	15	10	26	25	57.1	197	-0.35	17.1	6.9	2.9
Rubber products	-0.3	-6.4	16	14	27	26	31.7	136	-0.31	20.0	12.4	16.2
Plastic products	13.2	4.0	8	5	11	10	31.7	59	-0.17	17.9	12.4	9.5
Glass & glass prod	1.3	-6.9	16	11	19	22	26.7	295	-0.10	11.2	6.2	8.1
Non-metallic mins	-2.6	-12.2	11	7	15	13	26.7	253	-0.15	10.9	6.8	5.2
Basic iron & steel	-0.2	-7.7	38	51	8	14	45.6	1 334	0.74	7.2	2.6	4.4
Basic non-ferrous	3.1	-5.9	43	64	16	31	45.6	1 352	0.60	7.6	1.8	0.8
Metal products	2.6	-3.9	13	14	10	13	36.0	65	0.16	14.0	7.2	7.3
Machinery & equip	2.6	-2.3	65	29	78	66	51.7	73	-0.32	6.3	1.1	2.1
Elec machinery	3.5	-1.6	18	11	30	30	40.3	50	-0.31	13.7	4.3	6.1
Tv, radio & comm.	5.6	-3.6	38	23	80	74	40.3	84	-0.73	14.3	3.6	2.9
Professional equip	-5.8	-5.2	72	42	92	84	40.3	85	-0.64	14.2	0.4	0.5
Motor vehicles	4.5	-1.1	20	8	20	29	48.7	187	-0.01	37.0	32.9	10.1
Other transport	1.7	-4.4	57	30	71	50	48.0	279	-0.30	11.6	1.9	0.1
Furniture	-5.7	-1.4	39	33	14	9	30.4	30	0.57	22.5	19.5	15.7
Other manufactures	0.7	-5.4	40	40	39	52	51.1	42	0.02	14.2	0.4	4.7

Source: TIPS Standardised Industrial Database

Appendix Table 2. Employment

Year	1996	2000	2001	2002 (yr end)	Avg gr, % 2001-02	Avg ann gr, % 1996-2002
food, beverages and tobacco	221426	187882	183064	184049	0.5	-3.0
textiles	77402	55081	53403	54904	2.8	-5.6
wearing apparel	149908	136767	132864	139147	4.7	-1.2
leather & leather prod	7714	9675	7896	6364	-19.4	-3.2
footwear	25088	15317	12758	12470	-2.3	-11.0
wood & wood prod	65535	80409	74078	76887	3.8	2.7
paper & paper prod	47805	43924	41836	42178	0.8	-2.1
printing, publishing & rec. media	52620	60789	60810	62508	2.8	2.9
coke & refine petr prod	18467	14229	13755	13971	1.6	-4.5
basic chemicals	28855	29092	27737	30393	9.6	0.9
other chemicals	65544	73625	67241	69238	3.0	0.9
rubber products	17681	13792	12721	12242	-3.8	-5.9
plastic products	46803	57932	57070	57108	0.1	3.4
glass & glass prod	9796	6839	6862	7240	5.5	-4.9
non-metallic minerals	65891	35692	34360	33384	-2.8	-10.7
basic iron & steel	59105	36950	39591	38948	-1.6	-6.7
basic non-ferrous metals	15982	11860	11808	11984	1.5	-4.7
metal excluding machinery	125327	102914	102790	108203	5.3	-2.4
machinery & equipment	76521	67325	68047	72399	6.4	-0.9
electrical machinery & apparatus	86689	84081	79780	79487	-0.4	-1.4
tv, radio & commu equip	16697	16025	13875	17615	27.0	0.9
motor vehicles, parts	81858	77248	77538	75301	-2.9	-1.4
other transport equip	13672	9050	10902	12574	15.3	-1.4
furniture	48134	44341	44903	51677	15.1	1.2
other manufacturing	32365	25327	24627	18799	-23.7	-8.7
Total manuf	1424519	1270840	1235688	1289070	4.3	-1.7

Source: TIPS Standardised Industrial Database, StatsSA release for end 2002 (previous years are average employment)

Interviews held

Organisations

ECDC

IDC

ECMAC

Chemin

ELIDZ

CDC

Noma Consulting/Uitenhage Despatch Development Initiative

Border-Kei Chamber of Business

Firms

Mario Levi

Industex

Ariston Plastics

Spicer Axle/Dana

Suntex

Plastech Moulders

Nampak/Kohler

First National Battery

Summerpride

Molan Pino