CAPTURING
THE
GAINS

Capturing the Gains Global Summit, 3-5 December 2012

Keynote address of Minister of Trade and Industry, South Africa: Dr Rob Davies

It is a great pleasure to be able to participate in this conference. It is timely and the right kind of theme. I am sorry I was not here yesterday – I was, in fact, trying to do a practical on some of the themes you have been raising. I was trying to see if we could settle the issue in the fruit and wine industry in the Western Cape here, based on some contribution to trying to raise the profile of the industry in value chains and capture more of the benefits of ethical trading. The percentage that you have calculated of what the supermarkets capture of the value chains is a very telling story. So I think that the research and the work presented in this conference are important.

What is also important is that the question of value chains is cropping up in a lot of international discourse; but around a very narrow set of policy prescriptions. This is what I am going to talk about largely. The issue of how communities, workers, and ordinary people in productive activities gain the benefits of this, is an extremely pertinent question.

Let me just start by saying that, from the South African government point of view, we have been looking to bring about some very fundamental and important structural changes in our economy over the course of this administration, in the context of the worst global economic crisis at any time since the 1930s. So the circumstances have not been what we want. But we have been seeking these structural changes because the growth path we have been on in SA, really up until 2008 and the onset of the recession, was one characterized by much higher growth in our consumption-driven sectors (in fact, twice that of our production-driven sectors, retail, financial services and things like that). This led to a growing deficit on the balance of trade/current account, which is now reaching record levels, and too weak a performance by our value-added sectors. All of this has meant that we have been unable to sufficiently address key social challenges in SA – mainly to reduce unemployment. So we have oscillated. When the economy performed well, we had 22.5 percent unemployment, on the strict definition, going up to about 25 percent when the economy performed badly.

So we have committed ourselves to making structural change or changes which are not easy to bring about. Those changes have been outlined in our New Growth Path, and the Industrial Policy Action Plan (IPAP) that has been introduced in this administration. However, we are well aware that there are important and significant changes in the global economic environment. These changes have created positive opportunities for us – I want to emphasize in particular regional integration – but have also brought a number of challenges, in particular because a number of our major traditional export markets have been really constrained as a result of the fact that the crisis has had its epicentre in a number of our developed-country trading partners.

Our trade policy (TP), which we adopted in 2010, is shaped by the needs of our IP. The TP will be subordinate to the IP. Our TP seeks to adopt a strategic approach to tariff setting – wherein we have no *a priori* view of whether tariffs should go up or down – that depends on the evidence presented and the needs of particular sectors. We seek to defend the policy space that we have in terms of international rules, and our TP policy priorities are to strengthen and deepen regional integration.

Why are we are focusing on regional integration? Basically, if we look at the African continent and its position in the world economy (as I said earlier on, there have been some important structural changes which are positive), Africa has emerged as the next growth frontier after Asia. The average rate of growth on the African continent this year is about 5-5.5 percent, which is second only to Asia and ahead of Latin America.

If we look at an analysis of what has driven growth in the African continent, there are four main factors:

a) Mineral products boom: this has been the result of industrialization in Asia and the imports of raw materials, which have fuelled higher prices for raw materials. Some analysts find that this is responsible for 25 percent of the growth in the African continent.
b) Then we have seen a consumption-driven component of new growth in Africa, particularly around technologies like cell phones and ICT. This has also spawned new service industries and sectors in countries like Kenya, for example.
c) Then we have seen that Africa has not been subjected to a systemic financial crisis or a sovereign debt crisis
d) Finally, there has been some investment in infrastructure.

These have all driven growth in the African continent. However, there is a general recognition that the next decade is not going to be the same as the last, and if we want to grow and develop, there are going to have to be some shifts. In particular, we cannot rely any longer on a mineral products boom as something that we can simply latch on to. We hear an increasing number of African leaders who talk about a need for Africa to 'industrialize'.

African trade ministers have identified three broad directions that can shape industrial development in the African continent. These are: adding value to our mineral products, such as 'mineral beneficiation'; a similar proposition with respect to agricultural products, such as agro-processing; and, thirdly, pharmaceuticals, based on the recognition that many of the diseases on the African continent are not going to be catered for by the research and development of pharmaceutical industries based in the North. These are the three broad directions.

But the problem we have as an African continent is that if we look at other emerging economies, like China, for example, their next phase of growth is going to be drawing on its domestic market. China is making that structural change to support its next phase of growth. Africa has the disadvantage that colonialism divided us into 54 different countries, and as individual countries we have too small populations, too small resource bases, to sustain industrial development. But if we look across the continent, large swathes of the continent, we start to hit the numbers that make sense. So the project we are engaged in and are prioritizing in SA at this moment, is the broadening of regional integration across the existing regional economic communities; and that takes the form of the SADC-COMESA-East African Community (EAC) project. This is seeking, in the first instance, to negotiate a free trade agreement across 26 countries on the African continent, with a combined population of between 600 and 700 million people, and a combined GDP of over USD1 trillion. That starts to give us the basis, we think, for industrial development (ID) in the decade or so that lies ahead.

Our approach to regional integration is that we have to address real factors and real constraints, not set in place ideal-type regional trade arrangements. So we will negotiate an FTA which will principally cover relations between countries that are not covered by existing FTAs; in other words, we are not going to reopen the SADC FTA. The EAC is not going to reopen its own FTA. It will prioritize negotiations between groups of countries in that broad configuration that do not have trade arrangement amongst themselves. But we also need to recognize that the biggest barriers to intra-regional trade are not really tariff regimes. They are much more to do with inadequate infrastructure; infrastructure that does not connect up our economies one to another; infrastructure we have inherited, which largely takes raw materials from where they are located, to the port and then outside of the region.

The second point is that we do not have adequate 'productive capacity'. Therefore we need to cooperate and support the development of regional industries emerging in different parts of that large region. Of course, the AU has drawn the obvious conclusion from all of this: where is West Africa in all that? And so, following the tri-partite, the AU has enunciated the objective and ambition to negotiate a continental FTA, which will take us into the realm of more than 1 billion people and a combined GDP of about USD2.65 trillion. This would be a sizeable and significant basis for ID.

Within that, we can identify various value chains. For example, some of the work we are doing in Southern African Customs Union (SACU) is to say that there are within this customs union value chains of different sorts, also integrated into global and other regional value chains. How can the smaller economies identify ways to link up, through these value chains, with the fact that they happen to be in a customs union with the most industrialized countries in the African continent? How can this create a more equitable ID pattern in the customs union? This work is on-going. There is a similar set of propositions at the level of SADC.

We have become aware that there is a huge debate taking place around GVCs. I think this debate has started, to some degree, in research that has been undertaken by and for the WTO. The so-called 'new narrative on trade' is telling us that there are GVCs (nothing new there – we have known that since the work of Manuel Castells). But they are telling us that GVCs are changing in character. Most international trade is now characterized by trade in intermediate products, about unfinished products moving around the world. That is now the biggest proportion of global trade.

We are told that there is an increasing collapse of the distinction between trade in goods and services. Out of this is emerging a discourse or new narrative, which is not confined to analysis but is also coming into the realm of a policy prescription. This policy prescription is telling us that import and export promotion is now blurred; that we should not just focus, as we have all done, on trying to promote our own export trade, but that we should also be open to more imports. That there should be more liberalization – particularly, we are told now, by developing countries. They should facilitate cross-border trade through a new ambitious advance on trade facilitation; and that, as I said earlier, because there is now a blurring of the distinction between trade in goods and trade in services, there should be liberalization also of trade in services.

This needs to be seen as mirrored in processes which are being supported within the WTO of pluri-lateral negotiations around trade in services, which are supposed to set a new, more ambitious agenda for trade in services (which everyone is supposed to follow later on) than the architecture which was agreed in the Uruguay Round and then taken into the Doha Round. And the other point is to prioritize the negotiation of a trade facilitation agreement with binding commitments on different partners. All of this in many respects is supposed to overshadow the agenda of the Doha Round, where the needs and interests of developing countries, and matters like subsidies and high tariffs on agriculture trade, were seen to be in the forefront.

While we are aware of the fact that there are GVCs, while it is an interesting observation that there is a change in the character of international trade and an increasing proportion of intermediate products, the policy prescriptions are quite problematic for a number of reasons.

Fundamentally, the challenge for us in SA and Africa is not just to integrate ourselves in to the VCs – we are already integrated into VCs – but to elevate our place in those VCs. We are at the moment largely integrated into GVCs as producers and exporters of primary products. We are producers and exporters of dirt out of the ground, which is going to support ID somewhere else. We produce and export unprocessed agro-products, which go into agro-processing industries located elsewhere. The challenge that we face is to raise our position in those GVCs and not to just acknowledge that they exist.

We think that a lot of the prescription that has gone along with the GVC analysis is actually a prescription to serve the needs and interests of multinational corporations which are at the head of these VCs. I have no doubt that they would like to see easier entry and exit into any market they choose; they would like to see services (financial, retail) available for them to access on and off. *But the problem for us in developing countries is that we need to move higher up the VC and industrialize our economies.*

We do not object per se to the policy prescriptions which arise from that – i.e. embark on trade facilitation (in fact in SA we could meet the obligations, it is not a problem for us so much, but we don't object to improved border procedure, provided that the needs and interests of developing countries and the resources required are made available, so that poorer countries can also meet these). But we think that agenda is not taking account of our needs and our ID needs. *We want to emphasize that the fundamental requirement for us is the 'policy space' to support ID.* The fundamental issue is the ability for SA to maintain and adopt a developmental approach to trade policy, to tariff setting, which gives us the space to prioritize regional integration within the perspective that I've talked about.

To get back at the point I made at the beginning: for many of us, the challenge is that we need to find a pattern of integration into VCs that supports and sustains improved living conditions for working people, improved developments for our communities, improved employment opportunities, and so on. That requires that we increasingly need to occupy a space in international trade as producers and exporters of products produced under adequate social conditions: where there are rights for workers to organize and engage in collective bargaining; where the benefits and fruits of participation in international trade of this sort are shared visibly by our communities. That is the challenge confronting us right now – in the Boland, right now, that's what it is about.

Our approach will continue to be shaped by the need to promote ID. It will be shaped by an approach where we look to our export sectors to visibly demonstrate that they are contributing to sharing the benefits and also that there is an adequate floor of basic social conditions. The research work is telling us that a large percentage of the benefit of VCs, for example in our fruit industry, goes to supermarkets located in other countries– this is a huge story. These are challenges we have to confront. We are going to have to struggle to make sure that more of the fruits of the VC are located in our countries. We should move up the value chain through industrialization, thereby sharing the benefits with the working class people and communities across our country.

Round of questions

Comment 1: *Fritz Mayer, Duke University*: I thought it was a superb synthesis of what we have been talking about. Thank you very much for that. I wondered if you could expand a bit more on the last point you were making: how do we ensure that the fruits of production are shared? What are the ways in which you can influence that from your position in the government?

Comment 2: *Sue Longley, Intl Union of Food & Agricultural Workers*: Can you give us more information on what should happen in the fruit industry to achieve that point you made? I really appreciated that you made the link between the VCs and distribution of wealth in the VCs, as that has been quite a contentious issue in this workshop, with some parts of the system not recognizing that unless we have equitable distribution down to the bottom, nothing is going to change. Can you elaborate a bit on the situation in the Cape and what you will be doing there?

Comment 3*: Johanne Maree, UCT*: I fully agree with aims and objectives that you spelt out, that SSA and S. Africa should move higher up in the VC. One of the blockages to me is the lack of skills to do so. I wonder if the minister could just address the question of the skills we require to enable us to move up the VC.

Comment 4: *Mandy Moussouris*, *Environmental Monitoring Group:* I work with smallholders that sell to FT in Africa. Industrialization is a good thing most of the time, but industrial agriculture has major problems, both in relation to ownership and workers' rights and all those issues. How does government plan to support small-scale agriculture? We see many important developments coming up, like sustainable agriculture, less use of inputs like pesticides and fertilisers, farming in an environmentally friendly way, and it has a much wider base and a lot more people involved and affected by the process. Are you looking at different ways that are more inclusive and more environmentally friendly – particularly for industrial agriculture?

Comment 5: *Isaac Shinekwa, EPRC Uganda*: I am trying to develop an IP for the EAC and I would like your thoughts on how to industrialize EAC. As you talk about tri-partite negotiations taking place – one of the thoughts we had was to develop a resource base for each country, or literally just plan or identify competitive advantage and areas of strength for each country. I know this is a contentious issue, as many negotiations break down because of disagreements. I want your thoughts on this and how to make a coherent industrial strategy and prevent breakdown.

Comment 6: *Shane Godfrey, UCT*: I agree we need to industrialize; the question is how labour-intensive that industrialization is going to be. A key issue is that SA is not at the bottom of many

GVCs needing to move up those VCs; rather, they are at the end of some GVCs, such as footwear, clothing, and so on. In those industries we have lost numerous jobs. So it's not a case of moving up the VCs, but moving down those VCs and winning back that production for local producers in our own markets. I would like your thought s on how you do that.

Comment 7: *David Kaplan, UCT*: I think the Minister's speech was very eloquent and I think he directed and made it clear where the thrust of the IP is. I wonder if there is not a trick that is missing here. One of the major areas where we are competitive is backward linkages into the mining sector and we have an immense set of capabilities around mining, geological services and the like. These are major exporters for us. SA has a current account surplus in this sector. With Africa opening up, there is enormous opportunity here. I would like the Minister to comment on possibilities. Also, how can the technological capabilities that we built in this sector be lateralized? How can we take advantage of capabilities that are world-class and lateralize them into other aspects – machine production, etc. And, in a sense, this is what the Scandinavians have done and this requires lots of skilling and so on. What is the potential of lateral migration of those technologies and extending SA capabilities elsewhere into Africa?

Reply to comments – Minister Davies

Thanks. I see there are a lot of individual questions and let me try and see if I can group some of them.

What we need to do in one respect, is to seize the moment we find ourselves in, with the situation in the agricultural sector, and place our industries into more of an *ethical trading space*. Yesterday I was in De Doorns, having a meeting with the workers there, and there was a team from Sky News. They were not there to take pictures of the pretty valley or the world class grapes. They were there because the reputation of De Doorns at this moment, whether we like it or not, is similar to Marikana. It is a centre of contestation, inequality, poverty and manifest non-gains sharing from that sector. The proposition we put forward yesterday to organized agriculture is that we need to and we will take the issues forward through a joint meeting of some kind – a conference or summit or something of that sort – with the Department of Agriculture, Forestry and Fisheries. This will be around the promotion of ethical trading.

I met with the Wieta [Wine Industry Ethical Trade Initiative] group a while ago and I asked what percentage of the wine farms are covered by ethical trading. They told me less than 10 percent. That tells us where we have got to go. We need to occupy more of that space. It arises from the fact that SA is not at the bottom of some of these VCs. There are markets where we are involved, markets where we can increase our presence, where in fact there is a premium available if we are seen to support decent working conditions, decent benefit sharing with our communities and with workers, and so on. I think that is one of the challenges we have: to move decisively away from the patterns of labour relations of the past and into an era where there is much more manifest gain-sharing. There are benefits and opportunities arising from the way in which international trade is structured.

The other side of it is that some of the tasks – this is perhaps responding a little bit to the question from the colleague in Uganda – how do we beneficiate? I think that the need to beneficiate is absolutely manifest. It arises from the fact that if we think we can keep digging dirt out of the ground and flog it to China and expect a huge premium for this in the next 10 years, we are living in a fool's paradise. We might be able to dig it out and flog it to China, but it is not going to be getting the same premium prices it has been up to now.

In any case, do we really want our resources to go out just as dirt out of the ground? You can go to Saldanha and look at an engineering marvel of the largest train in the world that brings iron ore down from Sishen and puts it on boats and sends it out. That's what it is. SA provided 38 percent of China's imports from Africa last year. We are the largest supplier of things like iron ore, chrome, manganese and chrome from Africa.

How do we move from there? I think there are a number of things that have to come together. They include a change in the way we award licences. We will have to insist that a proportion of the mineral resources are made available at discounted prices to support local industrial development. That is a battle we have been going through in the iron and steel industry – not with a great amount of success. But wait and see. Later this week there could be a communication from Cabinet about our approach going forward.

One of the points is that we need to negotiate with our customers. Brazil, for example, negotiated an iron and steel investment plant against a long-term contract with China around iron ore supplies. We need to negotiate with our customers and say, "You want our product, you can have it, but these are the terms and conditions." *The fact is, we can do it a lot better as a bloc than as individual countries*. That is the way we need to go.

There is one example that I often quote. There is a project that will eventually locate itself in Saldanha that will turn mineral sands into products like titanium, zirconium and things like that. The pre-feasibility study done a few years ago indicated that we received $440/ton for mineral sands we export raw at this moment. But, if we turn the sands into titanium alloy – which is not even aircraft parts, just processing the raw material – we can get over $100,000. There are several thousand tons of sand in that. But there is value which is going into other economies, creating jobs elsewhere, that we need to capture ourselves. This is a very fundamental challenge for SA.

SA is no longer able to offer as a competitive advantage for manufacturing what we used to offer: cheap electricity. Electricity in fact is a disadvantage now in SA. The *only thing we have to offer long term is this access to raw materials we have got here*, but that does not mean you can have it at an import parity price or the LME price. There has to be a VC that supports manufacturing of value addition in our own economy. This is not going to be easy to achieve, but this is the direction.

On the question of environmental issues in the fruit industry, small-scale farming and stuff like that: I think the environmental issue is critical. Our approach to making much more environmentally sustainable transformations in our economy is very fundamental. We need to do it for a lot of reasons – including that we need to make a contribution to avoiding catastrophic climate change. But we also need to see this as a source of economic development and growth.

The last technological wave we had in the world economy was the ICT revolution. SA and Africa were largely consumers and service providers to somebody else's manufactured goods. We cannot afford to miss the next wave, which is green energy generation, and relate to it only as service providers and consumers. We need to capture some of the manufacturing from that. SA has set an ambitious target. A quarter of our new energy needs by 2030 will come from renewables, a scale large enough to support ID. This is what we hope to do.

But there are also other issues about environment and trade. There is no multilateral discipline, either in the framework of WTO or the framework of UNFCCC, around unilateral trade measures. The same could be said about ethical trading as well. We see a lot of interventions and actions taking place in the developed world, for instance, imposing unilateral trade measures in the name of reducing carbon footprints. But these can disadvantage countries like our own, which are located some distance away from major markets. They focus only on the carbon used in transport and do not take account of the carbon used in the production process.

I read somewhere that if you drive six miles to the supermarket in England, you can use more carbon than it takes to fly the fruits or vegetables from Kenya. Long-distance transport will always be a disadvantage for countries like our own in the Southern Hemisphere. We had an incident recently where there was a threat in the name of the environment (there were other reasons as well) from supermarkets overseas with the support of NGOs funded by the British government, that they would buy more of our wine in bulk, rather than bottled. This meant the transfer of significant numbers of bottling jobs from SA to the UK. We raised the matter again and again but nothing happened, until we turned around and said, “But we import more whisky. What’s good for exports is good for imports. We can require the same for whisky imports. We can require bulk imports.” Suddenly there was an interest in negotiating! We need to find negotiating room. That is one of our challenges

On the question of skilled labour and training: that is our biggest medium-term constraint. Everyone who invests in SA is told that they had better get involved in skills development. We are seeking commitments from business that they will train more than their own needs, and in return for that organized labour will regard those people as trainees and not employees under the Labour Relations Act. This still needs to get moving much more expeditiously. Even our own department, the DTI, puts money into university courses to train our people, because we know that if you want to get successful in SA you had better get involved in training. That’s our message, no question about it. And if we don’t do it, we are going to have that constraint holding us back as we develop our industry. We also need to develop the skills base.

I don’t think that the answer to the clothing industry and the loss of jobs is for SA to go down the VC or downscale. The answer is to capture particular niches. Our niche, the one where we have really got to be in the clothing industry, is the advantage of fast fashion – linking up with retailers and identifying possibilities for us to respond more quickly to their needs than any importer can do. Along with that, supporting investment in upgrading the productive capacity of those industries. We have put some programmes in place and they are beginning to show some results, at least in terms of stabilization of that particular sector. It is very vulnerable still to import competition and illegal imports. But I cannot think of any conceivable industry where SA’s place is to engage in a race to the bottom. We should always identify some niche which is more intermediate than the bottom.

On Dave Kaplan’s point, he is absolutely right. But the problem we have been facing in the mining technologies is that we have been importing and we are knocking out productive capacity. That is what has been happening in South Africa. There have been too many cases where mines have decided to import this or that and knock out productive capacity. I think the way we can respond to that is that the engineering industries, capital goods industries, are one of the potential growth sectors in SA manufacturing – linked very much to infrastructure development programmes. The infrastructure development programmes – the acquisition of railway equipment, building of ports, railway lines, all that kind of stuff – I think this can generate a significant demand for engineering products.

We have said that government will procure according to certain percentages from SA operators, and that can begin to spin off into the mining technology. We are engaging with the Chamber of Mines on some of these issues. We need to be getting commitments from other social players, including the private sector, to adopt social procurement policies to support local industry. Because we must not neglect that sector, not let the sector go down, as it is critical to SA. However, it is happening at this moment, and I think it has got to do with things like the way the exchange rate was, and decisions influenced by those sorts of considerations.

I think essentially I have covered most of the questions. Thank you very much.

ENDS