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NEVA MAKGETLA: Localisation can only work if closely watched and tuned

A powerful way to jump-start new industries, it needs a strategy of diversification

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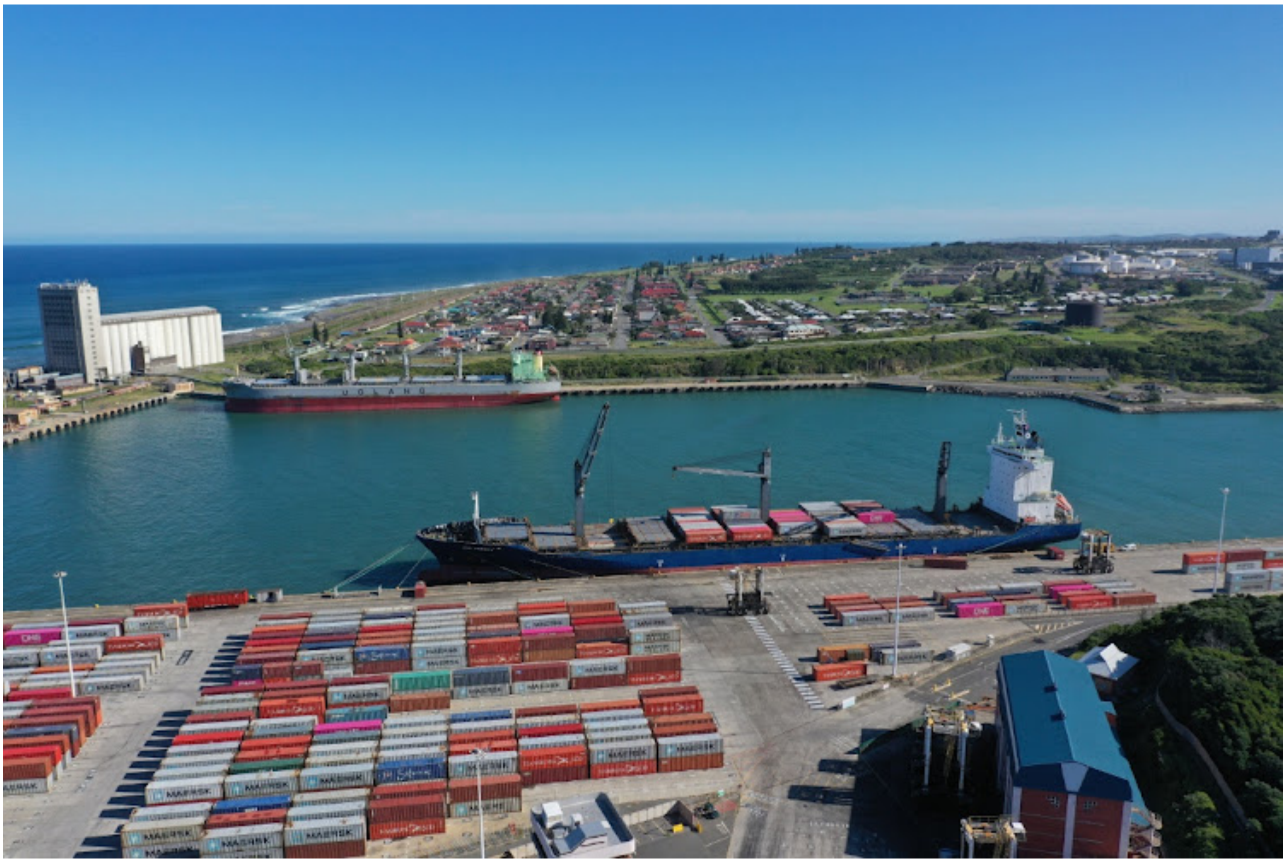

The Port of East London is shown in this file photo. Picture: ANDRE OOSTHUIZEN

Localisation has become largely synonymous with SA's industrial policy, although critics contend that it will raise costs and distract from export markets. However, debates about its general principles may miss the point. Industrial policy depends on a pragmatic, case-by-case approach to the constraints on different industries.

Instead of discussing localisation in the abstract, its fundamental methodology requires us to pinpoint the conditions where the benefits should outweigh the costs, and then testing that understanding against the evidence for specific value chains.

As defined by the department of trade, industry & competition, localisation diverges from import substitution industrialisation, which historically focused on consumer goods. SA's version of localisation also promotes local suppliers for export production, for instance manufacturing components for cars, the electricity grid or locomotives.

The nuance is important. Critics have long argued that import substitution typically leads only to assembly industries that rarely progress to more high-tech intermediate and capital inputs. In contrast, under the department's definition, successful localisation could secure substantial industrial deepening in some cases.

A more fundamental criticism is that localisation necessarily props up higher-cost or worse-quality producers. If suppliers were competitive, critics contend, domestic goods would prevail without government assistance. This argument indubitably holds true in perfectly competitive markets, which by definition enjoy perfect information and factor mobility. Alas, in our grubbier workaday world those conditions rarely hold.

Buyers may not know about local suppliers, or assume without evidence that imports are better. They may find it easier to rely on long-standing procurement networks. In many cases local producers need longer notice to gear up than more established and larger foreign suppliers.

At its best, localisation promotes "infant industries" that, given time to mature, will be able to match global prices and quality. Both Japanese and Korean car producers enjoyed decades of high barriers to foreign competition before they took over international markets. Proponents argue that this kind of long-term success could more than compensate for the immediate costs of localisation.

The hard part, of course, is to figure out which lagging industries can, in fact, catch up. That task means analysing two leading risks:

- First, localisation is less defensible for necessities, whether infrastructure inputs or consumer staples, where even a short-term price spike can undermine national competitiveness or cause real hardship. Infrastructure investment aims not to promote supplier industries, but to cut costs across the economy and improve living conditions. Localisation is not justified if it would threaten those gains. Similarly, SA's deep inequalities and mass poverty should rule out measures that raise the cost of consumer necessities or social services in poor communities. In the event, tariffs on basic foods rose more than 6% over the past decade, driving them higher than for other goods.

- Second, localisation cannot succeed if it protects markets without promoting higher productivity or lower rents. Yet local steel got tariff protection without visible efforts to diminish the rents on local iron ore sales. Similarly, extortionate tariffs for chicken, a staple food, have not been linked to measures to moderate import-parity pricing for soya, although feed accounts for most of the cost of chicken production.

It doesn't help that localisation in SA depends heavily on tariffs and on designating goods for state procurement. Neither system was originally designed to promote strategic industrialisation by consistently identifying potentially competitive industries, or to condition support on higher productivity. Instead, they often end up responding to lobbying by high-cost producers. Moreover, the enforcement mechanism for designations is at best patchy. At worst, the process risks facilitating corruption by increasing discretion for procurement officials.

Localisation can be a powerful way to jump-start new industries. However, to succeed, it should be embedded in a coherent strategy to promote long-run diversification, with a hardnosed case-by-case evaluation of costs and benefits. That is particularly important as the economy struggles with the transformations required by economic recovery and the climate crisis.

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