Industrial Policy in Secondary Economic Areas: Newcastle and MAP case studies

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Newcastle

Introduction

Newcastle, a historic city in North-Central KwaZulu Natal, features one of the more established industrial bases among comparator secondary cities. The city plays host to two large heavy industrial facilities, the ArcelorMittal Newcastle steel works and Karbochem chemicals facilities, as well as extensive light manufacturing through the presence of hundreds of textiles firms and a range of diversified firms in sectors like plastics and metals processing. This established industrial base, along with a capable local municipal government and a geography in which economic opportunities are located close to major townships, makes Newcastle a prime example of a high potential secondary city. Advancing industrial policy will, however, require a careful assessment of the increasingly limited opportunities available through linkages to large capital-intensive investments, as well as a balancing of worker protections and wage pressures in the textiles industry.

City Profile

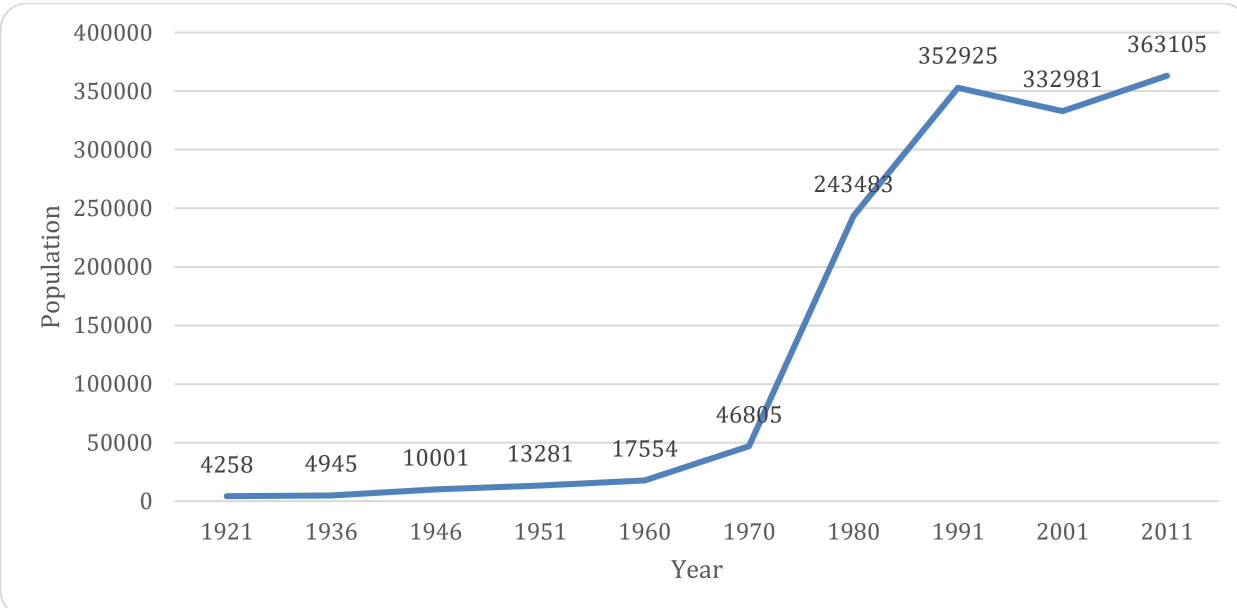
Newcastle is located midway between Durban and Johannesburg, and sits on the N11 and near the N3 logistics networks. The center of town is flanked by established middle-class suburbs, while a two large townships, Madadeni and Osizweni are on the outskirts of the town. Two large industrial complexes, in the form of ArcelorMittal Newcastle works and the Karbochem chemicals facility, are to the East and South of the city respectively; while two industrial zones, Madadeni and Riverside, flank either side of the Madadeni township.

The geography of Newcastle evolved in three distinct phases. The first, during the earlier colonial era, saw the city develop as a logistics hub, strategically located at the midpoint between the Port of Natal and the Afrikaans republics. The city's location, combined with the discovery of coal, led to the development of substantial road and rail linkages, and established the core of the town. The second phase was driven by the establishment of Newcastle Iron and Steel, which featured South Africa's first blast furnace. Additional investments in the steel industry followed by Durban Falkirk Iron company and Iscor, with the industry being driven by the easy availability of coking coal, the supply of power from the damming of the Ncandu river, and the logistics infrastructure running through the city. The steel industry developed vast housing tracts for employees, many of which would eventually form the core suburbs of the city today.

The third phase was driven by forced relocation of black-Africa people, particularly to the Mamadeni district, and the establishment of the sprawling KwaZulu homeland in 1981. The homeland drove dislocation and segregation of African people from the city of Newcastle, and established the spatial segregation that continues today. Supporting policy in the form of aggressive industrial decentralisation incentives also saw the development of the two industrial zones in Madadeni, and the subsequent arrival of Taiwanese-owned textile factories in the 1980s, and later the arrival of Chinese-owned factories in the 1990s.

Forced relocations and the development of industrial activity saw rapid growth in the city, which grew from 17,554 people in 1960 to 350,000 in 1991, as can be seen in Figure X..[i] The city houses 90,347 households, with a total population in 2011 of 389 117, or 4,3 residents per household.

Figure 1: Population of Newcastle, 1921 - 2011



Source: Socio-spatial effects of economic restructuring: the case of Newcastle, and StatsSA census data

The city plays home to the Majuba TVET college, which has seven campuses - three in Madadeni, three in Newcastle, and one in Dundee. A review of the college's performance for the years 2008 to 2010 noted a staff to student ratio of 1:30, slightly above the national average of 1:32.[ii] For the same period, Majuba college saw student throughput rates for National Accredited Technical Education Diploma (Nated) that were well below provincial and national standards, although the college performs better on the National Certificate (Vocational) qualifications.[iii] This data did, however, predate a R49 million investment in the college as part of a national recapitalisation programme, and recent interviews suggest that the college is viewed positively by local government and business people. The biggest complaint on the college was the lack of skills that could directly feed into the local economy, and it was suggested that closer cooperation with local business people could make for a more suitable offering of technical qualifications.

Industrial Sector

Overview

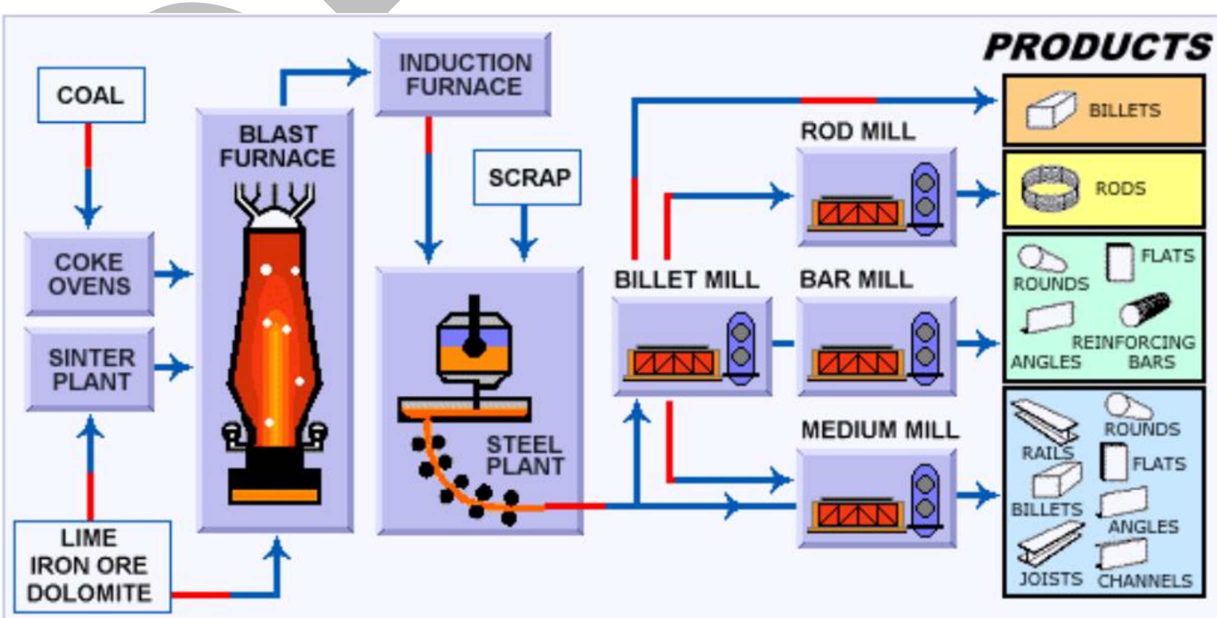
Newcastle's industrial mix largely results from a combination of two factors. The first is the presence of strategic resources, notably coal and linkages to both Johannesburg and Durban, which have encouraged the development of energy-intensive heavy industry like steel. The second are a set of industries that benefited from apartheid-era policies aimed at industrial decentralisation and economic independence, notably textiles and the chemicals industry. A range of supplier industries and other interests are in the space between these two central industrial poles, as well as some firms, notably in plastics, that have developed by building off preexisting investments in other sectors.

Steel

The steel industry in Newcastle has a history dating back to the 1920s, when Newcastle Iron and Steel works established South Africa's first blast furnace. A number of expansions and takeovers of the steel works eventually ended with the South African government's decision to acquire the facility as part of the establishment of a third works for Iscor, which would eventually become ArcelorMittal. The Newcastle works was seem as strategic for at least four reasons: the availability of water, the close availability of coking coal, the availability of road and rail linkages, and the location of the city midway between Johannesburg and Durban.[iv] In addition, the government was seeking to decentralise the steel industry from the Witwatersrand complex, and avoid overreliance on Iscor's Vereeniging and Vanderbijlpark works.[v]

The current factory focuses on the production of long steel products (as opposed to flat steel), which are used primarily in the construction industry. The factory's product offering includes "bar, billets, blooms, hot-finished and cold-drawn seamless tubes, window and fencing profiles, light, medium and heavy sections, rod and forged products."[vi] The plant also undertakes secondary production in its coke and chemicals business, with a focus on producing inputs for the ferroalloy industry. As can be seen in Figure X, the facility is dependent on a steady stream of coking coal, core metallurgical inputs like iron ore, and scrap metal - with coal and iron ore accounting for 70% of operating costs. While core inputs are brought in from other parts of the country, AMSA claims to have strong local community linkages, with 103 suppliers in Newcastle and 24% of procurement value going to local communities.[vii] Further details on these linkages were not immediately available.

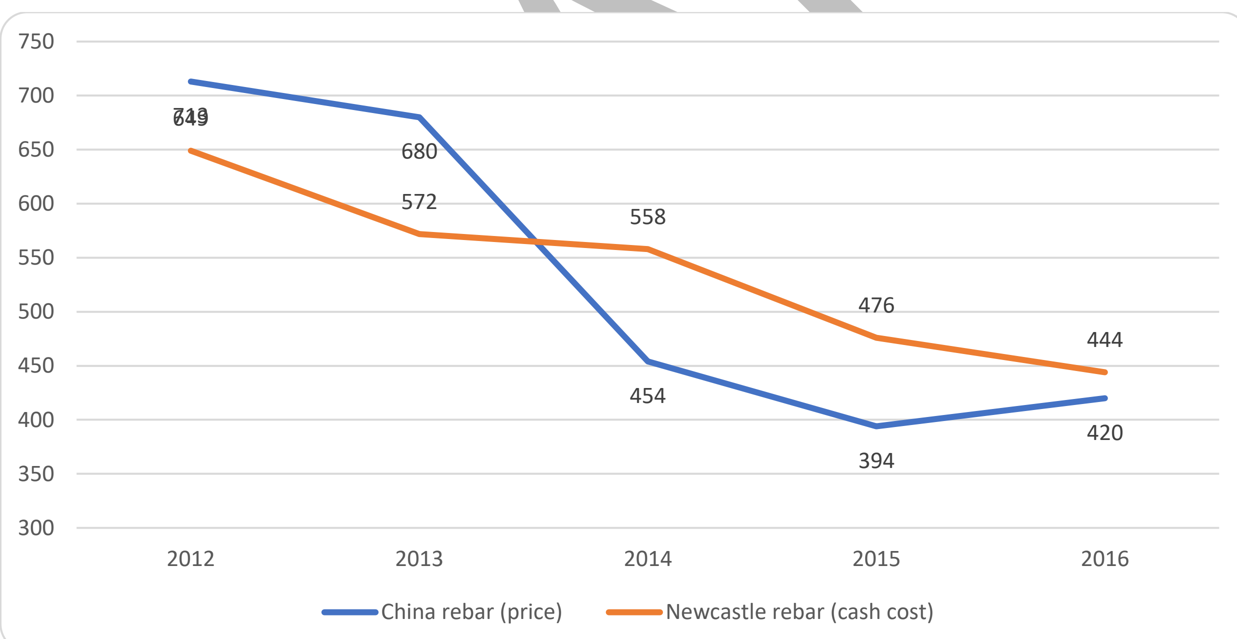
Figure 2: ArcelorMittal Newcastle works production flow



Source: https://www.arcelormittalsa.com/Portals/0/Newcastle%20Works%20Presentation%20-%20Investec%20(4June2012).pdf

The Newcastle plant, like AMSA and the South African steel industry more generally, have come under increasing pressure in recent years, resulting primarily from a global glut in steel caused by Chinese overproduction, but also from rising energy prices and history underinvestment in new technologies in the country's steel plants. As can be seen in Figure X, while the Newcastle plant remains efficient by global standards, it has nevertheless found itself under pressure from rapid price decreases in imported Chinese steel. The resulting competitive pressures forced AMSA into a loss in 2015, before a minor recovery to profitability in 2016.[viii] While the Newcastle works has traditionally been the second most efficient of AMSAs three core plants, on the basis of price including transport costs, recent improvements in the Vanderbijlpark facility has left Newcastle as the highest price producer in the group.[ix] While rebound steel prices and policy interventions has lifted some of the pressure on AMSA, at the height of the steel crisis the company was mulling the disposal of one of their plants, highlighting the risks involved in even major established industrial facilities.[x] More recent announcements have noted a commitment to the core facilities, including Newcastle, while the company is still considered the disposal of non-core assets.[xi]

Figure 3: China rebar prices versus Newcastle rebar cash cost, 2012 - 2016, USD/t



Source: ArcelorMittal. 2016. "Integrated annual report 2016: Five-ear brenchmarking", http://www.arcelormittal-reports.com/reports/integrated-2016/five-year-benchmarking.php

The ArcelorMittal plant is clearly a centerpiece of industrial development in the city, and indeed many secondary cities are framed around large industrial complexes like the AMSA plant. Understanding and building on the role of these facilities is, however, more complex than it first appears. Large industrial facilities don't play the same role in smaller cities that they once did. While the Newcastle works still employs 2998 people[xii], highly capital intensive production, and advancing technology have seen declines in the numbers employed in major facilities, while linkages to local industries are generally weak, as the plants ship in the inputs they need. And while investment and repairs are important - with AMSA investing R800 million in the Newcastle plant in 2017, including a R286 million coke oven battery repair[xiii] - the local linkages to this work is again relatively weak.

The role of the municipality in the relation to the plant is also complicated. Clearly the priority needs to be on business retention, and assuring a good working environment with a plant that forms a cornerstone of industrial development in the city. However, established plants like the AMSA facility are enormous investments and are unlikely to relocate except if they were rendered completely uncompetitive. In such a scenario, there is little a municipality can do. In 2016, AMSA had revenues of just over twenty times those of the Newcastle municipality[xiv], and the scale of investment in the steel industry would require support far exceeding what is possible for the local government. Given this difference in capability, there is realistically not much that the Newcastle municipality can do to provide direct support in the case of a crisis. Supporting local service delivery is similarly complicated. Companies of the scale of AMSA tend to negotiate directly with Eskom (via the Energy Intensive Users Group) and with Transnet (through a dedicated working group for the Newcastle plant). Nevertheless, problems persist, with the Newcastle facility having resorted to trucking in core inputs due to problems with rail linkages, and facing mounting concerns over energy costs. Again, there is little role for municipal government on these issues, and the impetus must come from a responsive national industrial policy infrastructure, with an emphasis placed on the two SOEs.

On balance, the focus for secondary cities should be, to the extent possible, capitalising on business creation around the steel industry (or similar capital intensive investments). This could by encouraging the development of support ingindustries, like maintenance for trucks or supporting infrastructure to non-crucial investments like walls and fencing at the plant. Navigating where the focus will be must be a deliberate process, since a company of the scale of AMSA has internal capacity for many of these functions and has established contracts with national service providers, but nevertheless some space is still available.

Local industry creation in the steel value chain is also possible, and does exist to some extent. For example, Metal press technologies is a small Newcastle-based producer of steel products, such as boilers. However, there is little evidence that being adjacent to a steel works provides better prices, particularly when that facility is part of a vast integrated conglomerate that tends to set prices centrally. Perhaps the greatest potential for local industry to leverage off the Newcastle works is in the skills creation of the plant, with ex-AMSA employees starting small businesses, but again, there seems to be limited roles for government in promoting such development, beyond creating an urban environment that encourages ex-employees to remain in the city.

Perhaps the core lesson of the Newcastle works is therefore that, at times, the industrial base of a town offers more limited opportunities for leveraging further investment than it may seem. The Newcastle works is best viewed as a mean to assure the stability of industry in Newcastle (and

South Africa more generally), and thus quick responses to problems at the plant and the industry, with a focus on retaining the plant, should be the priority.

Chemicals

The chemicals industry the Newcastle has its origins in apartheid era policy, which encouraged the production of synthetic rubber as a means to protect against the increasing isolation of the regime.[xv] Sentrachem, which Karbochem would later acquire, established a synthetic rubber plant in Newcastle in the early 1980s. While the plant would never successful produce price competitive rubber products during the period of isolation, the facility was eventually spun-off to produce specialty polymers, and later returned to synthetic rubber manufacture once the technology was sufficiently advanced.[xvi] Subsequent takeovers and changes of ownership saw various elements of the Sentrachem facility broken up into four firms.

The synthetic rubber business of Sentrachem was eventually acquired by US multinational Dow Chemicals,[xvii] and later spun off as Karbochem. Karbochem continues to operate in the synthetic rubber and elastomeric materials sector, which is used for functions such as tyre manufacturing, industrial purposes, and sports equipment manufacture. In 2011, the Karbochem facility was estimated to have a nominal production capacity of 30,000 tonnes of synthetic rubber per annum, with the majority of production inputs coming from close byproducts to Sasol's production.[xviii]

The chrome chemicals unit was acquired by German multinational Bayer Chemicals, and later included as part of the Bayer spin-off Lanxess after a restructuring in 2005. The company employs 140 people in Newcastle[xix], and sources chemical grade chrome ore from the company's own chrome mine in Rustenburg, and processes the ore into a range of specialty chemicals used for the likes of metal plating, the treatment of leather products, and more.

South African Calcium Carbide[xx] (SACC) was acquired from Dow chemicals in 2004 by Argentina's Adina group, and has generally been the largest producer of calcium carbide and derived chemicals on the continent. SACC produces a range of specialty chemicals, with many feeding into the steel industry, and used for purposes such as welding, oxidation of scrap, or as components in the creation of specialty steel products. The company is currently undergoing business rescue, as is discussed below.

Finally, African Amines, owned by American group US Amines, produces specialist ammonia-derivatives that feed into the fertilizer products, as well as some other applications, such as the manufacturing of paper and the creation of specialty explosives in the mining sector.

While the chemicals industry plays an important role as an employer and purchaser of baseload power in the municipality, the industry is otherwise relatively disconnected from the city. All four firms source their inputs from outside the region, and generally supply national and international markets. The extremely high sunk costs involved in the Karbochem facility make the industry largely immobile, and it would take very large losses for a shuttering of the chemicals production industry. Nevertheless, the chemicals sector in Newcastle face two key recent challenges: inflexibility in managing rising electricity costs, and the recent collapse of SA Calcium Carbide

Electricity costs are a concern across South Africa's heavy industry, an Eskom embarks on a push to increase prices and recover costs on the construction of the Medupi and Kusile power plants. While increased electricity costs are a burden for Newcastle's energy industry, interviewees didn't believe they were a risk to the sustainability of the industry. Rather, the more common complaint was that strategies to manage high energy costs were being limited by regulations and the municipality's dependence on energy sales for its revenue.

The issue seems to have arisen due to the collapse of IPSA-owned Newcastle Cogeneration (NewCogen), an independent power producer that established a gas power plant at the Karbochem facility in 2007. The NewCogen facility was the first independent gas power plant in South Africa, and has a nominal power capacity of 18MW.[xxi] The project was dogged with legal problems across its lifespan, including lawsuits from gas-supplier Sasol and turbine –supplier Iris Ecopower, but ultimately the company cited concerns over the broader operating environment as its reason for closure.[xxii]

These concerns seem to stem from two issues.

First is the uncertainty generated over the signing of new independent power producer agreements from Eskom. While problems with IPP agreements have generally been isolated to the renewables space, the uncertainty on these contracts, and the general state of disarray at Eskom, nevertheless seems to have created general doubts in the IPP space.

More importantly, however, have been limits on the municipality's ability to take on independent power purchase agreements. This is firstly a legal problem, with Nersa regulations preventing municipalities from acquiring independent power provision larger than 1 MW.[xxiii] But there is a broader issue at play, which is important across secondary cities, namely the dependence of municipalities on electricity sales. Newcastle derives 38% of the city's revenue from power sales, and off-grid solutions that remove base load from the city are therefore often viewed as a risk to the financial sustainability of the city.[xxiv] Indeed, under the current model, it would not be conceivable for Newcastle, nor really any municipality, to allow a large move to independent power production. At very least, this would need to be counteracted by large increases in rates, the charging of special levies on the independent power facilities, or the provision of additional funding transfers from the National government. The inflexibility around power is a major risk for a city that is, firstly, dependent on heavy industry, and secondly embedded in an energy system that is facing rapidly increasing costs. In the longer-term strategies will be needed to assist municipalities in managing higher energy costs, and eventually moving away from their dependence on energy revenues.

Even in the absence of these enabling conditions, there is room for innovation, but project execution needs to be carefully managed. This is clearly highlighted by the case of KC Energy, a second independent power producer located at the Karbochem facility. Backed by R70,6 million from the National Empowerment Fund,[xxv] the company aimed to produce energy off byproducts from SA Calcium Carbide's arc furnace. SACC is extremely energy intensive, and the project was estimated to offset 12% of energy usage from the running of the furnace, while employing 250 people.[xxvi] The investment was initially meant to be completed in 2013,[xxvii] but by February 2017 it was still only partially commissioned. The future of the investment seems particularly uncertain given, as discussed below, the uncertainty over SACC's future. The project nevertheless highlights the potential for progress to be made, provided there is adequate support from the national level (particularly for funding), effective project implementation, and a stable industrial environment.

Second, are the risks highlighted by the case of SA Calcium Carbide (SACC). SACC entered business rescue at the end of 2017. While details remain unclear on the exact reasons behind SACC's struggles, interviews with local policymakers indicated that it was at least partly due to rising costs of energy. SACC is extremely energy intensive, with the IDC claiming that the firm uses 50% of the energy Eskom supplies to the region (although this number seems unusually large, even for such an energy intensive industry).[xxviii] Regardless of the reasons, the core lesson from SACC is perhaps in the dynamics of how the company's struggles have been managed.

The local municipality notes that, after SACC entered business rescue, the national Economic Development Department (EDD) encouraged the municipality to offer a bailout for the company, in order to assist it in overcoming its cash flow problems. However, no financial support was forthcoming, and the local municipality did not have adequate resources to assist the company. The engagement highlights the limits of the municipality's business retention programme, which is a headline initiative to keep firms in the city. While Newcastle municipality can engage business groups and individual firms to try prevent firms from leaving or closing down, municipalities simply do not have the resources to assist these companies in times of crisis. Poor financial planning also plays a role, notably the construction in Newcastle of a new municipal building that reportedly dominates the local government budget.

For secondary cities with existing industrial activity, safeguarding and retaining that activity must be a first priority. And yet there is a systematic weakness in the capability of secondary cities to do so. Building institutional structures that facilitate such interventions is therefore essential, and is discussed in the recommendations below.

Textiles

The textiles industry is comprised of hundreds of primarily Chinese and Taiwanese owned firms. The industry is the product of the industrial decentralisation incentives offered by the apartheid state in the 1980s, which drove similar industry development, particularly in textiles, in numerous secondary cities across the country. The decentralisation initiatives and the low wages resulting from forced relocations saw industry move to Newcastle from both other cities, with the cities two largest textiles firms in the 1970s relocating from nearby Charlestown, and through investment from small foreign investors.[xxix] This first wave of this investment was primarily driven by Taiwanese textiles firms, and was accompanied by a secondary set of investments from Chinese firms, as part of China's more aggressive international expansion in the 1990s.

In common with the industry nationally, Newcastle textiles have been under significant pressure, notably from competition from imports. The industry underwent a contraction following the 2005 lifting of Chinese quotas on textile trade.

Newcastle is notable in that its industry has survived the subsequent decline of textiles in other secondary economic areas, even while still facing many of the global competitive pressures that had closed similar industries elsewhere. The continued presence of the industry is generally explained by the relatively large and established nature of the community, and the continued violation by textiles firms of basic labour conditions.

Textile firms in Newcastle regularly flout minimum wage requirements, working hours, basic working conditions, and basic safety standards. SACTWU, the textile workers union, labeled the Newcastle Chinese Chamber of Commerce and Industry (NCCI) as the worst employer in 2010, noting that "the clothing employer members of the NCCI continue to disrespect our country's labour laws. They pay clothing workers at wage levels which are far below the legally prescribed minimums."[xxx] SACTWU added that the award "is a broken brick, symbolising employers who break, not build, decent work in the clothing industry."[xxxi] Horror stories of lock-ins at Newcastle textiles factories, and incidents in which pregnant workers have miscarried due to working conditions, add to the animosity over labour rights in the sector.

The NCCI and some academics, such as the Centre for Development and Enterprise (CDE), contest these accusations. The CDE argues that the closing of minimum wage differential between metro and non-metro areas has particularly damaged local industry, noting that "in 2000, when minimum wages were still set through the Employment Conditions Commission, minimum wages in Newcastle were half those in Cape Town. By 2011, after nine years of wage agreements in the NBC, they had reached two-thirds of the Cape Town level." The local chamber claims that wage pressures risks undermining the industry, leading to a decline in low skill job opportunities in the city. The NCCI also claims that many workers are paid in excess of the minimum wage, and that it is primarily new employees who are paid less, due to the low levels of productivity of these workers. Nevertheless, the chamber notes that if the proposed national minimum wage is applied in Newcastle, it will result in the closure of factories.

The impasse over the issue of labour rights in Newcastle textile factories is extremely difficult to manage. Violations of labour laws hurt workers, and undermine efforts by government to partner with the industry, precluding access to incentives like the dti's Clothing and Textiles Competitiveness Programme (CTCP). And yet rigorous enforcement of labour regulations could result in an exit by the industry, particularly given strong competition from neighbouring countries like Lesotho and Swaziland.

Perhaps the core avenue for progress in this deeply contentious issue is through a reassessment the appropriateness of the current system of wage differentiation employed by the bargaining council. Factories in municipalities outside the metros are allowed to pay their workers lower minimum wages in order to account for the different cost structure of non-metros. However, the price distinction is very small (currently at 10%) and is not based on any systematic analysis of differences in living expenses, nor does it consider the different firm cost structures of secondary cities. Taking a more systematic approach to the calculation of minimum wage differentials could protect both workers and employers in secondary cities. This recommendation is discussed further in the policy lessons section below.

The local textile industry reports a range of additional costs associated with being based in Newcastle. Key among these are transport costs, with the industry sourcing inputs internationally and supplying national retailers. Smoothing logistics linkages may offer some benefits to the competitiveness of the industry, but are a double-edged sword, as they would also lower costs of importing from international competitors.

Outside of labour regulations, the most significant complaint raised by the NCCI is over the new immigration regulatory regime imposed by Home Affairs in 2015. The NCCI notes a range of problems, such as the stringency of the rules themselves, and the failure to issue work permits even when the rules are followed, a phenomenon that is perceived as being driven by corruption. Most worrying, however, are the changes that have been brought about by the outsourcing of processing to VFS. While Newcastle has a local Home Affairs office and has visa processing facilities at the office, the outsourcing to VFS now requires that all applicants must travel to Durban or Johannesburg to complete applications or renewals, a process that chamber members say is expensive and dangerous.

The NCCI explains the Home Affairs struggle as part of a general hostility to foreign investors, particularly smaller foreign investors. NCCI members complain about the habitual harassment of Chinese people in Newcastle, by police and other officials. Interviews with other business chambers seemed to confirm a tension with regards to the role of the Chinese community in Newcastle, which is often treated with suspicion, and viewed as exploitative of local workers. These social factors complicate the pure economic rationale of the industry in Newcastle, and would need to be carefully considered in protecting the industry.

Plastics and other

While small, the Newcastle plastics sector is an important example of how new industries can build off previously existing investments. In this case, the plastics industry largely builds off the presence of the textiles industry, with an initial focus on technical non-woven fibres, and a culturally link to textile firms through Chinese ownership in the plastics industry. The industry's positioning at the intersection of heavy industry, chemicals, and textiles seems to position it as the most obvious potential future cluster to be developed in the city.

Two firms in particular are notable in the Newcastle plastics space. Formosa plastics produces a wide variety of household items, such as containers and kitchen supplies. The owner of Formosa was reportedly initially also involved in the textiles industry, although this information could not be independently verified. President's Plastics produces a number of PVC compounds, with particular activity in manufacturing plastics coatings for wires and cabling. The company claims it is the only PVC compound supplier to the automotive industry in South Africa. While little information is available on these plastics firms, TIKZN does report that President Plastics expanded by R9,5 million in 2016.[xxxii]

Some other, general industrial firms also call Newcastle home. While a comprehensive scoping of these firms is beyond the scope of this study, the experiences of one firm - DCD Venco - are worth noting.

DCD is a manufacturer of precision engineering equipment, and first opened its Newcastle operation in 1973.[xxxiii] The Venco plant employed 208 people, until 2016, when the factory was closed. DCD's Newcastle general manager Willem Mare was quoted as explaining the closure by saying "(t)he closure had nothing to do with the performance of Newcastle DCD Venco, it was a business decision and a sign of the current economic situation."[xxxiv] The Newcastle Municipality noted that the closure of the Newcastle plant was actually driven by losses in DCD's Vereeniging and Vanderbijlpark locations. Despite this, the Newcastle plant was chosen for closure because the firm's headquarters are in Vereeniging, highlighting the difficulty of maintaining facilities outside the economic centre.

While other manufacturing firms are operational in Newcastle, data and fieldwork limitations prevent a comprehensive database of firms in the city. Two additional projects are worth noting. First, is Thirsty, a water bottler based at a natural spring around 50 kms from Newcastle. The plant uses highly advanced technology and control processes, and has been growing rapidly. Second is the mooted construction of the Walusile Waste Diaper Recycling Centre, a R50 million project that was announced by TIKZN, but for which further information is not currently available.[xxxv]

Governance and Policy

Governance

While municipal governance is generally weak across the country, respondents in Newcastle generally spoke highly of service delivery in the municipality. Respondents praised both the cost and reliability of municipal services, noting that core costs like energy or rates remained reasonable. This is also partially reflected in budget and audit data. Newcastle received qualified audit results for 2013, 2014 and 2015; before finally receiving an unqualified audit in 2016.[xxxvi] The core reasons for the qualified audits were insufficient records regarding infrastructure assets, as well as some problems with leave systems in 2014. Despite the positive audit opinion, the financial position of the municipality deteriorated rapidly in 2016. Newcastle's cash balance deteriorated from R340,813,000 in 2015, to R44,573,000 in 2016, following significant overspending on the operating budget, after two years of underspending.[xxxvii] This resulted in cash coverage for the municipality of 6 days, down from 2,7 months in 2015.[xxxviii]

Perceptions of corruption dog the municipality, and were mentioned multiple interviews with local business people, but few details are independently available on these accusations. One common point of contestation is the construction of a new municipal Civic Centre, which houses the local government and was completed in 2016. The Civic Centre tower was regarded by respondents as an extremely expensive investment, which had little benefit for the local community, and put immense strain on the city's budget.

National and provincial industrial policy

Local businesspeople report very limited uptake of national industrial policies, and similarly limited knowledge of what policies are available. The Chinese textile body, NCCI, were aware of the availability of textiles competitiveness incentives, but did not qualify, because of non-compliant labour standards.

Despite the lack of active awareness of the national industrial policy, a number of important crisis-management interventions benefit the city, particularly in the steel and textile industry. ArcelorMittal benefits from the package of incentives stemming from the steel task team, such as tariff barriers, support for upgrading, and rebates on customs duties, among others.[xxxix] Similarly, the textiles industry benefits from long-term protectionism for the industry. Both are, however, defensive interventions, with little evident policies to actively promote new industry development in the city. Newcastle also benefits from the Strategic Integrated Projects, notably from SIP2, the Durban-Free State-Gauteng logistics and industrial corridor, which will see upgrading of road and rail linkages between Newcastle and Durban and Johannesburg.

Newcastle receives support from provincial investment agency Trade and Investment KwaZulu-Natal (TIKZN). There is some level of discontent with the role of TIKZN, which took control of investment promotion activities for all municipalities in the province. Previously the local municipality led on investment promotion efforts, and some suggested that the municipality proved more successful in their efforts. Comprehensive data on TIKZN's efforts in Newcastle is not available, but three initiatives are mentioned in recent annual reports. First, is the aforementioned Walusile Waste Diaper Recycling Centre, for which TIKZN took the lead on developing a draft business plan to be submitted to the Department of Environmental Affairs.[xl] The second is the development of a soya bean processing plant, which would focus on the development of oil and animal feed, and would be located somewhere in the Amajuba district. The project is, however, in pre-feasibility stage.[xli]

Finally, and perhaps of greatest interest, is the work of TIKZN in developing a Business Retention and Expansion (BRE) programme. As the name suggests, the BRE programme targets existing firms and attempts to both assure the inventor remains in place, and assists in any expansion plans. TIKZN works with the Newcastle municipality BRE team, and directly with firms. Efforts to protect and expand existing investments are extremely important, and BRE is further discussed in the 'policy lessons' section below.

Municipal industrial policy

The Newcastle municipality states that their vision is that "(b)y 2035, Newcastle will be a Resilient and Economically Vibrant City, Promoting Service Excellence to its Citizens" and pledges to "develop Newcastle as a service and industrial hub."[xlii]

The municipality has a number of policies aimed at creating an environment for industrial growth, of which a full scoping is beyond the scope of this paper. Nevertheless, three initiatives are worth noting.

First are a set of municipal incentives, which include reduced rates, the provision of discounted industrial land, and a small scale grants. Discounted rates are probably the most significant incentives, with new business or commercial developments with a property value of at least R50 million qualifying for a 75% rebate after 4 years, with that rebate then declining by 25% every two years, until reaching 0% rebate after year nine.[xliii] These are mostly small scale interventions, most are also not offered in a systematic way, with no easy list of incentives available. Local incentives schemes are, however slightly more structured for the techno-hub that the municipality is developing at the old airport industrial site, and which includes specific incentives available for specific types of projects, such as non-profits or developers. Nevertheless, flexibility is still the main approach, with the techno-hub incentives guide stating that “Incentives are negotiable and all interested parties' requests will be evaluated.”[xliv]

Second is the development of the airport industria complex itself, which is discussed in the ‘industrial infrastructure’ section below.

Third is the business retention and expansion programme, which aims to work with existing firms and assure their continued operations in the city, and assist with potential expansions. This policy is discussed in more detail in the ‘policy insights’ section below.

Industrial Infrastructure

Industrial activity in Newcastle broadly takes place in five key areas. The city’s heavy industry is located at two privately owned complexes - the ArcelorMittal steel works and the Karbochem chemicals facility. Both facilities are relatively self-contained, but intersect heavily with public infrastructure such as rail and roads. The Karbochem facility also, until recently, played host to its own power plant, Newcastle Cogeneration. However, legal issues in the firm and the uncertainty around independent power procurement stemming from Eskom’s reluctance to sign agreements, led to the closure of the power plant.

Figure 4: AMSA Newcastle works (left), Karbochem facility (right)

Source: Google Earth satellite images

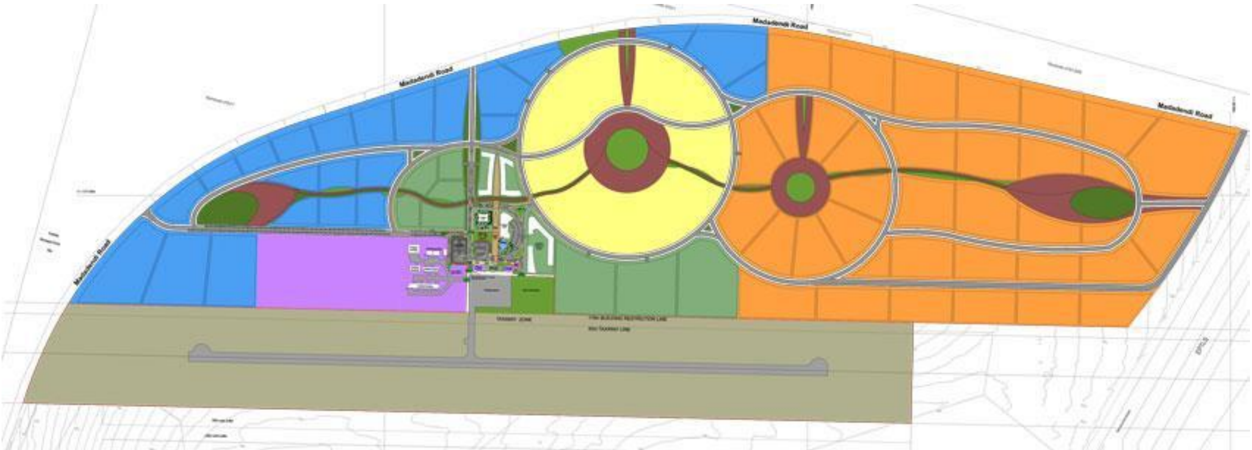
More general industrial activity is located at two industrial areas: Riverside industrial, beside Newcastle centre, and the Madadeni industrial park, which is located in the nearby township of Madadeni. Riverside is the larger and more established of the two, and is primarily comprised of privately owned land. The Madadeni estate is managed by provincial development finance body Ithala. While Ithala does not report on individual industrial estates, site visits to the estate revealed mixed conditions, with some well-established factories and other seemingly derelict structures. Nevertheless, the estate is noted as providing employment for an estimated 5000 people, and its location in the township is a positive move for the development of industrial activity in the sites of greatest need.[xlv]

Figure 5: Riverside industrial area (left), Madadeni industrial park (right)

Source: Google Earth satellite images

Airport industria is a new industrial area currently under development by the municipality. The area lies directly between Riverside industrial area and rail linkages on one side, and the Karbochem facility on the other. The development is meant as a general domestic airport, to which one local airline has thus far reportedly committed to serve, as well as a multi-purpose development that will include industrial space. The initial estimates put the cost of the project at R36 million (although procurement data suggests cost will be higher), which will be primarily donor-funded, and aims to be completed in 2018.[xlvi] The core of the airport (outside the terminal itself) will focus on a high tech hub, aimed at encouraging investment by technology firms. The remainder will focus on general purpose office space, conference venues, retail space, and some other facilities.

Figure 6: Plans for Newcastle Airport Industria



Source: KZN Techno Hub Newcastle, http://www.ncl.kzntechnohubs.co.za/about-kzn-techno-hub-newcastle

Procurement

Procurement offers a useful lever for local governments to encourage economic growth in the area. An analysis of bids awarded in the Newcastle areas from 2015 to 2017 indicates that efforts at local procurement are complicated by a procurement model that generally does not directly procure goods. Only 5,3% of the municpal budget for this period went to driect procurement of goods, with the vast majority focused on construction and services, in which the bid winners manage goods procurement for the project. Nevertheless, procurement seems to offer to offer clear linkages to the local economy, as can be seen in Table X below. Linkages to existing industrial infrastructure are clearly evident for procurement items like pipes (linked to steel fabrication), roads (linked to slag mining in the broader region), and information technology services (linked to the nascent ICT hub).

Table 1: Newcastle municipality procurement, share of spending by category, 2015 - 2017

Item	Share of category	Share of total
Construction		**45,77%**
Roads and infrastructure	42,79%	19,59%
Utilities	25,55%	11,69%
Housing	12,60%	5,77%
Techno Hub	10,68%	4,89%
Toilets	4,53%	2,07%
Community facilities	3,35%	1,53%
Municipal Buildings	0,48%	0,22%
Sewers	0,02%	0,01%
Manufacturing		**5,37%**
Pipes	34,08%	1,83%
Electronics and ICT	30,95%	1,66%

Automotive	15,73%	0,84%
Building supplies	3,81%	0,20%
Security	3,72%	0,20%
Utilities	3,55%	0,19%
Other	3,47%	0,19%
Furniture and office supplies	1,54%	0,08%
Clothing	1,50%	0,08%
Office supplies and furniture	0,93%	0,05%
Signs	0,45%	0,02%
Refuse containers	0,29%	0,02%
Services		**48,86%**
Finance & Insurance	85,65%	41,85%
Technical	4,61%	2,25%
M&E and Auditing	3,36%	1,64%
Security	2,07%	1,01%
ICT	1,42%	0,69%
Sale of properties	0,97%	0,48%
Planning	0,59%	0,29%
Training	0,47%	0,23%
Cleaning	0,44%	0,22%
Other	0,28%	0,14%
Event management	0,13%	0,06%

Source: Author calculation based on procurement reports, http://newcastle.gov.za/tenders/awarded-tenders/

Policy lessons

Reevaluate how heavy capital industry is leveraged

Newcastle, like many secondary cities, benefits enormously from the presence of two large, capital-intensive industrial facilities in the form of AMSA's Newcastle works and the Karbochem chemical plant. These facilities underpin local employment, municipal revenues, and can stimulate supporting industrial linkages. Increasingly, however, secondary cities need to reevaluate how heavy capital industry is envisioned in the context of the city. Large firms are increasingly sophisticated, with advanced technologies that can reduce employment, well established national linkages to input and service suppliers, in-house capabilities that reduce the need for external procurement, and close direct relationships with national departments and SOEs. The sum total of these impacts, while important to keep the fims' competitive, is that their impact on the immediate surrounds of the factory is often minimal. Similarly, as multinational companies that set prices and distribution networks at a head office level, it cannot be expected that the presence of the factories will stimulate local development that utilises, for example, cheap steel from the AMSA plant.

Heavy industry should therefore not be approached as the starting point for a value chain or for linkage-development, but rather in ways that assure the stability of investment and capitalise on what opportunities do exist. Three initiatives are particularly useful to consider.

First, is to build a robust eco-system for business retention and expansion. As already discussed, this is an established practise at both the provincial level (through TIKZN) and at the municipality level. It is also a complex undertaking, with neither level having the resources to prevent firms from leaving in the wake of a crisis of the scale needed to encourage a firm to walk away from the sunk costs of large-scale industrial infrastructure. BRE units therefore need to focus first on proactively addressing potential future threats. While constant meetings with big firms are useful, BRE funds could be more useful imagined as a special pool of funding for investment in critical infrastructure linkages that underpin the provision of water, electricity, roads and rail. While these services are crucial to municipal service delivery more broadly, it remains difficult to prioritise fixing a failure for a major firm over a more general outage in a residential area. Setting aside bespoke funds that concentrate on business-crucial municipal infrastructure can provide useful BRE activities for the municipality.

This is, of course, not enough in isolation. But the burden of building a stronger BRE infrastructure across the country must fall with national level policymakers. The current model seems to be that, in times of crisis, either the IDC is brought in to assist financially, or a more industry-wide set of interventions are considered through the creation of a task team. While these approaches have been moderately successful, a more systematised effort, including perhaps the creation of a special business rescue fund, would create a more explicit safety net and promote both business confidence and greater stability in uncertain economic times.

As a second initiative, the municipality, in partnership with large industrial firms, should conduct a comprehensive industrial symbiosis scoping study. Industrial symbiosis refers to a concept in which byproducts of industrial processes that are considered waste, are redirected to be used as inputs for other firms, thus creating value for both firms. Symbiosis is a useful concept in this regard because it is so difficult to create value off the core business of an established multinational. It is much easier, however, to utilise waste or byproducts, which generally end up collecting near the locality of the plant. Indeed, the Karbochem development can be seen, in a sense, as evidence of the success of industrial symbiosis, with many of the smaller firms producing chemicals based on byproducts from the production of synthetic tires. While the potential for industrial symbiosis is generally relatively small, it nevertheless would offer a profitable and self-sustaining way to benefit from existing industrial infrastructure. With support crowded in from the KwaZulu-Natal Industrial Symbiosis Programme, a scoping study and subsequent matching programme between firms would be a budget friendly and impactful intervention that would capitalise on existing industrial activity.

Third, as discussed above, there is potential for local industries to provide supporting inputs, such as fencing, office equipment, cabling, lighting, and so on. A scoping study of these needs, working in partnership with AMSA and the Karbochem firms, could help scope what is possible and how localisation could take place, and would leverage off preexisting local community development efforts in this regard by firms like AMSA.

Systematising wage differentials for secondary cities

Traditionally, the economic structure of small cities resulted in substantially different price structures from the metropoles, allowing for differentiated nominal wages, which drew investment to marginal economic locations without sacrificing real wages. The decentralisation of collective bargaining in South Africa has arguably undermined this function in South Africa. While collective bargaining does make a simple differentiation between metro and non-metro wages, the distinction suffers from at least three failings. First, municipalities directly adjacent to metros, which are effectively embedded in the same productive structure as the metro, benefit from the same lower minimum wages as secondary cities. Second, the distinction between the metro and non-metro wage has been declining over time. STATS. Third, the distinction remains highly arbitrary, with no systematic accounting for either distinctions in the cost of living or the cost of doing business.

The final point is the most serious, and carries risks for both employers and employees. Employers risk receiving inadequate differentiation which makes operating in secondary cities unprofitable; while employees risks having their livelihoods eroded in cases in which non-metros receiving inadequate minimum wages. There are a number of real uncertainties around wage differentials across the country, with weak data collection in this regard, and a largely undifferentiated measure of costs of living. The high level of oligopolistic retail in South Africa may drive similar cost structures across the country, while the weakness of rural areas might have the opposite effect.

Finding common ground on the difficult issue of wages is extremely difficult, but agreement should be possible on the more basic issue of having a sound basis for any differentials in bargaining council minimum wages, and in any potential future minimum wage. While the creation of better differential rates is a long-term prospect, the immediate term should see improvements in data collection, notably through a deepening of the scope of the expenditure surveys undertaken by StatsSA. Doing so will better enable policymakers to protect real wages of workers, while taking advantage of the lower costs structure present in secondary cities.

Deepen systems linkages for secondary cities

Secondary cities often struggle to access essential government services that are provided by national agencies. This includes access to Home Affairs, SARS, SABS, the Department of Labour, the dti incentives desk, industrial finance operators like the IDC, and a range additional agencies like SEDA. While this isn’t always a barrier, and firms can often manage occasional trips to major centres for key functions, smaller firms that rely on more transactional level interactions or that depend on advice and support to operate can struggle without the provision of adequate services.

A number of avenues are available to ameliorate this problem, of which three can be noted. First, the city of Newcastle has a relatively sophisticated system of municipal services, with well organised customer service and online systems. A municipality that is adequately advanced should be able to apply to be accredited as a service provider for national departments, enabling the municipality to take on simple front end processing tasks. Second, where cooperation with the municipality isn't easily achieved, national departments should consider having staff situated in the cities, particularly considering most of the more intensive work can be centralised in back offices and call centres. Finally, as a bare minimum, far more care needs to be taken in managing the transition to new service providers. In the Newcastle case, the outsourcing of visa service to VFS rendered existing Home Affairs capabilities in the city powerless to assist local firms, maintaining existing costs while harming service delivery. In the future, change management exercises should more explicitly consider the spatial dimensions of secondary cities.

Additional recommendations

Beyond the core observations noted above, a number of smaller issues were raised. These include:

Empower local municipalities to provide renewable energy generation

The Karbochem facility's cogeneration plant held great potential to improve manufacturing competitiveness while encouraging local investment in a new sector. Secondary cities should be able to promote IPPs, but are currently doubly constrained by cumbersome regulations and a dependence on electricity revenues that discourages the development of IPPs. Rethinking the funding model for municipalities to lift dependence on energy revenues, and changing the Nersa regulations for the registration of power generators, would create a useful mechanism for investment and competitiveness improvements.

Thinking generationally

Many small-scale business people who invested in secondary cities during the industrial decentralisation push of the 1970s and 1980s are now aging. Most are still personally involved in their business, and will soon begin to retire or consider handing over firms to the next generation. This process could be capitalised on by linking owners that wish to leave with interested potential business people, and supporting a handover of the firm with funds such as the black industrialist fund. Carefully managed, shifts in ownership can result in transformation, rather than closures.

Allow non-compliant firms to participate in bargaining councils

Textiles firms in Newcastle are generally non-compliant with labour regulations, and thus cannot engage in bargaining council structures. This is nonsensical. The most pressing firms to involve are the non-compliant firms that need to change their behavior. Even if the firms are not granted voting powers, they should be encouraged to actively engage with the bargaining council.

Maluti-a-Phofung

Introduction

Maluti-a-Phofung (MAP) is a sprawling municipality in the Free State, encompassing the logistics hub Harrismith, the former homeland areas of QwaQwa, and the large population centre of the Phuthaditjhaba township. In many ways MAP is an archetype of apartheid's spatial legacy, defined by a population centre that is located far from economic opportunities, and by new artificial constructions like QwaQwa, a former homeland. The geography of MAP means that many social and infrastructure demands mirror those of more rural municipalities, while the development of the industrial centre Harrismith requires a different set of interventions.

MAP's economy is dominated by agricultural and logistics, with the latter stemming from the location of Harrismith as the midpoint between Johannesburg and Durban and the strategically important N3 logistics corridor. The municipality has a limited industrial base to speak of, comprising of a few light manufacturing firms. This lack of existing economic base, combined with the unusual geography of the municipality and serious governance challenges, combine to suggest that the municipality has little potential for industrial development. While agroprocessing perhaps has some potential, MAP is more interesting as a case study in how secondary cities can develop off their strategic location, rather than any inherent economic advantages percent in that location. While there is much discussion of Harrismith as a logistics hub, there is not a clear vision of how this would work, or how such opportunities can create sustainable livelihoods for the people of MAP. MAP should therefore be seen as a case study in a new development path, in which logistics and other service industries are leveraged during initial stages of development, with the ensuing growth and economic diversification then leveraged for industrial development.

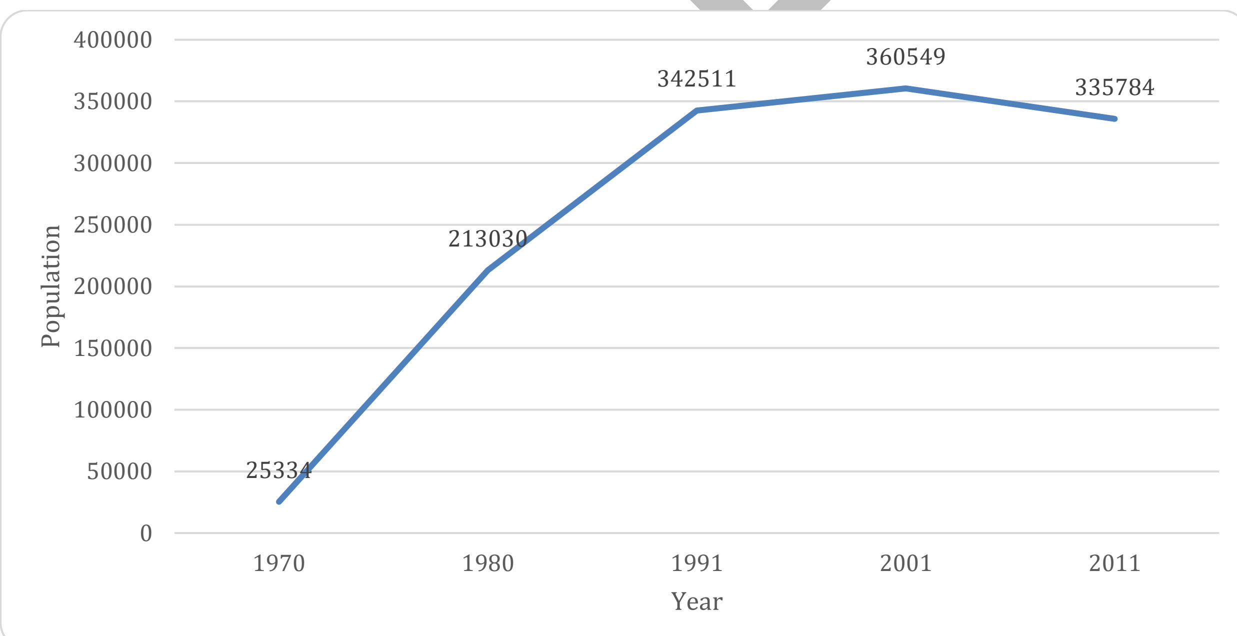
City Profile

The geography of Maluti-a-Phofung is an egregious examples of Apartheid spatial planning. The nominal economic centre in Harrismith is located 50 kms away from the population centre at Phuthaditjhaba, the capital of the former homeland of QwaQwa. 80% of the population of MAP like in the QwaQwa area, while Harrismith and Tshiame play host to most light manufacturing in the region. The resultant spatial dislocation places immense strain on those travelling across MAP (in which only 18% own a car[xlvii]), and leads to deep levels of segregation across the region. The divide between QwaQwa and Harrismith also leads to a fragmentation of economic development, in which neither area has the necessary mass of wealth to encourage the development of substantial formal retail space, with much of the retail and broader service industry anchored by travelers passing through the area.

The two poles of MAP, Harrismith and QwaQwa, owe their origins to the presence of the highway and to apartheid force relocations, respectively. Harrismith has always been a relatively small community, structured around supplying services to the flow of traffic on the N3 and N5 freeways. The area around Harrismith was traditionally rural, with the agricultural town of Kestell being the neighbouring hub, and QwaQwa standing as a small rural community. The population of QwaQwa in 1970 was only 25,334, but grew to 213,030 in 1980 and 342,511 in 1991 - as forced relocations to the area were driven though for the creation of the QwaQwa homeland.[xlviii]

While the area has always been poor, a modicum of wealth was made possible through the creation of a number of industrial zones, such as Industriqwa in Tshiama beside Harrismith, and the QwaQwa industrial zones in Phuthaditjhaba. The zones benefited from aggressive industrial decentralisation incentives, which drove investment in textiles in particular, and some other light manufacturing, with the surrounding communities serving as a pool of cheap labour for the factories. As discussed below, industry has been in a period of progressive decline, and recent population trends have been shaped by this economic contraction. The total population of the municipality declined in nominal terms, from 360,549 in 2001, to 335,784 in 2011 - at the same time as the national population grew by 14%.[xlix] At the same time, the population grew relatively older, even as the national population experienced a youth bulge. Among the population of MAP, approximately 140,000 people earn some form of salary, equivalent to a working population of 40%.

Figure 7: Maluti-a-Phofung population



Source: Marais, Nel, & Rogerson. 2005. "

The area has two higher education institutes: the University of Free State QwaQwa campus (formerly the University of the North) based in Phuthaditjhaba, and the Maluti TVET colleges, which has eight campuses, the majority of which are around Phuthaditjhaba and one of which is in Harrismith. While the presence of the UFS campus in Phuthaditjhaba is promising, the campus serves students from further abroad, with an uncertain, but limited amount of students from the local community. University employees also noted the lack of courses relevant to the economy of the region, such as agricultural courses. The Maluti TVET college provides a number of technical training courses, but the college faces a number of problems, such as throughput rates below the national norm[l] and serious evidence of corruption and lack of internal controls.[li]

Industrial Sector

Overview

Industrial development in MAP accelerated rapidly during the Apartheid era policy of industrial decentralisation. Substantial wage and capital incentives drove investment to Phuthaditjhaba and Tshiame in particular, as a way to prop up the homeland of QwaQwa, and reinforce planned racial segregation. Incentives saw industrial activity in Phuthaditjhaba grow from 35 factories employing 2100 people in 1982, to 200 factories employing 22,000 people in 1988.[lii] Incentives were accompanied by cheap land made available by the QwaQwa development agency, which 181 industrial stands for large industries and 193 for small industries made available in Tshiame and Phuthaditjhaba.[liii] Industrial growth was dominated by light manufacturing, notably in the textiles sector, which was driven by foreign investment by predominantly Taiwanese investors.

Following the disbanding of incentives during the early 1990s, industrial activity in the region initially remained strong. A review in the early 2000s reported that occupancy rates for the two sites in the former QwaQwa homeland remained at 90% for large industries and 49% for small industries, and that overall textile employment in the province expanded during the period from 1993 to 2003. This trend reversed sharply in later years, driven by three key factors. First was the lifting in 2005 of limits on Chinese textiles imports, which pushed the broader industry into crisis, and particularly threatened operations in marginal economic areas. Second was the growth of textile industries in neighbouring Lesotho, which boasts significantly lower wages, aggressive government incentives, and access to the US textiles market under the African Growth and Opportunity Act (AGOA).[1] Third was a degradation in the state of industrial parks, which fell into relative disrepair.

The result has been a broad displacement of industrial activity from MAP. This shift has been partly offset by the growth of logistics facilities, such as petrol stations, truck stops, vehicle repair services, and so on. While logistics has emerged as a leading industry in the MAP region broadly, that growth is concentrated around Harrismith, and is only shared by the relatively more isolated QwaQwa region through the employment of people in Harrismith. The collapse of industrial activity in QwaQwa has seen former industrial areas converted into retail spaces. A recent tour of the QwaQwa industrial areas revealed numerous restaurants, wholesalers, and retail shops, as well as services like doctors and restaurants.

While some manufacturing remains in MAP, it is highly idiosyncratic, with the location of industries largely being driven by a personal connection between firm foundeds in the area. Industrial employers such as Nouwens carpets (a carpet manufacturer), Boxmore (a PET plastics packaging company), and Turbex (a producer of windpumps for the agricultural

[1] While South Africa also benefits from AGOA, textile exports are effectively made impossible by restrictions on rules of origin. Least developed countries avoid these restrictions through special rules of origins for textiles, known as the Yarn-forward rule.

industry) were all founded in Harrismith by local entrepreneurs. Few established national and international investors have a presence in the area, although Nestle does have a facility producing baby food, and Afrimat, a national producer of aggregates, has two quarries in the region. All of these firms are located either in the industrial area directly adjacent to Harrismith, Harindustria, or in the neighbouring Tshiame industrial zone.

Logistics

Location is consistently identified as a core strategic advantage for Harrismith, not least in the capacity to develop the city as a logistics hub. The city sits on the N3 route between Durban and Johannesburg, and the N5 connecting to Bloemfontein and the West of the county. The city already plays host to significant logistics infrastructure, particularly in the Harindustria area, which is directly adjacent to the N3. The largest facility, the Highway Junction, offers a range of facilities, including accommodation for drivers (to enable shift switching for trucks), repair and maintenance facilities for trucks, tire fitment facilities, three petrol stations (to cater to exclusivity agreements between petroleum companies and freight companies), and infrastructure for a weigh-bridge (which is currently not in use). The facility services over 1000 trucks per day, and aims to serve over 2000 upon the completion of ongoing expansion plans.

Generally speaking, the private sector seems to provide relatively comprehensive services to the logistics industry. As a highly demand-driven industry, the capacity for growth in the logistics space would have to be facilitated either by changes in the flow of traffic through the town, or by changes in the services offered, such as growth in bulk-breaking (discussed below).

The logistics industry has been a focal point of the plannted Maluti-a-Phofung special economic zone, which aims to develop logistics capacity around five pillars[liv]:

1. VDC and supporting service providers.
2. General distribution centre: bonded warehouse.
3. Intermodal container yard and reefer connections.
4. Grain storage and intermodal commodity facility.
5. Trans freight branch line and terminal - intermodal.

VDC presumably refers to Vehicle Distribution Centre, which is effectively warehousing facilities for the automotives industry; while reefer containers refer to shipping containers with integrated refrigeration capabilities. Effectively, the five identified projects are all warehousing facilities of various descriptions, with connections to both road and rail. Perhaps the most interesting addition would be a bonded warehouse, which would give the facility in question an edge over preexisting logistics infrastructure in the city.

Nevertheless, expansion in logistics services (and manufacturing) has been in a state of deep uncertainty because of the long-running debate around a possible diversion of the N3. The plan would move the road away from the risky and slow-moving Van Reenen's pass, and onto the De Beers pass route, bypassing Harrismith. There is wide belief that this would be devastating to the economy of the city. While the rerouting has been discussed since the 1970s, the move is generally seen as prohibitively expensive, marginal in its benefits (saving an estimated 15 minutes), and damaging to the local environment. While the national government has been pushing the initiative since 2008, the plans were official suspended in February 2018, hopefully bringing more certainty to the logistics industry of the city.

Textiles

Maluti-a-Phofung, like many secondary economic areas, saw textile industries develop as a result of an explicit policy of industrial decentralisation by the apartheid state. This came in two forms: first, the provision on incentives for investors in homeland areas; and second, forced relocations which led to artificially depressed wages around the homelands. In the case of MAP, most textile firms developed around the two QwaQwa industrial parks in Phutadjiaba, and in Industriqwa in Tshiame - while there was less development in Harindustria in Harrismith itself. By 1982 there were 35 factories in Phuthaditjhaba, employing in 2100, and by 1988 there were more than 200, employing 22,000 people.[lv] In Industriqwa, 181 industrial stands were made available for large industries, and 193 for small industries.[lvi]

Following the end of apartheid, the textile industry came under two sets of pressure: first from the loss of incentives for secondary cities, and secondly from general pressure on the industry resulting from increased competition from imports - including, after 2005, from the rapid flow of Chinese imports. Despite the first wave of closures that resulted from the policy didn't do significant damage to the broader MAP region.[lvii] In the space set for large industries, by 2004 86% of the space in the QwaQwa zones were occupied, while in Industriqwa the figure was 70%.[lviii] Performance was less impressive for small industries, with occupancy rates of 50% and 57% respectively.[lix] Over 90% of the the firms were in the textiles industry.[lx] The high rates were explained by a number of factors, including the sunk capital costs of investors, and the presence of persisting economic advantages like depressed wages. The role of the QwaQwa Development agency - which later became the Free State development corporation - was also noted as important, as the agency was able to maintain close relationships with investors, and jeep rental costs very low.

The industry came under a period of decline in the mid-2000s. The textiles firms were largely noncompliant with a number of regulations, most notably minimum wages. Even when the standard was lowered to a midpoint of 70% of the minimum wage, a number of firms argued they would not be able to comply. In 2009 the NBC took legal action against 400 firms in low-wage areas of Newcastle, Bothabelo and QwaQwa, and in 2010 fourteen firms were shut down in these areas.[lxi] The push towards regulatory compliance had mixed results in different regions, but for Maluti-a-Phofung, it came amidst broader problems for the industry in the region, including structurally high transport costs, decaying public services, and competition from textiles producers in Lesotho and Swaziland, which also had preferential access to key export markets like the US and the EU.

Since then, the industry has remained in a state of decline. Although data is difficult to find on the textile industry in MAP, the general belief is that much of the industry moved either to other secondary cities, or to Lesotho and Swaziland. Some firms do nevertheless remain, spread among the three industrial hubs in the region. Harindustria plays host to knitwear manufacturer Citrix and glove manufacturer Empire gloves; Industriqwa plays host to the Ebenhaezer knitting factory, which employees 272 people; while the QwaQwa zones play host to Lincoln Clothing and Twilight clothing manufacturers.

Textile firms in MAP face challenges in common with the broader textile industry - including immense pressure from imports, a loss of competitiveness from the strengthening rand, and continue arguments over the wage differentials possible for minimum wages outside the metros (for more on this, see the Newcastle case study). But the firms face a number of additional challenges specifically related to MAP, and which are shared by the general manufacturing sector, as discussed below.

Light Manufacturing

A number of general light manufacturing firms are located in the MAP, with the majority being based either in the Harinsudstria area or Industriqwa. The majority are firms started by people who are from Harrismith. This includes Nouwens carpets (a producer of specialist carpets), Tubex trading (a manufacturer of water pumps for the agricultural industry), Entrawood (a high-end furniture manufacturer) and Boxmore (one of the country's largest bottling and packaging companies, which originated in Harrismith). In addition, Nestle South Africa has a factory in Harrismith, which focuses on child nutrition, and employs 400 people.

Local manufacturing firms face at least two major hurdles. The first was the uncertainty surrounding the relocation of the N3, which was widely criticised by local manufacturers, as removing the positioning advantages of being one of the country's major logistics corridors. This is particularly true for textiles firms, which generally import yarn and then send processed goods on to the city.

The second problem, however, is more serious: the state of municipal service delivery. MAP faces a number of serious deficiencies in the upkeep of basic infrastructure, such as roads, waste disposal, and water and energy provisions. The most serious and emblematic problem is with electricity provision. MAP is among Eskom's worst defaulters on electricity payments[lxii], and in February 2018, Eskom announced that it would begin rationing power supply to the municipality, cutting off power at scheduled intervals.[lxiii] For manufacturing firms, which are dependent on consistent processing, this is a devastating blow. The Eskom problem builds on concerns about electricity distribution. In 2011, the municipality hired an external consultant, Rural Maintenance, which the local business forum hailed for its efficiency. However, in 2013, the municipality reneged on the contract, claiming the municipal manager did not have the authority to enter into the energy management agreement.[lxiv] Local respondents claim that the consultants were subject to constant threats of violence within the community, aimed at forcing the consultants out of their contract, in order to facilitate corruption in the management of municipal energy revenues..

While details of corruption are beyond the scope of this study, the problems with service delivery highlight deficiencies in local government that are not limited to MAP. The lack of basic service delivery is devastating to small firms, but is also an important limitation on what is possible in terms of national industrial policy, and the unexpected impact of interventions. The development of the SEZ, for example, could see the creation of a set of efficient service delivery amidst a sea of difficulty. The result would be to give firms within the zone a serious competitive advantage over those firms outside. This could result in one of two things: either nearby firms move into the zone, and away from areas of greater need like QwaQwa; or they are put under increasing pressure from zone-based firms, and then exit the area. The core risk is that, instead of crowding-in firms from elsewhere, the SEZ crowds-out existing firms. This risk gets higher when the SEZ focuses on areas of existing competitive advantage, particularly for an industry like logistics, where demand is determined exogenously and is largely being met by private sector firms.

There needs to be a careful consideration of whether to priorities new business creation, through the SEZ and related initiatives, at a time when business retention is severely threatened by intractable failures of basic service delivery. The story of MAP in the last ten years has been one of decline, and that decline should be stemmed before turning to the potential for growth of industrial activity in the area.

Governance and Policy

Governance

The relationship between business and government in Maluti-a-Phofung is characterised by a high degree of mistrust. One local businessperson bemoaned that “the absolutely pathetic local council” and stated that the municipality “has been blocking every single attempt we made to work in harmony with local government whilst serious corruption has brought the council to its knees.” Concerns are supported by the Auditor General, which has given MAP a disclaimer of opinion audit for the last three years and noted R117,5 million in irregular expenditure in a draft 2016 audit opinion.[lxv] MAP is also severely indebted to national utilities providers, owing more than R200 million to the local water utility[lxvi] and over R1,3 billion to Eskom. The auditor-general notes that “during the year ended 30 June 2016 and, as of that date, the municipality’s current liabilities exceeded its current assets by R1 430 323 863.”[lxvii] MAP’s performance is part of a more general trend in the Free State, which has performed dismally in numerous governance measures, and continued to be wracked by corruption and mismanagement.

Poor governance has been exacerbated by accusations of corruption and inappropriate spending, which have dogged the scandal-riven municipality for years. Some of the accusations lodged by opposition parties and the media include the irregular addition of 558 individuals to the municipal payroll (at the cost of approximately R3,9 million per month)[lxviii], the throwing of a lavish party for sacked SABC chairperson Hlaudi Motsoeneng[lxix], the holding of week-long parties across the municipality[lxx], the awarding of municipal honours to religious leader Prophet Mboro for ending a local drought with prayer[lxxi], and general accusations of cronyism and corruption procurement practises. Mass service delivery strikes broke out in the municipality in June 2015, with strike leader Neo Motaung stating that “(w)e want to be led by a competent mayor and municipal manager. Those corrupt officials should step down. We will keep the area burning until they resign”.[lxxii]

In February 2018, COGTA recommended that MAP be placed under administration. Although final confirmation on the decision is not available at time of writing, it is expected to go ahead, after which COGTA will directly intervene in the municipality.[lxxiii] Local civil society leaders praised the move but were still critical, with union SAMWU stating that "(t)he intervention does not deal with the Mayor, Vusi Tshabalala who had been acting in the interest of his cronies, hiring people without following employment policies including adding ghost employees on the municipal payroll."[lxxiv]

While it is not the place of this report to more carefully assess the governance of MAP, capable governance is nevertheless essential to the functioning of industrial policy. Without capable local government, the policy options available for advancing development in MAP are extremely limited. While the pressing development needs of the region seem to demand some form of intervention, more progress may be possible thought simple improvements of controls and monitoring systems in local government, and by getting basic service delivery right. Until then, the focus of development projects in the region should remain with empowering the provincial development agency and other development bodies outside the municipality, and with creating clusters of excellence within the municipality. A special projects unit, which operates in a more detached way with exemplary oversight and ethical conduct, would be a welcome addition, but ultimately governance of any initiative cannot be detached from the problems in the municipal government.

Municipal industrial policy

The core documents in MAP's industrial policy and economic development planning are the municipalities integrated development plan[lxxv] and local economic development strategy[lxxvi]. The LED strategy aims to reduce unemployment by 5% per annum, build thriving and sustainable industries, and create benefits from the MAP SEZ and SIP2, through the meeting of five strategic objectives for economic policy in the region:

1. Drive the localization of economic benefits as a result of the SEZ and SIP opportunities by ensuring 60% of jobs and opportunities created are accessed by local communities.
2. Improve capabilities of communities through targeted skills development interventions.
3. Develop industries such as afro-processing, tourism and small enterprises by 2018.
4. Strengthen the institutional capacity of the LED unit to drive economic development by 2018.
5. Bridge the gap between location of jobs (economic opportunities) and location of people through conscious propelling of economic activities towards location of people.

The LED programmes are subdivided into five parts, with sectoral focus on agricultural, tourism and the green economy; support skills development; and multi-sectoral enterprise policies, which are focused on leveraging off the SEZ and SIP2. As can be seen by figure X below, most of these initiatives are in the early stage of development. The multi-sectoral enterprise, agriculture, and community skills development streams all focus, for the time being, on building solid business plans or conducting scoping work like a skills audit. Tourism appears to be more advanced, but is similarly focused on fundamentals, like infrastructure development; which will aim to build on existing infrastructure at the Golden Gate Highlands National park and Sterkfontein dam. The green economy seems to be a slightly more developed stream, but is less focused on manufacturing, and seems to concentrate on leverage off existing municipal activities (like waste management) and off national projects (like the provision of solar water heaters).

Figure 18: Maluti-a-Phofung LED Anchor Projects

While it is encouraging that the municipality has an active and engaging strategy for local economic development, real questions need to be asked about the capacity of MAP to implement these initiatives. In 2018, MAP is projected to run at a deficit just shy of R800 million and, with most of these projects still in very early stages, there would presumably need to be budget space created for the rollout of LED interventions. There simply does not appear to be scope for this to happen. SMME support and incubation, for example, would require consistent financial support, and the development of complex administrative procedures around selection and monitoring of firms - none of which seems possible until MAP is on a more sustainable footing. Outside of the budget process, serious issues remain on the capacity of local government to implement their selected interventions. In other cases, notably agriculture, the selection of the industry needs to be carefully considered against competition from neighbouring regions, and within a context in which changing agricultural patterns only happen over the very long-term.

On balance, while MAP's economic planning seems solid in the abstract, it seems deficient in the context of the realistic constraints on the municipality.

Special Economic Zone, and related developments

Without doubt the cornerstone initiative in MAP is the launch of the Maluti-a-Phofung Special Economic Zone (M-SEZ). The M-SEZ is located at the site of the old Industriqwa industrial park, in Tshiame, outside Harrismith. The zone already plays host to fourteen existing companies, including Boxmore and Entrawood (both discussed below). Initial commitments from Distell to develop a beverage plant in the zone give the M-SEZ a solid basis from which to grow.[lxxvii]

Figure 8: Industriqwa/M-SEZ

Source: Google Earth satellite images

The SEZ will focus on two core pillars: logistics (as discussed above) and agroprocessing. Indeed, the vision for the M-SEZ is primarily as a logistics hub, with the policy aiming for "the MAP SEZ to provide an inland port that will alleviate the demand for freight handling in the Durban area and support rapid transport of commodities and products to the Durban port (for export) and from the Durban port for inland markets." To this extent, the SEZ effectively folds-in two long-standing initiatives in MAP: the development of an agroprocessing zone at Tshiame, and the development of the Harrismith Logistics Hub.

The concept of a logistics hub has been discussed since 2006, and has now largely been integrated into the SEZ. But both as a component of the zone and as an independent policy, questions remain on how the logistics hub will work, and what changes it will bring. There is no doubt that Harrismith is a natural logistics hub, sitting as it does on the country's busiest freight thoroughfare, between Durban and Johannesburg. There is also a proven track record of logistics hubs being a fruitful zone initiative, which have the potential to drive both investment in the zone and improve logistics efficiency in the broader corridor.

But the prospect of developing a logistics zone is difficult. Logistics is inherently an extremely mobile sector, which tends to have fixed infrastructure primarily at the point of origin and destination for goods travel. Warehousing and maintenance functions aren't clearly needed midway through a relatively short freight journey, and Harrismith seems too far from both the coast and the land border to easily serve as an inland port. As one skeptical respondent asked: why would firms unload and repack goods in Harrismith? More worrying still, some sourves claim that a pre-feasibility study carried out on the Harrismith Logistics Hub found that the project was not viable. While the prefeasibility study was not available for ereview, one study claimed that “a prefeasibility study was carried out in 2007-2008 focused on the hub to be a cargo handling point from road to rail between Durban and Gauteng. However, as further research pointed out, cargo handling from road to rail at Harrismith would not benefit the value chain as it in fact would increase the cost of the value chain.”[lxxviii]

A full discussion of the potential for a logistics hub can be found in the Policy lessons section below.

Industrial Infrastructure

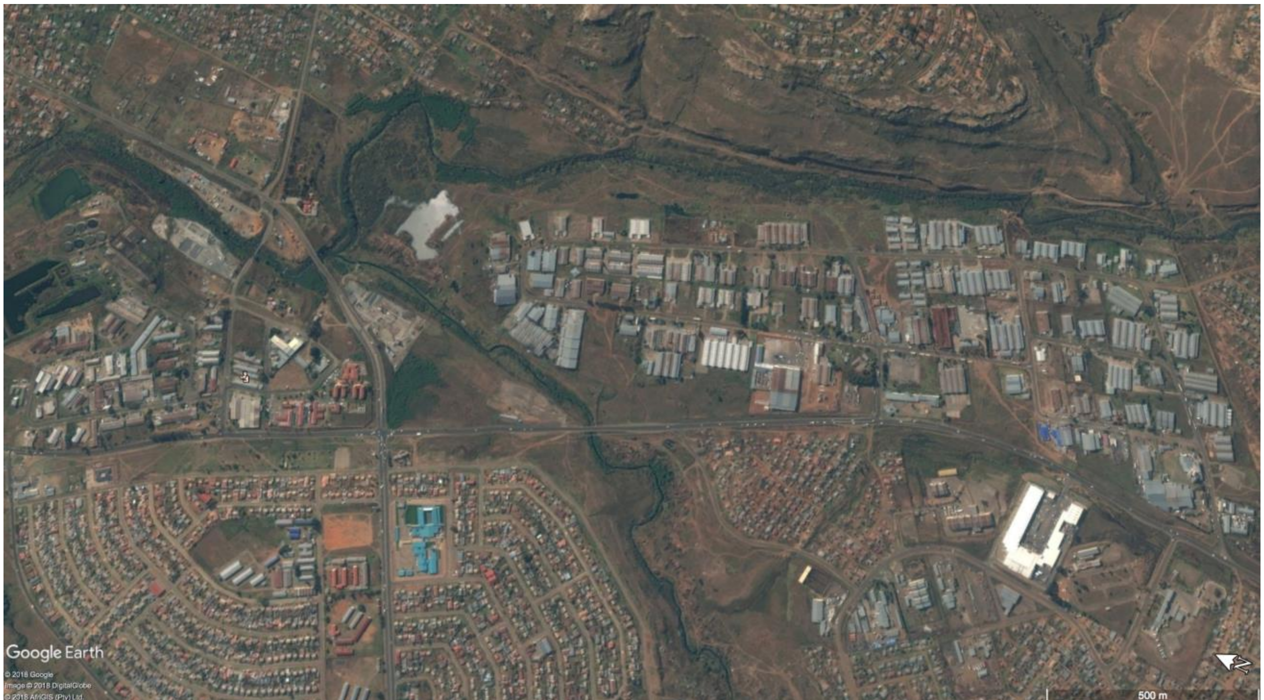
Outside of the SEZ, two sets of industrial infrastructure are worth noting.

Figure 9: Harindustria

Source: Google Earth satellite images

Harindustria is the core industrial area of Harrismith itself. The area is zoned for industrial purposes but is not a traditional industrial park like the other areas in the region, and is largely privately owned. The area plays host to both the largest logistics operator in the region, and some light manufacturing firms, such as Nouwens carpets, Turbex manufacturing, and Casrix textiles. The area is relatively well developed, although large pieces of land that are zoned for industrial use are not occupied. Satellite imagery shows that there has been virtually no growth in Harindustria in the last ten years, although firms have reportedly reinvested in existing facilities.

Figure 10: QwaQwa industrial zone 1 and 2



Source: Google Earth satellite images

The two QwaQwa industrial zones were historically among the key centres of industrial activity in the region, and were created as part of the apartheid state's push towards industrial decentralisation. As discussed above, both zones were relatively resilient for a long period of time, maintaining high occupancy rates, but have since seem an exodus of manufacturing activity. While some firms still operate in the QwaQwa zones, such as Lincoln clothing and Twilight clothing, the zones are largely retail centres now, servicing both formal and informal retailers and service providers. Zone infrastructure is also under strain, and the dynamics of the development of the area as a retail centre complicate efforts to introduce new infrastructure like security. The poor condition of roads and general lack of upkeep in the area seems to indicate the need for renewed investment in revitalising the zones.

Policy lessons

Addressing apartheid geography

MAP is a prime example of how intractable apartheid geography can be. While QwaQwa is the local population centre and the centre of most economic need, it remains extremely isolated, and offers few natural economic advantages. The erosion of existing industry in the area and the general state of disrepair of the regions industrial parks makes it extremely difficult to see a path forward for industrial development in QwaQwa. Policy developments in MAP more generally risk deepening QwaQwa's decline, as the development of very large industrial tracts in Tshiame, including the M-SEZ, risk pulling investment away from Phuthaditjhaba. Indeed, it is difficult to see why a potential investor would opt for QwaQwa instead of the Tshiame. And yet, Tshiame is the natural location for the SEZ and for further policy developments. With a strategic location adjacent to the N3, and close linkages to existing industrial infrastructure, policy has a much better change of working in Tshiame than in QwaQwa.

The result is a set of policies must focus on what works for business, but not for the most vulnerable.

Supporting policy is therefore needed to manage the geographic dispersion in the area. While a number of options are on the table - such as building more efficient transport linkages, working with firms to create bespoke transport options for workers, investing in housing closer to Tshiame/Harrismith, and creating supporting industrial initiatives in QwaQwa - none of these options are easy, given the scope of development that is possible in Harrismith. While the SEZ and related interventions are likely to drive some level of industrial growth in the region, there needs to be a realistic assessment of the extent of this growth. Development is extremely unlikely to be so rapid as to justify large infrastructure developments or changes in the spatial distribution of where people live in MAP. The developments at the M-SEZ should be seen as an important contributions to the region, but not be expected to be so large as to revolutionise the economic geography of the area.

In the short term, the difficult reality is there are extremely few options available for industrial development in QwaQwa. Apartheid spatial planning designed the area to be poor, and unfortunately that policy has largely succeeded. While some supporting policy should be tried - notably investing in refurbishing industrial parks - the focus in the case of QwaQwa must be in create avenues of opportunity outside the area. This can create both prospects for local people, and streams of remittances that can maintain economic activity in the region. Support must concentrate on crucial aspects such as creating quality housing, quality education, providing support and advice for job and other opportunities outside the region, and maintaining aggressive social development projects, grounded in the social grants system.

This is, of course, a deeply imperfect solution. But aggressive investment in an area without clear development potential risks wasting spending that might better create opportunities elsewhere.

A lack of development in QwaQwa does, however, raise questions on Harrismith, most notably: is it worthwhile developing an area that is relatively isolated from most of the population of MAP? This is a difficult question that perhaps required a more thorough analysis before investment was committed to various government projects in the area, most notably the SEZ. Doubts are deepened by the presence of a highly dysfunctional local government.

Managing a dysfunctional municipality

The linkages between governance and industrial policy are too often overlooked. And yet successful industrial policy is predicated on the existence of a government that is well capacitated, has credibility with the business community, and has the scope and scale to make the type of interventions that can be transformative for industry. In this regard, the governance situation in MAP is of serious concern to the implementation of any industrial policy, but particularly industrial policy that creates lasting, sustainable benefits for the population of the municipality. While it is true that industrial policy in South Africa is generally driven by the national or at least provincial government, and that this is certainly the case for a municipality structuring its plans around an SEZ, these initiatives nevertheless need a functioning environment for business in order to be successful. Basic service delivery - such as a stable supply of energy and water, sound logistics networks, a working population that is not left in destitution, and minimal hindrances from crime and corruption - are absolutely essential to the operation of any business. At present, MAP municipality has failed to deliver many of these services, and the structural problems that plague the bankrupt municipality will undermine efforts to improve service delivery in years to come.

This is not a unique situation for the MAP municipality. Local government is amongst the most dysfunctional in the country. At times this is because of corruption or poor governance, but at other times it is because of the legacy of apartheid spatial dynamics and overwhelming poverty, which render the municipalities with the most pressing social problems as the least capacitated to tackle those problems. The experience of industrial policy around MAP is therefore a vital learning opportunity for how industrial policy should be approached in problematic municipalities. At present, the approach seems to be structured around heavy infrastructure spending, through SIP2 in particular, and the SEZ. Both have problems.

Infrastructure investment in particular is generally underpinned by materials procured from outside the immediate vicinity of the investment, and while it does generate good employment opportunities, the effect is often short-term and not independently sustainable. For that reason, the SEZ is perhaps the prime initiative, and there are reasons for concern in that regard. Most of those concerns regarding the specific strategy chosen by the SEZ are dealt with below, but the more general problems result from the impact of creating a bubble of economic efficiency amidst a broader landscape of poor service delivery.

The SEZ probably can create an isolated zone of efficient industrial space. The infrastructure created thus far, such as a new perimeter fence and new entrance facilities, look impressive, and the Free State Development Corporation has a history of useful interventions and the management of zones. Putting aside for a moment, however, the questions on whether the zone will succeed, even if we assume the zone works, that could create serious disruptions in the area. Business within the zone will effectively be granted a disproportionate advantage relative to the majority of MAP's industrial base, which continues to struggle with fundamental problems. The result could be an erosion of existing manufacturing, either through competition with zone-based firms, or movement of existing firms into the zone. The latter is particularly a problem, since current industrial activity in QwaQwa is extremely vulnerable, and important for its close location to the centre of greatest need in the municipality.

In reality, industrial policy will always remain limited until the fundamental problems of governances in the municipality are addressed. This is a difficult prospect, because national departments cannot afford to hold off on assistance to municipalities that are in dire economic need. Sequencing is a luxury that isn't always available, but in this case, careful consideration should be given to how funding is distributed between fixing core service delivery issues and starting hugely ambitious projects like the SEZ. This is particularly so for a municipality like MAP, where the industry the SEZ hopes to attract is highly mobile, and there is nothing absolutely unique about the municipality's location (even if that location is a plus for logistics development).

There is no simple answer to how to manage industrial policy in dysfunctional municipalities. But, as a starting point, industrial policy needs to at least begin considering governance capacity in economic planning. Investing efforts in municipalities that have the capacity to turn those initiatives into economic opportunities, will make for more effective industrial policy that reaches those most in need.

The logistics hub concept needs greater refinement

Visions for development in Harrismith frequently come back to the city's strategic location, placed as it is on the country's prime freight route between Durban and Johannesburg. There is certainly a strong logic to this, with the positioning supporting manufacturing, particularly when that production is dependent on imports. Nevertheless, the vision seems to be for the development of a logistics hub.

The hub plans to include "intermodal rail based container terminal, car terminal, a vehicle distribution centre and bonded warehousing facilities."[lxxix] The hub will be located in Tshiame, and will be linked to the development of the Special Economic Zone. Free State MEC for economic development Mosebenzi Zwane claimed that ""(once this hub is operational more than 1000 people from the Thabo Mofutsanyana district will be permanently employed", with overall employment impact estimated at 29000.[lxxx]

While the logistics hub concept seems to be solidly grounded, there are serious questions that remain, of which three are important. First, is what elements will comprise the hub. Aside from a general commitment to freight storage, it currently isn't clear exactly what services will be offered. Greater public awareness of the development would improve oversight. Second, this vision is particularly needed, since many of the aforementioned initiatives like bulk breaking or warehousing, don't have as obvious an economic logic as they might first appear. One could legitimately ask why a firm would accept the cost of developing additional bulk breaking infrastructure and diverting their freight from an established route, rather than travel the extra three hours to existing facilities in Durban or Johannesburg. When you consider that the round trip to and from the freeway to Tshiame would take an hour, the logic of stopping midway doesn't obviously hold, even if it does potentially make sense in some unique situations.

Third and most importantly, it remains unclear why the development of a logistics hub needs to be state driven. Harrismith is effectively already a logistics hub, with a range of intermodal services offered by private players in the city. Some, like the Highway Junction complex, are extremely large and well developed. Rebuilding what already exists seems to pose a risk to existing business, and frames the logistics hub as a seemingly unnecessary expense. Even in the case of functions which are not currently offered in the city, the business case for the development of bulk-breaking or rail linkages seems solid, and it remains unclear why the private sector would need public funds to underpin their work. Often, it seems rather that supporting interventions, such as fixing the dire state of freight rail in the region, would provide the enabling environment needed for the private sector to shoulder the burden of logistics development.

Figure 11: Highway Junction complex, Harindustria, Harrismith

Source: Google Earth satellite images

Fundamentally, the development of the hub will add value if it stimulates investment in areas that otherwise wouldn't have good reason to locate in the city. This issue is not limited to logistics or to the case of MAP. Indeed, the impulse in most secondary city developments is to build off what already exists. But if there are strong preexisting business advantages, the risk is that the state ends up subsiding investment that would have happened anyway.

In addition, consideration does perhaps need to be given to what the benefits of state-sponsored development of logistics capacity would be. The business case for offering large incentives to manufacturing is reliant on the subsequent investment not only creating jobs, but adding to the broader manufacturing ecosystem, and promoting further manufacturing linkages that can substantially grow the economy. That multiplier effect isn't the same for logistics. Rather, the benefits seem to come not simply from local job creation, but in building a more efficient freight network. In the case of the development of services at the logistics hub that create jobs but don't improve logistics efficiency, the state might be better off offering direct support to individuals, rather than indirect support via creating jobs.

Overall, the logistics hub concept does have potential, but it is a difficult undertaking. At worst, the hub could duplicate existing private sector infrastructure, diluting the pool of business for both the logistics hub and local business, and undermining the sustainability of the broader logistics infrastructure in Harrismith. At best, however, the hub would target the narrow selection of services that are viable but, for structural reasons, the private sector will not take up. Careful planning will be needed to reach the best case scenario.

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