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STATES, DEVELOPMENT AND MACROECONOMIC POLICY

REFLECTIONS IN A SOUTH AFRICAN CONTEXT

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Over the past forty years, the proper role of the state in economic development has been hotly debated in both development strategy and macroeconomic policy circles. The powerful rise of a new neoclassical view in the 1980s shaped the policy choices of many countries, including South Africa's ANC-led government after 1994. This article sets out that context and indicates the way forward.

"The end of history lasted for such a short time. If the early 1990s raised hopes of a broad-based consensus on economic policy for growth, equity and poverty reduction, the late 1990s dashed them" (Kanbur, 2001:1083).

The orthodox neoclassical view of the priority of markets in economic development rests on three pillars:

- developing countries should pursue closer integration with the world economy
- governments should desist from intervening in the economy in general, and particularly in industrial development
- the privatisation of public enterprises should be a key element of any strategy of growth.

Dutt, Kim and Singh (1994) return again and again to these pillars to support their opposing contention that both states and markets have played important roles in development. Studies of developing economies in East Asia and Latin America demonstrate that many of these countries sought only "strategic integration"; that governments in Taiwan, South Korea and Japan played a vigorous economic role and pursued a highly active industrial policy; and that there is neither theoretical nor empirical evidence to suggest that public enterprises are intrinsically inefficient or that they perform poorly (Padayachee, 1996: 428).

By 2001, former World Bank economist Ravi Kanbur could point to a surprising amount of agreement – or, more accurately, not as much disagreement as 30 years previously – about the old markets-vs-state debate. Kanbur (2001) suggests that one major reason for this consensus was practical and pragmatic, arising from the grounded work of non-governmental organisations (NGOs) and other civil society organisations. In the consultations, the positions of NGOs working directly with the poor were particularly interesting and influential. Not burdened by ideologies that favoured state over market or the other way round, the issue for them was always what worked to improve the standard of living of the people they were helping. It seems to me that this legacy has survived the 2008 crisis, albeit somewhat bruised.

Certainly the state's role in ensuring infrastructural development (e.g. for road, rail, water, energy, education, and information technology) is now universally accepted as a critical foundation for growth and development. There is even some limited consensus on the need for industrial policy in certain contexts. Referring to the state-market debate in industrial policy, Cambridge economist Ha-Joon Chang comments:

> Once the adversaries in the debate abandon theoretical grandstanding and focus on more practical issues, there are vast and fertile middle grounds to explore. This is not to say that there won't be disagreements in those grounds. However, there at least the two sides can have productive debates on pragmatic things without thinking about destroying each other. Would that be too much to ask? (2009: 36)

Decisions based on fiscal conservatism then – e.g. not to support Eskom's request to extend its capacity-generation programme, or the closure of technical, vocational and teacher-training colleges – are impacting massively and negatively on the economy today.

MACROECONOMIC DISPUTES

Far less consensus can be found in respect of macroeconomic policy. Three major theoretical propositions have shaped and reshaped our views over the course of the last century.

First, there is the position articulated by John Maynard Keynes more than seventy years ago. Keynes emphasised the importance of an activist macroeconomic policy to deal with deep slumps and depressions, believing that events like the Great Depression were not one-off, but an intrinsic feature of capitalist development. Governments therefore had a crucial role, principally (but not solely) through fiscal policy, to ensure that this did not happen – not just after the fact, through state-led investment and consumption spending, but continuously, in areas such as monetary management and bank regulation.

In Keynes's view, financial markets are inherently unstable, an argument that was brilliantly developed by one of his greatest followers, Hyman Minsky. Minsky's *Stabilizing an Unstable Economy* (1986) shows how the banking system is the achilles heel of instability in the modern capitalist economy. But rather than proposing its elimination, as do some modern conspiracy theorists, Minsky argues for a greater role for state/public investment in the economy to support job creation, and rigorous regulation of the banking sector. In his emphasis on the government's function as "employer of last resort" even at relatively low wages, Minsky, following Keynes, harks back to the mercantilist idea that a nation is strong and healthy when its population is fully employed. In 1971, after taking his country off the gold standard, even US President Richard Nixon said he was now a "Keynesian in economics".

But since the rise of neoclassical economics in the 1980s, Keynes's position has been caricatured beyond recognition, to the point that few economics department in the Western world even teach it any longer. Conveniently forgotten in this caricature is Keynes's argument that government budgets should normally be in surplus and his belief in stable prices. These are hardly the views of a socialist hell-bent on destroying capitalism! Of course he did argue, correctly in my view, that it was "idiotic to worry about inflation when prices and output were in free fall" (Skidelsky, 2009: xvii).

One final point here, by way of reminder, was Keynes's concern that, if governments failed to stabilise market »

economies at close to full employment, this would open up space for extremists whose solution could involve abolishing markets, peace and liberty (ibid.: xviii). Who among us cannot see the danger of this, given high levels of unemployment, especially among restless young people, across all parts of the world, and in the context of our increasingly violent, unstable and unequal world? The stakes are surely too high to worry about ideological correctness.

EGREGIOUS INTERVENTION

Two propositions of the neoclassical revolution have influenced our views about the role a state can and should play in macroeconomic policy formulation. The first relates to what economists rather poshly call the "dynamic time inconsistency theorem", where the best plan or policy made now for the future may no longer be optimal when that future period arrives. In this view, uncertainty about the consistency of policy into the future and about the true intentions of policymakers will serve to slow down or curtail private-sector investment, and it would therefore be best to remove direct governmental power wherever possible.

I do not have the time to develop this complex argument here. Suffice to say that it has had the most traction in the area of central bank independence and monetary policy. It argues that, if a central bank is not independent from government, the government may have an incentive to change an "optimal" monetary-policy decision because of political expediency. And the solution to the possibility of such "egregious" political intervention is an independent central bank that operates free of government intervention.

This was arguably the critical theoretical argument that led at least 30 countries, spanning five continents, to legislate increased statutory independence for their central banks between 1990 and 1995 (Maxfield, 1997: 50). Why would governments voluntarily give up power over monetary policy? The answer rests on issues of international credibility and market creditworthiness that were especially important for countries with regular balance-of-payment difficulties that needed capital inflows. As Maxfield observes, "put telescopically, the likelihood that politicians in middle income countries will attempt to signal creditworthiness by increasing central bank independence is an increasing function of their nation's objective need for balance of payments support" (1997: 35). This was certainly true of South Africa in the 1990s.

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> **In six short years, the ANC had made the shift from nationalisation to neoliberalism, hardly pausing to catch breath.**

Related to this is the "policy ineffectiveness proposition". Neoclassical economists argued that private agents will recognise and adapt to all fully anticipated changes in monetary policy, thus rendering ineffective such policy interventions to systematically manage the levels of output and employment in the economy. Again, the implication is to neutralise activist state or central bank policy.

A second new proposition applied to fiscal policy. Over the past forty years, new neoclassical economists have contributed to a public policy discourse that now takes for granted the belief that high public debt consistently stifles economic growth. In a famous and influential paper, Reinhart and Rogoff (2010) argued that, over the period 1946–2009, advanced economies with a public-debt-to-GDP ratio above

90 percent had an average real annual GDP growth of -0.1 percent. Where the ratio was lower, average annual growth ranged between 3 and 4 percent. Public debt levels of such a magnitude, in other words, were bad for growth.

However, in a powerful rebuttal, Herndon, Ash and Pollin replicated the Reinhart and Rogoff (RR) analysis for the same countries over the same period and found that growth rates for the first group in fact averaged 2.2 percent – not -0.1 percent. Their conclusion notes that:

> the debate generated by our critique of RR has produced some forward progress in the sphere of economic policy making. In particular, it has established that policy makers cannot defend austerity measures on the grounds that public debt levels greater than 90 percent of GDP will consistently produce sharp declines in economic growth. (Herndon et al, 2013: 279)

Despite this critique, the RR paper remains dominant in the US and Europe. Although written in 2010, it captures the spirit of the neoclassical position on debt that has dominated thinking on fiscal policy since the early 1980s. Nobel Prize laureate Paul Krugman – a critic of the paper – says that "Reinhart-Rogoff may have had more immediate influence in public debate *than any previous paper in the history of economics*" (quoted in Herndon et al, 2013: 261, emphasis added).

The effect of these new neoclassical interventions since the 1980s has been to severely limit, if not exclude, a role for a democratic state in macroeconomic policy. It is not our intention to engage that debate here, save to use it to show that policymakers who are concerned about growth can be spooked by such analyses. They are persuaded to hand control of monetary policy over to an independent central bank or to focus their attention solely on reducing public debt – even at the expense of growth-enhancing public investments. It is time for some degree of pragmatic re-balancing.

THE CASE OF SOUTH AFRICA

The dominant neoliberal culture of the 1980s appears to have been deeply impressed on the minds of ANC policymakers (in the making) in the early 1990s. Senior figures and some of their academic advisors argued that the levels of debt left by the apartheid regime precluded any possibility of a state-led public investment programme. Understanding apartheid (correctly) as a perverse form of state intervention, both politicians and policymakers appeared to want (incorrectly) to minimise all forms of state intervention. In the process, and forgive the cliché, they threw the baby out with the bathwater. Decisions based on fiscal conservatism then – e.g. not to support Eskom's request to extend its capacity-generation programme, or the closure of technical, vocational and teacher-training colleges – are impacting massively and negatively on the economy today.

Who among us cannot see the danger of this, given high levels of unemployment, especially among restless young people, across all parts of the world, and in the context of our increasingly violent, unstable and unequal world?

In his first speech after being released from prison in 1990, Nelson Mandela proclaimed from the balcony of Cape Town City Hall that nationalisation of the banks, mines, etc. in terms of the 1955 Freedom Charter was official ANC policy. This was short-lived rhetoric. By the end of 1993 – when the ANC leadership unceremoniously dumped the broadly Keynesian recommendations for a state-led public investment programme focussed on housing, education and healthcare delivery proposed by its own thinktank, the Macroeconomic Research Group (MERG) – a choice had been made. The Reconstruction and Development Programme (RDP) that the ANC national executive committee (NEC) finally approved in early 1994, after seven rewrites, had been watered down and all its radical interventionist ideas exorcised. In June 1996, the highly market-friendly neoliberal Growth, Employment and Redistribution (GEAR) programme was hastily modelled and introduced as a non-negotiable policy document in the context of a serious currency crisis. In six short years, the ANC had made the shift from nationalisation to neoliberalism, hardly pausing to catch breath.

Noted Berkeley sociologist Michael Burawoy sets out the context within which these changes in ANC economic thinking occurred:

> Without a critical stance toward ... Soviet socialism, having never partaken in the debates about the meaning of socialism – real and imaginary – the liberation movement in power found itself without a cognitive map to navigate the enormous problems of national reconstruction. An exodus without a map, as Adler and Webster call it, became vulnerable to a neoliberal redemption, especially when the entire globe [was] spellbound by the magic of the market. (1997:1)

We fully respect that tough decisions had to be made by people who were quickly coming to terms with economic theory and choices for which they were largely untrained. But we are now 25 years away from those early »

challenges: our economy, which arguably performed well in terms of growth and employment only in the early years of the new millennium, has consistently underperformed. The global financial crisis has compounded, not caused, our economic and financial difficulties. While it is laudable that the state now provides social grants of many forms that reach over 16 million citizens, this is also, in my view, the most chilling barometer of the failure of both the state and the private sector to make the investments and the policy interventions that would have accelerated economic growth and job creation. Capital flight has reached crisis proportions, even if we go by the low estimate of the sums involved. With the notable exception of the Treasury and the South African Reserve Bank (SARB), our key state and parastatal institutions face serious crises of governance, capacity and delivery.

Is it not time to revisit the very foundations of our thinking about the economy, to abandon theoretical grandstanding and ideological straightjackets and come up with fresh new ideas to regenerate our economy that are based on boosting growth, industrialisation and investment, rather than consumption, finance and hand-outs?

To my mind, such an approach would need to include the following approaches.

On macroeconomic policy: I do not believe there is anything to be gained by reversing the constitutionally entrenched independence of the SARB (although it is true that it is now among only a handful of central banks in the world with private shareholding). To the contrary, such a move could backfire on the country through loss of credibility and reputation. The key is to institutionalise new and more transparent mechanisms for policy coordination between the SARB and the Treasury/government, designed *primarily* to accelerate economic growth while managing inflation and the deficit within reasonable parameters, and, critically, to use exchange rate policy to prevent or stem the long-term illegal haemorrhaging of capital.

Unless a country's development strategy and its macroeconomic policy are effectively coordinated in terms of objectives, financing, timing and sequencing, one may as well not bother with either. The role of the state in making this possible is vital.

On development strategy: I have little faith in the vague, unprioritised claims and policy prescriptions of the National Development Plan (NDP), which has failed to win support even within the ANC alliance. Far from offering a new vision of structural development economics as an alternative to the Washington Consensus, the NDP constrains the restoration of a more activist role for the state, endorsing the view of Harvard economist Dani Rodrik that the state can do little more than facilitate entrepreneurs in their processes of "self-discovery" (Hausmann and Rodrik, 2003). What is needed rather is a coherent, funded, labour-absorbing industrial policy aimed to diversify the economy away from its stultifying historical roots in a minerals-energy complex by increasing manufacturing production, employment and exports. Such a full-blown industrial policy action plan, coupled with a revitalised, well-governed set of state institutions and state enterprises in areas such as energy generation, and the provision of finance, especially for industry and small business, should be the centrepiece of any national development plan.

Ultimately, unless a country's development strategy and its macroeconomic policy are effectively coordinated in terms of objectives, financing, timing and sequencing, one may as well not bother with either. The role of the state in making this possible is vital. NA

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