Mapping a path for South Africa's economic renewal

By staff of the Institute for African Alternatives

The Institute for African Alternatives (IFAA) brought together some of South Africa's leading economists to discuss South Africa's seriously weakening economy. This emerged out of concern in the sector that the President's strategy of an intensive international investment drive is not the answer to the country's urgent need for reform in economic policy and practice. A total of 22 people attended the Netherlands Embassy-sponsored event.

President Ramaphosa's call to South Africans to get behind the New Dawn and Thuma Mina campaigns may have lifted some of the pessimism that has engulfed the country over the past few years. However, the real work of transforming the economy has yet to begin. The President's investment drive may be bearing some fruit but that is not the panacea to the country's economic woes. This seminar came up with ideas on what we need to stimulate the economy?

The two major causes of South Africa's economic decline were identified from the start by the very first speaker: gradual de-industrialisation over a 25-year period and the emergence of financialisation as a magnet for investment which has had a serious negative effect on the capital flow into the production of goods and services.

This explains the low levels of fixed investment, limited structural transformation, weak export performance and the low contribution of manufacturing to GDP. As a consequence, employment levels have declined with very few new entrants being absorbed into the labour market. The effect, in turn, is a fall in aggregate demand and, with the high levels of unemployment, households have been unable to afford municipal services.

It is commonly said that overcoming these conditions requires dealing with state capture, re-structuring State Owned Enterprises (SOEs), lowering the budget deficit, reducing inflation and social expenditure and some minor micro-economic reforms. This, it is argued, will improve investor confidence and growth will rise.

An economist at the seminar challenged this view, arguing that while some of these prescriptions may be necessary, they are similar to the Growth, Employment and Redistribution (GEAR) policy adopted in 1996 which did not generate an increase in fixed investment. A result of this policy is that the country remains a net importer of goods and a net exporter of capital. Bleak as the situation may appear, he said, it was not entirely hopeless. Eskom's debt and the wage bill are extremely high but the debt to GDP ratio puts us at the median level and government debt is largely Rand denominated, which limits our risk compared to other middle-income countries. To start fixing the economy, he proposed we do the following:

- Introduce tax incentives and restructure tax policy to disincentive large holdings in order to raise fixed investment;
- Make monetary policy more responsive;
- Use the Industrial Development Corporation (IDC) and other similar agencies to drive funds towards major projects;
- Revise trade policy, specifically competition policy, to reduce monopoly power and reorient Black Economic Empowerment (BEE) towards productive sectors;
- Deal with the high pricing in upstream industries that impact on the downstream, including mining and its linkages with other industries;
- Strengthen the linkages between manufacturing and the retail sector to sustain growth.

The second main speaker noted that we had reasonable growth for the first 15 years after the transition. Since the international financial crisis of 2008, however, growth has suffered severely. More than twice the number of people were added to the ranks of the unemployed over a 10-year period.

In response to some analysts who hold that this is because of rising wages, he presented a graph to show that the wages and productivity lines move together. He also pointed out that union density in the private sector is not that high.

The mismatch in skills may partly explain the lack of growth, but he is more persuaded that it is the falling ratio of capital stock to GDP that is a better explanation. Growth without employment will not help South Africa. He made a strong case for labour-intensive growth, noting that this has been small in most of the sectors of the economy except for construction and agriculture. In an export-driven growth strategy, we should bear in mind that wages are generally higher which is not matched by our productivity. The turmoil in international trade is another factor to consider.

The possible solutions he recommended are:

- Focusing on the Southern African Development Community (SADC) as a regional market;
- Achieving an investment target of 25% of GDP;
- Improving savings levels as households show consistently low savings rates;
- Negotiating investment compacts on a sectoral basis – finding out what is holding investment back and provide incentives to match the targeted levels;
- Using the concentrated nature of the market to negotiate;
- Addressing poverty in the rural areas;
- Thinking about title deeds and moving beyond the conventional private property conceptions since 32% of South Africans live on communal land, as do half of discouraged workers;
- Creating supply chains on these lands;
- Stopping the institutional rot that has infected government departments and SOEs.

In the discussion that followed the presentations of the two main speakers, issues of Reserve Bank policy were raised. There is a view that the South African Reserve Bank (SARB) decides interest rates on its own with hikes being introduced before we reached the 6% inflation target level. There was robust debate on the independence of the SARB, with one participant asserting that there was no truly independent reserve bank and that what we should be seeking to establish is an autonomous reserve bank.

The collapse of labour-intensive manufacturing was also mentioned as a major concern and any growth strategy will have to include a mix of labour-intensive production, exports and foreign and domestic investment.

There was concern that while we remain preoccupied by the level of growth we are not tackling the massive environmental crisis that threatens the planet. Increased automation (the 4th Industrial Revolution) must also form part of the policy proposals for economic renewal.

Questions were raised about binding constraints on growth. The minimum wage is one possible issue. Another constraint identified is education. Can this be fixed in the short to medium term? It was agreed that matters like education cannot be divorced from the broader transformation of South African society.

On the political front, one participant said we need to consider what impact the tightly contested race within the ruling party is having on policy-making. He felt the lack of coherence within the ANC and the deal-making that results from seeking to satisfy the different factions, influences which policies get adopted.

This could change with the possibility of coalitions being formed after the national elections.

Another view was that a number of policies have caused major problems. On implementation, a participant felt that we could only succeed if there was state capacity to do this. Without proper monitoring, we would remain far behind countrie such as Korea. He warned in South Africa cooperation between state departments is limited and inefficient.

A caution was also sounded about the relationship between high profitability and growth, and South Africa has been a classic case. Many functions of the state have been outsourced to market-related entities. An institution such as the Public Investment Corporation (PIC) should be studied as a means to making investments in non-productive industries. The design of state departments is another area for reflection: what does it say about the sociological and behavioural problems in our society?

We should be clear about what makes our GDP grow. Data will show that it comes from finance and services, which are linked to the short-term capital flows that we have. >>

The investment narrative has to be questioned. Not investing in South Africa is seen as an advantage of pension funds. Rather than being focused on the next quarter, we should be talking about the next quarter of a century. We need a narrative that covers investment in fixed capital, infrastructure, production capacity, education and other social sectors.

Other issues that were raised dealt with industrial policy (do we have one when so little of the budget goes to the Department of Trade and Industry?); the informal sector in South Africa, which is small compared to countries similar in size with 800,000 people employed by informal sector entities; the lack of analysis on the investment ratios to profit, remuneration and retained earnings. The two main speakers responded and the following key points were made:

- In the context of compacts and bargains we should reflect on the nature of the bargains that were struck at the time of the transition and in the period since. The seeds of our problems were planted then with a group of powerful conglomerates positioning themselves at a time when the economy was undergoing severe strain. Their objective was to have as much freedom as possible to restructure. The liberalisation of capital markets was one of the victories they secured. This was done through ideological persuasion that the market (and the stock market in particular) was the most efficient instrument for allocating capital. Next was trade liberalisation. BEE was meant to be a part of this, but what was not carefully thought through was the effect of debt-based transfer of assets.
- A range of market-based reforms was recommended. On the fiscal and monetary side, keeping the deficit and inflation under control was seen as a major objective of policy which was linked to protecting the value of profits. To move profits offshore, a relatively strong exchange rate was required. There was extensive support in capital- intensive, heavy industry with the IDC underwriting most of the risks and expansion. The private sector re-positioned itself out of the manufacturing sector and into the services sector. There was no coherent strategy for development in mining and other sectors. As we reflect on the consequences of these bargains, we should be careful not to repeat these arrangements as this will not fix any of the problems that afflict us.
- On considering the issues of institutional design and coordination, one comment was that institutional arrangements that work in some countries may not work here. Another was that decisions made in Cabinet are not implemented because there is no central structure to coordinate and implement these decisions.
- A question that arose is that if we are to have a New Deal what concessions need to be made? What kind of a deal will there be between business and society? The social context of these deals have to be examined, they shouldn't be done in isolation. One participant questioned the notion of business-government deals, saying they are fundamentally flawed. If we look at the history of such deals, from the New Deal in the USA to Scandinavian countries and the Asian Tigers, it is clear that there were too many carrots and too few sticks. He sees an emerging consensus that we have some good policies but they are incoherent.
- We also continue to view the informal sector through conventional lenses. From a structural standpoint there is the peasantry and the informal sector that must be taken into account in our policy formulation and analysis.
- The state is weak but the paralysis of the SOEs spells disaster. The lesson from the Asian Tigers is that they built strong states that played a decisive role without undermining the private sector. One way to do this is through a strong planning framework and mechanism.
- The discourse on everyday economics must change: we need to erase the ideas of trickle down. Growth AND full employment must be coupled in every policy recommendation.
- While the mandate of the SARB is seen as inflation targeting this must be opened for discussion with a view to broadening it. Tax policy should also be reconsidered with a wealth tax on inherited wealth and a revision of marginal tax rates.

CONCLUDING THOUGHTS

There was broad consensus that South Africa is facing the "perfect storm" of high inequality, unemployment and deepening poverty alongside state incapacity and private and public sector corruption. In this context it is vital that a new and progressive macroeconomic and industrial policy be developed and implemented with speed. Those policies must guarantee the structural transformation of the South African economy through increased investment in labour-intensive sectors coupled with strong redistributive mechanisms.

These recommendations must be a point for discussion across the political spectrum, among various social formations and business associations. The seminar ended with an agreement to hold a second round of discussions and to make it a platform for engaging key government representatives. NA