CDE ROUND TABLE

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GROWTH IN A TIME OF UNCERTAINTY

Does South Africa have a growth plan?

Edited proceedings of a Round Table convened
by the Centre for Development and Enterprise

The Centre for Development and Enterprise is a leading South African development think tank, focussing on vital national development issues and their relationship to economic growth and democratic consolidation. Through examining South African realities and international experience, CDE formulates practical policy proposals for addressing major social and economic challenges. It has a special interest in the role of business and markets in development.

Series editor: Ann Bernstein

This report summarises the proceedings of a Round Table hosted by CDE in June 2013.
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EXECUTIVE SUMMARY

South Africa's economy is in trouble. With unemployment (which is most appropriately measured using the broad definition) running at 34 per cent, and with barely 40 per cent of adults in employment, the crisis in the labour market is the country's most serious. But critical challenges exist elsewhere, too: there are concerns about the size and trajectory of the budget deficit; investment rates are low, and, because savings rates are even lower, the current account is in persistent deficit; long reliant on the carry-trade to boost its value, the exchange rate has become increasingly vulnerable, a phenomenon that could affect capital flows and, together with relatively rapid growth of unit labour costs, could also lead to rising inflation. Add to all of this the many supply-side constraints on growth—underinvestment in electricity generation has left the country with too little capacity, we have expensive but inadequate network infrastructure, and we are seeing more and more costly labour strife—and the result is that South Africa's continued economic progress seems increasingly uncertain.

It was in this context that CDE hosted a Round Table in June 2013 focused on a key question: does South Africa have a growth strategy?

Growth really matters for poverty

The centrality of economic growth to resolving or ameliorating many of South Africa's most pressing challenges is widely accepted by all. But precisely how important growth is to reducing poverty was emphasised by Prof Arvind Panagariya, the Jagdish Bhagwati Professor of Indian Political Economy at Columbia University, and co-author (with Prof Bhagwati) of an important new book on India's growth experience. In a presentation to the Round Table, he showed how the rapid acceleration of economic growth in India between 1991 and 2010 had reduced poverty far more rapidly than previous policies—many of them described by their proponents as being "pro-poor".

Between 1950 and 1990, economic growth in India was quite slow especially in per capita terms, averaging less than 2 per cent a year. In the 1990s, after a series of economic reforms that liberalised the business environment and opened up trade, per capita growth accelerated first to around 4 per cent a year before rising to over 6 per cent a year after 2003.

High levels of growth have had a profound impact on poverty: overall, the proportion of people living below India's poverty line fell from nearly 50 per cent in the early 1990s to 30 per cent in 2010, in the process raising 200 million people out of extreme poverty.

Prof Panagariya identified two mechanisms through which growth reduced poverty. First, increased economic activity was directly reflected in rising incomes as people moved into more productive jobs or as incomes rose in their existing jobs. Second, growth increased tax revenue, providing the resources for poverty-alleviation schemes such as the employment guarantee scheme in rural areas.

This has been South Africa's experience, too. Between 2003 and 2008, when annual growth averaged over 5 per cent, the country saw rising levels of employment, with two million net new jobs created between the first quarter of 2003 and the last quarter of 2008, or about 1 000 new jobs a day. The result was that the rate of unemployment fell by six percentage points and incomes rose for many. In addition, increased tax revenues allowed government to expand the social safety net, with the number of people receiving social grants rising from under 6 million in 2003 to over 12 million in 2008.

There is, therefore, clear evidence that rapid and sustained economic growth has the potential to impact very strongly on levels of poverty. And this has happened in as large a country as India and as unequal a society as South Africa's.

South Africa has been ambivalent about growth

And yet, South Africa's attitude to growth has been ambiguous and ambivalent. On the one hand, government has repeatedly proclaimed a desire to see the economy grow more quickly; on the other, it has emphasised policy initiatives that undermine growth and has also devoted considerable energy to policies and programmes that are more redistributive than growth-enhancing.

No-one doubts that redistribution programmes have helped improve the quality of life of the poorest. But, despite levels of redistributive spending that are among the highest in the developing world, inequality has barely moved and poverty rates remain high. The central reason for this is the slow pace of employment growth. As impressive as South Africa's creation of net new jobs was during the boom years, the loss of jobs during and after the financial crisis has been more rapid than in almost any other country in the world, and narrow unemployment which had fallen to a low of 22 per cent is now around 25 per cent. This reinforces the key point: for South Africa to create large numbers of jobs, the economy has to grow quickly.

How much growth is needed? The answer depends on some important assumptions. One estimate—from the National Development Plan—is that the country needs to grow at over 5 per cent a year until 2030 to create the 11 million jobs it predicts will be needed to reduce unemployement rates to 6 per cent. But this is only true if economic growth between now and 2030 has the same structure as it did in the last period of economic growth and has similar employment effects. If future growth is less heavily biased towards skill- and capital-intensive sectors and more concentrated in labour-intensive industries, it may be possible to generate considerably more jobs per unit of economic growth.

Different patterns of growth have different implications for employment. This fact is especially important in light of the considerable differences in the approach to economic policy exhibited in government's three most significant economic policy documents—the Industrial Policy Action Plan (IPAP), the New Growth Path (NGP) and the National Development Plan (NDP). Given that all three agree that employment growth is the economy's key challenge, the country needs to prioritise strategies that would increase growth rates and increase the overall labour-intensity of the economy.

South Africa's three growth plans

South Africa has three core economic policy documents, each produced by a different government department: the NGP, released by the Economic Development Department in 2010; the Department of Trade and Industry's IPAP, produced in 2010 and updated in 2012; and the National Planning Commission's NDP, released in 2012.

All three documents place employment growth at the centre of South Africa's economic policy, but each offers a different (sometimes mutually incompatible) diagnosis of the challenges the country faces. The three documents also offer different (again, sometimes mutually incompatible) recommendations about the policies needed to address the challenge. And, while employment growth is the key objective of each document, there are important differences in the absolute size of the targets and timeframes. In addition, there are differences in the subsidiary and complementary objectives included in each document (see Table 1).

There are also important differences in how the three documents describe and explain South Africa's economic trajectory over the past few years (see Table 2). IPAP and the NGP suggest that the core reason for slow employment growth has been the growth of sectors dedicated to "consumption" at the expense of those dedicated to "production". Both documents suggest that the growth of the financial sector is a cause and consequence of this trend, but offer differing accounts of what has happened.

By contrast, the NDP sees the financial sector as one of South Africa's comparative advantages and offers no

Table 1: Summary of differences in objectives between IPAP, NGP and NDP

	OBJECTIVES	QUANTIFIED OBJECTIVES	EMPLOYMENT OBJECTIVE	CHARACTERISING EMPLOYMENT
IPAP	• Exports • Technology • Skills • Employment	• Employment (aggregate)	• 2 447 000 by 2020 (direct and indirect) • 350 000 by 2020 (direct)	• N/A
NGP	• Employment • Growth • Green economy • Reduction in inequality	• Employment (sectoral targets)	• 5 million jobs by 2020	• Decent work
NDP	• Output • Investment • Exports • Employment • Poverty and inequality	• Output • Investment • Exports • Employment • Poverty and inequality	• 11 million jobs by 2030	• Decent work over long term

analysis compatible with the idea of an imbalance between consumption and production identified in the other documents. The NDP suggests that the root of the economy's challenges is that it has succumbed to a "middle-income trap" (in which South Africa is unable to compete against the low-wage economies of east Asia in light manufacturing because the cost base is too high, but lacks the skills and capacity for innovation to compete in high value-add sectors). The NDP also suggests that local industry is overly-concentrated, and that this stifles growth and innovation. Unlike both IPAP and the NGP, the NDP sees the labour market as being too tightly regulated, with those regulations playing a big role in explaining unemployment.

Given these divergent analyses, there are big differences in the policies proposed: IPAP and the NGP seek to drive employment growth through industrial policy interventions (though the sectors prioritised in the documents are not identical), while the NDP expects that employment growth will be driven by growth of small-scale services businesses.

While there is some consistency in the approaches of IPAP and the NGP (though IPAP has a narrower focus than the NGP), the assessment of the roots of poverty and unemployment offered by the NDP differs quite markedly from theirs, as do the resulting policy recommendations. The biggest differences between IPAP/NGP and the NDP relate to industrial policy, interest rates, and the external value of the Rand. Particularly stark differences emerge in relation to labour market reform, where the NDP's approach, which would liberalise some aspects of the labour market, contrasts with the emphasis in the NGP on ensuring that new jobs conform to (undefined) norms of "decent work." Unlike the NGP, the NDP sees work becoming more and more "decent" over time as the economy grows, rather than seeing this as a requirement for all jobs that are to be created between now and 2030.

These differences make it clear that South Africa does not have an agreed approach to economic growth in the cabinet. They also make it impossible to define, describe and sell a coherent policy vision. There are, therefore, legitimate grounds to question the assertion sometimes made by political leaders, including President Zuma, that IPAP and the NGP are compatible with the NDP. It is not obvious what it means, for example, when he told Parliament in June 2013 that, "We have moved to the implementation phase of the plan, incorporating the economic strategies, the New Growth Path, the Industrial Policy Action Plan and the infrastructure development plan which now fall under the NDP umbrella."

Matters are made even more complicated by the shape, structure and substance of the document that is supposed to be the core "plan" for South Africa's development over the next few decades—the NDP.

Could the NDP become South Africa's growth plan?

Despite its endorsement and embrace by a broad range of official structures in the ruling party, the cabinet and other organs of government, as well as by a variety of other constituencies (including organised business), the depth of support for the NDP remains uncertain.

That the NDP has found support outside of government is unsurprising, given that the document, along with the diagnoses that were released before its publication, offers the most frank and serious official assessment of the country's trajectory. Uncertainty about the strength of government's commitment to the NDP, however, reflects on-going debate

Table 2: Characterising the economy: Identifying macro and micro constraints

POLICIES	CHARACTERISING THE ECONOMY	MACRO CONSTRAINTS	MICRO CONSTRAINTS
IPAP	• Consumption-led	• Mal-functioning financial sector • Overvalued and volatile exchange rate • High interest rates	• Economic concentration • Skills
NGP	• Consumption-led	• Overvalued and volatile exchange rate • High interest rate • Low saving rate	• Carbon emissions • Energy infrastructure • Economic concentration • Skills
NDP	• Low growth middle income trap	• Low saving rate	• Economic concentration • Uncompetitive labour market • Skills

about policy within the structures of the ruling alliance and the antipathy for the NDP's leading political sponsor felt by some constituencies in the alliance. Another factor concerns the structure and content of the NDP, which was described by participants at the Round Table as "reading more like an intervention into a larger political debate than like the resolution of that debate" and, by others, as consisting, in some measure at least, of "whimsical poetry", "wild extravagance" and "options analyses".

The NDP's length—it's nearly 500 pages long—and the range of issues it covers, may also be working against its becoming the core of a national vision. A key problem, for example, is that it can be read by different constituencies as supporting a wide range of potentially mutually exclusive policy proposals. Thus, readers can interpret it as supporting quite divergent visions of the role of the state in the economy. In addition, its sheer breadth means that the uneven implementation of all its proposals could result in very different policy mixes and outcomes. For this reason, the detail and sequencing of policy implementation will shape and reshape the vision of the NDP. All of this makes it difficult to see the NDP as representing a clear and consistent vision of the future trajectory of public policy.

In sum, there are considerable differences between the country's three most important economic policy documents and the government departments from which they originate. The three documents reflect different views about the way the economy functions and how this might change over time.

To be fair, some differences might be explained by different objectives and mandates. By its nature, for example, the NDP must take a view on a wide range of factors that can and will impact on the country's developmental trajectory; IPAP, by contrast, is more narrowly focused on a range of industrial policy interventions, and, while likely to be impacted on by other forces, treating them in isolation is not unreasonable. Nonetheless, it is clear that different ideas about economic development and priorities for growth are present at the centre of government, differences that are too large to allow the three to cohere into a single vision and approach to economic policy.

These differences and contradictions introduce uncertainty for economic actors—here and abroad—about the content, nature and direction of government policy. Worse, the direction of public policy appears to be hostage to unpredictable political battles within the ruling alliance. All of this leads to a degree of paralysis in South Africa's current approach to economic strategy.

South Africa needs an agreed growth strategy

South Africa—like other developing economies—faces a challenging global and domestic policy environment. There are no easy answers or full proof solutions. What is required is an understanding, shared by key players in government and across society, about the fundamentals of South Africa's present situation and the direction in which to take the economy. A leap of faith may be required based on our best understanding of what has worked elsewhere, what has already been tried unsuccessfully here, and what might provide the country with the best road forward.

The NDP has wrestled with some of the difficult issues facing the country. It does not address all our dilemmas nor does it clarify or resolve all of the "tough choices" that it says must be made. And, while various participants at the Round Table offered their assessment of some of the priorities for a growth strategy—investment in infrastructure, increased trade with fast-growing African countries, etc.—a conversation of this type cannot engage fully with all the issues that need to be considered. Having said that, there are some areas on which it is relatively easy to see what is needed. Some of these were identified by various participants at the Round Table:

- *South Africa needs to "stop scoring own goals"*. Ranked against other countries, South Africa's economy has many strengths—good corporate governance, stable financial institutions, considerable natural endowments, and good, if aging, infrastructure. But it also has many weaknesses, some of which relate to the quality of the workforce, the regulation of the labour market, and the costs employers incur in hiring and firing employees. While some of these challenges will take time to overcome, policy-making energies should not be directed at aspects of the economy that work relatively well, but at those where we fare badly.
- *Faster growth requires considerably higher levels of investment than has characterised the economy over the past few decades*. The key challenge is to persuade investors that appropriate policies will be implemented and that they will be pursued over the medium and long term. Macroeconomic vulnerabilities increase when societies rely too heavily on foreigners to finance investment, raising costs. So, if South Africa is to invest far more, it needs also to save far more so that already large external imbalances do not grow larger.

Table 3: Policy proposals made by the three documents

POLICIES	IPAP	NGP	NDP
Exchange rate	• Unqualified support for depreciation	• More competitive • Requires fiscal restraint • Accord on wages and prices	• No nominal devaluation • Conditions for effective devaluation do not exist
Development finance institutions and capital subsidies	• Expanded DFIs • Investment subsidies	• Expanded DFIs • Investment subsidies • Development bond • State-owned bank for rural areas	• None advanced
Local procurement	• Unqualified support	• Unqualified support	• Caution on higher costs jeopardising growth
Sector support strategies	• Very wide ranging industrial policy, with an emphasis on beneficiation	• IPAP plus: - infrastructure - agriculture - mining - green economy - tourism - high level services	• Protect sectors with long-term prospects • Short-term support measures for industries affected by cyclical downturn • The financial sector • Retail and business services
Labour market	• No consideration	• Productivity accord • Tighten sub-contracting, labour broking, and outsourcing • Support for workers in unorganised sectors to achieve greater organisation	• Youth Wage subsidy • Wage restraint • Regulation and subsidy to labour placement sector • Unfair dismissal not to apply for probation period • Simplify dismissal procedures • Migration policy reform to attract more foreign skills

- *Education reform is critical for growth and inclusion*. South Africa's stock of human capital is too small and, because the education and skills systems are weak, it is growing far too slowly to support faster economic growth. These systems must be fixed if the country is to have the entrepreneurs and workforce needed to generate rapid growth. Bold decisions are required to deal with performance management in the public system, value for money, and the political obstacles that prevent these two essentials being met. We should also be tapping the power and innovation of markets, entrepreneurs and NGOs more in helping to improve and transform the schooling system.
- *Skilled migrants are essential*. In the short-term, South Africa should seek to attract far more skilled people (professionals, teachers, managers, entrepreneurs) to help train South Africans, manage projects, start new businesses. This may be easier to do now, when the economies of much of the developed world are depressed, than it has been for a generation. Rapidly increasing the supply of skills in this way would have the added benefit of reducing the skills premium which would both lower the cost of doing business and reduce wage inequality.
- *Faster growth requires more efficient and affordable public infrastructure*, especially transport, roads, energy, water and logistics. How can we get higher growth when South Africa's mines have to cope with periodic load-shedding in order to keep the lights on in the suburbs? The country needs to invest in its infrastructure if it is to create the platform for faster growth. Public sector management of infrastructure spending needs to be professionalised to ensure that value for money is obtained from all tenders. This in turn means that appointments need to be made on merit, not patronage or political loyalty. And the role of the private sector in infrastructure provision should be maximized and not minimized.
- *The governance of the country's most economically important areas must be improved*. While improving governance everywhere would be ideal, focusing public sector reform initiatives in the metropolitan areas—in which nearly 60 per cent of economic activity takes place—would kick-start both growth and governance reform. Getting governance

right in these areas ought to pose fewer challenges and have a disproportionately large impact on the economy. Key appointments in the metros need to be made on the basis of ability rather than party (or factional) loyalty.

- *Opening the economy to new firms and greater competition*. Concerted efforts are required to change the business environment in the country so as to encourage new firm entry, more competition in all sectors of the economy, and much greater innovation and economic efficiency.
- *Improving trust and cooperation among key constituencies*. Trust deficits between business and government and between business and labour are an important source of current social, political and policy uncertainty. South Africa needs an economic strategy that all constituencies believe is in their interests and believe will deliver results. Only then will they work together and not at cross purposes. There are two critical challenges. The first lies in labour relations which have become increasingly fraught and conflictual, and which are doing considerable damage to the economy and its prospects. This trend must be reversed. At the same time, resolution of these challenges should not be at the expense of the unemployed whose interests are sometimes forgotten when organised business, labour and government negotiate. Relations between the state and business are a second area that requires attention, with business leaders feeling that their concerns are not taken sufficiently seriously in the corridors of power, and a cynicism about consultation processes taking hold.

This is not a comprehensive list, but what is clear is that South Africa urgently needs to reduce the cost of doing business. This has many components: the country needs to focus on the right issues, policy certainly is essential to reduce risk, labour relations need to move towards a more stable base, the costs of employing people need to be lowered, the skills supply dramatically expanded, and a more competitive economy must be created to encourage new firm growth.

Some of the "tough choices"

In addition to the above list, South Africa needs to focus on some underlying issues that are seldom properly debated, but which are in need of resolution. The NDP hints at and talks of "tough choices" but does not go into all of them sufficiently, sometimes not even defining the issues and options involved. Three areas in which choices must be made if South Africa is to grow more quickly and raise employment levels are identified below.

South Africa's growth strategy must prioritise labour-intensive industries

The point is frequently made that South Africa needs to grow at around 6 per cent a year for a generation if it is to achieve an employment to population ratio that is closer to global norms and that meets our national needs. But is this correct?

The idea that we need very high levels of growth for a very long time is founded on the assumption that future growth will look a lot like past growth. But what happens if we weakened this assumption? We need to free up the economy in all the ways traditionally discussed—less red tape, more competition, better infrastructure for growth, etc. But in addition, we need to ask what if South Africa were to encourage the emergence and growth of a large low-skill, low-wage manufacturing sector? What if Newcastle's garment industry were encouraged to grow rapidly and to attract some of the millions of manufacturing jobs that rising wages in China may be making uncompetitive? In other words, if we said that what South Africa needs is to dramatically grow its low-skill, low-wage sector, less economic growth would be needed to achieve significant employment growth.

This raises the fundamental question: what kind of economy can South Africa reasonably expect to build? This is a question that ought to be at the centre of the debate about economic policy because the country does face some choices. As of yet, and apart from some skirmishes on the side-lines, this issue has not yet been fully debated and explored, much less resolved.

At its heart there are at least two questions to be addressed:

- Is it really possible to create 5 or 6 million more "decent jobs" in South Africa in the short-term? If so, what has prevented us from doing this over the long period during which this has been the stated objective of government policy? And, if the pursuit of millions of "decent" jobs proves fruitless and condemns further millions of South Africans to live without any employment at all, is that a price worth paying? Surely this choice needs to be explicitly and clearly debated in the country?
- Is it possible for South Africa to create 3 million and more low-productivity, low-wage jobs? Could we realistically compete with Ethiopia or Bangladesh or Vietnam or Costa Rica to attract some of the world's millions of light manufacturing jobs? What would it take to achieve this? What reforms would be necessary? What would be the social impact of both the jobs and the policy changes that might be needed to attract new investors?

These are some of the most important "tough choices" facing South Africa today. They should be debated much more openly and fully. But we could also test the feasibility and impact of growing a genuinely labour-intensive manufacturing sector by establishing large special economic zones specifically designed to attract these kinds of jobs. And by allowing and encouraging Newcastle's competitive garment industry to grow rather than shrink.

South Africa needs to use the market to address the country's challenges

Few doubt that the majority of new jobs to be created in coming years will be private sector jobs. Even the most ardent advocate of state intervention in the economy or state assistance to industry—whether through a state mining company, industrial policies, trade protection or wage subsidies—accepts that most of the jobs that such interventions help generate will be in private firms, as will all of the jobs that might be created indirectly. Despite this consensus, the debate about the role of the market and the state in addressing South Africa's most important challenges is still unresolved.

It is vital that the core debates about the role of the state and the market in South Africa are joined much more deeply and openly if we are to develop an effective approach to growth.

Developing countries need smart and effective states to leverage private sector capabilities. Economic and social development requires dynamic, robust private sectors and competitive markets to take on risk and seize opportunities. South Africa has to get this balance right overall and in each sector of the economy and every area of social policy.

Private sector involvement in the delivery of infrastructure, education, healthcare and much more has been critical to raising living standards in developing countries across the world. The need for this in South Africa is increasingly obvious.

In education, for example, a large majority of public schools deliver inadequate educational outcomes. While improvement of the public system is needed—and urgently— there is an important role in the system for private schooling (at all levels but especially low-fee private schools) and contract schools (public schools, privately managed) in raising educational quality.

Similarly, there remain considerable regulatory and policy obstacles in many other industries—important examples of which include telecommunications and electricity generation. Here, there is considerable scope for opening up the industry to greater competition and competitive forces.

In addition, as both the NGP and NDP suggest (and independent academic research confirms), there seems to be considerable scope for increasing competitive pressures in manufacturing, particularly where barriers to entry for new firms exist. Properly designed and implemented regulatory reform could expand competition and increase output while lowering prices.

However, it would be a mistake for the authorities to target firms merely because of their size. Competition policy should be used to attack abuses of market dominance not dominance itself since the latter could be a result of efficiency and economies of scale (and might be necessary for firms to compete internationally).

South Africa's ambivalence about urbanisation holds back growth

South Africa's policy-makers continue to be ambivalent about urbanisation, a process that helped drive economic growth in the developed world, Asia and Latin America.

Urbanisation is one of the key elements in the myriad processes that have seen levels of human productivity explode over the past two centuries. By creating large pools of labour and mass markets for goods, urbanisation has delivered the two critical elements identified by Adam Smith in generating increased productivity: scale and specialisation. It is for this reason that in much of the world urbanisation has been associated with rapid productivity growth, rising incomes and much improved quality of life.

Despite this, and despite the fact that South Africa is under-urbanised for a country at its level of development, policy-makers frequently emphasise the importance of rural development rather than facilitating a process of more rapid urbanisation and effective management of growing cities. We should not ignore the rural sector, but South Africa's future and the bulk of its economic growth will be found in larger and larger urban centres.

Critical as urbanisation has been to the success of societies that have risen out of poverty, there are numerous examples in the developing world (principally in Africa, parts of Asia, and the Middle East) of urbanisation processes that have not delivered the productivity- and growth-enhancing effects seen among the success stories. It is important, therefore, that South Africa manages the dynamics of urbanisation and of growing metropolitan areas, cities and towns effectively.

A positive approach to urban growth and increased urban migration is essential because there are no examples of successful middle-income countries whose economies are growing rapidly without large (usually rapidly growing) urban populations.

Concluding remarks

South Africa desperately needs higher economic growth. The difficult global environment and the many unknowns involved in achieving higher growth in any country make this challenging. But it is not impossible, and the international climate provides opportunities as well as threats.

If the country is to grow more quickly, South Africa needs a realistic, workable strategy that has the support of all key constituencies. Little progress is possible if the cabinet is deeply divided on priorities and direction. Higher growth and significantly more employment will require a more open, reasoned debate and then resolution of some fundamental issues.

What kind of growth is South Africa able to achieve? Has the country been too quick in writing off the possibility of building genuinely labour-intensive industries at scale, and has sufficient consideration been given to the implications of failing to do this? What package of reforms would get South Africa much more growth in this sector at a time when international firms are looking for alternatives to China?

How can business, labour and government find common ground so as to work together on a plausible approach to growth? What is the role of leadership in reconciling divergent views with the national interest? How do we maximize the role of markets and entrepreneurs in moving South Africa to a higher growth path? Are there changes to competition policy that are needed if South Africa is to ensure a robustly competitive domestic market as well as provide the platform for international competitiveness?

These are some of the tough choices the country needs to debate openly and then resolve in the national interest. There is no question that economic reform—especially of the labour market—is politically difficult. And it is particularly difficult when those who are likely to resist change have the capacity to disrupt the process and impose costs on others, while those who might benefit are unorganised. It is for these reasons that political leadership is so important in articulating what is in the national interest and leading the process of building trust and securing sufficient consensus about the need for, and direction of, change.

For all its weaknesses, some of which are the direct result of the fact that the process of building consensus is incomplete, the NDP represents an important milestone in the quest for defining and consolidating a vision for South Africa that must underpin future economic policy-making. This is the best starting point the country has, and can serve as a platform for debating and convincing people of the tough choices that must be made. The NDP itself is imperfect, but, together with the diagnoses that back it up, it demonstrates conclusively how undesirable our present trajectory is.

Achieving higher growth in South Africa is urgently necessary. Making sure that this growth results in millions of new jobs is equally important. The country needs to move beyond its present impasse and make the "tough choices" to enable growth. At the very least we need to agree on some major experiments in parts of the country to test new directions and possibilities that could generate economic growth and employment at the scale required.

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DOES SOUTH AFRICA HAVE A COHERENT GROWTH STRATEGY

While not a panacea for all South Africa's social and economic challenges, a rapidly growing economy in which the unemployed were finding jobs, incomes were rising and poverty was falling would solve many problems and ameliorate the effects of many more. So obvious and uncontroversial is this statement that it would be fair to say that there are no significant constituencies who would disagree with it: everyone in government, organised business and labour, and the vast majority of groups in civil society, agrees that economic growth is a precondition for the country's achieving its aspirations. So far, so easy. Much more complex and controversial, however, is a set of questions that follows from an acceptance of the need for growth:

- What is stopping the economy from growing more rapidly and what is needed to get it growing?
- What trade-offs must be made between the desire to address poverty in the short-run and the need to prioritise policies and programmes that would boost long-run growth?
- To what extent do present policy commitments—to "decent" jobs, for example, or to low inflation—undermine the achievement of more rapid growth?
- How would an unwavering commitment to the pursuit of more rapid growth affect the country's politics, and what would be required from its political leadership?

How would an unwavering commitment to the pursuit of more rapid growth affect the country's politics

These questions go to the heart of debates about the trajectory of the South African economy. In June 2013, CDE brought together a range of leaders from all walks of South African life—government, business and civil society—to discuss these issues (*See participants list on page 11*). The discussion, summarised in this report, was organised around key inputs, including:

- A presentation by Prof Arvind Panagariya, Jagdish Bhagwati professor of Indian Political Economy at the University of Columbia and co-author, with Prof Bhagwati, of *Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries* (2012), on how India's growth acceleration has led to a rapid decrease in poverty;
- A research paper commissioned from Prof David Kaplan, Professor in Business Government Relations at the University of Cape Town, into the commonalities and differences between three of South Africa's most important statements of economic policy;
- Prof Johann Fedderke of Pennsylvania State University on the impact of low levels of competition in South African manufacturing on economic growth ; and
- Dr Chris Loewald, Deputy head of research at the South African Reserve Bank, on whether the external value of the Rand or its volatility has had an impact on South African growth.

Leaders from government and from business participated actively in the Roundtable.

INTRODUCTION

Ann Bernstein

Executive director, Centre for Development and Enterprise

South Africa's economic prospects have deteriorated badly in the past year. This is both reflected in and a result of the labour and civil unrest we've seen recently. There's also growing pessimism about the longer term outlook for the economy: even the Monetary Policy Committee of the Reserve Bank has expressed alarm about the prospects of wage settlements well above inflation and productivity growth, and about the risk of protracted and disruptive strike action. All of which is on top of a very serious crisis in youth unemployment, the dysfunction in far too many schools, and the many challenges in healthcare and elsewhere.

Given this context, what is government's strategy to make progress with respect to growth and employment? And, given the skills (or lack thereof) of the existing labour force, in which industries is it realistic to expect to grow? What progress is being made in effective education and training reform? Or immigration reform? Or the delivery of infrastructure for higher growth? Are there opportunities for South Africa in Europe's economic difficulties or rising wages in China, and are we taking advantage of them? These are some of the questions we confront.

South Africa is desperately short of leadership

The most critical question, ultimately, is whether South Africa has a strategy for faster economic growth. I don't think we do. The National Development Plan's diagnostic reports were frank and forthright about the challenges facing the country. But as a strategy for growth the NDP falls somewhat short. We are told in the NDP that the country needs to make some "tough choices" but the document does not go nearly far enough in articulating what these choices are. There are also some issues with which the NDP fails to come to grips. One example of this, is urbanisation and its relationship to higher economic growth and inclusion.

South Africa is desperately short of leadership. This is obviously a national challenge and government bears the primary responsibility to show leadership. But business, too, must lead. BUSA is speaking out more than it did in the past and seems to have a more coherent policy stand than it did. Some other business organisations are also participating more in policy debates. But the peak business organisation, Business Leadership South Africa, seems to have made a choice to go more silent as the country has slipped into deeper and deeper waters. It is in that context that some individual business leaders have started to speak out themselves. However no one has put a set of priorities or a more focused plan for growth on the table, as yet.

Serious as the situation is, it is important to remember that South Africa does not have to fix everything at once. We can and must prioritise. This is something CDE has learnt from the experiences of Brazil and India, which have made enormous progress despite their many imperfections. These are countries that have labour market issues that are at least as complex as ours, for example, but have made phenomenal progress nevertheless.

South Africa can and must do better than it is doing, and the lesson of other countries is that this is possible. Determination and effective leadership can work wonders.

We need to agree on a road to growth for the country and introduce the necessary, albeit politically difficult, reforms. There are also some historically unprecedented opportunities for South Africa.

The first relates to our skills crisis, which we could dramatically reduce if we took advantage of the fact that opportunities for skilled professionals in Europe are much less exciting than they were a decade ago. This has already helped slow skilled emigration from South Africa. Now we should take advantage of the global market for skills and try to import them much more aggressively than we have in the past. We should be doing everything in our power to get foreigners to come to South Africa, to teach and train, to manage projects and to start businesses here. Of course we must fix our education and expand the production of skilled people. But education and training reform takes time and in the meanwhile we should be looking to attract an abundance of skills trained and paid for elsewhere.

The second area of opportunity relates to changes in the global economy. Justin Lin, former chief economist of the World Bank, has argued that as wages rise in China and as its manufacturing sector moves up the value chain, many of its millions of low-wage, low-productivity jobs will relocate to other countries. South Africa should be trying to get some of those jobs as more and more firms are predicted to move their operations out of China. I don't share the NDP's assessment that South Africa cannot look for increased manufacturing in the low-skill, low-wage area. This is an unprecedented opportunity, but it won't last for ever.

The third opportunity has to be Africa. We need to ask whether South Africa is making the most out of the unprecedented growth of some 17 African countries. Are we really positioned to be the continent's financial centre? Are our companies and entrepreneurs getting the most out of Africa's growth and expansion? What is the government's strategy to maximize this new and large set of opportunities? So there are areas of opportunity in the gloom that I think we should be thinking about.

Let's turn now to talk about the importance of focusing policy attention on growth, its impact on poverty and whether SA has a growth strategy.

We should take advantage of the global market for skills and try to import them much more aggressively

India's growth acceleration and the decline in poverty

Arvind Panagariya

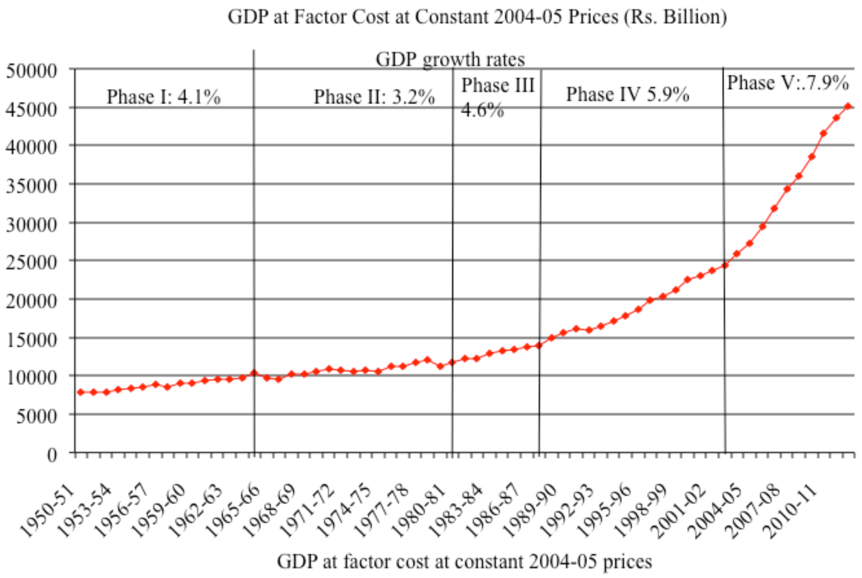
Professor, Columbia University

Growth and poverty

There is a lot of debate in India about growth and poverty reduction, and the effect of the former on the latter. But the facts are in, and the picture is actually pretty clear: growth has been enormously beneficial for the poor.

Between 1950 and 1980, economic growth in India was quite slow, especially in per capita terms, averaging just 1,5 per cent a year. Then, in the 1980s, economic growth increased to around 4.5 per cent. This was better than before but was still not making an impact on household income, especially of the poor. It was when annual growth picked up to levels of around 6 per cent in the 1990s (and around 8 per cent since 2000), that significant improvements began to be felt.

Figure 1: Growth phases in India between 1950 and 2011.

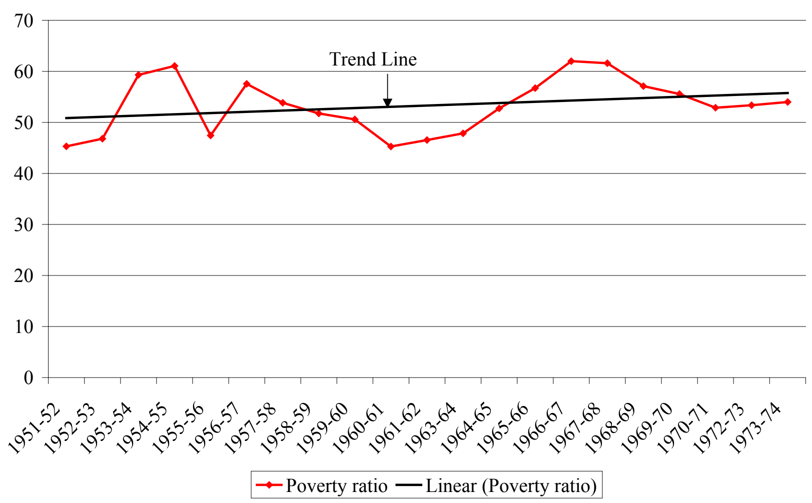


Source: Author's construction based on the data from the Central Statistical Office (CSO) of India

Growth has been enormously beneficial for the poor

Faster growth made an enormous difference to poverty levels, as surveys of household expenditure dating back to the 1950s show. Between 1950 and 1980, when per capita income growth was less than 1.5 per cent a year, there was no reduction in poverty. If anything, there was a slight upward trend in the proportion of people in poverty through the 1950s, '60s, and '70s. Essentially, what happened is that in years when rains were good, the income of the poor went up; when the weather wasn't as good, the poor ate less. (See Box 1 on the definition of poverty lines in India and elsewhere).

Figure 2: Poverty levels in India between 1951 and 1974



Source: Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries, 2012

Box 1: Poverty lines and what they tell about measuring poverty

Comparing levels of poverty and tracking their trends over time is facilitated by the use of poverty lines. These are cut-off points which demarcate the 'poor' from the 'non-poor', usually based on calculations on what income and/or expenditure is necessary to provide for an individual's or household's basic needs. The setting of a poverty line is somewhat controversial (and politicised) because of contestation over what should be counted as a 'basic need', resulting in different definitions:

- The World Bank uses $2 (measured in purchasing power parity terms per person per day) as a measure of poverty, and $1.25 to mark extreme poverty.
- South Africa has no single official poverty line, but the National Planning Commission uses R524 a month per person (about $2 per day) as a rough guide in its poverty measures.
- India uses a variety of official poverty lines: in 2009 the poverty line for urban India was set at 26.28 rupees or $0.53 per person per day, translating into purchasing power parity terms to about $1.45.

It is important to keep the shortcomings of poverty lines in mind: (i) while great thought has gone into how to keep poverty lines internationally comparable and up to date to current welfare standards, they remain idiosyncratic and arbitrary, (ii) they don't take into account from how far below and to how much above the line people's incomes have moved, and (iii) money-metric measures focus only on one point of the many that matter for poor people, neglecting changes to the quality of life that are not measured by changes in income (e.g. increased access to piped water and proper housing, reductions in the burden of disease, increased access to and the quality of education, etc.).

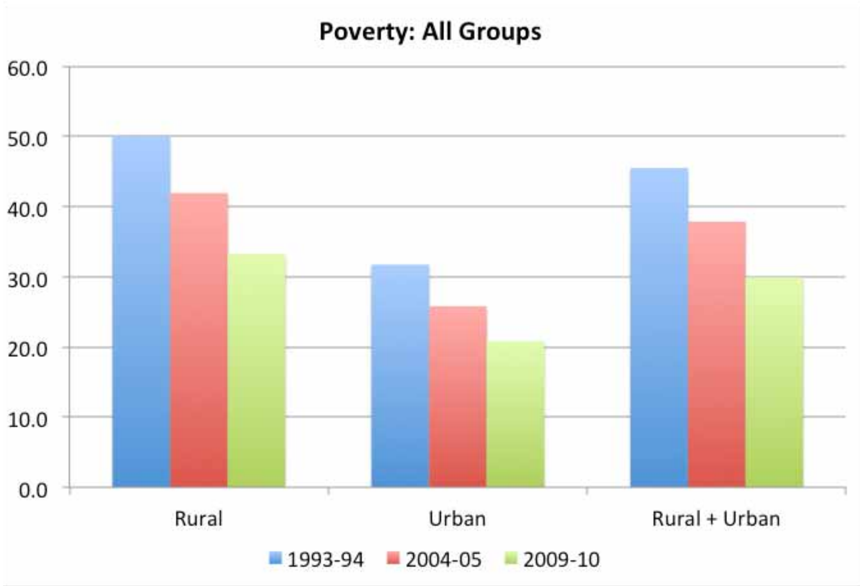
Importantly, rapid reductions in poverty rates are easier to achieve if (i) the poverty line is low and (ii) the initial distribution of incomes places large numbers of people just below the poverty line.

CDE 2013

By the end of the 1980s, economists started to fear that there was no hope for India. Ironically, this is just when growth took off and poverty finally started to fall. And, over the course of the next 20 years, poverty rates fell for everyone, whether urban or rural, whether a member of a scheduled caste/tribe or not. In fact, the rate of improvement among scheduled castes and tribes finally began to outstrip the improvement of other groups, so that the gaps between them is starting to narrow.

Rapid reductions in poverty rates are easier to achieve if (i) the poverty line is low and (ii) the initial distribution of incomes places large numbers of people just below the poverty line

Figure 3: Poverty rates by location.



Source: Author's construction based on the poverty estimates by the Planning Commission, Government of India

Growth is crucial for redistribution programmes

Two basic mechanisms account for the turnaround in the fortunes of the poor.

Firstly, and in contrast with what the popular imagery of "trickle down" implies, growth reduces poverty by pulling people up. Basically, when growth hits 8 or 9 per cent, it becomes a forceful mechanism that pulls people in to gainful employment. On top of that, high growth means that real wages rise. So you get a double benefit that comes from people moving from jobs that pay poorly (especially in agriculture) into jobs that pay better (often in manufacturing or services in the cities).

The second effect is that growth generates increasing public revenues, which are crucial for redistribution of any sort. Now, redistributive policies have been prominent in government thinking since 1950. But when incomes are so low, and when there is a large imbalance in the number of people from whom you want to take relative to the number to whom you need to give, you really can't get very far this way. Apart from anything else, population growth would make this unsustainable very quickly. So growth is crucial for redistribution programmes, such as the rural employment scheme, and also for public education and other services.

Growth and inequality

One area of continuing debate relates to inequality, with sceptics saying that India's growth has been captured by the rich. The data show, however, that there has been relatively little change to the Gini coefficient: inequality in urban areas increased a little, but there was no change to levels of inequality in the rural areas.

In any case, poverty rates are what should matter; inequality is something of a red herring. As long as poverty is declining and the poor are seeing improved incomes, a modest rise in inequality should be tolerable. And all the evidence suggests that this is so. Here's an example of what I mean. Kerala and Bihar are large states, but are very different. Kerala is the most unequal state in terms of income distribution, but it also has the lowest proportion of its population that is poor. Bihar, at the other extreme, has the lowest level of inequality but the highest level of poverty. Now, if it were inequality that motivated people, surely they would be migrating out of Kerala into Bihar? But that is not what's happening. Migration is all from Bihar, with the highest poverty level, to Kerala, which is more unequal.

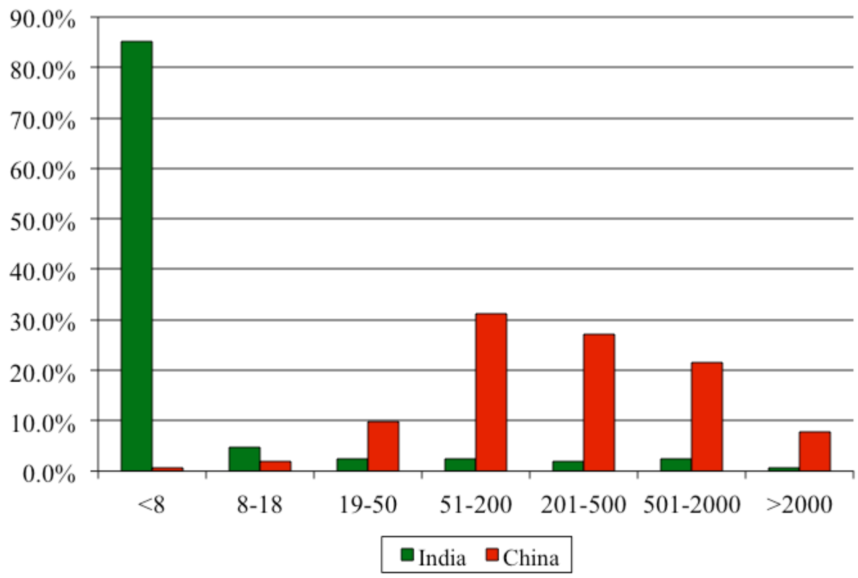
Why has India not done as well as the Asian Tigers?

Despite the successes, India has not seen the kind of rapid decline in poverty that occurred in countries like Korea and Taiwan in the 60's and 70's, or China more recently. The reason for the difference lies in the fact that the manufacturing sector, which in those other countries employs a lot of workers, has not grown rapidly in India. In fact, in our case, growth is concentrated in the services sector. Why is this so? Essentially because our highly-regulated labour market makes it very difficult for large manufacturing firms to emerge.

India's economic growth took off in 1991 after a series of pro-market economic reforms which saw industries like telecommunications, airlines and banking being liberalised. In addition to, the economy was opened to foreign investment. Despite these reforms, today's labour market remains very highly regulated, with regulations getting increasingly complicated and stifling as firms get bigger. This has the obvious result of keeping Indian manufacturers very small. Thus, 85 per cent of the apparel work force is employed by firms with seven workers or fewer. In China, by contrast, these small firms account for only 0,6 per cent of the workforce. Conversely, if you look at the large firms with 200 workers or more, you find more than 50 per cent of China's workforce there, while in India it is only 5 per cent.

India's highly-regulated labour market makes it very difficult for large manufacturing firms to emerge

Figure 4: Size distribution of firms: apparel



Source: Why Growth Matters: How Economic Growth in India Reduced Poverty and the Lessons for Other Developing Countries, 2012

Not only does the absence of large firms mean the manufacturing sector is smaller than it could be, it also means that it is less innovative. This is because large firms tend to drive the innovation process that increases productivity of all firms, both in end products and production processes, partly because they demand quality of these medium and small firms in their supply chains.

It would not be true to say that India has no large firms, of course. However, where there are large firms—like in the automotive sector—it is because the proportion of total costs made up by wages is quite small. This means that motor vehicle manufacturers are able to absorb the risks and costs of employing people, something that isn't true of large labour-intensive firms.

Concluding remarks

I would say that the key lesson to learn from India is the importance of economic growth. Let me illustrate that by noting that the period of most rapid poverty-reduction—2005 to 2010—was also the period of most rapid growth. This was also the period during which India's largest public programme for poverty reduction—the rural employment guarantee scheme—started. Seeing this, some people say, "Was it redistribution or was it acceleration in growth that caused the reduction in poverty?" My response to that question is, "Where would the employment guarantee scheme be without growth?" It is the availability of the revenues through higher growth and much larger revenues that enable you to undertake that programme. Frankly, it doesn't matter whether it was done using the instrument of redistribution, which I think most democracies have got to do to some degree at least. What is vital is that you do it in a way that doesn't kill growth.

South Africa's policy intent in the mid-1990s was focused strongly on redistribution

Does South Africa have a growth strategy?

Following Prof Panagariya's presentation, CDE asked a panel of leading policy-makers and businessmen to offer their thoughts on whether South Africa had a growth strategy, and what ought to be prioritised if growth were to be accelerated.

Andrew Donaldson

Deputy director-general: Public finance, National Treasury

South Africa enjoyed a period of strong economic growth in the five or six years preceding the 2008/09 recession although the subsequent recovery has been sluggish. I'd like to say a few things about where we were in 1993/94, the development of policy since then, and the challenges ahead.

Democratic South Africa inherited a divided and dysfunctional economy, considerably more unequal than India's, with spatial and human development shaped by a century of white-racial hegemony. It's not surprising, therefore, that South Africa's policy intent in the mid-1990s was focused strongly on redistribution.

Policy-making at the time was not primarily driven by an intention to generate a growth dynamic—though "building the economy" was one of the themes of the Reconstruction and Development Programme. We were at the end of a decade of very slow growth in which income per capita had declined and disinvestment—especially in infrastructure—had occured. It was recognised that growth was needed, and steps were taken to liberalise trade and open opportunities for investment. But more energy went into redistributive policies than into growth policies. And, indeed, the deepening of redistributive transformation efforts is still very much part of our thinking, codified in black economic empowerment objectives across almost all areas of social and economic policy and development programmes.

So that's a key part of our context: in important ways, growth has been secondary to redistribution objectives over the last 20 years. Meeting basic needs and investment in education and skills are of course both redistributive and important foundations for growth. But we have probably expected too much both in the scope for redistribution and in its growth impact. In areas such as housing, education, health and welfare services, it takes time to reorganise systems and build institutional capacity. Fiscal and legal measures to redistribute income and wealth, while avoiding social and economic disruption, are difficult and slow to take effect.

Another important feature of our context is the stark divide between the capital-intensive, modern, logistics-oriented parts of the economy; and regions or sectors that have remained stagnant and are characterised by weak institutions and poor linkages to both the domestic and international formal economies.

What we sometimes call the "informal" economy—though low skills, limited assets, weak property rights and social marginalisation are at least as important as organisational form—provides income to something like half our population, but accounts for at best 10 per cent of GDP, while the modern sector accounts for the rest. The modern part of the economy is supported by advanced financial institutions and strong infrastructure networks, and we expect it to generate rising investment and employment and yield most of our taxes. In this regard, it's useful to compare our situation to Prof Panagariya's data on the extent to which large companies are missing from the Indian economy. In contrast, ours is an economy dominated by large corporations that are both capital-intensive and operate across national and regional logistics networks.

But global growth today is no longer dominated by the advanced economies, but by the staggering pace of China, India and other emerging markets in "catching up" with the developed world. So perhaps it is time to let go of the idea that South Africa's progress is driven by further investment and growth of the established parts of our economy. Perhaps we have to concentrate efforts more on parts of our economy that have been left behind. Economic convergence is not just about the expansion of the modern, but also involves the rise of participation and productivity in the periphery.

A weaker Rand might create opportunities for manufacturing, but it could also lead to inflation, capital outflows, and higher interest rates

Policy development and economic growth

For much of the past decade, we have benefited from a global commodity boom and a long upward trend in our terms of trade. The minerals-based economy has delivered rising prosperity over and above the increase in output and productivity. But now we have reached the end of that road, and we have to build a more diversified economy and expand enterprise and participation in other ways.

One sign of a new direction is that the Rand has weakened, though perhaps, as one commentator put it, this might be the light at the end of the tunnel that is an oncoming train. A weaker Rand might create opportunities for manufacturing, but it could also lead to inflation, capital outflows, and higher interest rates. This is a particular concern because, even though our foreign debt is relatively low, there has been a rapid increase in the proportion of domestic, Rand-denominated debt held by non-residents. So, we are more vulnerable to capital outflows and external risk perceptions, even though we have grown foreign reserves very substantially over the last decade.

One account of what has happened over the past two decades is that we indulged in a spending binge made possible by the windfall gains associated with the commodity boom. While there is some truth in this, there is another narrative that is perhaps more important in understanding the growth challenge ahead.

Between about 1998 and 2008, there was progress in implementing an investment-based growth strategy accompanied by financial reforms, modernisation of the tax system, improvements in the public finances, and advances in skills development and housing investment, for example. Investment as a share of GDP rose from 15 per cent to 23 per cent, and economic growth averaged 5 per cent a year between 2003 and 2008. Progress was uneven, but a more buoyant growth dynamic was gaining impetus.

After 2008, it is not just that the global recession dragged us back—we also lost momentum in the economic reform process. We had an emerging growth strategy that was smothered by political fragmentation, policy contestation and contradictory trends, dysfunctional municipalities, parastatal governance failures, regulatory over-reach and unresolved aspects of labour market policy, communications sector development, and exchange rate management.

It is not just that the global recession dragged us back—we also lost momentum in the economic reform process

We've also seen poor design and implementation of industrial policies, most obviously in the failure to take advantage of private sector impetus in industrial development zones (IDZs). We built a new port at Coega, but failed to bring in a global logistics partner of substance. We declared Richard's Bay an IDZ, but there is not a single investment to show for it, mainly because of a complete absence of coordination between the national and provincial departments involved, the local municipality, and business stakeholders.

Coordination failures of this kind are pervasive. They confound progress through lack of trust and delays in decision-making not just between government and the business sector, but also between government departments, regulators, and state-owned utilities. You can't implement policy coherently or get the regulatory framework right in complex industries such as telecommunications or transport if there are not well-informed regular engagements between stakeholders, advisors, regulators and planners.

Another weakness has been in repositioning and reconceptualising the role of our state-owned development finance institutions (DFIs). There has been little progress in partnering or risk-sharing between the housing DFIs or the state-funded small enterprise agencies and private banks. The Development Bank of Southern Africa does too little municipal funding and too many other things. Too much of the energy and capital of our DFIs has been taken up by transactions that move money and wealth around, rather than in pursuing investment opportunities that would grow the economy and increase opportunities.

We probably also have to acknowledge that our engagement with the rest of the world does not yet reflect a coherent strategy for growth in trade and development. The world, of course, is a tough and difficult place, and South Africa has articulated a complex agenda in its positioning on the international stage. But internally, there is not enough engagement on our external interests and priorities. States need to achieve the kind of consensus that enables government and business to collaborate in attracting investment, developing opportunities in the region, engaging with the complexities of trade relations with the rest of the world.

Do we have a growth strategy?

So, do we have a growth strategy, in the National Development Plan? We should immediately note that the NDP is not a plan in the sense in which India's Planning Commission prepares plans, or in the sense that "development plans" are tabled by many developing economies. It doesn't try to be that—it isn't structured as an inter-connected set of demographic and social and economic projections; it doesn't contain specific infrastructure commitments; it doesn't have a costed set of programmes and projects. It is also not a growth strategy in the sense of an economic reform framework or roadmap. It has to be read as a discussion document designed for a context in which there's still debate about several important questions, and where consensus between many key stakeholders is far from being achieved. In our disputatious circumstances, this is perhaps what we need, but there is further work to do if this prolegomenon is to be elaborated into a growth plan.

And in so doing, there is an opportunity to focus on expanding opportunities for people currently trapped in those parts of the economy that are weakest—the informal, unregulated, low-skill, poorly-institutionalised economy in which half the population earns its income.

Let me conclude with two illustrations. The first relates to public works programmes. In 1993, a detailed plan was developed for a public works employment programme. It was endorsed by the Transitional Economic Council, a public works programme was implemented in due course as part of the RDP. But it was slow to get going, and was never really given the kind of real impetus and resources required to undertake and expand public employment as a residual source of employment opportunities for people who otherwise don't have work. In order to gain unions' support for its employment terms, it could only create temporary jobs and there are somewhat impractical training obligations attached to every job opportunity. But this is an unrealistic way of thinking about the role of labour-based employment in construction, in municipal services, and many of the other kinds of activities that have potential for growing job opportunities. It's not sensible to think about public works as temporary, as responding to a business cycle; we need to confront the deep structural challenges in our employment situation.

The second example of the challenges in our shadow economy is politically perhaps more revealing—it is astonishing how the spatial landscape of the old apartheid economy remains unreconstructed.

In the 1980s, there was a fair amount of job creation in targeted "industrial decentralisation" areas. By the early 1990s, Dimbaza in the Eastern Cape had 168 businesses. Now it's an industrial wasteland—an entire industrial estate is falling to ruins with cattle roaming on the streets. And there are similar stories to tell about Limpopo, Newcastle and elsewhere.

For policy-making purposes in the 1990s, places like Dimbaza were relics of another era. So we were in denial about what the removal of incentives meant for labour-intensive industries that were dependent on the fiscus. Perhaps that is a transition artificially subsidised industries have to go through. But there are surely better transition paths than simply to cut off support without notice. And for these hinterland areas where unemployment is now 60 per cent or 70 per cent of available labour, how do we create future opportunities for employment-intensive industry and associated services? Now is the time to ask these questions, because, as has been said, factory jobs in China will give way, over the decade ahead, to industrial opportunities in Africa, Southern Africa, and perhaps even in South African industrial growth centres.

The NDP has to be read as a discussion document designed for a context in which there's still debate about several important questions

Asad Alam

Country director, World Bank

To contextualise the issue of South Africa's growth strategy, we need to recognise four mega-trends that are shaping the global economy.

- We are in an era of policy uncertainty, which is going to continue for the foreseeable future as policy-makers everywhere try to grapple with a fast changing interdependent world. This is true not only of emerging markets including South Africa, but also of developed markets. It is also increasingly unclear who does what in economic policy: the boundaries, for example, between fiscal and monetary policy that we used to think of as clear cut, have become blurred. Central banks' roles have also been changing, with many embarking on unconventional monetary policies. So a lot of the conventional wisdom about policy options and what works is changing.
- Related to this trend are the challenges arising from increasing interdependence between countries. Capital, we all know, has been very mobile. But so too has been labour. So much so that there is growing resistance in many countries to cross-border movements of people.
- The third trend is the growth of inequality which is now a global phenomenon. You see it rising in the US, India, China, and many other countries. This has developed real political salience reflected, for example, in the debate in the US on the share of the economic pie going to the 99 per cent. This should give us pause because it's clear that high levels of inequality impede the reduction of poverty as well as growth. Countries are increasingly looking for economic approaches to promote shared prosperity or inclusive growth.
- A final trend is the democratisation of economic voice and power, particularly with the expansion of the reach of social media.

High levels of inequality impede the reduction of poverty as well as growth

So what are the implications of these global trends for South Africa, a country with many unique challenges? We can frame the issues in relation to four "I's".

- *Inequality*. This is, of course, a legacy of the apartheid and is largely structural in nature. This is true, for example, in relation to human capital endowments. Addressing this is a major challenge for policy-makers if poverty is to be overcome.
- *Integration*. South Africa has done quite well in terms of integrating with the global economy. But there is quite a lot of work to be done in integrating the economy domestically, and in promoting spatial and economic integration.
- *Institutions*. There is an obvious challenge with the institutions regulating the labour market. This is particularly important now capital has become very much cheaper in relation to labour. But there are also severe rigidities also in the land and capital markets. Output markets are also concentrated. So I think a lot more flexibility is needed across factor and product markets, in a way that promotes jobs, higher incomes, and inclusive growth.
- *Infrastructure*. There are a lot of things that have happened in relation to infrastructural development, even if they have not always met the aspirations of South Africans—the expansion of access to electricity that took place in the 1990s, for example. I'm not sure you can pick another country which over a small period of time has had such a massive expansion of access to power. Compare this, for example, to other emerging markets where there are severe supply constraints to

power. Look also at the expansion of housing that has taken place, notwithstanding concerns over quality. But there is still a huge infrastructure deficit that needs to be addressed, particularly to enable the poor to access economic opportunities and quality public services.

Donna Oosthuyse

Chief country officer, Citigroup

Growth really does matter in South Africa. And it matters in many ways. We hear a lot about the social impact of growth, but that is just the beginning of why it is important.

South Africa may not have a growth strategy, but we have growth aspirations. We also have a vision as articulated in the NDP, though I don't know that the vision is broadly shared at the moment. This needs to be addressed. In order to do that, we need a sense of civic responsibility that goes beyond the National Planning Commission. We need all leaders—in business, labour, government—to try build consensus on the vision in their own spheres of influence. I see this as part of nation-building in South Africa.

I would point to three more trends that are important: globalisation (which is driving changes in business), urbanisation (which is a powerful force in Africa) and digitisation (which could potentially allow countries like South Africa to leapfrog into new technologies).

Those are global trends, but I want to pause for a moment to say a few things about what India is getting right in the context of its huge take-off in growth. One of the things that has happened in Indian manufacturing is a trend towards high-value added manufacturing. Something else they've done is produce enormous numbers of skilled graduates every year, creating a huge supply of skills that's coming into the market. India has also had a very impressive productivity growth, and it saves about 34 per cent of its GDP and invests 36 per cent. That, for me, is an important contrast to South Africa.

So what are South Africa's growth levers? It's extremely important to ensure policy alignment and clarity. Just look at the front page of today's *Business Day* from the perspective of an international investor: there are three articles that hit you straight in the face. One is about the troubled passage of labour laws through Parliament. The other is the youth wage subsidy being proposed by the National Treasury. And the third one is about troubles in the mining sector. None of the stories inspires confidence in the coherence and clarity of our policies.

South Africa also needs to prioritise creating an enabling environment for the private sector. We have done quite a lot of redistribution, even though it may not have gotten all the kudos for these programmes that perhaps government deserves. But the problem with this is that the redistribution has come through social grants, spending on infrastructure, and public sector employment. South Africa now has the highest per capita number of public sector jobs in the emerging markets.

So what should be our priorities be now? I'd suggest three: firstly, improving the availability of skills and the labour relations environment. Secondly, making sure that the infrastructure-spend actually improves potential growth, which means spending on integration with Africa. Thirdly, creating buffers for exogenous shocks—our national accounts are much less healthy than they were a few years ago and I think we don't have the external buffers that we had even as the world becomes more uncertain.

South Africa also needs to prioritise creating an enabling environment for the private sector

Stephen Koseff

Chief executive officer, Investec Group Ltd

Recently, I did a presentation at the IMF to various institutional counter-parties about South Africa. I noted what the NDP requires of the state: professionalise the public service, strengthen accountability, improve coordination, and prosecute corruption. I then offered some data on where South Africa is highly-rated in the world. For the strength of auditing and accounting standards, we're rated number one by the World Economic Forum (WEF); the regulation of securities exchange, number one; efficacy of corporate boards, number one; legal rights index, number one; soundness of banks, number two; protection of minority interests, number two; availability of financial service, number two; financing through local equity market, number three; strength of investor protection, number ten. All of that was out of 144 countries.

So where are we rated number 144? Cooperation in labour employer relations, quality of maths and science, hiring and firing practices, flexible wage determination, and quality of educational system. They all rank between number 140 and 144.

We have, in other words, a very developed part of our society that we should be proud of and not destroy. Then we have the other side of our society that we all have to work very hard on to fix. And it's not only Government that can do it; business and labour are very important factors in that society. At the moment we're heading in the wrong direction, and, unless we come together as unified force, we are going to sit here in 20 years' time and have this growth rate of 2 or 3 per cent and increasing inequality.

At the moment we're heading in the wrong direction

South Africa started out with the redistribution objective, aiming to share the pie better. But, really, we need to make the pie much bigger. Now, that may mean you have more inequality. But it will certainly uplift people from poverty.

South Africa's problem is that we score so many own goals. We had a global mining boom, from which South Africa barely benefitted. Why? Because of bureaucracy. Because of policy. As a result, people don't want to invest. Here we compare badly with Australia, which really benefited from the boom. But in Australia mining is completely automated: the truck goes to the mine, automated; loading of the truck, automated; unloading at the port, automated. And, frankly, I think that's what's going to happen here.

With a fast growing continent on our doorstep, we should be benefiting from this. We really can't replay what we did in the last ten years and lose out again.

We have very sound capital market infrastructure and strong corporates. What we need to do is fix the other side of our society. That means improving education because we're not going to get anywhere until our people are properly educated.

As a bank, we run a programme for kids in townships where we pull them out of their township schools into maths programmes over the weekend. They end up getting "As" and "Bs". And they can then go into medicine, science, accounting, engineering—all those skills that we're very short of in society. But, you know, how many can you take? We've got 3 000 on that programme at any point in time. So it's a big challenge. And until we actually wake up to that fact, and we get our policy issues right, we won't make progress.

Bheki Sibiya

Chief executive officer, Chamber of Mines of South Africa

As a country—and as a mining industry—we face a triple deficit.

One is the trust deficit between organised business and political leadership. Trust levels are low; they don't trust us, we don't trust them. We need to deal with it, because if we don't, we won't solve our problems. The second deficit is the transformation deficit. We need to admit that we haven't made the progress we thought we would have made 20 years ago. The third is the trade deficit, which you are aware of. But one must remember that mining accounts for nearly half the country's exports. Unfortunately, those exports are falling rather than rising.

The mining sector needs the country to focus on its infrastructure. South Africa has more than 80 per cent of the world's high grade manganese, but our market share is 23 per cent. The reason is infrastructural bottlenecks. We could export probably a good 20 million more tonnes of coal if we just remove a few bottlenecks. If we did this, it would actually help resolve the transformation deficit because black mining companies could then export much more than they do. As it is, existing mines are saying to the ports, "Give us more volume," so smaller players don't get prioritised.

Another critical issue is the security of energy supply, especially since the industry is currently on revolving blackouts to keep the lights on in the suburbs. We're also concerned about electricity prices which are incredibly high. Without supply security and lower prices, there's no chance we can beneficiate our minerals.

> The mining sector needs the country to focus on its infrastructure

Finally: industrial relations. If you look at NUM, which has been with us for 30 years, I think you'll find we have a solid relationship. But they just took their eyes off the ball and lost ground to Mr Mathunjwa and AMCU. How have the ruling party and the Government responded to AMCU? My view is that it's an example of the cycle of grieving: they're in denial but will get to acceptance at some point.

Without being arrogant, mining understands that we are still the goose that lays the golden egg, even though we find that sometimes we are not fed well. I think the Government's intentions are good, but the execution so far has left a bit to be desired.

Discussion

The NDP as a growth strategy

A number of participants picked up on the points made by panellists about South Africa's prioritisation of redistribution over growth in the first 20 years after the end of apartheid. A businessleader noted that one of the political challenges that South Africa confronts is that many people think that growth has been biased towards enriching the already wealthy, and now see themselves as "victims of growth". The only way this could be reversed was by ensuring that the benefits of growth arrived in poor households more rapidly.

One response to this was offered by a local economist who suggested that South Africa's transformation agenda had been shaped primarily by the imperatives of redistribution, resulting in energies being expended in chasing deals from which beneficiaries would get stakes of existing companies. "But," he said, "if we think about what South Africa really needs if it is to grow, it's new firm entry. We need lots and lots of new firms. The challenge we have is that the incentives created by our transformation programme have meant that, to the extent that there are new firms emerging, far too few of them are owned and run by black entrepreneurs. One of the things we need to do is redirect the path of transformation so that it guides much more energy into creating new firms."

A critical issue, in this regard, was whether the NDP, as currently formulated, represents a plausible and coherent growth strategy around which the country could rally. A number of participants noted that the NDP had achieved broad support from a range of constituencies, but that the depth of that support was questionable. And, as one local economist noted, the ruling party and Cabinet themselves appeared divided about the NDP even though they have supposedly adopted and embraced it. Nor were the differences minor: one business leader suggested, for example, that there remained considerable ideological gaps between constituencies, and that the resulting uncertainties about the status of the plan were more profound than the uncertainties that might exist in other economies about the direction of economic policy. "Those uncertainties [in other economies] are largely tactical: people agree on what they want to achieve, but disagree on how to do it. Our disagreements are deeper than that."

Another concern, voiced by many, including senior officials, is that the NDP is not really a plan in the true sense of the word. "Parts of the NDP," one official said, "are whimsical poetry, a lot is wild extravagance. And some parts are better described as option analyses than as a plan."

The ruling party and Cabinet appear divided about the plan even though they have supposedly adopted and embraced it

The idea that the NDP was not an implementable plan was broadly endorsed by a range of speakers, but some also stressed that it seemed to duck some of the really "tough choices" to which it pointed. Chief among these was labour market reform.

Growth and labour market reform

Views differed on the centrality of labour market reform to accelerating South Africa's growth. One view was that, while reforming the labour market is important, it is not the sole priority and that serious labour market reform efforts could be politically disruptive and, therefore, damaging to the country's prospects. "India and Brazil," one participant noted, "made significant social and economic progress with very highly-regulated labour markets, and it is possible for South Africa to do the same." A related point was made by a senior official, who said that, while labour market regulation probably didn't harm a fast-growing economy's prospects all that much, when growth slowed down, rigid labour markets made adjustment more painful than it might otherwise be. Unfortunately, he said, it is far easier to reform the social contract—of which labour market regulation was an important component—when an economy was growing fast, and when a deal could be struck with those who were losing some protections afforded by the existing regime. When the economy grew slowly or shrank, organised labour was much more likely to resist reform.

Other participants insisted that labour market reform remained of paramount importance.

Picking up on Prof Panagariya's comments about the structure of the apparel industry in India and the relative absence of large firms (especially in comparison to China), one participant suggested that a key challenge in South Africa is that some bargaining councils (including in the clothing sector) set wages which might be appropriate only for relatively large and capital-intensive firms. He noted that, even though exemptions might be offered, and that, historically, at least, the different wages were agreed for urban and rural workers in the clothing sector, the gap between the two was narrowing. "If wages are agreed by big unions and big employers," he said, "that's a killer for small and medium-sized firms, because the key advantage they have is that lower cost of labour. They lose that if they have to pay the same wages as the big guys."

The Chair reinforced the importance of labour market reform, noting that one of the reasons that South Africa has the problems that it does is that "big labour, big government and big business have often done insider-only deals that resulted in keeping outsiders from getting into the economy." Many of these, she said, related to the labour market where big business was able to absorb the costs of more highly-regulated labour markets, but that this made it far harder for smaller businesses to compete.

A former public official differed, saying that it was something of a caricature of the process to say that institutions like Nedlac and other forums for policy debate resulted exclusively in deals done for insiders. Government, he pointed out, represented voters, many of whom were unemployed. In addition, other organisations and institutions had voices and could be heard during policy debates. Nedlac, he said, also had space for community representatives.

Other priorities for growth

Apart from the urgent need for the ruling party to get clarity on what policies would ultimately prevail in the elaborate debate about the NDP, most participants who spoke about the key priorities for accelerating growth agreed with the views of the panellists that key priorities remained education and infrastructure. A number of participants also emphasised issues relating to governance at various levels.

Noting that the NDP envisaged the creation of a professional, capable state, one participant suggested that professionalising the state and improving the quality of governance were the key priorities for growth. Irrespective of the other policy priorities, he said, this was a precondition for success in building a more prosperous country. Picking up on this theme, another participant noted that the bulk of the country's GDP is produced in five or six metropolitan areas, which, she suggested, ought to be the focus of efforts to improve governance and delivery. Since these areas were both smaller and had above average economic potential, focusing energy and resources on improving outcomes in these areas ought to maximise the benefits that accrue. Finally, a third participant noted that it might also be desirable to focus attention on places even smaller than the six metro areas: South Africa, he said, should have a strategy to create dozens of special economic zones, each of which might be used to develop different industries, and each of which could house policy experiments from which South Africa's policy-makers could learn. He suggested that the key investment in many zones—especially those linked to sea- and airports—was infrastructure; but noted that different kinds of industries required different kinds of incentives or institutional reforms, and that there was space for considerable variation among zones depending on what they offered.

The bulk of the country's GDP is produced in five or six metropolitan areas, which ought to be the focus of efforts to improve governance

What do key economic players really want?

David Kaplan

Professor, University of Cape Town

Government is pursuing economic growth through three different economic policies: the National Development Plan (NDP), the Industrial Policy Action Plan (IPAP), and the New Growth Path (NGP). The question is whether they chart a consistent course for South Africa's growth. In fact, they do not. Indeed, quite astoundingly for what are supposed to be three growth documents, the NDP is the only one that puts economic growth at the centre of its strategy, and the only one to set some explicit quantitative growth targets.

Differing growth objectives

First, let us look at the three documents—IPAP, the NGP and the NDP—by looking at what they say their objectives are.

The NDP is the only document that puts economic growth at the centre of its strategy

- IPAP sets out a list of objectives, with the most important being raised exports, more technology-intensive industry, increased skill content, and more employment. Of these, employment is clearly the key objective and is the only one with a clear, quantifiable target: 2,5 million jobs by 2020 of which 350 000 should be direct jobs. Oddly, the document says nothing about growth, either by industry, by sector or for GDP as a whole. So they want to judge the success or otherwise of the programme by its impact on employment.

  As an industrial policy document, IPAP says that new jobs will come from manufacturing, though it says very little about the kinds of firms that will grow (whether large or small, new or existing) or how much growth will come from exports.

- Like IPAP, the NGP lays out a range of major objectives including building a green economy, inequality reduction, etc. And like IPAP, the key objective is employment, with a target of five million jobs by 2020. The NGP says very little about growth or how much growth is needed to achieve these objectives. Normally a growth programme would say, "We're growing at 2 or 3 per cent, we want to grow at 7 per cent, what are the structural barriers? How do we address them?" You won't find that in the NGP, even though it has the word growth in its title.

  The NGP expects most of the jobs created to be in infrastructure and productive sectors—like industry, agriculture, mining—and some to be in the knowledge economy and the social sector. Again, it doesn't say very much about the kinds of firms that will create jobs or how much will be export-driven.

- The NDP is the only document that sets out targeted objectives. It says we need to grow output by 5,4 per cent a year, grow investments at a rate of 15 per cent per year, grow exports at 6 per cent a year, and grow employment at 3,3 per cent per annum. In a real sense, then, the NDP is a growth strategy and it is the first time that government has actually said growth is the principal target without which we won't get the employment that we all recognise is ultimately the key issue. It says we can only achieve the targeted 11 million jobs by 2030 if we get the growth target of 5,4 per cent per year, and it says that the private sector must lead this: if we are to get 11 million new jobs, the private sector will have to triple in size. So the NDP really has a growth story and it's a growth story that stresses the private sector.

The NDP sees up to 90 per cent of new jobs being created in new, small, labour-intensive firms that produce services for the domestic market. The NDP also says that an important benefit of export growth is that it makes substantial employment in the non-traded service sectors possible.

Table 1: Summary of differences in objectives between IPAP, NGP and NDP

	OBJECTIVES	QUANTIFIED OBJECTIVES	EMPLOYMENT OBJECTIVE	CHARACTERISING EMPLOYMENT
IPAP	• Exports • Technology • Skills • Employment	• Employment (aggregate)	• 2 447 000 by 2020 (direct and indirect) • 350 000 by 2020 (direct)	• N/A
NGP	• Employment • Growth • Green economy • Reduction in inequality	• Employment (sectoral targets)	• 5 million jobs by 2020	• Decent work
NDP	• Output • Investment • Exports • Employment • Poverty and inequality	• Output • Investment • Exports • Employment • Poverty and inequality	• 11 million jobs by 2030	• Decent work over long term

The NDP says we can only achieve the targeted 11 million jobs by 2030 if we get the growth target of 5,4 per cent per year

Economic policies

The three documents offer quite different diagnoses of the state of the economy.

- Both IPAP and NGP say that too much of South Africa's recent growth was driven by consumption rather than production. This is ascribed to a malfunctioning financial sector which gives short-term money to consumers, but fails to support long-term investments by entrepreneurs or industry. Another major constraint is the overvalued and volatile exchange rate, which also encourages consumption. The NGP further stresses a low savings rate, and various other constraints like carbon emissions, inadequate energy infrastructure, excessive industrial concentration, and the lack of skills, as main contributors to the curtailment of investment in productive sectors.

- The NDP has a very different characterisation of the South African economy. It characterises South Africa as being caught in a low-growth, middle income trap: it says we're not competitive in labour-intensive industries because we're too expensive and we're also not competitive in more high technology and more sophisticated exports because we don't have the innovation and the skills that are needed. It says we need to get into more value-added export activities, but that our uncompetitive labour and product markets make this difficult. The NDP is the only plan that brings up the adverse impact of the uncompetitive labour market on South Africa's economic growth.

Table 2: Characterising the economy: Identifying macro and micro constraints

	CHARACTERISING THE ECONOMY	MACRO CONSTRAINTS	MICRO CONSTRAINTS
IPAP	• Consumption-led	• Mal-functioning financial sector • Overvalued and volatile exchange rate • High interest rates	• Economic concentration • Skills
NGP	• Consumption-led	• Overvalued and volatile exchange rate • High interest rate • Low saving rate	• Carbon emissions • Energy infrastructure • Economic concentration • Skills
NDP	• Low growth middle income trap	• Low saving rate	• Economic concentration • Uncompetitive labour market • Skills

In relation to the labour market, the NGP proposes the tightening of regulations regarding subcontracting, labour broking, and outsourcing

It is no surprise that the different diagnoses of economic malfunctioning and remedies across the three plans lead to a very different set of proposed economic policies for South Africa's growth.

- IPAP wants a depreciation of the exchange rate to prompt the private financial sector and DFIs to put money into the productive sector. It also wants major investment subsidies and soft loans for investors in the productive sectors from the IDC. Industrial support, such as that available to the motor vehicle manufacturers, and more programmes to enhance manufacturing competitiveness, are advocated. It is very supportive of local procurement policies, and a very strong advocate of beneficiation.

  Labour market reform is given no consideration at all.
- The NGP, taking a somewhat different position on the exchange rate than the IPAP, says we need a more competitive exchange rate, but that this will only work if it is followed by fiscal restraint and control of wages and prices. It, too, calls for expansion of IDC and the DFIs, as well as for significant investment subsidies. Improved financing, the NGP suggests, could be effected through a development bond, mobilising resources from retirement funds, and utilising the Government Employee Pension Fund and Public Investment Corporation. It is fully supportive of IPAP's industrial policy, including public procurement policy reform. It supports sector support policies for a wide range of economic sectors.

  In relation to the labour market, in addition to arguing for wage restraint, the NGP proposes the tightening of regulations regarding subcontracting, labour broking, and outsourcing. It also proposes support for unorganised labour, particularly in the agriculture sector.

- You don't find support for nominal devaluation in the NDP because it argues that the conditions for effective devaluation, which are flexible labour and product markets, do not exist in South Africa. It also favours local procurement, but with a word of caution that this might jeopardise growth because it is expensive and may result in delays, etc. It says beneficiation is an inappropriate priority because of the country's power supply constraints. Unlike IPAP and the NGP, it says government should encourage the financial sector as a source of comparative advantage, together with retail and business services. In relation to the labour market, the NDP calls for various reforms to raise employment, including a youth wage subsidy, wage restraint, and support for the labour placement sector. It would simplify dismissal procedures and give firms much more flexibility on the hiring and firing. So this really is an easing of the labour market with a view to encourage, particularly, new entrants to come into the labour market. This is in marked contrast to the NGP.

Table 3: Policy proposals made by the three documents.

	IPAP	NGP	NDP
Exchange rate	• Unqualified support for depreciation	• More competitive • Requires - fiscal restraint - accord on wages and prices	• No nominal devaluation • Conditions for effective devaluation do not exist
Development finance and capital subsidies	• Expanded DFIs • Investment subsidies	• Expanded DFIs • Investment subsidies • Development bond • State-owned bank for rural areas	• None advanced
Local procurement	• Unqualified support	• Unqualified support	• Caution on higher costs jeopardising growth
Sector support strategies	• Very wide ranging industrial policy, with an emphasis on beneficiation	• IPAP plus: - infrastructure - agriculture - mining - green economy - tourism - high level services	• Protect sectors with long-term prospects • Short-term support measures for industries affected by cyclical downturn • The financial sector • Retail and business services

In relation to the labour market, the NDP calls for various reforms to raise employment

	IPAP	NGP	NDP
Labour market	• No consideration	• Productivity accord • Tighten sub-contracting, labour broking, and outsourcing. • Support for workers in unorganised sectors to achieve greater organisation	• Youth Wage subsidy • Wage restraint • Regulation and subsidy to labour placement sector • Unfair dismissal not to apply for probation period • Simplify dismissal procedures • Migration policy reform to attract more foreign skills

Annabel Bishop

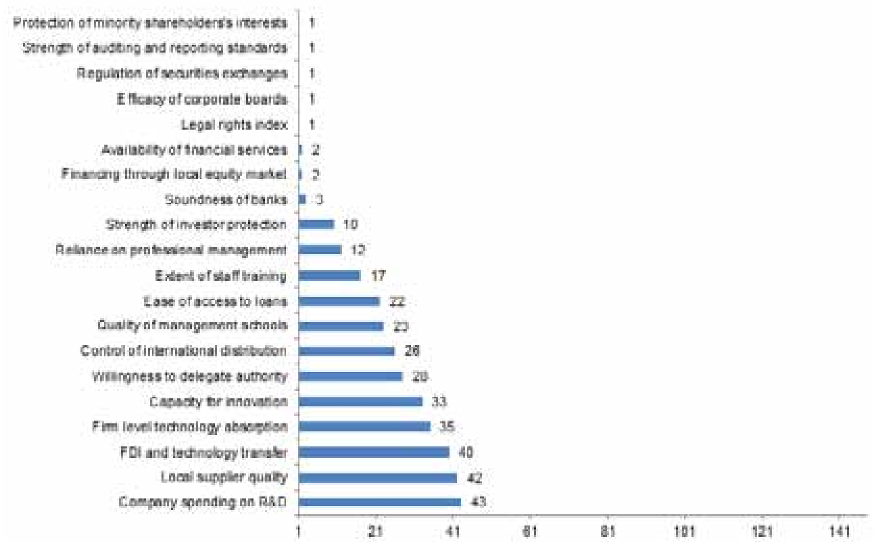
Group chief economist, Investec Bank Ltd

South Africa already has a highly-rated private sector

Achieving growth in adverse circumstances necessitates successful public sector policies. An active, forward-thinking state, which is commercially orientated towards driving and supporting a free market environment for business, is vital in achieving accelerated economic growth. This can only be accomplished through continual, active engagement with a broad number of private sector individuals, particularly business-owners and managers. It is crucial for a trust-based working relationship to be established in South Africa between the public sector and business, and for labour to be included in this. this is necessary to stem the ongoing loss of global competitiveness South Africa is facing. Indeed,since 2010, economic growth has been slowing alongside this loss of competitiveness.

Uncertainty about the implementation of proposed policies is reducing business confidence. Policies need to clarify the respective roles of business and government. Government must assist businesses to expand, invest, employ and generate higher profits for government to tax. Currently businesses do not rate highly government's provision of services for improved business performance. In addition, complying with government administrative requirements is seen as excessively burdensome.

Figure 5: Rankings in 2013 (out of 148 countries)



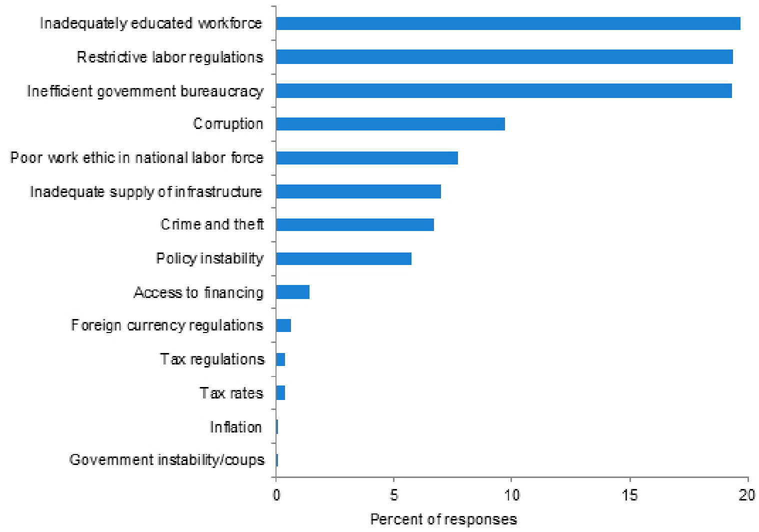
Source: Global Competitiveness Report 2013/14

South Africa already has a highly-rated private sector. The Global Competitiveness Report (WEF) shows South Africa's private sector is ranked first out of 148 countries in five categories while its banking sector is the third soundest in the world.

This contrasts with the basic requirements for economic success in which South Africa performs poorly, namely efficient government bureaucracy, good health, the costs of crime, the extent of corruption, labour market efficiency and the existence of an adequately educated workforce.

While many countries' government finances have been improving, South Africa's have deteriorated recently

Figure 6: Most problematic factors for doing business in South Africa



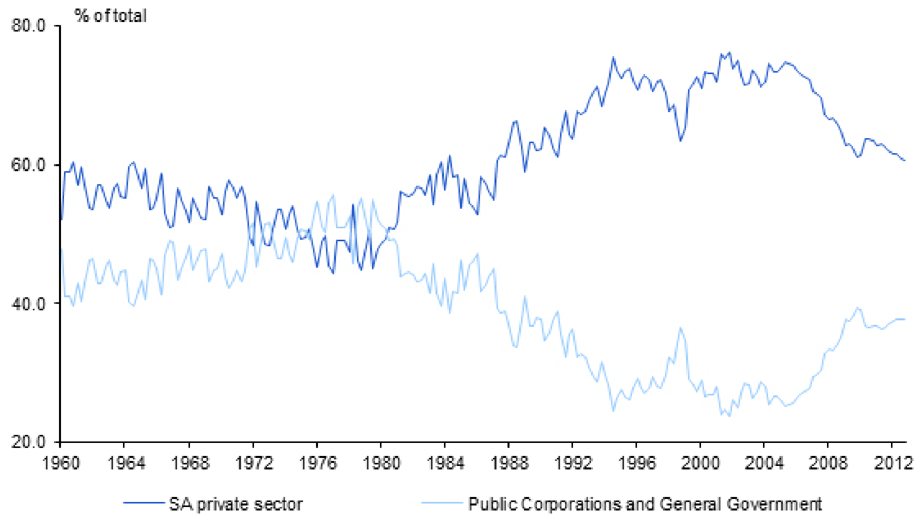
Source: Global Competitiveness Report 2013/14

While many countries' government finances have been improving, South Africa's deteriorated recently. Strike action negatively impacted corporate profitability (and hence tax revenue), while spending on civil servant salaries and wages has increased substantially, both because settlements are higher than budgeted for, and because more civil servants are being employed. Real expenditure exceeds revenue, with the budget deficit widening and the government borrowing to fund it. Indeed, borrowings are being used to pay for current expenditure such as civil servant remuneration and social welfare.

Public sector debt servicing costs now account for 10 per cent of total government expenditure, and are rising rapidly. South Africa's credit rating was downgraded recently as the forecast period for fiscal consolidation was extended again, economic growth slowed, and the current account deficit widened. The risk is that this will happen again, and, since corporates cannot have a credit rating higher than the country in which they are domiciled, any further sovereign rating downgrades will increase the cost of doing business.

Corporates are falsely perceived to have failed to invest in South Africa and to be sitting on their cash. This is a misconception. While gross non-financial corporate savings total R370bn, the real value is R218bn. Furthermore, after the depreciation cost of infrastructure non-financial corporate net savings drop to R42.7bn in real terms, below the R46.8bn in 1994. So corporate saving are actually lower now than in 1994. In any event, the private sector still accounts for 60 per cent of domestic fixed investment spending.

Figure 7: Private sector spending as a proportion of total capital expenditure



Source: SA Reserve Bank

Foreign direct investment into South Africa is negligible

Governments of successful emerging markets such as Brazil, India and China have pursued policies that made it attractive for foreigners to invest directly in their economies. However, FDI into South Africa is negligible. The significant current account and fiscal deficits mean we need to import savings. Large current account deficits clearly leave the country open to currency volatility.

Government must ensure businesses flourish, otherwise public finances deteriorate. The NDP aims to triple the size of the economy by 2030 to create 11 million more work opportunities, implying annual economic growth of over 6 per cent. This requires free market policies that reduce regulation, government spending growth, labour market rigidities, and state control and intervention.

DISCUSSION

What kind of jobs?

That IPAP and the NGP envisage employment growth being concentrated in manufacturing and other productive sectors, while the NDP assumes that the bulk of new jobs would be in the services sector, led to a number of questions about precisely what kinds of jobs might emerge as the economy grew.

Speaking about the Indian experience, Prof Panagariya said that the overwhelming majority of new jobs created during the growth acceleration had been in services and construction, and that manufacturing jobs—especially in the formal sector—had barely grown. This was largely as a result of inappropriate labour laws. He noted that jobs in the services sector were important in China also, but said that the Indian experience showed that a key difference between manufacturing jobs and services jobs is that, with the exception of some IT-related services, most of the Indian services jobs that had been created were low-paying and did not offer viable pathways to increased productivity and higher pay.

Prof Kaplan noted that even if South Africa did manage to engineer a rapid acceleration of exported manufactured goods, many of the jobs that would flow from this process would be services in the non-tradable sector as these sectors grew in response to the growth in manufacturing. He agreed with another participant that one of the issues bedevilling economic policy in this arena was the idea of "decent work". This is generally understood in quite static terms as referring to the qualities of a particular job at the present moment: how much it pays, how secure it is, etc. If, on the other hand, the concept of "decency" were expanded to include the notion of whether a job expands the employee's prospects of getting a better job, then there might be less contention over the idea that a significant proportion of new jobs created are likely to be bottom-end services sector jobs.

It is historically very rare for an upper middle-income country to grow that fast for that long

How much growth does South Africa need?

Having heard the expectation of 6+ per cent a year growth for a substantial period of time, one participant noted that framing the country's growth objectives in this way was unrealistic. "It is," he said, "historically very rare for an upper middle-income country to grow that fast for that long, if only because the quantum of growth you need per worker to achieve that kind of growth when you're already a middle income country is larger than is realistically possible. In India, where GDP is $1 500 a year per capita, 10 per cent growth amounts to an annual increment of $150 per person, but South Africa would need 7 or 8 times as much output growth per person to achieve that."

Having noted that it was unrealistic to expect growth of this magnitude for a long period, he said that the assumption that this is what was needed, was premised on the idea that growth would be reproducing and expanding an economy that looks very much like the existing economy. "If, however, you think about trying to grow a different, more labour-intensive economy," he said, "South Africa didn't actually need as much growth as the NDP and other policy documents suggest." Offering a "back-of-the-envelope" calculation, he said that if a low-wage industry were to be created which paid $200 per month to its workers, and if one assumed that inputs per worker averaged $200 per month and profit per worker averaged $200 per month, then even if that industry employed 5 million people, it would amount to just around 11 per cent of the entire national economy. “In other words,” he said, “in principle, we could get 5 million jobs if the economy only grew by 5 per cent a year for two years.”

Other points

Two other important points were made in the course of the discussion. The first was that some aspects of policies under discussion needed to be aligned with the imperatives of competition law. Industrial policy, for example, tries to direct resources and support at particular local champions. This is also true about procurement policies. The participant noted that it’s important that whatever support is offered is done in a pro-competitive manner. For example, if companies are to get preferential treatment in procurement processes, there have to be rules and safeguards that ensure that it’s not about government and corporate South Africa getting together to support monopolies. Also, what support is provided had to be contingent on growing productivity and on fair market conduct. “We need,” she said, “incentive mechanisms that are structured in a way that helps make the economy more competitive, not less.”

Finally, a participant suggested that the desire of DTI and other institutions to set quantified jobs targets when setting out their policy proposals was likely to end in tears. “This,” he said, “was exactly what GEAR did, and its failure to deliver on those promises fatally undermined its legitimacy.”

There are important problems in product markets that constrain growth

The reality of doing business in South Africa

Johann Fedderke

Professor, Pennsylvania State University

I’ve been asked to talk about some work I’ve been doing on how a lack of competition in output markets may have reduced growth in South Africa. In broad terms, I want to suggest that, while we certainly have problems in the labour market, there are also important problems in product markets that constrain growth. In fact, the two tend to support and mesh into one another.

One of the things that is unusual about South Africa’s economy is the large proportion of GDP generated by services, especially financial services. South Africa’s economy also has a relatively small contribution from manufacturing (15 per cent). One important implication of this is that it may just be unrealistic to expect that the manufacturing sector will generate the kinds of growth that some of our economic plans say it will. That may simply not be viable.

An important issue, in this regard, is the extent to which manufacturers are able to set prices and, by implication, restrict output. If they can restrict output to keep prices up, that’s because they do not face sufficient competitive pressures. But it also means that output growth will be lower than it would have been. In this regard, one of the more startling findings of economic research in the past decade is that the mark-up of price over the marginal cost of production in South African manufacturing, estimated at between

54 and 80 per cent, is two to three times higher than in the United States. That is very substantial and there is no evidence of the gap's declining over time.

One way of saying this is that our circumstances are also different from India's: if anything, our manufacturing sector is too dominated by large firms. Worse, the pricing power of South Africa's large firms has grown substantially. In fact, the ratio of the mark-up between large and small firms in South Africa is three times as high as it is elsewhere.

When we looked at China, India and South Africa, we found that in China mark-ups are around 30 to 40 per cent; in South Africa they're in the range of 55-77 per cent; and in India the mark-up is even larger—close to 100 per cent. While in India, unlike in South Africa, there are a large number of small firms present in manufacturing, the existence of a large number of small firms does not in and of itself guarantee competitive pressure. If small firms are inhibited from growth (through product market regulation, the inability to access finance because they have little collateral or due to the existence of credit rationing, for instance), they cannot effectively challenge large incumbents in the market. The absence of small firms in South Africa suggests that such barriers are even more binding than in India.

One of the consequences of these patterns is that in China, productivity growth in manufacturing has far outstripped the rate achieved in services. As a consequence manufacturing has become a large part of the economy—close to 40 per cent. In India, by contrast, manufacturing productivity growth is close to zero, at least in the formal sector, and all the productivity growth is in services. Unsurprisingly, services there are a much larger component of the economy than manufacturing.

What's the logic here? It's quite simple: if you have pricing power, it's because there's less competition and it's easier for firms to maintain market share without having to innovate. In other words, when firms have market power you forgo growth. And this is something we see in South Africa, too, where there's a very strong relationship between productivity growth and pricing power.

My estimate is that for every 10 per cent of the mark-up you can lop off, you'd gain one percentage point of productivity growth per year in the manufacturing sector. Increased competition has one of three effects on firms, conditional on how close they are to the technological frontier. For firms located at the technological frontier, increased competitive pressure leads to increased investment in innovation (think R&D) so that the technology leader can unambiguously "escape" competition. Just behind the frontier, the effect is similar, though smaller. If firms are moribund, and lag far behind the frontier, they are not able to respond to the increase in competitive pressure, and are eliminated by increased competitive pressure. Which of these three effects dominates, is an empirical (not theoretical) question. Our evidence for South Africa suggests the first two outweigh the latter.

The consequence of this is huge. If, for example, we suppose that in the period between 1970 and 2010, South Africa had maintained a mark-up in the manufacturing sector which was 10 percentage points lower than it in fact was (and hence gained 1 per cent in productivity growth per year), the manufacturing sector would be 30 per cent of the economy rather than 15 per cent. In other words, by allowing the pricing power, you leave substantial growth on the table.

The employment effect is symmetrical—even accounting for labour-saving production trends—the doubling of output levels in manufacturing is simulated to have a roughly proportional effect on employment also. So the doubling of manufacturing sector

For every 10 per cent of the mark-up you can lop off, you'd gain one percentage point of productivity growth per year

employment would have been sufficient to reduce the unemployment rate from 27 per cent to roughly 11 per cent.

Having said all this, there is a critical caveat: if manufacturing firms' pricing power was reduced without also liberalising the labour market, avoiding significant employment losses would require increased wage restraint in the labour market.

Nonetheless, since the employment elasticity of growth in South Africa is relatively large, an emphasis on growth policy remains an obvious and immediate policy imperative as a means of raising employment levels. In the absence of buoyant growth, the only alternative is significant wage restraint.

If the key policy implication of all of this is that we have to ensure much more competitive product markets, it has an important implication for the way we think about the growth process. If we are going to have growth, we have to have more competition. But if we are to have more competition, we have to embrace the idea that competition means that some firms, some industries, will fail.

The essence of the growth process is that inefficient old firms and inefficient old jobs are taken out. We need, in other words, to allow firms and sectors to fail. This is something that the Chinese are very good at: there is an enormous amount of turnover in the firms operating in individual sectors in China, and, while some firms survive and prosper, many are allowed to die.

The essence of the growth process is that inefficient old firms and inefficient old jobs are taken out

Roger Jardine

Chief executive officer, Aveng Limited

At the risk of being accused of cheap advertising for Aveng, I want to say that we operate in 30 countries—eight in Africa, some in South East Asia—and I have a very distinct impression of the difference between how we operate there versus how we operate here. In every other market we're in, the only issues that we ever deal with are contractual issues: have we delivered what we said we would deliver? There is very little noise in the system. That's not the case here. Here, we have to deal with a great many demands that are not strictly contractual, a fact that is partly the result of tenders' being very poorly specified.

Now, it's not like South Africa can't do better. I think everyone who's been involved in the process of tendering for renewable energy agrees that it was a relatively seamless, well-managed process. That was made possible because private sector players were brought in to assist in the technical components of the tender. This process was very impressive: the tender documents, put together with tons of external expert assistance, were literally delivered in trucks. So there was a real commitment to scope projects properly, which makes it much, much easier to spec our tenders properly. Then, when the tenders came in, government was able to draw on real expertise in evaluating them.

We need to do this in infrastructure programmes more generally. We are seeing mind-boggling numbers about the scale of government's infrastructure plans: R1 trillion, R2 trillion, R3 trillion. Well, obviously this hasn't happened yet, but when it does, someone will have to scope, adjudicate, reward and manage those contracts. And that's a very technical process which the public sector is not always good at, and which can create mistrust and delays and extra costs. So one of the keys to managing this infrastructure plan is going to be very strong public sector management. Employment creation and infrastructure development and skills development are all part of the same continuum. But our state is not very good at connecting the dots.

Here's an example. When we were building Soccer City, we employed 4 500 people at the peak. In the process, over 300 women were trained in areas that women don't traditionally go into: electricians, crane operators, etc. The fact is, though, that we have no idea where they are now. Why? Because we don't have sustained demand for their work because the infrastructure programme starts and stops and you get a situation of feast or famine with massive projects like the World Cup not being followed up by anything substantial. This creates real problems for the industry, which really needs a more stable pipeline of projects.

But it's not the only problem the industry has. Take our demographics: 40 per cent of the engineers in our workforce are over the age of 55, and another 40 per cent are between the ages of 40 and 55. In the meantime, many younger engineers have left South Africa for overseas work. This is related to the uncertainties about the project pipeline: people just don't know how much work there's going to be. This is the reality of doing business at the moment, and we really need much more certainty. We need, in fact, a clear national infrastructure development plan that tells everyone, including investors, what's going to happen.

Trudi Makhaya

Deputy commissioner, Competition Commission

When competition policy was being conceptualised in the late 1990s, it was a very classical tripartite negotiation process where it was discussed by labour, business and government, all of whom came from very different positions. But it was one area of policy where there was a lot of consensus, and also a lot of compromise. Some came to the process with the idea that competition policy would help challenge the dominance of racially-exclusive capital. And, in fact, this is transformative policy that can create a more inclusive economy—one with broad-based growth, a strong middle class and opportunities for everyone.

Business approached competition policy cautiously, and this resulted in some compromises such as the restrictive ways in which abuse of dominance can be challenged. This limits the competition authorities' discretion, and there are very specific tests about how you can challenge those types of behaviour and what you need to prove in court. Companies are also able to defend their practices on the basis that they increase economic efficiency, for example. The fact is, though, that the South African economy still has worrying degrees of dominance and excessive pricing power.

It's important to recognise that our competition law doesn't have a problem with dominance; its focus is abuse of dominance. The law also prohibits behaviour that is common in concentrated markets, such as collusion. The cement industry is the focus of competition law challenges across the world. Why? Because the product is homogenous, it's highly capital-intensive, and there are huge economies of scale. So you always have very few players, and there are often problems of cartel-like behaviour. Now, as I said, we are not against dominance per se—firms can grow as much as they like as long as they do it in a way that is pro-competitive and they don't restrain other firms. But, for a product like cement, higher prices have huge knock-on effects for the rest of the economy and its competitiveness. So our approach was based on the recognition that it's not about the size of the firm or its success, but what you have to do to enable the economy to succeed.

Firms can grow as much as they like as long as they do it in a way that is pro-competitive and they don't restrain other firms

The fact is that a lot of our markets have one or two large players. In itself, that's fine. But it's the way that dominance is being used that is still quite problematic. In this regard, one of the myths about competition policy is that we target private sector companies. But, if you look at the penalties we've imposed, some of the highest have been imposed on companies like South African Airways and Telkom, which are state owned but operate in liberalised markets. So we're actually challenging a lot of policy-driven anti-competitive behaviour. Two points need to be clarified: we act against all anti-competitive behaviour, and we don't have a principled issue against dominance—it's how that dominance is used that's often the problem.

Now, I don't want to play the game of also trying to pass the buck, but clearly competition policy is only one instrument of challenging that legacy of anti-competitive and lack of competitiveness. Clearly, competition policy cannot overcome all the structural reasons that the economy is not especially competitive—the lack of skills, for example, and constraints in access to finance.

Initially, most of the commission's work revolved around assessing the implications of mergers and of the conduct of large companies such as Telkom. More recently, we've been looking harder at cartels. One of our most important interventions was in relation to bread prices, where we found lots of problems across the milling, baking, and retail of key staples. This followed a series of sectoral studies looking of abusive behaviour and it showed the extent of anticompetitive behaviour in some basic markets.

South Africa's export growth is disappointing, especially since 2008, when compared to other countries'

Dr Chris Loewald

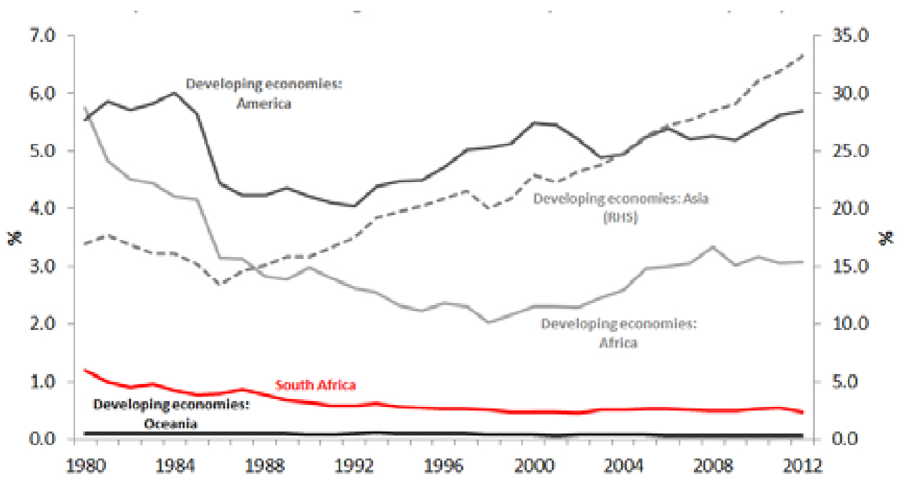
Deputy head of research, South African Reserve Bank

South Africa's various policy documents deal differently with the role of the exchange rate in explaining our disappointing growth. I want to talk about whether the value of the Rand or its volatility really matter. Frankly, I am sceptical about the Rand's being a big factor in all this, and will explain why. The question to ask is whether the exchange rate is a scapegoat for an issue that is essentially about our domestic cost structure.

South Africa's export performance and the Rand

As you know, South Africa's export growth is disappointing, especially since 2008, when compared to other countries'. This is reflected by the fact that our share of world exports is declining. How much of this is about the value of the Rand and its volatility?

Figure 8: Exports of merchandise goods and services (share of world exports)



In relation to volatility, the evidence of its impact on exports is elusive. The range of firms involved in exporting (mostly very large firms, that are also involved with importing) suggests that volatility is either a small problem or one that's been solved by hedging. However, volatility is likely to be a problem if we want to see the emergence of small tradeables producers. It is quite plausible that some firms that might have come into existence have not because of the degree to which the value of the Rand is unpredictable. Still, despite the fact that the Rand is more volatile than other currencies, and despite the fact that the policy consensus seems to be that volatility is reducing growth, the recent empirical literature finds little or no impact of volatility on the level of economic activity. This is true whether one looks at individual sectors or at the economy as a whole. Even in the case of manufactured exports, in the medium and long-term, the impact of exchange rate volatility on the volume of exports is dwarfed by the impact of foreign demand.

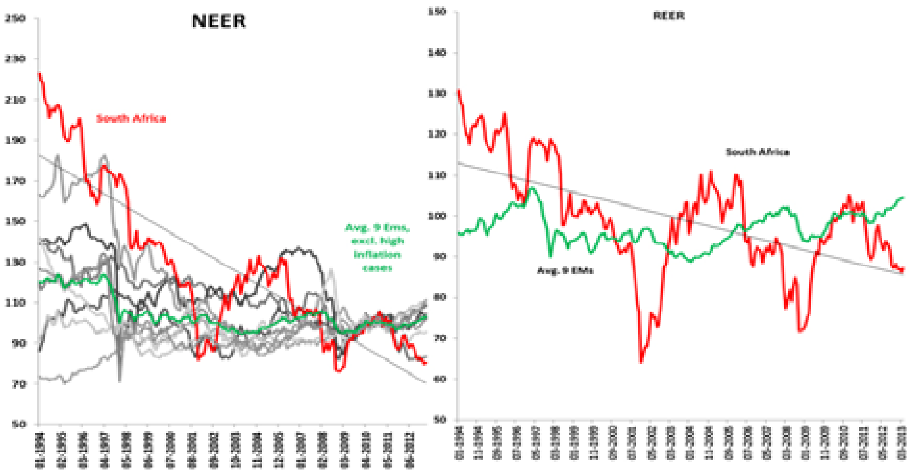
We should focus on the price of our output, not the nominal exchange rate

So if volatility doesn't seem to matter, what about the level of the Rand? Does that affect growth and exports?

Well, the literature says that an undervalued currency stimulates growth, particularly for developing countries, and that an overvalued currency reduces growth. So, global development experience shows that keeping the real exchange rate at competitive levels can be critical for jump-starting growth. Importantly, though, this is not the same thing as saying that exchange rate policy can substitute for the presence of a disciplined labour force, high savings, or investor-friendly business climate.

In relation to South Africa, the key finding of the literature is that we should focus on the price of our output, not the nominal exchange rate. This is clear, in part, from the fact that since 1994, South Africa has achieved real effective exchange rate depreciation, attendant on a big nominal depreciation. And, if you think of our competitors as being emerging markets, we've had a larger depreciation than they have.

Figure 9: Since 1994 has achieved real effective exchange rate depreciation

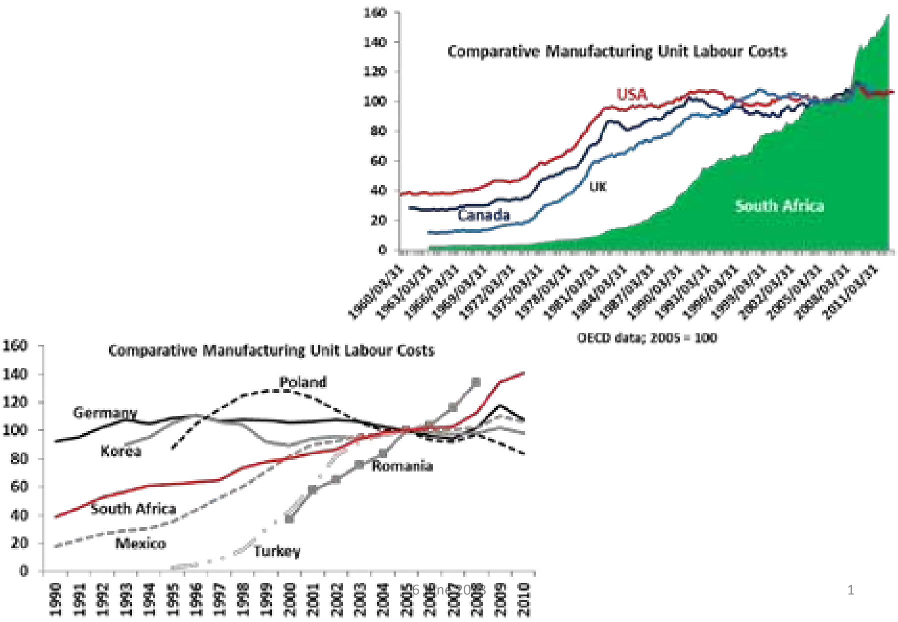


Matters are a little different, however, if you look only at the last ten years, when there's been quite strong nominal depreciation. Because we've had higher inflation than our trading partners, this hasn't translated into a sustained real depreciation over the period. There have also been some periods of significant real appreciation, which have reversed the episodes of real depreciation. So over the last 10 years, it is certainly fair to say that the real effective exchange rate has been quite volatile, if not on a daily or monthly basis, then over several years. This has definitely had some impact on the way business is done, on levels of investment, and so on.

If you compare South Africa's unit labour cost, you can see that we've done quite badly against both developed economies and against emerging markets

But we need to see these data for what they are. What they really show is not that the nominal level of the Rand is critical, but that we have a serious cost problem. If you compare South Africa's unit labour cost, you can see that we've done quite badly against both developed economies and against emerging markets on both measures. And obviously this matters quite a lot in this recent period of financial crisis. Indeed, in the global financial crisis, our domestic costs measures have risen much faster than is commensurate with maintaining a certain level of competitiveness.

Figure 10: South Africa has a cost problem



Policy implications

How have countries dealt with this issue of over-valuation of the exchange rate? Well, some, like Brazil, have intervened, and the question is whether we should be intervening more.

The problem with this is that the foreign exchange markets is really a big player's game. If you want to play the intervention game, there are no easy options for a country with limited reserves and a reasonably large fiscal deficit. In that context, one problem with intervention is the impact of capital controls on the cost of capital and, hence, the cost of financing the fiscal and current account deficit. It is also not clear how effective controls are, with the international experience being mixed at best. Direct intervention in foreign currency markets should be more effective in achieving some movement in the currency, but we know little about how big such interventions should be nor how to implement them. We also know that using interest rates on an ongoing basis to limit currency volatility hurts GDP growth. More generally, it's easier to impact the level of currency when you are in a position of saving than when you need to borrow to finance the deficit, because real depreciation occurs when saving and investment rise relative to consumption.

So, let me conclude. There is more consensus that Rand volatility is a really big problem than there is evidence that this is so. In relation to the value of the Rand, we know that the real effective exchange rate matters for competitiveness. But we also know that there has been quite a lot of real depreciation since 1994. From a policy view, the question is how we should think about limiting the episodes of real appreciation through competitive market forces and appropriate regulation.

> The South African goods market is more heavily regulated than France's or the UK's or Germany's

DISCUSSION

Some important issue were raised concerning Prof Fedderke's finding that South African manufacturers have significant market power and are able to command unusually high mark-ups. Prof Panagariya said that, speaking as a trade economist, he would be very surprised if such high mark-ups could be maintained in a country with a reasonably open trade regime. He argued that if exceptionally high mark-ups were a feature in South Africa, whose trade regime is quite open, this might simply reflect higher levels of perceived risk, in which case the mark-ups simply meant that returns on capital had to be higher to attract investment. The only other alternative, he said, was that imports to South Africa were very imperfect substitutes for local goods, which could, therefore, attract premium prices.

Prof Fedderke said that, while he in principle agreed with Prof Panagariya's view that an open trade regime should mean the whittling away of exceptional mark-ups, repeated explorations of multiple sources of data continued to show that mark-ups were around 50 per cent higher in South Africa than one would expect. This did not appear to be a risk premium, because such a premium could not be found, for example, when comparing bond prices and returns (though this was evident in the 1980s when the country was much less stable). This finding—that the mark-ups found were an indication of pricing power rather than a risk premium—was confirmed by data that show the extent of concentration in South African industries, many of which are dominated by only one or two firms.

Prof Fedderke offered two reasons why the high mark-ups might be consistent with South Africa's trade regime. The first is that the extent of trade liberalisation in South

Africa was often exaggerated by commentators, and effective tariff rates, when weighted by GDP, were not as low as might be expected if one looked simply at their nominal levels. The second was that product market regulation was very significant in South Africa with the regulatory burden on manufactured products being higher in South Africa than in all but one country for which the OECD publishes an index of regulatory intervention. In fact, the South African goods market is more heavily regulated than France's or the UK's or Germany's. This regulatory burden acts as an important barrier to entry in manufacturing, and protects incumbents from competition from new firms.

KEY INSIGHTS

South Africa's economy is in trouble. With unemployment (which is most appropriately measured using the broad definition) running at 34 per cent, and with barely 40 per cent of adults in employment, the crisis in the labour market is the country's most serious. But critical challenges exist elsewhere, too: there are concerns about the size and trajectory of the budget deficit; investment rates are low, and because savings rates are even lower, the current account is in persistent deficit; long reliant on the carry-trade to boost its value, the exchange rate has become increasingly vulnerable, a phenomenon that could lead to rising inflation and might also affect capital inflows. Add to all of this the many supply-side constraints on growth—the lack of investment in electricity generation capacity, the scarcity of skilled labour, expensive but inadequate network infrastructure, and rising levels of labour strife—and the result is that South Africa's continued economic progress seems increasingly uncertain. It is clear South Africa needs a strategy to grow faster.

Between 2003 and 2008 the country saw rising levels of employment, with two million net new jobs created or about 1000 new jobs a day

Growth really matters for poverty

The centrality of economic growth to resolving or ameliorating most of South Africa's socio-economic challenges is widely accepted. But precisely how important growth is to reducing poverty was emphasised by Prof Arvind Panagariya, who showed how the rapid acceleration of economic growth in India between 1991 and 2010 had reduced poverty far more rapidly than previous policies—many of them described by their proponents as being "pro-poor".

Prof Panagariya identified two mechanisms through which growth reduced poverty. First, increased economic activity was directly reflected in rising incomes as people moved into more productive jobs or as incomes rose in their existing jobs. Second, growth increased tax revenue, providing the resources for poverty-alleviation schemes such as the employment guarantee scheme in rural areas.

This has been South Africa's experience, too. Between 2003 and 2008, when annual growth averaged over 5 per cent, the country saw rising levels of employment, with two million net new jobs created or about 1 000 new jobs a day. The result was that the rate of unemployment fell by six percentage points and incomes rose for many. In addition, increased tax revenues allowed government to expand the social safety net, with the number of people receiving social grants rising from under 6 million in 2003 to over 12 million in 2008.

There is, therefore, clear evidence that rapid and sustained economic growth has the potential to impact very strongly on levels of poverty. And this has happened in as large a country as India and as unequal a society as South Africa's.

South Africa has been ambivalent about growth

As was emphasised by a number of participants, South Africa's attitude to growth has sometimes been ambiguous and ambivalent. On the one hand, government has repeatedly proclaimed a desire to see the economy grow more quickly; on the other, it has also emphasised policies that undermine growth and has invested considerable energy and resources in policies that are primarily redistributive in character. While this has raised the living standards of the poor, the expansion of redistributive spending has had no impact on inequality and only modest effects on poverty. The central reason for this is the slow pace of employment growth. As impressive as South Africa's creation of net new jobs was during the boom years, the loss of jobs during and after the financial crisis has been more rapid than in almost any other country in the world, and unemployment remains very high. This reinforces the key point: for South Africa to create large numbers of jobs, the economy has to grow quickly.

How much growth is needed? The answer depends on some important assumptions. One estimate—from the NDP—is that the country must grow at over 5 per cent a year until 2030 to create the 11 million jobs it says will be needed. But this is only true if future economic growth has the same structure as it did in the last period of economic growth and has similar employment effects. If future growth is less heavily biased towards skill- and capital-intensive sectors and more concentrated in labour-intensive industries South Africa will generate considerably more jobs per unit of economic growth.

If future growth is concentrated in labour-intensive industries South Africa will generate considerably more jobs per unit of economic growth

The fact that different patterns of growth have different implications for employment is important in light of the considerable differences in the approach to economic policy exhibited in government's three most significant economic policy documents—the Industrial Policy Action Plan (IPAP), the New Growth Path (NGP) and the National Development Plan (NDP). Given that all three agree that employment growth is the economy's key challenge, the country needs to prioritise strategies that would increase growth rates and increase the overall labour-intensity of the economy.

South Africa's three growth plans

South Africa has three core economic policy documents—the NGP, released by the Economic Development Department in 2010; the Department of Trade and Industry's IPAP, produced in 2010 and updated in 2012; and the National Planning Commission's NDP, released in 2012.

All three documents place employment growth at the centre of South Africa's economic policy challenges, but each offers a different (sometimes mutually incompatible) diagnosis of the challenges the country faces. The three documents also offer different (again, sometimes mutually incompatible) recommendations about the policies needed to address the challenge. And, while employment growth is the key objective of each document, there are important differences in the absolute size of the targets and timeframes. In addition, there are important differences in the subsidiary and complementary objectives included in each document. One of the most significant of these is that, while the NGP explicitly endorses the view that all new jobs must be "decent" (though it does not provide an operational definition of the term), the NDP suggests that mass access to employment is the immediate priority and that the quality of these jobs will rise over time.

There are also important differences in how the three documents describe and explain South Africa's economic trajectory over the past few years.

IPAP and the NGP suggest that the core reason for slow employment growth has been the growth of sectors dedicated to "consumption" at the expense of those dedicated to "production". Both documents suggest that the growth of the financial sector is a cause and consequence of this trend, but offer differing accounts of how this has happened.

By contrast, the NDP sees the financial sector as one of South Africa's comparative advantages, and offers no analysis compatible with the idea of there being an imbalance between consumption and production. Instead, it suggests that the root of the economy's challenges is that it has succumbed to a "middle-income trap" (in which it is unable to compete against low-wage economies of East Asia in light manufacturing because the cost base is too high, but lacks the skills and capacity for innovation to compete in high value-add sectors). The NDP also suggests that local industry is overly-concentrated, and that this stifles growth and innovation. Unlike both IPAP and the NGP, the NDP sees the labour market as too tightly regulated, with those regulations playing a big role in explaining unemployment.

The NDP can be read by different constituencies as supporting a range of potentially mutually exclusive policy proposals

Given these divergent analyses, there are big differences in the policies proposed: IPAP and the NGP seek to drive employment growth through industrial policy interventions (though the sectors prioritised in the documents are not identical), while the NDP expects that employment growth will be driven by growth of small scale services businesses.

While there is some consistency in the approaches of IPAP and the NGP (though IPAP has a narrower focus), the assessment of the roots of poverty and unemployment offered by the NDP differs quite markedly from theirs, as do the resulting policy recommendations. Some of the biggest differences between IPAP/NGP and the NDP relate to industrial policy, interest rates, and the external value of the Rand. Particularly stark differences emerge in relation to labour market reform, where the NDP's approach, which would liberalise some aspects of the labour market, contrasts with the emphasis in the NGP on ensuring that new jobs conform to (undefined) norms of "decent work" and its proposals to strengthen and tighten the regulation of parts of the labour market, particularly so-called "labour-broking".

These differences make it clear that South Africa does not have an agreed approach to economic growth in the cabinet. They also make it impossible to define, describe and sell a coherent policy vision.

Could the NDP become South Africa's growth plan?

Despite its endorsement and embrace by a broad range of official structures in the ruling party, the cabinet and other organs of government, as well as by a variety of other constituencies (including organised business), the depth of support for the NDP remains uncertain.

That the NDP has found support outside of government is unsurprising, given that the document, along with the diagnoses that were released before its publication, offers the most frank and serious official assessment of the country's trajectory. Uncertainty about the strength of government's commitment to the NDP, however, reflects on-going debate about policy within the structures of the ruling alliance and the antipathy for the

NDP's leading political sponsor felt by some constituencies in the alliance. Another factor concerns the structure and content of the NDP, which was described by participants at the Round Table as "reading more like an intervention into a larger political debate than like the resolution of that debate" and, by others, as consisting, in some measure at least, of "whimsical poetry", "wild extravagance" and "options analyses".

The NDP's length—it's nearly 500 pages long—and the range of issues it covers, may also be working against its becoming the core of a national vision. A key problem, for example, is that it can be read by different constituencies as supporting a range of potentially mutually exclusive policy proposals. Thus, readers can interpret it as supporting quite divergent visions of the role of the state in the economy. In addition, its breadth means that the uneven implementation of all its proposals could result in very different policy mixes and outcomes. For this reason, the detail and sequencing of policy implementation will shape and reshape the vision of the NDP. All of this makes it difficult to see the NDP as representing a clear, consistent and coherent vision of the future trajectory of public policy.

In sum, there are considerable differences between the country's three most important economic policy documents and the government departments from which they originate, reflecting different views about the way the economy functions and how that might change over time.

To be fair, some differences might be explained by different objectives and mandates. By its nature, for example, the NDP must take a view on a wide range of factors that can and will impact on the country's developmental trajectory; IPAP, by contrast, is more narrowly focused on a range of industrial policy interventions, and, while likely to be impacted on by other forces, treating them in isolation is not entirely unreasonable. Nonetheless, it is clear that different ideas about economic development and priorities for growth are present at the centre of government, differences that are too large to allow the three to cohere into a single vision and approach to economic policy.

Different ideas about economic development and priorities for growth are present at the centre of government

These differences and contradictions introduce uncertainty for economic actors—here and abroad—about the content, nature and direction of government policy. Worse, the direction of public policy appears to be hostage to unpredictable political battles within the ruling alliance. All of this leads to a degree of paralysis in South Africa's current approach to economic strategy.

South Africa needs an agreed growth strategy

South Africa faces a challenging global and domestic policy environment. What is required is an understanding, shared by key players in government and across society, about the fundamentals of South Africa's present situation and the direction in which to take the economy. A leap of faith may be required based on our best understanding of what has worked elsewhere, what has already been tried unsuccessfully here, and what might provide the country with the best road forward.

The NDP has wrestled with some of the difficult issues facing the country, though it does not clarify or resolve all of the "tough choices" that it says must be made. And, while various participants at the Round Table offered their assessment of some of the priorities for a growth strategy—investment in infrastructure, increased trade with fast-growing African countries, etc.—a conversation of this type cannot engage fully with all the issues that need to be considered. Having said that, there are some areas on which it is relatively easy to see what is needed. Some of these were identified by various participants at the Round Table:

- *South Africa needs to "stop scoring own goals"*. Ranked against other countries, South Africa's economy has many strengths—good corporate governance, stable financial institutions, considerable natural endowments, and good, if aging, infrastructure. But it also has many weaknesses, some of which relate to the quality of the workforce, the regulation of the labour market and the costs employers incur in hiring and firing employees. While some of these challenges will take time to overcome, policy-making energies should not be directed at aspects of the economy that work relatively well, but at those where we fare badly.
- *Faster growth requires considerably higher levels of investment than has characterised the economy over the past four decades.* The key challenge is to persuade investors that appropriate policies will be implemented and that they will be pursued over the medium and long-term. Macroeconomic vulnerabilities (and, therefore, costs) increase when societies rely too heavily on foreigners to finance investment. So, if South Africa is to invest more, it needs also to save more so that already large external imbalances do not grow larger.
- *Education reform is critical for growth and inclusion*. South Africa's stock of human capital is too small and, because the education and skills systems are weak, it is growing far too slowly to support faster economic growth. These systems must be fixed if the country is to have the entrepreneurs and workforce needed to generate rapid growth. Bold decisions are required to deal with performance management in the public system, value for money and the political obstacles that prevent these two essentials being met. We should also be tapping the power and innovation of markets, entrepreneurs and NGOs in helping to improve and transform the schooling system.
- *Skilled migrants are essential*. In the short-term, South Africa should seek to attract far more skilled people (professionals, teachers, managers, entrepreneurs) to help train South Africans, manage projects, start new businesses. This may be easier to do now, when the economies of much of the developed world are depressed, than it has been for a generation. Rapidly increasing the supply of skills in this way would have the added benefit of reducing the skills premium which would both lower the cost of doing business and reduce wage inequality.
- *Faster growth requires more efficient and affordable public infrastructure, especially transport, roads, energy, water, and logistics*. How can we get higher growth when South Africa's mines have to cope with periodic load shedding in order to keep the lights on in the suburbs? The country needs to invest in its infrastructure if it is to create the platform for faster growth. Public sector management of infrastructure spending needs to be professionalised to ensure that value for money is obtained from all tenders. This in turn means that appointments need to be made on merit, not patronage or political loyalty. And the role of the private sector in infrastructure provision should be maximized and not minimized.
- *The governance of the country's most economically important areas must be improved*. While improving governance everywhere would be ideal, focusing public sector reform initiatives in the metropolitan areas—in which nearly 60 per cent of economic activity takes place—would kick-start growth and governance reform. Getting governance right in these areas ought to pose fewer challenges and have a disproportionately large impact on the economy. Key appointments in

How can we get higher growth when South Africa's mines have to cope with periodic load shedding in order to keep the lights on in the suburbs?

the metros need to be made on the basis of ability rather than party (or factional) loyalty.

- *Opening the economy to new firms and greater competition*. Concerted efforts are required to change the business environment in the country so as to encourage new firm entry, more competition, and much greater innovation and economic efficiency.
- *Improving trust and cooperation among key constituencies*. Trust deficits between business and government and between business and labour are an important source of current social, political and policy uncertainty. South Africa needs an economic strategy that all constituencies believe is in their interests and believe will deliver results. Only then will they work together and not at cross purposes. The most important challenges are two-fold. The first is that labour relations have become increasingly fraught and conflictual, and are doing considerable damage to the economy and its prospects. This trend must be reversed. At the same time, resolution of these challenges should not be at the expense of the unemployed whose interests are sometimes forgotten when organised business, labour and government negotiate. Relations between the state and business are a second area that requires attention, with business leaders feeling that their concerns are not taken sufficiently seriously in the corridors of power, and a cynicism about consultation processes taking hold.

While there is a degree of heterogeneity among these priorities, they cohere around the idea that South Africa needs to reduce the cost of doing business by reducing risk, lowering the costs of employing people (both skilled and unskilled) and/or increasing the productivity of labour, reducing mark-ups, and reducing the overall cost of public services.

These priorities, they cohere around the idea that South Africa needs to reduce the cost of doing business

One response to this challenge (offered by IPAP and the NGP) is a weakening of the currency which would, so they argue, increase the competitiveness of South African goods and services on international markets. However, as the Round Table heard from Dr Chris Loewald of the South African Reserve Bank, there is some doubt about whether the value of the Rand or its relative volatility in comparison to other currencies, has actually had a significant impact on the size and competitiveness of South African industry. This is not quite the same as saying that a once-off devaluation would not make South Africa more competitive, however, but this could only result in increased competitiveness if a nominal depreciation were not offset by higher inflation. Whether the country has the ability to turn the recent nominal depreciation of the Rand into a real depreciation—by ensuring the improved competitiveness on international markets isn’t offset by higher inflation—remains to be seen.

Some of the “tough choices”

While there are areas in which the substance of a plausible growth plan seems relatively straight forward, one of the features of all three of South Africa’s economic policy documents is that they fail to grapple with some really fundamental issues. The NDP hints at and talks of “tough choices” but does not go into them sufficiently, sometimes not even defining the tough choices involved. Here we identify three of the most important.

South Africa's growth strategy must prioritise labour-intensive industries

The point is frequently made that South Africa needs to grow at around 6 per cent a year for a generation if it is to achieve an employment to population ratio that is closer to global norms and that meets our national needs. But is this correct?

The idea that we need very high levels of growth for a very long time is founded on the assumption that future growth needs to look a lot like past growth. But what happens if we weakened this assumption? In addition to freeing up the economy in all the ways traditionally discussed (less red tape, more competition, etc.) South Africa could and should encourage the emergence and growth of a large low skill, low wage manufacturing sector. Newcastle's garment industry, for example, could be encouraged to grow rapidly and to attract some of the millions of manufacturing jobs that rising wages in China may be making uncompetitive. In other words, if we said that what South Africa needs is to dramatically grow its low-skill, low-wage sector, less growth would be needed to achieve significant employment growth.

This raises the fundamental question: what kind of economy can South Africa reasonably expect to build? This is a question that ought to be at the centre of the debate about economic policy because the country does face some choices in this arena. Yet, apart from some skirmishes on the side-lines, this issue has not yet been fully debated and explored, much less resolved. At its heart there are at least two questions to be addressed:

> If the pursuit of millions of "decent" jobs proves fruitless and condemns millions of South Africans to live without any employment at all, is that a price worth paying?

- Is it really possible to create 5 or 6 million new "decent jobs" in South Africa in the short-term? If so, what has prevented us from doing this over the long period during which this has been the stated objective of government policy? And, if the pursuit of millions of "decent" jobs proves fruitless and condemns millions of South Africans to live without any employment at all, is that a price worth paying? This trade-off needs to be explicitly and clearly debated.
- Is it possible for South Africa to create 3 million and more low-productivity, low-wage jobs? Could we realistically compete with Ethiopia or Bangladesh or Vietnam or Costa Rica to attract some of the world's millions of light manufacturing jobs? And can we do it now as some of these jobs move out of China? What would it take to achieve this? What reforms would be necessary? What would be the social impact of both the jobs and the policy changes that might be needed to attract new investors?

These are some of the most important "tough choices" facing South Africa today. They should be debated much more openly and fully.

We could also test the feasibility and impact of growing a genuinely labour-intensive manufacturing sector by establishing large special economic zones specifically designed to attract these kinds of jobs. And by allowing and encouraging Newcastle's competitive garment industry to grow.

South Africa needs to use the market to address the country's challenges

Few doubt that the majority of new jobs to be created in coming years and decades will be private sector jobs. Even the most ardent advocate of state intervention in the economy or state assistance to industry—whether through a state mining company, industrial policies, trade protection, or wage subsidies—accepts that most of the jobs that such interventions help generate will be in private firms, as will the jobs that might be created indirectly. Despite this consensus, the debate about the role of the market and the state in addressing many of South Africa's most important challenges is still fraught with unresolved issues.

It is vital that the core debates about the role of the state and the market in South Africa are joined much more deeply and openly if we are to develop an effective approach to growth.

Developing countries need smart and effective states to leverage private sector capabilities. Economic and social development requires dynamic, robust private sectors and competitive markets to take on risk and seize opportunities. South Africa has to get this balance right overall and in each sector of the economy and social policy.

Private sector involvement in the delivery of infrastructure, education, healthcare and much more has been critical to raising living standards in developing countries across the world. The need for this in South Africa is increasingly unarguable. In education, for example, a large majority of public schools deliver highly inadequate educational outcomes. While improvement of the public system is needed—and urgently—there is an important role in the system for private schooling (at all levels and especially low-fee private schools) and contract schools (public schools that are privately managed) in raising educational quality. Similarly, there remain considerable regulatory and policy obstacles in many other industries—important examples of which include telecommunications and electricity generation. Here, there is considerable scope for opening up industry to greater competition and competitive forces.

In addition, as both the NGP and NDP suggest (and independent academic research confirms), there seems to be considerable scope for increasing competitive pressures in manufacturing, particularly where barriers to entry for new firms exist. Properly designed and implemented regulatory reform could expand competition and increase output while lowering prices.

Regulatory reform could expand competition and increase output while lowering prices

However, it would be a mistake for the authorities to target firms merely because of their size. Competition policy should be used to attack abuses of market dominance not dominance itself since the latter could be a result of efficiency and economies of scale (and might be necessary for firms to compete internationally).

South Africa's ambivalence about urbanisation holds back growth

South Africa's policy-makers continue to be ambivalent about urbanisation, a process that helped drive economic growth in the developed world, Asia and Latin America.

Urbanisation is one of the key elements in the myriad processes that have seen levels of human productivity explode over the past two centuries. By creating large pools of labour and mass markets for goods, urbanisation has delivered the two critical elements identified by Adam Smith in generating increased productivity: scale and specialisation. It is for this reason that, in much of the world, urbanisation has been associated with rapid productivity growth, rising incomes and much improved quality of life. Despite this, and despite the fact that South Africa is under-urbanised for a country at its level of development, policy-makers frequently emphasise the importance of rural development rather than facilitating a process of more rapid urbanisation and effective management of growing cities. We should not ignore the rural sector, but South Africa's future and the bulk of its economic growth will be found in larger and larger urban centres.

Critical as urbanisation has been to the success of societies that have risen out of poverty, there are numerous examples in the developing world (principally in Africa, parts of Asia, and the Middle East) of urbanisation processes that have not delivered the productivity- and growth-enhancing effects seen among the success stories. It is important, therefore, that South Africa manage the dynamic of urbanisation and growing metropolitan areas, cities and towns effectively. This should prioritise economic growth as the foundation for improved quality of life and for expanding opportunities for all.

A positive approach to urban growth and increased urban migration is essential because there are no examples of successful middle-income countries whose economies are growing rapidly without large (usually rapidly growing) urban populations.

CONCLUDING REMARKS

South Africa desperately needs faster economic growth. The difficult global environment and the many unknowns involved in achieving higher growth in any country make this challenging. But it is not impossible and the international climate provides opportunities as well as threats. If the country is to grow more quickly, South Africa needs a realistic, workable strategy that has the support of all key constituencies. Little progress is possible with a cabinet as deeply divided on priorities and direction as it is. Higher growth and significantly more employment will require a more open airing, reasoned debate and then resolution of some fundamental issues.

South Africa desperately needs faster economic growth

What kind of growth is South Africa able to achieve? Has the country been too quick in writing off the possibility of building genuinely labour-intensive industries at scale, and has sufficient consideration been given to the implications of failing to do this? What would a package of reforms comprise that would get South Africa much more growth in this sector at a time when international firms are looking for alternatives to China?

How can business, labour and government find common ground so as to work together on a plausible approach to growth? What role for leadership in reconciling divergent views with the national interest? How do we maximize the role of markets and entrepreneurs in moving South Africa to a higher growth path? Are there changes to competition policy that are needed if South Africa is to ensure a robustly competitive domestic market as well as provide the platform for international competitiveness?

These are some of the tough choices the country needs to debate openly and then resolve in the national interest. There is no question that economic reform—especially of the labour market—is politically difficult. And it is particularly difficult when those who are likely to resist change have the capacity to disrupt the process and impose costs on others, while those who will benefit are unorganised. It is for these reasons that political leadership is so important in articulating what is in the national interest and leading the process of building trust and securing sufficient consensus about the need for, and direction of, change.

For all its weaknesses, some of which are the direct result of the fact that the process of building consensus is incomplete, the NDP represents an important milestone in the quest for defining and consolidating a vision for South Africa that must underpin future economic policy-making. This is the best starting point the country has, and it can serve as a platform for debating and convincing people about the tough choices that must be made. The NDP itself is imperfect, but the diagnoses that back it up demonstrate conclusively how undesirable our present trajectory is and the necessity for reform.

Achieving higher growth in South Africa is urgently necessary. Making sure that this growth results in millions of new jobs is equally important. The country needs to move beyond its present impasse and make the "tough choices" to enable growth. At the very least we need to agree on some major experiments in parts of the country to test new directions and possibilities that could generate economic growth and employment at the scale required.

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