CDE INSIGHT

RAISING SOUTH AFRICA'S 'SPEED LIMIT'

A presentation by Ricardo Hausmann

Ricardo Hausmann is the Director of Harvard's Center for International Development and Professor of the Practice of Economic Development at the Kennedy School of Government. He was the Minister of Planning of Venezuela (1992-1993) and was a member of the Board of the Central Bank of Venezuela. He also served as Chair of the IMF-World Bank Development Committee. Professor Hausmann chaired the International Panel on the Accelerated and Shared Growth Initiative (ASGISA) that advised the South African government between 2004 and 2008. The group was made up of 29 academics, primarily economists. They submitted their recommendations in 2008. On a recent visit to South Africa, Professor Hausmann spoke at a meeting hosted by the Centre for Development and Enterprise. He reflected on his past engagements with the South African economy and assessed their relevance in the light of the challenges now confronting the country. Professor Hausmann's insightful analysis, based on leading an intensive and multifaceted study of South Africa's economy as well as subsequent reflections, is, in many respects, congruent with CDE's ongoing calls for higher rates of job creation, greater policy certainty and immigration reform. This report presents an edited version of Hausmann's talk and, in a series of boxes, points to these areas of congruence.

Introduction

To understand South Africa's poor economic performance since the end of apartheid, and especially in the last decade, we must focus on key features that set the South African economy apart from many other, more successful countries. The very low levels of labour participation in South Africa are a good place to start. Relatively few people are looking for work, and those who are, find it very difficult to make it into a job. This has to be overcome if the country wants to have any hope of creating opportunities for the poor. To create the jobs that South Africa needs, significant expansion of export sectors must urgently take place. Unfortunately, South Africa's export performance is dismal. Mineral exports are declining and manufacturing remains stagnant. Until these structural

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problems are overcome South Africa will not grow and unemployment will remain unacceptably high.

Driving above the economic 'speed limit' that the current environment imposes will only lead to further problems. What South Africa needs is to implement the changes that will permanently raise this limit. To do that some core policy challenges must be addressed urgently.

Mineral beneficiation has long been considered by many in government and the ANC as the panacea for South Africa's woes, but focussing on this relatively difficult to achieve economic outcome is unnecessarily costly while preventing policy makers from seeing other opportunities for economic development.

Black Economic Empowerment (BEE) of some sort is certainly necessary in South Africa, but too much emphasis in the existing policy framework has been placed on changing ownership, rather than on helping create jobs that can be accessed by ordinary South Africans. BEE is also impacting adversely on the creation of new firms, and thus preventing further job creation.

The country has gotten into a rut of thinking that wage agreements have to be 'progressive', but not whether they should be realistic. This has put the country in a weak fiscal position, meaning there is not enough left for public investment, resulting in major challenges for Eskom, Telkom and other state-owned enterprises.

In general, the country lacks agreement over what the vision for South Africa should be. More prosaically, and partly as a result, the various tiers of government and the private sector are not working towards a common goal or co-operating to achieve outcomes that will benefit the whole country.

Finally, it is critical to alleviate South Africa's skill constraints. The cheapest and most effective way to do that is to encourage skilled immigration. Unfortunately, recent immigration policy reform has made a bad policy even worse.

Entrenched barriers to inclusive and sustainable economic growth

Ten years ago, when I first started working on South Africa, the country had made it through a remarkably successful political transition and had gone from being heavily sanctioned to being the darling of the world. After being a pariah, the country now had unprecedented access to international markets.

South Africa's macro-economic performance had improved dramatically. In 2004, inflation was in single digits, monetary policies were consistent, the country was attracting investment, and international reserves were recovering. Government had implemented substantial economic reforms between 1994 and 2004, especially the Growth, Employment, and Redistribution (GEAR) programme. However, all these positive developments appeared not to deliver the expected results. Economic growth was low, the unemployment rate rose from the teens to close to 30 percent, and inequality was rising.

To unpack the causes of these disappointing results my team and I decided to focus on potential growth constraints. We soon made some discoveries that we, as outsiders, found surprising. For example, participation and employment rates in South Africa were incredibly low. It is amazing how few people work in South Africa. The country has not only a low labour participation rate, but also a high unemployment rate.

If South Africa had a labour force employment ratio similar to Latin America, employment in South Africa would be higher by 66%. For example, South Africa's labour force participation rate for women older than 15 is 44%. In Brazil the labour force participation rate for women is 60%, in Colombia it is 56%, in Peru it is 68%, and in Venezuela it is 51%. Among males older than 15, South Africa's labour force participation rate is 60%. In Brazil the equivalent rate is 81%, Colombia has a rate of 80%, Peru is at 84%, and in Venezuela it is 79%. A comparison can also be made with Egypt. That country has a very low labour force participation rate, mainly because women do not work, but unemployment is low. The few who want to work usually manage to find a job.

In South Africa the few who search for it struggle to find work. This is clearly a problem and bad for growth. A lot of productive potential goes unused; those who are not in the labour force have no chance of ever attaining prosperity.

The South Africans outside the labour market are predominantly less-skilled, black, young, and female. If South Africa raised its employment rate to Latin American levels these would be the people who would be incorporated into the development process. As a result, sharing the benefits of growth in this country is not really about wage differentials, it is mostly about increasing employment levels.

Another trend which concerned my colleagues and me at the time was that the tradable sector had been shedding jobs for some time. The tradable part of the economy is made up of sectors that produce things that are exportable and can be sold to non-residents, such as mining, agriculture and manufacturing. Non-tradable parts of the economy are sectors in which there are no goods that can be sold in this way. These sectors include: tourism, the financial sector, construction, electricity, water, retail, wholesale, and transportation. The non-tradable sector is – on average – more skills intensive than the tradable sector. Shifting resources from tradable to non-tradable activities tends therefore to aggravate any skills constraint that a country has. South Africa, as we know, has very significant skills constraints. Those who have a university degree usually want to work and are mostly able to find work. Participation rates and employment levels drop along with South African education levels. The highly skilled, in stark contrast to the uneducated, effectively have full employment.

The shift from the tradable to the non-tradable sector means that the economy is becoming more skill-intensive, but many South Africans do not have the relevant and necessary skills to participate in this trend.

This has powerful implications and might explain the very high unemployment rates in South Africa. It also explains why increased government spending along Keynesian lines fails to generate higher growth and falling unemployment. If you increase government spending to boost aggregate demand, the resulting increases in domestic spending can lead to more spending on tradable imports and locally produced non-tradables. If this trend then further boosts the already expanding non-tradable sector then employment in that sector ultimately needs to go up.

FOCUS ON TACKLING THE UNEMPLOYMENT CRISIS

The unemployment crisis is the biggest policy challenge that South Africa confronts.

In 2011, in *A Fresh Look at Unemployment* (CDE Workshop, 2011), CDE pointed out that although South Africa's unemployment rate was very high by international standards, it actually understated the magnitude of the crisis because it included only those adults who were not employed and actively looking for work, which meant that millions of adults who wanted to work had given up looking for jobs, and were therefore not counted as unemployed. We then argued that a more revealing statistic is that only 41 per cent of the population of working age (everyone aged 16 to 64) have any kind of job – formal or informal. This rate (called the employment rate) was 30 percentage points lower than that of China, about 25 points lower than those of developing countries such as Brazil and Indonesia, and 20 points lower than the rate in the developed world. An employment rate of 60 per cent – roughly the global norm – would require 19 million jobs, nearly 50 per cent more than the 13 million formal and informal jobs that exist today. These statistics reinforce the view that directly or indirectly, unemployment is at the root of all of South Africa's most serious social, economic and political challenges. The rapid progress that needs to be made in overcoming this crisis demands that the country's most important constituencies rethink many of the policy positions to which they are committed. This was true in 2011, and, unfortunately, it is still true today.

There are concrete steps South Africa should take to reform the labour market.

In *Routes into formal employment: Public and private assistance to young job-seekers* (CDE In Depth, 2012) CDE research found that temporary employment services firms were a vehicle that people least connected to the labour market were able to use to access jobs. At the time there was strong pressure from trade unions for an outright ban of, what they called, labour-broking. CDE research leads us to question whether the gains the unions thought might accrue to the already-employed from such a policy would be worth the cost of reducing access to the labour market – and the economy – for those who are most excluded. South Africa needs to deepen and broaden the links that unemployed and marginalised people have with the formal economy. Closing down vehicles that increase access to work should therefore not be a serious option.

In *Coping with Unemployment: Young people's strategies and their policy implications* (CDE Workshop, 2012), CDE argued that the most important set of policy interventions required to change the prospects of young people stuck in multi-generational unemployment is to find ways of increasing the proportion of South Africans in wage employment.

Finally, in *Job Destruction in the South African Clothing Industry: How an alliance of organised labour, the state and some firms is undermining labour-intensive growth* (CDE Focus, 2013), CDE pointed out that Government's and COSATU's hoped for 'high-road' of substantial job creation through skill and capital-intensive growth has yet to materialise, and the costs have been borne by workers in labour-intensive industry and the unemployed. A much more differentiated approach that tolerates low-wage employment would, we believe, be far more realistic and would give the unemployed and the excluded hope.[1]

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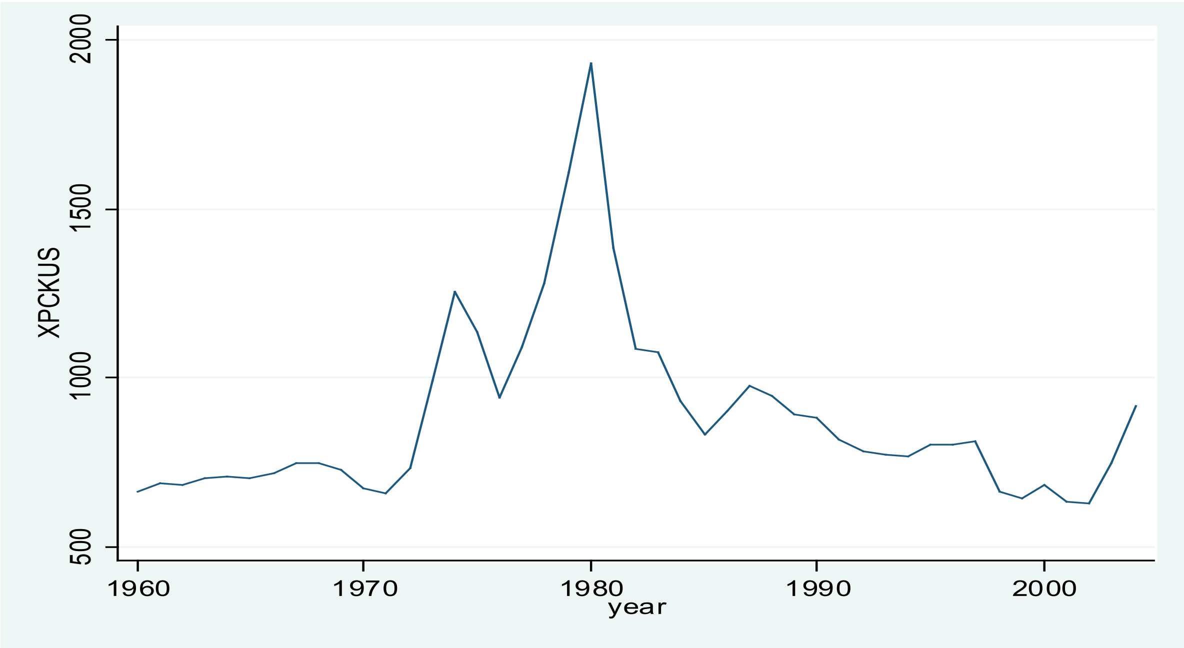
However, as I noted, the non-tradable sector is skill-intensive and there is effectively full employment for highly-skilled people, so they have to be taken out of the tradable sector. When you take an engineer out of the tradable sector (say from manufacturing into banking) you may be destroying 200 blue-collar jobs. Every skilled person who moves out of tradables may be destroying many more non-skilled jobs than the ones created in the non-tradable sector. Unemployment could thus rise along with an expansionary monetary or fiscal policy, which is a very unusual outcome.

The best way to expand the tradable sector is to increase exports. My colleagues and I found that South Africa's recent export performance was dismal. In the past, export earnings were much higher, a trend that peaked in the 1980s when gold prices were at an all-time high. Since then per-capita export earnings have fallen back down to 1960s levels.

Table 1: Trends in real purchasing power of South African exports



Source: Hausmann Presentation, CDE, 2014

Countries like Canada and Malaysia have seen the real value of their exports more than triple since 1960, and even a country like Argentina, which is something of an economic basket case, has seen the value of its exports more than double over the same period.

South Africa's poor export performance is partly due to the large decline of mining export value per capita, but this has not been compensated for by an increase in manufacturing per capita.

In 2004 my colleagues and I determined that whatever was holding back economic growth was to be found in the tradable sector, so we decided to focus our attention in that area. However, as we began our analysis South Africa seemed to turn the corner: growth began to accelerate and unemployment slowly came down. It appeared that the reforms were finally paying off.

When we analysed these emerging trends we found that growth had accelerated in the context of a widening current account deficit. South Africans were spending more, and buying more imports, but this was not being funded by export growth. There was an investment boom but it was concentrated in non-tradables. It was a boom in construction, not in manufacturing, mining, or agriculture.

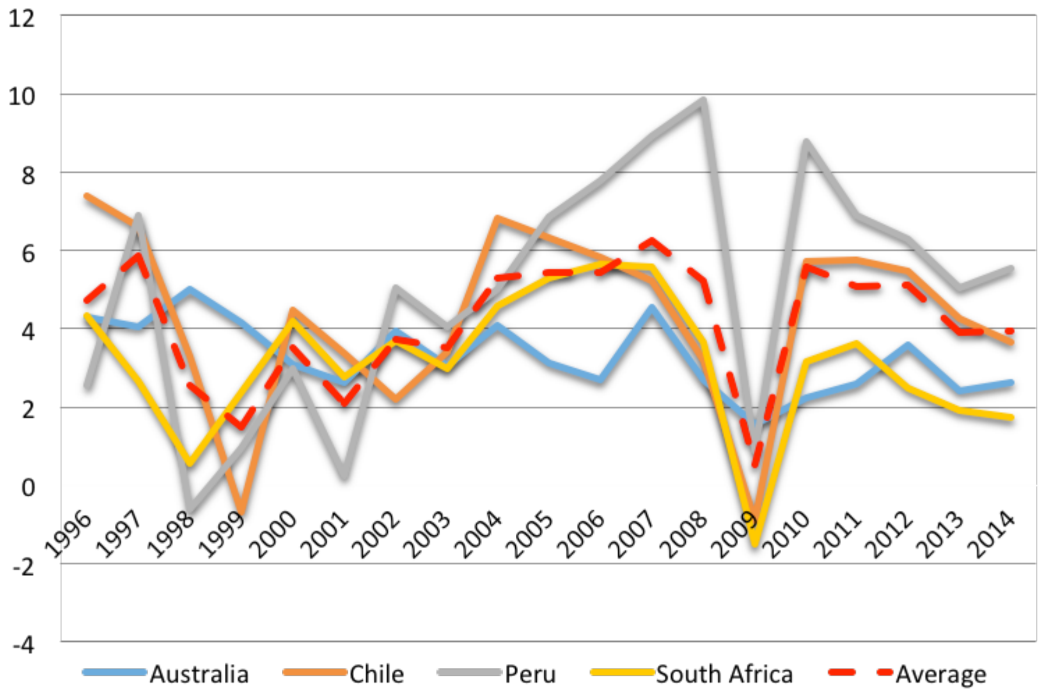
There was also a consumption boom in durables, which means that there was more credit and more bank loans. This led us to believe that the growth acceleration was going to be temporary. The growth was based on a boom in domestic spending financed by foreign borrowing. The money borrowed was not used to increase the future exporting capacity of the country and as a consequence it wasn't going to generate the resources with which to pay additional debt. Eventually, when borrowing slowed down, domestic spending would also come down. The economy's growth would then be limited by the rate of growth of its exports – it would not be able to outgrow its exports because it would not be able to keep on borrowing to fund the current account.

Facing Current Challenges

That has been the situation for quite a few years now. What we have seen is a significant decline in growth. This dip started in 2009, there was something of a bounce back in 2010 and 2011 due to fiscal stimulus policies, but since then growth has been down and unemployment up. Growth is likely to only be slightly above one per cent this year.

Is South Africa's growth slowdown mostly linked to the global growth slowdown? If we compare South Africa to other commodity-exporting countries, such as Chile, Australia, and Peru, we see that these countries all suffered a dip in growth during the global economic crisis. However, South Africa's recovery since then has been much slower than the others.

Table 2: Real growth rate in USD – Chile, Australia, Peru, South Africa



Source: Hausmann Presentation, CDE, 2014

I agree with the view that, for historical reasons, there is a deeply rooted antipathy towards the mining sector within South Africa. Unfortunately, the country's failure to take advantage of the commodity boom is killing the goose that lays the golden eggs. By focusing on short-term redistribution in the mining sector, government policies are destroying long-term value.

South Africans have been unable to agree on a growth-oriented strategy. I would have suggested giving workers 20% of the shares in the company they work in, so that they benefit from upswings in profits, or a similar type of arrangement that would lead to win-win outcomes. For complex reasons, such agreements have not been reached.

Government revenues came down with the recession and then recovered somewhat. However, spending went up significantly. This was not due to cyclical items, such as investment. Rather it was due to large rises in public sector wages and public sector employment. This is a permanent increase in spending, which in turn has led to a rising level of debt and resulted in credit downgrades.

At this time, there is no space for increased fiscal spending and there is also no flexibility in monetary policy. The South African Reserve Bank (SARB) does not have room for relaxation – it can only raise or leave interest rates steady. This re-enforces our earlier analysis – this is not a cyclical problem and cannot be solved by Keynesian means. South Africa has had major fiscal expansion, very accommodating monetary policies, but this has not raised the long-term growth prospects of the country.

Exports have also continued to under-perform significantly compared to other commodity-exporting countries. There was the super-cycle, so export volumes and prices did accelerate after 2004, but compared with the relevant other countries, such as Australia, Chile and Peru, South Africa continues to underperform.

New export jobs are not being created quickly enough to replace the jobs that are being lost in the tradable industries, which continue to decline. Nor are exports growing quickly enough to keep up with the growing import demand, which is leading to an expanding current account deficit.

Brazil, Chile, China, India, Indonesia, Mexico, and Turkey, have also all done better in *diversifying* what they export. South Africa's exports are still dominated by minerals and mineral products, and the value of these has been dropping.

However, South Africa's exports can be quite varied, depending on their destination. One of South Africa's major export markets is Asia, and most of the country's exports to this region are raw materials. South African exports to the United States, by contrast, have a large component of raw materials, but also include cars, chemicals, machinery, and textiles. Exports to the rest of Africa are mainly finished products. For example, a large proportion of South Africa's exports to Nigeria are cars and other types of motor vehicles. The problem is that South Africa accounts for only two per cent of Nigeria's imports. These are the kinds of goods that South Africa should be diversifying into, but the levels remain far too low.

A case study that points to the problems bedevilling South Africa's export strategy is a project in Saldana Bay, which proposed to rebuild and refurbish oilrigs, and eventually also build them from scratch. I followed the resulting saga and eventually turned it into a very useful teaching case study that I still use for classes at Harvard.

Initially the idea seemed to be very promising. Ships have been coming into Cape Town to be repaired, refurbished, and supplied on their route around the Cape for a very long time. Repairing oil rigs represented a new industry that could use existing capabilities, adding some new skills in the process and accessing a new global market. South Africa would also benefit from some natural protection against foreign competition by being relatively close to some of the oilrig markets. In addition, Cape Town had internationally-certified labour and could impose the relevant safety standards. This was all extremely promising, but it required some co-ordination and help from Transnet. It required a commitment to supply trained workers; it required solving problems associated with having lots of small suppliers working together on big bulky contracts. Many of the co-ordination challenges could have been addressed by allowing a major global firm to enter the South African space.

What happened instead is that the sector is currently miniscule relative to initial expectations. The barriers preventing the expansion of this industry do not include high wages or labour market regulations. Instead, the problem is co-ordination failures at the level of government. This was a project of the Western Cape, so it required a degree of co-ordination the national government, between the provincial government, and state-owned enterprises. In spite of the best efforts of some of those involved, this co-ordination never emerged.

If this project had started in China, it would be a huge industry today. The structural transformation that South Africa needs in order to succeed at the same level includes the state capacity to identify opportunities, to see the obstacles in the way of those opportunities and to then take decisive action to overcome them.

South Africa managed, on the whole, to undertake this type of complex co-ordination for the 2010 Football World Cup, but so far this appears to be an exceptional case. The capacity to take decisive action derives largely from high levels of trust between different parts of government, between the government and the private sector, as well as from the capacity of these various institutions to co-operate. These things emerged to some extent around the World Cup but have been generally absent before or since then.

SA'S MAJOR ECONOMIC POLICIES CONTRADICTORY

In a *New Age* article, published in November 2013, CDE's Executive Director Ann Bernstein said that 'there is no common and coherent view in the government's three major economic policies. It's really important that we see more policy coherence. The economy is in trouble and South Africa needs certainty'.

These comments were based on CDE's assessment of the National Development Plan (NDP), the economic development department's New Growth Path (NGP), and the trade and industry department's industrial policy action plan (IPAP), which was published in a report, written for CDE by Professor David Kaplan of the University of Cape Town, entitled *Policy Gridlock? Comparing the proposals made in three economic policy documents*.

CDE's report found that the three documents offered contrasting accounts of the constraints South Africa faced. IPAP and the NGP characterised the economy as being 'consumption-led', which suggested that the key problem lay with the financial sector, which was starving the productive sector of investment funds. The NDP, by contrast, said nothing about this. The three documents also have very different ideas about where the jobs will come from. IPAP and the NGP talk about jobs in the 'productive sectors' including manufacturing, infrastructure, agriculture, and so on, while the NDP expects most new jobs to be in small services firms serving the domestic market.

According to Professor Kaplan the IPAP and the NGP see a weak rand as fundamental to the success of their strategies. However, the NDP said it would not stimulate growth and employment creation, as the economy was not geared to take advantage of a cheaper rand.

Ann Bernstein added: 'It's time to make the tough choices and stick to them. It is not clear which approach the government had chosen from the three documents. It's no wonder more and more business leaders are speaking out about their concerns'.[2]

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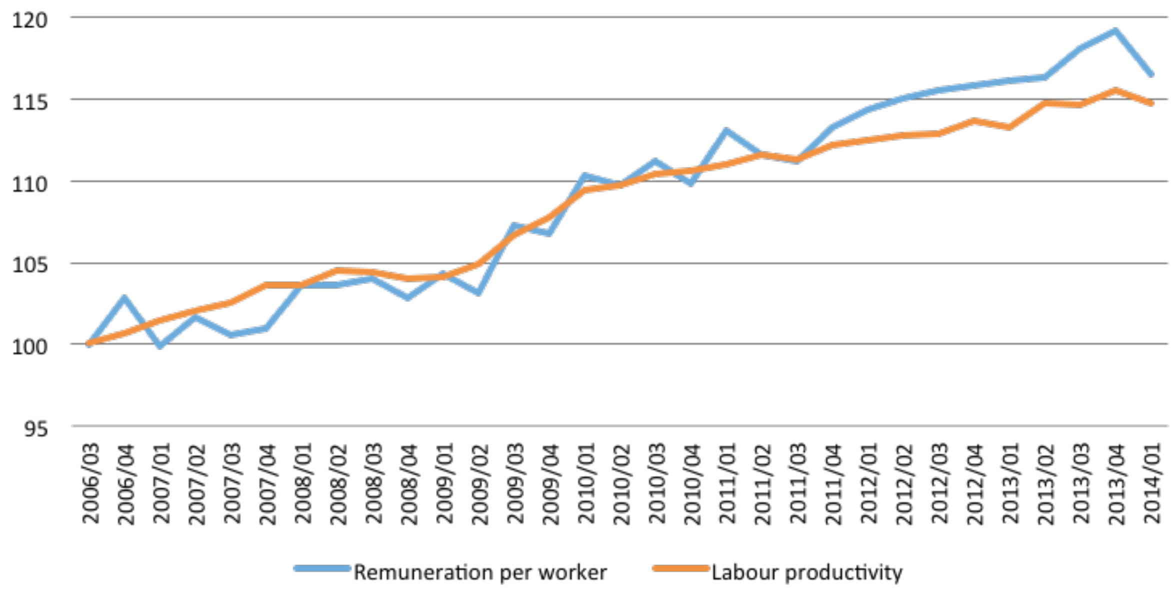
Another serious problem in South Africa is that the rate at which remuneration has been increasing is far above the rate at which productivity has been increasing. Unit labour costs have been rising but productivity and competitiveness are falling. Furthermore, hiring labour is relatively problematic in South Africa, and is identified as a risk by the Economist Intelligence Unit.

Table 3: Remuneration and labour productivity: 2006 – 2014



Source: Hausmann Presentation, CDE, 2014

When my colleagues and I started advising the South African government in 2004 we emphasised the importance of increasing exports to create more jobs and to fund the current account deficit. With the current lack of export dynamism South Africa is not going anywhere. The current account deficit is already too wide, which means that the economic growth rate will be unable to rise above the rate at which exports expand. Higher growth without structural changes will only increase the gap between the cost of imports and the revenue generated by exports. Low growth is therefore the prognosis unless things change dramatically. The rand has weakened significantly, which should favour exports over imports, but we have not seen this affect the export numbers.

Export jobs are hard to create because they need to compete with other exporters in other parts of the world. But there is no way around this. Exports, and jobs related to exports, are the key to growth. These are the sectors that will create jobs for the less skilled people who constitute the unemployed. In addition, growth in these jobs will trigger jobs in the non-exportable sectors and throughout the economy, and that is what will generate wealth. There are few opportunities to accelerate the economy through fiscal stimulus. Growth generated by government spending can be equated with driving above the current economic speed limit. As I said at the beginning, given its current constraints, South Africa needs to work hard and creatively on increasing the 'speed limit'.

Policy Issues

There are a number of ways to achieve this higher speed limit, including a rebalancing of BEE. I understand that BEE is necessary to tackle the inequities of the past, but it has been implemented in a way that is biased towards making the top of society black, rather than helping those at the bottom. Too many of the BEE incentives were about shares, about board positions, about senior management, and so on, with very little emphasis on generating jobs at the lower end. BEE policy has actually accentuated skill constraints. What is needed is a rebalancing of the score card to give more kudos to companies that generate opportunities at the bottom, mostly by creating the kinds of jobs that will make inroads into South Africa's employment crisis.

BEE is a correction for past sins, but growth comes from start-ups, from new firms. Start-ups in any country face typically high death rates. By diverting attention away from creating new firms and imposing costs on existing firms, BEE is probably having the deleterious effect of causing fewer of these firms to be created, and more of the firms that do get off the ground to die. This is a very serious problem.

It also vital to address youth unemployment directly. A median South African matric graduate is about 18 when he or she finishes school, but they get their first job at age 30. This gap is far too large. If someone is going to spend 12 years after school not doing very much the decay of human capital is very significant. We need school leavers to get their first jobs as quickly as possible and it is gratifying that the youth wage subsidy the Harvard group proposed in 2008 was finally passed into law in January of this year.

It is likely that it took six years because there is very little political competition in this country. The governing party does not fear losing power to an opposition party, which has implications for accountability. I was very angry about the opposition to the youth wage subsidy, and if I were a politician here, I would have taken on the opposition on moral, rather than technical, grounds. There should be no division between young and old. The old are the parents of the young and should be in the business of creating opportunities for their children. I would have depicted those opposing the youth wage subsidy as 'child haters'.

South Africa, as I have argued, needs urgently to expand the tradable sector. But it is still relatively unprofitable to be in tradables. I was speaking to some institutional investors in South Africa recently and I asked them if they knew of a company – given the new level of the rand – that was profitable and expanding. None of the investors could come up with a name. This is a matter of great concern.

Wage agreements are often unrealistic. People are thinking that wage agreements will come out at CPI plus 2 or 3, but the economy is growing at CPI minus 1 or 2. At that level, wages are already much too high, especially in the public sector, which is paying more than the private sector. This has put the country in a weak fiscal position, meaning there is not enough left for public investment, resulting in major challenges for state-owned enterprises.

THE EMPLOYMENT TAX INCENTIVE ACT

The Employment Tax Incentive Act, also known as the youth wage subsidy, came into effect in January 2014. An employer is eligible to benefit from the incentive if they are registered to pay tax and employ a South African citizen who is between the ages of 18 and 29 and earns less than R6 000 per month.[3] The government will then share the costs of employing that person by reducing the payroll tax the employer is required to pay. There is already evidence that take-up of the incentive has been stronger than expected, with payroll tax data indicating that as many as 140 000 young people benefited from the incentive in the first 5 months of its operation.[4]

There has been intense opposition to the Act, particularly from the ANC's union allies in the tripartite alliance. The National Union of Metalworkers of South Africa (Numsa), until their recent expulsion, the biggest trade union within the Congress of South African Trade Unions (Cosatu), said the Act was a 'sham' and a 'handout' to the rich.[5] In March 2014 Numsa called a one-day strike and country-wide marches to incongruously both highlight the issue of youth unemployment and protest against the Act designed to combat youth unemployment.[6]

CDE has consistently supported the proposal of a youth wage subsidy as proposed by the National Treasury in 2008. In August 2011, CDE published a Round Table document: *Jobs for Young People: Is a wage subsidy a good idea?* in which argued that the Treasury's proposal was not a comprehensive response to the youth unemployment crisis, but was certainly a step in the right direction. The report called for the youth wage subsidy to be implemented as part of a series of initiatives, rather than as an isolated response and argued for a probationary period in which new, subsidised workers could be fired – 'no questions asked'. By allowing employers to dismiss unsuitable workers quickly and easily, a probationary period could increase the number of jobs created - perhaps significantly, help target subsidies to the most productive, capable workers, and increase the likelihood that those employees retained by their employers would be kept on when their subsidies expired.[7]

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Beneficiation is often hailed by the government and the ANC as a strategy that will save the South African economy. I think that beneficiation is not just a mistake, it also narrows the country's field of vision away from all the things that are feasible to do in the world. Past strategies have similarly been influenced by this type of thinking. Alec Irwin, when he served as minister of trade and industry, argued that South Africa has coal so it can produce cheap electricity, and because the country has cheap electricity, it should export aluminium, which meant that aluminium smelters needed to be constructed. This policy now seems misguided as electricity prices continue to rise. In addition, how many other, less obvious opportunities did South Africa miss as a result of this narrow thinking?

A better strategy would have been to look at the knowledge associated with South Africa's vast experience in mining. There are many technologies, services, and capital goods associated with mining. Experience with these activities provides South Africa with advantages and know-how that can be leveraged in industries and markets that may have nothing to do with mining. Things like this do happen in South Africa, but not at sufficient scale. I visited a plant run by Bell Equipment in KwaZulu-Natal a while ago, and it had the most incredible innovative moving equipment. The lesson is that it is possible to build on the knowledge that companies have acquired over time.

Another problem with beneficiation is: how much do you want to subsidise economic activities? If you are willing to subsidise something, the next question is, why only that? Why are you going to subsidise beneficiation rather than subsidising the capital goods industry for the mining industry? In the end you are using the coercive power of the state to transfer income to an industry. Why restrict it to one particular industry?

Finally, to overcome the major blockage of skills shortages South Africa needs a much better, more open migration policy. South African migration policy has recently been reformed, but it has gone from a very bad policy to an even worse policy. A number of countries in the world – including the US, Canada, and Australia – got many of their skills by attracting people to their shores. South Africa, on the other hand, has been shedding skilled people and not attracting many new skills.

IMMIGRATION REFORM HEADS IN THE WRONG DIRECTION

Malusi Gigaba, the new minister of home affairs appointed in May 2014, appears to be determined to push through a number of immigration reforms that would make an already restrictive environment even more difficult for immigrants to South Africa.

The new regulations will hamper foreigners who want to open a business in South Africa. Previously they had to prove that they would invest at least R2.5-million in the country. Now they have to prove that at least 60 per cent of their workforce will be South African, and that their business will not be 'undesirable'.[8] They also have to invest R5-million towards new machinery or equipment. Businesses determined by officials to be in the 'national interest' can qualify for a reduction or a waiving of the capital investment requirement.[9] In addition, all businesses will have to get a 'recommendation' letter from the Department of Trade and Industry, and visas will only be granted for three years at a time.[10] Some analysts argue that these requirements could place South Africa in breach of international trade treaties.[11]

Furthermore, foreigners coming to South Africa on a general work visa will have to obtain confirmation from the Department of Labour that the benefits and salaries they will be receiving are commensurate with those of a South African in a similar position. The Department of Labour will also have to confirm that the potential employee's company is registered with the Commission on Intellectual Property and Companies.

Foreigners living in South Africa could previously continue to stay and work in this country, if they could prove that they had applied for a visa extension. This is no longer the case, and foreigners whose visas have expired – even if they have applied for an extension – can be declared 'undesirable', and prohibited from entering the country for as long as five years.[12]

CDE has been lobbying for a relaxation of immigration laws for some time, and in November 2010 published *Skills, Growth, and Borders: Managing migration in South Africa's national interest*. The publication argued that anybody with a tertiary qualification from a recognised institution should be considered 'skilled' and allowed to live and work in South Africa. The report also recommended that it should be made easy for entrepreneurs with proven small business skills to come to South Africa. CDE called furthermore for skills quotas to be abolished, and an end to politically-correct ideas about not recruiting in developing countries. CDE research falsified the idea that skilled immigrants take jobs and opportunities away from South Africans. This is a view that has been endorsed by Gill Marcus, outgoing governor of the Reserve Bank, who has stated that one skilled immigrant creates eight low-skilled jobs.[13] Unfortunately, South African policy trends are currently moving in the wrong direction.[14]

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When people hear the word 'skills' they immediately think of schooling and school quality. Schooling is important but so is 'know-how', or the ability to do things. A lot of 'know-how' is acquired on the job. As a result unemployment creates massive costs by preventing millions of people from acquiring on-the-job know-how. An additional challenge is, how can countries shift into new economic activities that have never existed in that country before?

HAUSMANN ON THE ROLE OF 'KNOW-HOW' IN ECONOMIC SUCCESS

Economists agree that, beyond natural resources, income differences between rich and poor countries are largely attributable to 'technology'. Technology has been defined as a collection of devices and engineering practices available to a culture. But if ideas are easy to copy and devices are easy to ship, why do differences in technology persist between countries?

The problem is that a key component of technology is know-how, which is an ability to perform a task. And know-how, unlike devices and ideas, neither involves nor can be acquired through comprehension. Technology has trouble diffusing because much of it requires an ability to recognize patterns and respond with effective actions. It is a wiring in the brain that may require years of practice to achieve. This makes its diffusion very slow. Know-how moves more quickly to new areas when the brains that hold it move there. Once there, they can train others. This makes immigration central for development outcomes. Countries that encourage skilled immigrations will benefit from the know-how immigrants bring. Unfortunately the South African government appears to want to further tighten an already restrictive immigration policy.

Moreover, now that know-how is becoming increasingly collective, not individual, diffusion is becoming even slower. Collective know-how refers to the ability to perform tasks that cannot be carried out by an individual, like playing a symphony or delivering the mail: neither a violinist nor a letter carrier can do it alone.

A society cannot simply imitate the idea of Amazon or eBay unless many of its citizens already have access to the Internet, credit cards, and delivery services. In other words, new technologies require the previous diffusion of other technologies. That is why cities, regions, and countries can absorb technology only gradually, generating growth through some recombination of the know-how that is already in place, maybe with the addition of some component – a bassist to complete a string quartet. But they cannot move from a quartet to a philharmonic orchestra in one fell swoop, because it would require too many missing instruments – and, more important, too many musicians who know how to play them.

Progress happens by moving into what the theoretical biologist Stuart Kauffman calls the 'adjacent possible', which implies that the best way to find out what is likely to be feasible in a country is to consider what is already there. Politics may indeed impede technological diffusion; but, to a large extent, technology does not diffuse because of the nature of technology itself.[15]

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This is a problem that even exists in countries like Germany and Sweden, where colleagues and I undertook an analysis of the area-of-origin of workers in new 'pioneer firms', i.e. firms that are the first of their kind in a particular region. We found that workers in these pioneer firms tended not be 'pioneer workers'. They were workers from other regions with experience in that industry, who relocated to the new locations where their know-how was needed. The diffusion of industries therefore happens due to workers' willingness to migrate. It is much easier to move brains than it is to move knowledge into brains. To move know-how into brains, as Malcom Gladwell says, takes

10 000 hours of practice. It does not take 10 000 hours to go from New York to Somalia. Once the new brains arrive there will be lots of time to train the next generation of workers. That is why migration is such an important issue in relation to skills acquisition.

Not one of the people who made up the Harvard team that came to advise the South African government was born in the US. If the US had South Africa's current immigration policy this team would not exist and, indeed, Harvard as an organisation would probably not exist. South Africa needs skills, and it needs a clear strategy, co-ordinated across many sectors of the state and the economy, to change the structure of the economy. Only then will the country grow and create the jobs that will reduce inequality, eradicate poverty and allow the country to fulfil the massive promise that my colleagues and I encountered when we first came here in 2004.

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