South Africa-New Opportunities for Structural Policies And Growth

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Introduction

Global economic and financial developments since 2008 have forced closer attention on the role of national structural policy interventions, both as potential sources of growth but also as necessary policy initiatives to achieve and maintain macroeconomic stability. The standard fare for stabilization policy has included fiscal, macroeconomic and exchange rate policies. Yet, significantly worsening prospects for global growth and the absence of coordinated global remedies to reverse weakening growth prospects in the advanced economies are now forcing a re-examination of the potential for both national and internationally coordinated structural policy interventions. At the Seoul Summit and more recently, G-20 leaders have increased their emphasis on coordinated short-term and longer-term policies to reverse declining growth. They have also raised attention to the contribution of structural policies in this collective quest. The forthcoming G-20 Cannes Summit is likely to give further momentum to this approach.

For several reasons, South Africa is well placed to contribute to this new focus on structural policy as a key driver of growth. First, South Africa is an emerging market economy with a remarkable track record of fiscal, financial and macroeconomic management. The country reversed the macroeconomic decline, which characterized the closing years of apartheid. Yet with a substantial uncompleted structural reform agenda since the fall of apartheid, the balance of policy efforts for the foreseeable future in South Africa will be focused on addressing several longer-term structural impediments to growth, while maintaining what has been an effective macroeconomic stabilization policy.

Second, South Africa is the leading driver of regional economic growth and development in a continent that requires massive transport, environmental, energy and other economic and social infrastructure.

Third, South Africa is well placed to take advantage of a new global focus on structural policy precisely because of its extensive pre- and post-apartheid, experience and experimentation with conceptualizing and implementing structural policies.

Fourth, South Africa has positioned itself effectively, both in the global discourse on structural policies for development as well as in its outward strategy for development. South Africa is co-chair of the G-20's Development Working Group and has been an active contributor to bringing a wide range of G-20 voices to bear in understanding both the sources of growth, their long-term sustainability, and the interplay between fiscal, monetary and structural policies. The country is also now formally a member of the India-Brazil-China-Russia emerging markets group and is increasingly positioning itself, through several bilateral trade and investment agreements, to take advantage of these relationships in the quest for higher and more sustainable growth.

The remainder of this paper briefly traces South Africa's background and track record in pursuing structural reform programs; the paper highlights several structural challenges for the country and identifies a number of structural policy measures likely to be pursued in the next few years, as the country repositions its economy, takes advantage of emerging opportunities and seeks to address its structural challenges.

Background and Recent Developments

The apartheid economy—a closed and deeply flawed economic system—when it collapsed in 1994 left policymakers with large fiscal deficits, substantial net negative external reserves, a poorly-skilled and uneducated workforce, extreme levels of inequality and a profoundly uncompetitive economy. In its collapse, apartheid also left some of the seeds for renewal. Four in particular warrant emphasis. Firstly, South Africa had a diversified, albeit uncompetitive manufacturing sector, which had been built from the mid-20th century utilizing surpluses from deep-level gold mining discoveries in the mid-1950s and new mineral discoveries since then. The post-apartheid policymakers have taken advantage of this to forge major sources of competitive advantage. These include the nurturing of a globally competitive motor vehicle manufacturing capacity without state support and the development of several globally competitive manufacturing sub-sectors, such as chemicals, and the food and beverage sector.

Secondly, South Africa embedded an industrial policy strategy focused on identifying new industries and new sources of growth. It was originally intended in the apartheid era to isolate and make the apartheid economy self sustaining, but it later served as a key inheritance in enabling the country's economy to achieve global competitiveness in some niche industrial policies.

Thirdly, the country had an extensive minerals and extractive industry, albeit insufficiently downstreamed to exploit opportunities for domestic value-added.

Fourthly, South Africa established several institutions and institutional tools for development. These included: a well-capitalized Industrial Development Corporation that initially drove the large-scale acquisition of colonial mineral, financial and manufacturing capital, but later drove small and medium-sized enterprise incubation and development; the Development Bank of Southern Africa, which was initially designed and resourced to perpetuate spatial separation under apartheid, but would later provide the capacity and opportunity for significant infrastructure financing within South Africa and within the region; a military, industrial and scientific complex, spawned to promote long-term isolation and defense against the majority population, which would later serve to promote opportunities for high-value-added new sources of growth, diversification and new industrial development in the post-apartheid economy.

A Macroeconomic Foundation to Pursue Structural Policy

Since democracy, there has also been remarkable progress in macroeconomic management. As global attention shifts to the value of structural policy interventions as a source for global growth, the success of South Africa provides an important foundation for the country's future efforts to more effectively integrate and pursue structural policies.

Success in stabilization policy has been remarkable and multifaceted. Macroeconomic stability has been achieved and maintained, despite persistent exogenous shocks. There has been an extraordinary, managed process of trade opening from an altogether closed and uncompetitive system. Economic growth has accelerated in comparison to the decade prior to the end of apartheid. Inflation has been reduced significantly and an inflation-targeting framework has been introduced. Fiscal policy has proved robust and consistent, quickly correcting an extraordinary tangle of excess and inefficient inter-governmental transfers to support apartheid. The country has set in place a constitutionally binding system of inter-governmental transfers and a mechanism for equitable distribution of fiscal resources to sub-national tiers of government. It has progressively reoriented the direction of spending to address structural legacies and promoted the competitiveness of the economy. In the past decade, the exchange rate system has been unified and made open; and an apartheid-era legacy of net negative international reserves has been transformed, with the country now running substantial net foreign exchange surpluses. South

Africa's financial system and its regulation have strengthened, allowing it to adequately weather recent global financial crises and maintain levels of capital and liquidity well above new international standards for prudential regulation. Some progress has also been achieved in improving growth and addressing unemployment with growth expanding to almost 4 percent in per capita terms from 2004 to 2007, until the recent global economic crisis.

Yet, these gains have come at some cost. The global crisis has reversed several gains in employment and growth. It has also highlighted several structural obstacles, particularly challenges to higher growth. Export performance has been relatively slow to adjust to sector-specific and other incentives. The impact of the crisis has emphasized the shallowness of recent economic gains, with a substantial part of labor creation in the period since 2004 occurring in low-wage sectors and those particularly susceptible to cyclical factors and reliant on domestic consumption.

A Track Record of Structural Reform Initiatives

South Africa has had a long experience in structural policy reform. Since the demise of apartheid, several structural policy initiatives have been promoted, all focusing on the nexus between development and macroeconomic policies. The Reconstruction and Development Program launched immediately after post-apartheid elections targeted the realignment of the structure and direction of national budgetary resources toward the provision of social infrastructure. It addressed the immediate social and economic legacies of apartheid and made a first attempt at addressing extraordinary disparities in income and wealth.

The early post-apartheid years also necessitated a strong program of macroeconomic stabilization with policymakers confronted with addressing an inheritance of large scale poverty, very large fiscal deficits, significant sub-regional discrepancies in income and employment, a dual exchange rate with large negative foreign exchange reserves, high inflation and high real interest rates. The government's response was a further macroeconomic and structural intervention—the Growth, Employment and Reconstruction Program launched in 1996. The program sought to address the acute lack of economic competitiveness after decades of closed an inward-looking development while building macroeconomic stability. In 2005, a further approach was launched, the Accelerated and Shared Growth Initiative for South Africa. The program sought to address inequality, shift the economy away from low-skilled employment and achieve higher levels of growth. More recently, a New Growth Path strategy has been proposed and is being pursued. The strategy is particularly important in the context of the current global discourse on the role of structural policy. It recognizes the monetary, fiscal and other facets of previous experience in structural policy reform and seeks to make these more consistent with a stronger focus on structural policy measures in order to strengthen South Africa's global competitiveness and to address the labor, inequity and other legacies of apartheid.

Key Structural Challenges for South Africa

The global crisis has highlighted several constraints in pursuing structural policies in South Africa. The crisis had acute impacts on disposable income, resulting in the large-scale shedding of employment in several sectors and exposing the persistence of many structural challenges, which have not been addressed in the decade and a half since apartheid. The experience has shown that at least six major structural challenges need to be addressed.

First, South Africa must address its high levels of unemployment. In the first quarter of 2010, unemployment among 16 to 30 year-olds was 40 percent, with most receiving poorly paid and insecure employment. New strategies are needed to absorb and retain employment for a large pool of unskilled labor, while creating new higher income employment in sectors able to achieve and maintain global competitiveness. Several new initiatives are being pursued by the government, including substantial public investment in energy, water, transportation and communications infrastructure. There needs to be a stronger focus on labor-absorbing activity in agriculture through smallholder farming programs and a new focus on employment opportunities in pursuing sustainable development, which includes expanding public employment programs to protect the environment and promoting biofuels production and other renewable energy opportunities.

A second structural challenge is to build sustainable workforce skills. A major intergenerational legacy of apartheid was its failure to train successive generations of the workforce. Post-apartheid policy has focused on bringing large swathes of the school-aged population into formal education. However, it has not succeeded in training labor to compete internationally, it has failed to produce a new generation of technicians and engineers, and it has failed to provide workers with the skills to tap into new knowledge-based service sectors and other sectors, such as health care, education and tourism. A new, significantly strengthened focus on skills development is required to promote a more versatile, adaptable workforce that is capable of attaining high levels of productivity in emerging new industries.

A third major structural impediment comprises very high levels of inequality in income and wealth. The emergence of a substantial middle class, through a deliberate policy of Black Economic Empowerment has been pursued to help address historical inequalities in economic participation and to lay a foundation for broader-based growth. However several challenges in the implementation of this policy have emerged, which will require closer calibration of the policy.

A fourth challenge is that South Africa suffers from a lack of infrastructure to sustain higher levels of growth. The capital stock has aged and the opportunity of pre-crisis growth was not used to modernize and realign the stock of infrastructure. While the share of fixed investment to GDP increased for a period during the first decade of this century, it has fallen back since the global crisis. As a result, significant domestic and regional deficits have emerged in energy, transport, logistics, social and rural infrastructure. The prioritization of infrastructure will catalyze employment, help identify new sustainable sources of green growth, consolidate regional infrastructure, lower unit transport costs and increase the competitiveness of both the domestic and regional economy. Reducing inputs costs, particularly in energy remains crucial if South Africa is to become globally competitive in several key energy-intensive sectors, such as mining, minerals extraction and processing, and chemicals. This will also require strengthening logistics and supply chains both domestically and within the Southern African region, which will require significant new infrastructure expenditure in transport. With ongoing prudence in fiscal and monetary policy, how will these investments be financed? South Africa is likely to utilize a combination of private-sector led commercial finance, regional industrial and development financing, and a recently proposed new African infrastructure financing mechanism to achieve a part of this ambition.

A fifth structural challenge comprises more effective identification and pursuit of new sources of growth and diversification through; increased business incubation, enhanced financing for small and medium-sized enterprises; and stronger export promotion and export diversification initiatives; and developing and deepening value-chains in agriculture, manufacturing and services. South Africa's extensive industrial, developmental, scientific and industrial research capacity will provide a strong foundation for this effort. A part of this strategy will engender taking advantage of opportunities to expand and build international and regional competitiveness in several sectors where South Africa has developed a comparative advantage. Another part of this strategy will require specific initiatives to expand and increase the dynamism of the tradable sector, prioritizing the expansion of exports, including through government-led sectoral prioritization. South Africa should take advantage of its recently expanded collaboration with other large emerging markets, including Brazil, India, China and Russia, and several emerging markets in East Asia. Here, initiatives to take advantage of several recently established bilateral agreements with these countries offer potential to expand the export of higher value-added products.[1]

Sixth, South Africa has the opportunity to take advantage of green infrastructure and growth. Extensive policy planning has taken place and several initiatives are now being launched to shift the economy toward a low-carbon economy. South Africa will enjoy some advantages in this process, benefitting from the experience of other comparable emerging markets which have taken quicker and more trenchant steps to begin their adjustment. But if the country is to benefit from and utilize its domestic comparative advantages, policy implementation will need to be accelerated.

The country's key structural challenges are immense and the above provides an illustration of only a few of these. Many of the following challenges can be considered equally important: a more explicit strategy to address poverty; a stronger focus on rural development; increased attention to competition policy; a specific focus on regional and African integration and development; more explicit enterprise and private sector development strategies; and more directed policies to address labor market rigidities and to adopt technologies that can catalyze new sources of sustainable growth.

These challenges are of course known and well understood by the government. In fact, in recent years, the government of South Africa has continuously and extensively consulted international partners to identify challenges and consider strategies to address them. Recently, contributions have been made inter alia by the OECD, in its assessment of structural challenges in emerging market economies and by a group of Harvard-based economists, who contributed a series of views and recommendations to the South African National Treasury in 2009.

A detailed strategy to address structural challenges in a manner which better integrates macroeconomic, fiscal, monetary and structural policy goals has been set out by the government in its most recent structural reform policy initiative. The strategy seeks to combine both micro and macroeconomic interventions focused on improving labor absorption, together with the composition and rate of growth. The approach integrates a specific set of industrial policy initiatives with new policies and programs in rural development, agriculture, science and technology, mining and beneficiation, tourism education, and skills and social development.

The G-20 consensus to look beyond fiscal and monetary policy as drivers of national and global growth will assist South Africa's pursuits of these initiatives. It will give South Africa a greater sense of confidence that these measures are consistent with the thrust of globally accepted policy practice.

Interplay between Macroeconomic and Structural Policies

How will fiscal, monetary and structural policies coexist and complement each other, as South Africa pursues its new approach to structural policy reform? South Africa's macroeconomic experience with the global crisis has revealed the need for a new and clearer set of policies to better address the inter-linkages between fiscal, monetary and structural policies as the latter are pursued in coming years.

In the decade prior to the global economic crisis, South Africa achieved higher levels of growth by tapping into traditional comparative advantages and utilizing existing sources of surplus. Surpluses from the commodities-based economy, coupled with ready access to international capital, precipitated an appreciation of the nominal value of the rand. The opportunity to rebuild and renew the capital stock in mining and manufacturing and to invest in the capital needed to diversify into high-end services was not taken. Instead surpluses were channeled into the expansion of the retail, financial and telecommunications sectors. Labor absorption occurred only in low-level business services and the construction sector.[2] A rising nominal exchange rate prompted increasing imports of consumption goods, enabled a reduction in interest rates, reduced the competitiveness of the tradable sector, and precipitated widening income inequality.

A new approach to structural policy in South Africa is likely to see a new, more focused and consistent interaction between monetary, exchange rate and structural policy development. It is likely to engender: continued accommodative monetary policy, particularly as global economic uncertainty persists; the maintenance of current fiscal policy, including maintenance of current spending objectives, which envisage real growth in expenditure of approximately 2 percent per year in coming years; a gradual weakening of the external value of the currency, enabling a stronger focus on building competitiveness in high-value manufacturing exports.

A new approach is also likely to embrace a more explicit strategy to increase minerals beneficiation, taking advantage of the country's long-established comparative advantage in this sector.

An environment of low global interest rates can be expected to be utilized to help finance the rebuilding and modernizing of economic and social infrastructure, including financing initiatives to address key impediments to higher levels of sustainable growth, including transport, energy and environmental infrastructure. The governments' new approach to addressing structural constraints to growth is also likely to elicit a more targeted approach to picking winners.

Addressing prospects for continued short-term capital inflows will need innovation. The government's recent proposals to develop a regional infrastructure facility will help address a part of the exchange rate impact of likely continued capital inflows, as will the stronger and more focused national strategies which are being developed for external investment in several emerging markets. These markets are increasingly new sources for South African exports, employment and growth.

Conclusions

The recent focus within the G-20 on structural policies to address global growth augurs well for South Africa and offers important policy space for other emerging markets. It puts a stronger focus on a range of opportunities to place structural change at the center of South Africa's efforts to address its vulnerabilities and challenges. Several key pillars will support South Africa's structural policy initiatives—extensive experience in structural reform over many years; several key successes; a platform of sound fiscal and monetary policy management; and an institutional capacity to affect the adjustments needed to reposition the economy. As with most countries—advanced, emerging and developing—the challenge will not be to identify the key structural priorities but to isolate those for which political will and resources can be devoted to their achievement. For South Africa, the list is substantial, yet many among them are readily achievable.

Endnotes

1 See opportunities highlighted in the governments' recent paper on the New Growth Path.

2 New Growth Path Framework, 2010. Available at: http://www.info.gov.za/view/DownloadFileAction?id=135748.