



**national treasury**

Department:  
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REPUBLIC OF SOUTH AFRICA

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## PRESS STATEMENT

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### RELEASE OF RESEARCH PAPERS ON GROWTH IN SOUTH AFRICA BY THE INTERNATIONAL PANEL

#### Background

In 2004 the government of South Africa committed itself to the halving of poverty and unemployment in the country by 2014, in line with the UN Millennium Development Goals. In the first decade of freedom, annual economic growth in South Africa averaged about 3% per annum, a level much higher than the 1% per annum achieved in the decade before 1994. However, this was still not enough to achieve the goals of reducing unemployment levels to below 15% and poverty levels to less than one-sixth of households, by 2014.

The South African government initiated a discussion on growth at the 2005 Cabinet lekgotla. In February of 2006 the Accelerated and Shared Growth Initiative of SA (AsgiSA) was formally launched by government under the leadership of Deputy President Ms Phumzile Mlambo-Ngcuka, with the objective of attaining a higher growth rate of at least 6% per annum by 2010. The underlying approach to AsgiSA was a growth diagnostic analysis which seeks to identify the 'binding constraints' on growth, which the government identified to be:

- Volatility and level of the currency.
- The cost, efficiency and capacity of the national logistics system.
- Shortage of suitably skilled labour amplified by the impact of apartheid spatial patterns on the cost of labour.
- Barriers to entry, limits to competition and limited new investment opportunities.
- Regulatory environment and the burden on small and medium businesses.
- Deficiencies in state organisation, capacity and leadership.

The South African government's responses to the above binding constraints fell into six categories:

- infrastructure programmes
- sector investment (or industrial) strategies

- skills and education initiatives
- Second Economy interventions
- macro-economic issues
- public administration issues.

As part of the AsgiSA initiative, the government (via the National Treasury, in cooperation with the Presidency), engaged an international team of growth experts to research the above and other constraints on growth in the South African economy, and to provide a growth diagnostic in order to improve AsgiSA. The panel was led by Professor Ricardo Hausmann from the Kennedy School of Government, Harvard University, and included a range of economists, based at universities in the USA and UK like Harvard, MIT, LSE, University of Michigan and University of London, as well as experts originally from Venezuela, Turkey, Argentina, UK, France, USA, India, Chile, Pakistan and South Africa. The team worked closely with South African-based academics as co-researchers or assistants in order to ensure that the best local expertise is drawn on, and that there is some transfer of skills. The attached Annexure A is a list of the team.

The panel began its work with a first visit in January 2006, followed by further visits during July 2006, January 2007 and July 2007. During these visits the panel held workshops with government officials, economists, trade unionists, business and other stakeholders in South Africa. During each visit the panel also met with members of Cabinet, including the President and Deputy-President. It published its first set of 9 research papers in July 2006, and a second and final set in September 2007. Altogether 19 research papers and a consolidated report ("Final Recommendations of the International Panel on ASGI-SA") on the entire panel's recommendations were completed and submitted to the government. Annexure B is a list of the papers, which cover the areas of macroeconomic policy, industrial policy (including beneficiation and competition), trade policy, labour market policy, public administration and black economic empowerment.

It should be noted that the papers and final recommendations were written shortly before the current global slowdown, higher global and domestic inflation, and electricity shortages.

### **Binding Constraints to Growth**

The panel argued that the fundamental problem in South Africa is that very few South Africans are working. Those who are working are estimated at 13 million which represent only 42,6% of the working age population and 29% of the total population. This compares to 65% of the working age population in comparator countries and if employment reached the level of these comparator countries it would need to rise by 52%, that is, employment for an additional 6,6 million South Africans. Furthermore the panel argued that the unemployed are predominately less educated (30,4% have less than matric, 28,2% matric, 11,7% post matric and 3,3% university educated), they are young (between the ages of 20-35), and black (33% African, 20% coloured, 18% Indian and 5% white).

Achieving shared economic growth is therefore fundamentally about creating jobs for those currently not working.

The panel argues that it would be important to eliminate the binding constraints already identified in AsgiSA (skills, infrastructure, exchange rate volatility, state capacity, second economy and sector strategies), but recommends that we also grow the export sector. They argue that the consequence of sluggish performance in exports has been declining trends in employment in mining, agriculture and manufacturing. A consequence of this has been that employment in the tradable sector has decreased from 45% of total employment in the 1970s to 30% in 2004 whilst employment in the private non-tradable sector has grown from 24% to 36%. Employment growth in South Africa has therefore been concentrated in the non-tradable sector which happens to be more skill intensive as opposed to the tradable sector which is less skills intensive. The key therefore of absorbing the unemployed who are predominately less skilled is through creating “exports for jobs”.

A further problem that it identified in the short term is whether the current acceleration in economic growth is sustainable and can be maintained. In particular what is worrying is that the current growth acceleration is accompanied by a widening current account deficit as imports are rising much faster than exports (despite higher mineral prices), public spending is growing faster than GDP growth and is accompanied by rising inflation. Growth is being driven by growth in only three sectors namely (1) construction, (2) transport and communication and (3) financial, real estate and business services. They therefore argued, after testing it econometrically, that the economy is growing above its potential which they estimated at about 3,5%.

### **Recommendations of the International Panel**

The International Panel makes a total of 21 recommendations taking into account its view that “the current rate of growth of the economy is *above* what is sustainable...and still remains below the desired 6 per cent announced by ASGI-SA...”. The Panel points out that “a strategy for externally sustainable and shared growth involves the creation of jobs in the tradable sector, which in an open economy translates into *exports for jobs*”. In the context of South Africa, “it is clear that the sector that has grown less and that has suffered the biggest employment losses has been the tradable sector: this is expressed in the dismal long term growth in per capita real exports and in the massive job losses in that sector”. The Panel notes that “additional efforts will have to be made to relax the *binding constraints* that keep the speed limit of the economy below what ASGI-SA would like to achieve”. It breaks up its recommendations into five policy areas:

**Macroeconomic Policy:** The Panel makes four recommendations on macroeconomic policy, having published six papers. The key focus is around

macroeconomic constraints and risks to growth (current account, volatility of exchange rate, cyclicity of fiscal and monetary policy). The recommendations call for fiscal policy to be counter-cyclical and make a greater contribution to national savings, and suggest a larger fiscal surplus target for 2008 of at least 1 to 2 per cent of GDP. The Panel calls for the elimination of existing restrictions on capital outflows, maintaining the current inflation targeting regime but adopting a strategy to pay more attention to the level and stability of the real exchange rate.

**Trade and competition policy:** The International Panel makes four recommendations, having produced three papers on trade and competition policy. They recommend a radically simplified tariff system with low or no tariffs on inputs. They also recommend the review of the SACU arrangements, and the need for SA to take the lead in encouraging African economic integration, but at the same time avoid unrealistic custom union agreements. The Panel also recommends the adoption of a pro-active approach for competition policy, rather than a complaints-driven approach in order to reduce barriers to entry.

**Labour Market Policies:** The Panel makes three recommendations on labour market policy, having produced two papers. The recommendations deal with a wage subsidy for all 18 year olds, with a no-questions-asked job termination requirement. It calls for relaxing regulations on the creation of SETAs, and for firms to be allowed to move to one or more SETAs of their choice. It also encourages high-skilled immigration.

**Industrial Policy (including beneficiation policy):** The Panel makes five recommendations, having produced five papers covering industrial and beneficiation policy. It recommends a shift in focus of the activities of the Industrial Development Corporation (IDC) towards the financing of new activities, away from an asset management approach. It also recommends that the current Customised Sector Programmes be substituted or complemented by an open-architecture approach with self-organisation of relevant actors. It proposes a special central budget for structural transformation. It recommends changes to the existing MIDP by phasing out the IRCC scheme and replacing it with a supplier-based promotion scheme consisting of two windows. The Panel also recommends that beneficiation should not be used as the basis for selective intervention and industrial promotion.

**Public administration and Black Economic Empowerment:** The Panel makes two recommendations on Public Administration, and three on BEE, based on four papers. The first recommendation relates to a certification system for government entities providing economically-relevant services (e.g. visa procedures for immigrants, registration of firms and development of a safe medicinal drug industry, tax and customs collection services). It also recommends that municipalities with poor capacity be required to use central bodies to procure for municipal services. The Panel recommends a review of the BEE scorecard to include new elements to facilitate firm creation, employment creation, learnerships and training. They also recommend the development of a credible

system to collect information on BEE, and a mechanism to evaluate progress and signal future directions of policy.

The Panel has also published a paper on the impact of crime on economic growth. It noted that the most severe impact of crime on growth was probably through the discouragement of small and emerging businesses in poorer areas. No specific recommendations are made for this paper, but this paper has been referred to the research project on crime being conducted by PCAS.

### **Process following the publication of growth papers**

The research papers do not necessarily reflect government's views, nor has government adopted or rejected any of the recommendations made by the Panel. Government also notes that there is no universal recipe or set of policies for a successful growth strategy. Whilst government has been debating, and will continue to debate the issues raised in the research, the process of responding to the papers and recommendations will benefit from a broader public debate. At their last meeting with members of Cabinet on 19 July 2007, the President requested that the papers should be made public to encourage a broader debate on shared growth. It is with this objective in mind that the papers are now being released for further dissemination by the public in general and the economic community in particular.

To facilitate the broader debate, Government is planning a major workshop on the report, between the international panel, government officials, local academics and economists, policy researchers and various stakeholders. This workshop is planned for 17 or 18 June 2008 (*subject to confirmation*). It is hoped that this workshop will also encourage local economists and academics to prepare response papers in order to stimulate the broader public debate. In this respect, economic departments at SA universities and research institutions will be encouraged to convene workshops later in the year on various aspects raised in the research papers, where such local papers can be presented.

The research papers on growth by the international panel and related information can be found on our website at [www.treasury.gov.za](http://www.treasury.gov.za)

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## ANNEXURE A

<b>PANEL OF INTERNATIONAL EXPERTS AND AUTHORS</b>		
<b>NAME</b>	<b>COUNTRY OF ORIGIN</b>	<b>INSTITUTION</b>
Ricardo Hausmann	Venezuela	CID, Harvard
Dani Rodrik	Turkey	CID, Harvard
Federico Sturzenegger	Argentina	CID, Harvard
Jeffrey Frankel	USA	CID, Harvard
Robert Lawrence	South Africa	CID, Harvard
Jim Levinsohn	USA	University of Michigan
Philippe Aghion	France	CID, Harvard
Bailey Klinger	Canada	CID, Harvard
James Robinson	USA	CID, Harvard
Charles Sabel	USA	Columbia university
Daron Acemoglu	Turkey	Cambridge
Asim Khwaja	Pakistan	CID, Harvard
Matthew Andrews	South Africa	CID, Harvard
Abhijit Banerjee	India	MIT
Christopher Stone	USA	CID, Harvard
Steven Kelman	USA	CID, Harvard
Roberto Rigobon	Venezuela	MIT
Matias Braun	Chile	Universidad Adolfo Ibanez
Sebastian Galiani		Washington University
Jonathan Leape	UK	LSE, University of London
Lynne Thomas	UK	CREFSA (LSE), University of London
Laurence Harris	UK	SOAS, University of London
Johan Fedderke	South Africa	UCT
Ingrid Woolard	South Africa	UCT
Lawrence Edwards	South Africa	UCT
Ben Smit	South Africa	US
Stanley Du Plessis	South Africa	US
Stephen Gelb	South Africa	The Edge Institute
Alberto Ortiz	Mexico	Boston University

**ANNEXURE B**  
**List of ASGI-SA Growth Papers**

**1. Macroeconomic Strategy**

- 1.1. South Africa: Macroeconomic challenges after a decade of success – Frankel, Smit, Sturzenegger (September 2006)
- 1.2. On the Rand: Determinants of South Africa's Exchange Rate – Frankel (March 2007)
- 1.3. The cyclical nature of monetary and fiscal policy in South Africa since 1994 – Du Plessis, Smit, Sturzenegger (July 2007)
- 1.4. Through the Pass-through: Measuring Central Bank Credibility – Rigobon (March 2007)
- 1.5. Identifying aggregate supply and demand shocks in South Africa – Du Plessis, Smit, Sturzenegger (July 2007)
- 1.6. Estimating SARB's Policy Reaction Rule – Ortiz, Sturzenegger (August 2007)

**2. Trade and Competition Policy**

- 2.1. Competition and productivity growth in South Africa – Aghion, Braun, Fedderke (August 2006)
- 2.2. South African Trade Policy Matters: Trade Performance and Trade Policy – Lawrence Edwards and Robert Lawrence (October 2006)
- 2.3. SACU Tariff Policies: Where should they go from here? – Edwards and Lawrence (Sept 2007)

**3. Labour Market Policies**

- 3.1. Why has unemployment risen in the new South Africa? – Banerjee, Galiani, Levinsohn and Woolard (October 2006)
- 3.2. Two policies to alleviate poverty in SA – Levinsohn (Aug 2007)

**4. Industrial Policy**

- 4.1. Understanding South Africa's Economic Puzzles – Dani Rodrik (August 2006)
- 4.2. South Africa's Export Predicament – Hausmann and Klinger (August 2006)
- 4.3. Reconfiguring Industrial Policy: A Framework with an application to South Africa – Hausmann, Rodrik, Sabel (August 2007)
- 4.4. Examining Beneficiation: Hausmann, Klinger, Lawrence (July 2007)

**5. Public Administration and BEE**

- 5.1. Discussion paper on procurement issues in South Africa that affect growth and development – Kelman (August 2007)
- 5.2. Black economic empowerment and economic performance in South Africa – Acemoglu, Gelb, Robinson (August 2007)
- 5.3. Is BEE a south African growth catalyst? (or could it be?) Andrews (Sept 2007)

**7. Crime**

- 7.1 Crime, Justice and Growth in South Africa: Towards a plausible contribution from criminal justice to economic growth – Stone (Aug 2006)