MINISTRY OF FINANCE

REPUBLIC OF SOUTH AFRICA

Trevor A. Manuel

Minister of Finance

Republic of South Africa

Stanford University, Graduate School of Business

Conference on Global Business and Global Poverty

19 May 2004

Introduction

Allow me first to thank you for inviting me to address you today. Since I was appointed Minister of Finance in 1996, addressing the international and domestic aspects of globalisation has been a primary concern of South Africa's policy making.

Our decision to reintegrate the South African economy with the global economy has created for us unprecedented challenges in addressing the various pressures, risks and opportunities that derive from that process.

Of those challenges, perhaps the most difficult has been trying to ensure that our social and political values are expressed via our policies and institutions in the face of expectations by international organisations, other governments, investors and business of conformity with practices elsewhere.

The challenge is to balance policy in such a way that we maximize the political contentment of our citizens and the economic value of the practices and benchmarks that globalisation carries with it.

At the same time, however, a wide swathe of globalisation's practices either do not add positive economic value or are biased against the poor. For this reason, the creation of appropriate and strong institutions holds such critical economic and political value to developing countries – such institutions enable the poor to gain from economic integration and globalisation. And, they make many of the policy prescriptions that accompany globalisation capable of being realised by developing countries.

Consider the failure of monetary authorities in the Asian Crisis: East Asian central banks, after years of strong capital inflows, stopped monitoring the inflows and stopped sterilizing them. The result was a massive build-up in foreign currency liabilities, such that when the outflows occurred, monetary and fiscal adjustments dramatically increased poverty, unemployment and dislocation – with the poor bearing the brunt of the adjustments to income. The average decline in GDP in countries afflicted in the Asian Crisis was 12.2%.[1]

In the example of the Asian Crisis, moreover, other institutions failed, including those responsible for preventing international financial contagion. The International Monetary Fund did not have appropriate instruments to address the crisis. This has resulted in considerable reform of the international financial architecture since 1998, including the development and use of Reports on Standards and Codes, the use of collective action clauses in sovereign debt issuance, and constant interaction between countries to identify and act on shortcomings in the system.

In Africa, however, institutional weakness and dependence on resource transfers from the North feed on each other, confounding many of our national and multilateral attempts to come to grips with the challenges of globalisation – in particular ensuring that the poor gain from globalisation. Again, appropriate private and public institutions and good policies, especially those to sustain rapid economic growth, can provide some of the solutions to these problems, but not all. Poverty in Africa is of such scale that efforts to address it require far more than reform in individual countries – it requires a wide range of actors, reform to our multilateral institutions, their instruments and

[1] An IMF paper (Saxena & Cerra, 2003) estimates the average cumulative output loss from the Asian crisis to be 12.2% of GDP. This figure is based on an average of 6 countries (Hong Kong, Indonesia, Korea, Malaysia, Philippines & Singapore) and represents the permanent reduction in output due to the crisis. However, there are signficant variations between countries, with estimates ranging from 1.5% for the Philippines to 22.3% for Indonesia.

their attitudes, and a sea change in political attitudes on trade and agriculture in developed countries.

In the African context of inconsistent growth and widespread poverty, the globalisation challenge can tip states in the wrong direction – away from good governance, effective regulation, and pro-growth policies and toward rent-seeking, the stifling of the private sector, and the further weakening of already inadequate social policies and institutions.

Africa has been slow to develop the sort of international institutions capable of assisting in the policy and sectoral adjustments needed to benefit from globalisation. The OAU was notoriously weak in this area. Regional institutions and arrangements have also lacked the institutional capacity to offer external support to adjustment or to create the large-scale infrastructure projects to support market creation. And that weakness is often mirrored by the cautious approach of many African states to integration, largely because of a perception that regional integration results in a loss of sovereignty or policy autonomy.

These considerations should help to focus our attention on continued efforts to arrange our international financial system in a way that helps poorer countries to benefit from globalisation. A number of institutions and processes currently operating or underway have this aim in mind – the challenge is how to ensure their success in an inhospitable global political and economic environment.

Tony Blair, Prime Minister of the United Kingdom, recently launched a Commission for Africa to look at a range of issues constraining growth and development in Africa. A primary goal of the Commission is to leverage financing from the G8 for further development, and ensure that countries that are capable of using more development assistance are not constrained financially.

In considering the Commission and its efforts, it seems important to keep in mind that many developing countries in Latin America, Africa, and South Asia have made great strides in policy reform, institutional development, and economic governance. Their ability to use greater levels of aid comes at a time when the political will in developed countries to give more aid is low. All countries have agreed to provide 0.7% of their GDP in development assistance. Very few come even close to achieving that, in particular the United States, which gives a mere 0.13% of GDP in aid.

The Development Committee, which is a joint IMF and World Bank committee of ministers of finance and ministers of development, has over the past 5 or so years played an increasingly important role in enabling the international community to guide the policy and programmatic focus of the Bank and Fund in their work in low-income countries. In particular, we have refocused the Bank on harmonizing development aid and ensuring that the Bank is at the center of the process of coordinating movement toward the Millennium Development

Goals. In April the Committee approved the first of a series of tools for measuring progress called the Global Monitoring Report.

Both of these efforts reflect a deeply troubling reality – one in fact which we all are aware of to some extent, and one which the Global Monitoring Report makes abundantly clear. That is, that on balance the developed world is not living up to its own commitments made at the Millennium Summit, in Monterrey, at Johannesburg.

Among them was to raise the levels of development aid to 0.7% of GDP, and to ensure that the aid is harmonized and effective. Probably more important was the commitment made to lower trade barriers and subsidies to exports of manufactures, textiles and agricultural products.

In an environment where the cost of informing an educated public is low, and therefore the politics of keeping these commitments in rich countries should not be so adverse, it becomes increasingly difficult for developing countries to not view the lack of commitment as a veiled attempt to constrain development in developing countries. This sentiment becomes even stronger when there is resistance to reforming the governance structures of our multilateral institutions.

Why is it that the managing director of the IMF must come from Europe when almost of all of its lending, whether short or medium term, goes to developing countries? The argument normally used about shareholdings – that current shareholders finance the Fund – does not hold, because any reasonably accurate attribution of global GDP would see a much larger chunk of GDP and therefore shareholding go to big and fast growing developing countries. At the end of the day, European countries are vastly over-represented on the boards of the Fund and the Bank.

In this inhospitable climate, two broad priorities emerge for Africa and developing countries generally. The first is to overcome the barriers to our economic expansion and industrial diversification posed by developed countries. Brazil, India and South Africa have begun to build and strengthen South-South cooperation on international financial issues and trade – both in terms of a position in the WTO and in terms of reducing barriers to trade and investment between our economies. But such an extra-regional approach needs to be complemented by regional and national development strategies.

Africa's economic development

At the national level, Dani Rodrik has pointed out the importance for growth of macroeconomic stability and microeconomic policies that facilitate the shifting of people from old and non-competitive industries to new industries and new forms of economic activity.[2] Such policies entail assertive re-skilling, high quality education, and access to social and other forms of capital in open environments in which individuals can take advantage of new economic opportunities.

Such a view of economic growth also needs to take into account the capacity of some social groups to consistently push the burden of economic adjustment onto the poor and marginalized. As a prerequisite for more effective financial assistance, reform of domestic economic governance, policies and institutions seems vital.

The difficulty is that such reforms are unlikely to be achieved by weak states, which can themselves be further weakened by large-scale financial assistance with tight conditionality. Not only are weak states incapable of defining and operationalizing broader notions of public welfare, but they often have no interest in moving in that direction. As Nancy Birdsall has pointed out, conditionality can both be a reflection of and cause of a conflict-of-interest between donors and governments.[3]

For African states to balance the distribution of economic burdens and opportunities requires creativity and active, capable state institutions – governance reforms and technical capacity building should go hand-in-hand. In short, while governments and states need to be inventive and devise new policies and new ways of resolving the problems caused by globalisation, relatively traditional functions of the state still need to be fulfilled – providing economic security at the same time as they allow economic activity. The dimension of the challenge to states has been enlarged by globalisation, but the state's function remains the same.

The challenge posed by globalisation is that as policy makers we must constantly grapple with the new pressures and changes of our environment – new areas of policy, new regulations and institutions all confront us every day. And some times, of course, the pressures become very great and we do nothing, taking refuge in the idea that we are sovereign and using the threat of its loss as a means of defending our inaction.

Indeed many African communities hold too dear the idea of national sovereignty, perhaps because it is a relatively recent facet of our existence, but also – because like in all other communities – it is seen to be politically useful. Unfortunately, this has tended to slow the development of African institutions – even though the economic and political bases for their

---

[2] Dani Rodrik, "Development strategies for the next century" February 2000.

[3] Nancy Birdsall, "Why it matters who runs the IMF and the World Bank," Centre for Global Development Working Paper #22, January 2003.

development are manifest in the weak level of trade between our economies, the lack of infrastructure, and our small size.

Building regional economies

To overcome our aversion to regional and global institutions, it seems critical that we recognize that collective state action need not reduce sovereignty. Indeed, it seems to me that the European experience of integration suggests that national sovereignty may be enhanced through integration, despite the piecemeal loss of sovereignty in some areas. When applied to the pressures of globalisation, this thesis seems to hold even more strongly -- globalisation can be addressed in regional and global institutions in such a way as to increase the power of states and better reflect the social and economic preferences of their citizens.

This idea seems especially pertinent in a regional context. Limited infrastructure, non-existent regulation or limited enforcement capacity, thin and undiversified markets for finance, goods and services all limit the extent to which African economies develop. The experience and practice across the continent is of course diverse. While some regions remain in low-level equilibria, others have made great strides in bedding-down policy, regulation, and macroeconomic stability, and are reaping the rewards of higher investment.

Despite international economic turmoil, economic growth in Africa is expected to average 3.1% this year and 4.2% next year. This is more than twice the average growth we achieved from 1984 to 1993, and marginally higher than the average for all developing countries.

Macroeconomic stability is being consolidated, with average consumer price inflation rising by about 9.7% in 2002, down from 13.2% in 2001, and 54.6% in 1994. Underpinning these improving inflation figures are our fiscal balances, which have declined from –5.2% of GDP in 1994 on average to –2.1% in 2001.

But we are unlikely to reap the rewards of more rapid economic growth with only macroeconomic stability. Growing our economies requires us to create and support effective regional institutions that are credible interlocutors for national governments. This means that they are backed by appropriate economic and political governance mechanisms, both internal to the regional institution and at the national level. They should be able to ensure public sector lead provision of market infrastructure and foster the private sector. As the cornerstones of the African Union, Regional Economic Communities (RECs) must be strengthened to provide the framework for developing cross-border market infrastructure, addressing externalities, and forming common policies and regulations.

As in the context of domestic governance noted earlier, in this area weak states can be critical obstacles to progress.

I am not a believer in the idea that either the institution of the state or the institution of the market can or should do everything in economic development. There are simply too many examples of failures of systems of paternalistic states and uncontrolled markets for me to accept either as a one-size-fits-all model for development.

Our model is one of an active, accountable state, dependent on appropriate and non-distortionary revenue generation to provide the means for individuals to engage in economic activity in markets – and where people are unable or incapable of doing so, to provide a standard of living. That model depends in turn on well-regulated markets in which the private sector invests, produces, employs, and competes.

To my mind, that is a very special partnership, and one which informs NEPAD, and in particular the move toward peer review and use of standards and codes in Africa. Such a state can work in partnership with the private sector to unlock rents, expand economic activity and reduce poverty.

Africa and global economic governance

More generally, the idea of coalescing national economic demands into politically sound regional institutions is also important for the achievement of broader objectives, especially the development of a more fair global trade regime, some capacity to address the impact of capital flows, and reform of global economic governance.

In part, the development of common interests through deeper regional institutions becomes increasingly important for Africa, as multilateral trade discussions have become less useful in the current environment of stronger regional trading blocs – but also because deeper regional cooperation enables Africans to approach the multilateral system differently.

A more robust African response to a weaker multilateral system might entail greater focus on basing regional economic communities in Africa on free trade agreements and customs unions of regional neighbours, and then progressively linking them to each other through phased reduction of tariffs and non-tariff barriers. Functional regional economic governance structures based on a core of free trade between members would provide a solid institutional underpinning for the African Union and for negotiation with other countries and regional communities.

Common monetary areas in regional economic communities, and later the African Union, and the development of effective and accountable institutions, such as the parliament for Africa and the peer review mechanism, will further contribute to Africa's ability to address the pressures of globalisation.

In summary, NEPAD enables us as Africans to better manage what we get out of the international financial and developmental architectures, at the same time as it asks us to pursue domestic reforms that ensure that we maximise the benefits.

In combination with the finely structured NEPAD efforts, the international environment must become more supportive of our efforts in Africa and the developing world more generally. The failure so far to make significant progress in lowering agricultural subsidies and increase market access is a dismal reflection of global insecurities, and sours the commitments made in Monterrey and Johannesburg to do much more than trade reform.

Completing reform of the international system

Nonetheless, I want to conclude my talk with some comments on what increasingly seems to me to be a prerequisite for a supportive international economic environment. That is, to complete the reform of the international financial architecture that was given so much energy by the Asian crisis.

One of the key realisations in the aftermath of the Asian crisis (and reinforced by Argentina) was that domestic regulatory institutions and governance matter, not just for prevention of crises but also for their resolution and the recovery of the stricken economies. To get a handle on domestic weaknesses that make economies prone to crisis, it was important to engage more fully with governments and the national economic and regulatory systems they are responsible for. For that reason, and others, a range of emerging market economies were invited to the discussions on prevention and resolution and helped in the formulation of new codes and standards.

All of this has been immensely beneficial for the international financial system, the strengthening of regulatory and oversight functions in national systems, and the spreading of knowledge. Global economic governance, and hence reform of the international financial architecture, however, remains incomplete. We need a multilateral basis for overcoming future bouts of financial contagion – to maintain the connection between developing economies and international capital and goods markets and enable them to grow and reduce poverty.

The logical extension of the new role of emerging market economies and other developing countries would have been to reform the governance of multilateral institutions to enable them to take part in the decision making of those bodies. Not only would this strengthen reform efforts, and thereby reduce the contingent costs of future crises, but would also strengthen the legitimacy of those institutions in other parts of the developing world – thereby helping to start developing countries on the right institutional and policy footing as their economies mature and diversify.

Instead we are left with multilateral institutions, which, despite the impressive efforts of their staff, are experiencing a degradation of their legitimacy because of their governance structures. As a result, few developing countries want to heed their advice, unless they have to – a situation that reinforces weak legitimacy.

That hope, however, is merely a reflection of a more general point – that for too many countries around the world the idea of a reasonably stable international financial and economic order are quickly becoming remnants of a multilateral past – even as the social and economic implications of our growing interdependence touch our most remote communities.

Perhaps we should not be fooled into believing that multilateralism worked so perfectly in the past. After all the Bretton Woods System itself masked many international conflicts over macroeconomic policy coordination and negative spillovers. And most African countries have had a dismal one-sided relationship with that system – one that has done little to help them become independent and sustainable.

We have defined a path to resolve the complex of problems associated with dependence and sustained growth, but it is time that the international system made our work easier, not more difficult. We should keep in mind that there are many more actors on the international political and economic stage today and there will be even more tomorrow – common interests might be more difficult to define in our developing plurality but they are no less critical to our common future.

Thank you.