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OPENING REMARKS: G20 SEMINAR ON ECONOMIC GROWTH, 4 AUGUST 2005 AT THE SOUTH AFRICAN RESERVE BANK

I wish to welcome you all to South Africa, not only because South Africa is such a wonderful country to visit, but also because economic growth is probably the most important intellectual and analytical challenge facing all developing countries. It is not just a matter of empirical facts and understanding, it is also a policy challenge, about values and priorities.

And unfortunately, there is no universal recipe, it requires separate journeys of discovery, country by country. We can't assume that what works in one context can straightforwardly be applied in other. We all have hard work to do, which is why this conference is so important.

In South Africa we are currently involved in an intense debate about our own growth strategy. Our growth rate has increased steadily and has stabilised at around 3-4%, although our potential growth rate is higher and we still have a considerable gap between available resources – unemployed workseekers – and the actual level of activity. We need to accelerate our growth performance if we are to halve poverty and double household incomes by 2014, enabling us to meet the first Millennium Development Goal. If, however, we continue on our current growth trajectory, average household income will take 25 years to double, unemployment will stay above 20% and progress in reducing poverty will be slow.

So I am pleased to see such an eminent group of academics, researchers, economists and policy-makers here today to help us find the appropriate recipe for growth in the next ten to twenty years. In finding responses to this challenge, I want to pose a number of questions that we are struggling to find answers to in the South African context. It is my hope that this conference can assist G20 and other countries to develop road maps for higher growth.

Globalisation and Growth

The first issue with regard to growth, and that we are all aware of, is that growth in a developing country is highly dependent on external international factors largely shaped by developed countries. National efforts for higher growth cannot fully succeed at the global level unless they are complemented by equitable and stable rules of the “global game”. And I think most of you will agree that we are still far from a balanced, fair and efficient international economic system.

The rules of the game are biased, in several ways, against developing countries. The most obvious example is the global trading regime, in particular agricultural subsidies. This constitutes a major constraint to growth for many poor developing countries, particularly those in Africa, because of limited opportunities to export the products in which they have a comparative advantage.

Whilst the G8 debt relief initiative which is currently on the table should go some way to promoting growth on the continent, it is not a substitute for the pressing challenge of expanding trade opportunities.

African countries require a combination of trade, aid and debt relief alongside the reforms underpinning a growth path consistent with achieving the MDGs.

Our countries, represented in the G20, are typically major players in our particular regions. It is therefore important to consider our growth and trade strategies in a regional context - to look at issues like tax and customs harmonisation, for example. If the G20 is to play a role in fostering a more equitable global economic order, it is imperative that our domestic growth policies explicitly endeavour to stimulate growth in smaller and less developed economies. In South Africa, fostering economic prosperity in our neighbouring countries is a key objective, since our fortunes are inextricably linked through flows of people, capital and goods.

The international financial system has proved to be a major source of instability for developing countries, particularly emerging markets. We have made important strides – particularly in the G20 – in developing and implementing standards and codes for the financial sector. But we have not yet come close to addressing the external causes of financial crises, nor have we developed an international mechanism that adequately deals with adverse effects of financial contagion – the way in which markets transfer shocks in one place into damage in other places. An important question for further exploration, therefore, concerns the problem of international cooperation: how can we improve the effectiveness of joint international initiatives, to manage the risks of the international economy and assist both developed and developing countries to grow?

Let me turn to a different but related question: How appropriate for developing countries are the lessons of growth from developed countries?

In considering a growth strategy for South Africa, we are keenly aware of the major constraints that we face, which are often the result of our apartheid history, which denied economic and educational opportunities to the majority of our people. We have recognised since 1994 that two main pillars of a growth and empowerment strategy are the need to create an enabling environment for productive investment by enterprises, and the need to invest in skills and human capabilities.

In addition, we have identified several critical reform challenges for the next few years. These include macroeconomic and exchange rate stability, accelerating public investment in infrastructure, improving the quality of our housing and community environments, improving productivity and lowering the costs of job creation, improving the effectiveness of industrial policy, and strengthening public administration.

These are unavoidably complex areas of policy, combining macroeconomic and microeconomic considerations, and also institutional and social dynamics. We need to learn from international experience, and perhaps some of our experience will be of interest in other countries.

Macroeconomic and exchange rate stability

Clearly there are a number of basic pro-conditions for growth, like political and macroeconomic stability, including low and stable inflation and a sustainable fiscal position. We have achieved macroeconomic stability in South Africa, and though it has taken us longer than we hoped, we are today enjoying the fruits of the macroeconomic policy we adopted soon after 1994. But we have also recognised that we need to do even more that we have in order to put South Africa on a growth path higher than the 3-4 per cent range, and the questions that we are asking relate to how we can do so.

How do we ensure that we have a more stable, competitive exchange rate level? You may be aware if you go through the back page of The Economist, that in 2004 the SA rand was amongst the currencies that experienced the highest appreciation against the US dollar. A few years ago we experienced a steep depreciation of the currency, feeding through to rising inflation and financial uncertainty. These kinds of volatility adds to the risks businesses face and hold back investment. To some extent, market movements in prices are a fact of life. But there may be ways in which a country like South Africa with a flexible exchange rate can improve the operation of the exchange markets and contribute to a more stable rand, and hence a more favourable climate for investment and trade?

One of the key constraints for growth in many countries is the deficit in the current account. While this may be less of a barrier to growth in a world in which capital is highly mobile, the determinants of trade finance requirements are not automatically linked to the dynamics driving capital flows. These are general policy challenges – there are also the specific uncertainties of the world today. Within a developing country context, we have to ask ourselves what the impact of an abrupt correction of the US twin deficit would be on the international financial environment and on individual countries.

Why is the current account deficit less of a problem for the US economy than the South African economy? Are the models of a developed country in the Northern Hemisphere relevant to us here in South Africa?

Governance Arrangements and Role of Government

What should be the role of government in the growth process? It is generally agreed that the public sector should strive to create an enabling environment for the private sector to flourish. However, the extent to which government can influence the nature of the growth process, and who benefits from growth, is still open for debate.

The state clearly has an important role to play in establishing and maintaining stable governance and institutional arrangements that ensure that investors – both domestic and foreign – face as certain and predictable a climate as possible. We have in South Africa a democratic constitution, which provides for the rights of citizens and property owners, and also clearly establishes three tiers of government and the powers and functions of each. We have an independent central bank whose primary responsibility is to "protect the value of the currency in the interest of balanced and sustainable growth" in South Africa. Our Constitution has strong provisions outlining the way government handles public funds, including measures to deal with corruption and inefficiency. We have an independent Auditor-General to audit and report on the financial statements and management of all organs of state. We have active political representatives in Parliament, provincial legislatures and municipal councils to oversee the performance of the executive, and ensure they are accountable.

I have no doubt that these institutions have made a big difference in improving our growth prospects during the last ten years, compared to the ten years before 1994. However, I am also aware that country circumstances differ widely, and economic growth can be achieved under many difference political and institutional frameworks. This is a particularly interesting and important area of inquiry – how do the institutions of governance contribute to economic performance, both in respect of growth and the broader challenge of deepening participation and improving the distribution of income and opportunities?

Another important factor to consider is the extent to which government has the capacity to *implement* its policies. This includes the power to implement its budget; to spend its funds as budgeted, particularly on capital projects. This power to implement has to be at all levels of government, not just national government. Another example is to ensure that our criminal justice system works effectively – we have good legislation in place to deal with crime, fraud, corruption, money laundering etc – the tougher challenge is to deal with those guilty of transgressing the law, and more important, to build a society that respects the law.

Growth and Inequality

I am assuming that the focus of this conference is on growth that is employment generating, and poverty alleviating. We cannot simply assume a trickle-down approach to growth, and it goes without saying that what we want is growth with redistribution.

We in South Africa recognise that we have a society characterised by a very skewed income distribution, that we have two economies living side by side – one part a modern first world economy living side by side with a poverty-stricken and informal economy. Thus, in addition to the need to create an enterprise economy, we have to also recognise that South Africa is a developmental state where government has to take active steps to close the gap between the two economies.

In wanting to create an enterprise economy, we have taken the right steps to lower the tax burden on all South Africans. We have kept our national tax to GDP ratio at around 25 per cent, in an effort to increase the incentive for entrepreneurs and investors, as well as to boost the spending power of consumers. What more do we have to do to improve or decrease overall taxation, or particular types of taxes, to improve the climate for investors?

What is the impact of spending such a budget on our growth prospects? In our first ten years of democracy, we have substantially grown recurrent expenditure on programmes, social grants and increased remuneration of teachers and health workers in order to provide basic services and alleviate poverty. How do we ensure an optimal balance between social and capital expenditure, which fosters strong economic growth while also reducing poverty and promote a more equitable society? Recent studies have also shown that relatively unequal societies on average grow at a slower rate than societies where income is more equally distributed. The higher the level of inequality, the higher the level of growth needed to challenge the problem of poverty.

Given the need to achieving macroeconomic stability, we were initially constrained from playing a more significant role in promoting growth. Public investment, for example, has lagged private investment for many years. We need to review the optimal size of the public sector, as the Washington consensus does not take account of market failures or weaknesses, which need to be addressed in meeting our developmental challenges.

But we also recognise that making money available on the budget does not mean that such funds are going to be spent as intended, or spent effectively. In spite of our budget reforms like three-year budgeting, greater transparency and an increasing focus on performance, we have seen that many government departments and public entities fail to spend their entire capital budgets each year, and hence undermine our growth prospects as a result. These budget reforms have assisted in modernising the way government works, but are not enough by themselves to ensure that there is effective spending. We need to improve our accountability and incentive systems within the public sector to ensure that government spends its budget more effectively. Developing our policy, planning and project management capacity is critical for a higher growth path, particularly in the area of transport and logistics. To what extent can we or should we co-ordinate the capital programmes of all organs of state including our public entities in order to promote faster growth? How can we strengthen our public administration to ensure a capable state sector able to delivery on its promises?

We also need guidance on the right balance between urban and rural development, in order to promote higher growth with a better distribution of income. Bridging the two-economy divide in our country is a major challenge for us, and, I believe, for many other middle-income countries in the G20. I hope this seminar will provide an opportunity for us to learn from the experiences of others in this area.

CONCLUSION

I have left you with many more questions than answers this morning – these are difficult matters requiring careful analysis and intelligent consideration of policy choices. We won't find all the answers, but I look forward to learning from the proceedings of this conference – learning about our own choices, and about the issues we face collectively as part of the international community.