MINISTRY: FINANCE
REPUBLIC OF SOUTH AFRICA
Private Bag x115, Pretoria, 0001 • Tel: +27 12 323 8911• Fax: +27 12 323 3262
PO Box 29, Cape Town, 8000 • Tel: +27 21 464 6100 • Fax: +27 21 461 2934

Africa, our future

Trevor A Manuel, MP

Minister of Finance

Economist of the Year Banquet

8 May 2007

Introduction

Allow me to thank you for inviting me to address you today.

We celebrate today the accurate forecasting of certain data, and this is an important exercise. Fiscal policies, decisions about interest rates, the values of foreign currencies, and countless other observable and unobservable variables affect the future values of key data. Forecasting any of these is no mean task. I want to take this opportunity to push the boundaries of what we normally think of as the job of economists. We need to recognise the importance of pushing our limits, of identifying and testing new relationships, of finding causal linkages between economic outcomes and inputs of less-clear, social and political origin. In particular, given our regional and domestic economic context we need to work harder on drawing out the links between institutions, their effectiveness, what goes into creating them, and the ways in which they affect long-term economic outcomes.

Because institutions and their governance have a temporal dimension covering many decades, they provide a critical tie between how we think about South Africa's present economic conditions and South Africa in the long-term. Institutions are also critical to how we manage integration with the world economy, and in particular how we as South Africans think about building the foundations for more rapid economic growth in the Southern

Africa region in the context of globalisation. It is in this area – the challenge of growth for Africa – that I want us to stretch our thinking.

Globalisation presents a critical challenge to sound institutional development and economic governance in all states, and in particular African states. The heightened sense of challenge one gets in Africa arises from two systemic fragilities – the role of the state in growth and the weaknesses of regional African institutions.

In the 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.

At the same time, 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. 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 perceived losses of sovereignty incurred by regional integration.

In both of these areas, however, Africa is making great strides. The open question, and one which will influence global economic issues for decades to come, is whether further progress will be made on the creation of an international environment that is capable of supporting our efforts.

Globalisation and fragile economic growth

One of the larger challenges posed by globalisation is the extent to which governments need to adjust macroeconomic and/or microeconomic policies to achieve more rapid economic growth in an environment of open markets.

For African countries, that challenge assumes giant proportions. Most African economies retain fairly high trade barriers, largely due to weaknesses in revenue collection from other forms of taxation, whose reduction would require significant economic adjustment in the domestic economy. Added to the adjustment consequences of liberalising trade policy are the effects of even small financial imbalances. Public and private regulatory institutions and market structures are often not sufficiently developed and deep to weather the effects of poor policies and exogenous shocks.

These brief considerations give rise to a few tentative ideas. First, African economies will remain highly sensitive to the role of multilateral institutions and donors – financial flows need to be handled delicately to avoid severe economic repercussions.

And, second, that multilateral adjustment programmes need to be more holistically conceived than they are at present. Dani Rodrik has pointed out

the importance for growth of microeconomic policies that facilitate the shifting of people from old and non-competitive industries to new industries and new forms of economic activity.[1] 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.

In other words, economic growth is a function of both prudent macroeconomic policies (low deficits and inflation and manageable debt levels) and microeconomic policies that facilitate adjustment through the provision of social capital and opening up of economic opportunity – especially to the poor.

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. 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.

Building regional institutions

To overcome our aversion to regional and global institutions, it seems critical that we recognise 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 me 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 over 5% this year and between 6 and 7% next year.[2] This is more than twice the average growth we achieved from 1984 to 1993.

---

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

[2] See *Regional Economic Outlook for Sub-Saharan Africa*, April 2007, IMF.

Macroeconomic stability is being consolidated, with average consumer price inflation rising by about 7.2% in 2006 down from 9.7% in 2003 and 13.2% in 2001. Underpinning these improving inflation figures are our fiscal balances, which have declined from –5.2% of GDP in 1994 on average to a surplus of 1.5% in 2005 and 4.1% in 2006.

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.

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. As I said in this year's budget speech*, we do this, consciously, as a choice of this government because without a powerful countervailing force, the shadow of history will dictate opportunities, entitlements and outcomes*. 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.

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 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.

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.

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.

In a world of volatile capital flows, powerful financial markets, and destabilizing macroeconomic policy decisions, it seems only a matter of time before the major financial contributors to the IMF and World Bank recognise the prudential character of reform as financial costs grow ever higher.

We should keep in mind that there are many more actors on the international financial 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