

ADDRESS TO THE TIPS/DPRU CONFERENCE

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Chairperson,

We are indeed very privileged to be able to gather some of the best and the brightest minds from our country and abroad to this gathering. This is absolutely appropriate because the challenges we face will vex even these formidable intellects.

As we approach the end of the first decade of democracy, it is opportune for us to reflect on our achievements. To celebrate how far we have come and to gain sustenance for where we still need to go.

1994 marked the end of one struggle and the embracing of a new one. Our struggle for political freedom had ended. We celebrated. We were jubilant. Indeed, we were a nation filled with hope and expectation.

At the same time, we realized that we were not even half way on our long walk to freedom. Political freedom is paramount. But that democracy must provide the vehicle for the realization of our dreams and aspirations. Both as a nation and as individuals.

On the economic front, we have every reason to be proud. We have successfully turned around a virtually bankrupt economy into one capable of delivering 19 quarters of uninterrupted growth. But as this conference recognizes, our community remains scarred by the experience of intense poverty and social exclusion that affects so many of us.

For this reason, I hope that you complete these sessions having defined further research directions, new proposals for Government policy, and new perspectives for the public at large to consider.

I would of course be remiss if I didn't take this opportunity to make a few remarks about economic policy and poverty.

Between 1994 and 2002, economic growth averaged almost 3 percent. In the 10 years preceding democracy, the economy spluttered along at less than 1 percent a year.

Similarly, over the past years, we have restored health to the public finances. The budget deficit has fallen to 1.2 percent of GDP last year from over 7 percent in 1994.

These are remarkable achievements. Particularly so, if one merely considers the international turbulence that has buffeted our economy over the past decade. From emerging market crises in Mexico in 1995 to Asia in 1997 and Argentina a year or so ago, emerging markets have faced considerable volatility.

But, on the basis of sound macroeconomic management, we have been able to meet these challenges.

Despite this, we cannot pretend that we are divorced from events in the global economy. The world is at a stage of inter-connectedness that ties our development path with our sister national in Africa, the rest of the developing world and of course the rich nations of the north.

The past year has been especially challenging for the global economy. Geopolitical uncertainty compounded weaknesses in the major economies.

The eternal optimists were forecasting a strong rebound in the global economy during 2002.

But, growth forecasts were consistently revised downward over the course of last year, as the reality of weak global demand weighed on global production, which compounded by rising unemployment and worsening fiscal positions.

In the event, in 2002, these economies realized growth of:

2.4 percent for the US

1.0 percent for Europe (EU)

0.8 percent for Europe (Euro region)

1.8 percent for the UK

While the rate of growth is slowly increasing in some major world economies, serious misalignments will continue to make the recovery fragile.

These include the development of interest rate differentials between the US, Europe and Japan, and result in inappropriate monetary stances for some, particularly Europe. As interest rates diverge in the near-term, the possibility of significant shifts in capital is likely resulting in greater exchange rate volatility until new equilibrium (including growth, employment, interest and exchange rates) are reached.

At the same time, stronger growth in the US, while certainly desirable, carries with it the possibility that structural balance of payments misalignment between the US, Europe and Japan will continue. Stronger growth in private consumption, investment and employment in the US will lead to significant further deterioration in the US current account deficit in the short-term, and will probably add to the long-term misalignment – especially if the US dollar strengthens.

European economies need to shed the fiscal constraints on growth at the same time as they pursue structural reforms. Germany's efforts to reform the labour market are a positive sign. It is very unlikely that the US current account deficit will be unwound in a positive way if Europe does not raise its growth rates significantly.

Of equal concern in the short run are the exchange rate policies being practiced by China and other Asian economies, which are pegging to the US dollar and thereby maintaining highly competitive export orientations.

In addition to undermining European growth (exports to US markets), this policy adds to deflationary pressures on their own domestic prices because the real depreciation requires tight monetary policy and hence reduced domestic consumption.

The development of interest rate differentials in the North carries further risks for the South. In particular, rising interest rates in the US will put upward pressure on monetary policy in developing countries that borrow on international markets (and all others more indirectly). The impact on growth will be negative, even if the interest rate rise is restricted to long-term rates. Exchange rate policies in most developing countries still tend to peg against major currencies, so they are unlikely to provide much of a buffer for domestic interest rates and growth.

Finally, it is worth noting that the fragility of growth in Europe will weigh heavily against any serious reform of the Common Agricultural Policy via the WTO and the Doha negotiations.

Despite weakening production in the face of global adversity, it is clear that strength remains in the domestic economy. This bodes well for our future development path.

It is particularly notable that we continue to build for a prosperous future. Capital formation over the first half of the year was a healthy 8 percent, continuing the momentum from the 9 percent in the second half of last year.

Sustaining this growth is the challenge, not least because growth creates employment, and employment is the single most important factor in reducing poverty. How we get growth and employment is the central challenge.

I trust that the debate today on Dave Kaplan's paper was a step forward in this regard. Industrial policy is not only important, but it is also difficult. The economic history of most developed and developing countries – including our own – is littered with the debris of failed strategies, inefficient and subsidized parastatals and private companies, costly services and unsustainable fiscal commitments and debts. For South Africa, and I think my Cosatu colleagues have said the right things here, industrial policy needs to focus on labour-intensive capital accumulation.

Trade policy and fiscal policy are also critical components of a growth strategy. Through trade policy we can lower the costs of imports to both our manufacturing sector, which needs capital imports, and to our consumers. Reduced costs to both consumers and producers, frees resources for other consumption and investment, thereby contributing to growth.

With the gradual real depreciation of our exchange rate over the past 9 years, the effective protection of our industries has risen after the initial deep liberalization. Tariffs have fallen faster on inputs than on output, leading to increases in effective protection. More than 50 percent of the economy has seen an increase in effective protection over the 1990s, with just 15 percent of the economy experience a reduction in effective protection.

These results are confirmed by the IDC. Of the 29 sectors evaluated by the IDC in 1998, 14 show effective protection rates of greater than 10 percent of which 10 are higher than 20 percent. Most of these sectors produce manufacture goods and the average effective protection rate for the manufacturing sector as a whole, at 23.7 percent, is almost twice that of the total economy.

Even where effective protection has fallen, so too have export subsidies, and anti-export bias remains prevalent in almost all sectors of the economy. The IDC analysis shows that in 1998, mining and services were the only sectors to show an anti-export bias of less than 1 (production for export is more profitable than production for the domestic market).

The price raising effect of import protection therefore remains a disincentive to export, it also imposes a significant welfare cost on the consumer. Van Seventer and Edwards (TIPS May 2001) show that the total welfare cost of tariff protection in South Africa is "considerable" and has increased between 1998 and 2000. This cost is also reflected in the relatively high mark-ups charged by South African industry.

Regional and bilateral trade agreements can help to open new markets but they do entail a number of costs. Preferential tariffs seldom generate new trade, but are more likely to divert trade from suppliers favored by importers to less favored one.

This in itself imposes welfare costs on domestic consumers of goods imported from outside of the preferential trade area. Either they continue to purchase from favored suppliers but at a higher relative cost, or switch to imports from within the region, which may be of inferior quality or type.

The results of these studies are confirmed by the National Treasury's own analysis of prospective trade agreements with Brazil and India (TIPS Working Paper 10 – 2000). The trade and welfare benefits arising out of a number of alternative scenarios, including autonomous liberalization, are higher than those involving Mercosur and South Asia.

Moreover, almost all of the increased trade resulting from bilateral liberalization with Mercosur or South Asia arises from the artificial diversion of demand away from favored to less favored suppliers (at the expense in the case of SACU imports of South African consumers, including producers using imported inputs).

In terms of fiscal policy, we have not gone far enough down the road of creating an activist developmental state, equipped with the newer tools of market intervention to minimize negative externalities, maximize the positive externalities, and ease the adjustment of burden of labour and capital.

Our understanding of a developmental state is one where poverty is reduced in the long term through providing people with the capabilities to engage in productive employment in an economy that is expanding with opportunities. At the same time, our social safety net plays a crucial role in preventing the worst effects of poverty and malnutrition.

This requires government to perform a balancing act. From a macroeconomic perspective, one consideration is whether or not social insurance policies facilitate or impede the adjustment of individuals and communities to new forms of economic activity. The microeconomics of the problem is how and to what extent the precise social insurance policies or instruments incentives individuals to choose between remunerative and non-remunerative activities.

But what has become increasingly clear to many policy makers is that even social insurance is geared toward incentivising remunerative activity, there are many impediments that exist and which have become more debilitating over time, especially for the poor who usually have neither the social nor physical capital to overcome them.

The concept of a social wage is one way in which these impediments can be reduced, through the public provision of services, such as inexpensive transport, better education, re-skilling, communications facilities and credit to name a few of the more important components.

Perhaps more importantly, these aspects of a social wage rise above the contradictions that do exist between creating economic opportunity and reducing economic insecurity. Better education or inexpensive public transport, for example, serve to both reduce economic insecurity and create economic opportunity by making it less costly for even the poor to engage in economic activity. That said, it is also important for our social policies to address those that need welfare that is those who cannot engage in economic activity.

Only a balanced agenda of this sort is likely to meet our objectives of growing our economy and reducing poverty and inequality.

Healthy fiscal balance over the past few years have allowed us to concentrate our energies on important areas of social transformation.

In particular, we have been able to:

- Expand infrastructure support in recent years
- Improve the capacity of the health system to deal with HIV/AIDS
- Invest in quality enhancement in the education system
- Widening and deepening our social security systems, particularly for children and the aged.

The recent census pointed to many of our successes in delivering key social services. Overall access to key services, such as electricity, sanitation and health and welfare have all increased.

But equally, we are reminded that this is not good enough. Too many people do not have jobs. Too many people still do not have adequate accommodation. Too many people go to bed hungry.

It is images of these people that must be with us this week. We must put aside ideology and self-interest to ensure that we engage in debate on trade policy. Industrial strategy and welfare policy that we bear in mind our broad objectives. In closing, in the course of your deliberations I challenge that the discourse must be fresh, it must probe, it must provoke.

But above all, it must challenge, it must drive us from our place of comfort – because the poor know no comfort. And we carry a burden of responsibility to develop sustainable solutions to economic growth and development.

I wish you well...

Thank you