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STRENGTHS, WEAKNESSES, OPPORTUNITIES AND THREATS: THE STATE OF THE SA ECONOMY

INTRODUCTION

Good morning esteemed business leadership and ladies and gentlemen gathered here today. It's a pleasure to be speaking to you today, but truth be told it's a bit intimidating addressing an audience of so many of the country's top directors. I have decided to do a quick SWOT analysis on the SA economy. I'm sure the management guru's here will argue that there is some inherent logic in starting with the strengths and ending with the threats, but I have decided to do it my way - beginning with the weakness, then discussing the current and emerging threats we need to manage, after which I will discuss the strengths we can build on and the opportunities we can leverage to get the economy on a path of sustained recovery. It's probably the politician in me wanting to end on an optimistic note, and I'm sure we would all agree we could do with a little bit of optimism at the moment. Unfortunately, I may speak a little more on the weaknesses and threats than on the strengths and opportunities. This is the space we are in.

WEAKNESSES

So let me then begin with the weaknesses. There are many, so I will cut to the chase. Over the recent past I have written and spoken extensively on the weaknesses of the SA economy. I have argued that we are stuck in a low growth trap.

The recent growth data released earlier this week by StatsSA shows that we have technically entered into a recession. The South African economy contracted by 0.3% in the last quarter of 2016 and 0.7% in the first quarter of 2017, meaning that it has contracted for two successive quarters. A closer look at the data shows that the primary sector – that is mining and agriculture – is recovering, growing by almost 15% quarter on quarter. This is as a result of global commodity prices starting to improve, as well as the effects of the drought which had crippled our agricultural sector beginning to ease. But both the secondary and tertiary sectors have shrunk, and given their relative size, especially the tertiary sector, it has taken the economy into recession. The trade sector has contracted by 5.9% on the back of falling consumption expenditure. People are spending less on goods and services they don't need. Spending on clothing and footwear for example has fallen by more than 12%, and spending on restaurants and hotels by almost 9%. There is less money in circulation, and banks are holding back on credit extension in the face of current and possible further downgrades. This is what has driven the contraction in the services sector.

Unfortunately, this low growth is not cyclical, it is structural. The SA economy has grown at an average of 1% since 1990. Compare this to countries like China that have grown at more than 8.5% average growth since 2000, and India at around 7%. In fact the whole of emerging Asia has grown at just under 7% and Africa at more than 4% (although this is from a low base). So why are we not growing like other developing economies, especially given that we have sophisticated infrastructure and business capability many countries only dream of having?

Firstly, we remain too dependent on unreliable sources of foreign investment to finance our growth ambitions. Like countries such as Brazil and Turkey, South Africa is extremely vulnerability to external shocks, with susceptibility to large-scale financial crises caused by even relatively small economic shocks. We remain locked-in to global markets as a primary commodity exporter, and find ourselves extremely vulnerable in times of lower commodities demand and prices. This accounts for the poor performance of economies such as Russia, Brazil, Nigeria and of course South Africa. Economies that have enjoyed higher and more equitable growth, and have proved far more resilient in the recent global downturn, are those with more diversified economies and higher levels of manufacturing value added. South Africa's manufacturing value added as a percentage of GDP is around 12%, Turkey's around 13% and Brazil's 17%, compared to China (32%), South Korea (31%) and Thailand (33%). It is especially in the high technology exports that the real differences are exposed. As a percentage of manufactured exports, high technology goods make up only 4.5% in SA and 2% in Turkey, compared to 43% in Malaysia, and 26% in both China and South Korea. This is directly attributed to government support in areas of R&D, technology development, industrial policy, export incentives and logistics efficiencies, as well as private investment in R&D and venture capital funding.

Secondly, we are not investing sufficiently in fixed capital. South Africa's fixed capital investment as a percentage of GDP stands at around 18%, similar to Brazil at 18% and Turkey at 20%, compared to China at 47% and South Korea at 30%. We need to ask hard questions here today why many of our big firms are investing more in other developing countries (including China) than here at home. Here we need to address issues of policy certainty (especially in areas like mining) as well as rising costs of doing business. This includes costs of electricity, costs of logistics (including high port handling costs), costs of broadband, and costs of labour (where wage increases outstrip growth in productivity). This is what we need to become infatuated with as a country if we are to pick up levels of fixed investment in the economy. Currently, it makes business sense to invest in liquid financial markets or simply keep your money in a bank, rather than invest in fixed capital. This must change. We need to drastically increase private investment in the economy, especially given that the fiscal space for the state to increase levels of fixed investment has closed given the weak balance sheets of many of our SOCs and the recent investment downgrade.

The third reason we are stuck in a low growth trap is due to our inherited inequality. I have argued elsewhere that countries with high initial conditions of asset inequality seem to be slower growers than countries with higher levels of equality. This has to do with reduced aggregate demand, and heightened social and political stability risks.

Unfortunately, there is no quick fix to this problem. Simple asset redistribution without growing investment and productivity might reduce inequality, but will also increase unemployment and poverty. We must rather focus on creating new wealth and assets in which the previously dispossessed have a growing share. We have a very sophisticated fiscal redistribution programme, but our efforts to reduce wealth and asset inequality have not had impact. Our BBBEE policies have created some wealthy black business people, but real inequality has increased across all race groups. Our poor education and training outcomes have not helped here. So we need a new and different conversation about what inclusive growth means, and what instruments we need to assemble to make real economic participation among the majority of citizens a reality. I would think this needs to focus both on how we create many more black entrepreneurs (through incubation programmes, venture capital etc), as well as how we can create jobs for the low skill segments of our population.

The fourth reason we are stuck in a low growth trap has to do with the inability of the state to lead an economic reform project. The state has a critical role to play in driving a radical economic reform agenda, but has been compromised by its lack of policy focus, insufficient technical capabilities, and capture by narrow political-business complexes (as outlined in the Public Protectors State of Capture Report, the SACCs unburdening report, and the recent work by some of our esteemed academics). Our SOEs should be primarily focused on driving the economy (cheap and secure electricity, cheap port handling costs etc), but unfortunately have been repurposed to serve corrupt interests. Looking at countries like Singapore, we can agree that the state has a vital role to play in economic reform, but this can only happen if we free the state from the scourge of corruption and patronage appointments. So building a capable, professional and corrupt free state must be our priority over the short to medium term.

Continuation of our existing growth model, with its low growth and inherent structured inequalities, will increase spending pressures on welfare, security and debt servicing. This is a scenario we cannot entertain.

And given that our debt is increasingly foreign funded, failure to do so will compromise sovereignty. As you will note, a strong part of the MTBPS is dedicated to how we propose to continue fiscal consolidation to reduce our budget deficit and stabilize public debt. Also to be noted are the measures we are implementing to derive greater value for money in public service delivery, including strengthening supply chain management to eradicate opportunities for corruption and leakage.

THREATS

I will now turn to the threats we need to collectively manage. The first relates to the recent downgrade. While in many respects the economy was expecting and had factored in a downgrade, only one of the ratings agencies (Fitch) fully downgraded both foreign and local debt. Further downgrades, especially of local currency debt, need to avoided at all costs. The experience of countries like Brazil and Turkey show that downgrades were followed by increases in unemployment, reduced foreign investment, and rising costs of capital for both the private and public sectors. Treasury has predicted the downgrade will knock between 0.3% and 1% off growth prospects for this year. This is unfortunate, given that some green shoots of recovery associated with improved global economic conditions were starting to appear. It has also forced the hand of the Reserve Bank to keep interest rates unchanged, at a time when some monetary policy relief was on the cards. What has happened is history, but how we manage things going forward is critical.

The ratings agencies gave six main reasons for the downgrade. (1)Policy uncertainty (mixed signals on economic policy); (2) lack of will to implement economic reforms; (3) governance of our SOCs (corruption and contingent liability); (4) Government debt and the extent to which fiscal consolidation will be maintained; (5) concern over affordability of the nuclear programme; and (6) growing social pressures (citizen unrest) which could result in populist spending decisions. These will have to be attended to with urgency if we are to avoid further downgrades, and regain our sovereign investment grade.

Besides a further downgrade, the other key threats we need to deal with have to do with the growing rise of populism. In a recent paper I described how populism works best in low-trust societies, and encompasses a range of ideologies, left and right wing.[1] The essence of populism is to define friends and enemies, and demand that the state takes sides and behaves in a partisan manner even if it breaks its own rules and bypasses the institutions established to uphold law. Populism denies complexity, denies constraint, and denies risk. It distracts attention from the real issues that must be addressed, and, as evident in the current context, closes down space for democratic dialogue and conversation. It offers "absolute creative freedom to the bullshitter to come up with whatever the audience would enjoy hearing". Hence its appeal to desperate politicians (and unfortunately we have a few of those) and the massive traction it enjoys among electorates. We need the wisdom and the courage to resist the bullshit, especially bullshit that divides us as South Africans and bullshit that threatens to destroy the economy.

Much of the populist rhetoric at the moment is around radical economic transformation and the need to dismantle white monopoly capital (never mind that two thirds of the economy is either foreign owned or owned by pension funds). In its worst iteration, it casts established business, industrialists and farmers as some kind of enemy that must be defeated. As I also remarked in a previous paper, this would be akin to the 19th century Xhosa cattle killings, and would take us on the path of economic destruction and hyper-inflation seen in Venezuala and Zimbabwe.

I think the real likelihood of crazy policy choices being made is slim, but nonetheless the fact remains that it creates further mistrust and policy confusion. It is also probably leading to disinvestment, or at least constraining new investment especially in long term fixed capital (as is required for example to recapitalize the mines).

It is also probably leading to the increased out-migration of the skills and know-how we desperately need to get our economy going.

So we must collectively defeat populism and recast radical economic transformation as a genuine programme of inclusive growth around which society can be mobilized. The role of established business in this programme of inclusive growth must be affirmed. Without it, there is no inclusive growth.

STRENGTHS

Let me now quickly turn to our economic strengths before anyone slits their wrists. Ricardo Hausmann recently argued that the chances of SA taking the Venezuala route – making what he calls an historic mistake - are greatly mitigated by our extensive immune system. This refers to our strong and robust institutions - our Constitution, our judiciary, our media, our civil society, our academia, our Reserve Bank, our Treasury etc. We also have strong traditions of democratic accountability and mobilization, as well as of dialogue. This is what differentiates us from

[1] Harrowell, 2017

a Venezuala or a Zimbabwe, and is what ultimately safeguards us from absolute capture and collapse. Let us pay homage to those clever people who wrote the Constitution, and built in the necessary checks and balances. It was as if they could see into the future. And let us collectively protect our institutions that hold us accountable.

Our other strengths relate to our extensive infrastructure (ports, roads, telecoms etc), and large and sophisticated business sector. We are the financial and economic centre of Africa, we have sound macro-economic fundamentals, a highly sophisticated payment system, excellent academic and research institutions, etc. The problem is all these parts are not working together in a joined up way – as a coherent and functional eco- system. So we need to mobilize our collective capacity behind a national development project. This is the essence of the economic charter which we need to urgently work on and which will more clearly define the role of established business in building a faster growing and more inclusive economy. Good work had started with the CEOs initiative, which can be further developed going forward.

OPPORTUNITIES

Finally, as I conclude, some opportunities we need to harness. Firstly, there are signs of global recovery, albeit amidst much uncertainty. Commodities demand and prices are rising, and the drought is coming to an end. Already, as mentioned earlier, we have seen the primary sector growing 15% quarter on quarter. On the next commodities upcycle, we must do more to diversify our economy into areas where we have comparative advantage. These include export manufacturing, light manufacturing, high tech services, agro-industry, tourism, energy, and the ocean economy.

We are also beginning to see expanded trade with the rest of Africa. I believe the further realization of this opportunity – the effective integration of the SA economy with the continent – will be a game changer for our economy.

But probably the most significant opportunity which everyone has their eye on will happen in December. Leadership change in the ruling party is imminent, which should bring the necessary political and economic governance stability and policy certainty required to move us forward.

I thank you.