Two strange bedfellows

It is a relief to be back in Johannesburg's summer after the freezing temperatures that we endured the last month or so in Washington.

So what have I learnt during the 4 months in Washington? Growth and social capital stand out.

Low Growth

The numbers clearly illustrate that growth in SA has declined to the point where one can talk about being caught in a low-growth trap.

In the 19 years before democracy, South Africa's per capita income ***decreased*** by 0.5% p.a. In the 19 years after democracy, per capita income ***increased*** by 1.5% p.a. That average looks good, but masks the fact that over the last four years since the recession the increase has fallen to only 0.6% p.a.

Arriving back in SA the talk is all about growth of 2.7% for this year. With a population growth of 1.3% that would imply per capita incomes can rise by 1.4%. Close to the average since 1994, certainly better than the average for the last four years, but far below the more than 4% the NDP calls for to eliminate the triple curse of poverty, inequality and unemployment.

Why?

There are several explanations for this low growth, some global and some very local. If we focus on the local reasons, divergent views emerge.

The official (or public sector) consensus is that we are suffering from the effects of the global slowdown, aggravated by "market failures" in SA.

The private sector consensus is that it's all about "government failures". Remove regulations and red tape, appoint competent people and growth will be restored.

Both views have elements of truth. Personally I think the National Planning Commission has the best explanation. They said, in 2012 already, that SA is caught in a middle-income growth trap.

Growth trap

The economists refer to a "middle-income growth trap" where a country's costs have already risen too high to compete with low-cost producers and the country's level of innovation (of new products and services) is still too low to compete with higher cost countries. One neutralises the higher costs with more innovation. German labour and other manufacturing costs are certainly not low, but they lead in innovation around heavy engineering and luxury car manufacturing.

You cannot go back to lower costs, yet you are not innovative enough. This is not an uncontroversial analysis but it is helpful.

Way out?

So how to get out of the growth trap? Here a second big trap lurks darkly "Ideology". So those who talk developmental state on the left, that the State should just step in and those who talk free markets on the right, the markets should just reign – both get it wrong. Ideology is great for intellectual certainty, but not for growth.

The Growth Commission (on which Trevor Manuel also served) identified thirteen "25 x 7" countries. Since World War II there are only 13 countries that managed to grow at 7% a year for 25 years. It includes our neighbour Botswana, Qatar, Singapore, China of course and so on. Brazil was also one of the 13, but like SA it is now mired in low growth. The one common characteristic is that none of them followed a particular orthodoxy. They pragmatically searched for what works.

Some of the most fascinating reading I did was Dani Rodrik's illustration of how the one continent that followed the Washington Consensus most religiously, South America, is also the one with the worst growth record. Free markets are a desirable state of affairs, but it is not a growth strategy.

Rodrik has sadly not done a similar systematic analysis on countries that adopted the "developmental state" ideology, but we can see the results in the poor growth of many.

However, the ostensible clarity that the developmental states ideology has failed is of course muddled by the undeniable successes of China, South Korea, Taiwan and a few others who have practised such an approach and also had mouth-watering growth rates.

So what then is the best way forward?

- Basic economic principles are the starting point. Property rights, tolerable inflation, sound fiscal management and well-functioning markets are the foundation of economic progress.
- Then one needs investment to build capabilities. Investment is needed in physical infrastructure (ICT in particular); human capital (education, skills & health); and the accumulation of competencies and skills in regulatory authorities and government in general.
- Thirdly there must be "structural transformation" i.e. innovation or imitation giving rise to new or expanded industries. Here the emphasis shifts from macro-policy to sector policies that enhance "structural transformation" in those sectors. The Growth Commission put it as follows: "The growth of GDP may be measured up in the macroeconomic treetops, but all the action is in the microeconomic undergrowth, where new limbs sprout, and dead wood is cleared away."
- On-going attention must be given to building ever more sophisticated and efficient institutions that can sustain economic growth.

Bullet 1 is a pre-condition for growth; bullet 3 ignites growth; bullets 2 and 4 sustain growth.

I would submit the most urgent challenge in SA is in the third bullet: structural transformation within economic sectors. The second bullet is in process, at least partly, with the government's large infrastructure programme and huge spending in health and education. (Yes, the quality of the spending is vitally important). The fourth bullet will follow once the other three are in place.

It is worth noting that SA experienced huge "structural transformation" with the deregulation of agriculture, transport, telecommunications and the radio/TV sectors between 1990 and about 1996. This no doubt sparked a lot of growth (think of the increase in agricultural production, all the new cell phone activities and the myriad of radio stations), but the ***growth*** effect had probably largely run its course by the time of the 2009 recession. More structural change ***in sectors*** is now needed to ignite more growth.

Social capital

So, macro-economics are not enough to set growth in motion. We need growth within economic sectors. That requires knowledge of those sectors, knowledge of constraints and opportunities. Vitally, government needs to know what it can do to help the process of structural transformation along.

The process of growth within sectors can only start if there are networks in place connecting different players, particularly the public and private sector players. No networks leads to no understanding; no understanding means little trust. Little trust means limited co-operation.

These elements (networks, trust, co-operation) constitute classic social capital.

The empirical evidence is quite clear: low trust societies are also low-growth societies. It is interesting to note that China scores quite well on trust, and its growth performance is well known.

Listen to the political-economic debate and you will hear how little trust there is between various role players in SA. Reports from the mining indaba are more about the scepticism and mistrust than about what is going on in mining. Some tension between business and government is good and healthy (they do after all represent very different parts of society), but a lack of trust is not.

So What?

- High growth is the exception, not the rule – only 13 countries achieved it after WW II and even in that group there are regressions.
- Macro-policy is not enough to drive growth. One also needs on-going structural transformation in sectors.
- That in turn requires networks, trust, co-operation – also known as social capital.
- For SA to return to higher growth we need a very non-economic thing – social capital. Strange bedfellows these two: the one expressible in numbers and graphs, the other intangible and amorphous. But the one cannot proceed without the other.