SOUTH AFRICA: State considers 'Harvard Group' policies

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EVENT: On June 16-17, the South African government hosted workshops to discuss the recommendations made by a group of international economics experts, known as the 'Harvard Group'.

SIGNIFICANCE: The recommendations are based on a new developmental approach, which identifies key policies needed to ease bottlenecks -- the so-called binding constraints -- to economic growth. In the context of renewed left-right tensions within the ruling alliance, the results of the workshop will shed more light on whether policy will respond to the recommendations.

ANALYSIS: The concept of focusing on bottlenecks -- pressure points where a process is held up by incapacity or inefficiency -- has been applied in business, logistics and economics. It is consistent with formal orthodox economic models and is also being applied to development policy. 'Binding constraint' is standard economics parlance, but a group of distinguished economists at Harvard University advances the use of what they call a 'diagnostics approach' to identifying the bottlenecks to economic growth on a case-by-case basis. Perhaps the most instructive aspect of this approach is what it is not: it is not a laundry list of problems and desires. Targeting limited resources -- financial or administrative -- at key problems is the rationale for the diagnostics approach.

The binding constraints terminology is firmly embedded in South African government thinking, as embodied in the 2006 Accelerated and Shared Growth Initiative for South Africa (ASGISA). ASGISA has at its heart a list of "binding constraints [...] short enough and focused enough to allow for a coherent and consistent set of responses" (see SOUTH AFRICA: Government gropes for 'shared growth' - February 23, 2007).

ASGISA vs the Harvard Group. The government asked the International Panel on Growth, informally known as the Harvard Group, to advise it, based on the diagnostics approach. The Harvard Group made 21 recommendations based on its own set of binding constraints.

South Africa: binding constraints

ASGISA	Harvard Group
The volatility and level of the currency	The volatility and level of the currency
The cost, efficiency and capacity of the logistics system	The logistics system and other input costs
Barriers to entry, limits to competition and limited investment opportunities	High and complicated tariff structure
Insufficient skills and some aspects of labour costs	A lack of skilled labour and uncompetitive unskilled labour
Deficiencies in state capacity, organisation and leadership	Inadequate structural transformation away from minerals
Regulations and their burden on small and medium businesses	Some aspects of Black Economic Empowerment (BEE)

Source: Oxford Analytica

It is no surprise that the lists have much in common, given that the launch of ASGISA and the start of work by the Harvard Group coincided. However, the overlap is not as strong as implied by the government press release announcing the Harvard Group's recommendations, which highlighted the similarities and downplayed the differences. For a start, the angle adopted by the group has a more overt emphasis on raising exports.

There are other significant differences:

1. **More active exchange rate involvement**. The aim of improved export performance is most relevant to the Harvard Group's discussion of the value of the rand, which it argues is too high:
   - The Reserve Bank has been selectively intervening during periods of rand strength but, insofar as it admits to limited occasional interventions, it claims this is to build up foreign exchange reserves and not to influence the level of the currency.
   - The Harvard Group says the Reserve Bank should announce a desirable equilibrium exchange rate, communicate concern at deviations from that exchange rate, and intervene in the foreign exchange market to help move the currency closer to this equilibrium.
2. **Boosting skills through immigration**. Both the government and the Harvard Group identified skill shortages as important constraints:
   - The Harvard Group emphasises the need to facilitate legal immigration.
   - Through the Joint Initiative on Priority Skills Acquisition (JIPSA), the government has ambitious plans to address shortages through education and training.
   - Immigration has been absent from recent core government documents and past attempts at reforming immigration legislation have stalled due to a combination of incompetence and indifference (see SOUTH AFRICA: Riots expose immigration policy failures - June 2, 2008). However, there are renewed attempts at attracting South African expatriates.
3. **Downstream beneficiation**. The Harvard Group argues that downstream beneficiation should not be part of state led industrial policy (see SOUTH AFRICA: New policy backs 'lead' industry sectors - September 10, 2007):
   - Some factions within the government want more active involvement in targeted industries, including measures to stimulate beneficiation of mineral resources (see SOUTHERN AFRICA:Diamond beneficiation efforts increase - June 14, 2007).
   - The Harvard Group concludes there is no bottleneck state intervention would resolve and that, if at all, intervention could be more effectively targeted elsewhere.

Right or left wing? ASGISA is championed by Deputy President Phumzile Mlambo-Ngcuka and is spearheaded by the relatively conservative economic ideologies of President Thabo Mbeki and Finance Minister Trevor Manuel (see SOUTH AFRICA: Budget signals Manuel's policy authority - February 22, 2008). However, there are calls within the ruling alliance and within the government itself for a leftward shift in economic policy, especially towards more active state intervention and a more expansionary fiscal stance (see SOUTH AFRICA: Divisions emerge over economic policy - November 19, 2007).

The Harvard Group's views on the exchange rate can be seen as a leftward departure from conservative consensus. However, the group has recommended a structural budget surplus and an even bigger actual surplus than proposed by Manuel for next year. Other than dismissing the need for state-led intervention in beneficiation activities, the group has refrained from making strong pronouncements on how active the state should be in industrial policy. Therefore, the experts do not appear to have drawn their recommendations from one end of the ideological spectrum.

Initial official response. The current government is likely to use the Harvard Group's preliminary findings and final recommendations to support those aspects consistent with ASGISA, but has given no indication it will adopt those recommendations which were not already part of its thinking. There is little in the recommendations to enthuse left-leaning members of the ruling ANC alliance (see SOUTH AFRICA: Corruption charge blights Zuma's future - January 3, 2008). Reserve Bank Governor Tito Mboweni unequivocally dismissed the report's calls for explicit exchange rate intervention.

CONCLUSION: The diagnostics approach has infiltrated the thinking of government officials and development practitioners, but the recommendations of the Harvard Group are unlikely to lead to a pronounced move in policy. In particular, it is improbable that an officially managed weakening of the rand will result, that immigration policy will be materially affected, or that the debate on the role of the state will be settled.

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