

South Africa is not short of world-class policies and projects – the challenge is to effectively translate many more of them into reality. Our public institutions need to be strengthened and made to perform. This means better functioning state departments – including local authorities. We need to recognise the reality of a desperate skills shortage as well as the lack of organisational experience – and adapt our policy thinking and strategic planning accordingly. If we are looking for a role model, then the South African Revenue Services has already shown the rest of the public service how it should be done.

The South African economy: *will it survive 'the perfect storm?'*

Some of the more dramatic headlines of recent months include:

- global financial turbulence,
- fear strikes financial markets,
- CPIX inflation climbs even higher,
- Eskom's 'on-off' performance,
- Rand weakening further,
- growth prospects declining,
- violent crime appears up,
- international commodity prices soar including food prices,
- economic policy to shift to the left,
- Zimbabwe on a knife edge,

to name a few.

How to make sense of it all? Is it a 'perfect storm' of negative economic events? How do we gain perspective?

It would be helpful to draw on an historical analogy as a point of departure. So does 14 April 1912 mean anything to anyone? Probably not. 14 April 96 years ago was the day the Titanic hit an iceberg and sank in two and a half hours. We will come to the moral of the story later. First the facts.

In April 1912 the Titanic – the largest and most modern ship in its day – was on its maiden voyage from Southampton to New York. It inexplicably collided with an iceberg. More than 1 500 people were drowned and only 700 were saved.

There were insufficient lifeboats on board. The Titanic's sinking remains the greatest maritime disaster in peacetime. The drama captured the world's imagination and has been the subject of countless books and films.

The Titanic saga is also a valuable lesson to all those interested in the quality of decision making, even at the humblest level. It is a classic example of a continuous failure to adjust to new realities – in this case resulting in a tragedy. Reviewing the evidence it was an accident waiting to happen.

To begin with, there was the question of the lifeboats. British government regulations had not kept pace with the rapid increase in the size of ships at the beginning of the 20th century. The Titanic carried enough lifeboats to comply with the law, plus four extra. Nonetheless, only one third of its passengers

and crew could be accommodated when the ship was full.

But then, the Titanic, with its watertight bulkheads, was thought to be practically 'unsinkable.' This was not only tempting fate. It also did not allow for an accident which would exceed the limits of what the ship was designed for.

Then there was Captain Smith, esteemed master of the Titanic. His experience until then had been with rather smaller ships. The dynamics of steering such a large ship travelling at speed were not fully understood. He certainly took command of this huge ship with great complacency.

Given this attitude it is not surprising that Captain Smith and his officers failed to correctly interpret the various ice warnings which they received. There was an unusually large icefield looming up in his path.

Hitting an iceberg was inevitable unless special precautions were taken. Such precautions as he did take were inadequate responses to a new set of circumstances. The ship did not slow down, no extra lookouts were posted. Ice and arrogance did the rest.

It is also clear that the Titanic would have stayed afloat had it hit the iceberg head-on instead of the glancing blow it received in trying to get out of the way. It was an understandable, but flawed decision in crisis management. It would have required remarkable presence of mind to head straight for the iceberg.

Away from the Titanic there was also a failure to adapt to new circumstances. A smaller ship – the Californian – had stopped in the icefield nearby. It saw the distress rockets sent up by the Titanic in the distance. But the captain did not grasp what they meant. Nor did he switch on his ship's radio to pick up the distress messages. Ship radio was still a novelty in those days and usually shut down at about 11 o'clock at night.

So what is the message here?

Whether it is a great liner, the world economy, a national economy or even an ordinary business the lessons of great crises or tragedies are the same. In essence, real world crises mostly occur when there is a failure to:

- assess new developments timeously and plan ahead correctly,

- adapt to changing circumstances,
- respond with good crisis management.

I ask that this be borne in mind as I move through my analysis of the world and the South African economy – and decide for yourself when and whether decision makers have met these tests!

It is only through such a process that we can hold decision makers accountable for their actions whether globally or domestically. There is usually enough blame to go around. After all, in calm water every ship has a good captain.

The world economy

If we look at the global situation, it is hard not to worry about the world economy. The global economic and financial environment remains uncertain and volatile. The United States is already either in, or close to, recession and other rich economies are weakening as the global credit crunch tightens.

The continued fall-out from the US sub-prime mortgage crisis – shorthand for a proliferation of relatively new fangled negotiable instruments within and between major financial markets – has not been confined to financial markets only.

The International Monetary Fund has recently again cut its forecast for global growth in 2008. Although the IMF only sees a 25% chance of a world recession, it regards the current financial crisis in the US as the worst since the Great Depression.

The world economy is expected to expand by 3,7% this year, its slowest pace since 2002. Nobody yet knows what financial shocks still lurk under the surface or by how much credit might still shrink. (You may recall that seven-eighths of an iceberg is below the surface of the water).

In the meantime politicians and central bankers in the developed world as a whole are focusing on appropriate policy responses to stave off the worst that might happen. The US central bank has both cut interest rates drastically and also given massive financial assistance to troubled institutions – and the US Congress has passed a package of tax rebates and temporary investment incentives.

Analysts believe that this stimulus could reduce the odds of an even harsher financial crisis and deepening recession in the US. The IMF has cut its US economic growth forecast to 0,5% from 1,5% previously and expects the country to tip into recession.

The best case scenario seems a mild US recession and a slow recovery. In the meantime, the immediate priority is to shore up trust in the financial system.

But what has gone wrong globally? Was this also an accident waiting to happen?

In a nutshell, it appears as if the current financial turbulence may basically be



Prof Raymond Parsons is professor of economics at the University of Pretoria, economic consultant to Business Unity South Africa and overall convenor at Nedlac. He addressed the Northern Cape Chamber of Commerce and Industry's annual general meeting and annual dinner recently.

the result of the pace of inventiveness, globalisation and information technology outstripping the ability of certain financial institutions to handle the possible inevitable consequences.

The liquidity available in modern financial markets and the leveraged positions possible with new instruments, does expand the scope for potentially ruinous managerial behaviour.

Although the edifice of modern finance remains an impressive and necessary one,

it is clear from latest events that the rules of the 20th century are woefully inadequate to cope with the financial risks that have been created in recent times by new financial instruments, not only in the US.

Just like the inadequate lifeboat regulations for the Titanic, so the regulatory framework for financial institutions in the US proved to be defective. In the meantime, emergency interventions have been required from central banks and governments – especially in Europe and the US – to stabilise the system.

Arrogance has also played a role in the recent financial crisis. We would have thought that the most basic rule of banking is 'don't lend money to people who cannot pay you back.' Yet the sub-prime lenders persuaded themselves that – as they bundled together packages of debt – and on-sold it as securitised debt instruments, this rule of banking no longer applied.

In the same way as the builders of the Titanic thought they had a ship that could not sink, so global bankers have discovered that lending perhaps \$1 trillion to



The incident of the 'unsinkable' Titanic which forms an interesting analogy with the economic problems of the world today.

people who cannot pay you back was a bad idea.

It is clear that the current crisis has opened a new and uncertain chapter for financial markets at least for the time being. Yet, for all its occasional turbulence, modern finance has many advantages for economic growth. But the latest developments are a clear sign that the rules may no longer suffice.

The US Treasury has in fact already announced reform proposals by revealing plans to extend the Federal Reserve Board's oversight functions, no doubt especially of the new so-called 'derivatives.' There needs to be better balance between genuine financial innovation, on the one hand, and reckless speculation on the other.

A sound, but progressive financial system occupies a delicate middle ground between the absence of rules and the enforcement of suffocating rules. The challenge is to put sensible financial supervision in place where it is lacking.

The bottomline is that financial progress does require to be better policed. This process requires responses that are pragmatic rather than ideological. We may yet have to save capitalism from some capitalists.

In summary, all this confirms that a serious problem exists internationally which, although it is causing a global economic slowdown, need not become another 1929 'Great Depression' if properly handled. There is no need to expect a return to the economic traumas of the 1930s.

Quite a few powerful decision makers

would have to make many serious mistakes to turn the current grim global financial situation into real human pain on that scale. The changing balance in the world economy in recent decades also helps to limit the fall-out from a US recession.

The current dynamism and resilience of emerging economies means that, although the US economy still matters, it does not matter quite as much as it once did.

The South African economy

So how is South Africa placed?

South Africa's ability to ride out the storm (or not hit an iceberg!) rests on several factors. Let me single out only seven broad ones.

We should acknowledge that since 1994 South Africa has made great strides in overall *economic management* which – together with other supportive policies – have steadily improved South Africa's economic performance. Since 2003 we have grown at an average of 5% per annum as well as generating other positive developments.

In 2007 unemployment fell to its lowest since 1999 – 23% – with an encouraging message of continued job creation and declining unemployment rates. Per capita income is rising and is expected to continue to improve despite the present economic slowdown. Overall, we now have an economy which has gradually become bigger, stronger and better.

Whilst accepting that we remain vulnerable to financial turbulence, at least some *key policy anchors* are in place to provide a firm mooring while enabling the economy to adapt to cross-currents. A prudent fiscal stance, international reserves of about \$34 billion, low external debt, a sound banking system, the inflation targeting regime and a floating exchange rate can act as shock absorbers.

High commodity prices also provide an extra safety net for our external accounts. Broadly speaking, the country's strong fundamentals should help limit the impact of any shocks to the economy. We must nonetheless accept that the era of cheap oil is over and we must live with the consequences of higher oil prices and embrace the opportunities.

At the same time, although our large deficit on the *current account* may narrow this year (say to 6,5% of GDP), it still requires to be financed at a time when foreign purchases of South African shares and bonds have slowed to almost nothing and in some recent months have, indeed, been negative.

Fortunately, the high creditworthiness that South Africa enjoys internationally will stand us in good stead if the need ever arise. Other ways to finance the current account deficit are available if necessary. At the same time, it is a vulnerability, especially for the exchange rate – and hence a potential Achilles Heel in our economic performance.

South Africa's *economic performance in 2008* will probably get worse before it

gets better – growth is likely to decline from 5% in 2007 to about 3% or 4% this year – and inflation is at a five year peak of 9.4%. Food and energy costs are the main culprits.

Inflation is well outside the official target range of 3% to 6%, but is expected to return within it (electricity prices permitting) in 2009. There are two windfalls for South Africa this year – high export prices and an excellent agricultural season.

Our growth prospects now depend to a larger extent on the government's infrastructural developments, especially with the 2010 Soccer World Cup that much closer. Growth is being underpinned by the level of total investment spending in South Africa. It is therefore wrong to expect an imminent recession in South Africa, unless it is self-inflicted.

The IMF is also reported as saying that a recession in South Africa is unlikely. The only recession we will experience is the one we talk ourselves into. We can avoid a recession if our policy responses remain flexible. Longer term, perhaps, the rising or falling tide of external developments might begin to matter more.

We need to accept that, while electricity tariffs need to be more realistic, a price 'shock' of the proposed further 60% rise in electricity tariffs will damage the economy. Decisions on electricity tariffs cannot be taken in isolation from macro-economic considerations. To minimise harm to the economy, pricing decisions for electricity should be guided and managed more sensibly.

With Eskom's troubles we need much more evidence that we are mastering the situation, rebuilding confidence and learning from our mistakes. Accountability is too diffused among different structures.

Referring to energy supply problems in Africa generally, the IMF recently said that "the current power shortages were to a large extent foreseeable, but action was not taken far enough ahead to avert them." Eskom tries hard to do the right thing, but it keeps coming out wrong.

Credibility has to be restored in decision making around the electricity crisis so that investors can believe government's claim that it is possible for the South African economy to continue to grow – without running up against an impenetrable barrier of inadequate electricity supply.

There needs to be strong political leadership. Any mishandling of the electricity crisis and electricity tariffs has a greater potential to do damage to the South African economy than an American recession.

What about the *political outlook*?

On the political front in South Africa the same challenges of growth, employment creation and poverty alleviation remain – the same economic realities have to be successfully managed – whoever the political leadership in the years ahead. In

approximately one year South Africa will go to the polls again and decide who is to govern us for five years thereafter.

Harold Wilson, a former British Prime Minister, famously once said that, "A week is a long time in politics" – I would suggest that one year is a short time in South African politics! While obviously the markets want to see as much certainty and predictability retained in policy, it would be unrealistic not to expect some changes or a shift in emphasis.

Although changes are inevitable in the post-Polokwane situation, there will be no gainsaying the particular importance attaching to those who occupy key economic portfolios like those of Minister of Finance and Reserve Bank Governor.

Economies in transition are vulnerable to a shift in senior personnel and need continuity. We are nonetheless rightly cautioned about obsession with the 'indispensability' of any one person, whoever he or she may be. Some incumbents may well be indispensable in their field, at least for a while, but everyone is replaceable.

Emerging markets do, however, not always have the necessary pool of experience available and often their economic policies are not as entrenched as appearances suggest.

Post-Polokwane the markets have already begun to factor in the possibility that Trevor Manuel may not stay on as Finance Minister – although eventual market reaction will be strongly influenced by whether a new appointment reflects a serious shift in macro-economic policy. The Manuel years have come to represent much of what are certain and predictable anchors in South Africa's macro-economic stability.

If Manuel goes, the test of whoever among the prominent successors being tipped in some circles eventually succeeds him will be whether he or she can successfully build on the macro-economic track record to date. Perceptions will shape the confidence factor; and that, in its turn, South Africa's future economic performance.

In particular, it will be critical to maintain the confidence of non-resident investors through prudent macro-economic

policy. This will ensure that they continue to put money into this country which helps to finance the current account deficit.

If non-residents still have confidence in our economic management, portfolio inflows could remain at adequate levels, helping to sustain the higher levels of investment needed to support stronger growth.

A great deal depends on how entrenched the fiscal 'culture' and financial systems are which have been developed so far. Have Manuel and the National Treasury already succeeded in laying down fiscal principles like a railway track, a 'permanent way,' along which fiscal policies must in future run?

Sceptics argue that there are many examples in the world of 'fiscal recidivism' – lapsing back into bad old habits. Those populists who like 'tax and spend' (or worse, 'deficit and spend') policies are seldom downed for good, say the sceptics, and will keep up a relentless pressure.

The National Treasury has in reality become the central department with a finger in just about every pie that the government bakes. By its control over public finance the National Treasury holds in its hands the fate of many ministers and their policies.

Despite the present economic slowdown, the next Minister of Finance (if Manuel goes) will inherit a very sound fiscal balance sheet which the financial markets and sensible economists would not like to see jeopardised. In our highly centralised political system, if a future President decides to appoint another orthodox finance minister to succeed Manuel, it will remain necessary for him to fully back the new incumbent in the same way as Manuel has enjoyed the strong support of Presidents Mbeki and Mandela.

We need to accept that the real challenge facing government is not the availability of financial resources, but the *effectiveness of delivery*. We are now basically in a position where 'too much money is chasing too little capacity' – whether in generating electricity, in social services, urban housing, fighting crime, alleviating poverty or creating jobs.

South Africa is not short of world-class policies and projects – the challenge is to effectively translate many more of them into reality. Our public institutions need to be strengthened and made to perform. This means better functioning state departments – including local authorities.

We need to recognise the reality of a desperate skills shortage as well as the lack of organisational experience – and adapt our policy thinking and strategic planning accordingly. If we are looking for a role model, then the South African Revenue Services has already shown the rest of the public service how it should be done.



Enhanced delivery is one of the major tools needed to strengthen our ability to unlock future growth potential. There are questions here of foresight, preplanning, implementation, capacity building, under-spending and value for money in which the business community has a keen interest. Public private sector partnerships also need to be used on a far larger scale.

In my view the above are the main factors shaping our economic prospects. That all said, what then is eventually the balance of risks here?

Need I say that even on the best assumptions 2008 will be a tough year for business and consumers. As 2008 progresses two things appear certain. First, things will eventually get better. Second, they will get worse before that happens. As the 'bad' news is likely to outweigh the 'good' news in the short term, South Africa's 'misery index' (a combination of lower growth and higher inflation) will undoubtedly rise this year.

We must assume that interest rates will remain relatively high for the time being and perhaps for longer than originally anticipated with negative consequences for economic growth. There is a 50/50 chance that interest rates may now have peaked. We must also remember that monetary policy is a flexible instrument – it can be reversed quickly, if changing economic circumstances justify it.

If, therefore, we look at the big picture of where we are now, we must pin our hopes on 2009. In other words, we must trust that the economy is resilient and flexible enough to make a 'rolling readjustment' to the negative factors this year – and resume its upward growth next year.

In its latest regional economic outlook

for sub-Saharan Africa, the IMF predicts that growth in the region should again average about 6,5% this year. If we play our cards well, our economic growth could rebound next year on spending for the 2010 Soccer World Cup and if the worst of the global financial crisis is over by then.

Simply wringing our hands about the woes of the global economy is not helpful. Reducing vulnerability – and enhancing adaptability – remain the watchwords for economic resilience in the face of adversity.

Conclusion

So, you may say, this is all very interesting, but what can we concretely do about it?

In his budget speech in February, Minister Trevor Manuel said the following: "We are all in this together – business, government, the employed, the self-employed and the unemployed; the urban and rural; men and women. We may not all be affected in the same way, but we face the same headwinds and uncertainties. None of us has the privilege of perfect foresight; none of us are isolated from the tides and turbulence of the global markets."

In short, as President Mbeki has put it, it means "all hands on deck." I would suggest that you should start right on your doorstep – and link it to your role. The business voice must concentrate on bringing about positive change and making sense from the chaos that reigned in early days.

By synergising our efforts and energy we will create a vibrant, prosperous community to be proud of. Strong business leadership is what is needed in a period

which has now been designated as one of 'business unusual.'

What I am saying is that there has never been a more propitious time than now to reshape and renew the business agenda to meet the new challenges in South Africa that, like the waves on the beach, will keep coming. Organised business should be seen as a 'foul weather friend' to its members.

There needs to be much better engagement in future – 'partnership' if you like – between organised business and local authorities simply because so many of the solutions lie at the local level. 'Localisation' needs to play a much more effective and dominant role in shaping the future.

Business therefore needs to use the tools and institutions closest to it to empower the organised business movement to influence the course of events and produce better outcomes, whether locally or nationally.

By supporting and building capacity in our public and private institutions we strengthen confidence in the results. That is the way to create a better life for all by mobilising the talents of the whole community.

And with what mindset should we approach this task?

I would like to quote from a recent book on the economic history of the world over many centuries by Prof David Landes: "In this world, the optimists have it, not because they are always right, but because they are positive. Even when wrong, they are positive and that is the way of achievement, correction, improvement and success. Educated, eyes open optimism pays; pessimism can only offer the empty consolation of being right." ■

Now you have a choice ...

MANAGEMENT TODAY or e-MANAGEMENT TODAY

Yes, we have entered the electronic age and can now offer you a full version of the hard copy in electronic format. Existing subscribers can either continue with your printed copy at R513,00 (including VAT) or you can migrate to the electronic format at R285,00 (including VAT).

To subscribe, please send us an e-mail at richard@management-today.co.za or complete and return the reply form below.

Richard Havenga & Associates
P O Box 2239
NORTHCLIFF
2115

Name:..... Designation:.....
Company:.....
Address:..... Code:.....
Tel:..... Fax:..... E-mail:.....
Signature:.....

Paper @ R513,00/Electronic @ R285,00 (delete which is inapplicable).