

Fix the Basics, Not the rand

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You can't throw a rock in Pretoria these days without hitting someone who thinks that the problems of South Africa's weak manufacturing base and crippling unemployment levels can be solved by pulling a few simple economic levers.

There are those, from Cosatu to the commanding heights, who reckon the rand, rampant against pusillanimous dollar and collapsing the pound, is preventing local manufacturers from earning their crust in global export markets.

"The global financial crisis changed the script," they cry. "New options are open to us. We should follow the lead of successful Asian countries by aggressively weakening our currency and keeping it there".

According to this logic, a weaker rand would mean lower world prices for our exports and a surge in the competitiveness of local industry.

Speakers at the conference from the director general in the national treasury, Lesetja Kganyago, to Harvard economist Robert Lawrence ran that argument through the wringer, or at least subjected it to some basic economics.

For starters, Kganyago pointed out, the rand has been on a steadily weakening trend for three decades, but much of the gain that might have accrued to exporters was eaten by inflation. That is to say, a 10% fall in the nominal value of the currency is pretty meaningless if it leads to a 10% increase in the price of labour and other key inputs, which is exactly what tends to happen.

What matters is the real exchange rate, which takes into account what you can actually buy with your depreciated rand.

To achieve a lower real rand through depreciation you need to have exceptionally tight fiscal and monetary policy -- low government spending and high interest rates -- to keep inflation in check. Trouble is, all the proponents of intervention to weaken the rand also want lower interest rates and larger fiscal deficits. As Kganyago put it with characteristic pith: "You can't alter real economic facts by tweaking nominal variables."

The only plausible way, Lawrence argued, to drive down the real exchange rate sustainably is to increase saving dramatically. South African consumers have either limited ability to save (too many of them are poor) or they have limited will (too many of them are conditioned to buy now before the price goes up), so any real increase in saving would have to be driven by the state. Essentially that means that as the economy recovers the budget deficit will have to shrink rapidly.

It's a counter-intuitive but powerful insight. The less profligate we are, the weaker the rand.

Lawrence also had some unusual advice for those who advocate the other increasingly popular tool in the local trade policy arsenal - higher import tariffs to protect fragile local industry.

Higher tariffs, he explained, would probably have the effect of strengthening the rand because, by turning the economy inward, they reduce demand for foreign exchange. That effect could well erode some of the benefit provided by the higher tariffs.

The crisp point here is that, while the financial crisis threw up deep challenges to global economic arrangements, it did not abolish economics.

Growing the economy and shrinking unemployment requires much harder work than simply changing a few numbers, the nominal price of the rand or the level of tax on imports. It requires the much harder, messier and hitherto less successful work of improving the education system, sorting out transport infrastructure and enforcing competition law.

It's harder to fit all that into a headline, but it's better than throwing rocks at the rand.

And, by the way, as FirstRand economist Rudolph Gouws pointed out, the "strong" rand of 2010 is 40% off its 2004 peak against the feared Chinese yuan and 16% down on the average for the decade.