

CHAPTER 4

SOUTH AFRICA'S GROWTH PERFORMANCE 1960 TO 2001

World competitiveness nowadays depends as much on comparative advantage in the public policy arena as it relies on technology, human resources and physical capital.

GEAR (1996:21).

4.1 INTRODUCTION

In this chapter, South Africa's growth performance is assessed, firstly, in relation to the growth potential as set out by the best-known documents on this subject, namely the Economic Development Plan, which commenced in the mid-1960s and the more recent Growth, Employment and Redistribution: – a macroeconomic strategy (GEAR) of 1996. Secondly, performance in the light of the outward-orientation strategies of the newly industrialised East Asian economies is appraised.

Economic growth itself is the joint outcome of changes in aggregate demand and aggregate supply (Truu and Contogiannis 1987:269). Growth occurs through the extra inputs that enter the economy, but is empirically measured by the extra outputs that emerge from it. This implies that it is determined by both short-term and long-term forces. Thus, positive growth is caused partly by increases in aggregate demand (greater capacity utilisation) and partly by increases in aggregate supply (greater productive capacity), and *vice versa*.

The recent growth performance of the economy has proven that even though South Africa has achieved a period of political stability, it does not necessarily follow that the growth rate will rise in the long term to an average level that will permit a steady improvement in per capita welfare (University of Pretoria 1989:1). It is imperative that South Africa should raise its long-term growth rate. With 36.2 per cent of its economically active population unemployed (Stats

SA 2000:vii), the country certainly cannot afford to struggle through another decade with a stuttering economic performance or with experiments with unproven economic policies.

The potential real growth rate of the South African economy is quite rightly a matter of immense interest. The concept of the potential growth rate does not refer to what rate of real growth is likely to be achieved, but rather to the rate of real growth that could be achieved, given the right set of circumstances. It therefore refers to a ceiling that the economy will not be able to exceed. Determining this ceiling in quantitative terms is difficult, problematic and often controversial, if not impossible (University of Pretoria 1987:1).

The 1960s, in particular, represented a period of comparatively rapid economic growth, virtually on a worldwide scale, and growth came to be accepted as a policy objective practically everywhere. This trend was reflected in South Africa by the introduction of an official Economic Development Programme (EDP) in 1964, the first of nine such programmes. The key variable of those programmes has been the potential growth rate of the economy, estimated as the maximum average annual increase in the output of final goods and services that should be attainable, without placing undue strain on the balance of payments (Truu and Contogiannis 1987:269). In other words, a target growth rate was established for the economy, expressed in terms of the potential increase in real income.

Various more recent studies (GEAR 1996:7; NEM 1993:250; EDP 1981; University of Pretoria 1987:9; University of Pretoria 1992:6) have determined that the country's potential real growth rate varies widely (between 3.5 and 6 per cent per annum or even 7 per cent) largely because of differences in the underlying assumptions. These potential growth rates are much higher than the realised growth rates of about 2 per cent in recent years. Heilbroner (1970:231) is of the opinion that "we must think of growth not only as a means of remedying the under-use of resources, but as setting the trajectory that will define for us the scope of our realisable potential".

According to Truu and Contogiannis (1987:271), the actual output of the South African economy exceeded its estimated potential level until 1969, after which the position was reversed. Moreover, the range between actual and potential

growth rates tended to increase over time, except for the brief period spanning 1993 to 1996 when it momentarily decreased. It subsequently took another turn for the worst.

This is clearly disappointing growth performance. It can be attributed to forces related to both aggregate demand and supply. As in other oil-importing countries, aggregate supply was adversely affected by the steep increases in the international oil price that occurred in 1973 and 1979. But a more fundamental factor inhibiting both potential and actual output has been a steady process of so-called "capital deepening" in the South African economy (Truu and Contogiannis 1987:271).

It appears that the level of potential output – in other words, productive capacity – still remained underutilised. On the surface, such a situation might suggest that the authorities should have acted more vigorously to stimulate aggregate demand by fiscal and/or monetary policy. The evident reluctance to do so in a consistent manner may also be related to the observed process of capital deepening, in conjunction with the "open" nature of the South African economy (Truu and Contogiannis 1987:272).

To raise the growth rate to the potential targets, a deliberate strategy must be devised and implemented. This strategy must be simple in order to have a reasonable chance of success in the long term. Such strategies exist and have been followed with great success, particularly in the newly industrialised countries of the Far East. The core of this strategy essentially requires that the private sector should serve as the engine of growth to produce higher material welfare on a continuous basis. The government in turn should pursue its policies and activities in a way that is fully supportive of, rather than competitive with, the private sector (University of Pretoria 1989:1).

The ANC government published the Growth Employment and Redistribution (GEAR) macroeconomic strategy in 1996, which in brief targeted a reduction in government consumption expenditure, a moderation of private and public sector wages increases, the acceleration of tariff reform and an improvement in domestic savings performance. The compilers envisaged that these measures would counteract the inflationary impact of exchange rate adjustment, permit

fiscal deficit targets to be reached, establish a climate for continued investor confidence and facilitate the financing of both private sector investment and accelerated development expenditure (South Africa GEAR 1996: 5). The compilers envisaged that the GDP growth would accelerate from 3.3 per cent in 1996 to 6.1 per cent by 2000 and that additional employment would be created in 1996 for 126 000 people, increasing to 409 000 new jobs by 2000.

The following section analyses and evaluates the efforts towards sustained growth and development since 1960 through the decades and ends with the new political dispensation that followed the general elections in 1994. The latter highpoint witnessed an upsurge in the expectations of the previously disadvantaged South Africans, and aided the process of transition towards a liberalised economic system (Truu 1998:23).

4.2 THE GROWTH CONCEPT, POPULATION GROWTH AND WELFARE

Living standards in South Africa have declined during the past three decades. Economic analysts often contend that the decline started in the early 1970s, but judging by the performance of the real per capita income, this process had already commenced during the second half of the 1960s (Truu 1998:23). The golden sixties aptly named after the gold-induced prosperity associated with that decade, was not really Nirvana. The newly industrialised countries of the Far East showed that well-managed outward-oriented economic strategies, the enhancement of human capital and higher productivity, are the true engines of growth.

Negative growth rates were an unusual occurrence until 1972. During the 1970s and thereafter, the growth performance changed drastically for the worse and deteriorated even further as negative growth rates became commonplace (University of Pretoria 1992:2).

Many international growth studies use GDP per capita as their measure of growth. It is of course necessary to take account of the rate of population growth especially in countries with a high population growth. If not, this may

result in an overestimation of the improvement in the standard of living. The per capita approach is of cardinal importance when growth rates decline to a level lower than the population growth rate, because declining living standards will result.

The relationship between economic growth and living standards may be further complicated by changes in the distribution of income. The famous economist AC Pigou (1912:34, 364) assumed constant population numbers and showed that a gain in economic welfare (living standards) would result from the following combination of events:

- positive economic growth together with an unchanged distribution of income, or
- zero economic growth together with a more even distribution of income.

The process can therefore be accelerated if positive economic growth and a more even income distribution can be achieved at the same time. However, like most statements on the subject of income distribution, the above-mentioned propositions are, essentially, subjective value judgments rather than objective scientific conclusions.

4.3 INCOME DISTRIBUTION IN SOUTH AFRICA COMPARED WITH OTHER COUNTRIES

During the early stages of economic development, the distribution of income is usually unequal and the inequality could even increase because of the Kuznets (1973:252) effect. As the development process proceeds, income distribution should spread more equally. Income distribution in South Africa is rather skew since the largest part of the population has been deprived of quality education, training and equal opportunities.

Table 4.1: Human development index (HDI) and income shares (%) for selected groupings

HDI rank	Country (year)	Poorest 10%	Poorest 20%	Richest 20%	Richest 10%	Gini index
94	South Africa (1994)	1.1	2.9	64.9	45.9	59.3
69	Brazil (1997)	1.0	2.6	63.0	46.7	59.1
61	Venezuela (1997)	1.6	4.1	53.7	37.6	48.8
56	Malaysia (1997)	1.7	4.4	54.3	38.4	49.2
66	Thailand (1998)	2.8	6.4	48.4	32.4	41.4
27	Korea (1993)	2.9	7.5	39.3	24.3	31.6
70	Philippines (1997)	2.3	5.4	52.3	36.6	46.2
89	Tunisia (1995)	3.3	7.6	44.4	29.8	41.7

Note: A total of 162 countries are included in the ranking of which 48 were ranked in the high, 78 in the medium and 36 in the low human development ranges.

Source: United Nations, Human Development Report (2001:182-183)

Table 4.1 shows that the richest 20 per cent of the population in South Africa accumulates 64.9 per cent of the income, while the 10 per cent super rich enjoy 45.9 per cent. The table shows that South Africa's income distribution is much skewer than those of some of the newly industrialised countries of South East Asia. The South African distribution is more in line with that of Brazil.

The Gini index measures inequality of income over the entire distribution of income or consumption. A value of zero represents perfect equality and a value of 100 perfect inequality. Once more the Gini index for South Africa and Brazil at 59.3 and 59.1 are at the same level, and substantially higher than those of the other countries that range from the 49.2 of Malaysia to the 31.6 of Korea. Whiteford and McGrath (1994:50) calculated the Gini-coefficient for South Africa as 0.68 (1991). They compare South Africa's income distribution with those of Latin American countries (known for their skew income distributions) at the same level of development and show that these countries' coefficients are lower, ranging from 0.42 (1982) in Costa Rica to 0.61 (1972) in Brazil.

Pearce (1992:172) warns that the Gini coefficient is only a measure of *relative* size. He cautions that "one distribution might be more equal than another over one range, less equal over a succeeding range, and yet both might record the same coefficient".

The gulf between rich and poor in South Africa is therefore one of the widest in the world. This implies that the economy faces lower growth prospects, because countries with a more equitable distribution of assets grow faster than those with unequal distributions. Reducing wage differentials as well as unemployment would be an appropriate method of reducing income inequality in South Africa.

To return to the per capita concept, population growth figures prior to 1946 vary rather widely, casting doubt on the accuracy of these statistics. Table 4.2 bears testimony to that effect.

Table 4.2: Population census results and growth rates, 1904 to 1996

Census date	Population ('000)	Growth rate (% pa)
1904	5175	
1911	5973	2.1
1921	6927	1.5
1936	9588	2.2
1946	11416	1.8
1951	12672	2.1
1960	16002	2.6
1970	18299	1.4
1980	24264	2.9
1985	27704	2.7
1991 ¹	30987	1.9
1991 ²	37944	-
1996	40584	1.4

¹ Figures for 1970 to 1991 exclude former TBVC states and include Walvis Bay.

² Figures include former TBVC states and exclude Walvis Bay.

Note: 1985 population figures are HSRC estimates

Sources:

South Africa Republic. Bureau of Statistics, Statistical Yearbook (1964:A-7)

South Africa Republic. South African Statistics (1995:1.4)

South Africa Republic. South African Statistics (2000:1.4)

The wide swings in the population growth rates contained in table 4.2 can in some measure be ascribed to nonrecurring random events or phenomena. For example, the decrease in the population growth rate from 2.1 per cent during the 1904 to 1911 period to 1.5 per cent during the 1911 to 1921 period, could have been the result of the flu epidemic which occurred during 1919. Similarly, the decline from 2.2 per cent during the 1921 to 1936 period to 1.8 per cent during the 1936 to 1946 period could have been the result of the intervening Second World War. The other wide swings cannot be explained by any particular phenomenon and must therefore be ascribed to deficiencies in enumeration or a lack of compatibility of data associated with a number of border changes. These wide swings in the population growth rates could divert the economic and policy focus and bring in demographic complications without necessarily adding value.

The problem of incompatible or suspect statistics is not limited to either the subject of economic growth or the field of economics in general. Professional statisticians would be the first to reject the claim that "figures cannot lie", and seem fond of the old cliché, usually attributed to Benjamin Disraeli: "There are three sorts of lies: lies, damned lies and statistics." The potential uses and abuses of statistics fall outside the ambit of this study, but it is obvious that statistics cannot always serve as the sole and final arbiter of economic disputes. The truth "behind" the statistics must always be tested by innate theory.

The smoothed population growth trend over the entire period 1910 to 1946 comes to 2 per cent per annum. It appears to be a satisfactory assumption to take a threshold growth rate of 2 per cent per annum for the growth in the economy over this period to have been sufficient to maintain living standards. A lower growth rate will have meant lower living standards, and one that exceeds 2 per cent, rising living standards.

A similar analysis for the 1946 to 1996 period (latest available census statistics) returns a smoothed growth trend of 2.6 per cent per annum, thus raising the threshold growth rate by 0.6 percentage points. The adjusted population figures for 1970 to 1991 using 1991 boundaries gives a population growth of 2.5 per cent per annum. The assumption of a population growth rate between 2 and 2.5 per cent therefore seems appropriate.

It is obvious that economic growth, by itself, does not signify an increase in economic welfare or the standard of living. For the purposes of this study, economic growth is not defined in such rigorous terms, but takes any measured increment in total output, over a period of time, to be acceptable evidence of economic growth. According to this viewpoint, economic growth is thus a necessary, but not a sufficient, condition for economic progress or betterment to take place.

4.4 SOUTH AFRICA'S GROWTH RECORD OVER THE DECADES

The following sections will follow the macro approach and the growth rates in GDP as the comparative measure. Where appropriate, reference will be made to the threshold population growth rate to draw attention to the danger of declining living standards.

Table 4.3: Growth rate in GDP per decade, using upper turning points in the business cycle closest to decade endings and beginnings

Upper turning point periods	Exponential trend growth percentage per annum
1946-51	4.2
1951-60	4.5
1960-70	5.7
1970-81	3.5
1981-89	1.3
1989-01	1.9

Source: South African Reserve Bank, Quarterly Bulletin, June 2001, September 2002

The economic growth rate increased steadily from the 4.2 per cent in the 1940s to 4.5 per cent in the 1950s and 5.7 per cent in the 1960s.

During the 1970s the growth rate decreased by 2.2 percentage points followed by a further and an equally dramatic drop of 2.2 percentage points during the 1980s, pushing the rate of growth down to 1.3 per cent, while the rate seemed

to have stabilised somewhat during the 1990s, rising marginally to 1.5 per cent. The last two decades of the 20th century therefore returned declining living standards for the average South African as the economic growth rate decreased below the 2.5 per cent per annum population growth rate.

The harmful effects of these declines went beyond the economic implications to the social sphere, leaving in their wake the deterioration in income distribution and even more pernicious, a sharp increase in the unemployment rate. According to the October Household Survey of 1999 (Statistics SA 2000:vii) the unemployment rate was 36.2 per cent in 1999 having declined slightly from the 37.5 per cent in 1998, but still much higher than the 29.3 per cent in 1995. The Labour Force Survey (Statistics SA 2002:11, 13) conducted in February 2002 estimates the unemployment rate at 29.4 per cent according to the official definition and at 40.9 per cent using the expanded definition.

Three of the most basic driving forces in the economy have been performing below par during the last three decades (University of Pretoria 1992:fig 2c) The first of these growth factors is a growing, but less efficient institutional environment; secondly, South Africa's declining share in world trade; and thirdly, reducing foreign direct investment. This resulted in a steady decline in welfare.

4.5 THE INSTITUTIONAL ENVIRONMENT

Experience gained from successful developing countries over the past 30 years shows that governments have a clear and well-defined role to play. Apart from their indisputable role as provider of social wants, and a conducive economic growth environment, governments could and should provide assistance in certain carefully selected areas of economic activity. They should encourage those who are already successful, to expand both domestically and internationally. This should be done within a strictly limited government budget to leave the bulk of the country's economic resources and economic initiatives in the private sector. This ensures that efficiency is a matter of survival in the largest share of the economy, making it possible to be successful like most

outward and private sector oriented countries (University of Pretoria 48 1992:1).

There has been a long-term increase in the size of the public relative to the private sector of the South African economy. The term "public sector" includes a great deal more than the central government itself, for example, government at lower levels of authority, public enterprises (Transnet, the Post Office and Telkom), public corporations (Eskom, Iscor, SAA), agricultural control boards (most of which closed in the 1990s), and various official funds (housing, road construction and strategic supplies). The full extent of the public sector in South Africa has not been measured, partly because of the accounting difficulties arising from interrelated budgets. However, by the mid-1980s, total public sector expenditure was evidently more than twice the amount of the central government's budgetary expenditure (Truu and Contogiannis 1987:279). The latter concept is generally accepted as the pivotal concept in fiscal policy, as illustrated in figure 4.1.

The two most important measures to assess a conducive institutional environment are the economic growth performance and the employment performance of the economy. Table 4.4 shows employment growth rates in the public and private sectors respectively.

Table 4.4: Employment growth percentages in the nonagriculture sectors for selected upper turning points: exponential growth trends

Periods	Private sector	Public sector	Total
	Percentage annual average change		
1967-70	4.2	2.3	3.7
1970-81	2.7	4.3	3.4
1981-89	0.5	2.0	0.9
1989-01	-2.1	-0.9	-1.7

Source: SARB, Quarterly Bulletin, various issues

The table highlights the fact that the growth in public sector employment has exceeded private sector employment growth rates for the three decades since 1970. Truu (1998:25) observed that this trend did not decline, even during recessions. The result was that the state's share in the economy increased continuously. This is directly contrary to the policy objective applied by the successful newly industrialised countries, of efficiency in production via market orientation.

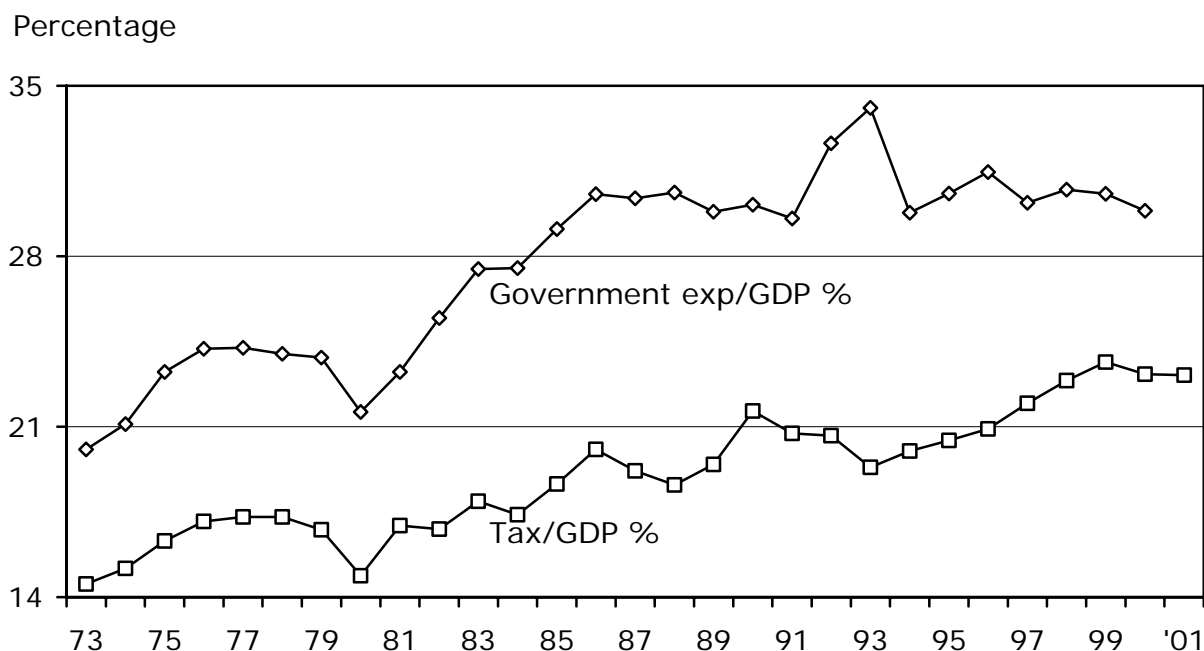
The growing public sector phenomenon also decreases the probability of achieving the objective of "limited but good governance" which is an essential requirement for sustained growth (Truu 1998:25). With such high growth in state employment the economy can be expected to become more lethargic and less competitive. To be able to finance this burgeoning giant, private sources are tapped in the form of increasing taxation in order to foot the government wage bill, which according to Truu (1998:25), is another form of nationalisation.

University of Pretoria's Focus No. 48 (1992:5) used a sample of developed and developing countries, which includes South Africa, to show that there is an "inverse relationship between the rate of real economic growth and government revenue as a percentage of total output". A rising trend in government expenditure to GDP is shown for South Africa in conjunction with a decline in economic growth as predicted by the model and it is concluded that "it must therefore be one of South Africa's growth inhibitors".

Barro and Lee (1993:21) states that economic growth is subject to aggregate consistency conditions, which requires that the total of goods sold by suppliers must equal the total bought by demanders. He maintains that the idea that markets clear is closely related to the notion that private markets function efficiently. With cleared markets, it is impossible (for the state) to improve on any outcomes by matching potential borrowers and lenders or by bringing together potential buyers and sellers of goods. "Clear markets already accomplished all these mutually advantageous trades."

For this reason, public sector encroachment on the domain of the private sector undermines efficiency of markets and distorts and reduces growth. Figure 4.1 shows two growth-determining factors of the public sector involvement in the economy.

Figure 4.1: Government expenditure and tax income as a percentage of GDP (1973-2001)



Source: SARB, Quarterly Bulletin, various issues

The general trend of government expenditure to GDP has clearly been upwards, rising from approximately 20 per cent in 1973 to 34 per cent in 1993, after which it declined and stabilised at a still relatively high level of 30 per cent from 1994 onwards. This reflects the expansion of state-supplied goods and services across a wide front, which cannot be consistently attributed to any specific source of expenditure.

South Africa is still an economically developing society and the upward trend in government expenditure has been associated with expanding socio-economic infrastructure rather than the proliferation of social welfare services, as in several economically more advanced countries. This is partly so because the proportion of the working population liable to income tax, is comparatively low in South Africa (Truu and Contogiannis 1987:280).

Figure 4.1 also shows that taxation as a share of GDP has increased over the decades, from 16.4 per cent in the 1970s to 18.4 per cent in the 1980s and further to 21.5 in the 1990s. This tendency is the directly opposite of the goals of efficiency in production via market orientation.

According to Sachs (1996:24), "African nations need simple, low taxes, with modest revenue targets as a share of GDP. Easy taxes are most essential in international trade, since successful growth will depend, more than anything else, on economic integration with the rest of the world." He states that Africa has to a large extent exiled itself from world markets and that it can end quickly by cutting import tariffs and removing export taxes on agricultural exports. He is also of the opinion that corporate tax rates should be cut from rates of 40 per cent and higher now prevalent in Africa, to rates between 20 and 30 per cent, as in the outward-oriented East Asian economies. He proposes a rule of thumb, that marginal tax rates of not higher than 20 per cent are realistic, as any higher rates will be evaded, and lead to corruption.

A positive development noticeable in figure 4.1 has been the narrowing gap between state incomes and expenditure since 1994. The new government achieved this by keeping expenditure from rising, but increasing tax incomes. This signifies the new government's commitment to move closer to a balanced budget, thus requiring less government borrowing, debt and interest payments, but still showing little evidence of reducing the expenditure of the public sector. The lower tax growth requirement enunciated by Sachs (1996:24) is therefore only a remote possibility under current circumstances.

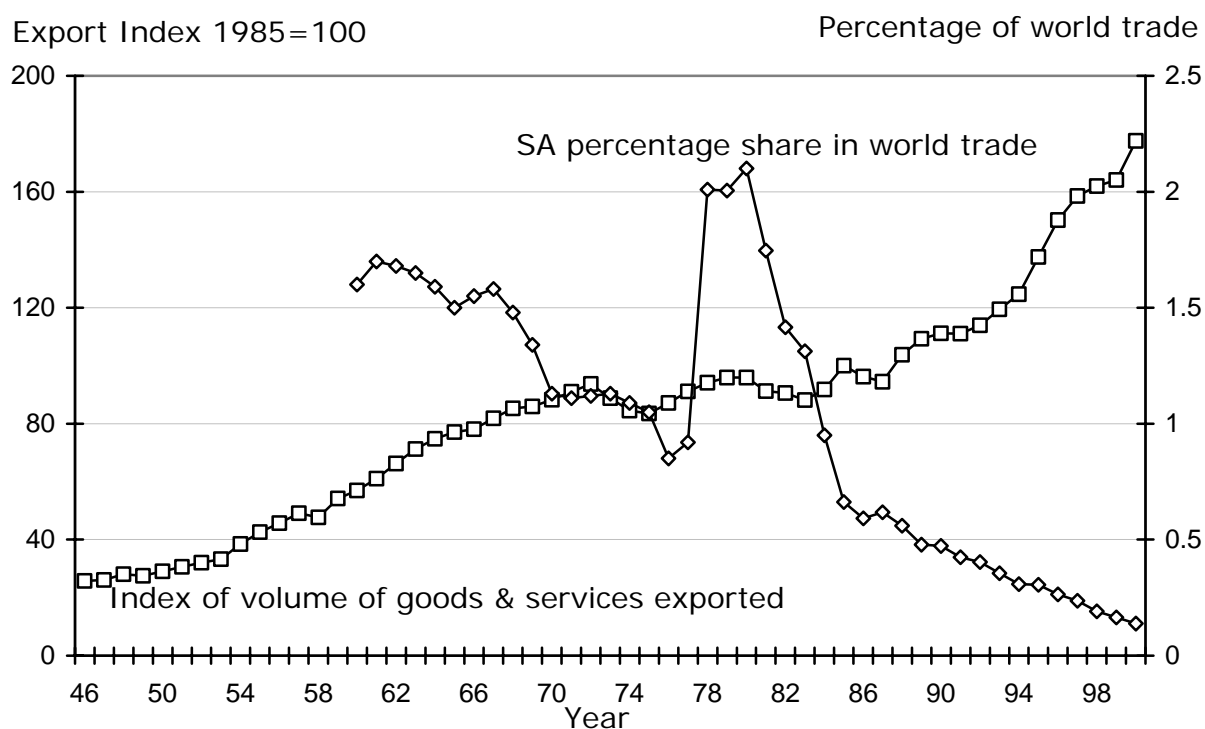
If government goes beyond its role of creating a conducive environment (by becoming increasingly involved in the provision of goods and services), it runs the risk of being a growth inhibitor. Apart from these structural constraints, other destabilising or growth inhibiting factors including various external shocks like declining commodity prices, a volatile gold price and economic sanctions, had a profound impact on economic stability in South Africa.

4.6 THE OUTWARD ORIENTATION OF THE SOUTH AFRICAN ECONOMY

This section examines the outward orientation of the South African economy and its effect on economic growth. University of Pretoria Focus No 48 (1992:6) suggests that a policy regime that is conducive to increasing South Africa's

share in world trade could grow South Africa out of its inward-oriented poverty trap.

Figure 4.2: South Africa's volume of exports and share in world trade (1946 – 2001)



Source: SARB, Quarterly Bulletin, various issues

Figure 4.2 shows that the export growth volume has increased continuously, but the country's share in world trade has declined steadily, from 1.6 per cent in the 1960s to 1.2 per cent in the 1970s, 1 per cent in the 1980s and further to 0.3 per cent in the 1990s. One may therefore conclude that over the decades South Africa's export growth was lower than the average growth in world trade, causing a loss in world market share. A more equitable outcome would have been the maintenance of its share, and with increased economic growth as the target, a steadily increasing share.

Since exports constitute about one-third of total output, one would indeed expect South Africans' material welfare to fall behind in world terms over the long term.

Simulations with the econometric model of the University of Pretoria (1992:6) showed that the average annual real growth rate of South Africa could be

increased to more than 7 per cent if South Africa could succeed in raising its share in world trade from the present level of 0.7 to 1.1 per cent over a period of seven years. While South Africa's share in world trade has been decreasing and direct foreign capital has become even scarcer, the situation has been aggravated by both the previous and the current governments through their redirecting an increasing share of scarce resources from the more productive private sector to the less productive public sector.

Holden (1993:225) points out that the new growth theories emphasise the importance of maintaining an outward-oriented trade policy to facilitate the introduction of new ideas and technology into an economy. South Africa traditionally followed an inward-looking policy, necessitated by economic sanctions. She also maintains that when exports were given more attention by policy makers in South Africa, it was found that growth in manufacturing exports had been closely tied to the growth of the economy. This growth is, however, only suggestive of the experience of other countries because the domestic R&D expenditures reveal that industries with a high propensity to export have not been R&D intensive.

Holden (1993:225) finds that although in terms of the new trade theory (with its emphasis on economies of scale, product differentiation and R&D expenditures) and despite the existence of intra-industry trade in South Africa, it was not possible to establish any relationship between economies of scale, R&D expenditures and the extent of intra-industry trade. Trading patterns in South Africa appear to be primarily driven by factor endowments, including the availability of natural sources.

However, theories of dynamic comparative advantage indicate that in the face of rising unit labour costs in the late 1980s and the 1990s, labour should have reallocated from low value-added activities towards high value-added activities in order to preserve export performance. Holden, however, found that export performance had been maintained and developed in those industries where the increases in unit labour costs had been less pronounced. In addition, the more successful exporters had not experienced greater increases in total factor productivity; nor had they located in higher value-added industries. Faced with ongoing domestic low-growth conditions, manufacturers who served the

domestic market turned to the export market and failed to develop new or higher value-added export industries based on comparative advantage.

Holden (1993:226) recommends that an increase in productivity and competitiveness can be achieved through better technology and the introduction of new ideas as well as through better education. Holden advises that the state could play a role in this process by the subsidisation of the R&D expenditure of private firms for the purposes of exports.

Lewis (2001:13) is of the opinion that "there may be some benefit from promotion of non-minerals exports through export processing zones or duty drawback schemes, especially if these efforts concentrate on employment creation". Lewis (2001:v) compared the current tariff regime with the one prior to reforms, and found that the recent tariff reforms have lowered average protection and removed most nontariff barriers, but that the spread of effective protection remains high, and that the structure of protection remains complex because it comprises 45 different rates.

In addition, the WTO agreement required the elimination of export incentives, which resulted in a higher anti-export bias for many exports. This was exacerbated by South Africa's failure to create a functioning duty drawback or tariff rebate system that would allow exporting firms to obtain inputs at world prices. Although negotiations have taken place to establish preferential trade agreements with the EU, SADC and possibly Brazil and India, which will bring some benefits, this may have shifted the focus from the pressing necessity to improve incentives and create a more solid foundation for long-term trade (Lewis 2001:v).

4.7 INVESTMENT AND ECONOMIC GROWTH

Easterly and Levine (2000:36) reviewed the role of investment and physical capital accumulation in economic growth and development. They concluded that the modern version of capital fundamentalism, which describes capital and investment as the primary determinants of economic development and long-run growth, should be revised. They propose that the relationship should be viewed as a part of the process of economic development and growth and not as the

primary connecting source. The new view should be the guide to research and policy advice.

Truu and Contogiannis (1987:271) regard capital and labour as both complements and substitutes in the process of production. Thus, while additional investment creates new jobs in the short term, it also establishes the scope for replacing labour with capital in the long-term. The authors are of the opinion that many of the large investment projects undertaken by the public sector in South Africa, especially during the 1970s, were for infrastructural and strategic purposes – that is, largely motivated by broad social and political rather than just economic considerations. Examples are irrigation schemes, the Sishen-Saldanha and Richards Bay railway lines, harbours, power stations, Sasol synthetic fuel plants, arms production and strategic stockpiles.

It is well known that these developments have been more conducive to capital-intensive production methods than a rapid increase in the output of the economy's combined stock of labour and capital. Capital deepening also occurred in the economy as a whole. This is evidenced by the growth in capital per worker as indicated in table 4.5.

Table 4.5: Growth rate in the average capital labour ratio, using upper turning points in the business cycle closest to decade endings and beginnings

Upper turning point periods	Private economy ¹	Private economy, excluding agriculture	Services ²	Public sector including public corporations
1970-81	4.3	4.0	3.3	2.9
1981-89	2.1	3.9	3.1	2.8
1989-00	2.6 ³	3.3	1.9	0.9

Source: National Productivity Institute, Productivity Statistics (2001:9-10, 13)

Notes:

1. Private economy includes agriculture, mining, manufacturing, electricity, construction, commerce, transport, communications and finance. Community services and the government sector are excluded.

2. The service sector includes finance, commerce, transport and communications. Since real estate is included in finance, the data should be interpreted with the limitations of the real estate component in mind. Real estate represents around 20 per cent of the service sector total.
3. For 1989-96, because of unavailability of agriculture employment.

The growth rate in the capital labour ratio during 1970-81 was the highest in the private economy, with an average annual rate of 4.3 per cent. It is interesting to note that the growth in capital intensity was even higher in the agriculture sector between 1970 and 1981 because growth in the private sector excluding agriculture was lower. The situation reversed in the subsequent two periods. The services and the public sector generally had lower rates of growth in capital intensity.

More capital-intensive production techniques displaced labour and as such contributed to (structural) unemployment, but did not necessarily have a reducing effect on economic growth. The fact remains that it did occur, and even the private sector of the South African economy tended to become "overcapitalised" after 1970. This is not tantamount to saying that there has been overinvestment in South Africa; on the contrary, from time to time declining investment growth has been one of the primary contributors to differences between potential and actual growth. Capital deepening is a relative concept, and the problem with the increasing capital-labour ratio was that it did not always happen for purely economic reasons, but for institutional reasons, which included restricted mobility of labour, a chronic shortage of skilled workers, wage increases unrelated to productivity, as well as strikes and work stoppages organised by trade unions. The disturbing outcome was that the change in the relative composition of South Africa's stock of production factors, in favour of capital, had reduced the rate of economic growth and increased the rate of unemployment (Truu and Contogiannis 1987:271).

Increasing capital intensity also frequently caused a rise in the ratio of investment to saving. In turn, the domestic savings needed to finance desired investment were frequently insufficient and caused a deficit on the current account of the balance of payments. This "overinvestment" savings gap had to be neutralised by an adequate net inflow of foreign capital to avoid depletion of

the foreign reserves. One of the more acceptable options to alleviate the problem was a flexible exchange rate and the "correction" was ultimately made in this way because the international value of the rand depreciated from 1971 onwards when the Bretton Woods system of fixed exchange rates was abandoned. This, however, did not balance the current account, and for quite a while before the debt "standstill" of 1985, South Africa was unable to attract sufficient foreign capital, on a regular basis, to compensate for a frequent shortfall of domestic saving to finance the domestic investment. The balance of payments deficit frequently aborted an economic upswing even before the economy needed slower expansion as a result of impending inflationary pressures.

In the domestic economy, a government can finance the deficit on its budget through money creation, although it might not be the most prudent policy alternative, but a country cannot create foreign exchange. It must be earned through exports (preferred option) or negotiated through borrowing (costly route) or come about through a spontaneous inflow of foreign financial capital – the latter being the best short-term alternative.

As mentioned above, the other growth-limiting factor was the fading interest of foreign investors to choose South Africa as a prospect for their investments. Their interest had already started to decline gradually in real terms during the early 1970s and almost disappeared in the mid-1980s. Towards the end of the 1970s, foreign loans (indirect investment) overtook direct investment in real terms as the preferred mode for provision of foreign capital. This change has two important disadvantages for South Africa. Firstly, loans carry an interest burden, and secondly, they must ultimately be repaid (University of Pretoria 1992:2).

Foreign direct investment is regarded as one of the best choices for South Africa to improve its growth performance over the long term because the most ominous growth-defeating factor in the growth history of the South African economy was the recurring deficit on the current account of the balance of payments. When this had occurred in the past, the authorities were obliged to implement deflationary domestic demand management to curb the rising imports associated with economic growth. The level of reserves and the

extremely sparse inflow of foreign capital were not sufficient to finance the current account deficits.

Furthermore, South Africa (after the 1985 debt-standstill agreement) had to service and repay its foreign debt according to a debt-standstill schedule. A threshold surplus had to be maintained on the current account to finance these repayments. This mandatory surplus imposed a growth ceiling on the economy, which meant that the economy could not exceed a growth rate of 2 to 3 per cent in real terms. South Africa was thus under an "iron law of the current account" (De Wet 1990:47). What is more, South Africa was compelled to be a net exporter of financial capital (as a result of the disinvestment campaign) and had to maintain a surplus rather than merely avoiding a deficit on the current account. This placed a functional ceiling on the average real economic growth rate lower than three per cent per annum in real terms (De Wet 1995:474).

After the democratic elections in April 1994, sanctions were abolished and the disinvestment campaigns against South Africa withdrawn. These processes, served to reopen foreign markets, and during 1997 alone, in excess of R17.5 billion of foreign direct investment capital flowed into the economy although R10.8 billion was disinvested, leaving a net inflow of R6.8 billion as well as a net inflow of R30.6 billion portfolio investment (SARB, December 2001:S-90).

The structural constraints imposed by the balance of payments appeared to have vanished. The relatively peaceful first democratic election, the initial political stability and ameliorating economic climate such as the declining rate of inflation, the record agricultural crops, higher real interest rates and a stable exchange rate, attracted foreign capital. The real economic growth responded favourably and swiftly increased, from 1.2 per cent in 1993 to 3.2 per cent in 1994 and peaking at 4.3 per cent in 1996 (SARB, December 2001:S-148).

Renewed political uncertainty, especially in Kwazulu-Natal, and the apparent uncontrollable high levels of crime and unrest, as from the latter half of the 1990s onwards, led to a swift repatriation of foreign capital. This resulted in a precipitous depreciation of the rand (-3 per cent in the first quarter of 1996 - 12.6 per cent in the second quarter and -3.6 in both the third and fourth quarters - in total -22.8 per cent compared with -3.2 per cent for 1995),

followed by uncertainty and volatility on the capital and share markets. The growth ceiling imposed by the balance of payments appeared to be back in force. This tendency continued through the 1990s with more precipitous falls in the value of the rand in 2000, and again in 2001, in the aftermath of the New York terror incidents and the war in Afghanistan.

An even greater blow for South Africa (in terms of economic growth as a result of reduced foreign direct investment) is the loss of new technological know-how usually embodied in these investments. It breaks the cycle of technology diffusion, brought about by the movement of employees, and reverse engineering. Another lost advantage is that these investments come with no strings attached and they are unlikely to contribute to capital flight and downward pressure on the local currency.

The new government introduced a comprehensive macroeconomic strategy (GEAR) by the middle of 1996 in an attempt to revitalise local investor confidence, attract foreign capital, reduce the external pressures and instability of the rand, and reverse concerns over the commitment to sound macro policies. With this in mind, GEAR built upon the strategic vision set out in the RDP rather than replacing it. In GEAR, the government committed itself to specific macro targets, including a programmed fiscal deficit reduction plan that provided for more stringent reduction phases than the existing ones.

GEAR also provided for better policy coordination and development, with planned involvement of selected government departments and the Reserve Bank. It was sanctioned by Cabinet and laid before Parliament by the (then) Deputy President Mbeki as the "central compass" giving direction to all other government programmes.

During the latter half of the 1990s South Africa improved its public financial management to the extent that in 2002, three USA investment grading agencies namely Standard & Poor, Moody's Investor Service and Duff & Phelps awarded South Africa "investment grade" ratings, which indicate that South Africa has the future ability, legal obligation and willingness to make full and timely payments due to investors.

Turning to investment, and specifically the area of investment incentives, the World Bank (Lewis 2001:13) advises that: "Targeted investment incentive schemes should be approached with caution". In South Africa, the Spatial Development Initiatives (SDIs) have concentrated on huge capital-intensive projects oriented towards exploitation and "beneficiation" of mineral resources with the result that the incentives for ordinary manufacturing enterprises have been limited, and the employment creation minimal. Lewis (2001:13) points out "international evidence suggests that schemes such as this frequently fail to attract the expected new investment, and are often costly and result in resource misallocation".

Lewis (2001:13) is of the opinion that labour market flexibility is an area of critical concern in South Africa, a viewpoint supported in surveys of South African managers and international investors. The evidence on unemployment by skill class and remuneration trends also confirms that job creation among the unskilled and semiskilled labour force has been constrained by rising real wages. Recent efforts to introduce modest changes in labour legislation to offset "unintended" employment consequences have proven contentious, and illustrate the difficulties in reforming labour market institutions and practices. But initiatives to enhance flexibility and market efficiency must be continued if the steady growth in unemployment is to be reversed. The focus should perhaps be on introducing greater wage flexibility for special groups (e.g. youth, high-unemployment areas, successfully applied in Australia) and reconsidering minimum wage levels for agricultural and domestic workers.

This leads to the conclusion that the macroeconomic growth performance of the South African economy remains disappointing in terms of domestic and foreign investment and its associated employment effects, despite a positive macroeconomic policy environment. The institutional environment appears to require attention.

During the first half of 2002 foreign investor sentiment towards emerging market started to improve. In the case of South Africa the low prices of domestic financial assets stemming from the sharp depreciation in the external value of the rand in the latter half of 2001, contributed to renewed foreign investor interest in South Africa. This was witnessed by an inflow of R1.6 billion

during the first quarter of 2002, which almost recovered the outflow of R1.9 billion lost during the fourth quarter of 2001 (SARB Quarterly Bulletin, June 2002: 32).

The World Competitiveness Yearbook (WCY) (International Institute for Management Development 2000) investigated the macroeconomic and microeconomic environments of 49 countries by sending questionnaires to a representative sample of business executives operating in a wide spectrum of activities in the economies of these countries. The executives were requested to rank their country on a scale of 1 to 6 on a number of microeconomic and macroeconomic factors that contribute to or impinge on their activities. The results of these questionnaires are aggregated and the business environments of the respective countries are scored so that the best-scoring country is ranked as number one and the worst as 49. The areas of the microenvironment in South Africa found to be lacking in terms of competitiveness according to the World Competitiveness Yearbook (2002) are listed in table 4.6.

Table 4.6: Growth limiting factors in South Africa highlighted by the World Competitiveness Yearbook (2002)

Factor	Ranking out of 49 countries
Equal opportunity: race, gender, family background	49
Murders, violent crime and armed robberies impair business	49
Labour regulations are flexible/not flexible in terms of hiring and firing, minimum wages	47
Immigration laws hinder/do not hinder the use of foreign labour	47
Investment incentives are attractive/not attractive to foreign investors	45
Education system meets/does not meet the needs of a competitive economy	48
Economic literacy is generally low/high among the population	49
Education in finance is sufficient/not sufficient in your country	48
Labour relations are generally hostile/productive	48
Skilled labour is available/not available	49
Customer satisfaction is emphasised/not emphasised in your country	46
Image of your country abroad hinders/supports business development	46
Science is/is not adequately taught in compulsory schools	49

Source: International Institute for Management Development (2002)

Since the scores of the factors in table 4.6 are close to or equal to 49, this means that South Africa scored low or last (49th) in the array of the alternative foreign investment destinations. Alternatively, all countries that scored closer to the best (which is number one) have a better chance than South Africa of attracting foreign investment.

Some of these areas have also been researched by Lewis (2001:vi), for example *indirect* measures aimed at making the economy more competitive and attractive to investors (through improvements in labour markets, enhanced trade competitiveness, promotion of SMMEs, etc.), but also *direct* measures (such as efforts to improve the quality and quantity of physical investment, or enhance opportunities for skill accumulation for the poor).

4.8 PROGNOSIS

From the above analysis it can be deduced that the economic adjustment process of the 1980s and 1990s fell short of sound economic growth fundamentals and growth and development were therefore seriously impaired. These growth-limiting factors had the effect that the country was unable to grow at a rate that would enable the employment of an expanding labour force. It is obvious that an ever-smaller portion of the labour force is absorbed in the formal sector, notwithstanding or even because of the endeavours of the public sector to reduce unemployment by raising its own employment number.

Given the fact that the largest share of South Africa's imports are intermediate and capital goods, which are relatively price inelastic, the declining exchange rate or any form of import restrictions will not enhance growth, but are more likely to further reduce growth through escalating cost structures for intermediary and capital goods, lack of cutting edge technology, and even worse in the case of import restrictions, more bureaucracy.

A higher real growth rate cannot be sustained because the higher growth would require more imports, and because of the fixed import content of the increased output, it would be impossible to pay for the increased imports. The import-reduction option therefore places the economy in a catch 22 situation. The balance of payments restriction on growth can thus best be solved or alleviated through sustained export growth and supplemented by FDI flows. Lewis (2001:13) is of the opinion that instead of targeted investment incentive schemes, the focus should rather be on efforts to improve the overall business climate.

The government has committed itself to a revised strategy to privatise the four largest state-owned enterprises (Transnet, Telkom, Eskom, and Armscor) by 2004. The broader investor community's reaction was subdued and even reserved, with concerns expressed over the slow pace and relatively limited scope of actual privatisation. Delays with privatisation also seem to have the effect that the perceived market value of the candidate privatisation corporations appears to deteriorate as investors become choosy and prefer to invest in countries with decisive privatisation track records.

4.9 POLICY OPTIONS FOR SUSTAINED HIGH ECONOMIC GROWTH

To break the privatisation and FDI *hiatus*, the World Bank advises more decisive action and faster progress with privatisation, which would bring immediate benefits. According to Lewis (2001:13), accelerating privatisation, together with market liberalisation can provide an important initial stimulus to FDI because it draws in foreign firms directly (through the purchase of assets) and indirectly (by sending a strong signal of the government's continuing commitment). Since FDI projects often have a strong export orientation, the trade balance will improve, increasing the economy's import capacity and providing an important stimulus for job creation Lewis (2001:24).

South Africa is currently in the back row as far as the promotion of non-mineral exports through export-processing zones or duty drawback schemes are concerned. There is no reason why these schemes and zones cannot be adapted to suit South Africa's circumstances as long as the conditions and institutional environment remain transparent, free of bureaucratic red tape, and these schemes concentrate on employment creation. There are encouraging indications that South Africa is moving in that direction with the Couga Harbour project.

It is also clear that South Africa should improve the institutional environment in other areas such as crime, more flexible labour regulations, human capital to enhance the availability of skilled labour, economic literacy, better education in areas such as finance and science and a business climate conducive to customer satisfaction.

According to De Long (1997:3), in sub-Saharan Africa, only Botswana, Lesotho and the Cameroon, have managed to reduce the relative income gap vis-à-vis the industrial west. In Africa as a whole, Kenya, Mali, Malawi, Zimbabwe, Guinea, the Côte d'Ivoire, Nigeria and South Africa, among others, have seen improved living standards, but an increasing relative income gap regarding the industrial core. In these countries the cup is still only half full – increasing relative income gaps regarding the industrial core have nevertheless been accompanied by improved living standards and productivity levels.

4.10 CONCLUSION

The growth performance of the South African economy remains lethargic, despite political liberalisation, the lifting of sanctions and prudent fiscal and monetary policies. In a seemingly positive environment, the growth performance remains below expectations and its estimated potential. Its lack of labour absorption capacity is its main shortcoming.

International investors remain aloof although some interest is noticeable with inflows of foreign direct investment recorded during the first quarter of 2002. Prospective investor surveys and international financial institutions indicate microeconomic rigidities as a deterrent to foreign direct investment. The international and local financial press points to slow or minimal progress with privatisation. Rather than foreign exchange reserves and emerging market contagion keep the rand vulnerable and foreign direct investment at a trickle. Zimbabwe is not helping either.

The low value of the rand makes local manufactured exports profitable, especially in the motor-vehicle manufacturing industry and its upstream supply chain. With greater pressure on industrialised countries to dismantle trade barriers against products from emerging markets, exports could become an engine for accelerated growth.