After GEAR

changing economic policy

1998 has not been a good year for the global economy, especially for so-called 'emerging market economies' of which South Africa is one. These countries have born the brunt of a global slow down and contraction. The working class has paid the price in the form of increased unemployment and reduced standards of living.

Many analysts have argued that South Africa has weathered the storm comparatively well. They attribute this mainly to government's economic policies. They argue that government has got the 'fundamentals' right.

These arguments beg the question: what are these fundamentals, and are they the right ones to focus on? Investment bankers typically focus on fiscal deficits, government expenditure as a proportion of GDP, taxation rates, etc. We argue that poverty alleviation, job creation and equality are among the important fundamentals.

Like any other economy, the South African economy is influenced both by factors within government's control, and by external factors upon which we have little impact. This latter set of factors refers primarily to changes in the global economy which, in turn, have substantial national effects, such as reduced markets for exports, changes in the value of the currency, inflows and outflows of capital, and so on.

Claire Horton, Fiona Tregenna and Thami Ngqungwana argue that poverty and inequality in South Africa can only be addressed through major changes in economic policy.

Although South Africa has little control over, for example, changes in East Asia, what we *can* regulate to an extent is the impact of such 'external' situations on our own economy. We need to avoid a scenario where domestic policy measures - such as exchange control liberalisation - make us more vulnerable to global instability, which, in turn, further restricts our domestic policy alternatives. Our policies should, rather, aim to maximise our space for pursuing developmental policy approaches.

Economic indicators

Unemployment

One of the key fundamentals by which the South African economy should be judged is its ability to create jobs. There is little doubt that we have failed dismally in this regard. According to the South African Reserve Bank, total employment now stands at 1981 levels. Using the 'expanded' definition of unemployment, the unemployment rate has increased from 31,5% in 1994 to 37,6% in 1997.

The ability of the economy to absorb new entrants into the labour market has been steadily declining. The labour absorption rate, that is, the percentage of the working age population that is employed, fell from around 46% in 1990 to 38% in 1994 and to 34% in 1997.

The table below shows employment trends for two periods – 1990 to 1998 and 1996 to 1998

Employment changes* in the non-agricultural formal business sector

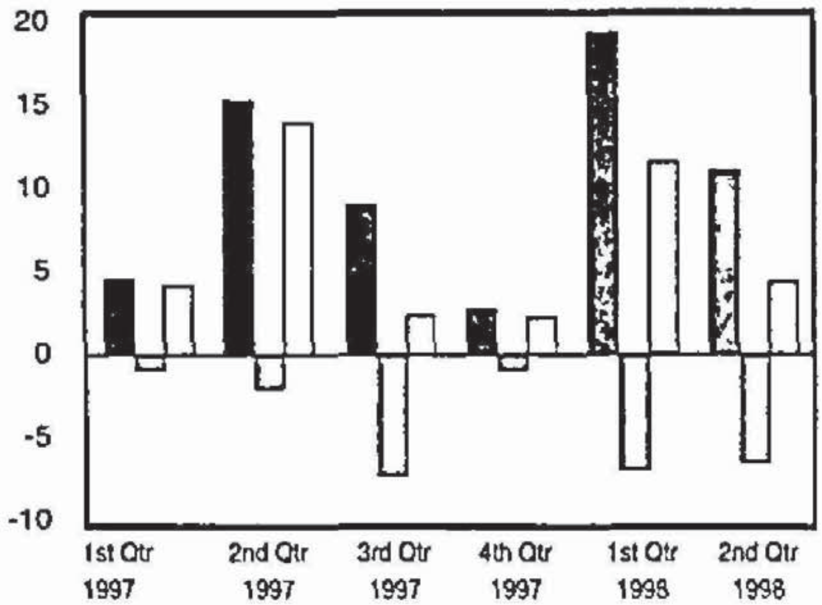
Sector	% change in employment 1990 to 1998	% change in employment 1996 to 1998
Mining & quarrying	–38,8	–24,8
Manufacturing	–10,9	–6,7
Construction	–22,7	–1,0
Trade & accommodation	–13,5	–9,6
Finance & insurance	+17,2	+1,4
Community, personal, social services (including government)	**	-0,8

(Source: Statistics South Africa, Calculations based on Series Po 200, Po 271 and *Unemployment and Employment in South Africa, 1998*)

* Calculations are based on June employment levels

** A longer time comparison has not been done, because of the inclusion of TBVC states and changes in definition.

Net capital movements, not related to reserves, 1997/98



(Source: South African Reserve Bank, *Quarterly Bulletin*, Sept. 1998)

The only sector that has shown increases in recent years is the finance and insurance sector. Between June 1994 and June 1997, there was a slight increase in employment (approximately 0,5%) within the community, social and personal services sector (including government). Since June 1997, there has, however, been a downward trend in employment in this sector. Due to budget cuts, it is likely that this sector will face continuing job losses. Mining and quarrying, in particular, have suffered substantial job losses.

Capital flows

The graph above shows net capital movements, not related to reserves, for 1997 and the first two quarters of 1998.

In 1997 there was a net inflow of long-term capital of R30-billion and a net outflow of short-term capital of R10-billion. The inflow consisted mainly of portfolio investments, especially non-resident purchases of bonds and shares on the domestic market. Unlike foreign direct investment, these portfolio investments are prone to market sentiment and are consequently far less stable. The turmoil in international markets saw a sharp decrease in foreign investment in emerging economies such as South Africa. As a consequence, the inflow of long-term capital fell from R18,2-billion in the first quarter to R10,6-billion in the second quarter of 1998.

Short-term capital outflows for the first two quarters of 1998 amounted to R13,3-billion compared with R9,8-billion for the whole of 1997. The effect of the slow down in long-term capital inflows, together with increasing short-term capital outflows, saw net total capital investment decrease from R11,2-billion to R4,3-billion over the first two quarters of 1998. This represents a 60% drop in net capital inflow to South Africa.

Exchange rate

1998 saw a repeat of the exchange rate turmoil experienced in 1996. In both instances, the rand depreciated by more than 20% against a weighted average of key exchange rates (the US dollar, British pound, German mark and Japanese yen). Interest rates increased in an effort to protect the value of the rand. The rand has recently shown signs of recovery. However, exchange rate volatility is damaging to the economy, as it makes planning difficult.

Gross Domestic Product

The international crisis has had a negative effect on economic growth, investment and consumption. GDP for 1998 is expected to be between 0,5% and 0,2%. GEAR predicted a 3% increase.

Inflation

Inflation is expected to rise from a low of 5% in April to 9,7% by year-end.

Policy issues

Economic policy issues impact on growth and socio-economic transformation. The

Assessment of some key Department of Trade and Industries programmes (1997)

Project	No of firms participating	Jobs created	Exports (R-m)	Investment (R-m)
Tax Holiday Scheme: *aims to encourage new investment in manufacturing according to regional, labour intensity and sectoral criteria*	35	3 534	n/a	837
Spacial Development Initiatives: *aim to facilitate private sector investment through public investment in infrastructure and the identification of viable projects across national boundaries*	29	10 000	n/a	17 000
Small/medium Manufacturing Development Programme: *encourage new investment in s/m manufacturing companies and facilitate job creation*	223	7 086	n/a	512
Export Marketing & Investment Assistance Scheme: *aims to partially compensate exporters for costs incurred in developing new export markets*	242	714	66,2	n/a
Export Credit & Foreign Investment Reinsurance: *provides export credit loans and insurance*	n/a	17 000	n/a	6 000

(Source *Industrial Policy and Programmes in South Africa*, Department of Trade and Industry, April 1998)

Department of Trade and Industry (DTI), reviewed a number of its policy measures during 1998, including broad industrial policy and competition policy. Other policy issues include black economic empowerment and the Presidential Jobs Summit.

Industrial policy

Many of the DTI's programmes focus on investment support and trade facilitation. These programmes have principally been guided by government's focus on export orientation.

It is vital that the new industrial support measures are able to transform the economy and ensure a development path that is consistent with overcoming inequality and addressing the social deficit. This requires an active industrial policy that targets and supports the development of more labour-intensive manufacturing and encourages value-added labour beneficiation. Up-stream and down-stream linkages must be nurtured.

Given the problem of job loss in the manufacturing sector, it is important that government programmes actively contribute to job creation, preserve existing jobs and assist in overcoming inequality. Other criteria, such as increased exports, are important insofar as they contribute to meeting these objectives. While it may be too early to properly assess many of these programmes, their initial impact on employment can be examined.

The following table on the opposite page provides a brief assessment of some of DTI's incentive measures.

As with all official statistics, these figures should be treated with caution.

Competition policy

A new competition policy was negotiated in 1998 through Nedlac. Competition policy is important in that it allows for the regulation of the corporate environment. The new policy has a number of positive aspects:

- it has a greater developmental orientation;
- it is more integrated with other policy objectives;
- it is sensitive to job losses in regulating mergers and acquisitions;
- there is some degree of ministerial intervention.

In general, the new policy is more workable and comprehensive than previous policies.

Labour was calling, however, for an approach which focuses not only on behavioural transgressions by companies but also on problematic structural concentrations. It also wanted involuntary divestiture to be strengthened as a remedy.

The unions were arguing for a stronger role for the state in ensuring that competition policy is used effectively in

Pic: Cobus Bodenstein AP

Thabo Mbeki.

achieving broader developmental objectives.

1999 will hopefully see the setting up of new competition policy institutions. It will be important to monitor the impact of the new regulations on corporate structure and conduct.

Black economic empowerment

For the majority of South Africans, economic transformation has been very slow in coming. Forty-six percent of South Africans (mostly black people, women and rural communities) live in poverty. The top 20% of the South African population accounts for 70% of national expenditure, whereas the bottom 20% accounts for 1%.

Changing current social relations requires a broad, systematic transformation of ownership patterns, together with proactive policies and programmes that are targeted at communities and individuals who have been historically disadvantaged.

Black economic empowerment has become synonymous with share acquisitions and the rise of black capital on the Johannesburg Stock Exchange. The recent share price collapse points to the fragility of this type of empowerment.

The National Empowerment Fund (NEF) is one of the mechanisms driving black economic empowerment. While changing racial ownership patterns is an important issue, it is important that poor South Africans are able to derive real gains from the NEF's investments.

Meaningful black economic empowerment must focus on:

- sustainable employment creation;
- improved labour standards;
- organisational transformation within big companies;
- development of viable SMMEs;
- meaningful shareholding and management control in big companies;
- skills development and training;
- poverty alleviation targeted at the most vulnerable, for example rural women;
- transforming ownership in a way that redistributes both wealth and income as widely as possible.

The Jobs Summit

The Jobs Summit brought the plight of joblessness to the fore. In its proposals, labour argued against a limited project approach. It called for a strongly interventionist government, promoting productive investments in socio-economic development and a focus on labour-intensive industries such as housing.

The summit conceded that there are differences amongst the social partners over macro-economic policy and its potential effects. Many of the areas where agreement could not be reached, particularly between government and labour, were underpinned by these differences. At the heart of this debate lies the question: should macro-economic policy be *adjusted*, particularly in the light of current global conditions, or should it be fundamentally rewritten? Areas of action range from the macro economy, to national programmes, to very specific programmes and pilot projects.

Some of the *agreements* between the parties on programmes and measures to promote job creation include:

- industrial policy measures and programmes to address unemployment and increase investment; such as a 'buy South Africa' campaign, sector summits, small business promotion and SMME mentorship schemes;
- enhanced housing delivery and an increase in rental stock;
- human resource development, focusing on training, and education programmes;

- special programmes and targeted groups – such as youth brigades, student community service, programmes targeting women and people with disabilities, working for water.

The summit should not be seen as a panacea for South Africa's unemployment problems. It has, however, opened up the macro-economic debate and set in motion projects and programmes with very tangible job creation effects.

Waiting for a job, Germiston, 1998.

After GEAR

The extent to which we are able to shift away from failed orthodoxies, will have a significant impact on the economic indicators we find ourselves analysing at this time next year. As the recent Alliance Summit agreed,'the present crisis is also a paradigm crisis for the simplistic "one-size fits all" strictures of the so-called "Washington Consensus". Worldwide, and amongst a broad spectrum of leading economists there is an acknowledgement that there is a need for fresh thinking, new leadership and greater flexibility in economic policy-making.'

While noting the significance of recent observations from the likes of Joseph Stiglitz, George Soros, Tony Blair and Paul Krugman, we should also be wary of uncritically taking on board their newfound enlightenment around the shortcomings of neo-liberal orthodoxies.

We need to move beyond the pro/anti-GEAR debate and begin to build a workable, post-GEAR consensus. In order to avoid being an empty shell, however, such a consensus would have to acknowledge the need for fundamental policy changes in certain areas. There is always a trade-off between the costs of changing policy in the course of its implementation, and the costs of sticking with destructive practices. Evidence suggests that, for some time now, the latter costs have far outweighed the former.

In a recent address to the NAFCOC congress, Deputy President Thabo Mbeki, criticised the 'business confidence index', arguing that it does not reflect black business confidence. This begs the question: whose confidence in the economy counts? Even if black business's opinions were incorporated into this index, to what extent should it be used as a barometer of public opinion on the state of the economy?

If we want to use confidence indices to get a sense of responses to current policies and anticipate future economic developments, we also need to construct a 'labour confidence index', or a 'people's confidence index'. Such barometers could use measures like employment rates, job security, the size of the wage gap and broader measures of inequality and improvements in human development indicators.

Big business may be comfortable with current macro-economic policies, but it is unlikely that any macro-economic policy can enjoy credibility and the confidence of labour and society at large unless it is generated through a participatory process and is directed at meeting basic needs.

The Alliance Summit has laid the basis for moving towards a post-GEAR consensus on macro-economic policy.

It has been agreed that macro-economic policy needs to be based on the following cornerstones:

- major structural transformation of the apartheid economy;
- alignment of macro-economic policy with reconstruction and development objectives, to address the social deficit;
- fiscal discipline, sustainability, and relative predictability;
- the possible implementation of contra-cyclical measures;
- relaxation of macro-economic targets to divert resources towards growth, development, and sustainable transformation.

The extent to which these tenets lead to substantive policy shifts remains to be seen, and will largely determine the extent to which the economy moves onto a more developmental path. Agreements and processes arising out of the Jobs Summit will also be important in opening up economic policies to greater debate and amendment.

Looking ahead

Some of the specific areas of economic policy which we should watch for possible change in the coming period include:

- a shift in the funding of the Government Employees' Pension Fund such that a greater proportion of it is funded on a 'Pay As You Go' basis;
- some strengthening of exchange controls, or at least greater regulation of capital flows;
- a degree of relaxation of deficit targets to allow more flexibility in government spending;
- greater regulation of some portion of the funds of the retirement and long-term life assurance industries, to encourage investment in productive, job-creating activities;
- a possible lowering of interest rates (through the Reserve Bank facilitating a reduction in the repo rate), in the context of a closer alignment of monetary policy to industrial and developmental policies;
- in general, a greater sensitivity of all aspects of government economic policy to their job creation implications.

Shifts in economic policies do not only need to be negotiated at 'peak' level. The sectoral summits which were agreed on at the Jobs Summit can play a crucial role in meso-level industrial transformation. Workplace forums can have a significant impact on enterprise democratisation and job creation/protection.

The South African economy faces serious structural problems. Unless the problems are addressed we will continue to live with inequality and poverty.

The market alone cannot solve these problems. It is clear that bold and proactive changes to many of our policies are needed. This is not change for its own sake, but change which is specifically directed at objectives such as increased employment, redistribution of wealth and income, and the democratisation of the South African economy. ★

The authors are researchers at Naledi.