Challenges of **growth and poverty**

Are existing government policies contributing towards growth and reducing poverty? A recent conference organised by Trade and Industrial Policy Strategies (TIPS) and UCT's Development Policy Research Unit (DPRU) attempted to answer this question. The ***Labour Bulletin*** *explores some of the debates which are likely to emerge following the release of the presidential ten-year review.*

The conference was held to take stock of developments in the policy environment since 1994. Many who attended – including government officials, researchers, academic economists, trade unionists and foreign donors – have at one time or another been either directly or indirectly involved in contributing towards the policy positions adopted by government.

Papers covered issues such as social security, public works, trends in poverty, inequality and unemployment, the economic impact of HIV/AIDS, privatisation and regulation, FDI and capital flows and black economic empowerment as a mechanism for redistribution. Areas such as trade reform were largely ignored.

The timing of the conference meant it became – at least informally – a forum to discuss some of the research commissioned by the presidency as part of its ten-year review process which was released on 16 October. The discussions made clear the challenges that lie ahead for the research community and the policy makers it serves.

The key focus was obviously on whether the growth strategy in place is appropriate to tackle poverty and unemployment. The dti's former chief economist Dave Kaplan and Cornell University Eric Thorbeke set the scene for this discussion.

Professor Kaplan, now at the School of Economics at the University of Cape Town, presented a scorecard assessing the performance of the manufacturing

This report has been sponsored by TIPS

Finance Minister Trevor Manuel (right) together with Alan Hirsch from the presidency.

sector since 1994.

The data clearly shows that South African growth has increased only marginally in the past decade and is significantly lower than other developing and developed regions worldwide. This poor performance has also been reflected in manufacturing exports, which have declined by a significant 0.2% since 1980.

Kaplan also focused on the equity dimensions of the manufacturing value added (MVA) sector – employment, remuneration and geographic spread. While employment has shown a steady downward trend since 1995 – declining even during high rates of manufacturing growth, output has been growing steadily. This rising productivity is mirrored by rising wages. Kaplan explained that those who have remained in manufacturing are 21% better off in 2002 than they were in 1990, with income increasing more for unskilled and poorer paid workers.

In a further exploration of the dti's policies, he questioned the effectiveness of a number of supply-side measures introduced. A dti survey of manufacturing firms reveals that they have had little effect on business.

Specific sector support was introduced for auto and auto components, and clothing and textiles. As a result the auto and auto-components sector has seen significant export and investment growth, although not employment growth. Kaplan cautioned that a complex set of questions underpin this apparent success. The data does not suggest that these productivity measures have resulted in significant advances in labour and capital productivity or that the necessary learnings have taken place. He added that upon closer examination it might prove that local consumers have been subsidising exporting firms through MIDP waivers on import tariffs. He suggested that these underlying supports demand a closer examination, which should also assess the broader social costs, associated with the apparent success of the sector.

Similarly, clothing and textile firms earned the right to import products duty-free as a specific support as well as significant economic opportunities under Agoa. In spite of these opportunities export performance has been weaker than that of other countries in the region also receiving Agoa support.

According to Kaplan, part of the problem was that the dti had too many responsibilities in relation to available capacity to deliver. As a result it had difficulty in keeping its eye on the 'industrial' ball.

The dti, he said was not always able to achieve objectives such as encouraging investment, when factors hampering such developments did not fall within its ambit. For example, research revealed that some of the constraints to investment included labour regulations, cost of labour, exchange rate fluctuations and skills shortages. Many of these major policy issues lie within the scope of other government departments, making it very difficult for the dti to address them at a policy level. Kaplan concluded that significant industrial growth required resource and capacity development, and instead of focusing on a wide range of sectors the dti could better achieve its aims by giving sector-specific support to only one or two sectors.

Kaplan's input not only caused some concerns amongst his former dti colleagues but also those in the labour department who initially believed that he was trying to lay the blame for poor growth on their doorstep. He also provided a platform for those economists who have, over the years, become increasingly critical of the growth path proposed by those (including Kaplan himself) involved in the ISP initiative in the early 1990s.

This was clearly illustrated by UCT economist Nicoli Nattrass who highlighted the long-standing tensions between industrial policy and labour market regulations and suggested moving towards an integrated labour/industry strategy (see p30). Kaplan responded that in 1994 industry might have underestimated the importance of wage issues and 'the hassle factor'. He said that maximising investment is imperative and highlighted the need to quantitatively measure the extent to which labour market issues constrain investment and limit exports. He revealed that smaller firms tend to raise more labour issues than bigger firms.

Cornell University professor Eric Thorbecke analysed the dynamics of poverty. He proposed that the cause of the poverty trap is an entitlement failure, where a lack human, financial or health assets characterises households. Hence, it would involve more than economic and political liberalisation to assist households to emerge from this

trap, saying that policies should include the promotion of local financial institutions, the delivery of essential services etc. Thorbecke questioned whether economic growth automatically translates into a reduction in poverty and inequality.

Thorbecke concluded that while growth is clearly a necessary condition for poverty reduction, it is not sufficient, since growth may take place entirely in the modern enclave of the economy with no trickle down.

University of Toronto professor Al Berry also explored the factors necessary for accelerated and sustainable economic growth. In view of SA's current levels of poverty and growth, he argued that there is a need for fast growth, but that the pattern of growth must also be appropriate to create employment in the right areas.

To give some guidelines on the 'right' package for SA, Berry highlighted countries that have showed accelerated or rapid sustained growth. The policy options for good growth over a relatively long period, he said, were not the same as those for fast growth. While most East Asian countries achieved fast growth, some did not go through a process of major acceleration. Berry focused on countries which experienced slow growth for a period of at least five to seven years and were able to translate into fast growth of between 5% and 9%. Berry looked at the common factors in Brazil, Chile, Korea, Malaysia, Indonesia and China in an attempt to develop this elixir for fast, sustained growth.

In Korea, growth accelerated from 3.5% to 10% between 1963 and 1979. This example perhaps epitomises the elixir, sharing all the characteristics of the other countries:

- The national savings rate rose from 3% to 26%.
- The investment rate rose from 9.5% to 31%.
- There was a major increase in the export GDP ratio from 3% to 27%.
- A clear devaluation of the currency.

All experiences of rapid acceleration involved buoyant aggregate demand – which is difficult to achieve without currency devaluation. With the exception of Singapore and Malaysia, all countries had moderate rates of inflation – between 15% and 25% per year. (Some countries had hyperinflation during their slow growth periods so inflation decreased during the accelerated growth periods.) Berry concluded that it would be difficult to achieve fast accelerated growth without inflation, generated by buoyant aggregate demand, suggesting that a conservative macroeconomic policy may not be in order.

Berry's input elicited an interesting response from Thorbecke who questioned some of the examples used, claiming that some growth patterns did not translate into a reduction of poverty or inequality. Thorbecke referred to the case of Brazil where growth in the modern enclave had little impact on the rural areas or on poverty reduction. Berry responded that the pattern of growth is extremely important, but that getting the right pattern and then growing at 4% will not be enough to reduce poverty. In the Brazilian example, poverty did decline. Surprisingly, in the poorest part of Brazil, distant from the hub of growth, agricultural wages went up 40% suggesting that fast growth will result in a fair amount of trickle down.

An important issue to emerge from these discussions was the use of exchange rates as a mechanism to boost growth. It was suggested that the stimulation of aggregate demand through inflation may introduce imbalances in the balance of trade with external effects. These effects may lead to new discussions about trade barriers and therefore how sustainable this strategy is from a global political point of view. Would steady growth not be better than fast tracking less stable growth?

Berry said China is one of the most recent examples of fast export growth through an undervalued exchange rate. (Recent reports have indicated that China is now coming under pressure from the US for adopting this strategy).

With regard to undervaluation it is hoped that the currency will only need to stay undervalued for five to ten years to facilitate fast growth, increased investment and savings. Devaluation may even suffice. The third world could take turns undervaluing their currencies to achieve growth.

Poverty levels and inequality

Discussion around levels of poverty and inequality focused on whether the number of those living in poverty has increased and whether SA has become more or less equal since the transition.

The general perception at the conference was that poverty has increased but to what extent? Natal University economists Charles Meth and Rosa Dias conducted research to measure the increase in poverty in view of the fact that the number of people in households in the lowest two expenditure categories (R0-R399 and R400-R799 per month) had increased between 1999 and 2002. Their research is based on an analysis of the 1999 October Household survey and the September 2002 Labour Force Survey. They found that close to 4-million people joined the ranks of those in poverty or 'new poor' between 1999 and 2002. This conclusion was determined by estimating the maximum per capita expenditure levels of people in the bottom two expenditure categories in the economy.

They argued that 'government's energetic attempts to persuade the public that it is winning the war against poverty are misguided'.

To counter claims by government that the social wage contributed to people's well-being Meth and Dias did some rather questionable calculations around the inclusion of various components of a social wage for the bottom two categories. Despite the calculations, they found that the situation did not change enough to take them out of poverty.

Alleviating poverty

There are different views about how to beat poverty – whether by beefing up social security, the introduction of a basic income grant (BIG) or the zero rating of basic foods. In support of BIG, Cosatu's Neil Coleman stated that the existing social security net is unable to deal with the crisis of rising poverty and inequality. Coleman said poverty constrained economic development while the current growth path could not generate greater equity or employment. BIG, he said, whilst being endorsed by the Taylor Commission report, has not been adopted by government where discussions had reached a stalemate.

In response, Nattrass said Cosatu faced some criticism for its support of BIG because the costs would be passed on to income earners (through taxes), many of whom are union members.

James Thurlow of the International Food Policy Research Institute threw a spanner in the works by examining the impact on the economy of introducing BIG. He said whilst impact studies reveal that BIG had the potential to close the poverty gap by 70% and stimulate economic growth by increasing productivity, employment and consumption demand one could not ignore how this would be financed. He claimed that perhaps BIG might be too ambitious. In 2001 the annual cost of introducing BIG was estimated at R54bn (almost 6% of GDP). He explored various ways of financing BIG, including increasing sales tax and personal and corporate tax, to ensure that the burden was spread evenly between high- and low-income households, but also commented that a balanced financing approach might lessen the risks of the impact of increased tax rates on capital flight and tax evasion.

Targeted transfers, public works and subsidised essential goods are alternative means of poverty alleviation. Thurlow concluded that the possibility of South Africa becoming the continent's first welfare state was unlikely.

Ingrid Woolard of the Human Sciences Research Council looked at the impact of the Social Old Age Pension (SOAP), Disability Grant (DG) and Child Support Grant (CSG). She found that the uptake in social assistance grants have increased from 2.9 million in 1997 to 5.9 million in 2003 while the State Old Age Pension and the Child Support Grant are the two biggest grants, accounting for 99,8% of the total value of social assistance grants in February 2003.

Despite targeting only the elderly, the very young and the disabled, she concluded that social assistance grants play a major role in redistribution and poverty reduction in South Africa. Her research suggested that the combined effect of the SOAP, DG and CSG (when extended to all those that are eligible) reduces the number of individuals in poverty from 40% to 24%. The grant system also reduces inequality – the Gini coefficient falls from 0.67 before grants to 0.62 after grants. She said there was some evidence that this reduction in poverty and inequality is growth enhancing but the financing of an ambitious social assistance programme through higher (and potentially distortionary) taxes or higher budget deficits could dampen growth.

Poverty and social services

The demand for the extension of basic services after 1994 failed to take into account the potential impact of poverty and lack of affordability. Almost daily reports now reveal that poverty is undermining social delivery. Coleman argues that there is a need to link income security with services security.

Albert van Zyl, University of Stellenbosh and Carlene van der Westhuizen of the Institute for Democracy in South Africa explored this area and the claim that social service spending was cut under Gear, and that this reduction led to a decline in the quantity and quality of service. They found there was no conclusive evidence to substantiate either claims.

Answers to unemployment

Public works is often bandied about as the solution to unemployment and poverty. Sten Dieden from the University of Gothenburg said it was tempting to think of public works programmes as a fix-all, but they involve a host of complex questions – as the presentation by UCT economist Anna McCord revealed (see SALB 27(2)).

McCord assessed the performance of public works since 1996 and concluded that an expanded public works programme is unlikely to have a significant impact on the problems of poverty and labour market access, or their associate – growth – unless the proportion of government expenditure allocated to the programme is substantially increased and the associated institutional constraints are addressed.

Cosatu's Neva Makgetla said public works should explore an extension into

the provision of important community services such as home-based care, childcare or adult education.

Employment trends

Is rising unemployment a result of government policy? What is not widely acknowledged is that jobs have been created since 1994. Miriam Altman of the Human Sciences Research Council looked at employment over the past 10 years, evaluated whether SA is on a sustainable job-creating growth path and reviewed whether these trends would support a basic definition of jobless or job creating growth.

Altman said that a sustainable growth path would require a combination of growth and reduced unemployment. She noted that it is possible to have growing employment and unemployment simultaneously – which often confuses the picture. Underlying the overall miserable employment experience is a turnaround in formal non-agricultural employment since 1998 – which is now growing in line with GDP. 'While this might offer a ray of hope, we cannot yet say that SA is on a sustainable growth path.'

Imraan Valodia of the University of Natal explored the reliability of data on informal employment and found them to be highly variable. He concluded that it is not possible to determine the precise level and extent of informal employment.

Employment and wages

UCT economist Jeremy Wakeford revealed some interesting findings in his presentation on the productivity-wage relationship. He found that unemployment is not linked to the long-run equilibrium between real wages and productivity. High rates of unemployment, he said, had little or no effect in terms of restraining real wage growth, and real wage increases cannot be blamed for raising the level of unemployment. Wakeford also found that in the short run, real wages impact on productivity negatively but productivity has no effect on real wages. He argued that the decline in employment is not due to the growth of real wages in excess of productivity (forcing employers to cut jobs), but rather that productivity has grown faster than real wages. As a result, labour's share of gross output has been shrinking over the past decade, and has now reached its lowest proportion relative to capital's share in the past 40 years.

Competition policy

Simon Roberts of Wits University looked at the role of competition policy in economic development, and the experiences of other developing countries such as Brazil and South Korea in this regard. He used the steel industry as a case study to assess the effect of competition policy and competition institutions in SA post-1994. Roberts said while there are clearly defined prohibited practices which should be regulated, few cases are in fact referred to the competition authorities. He also said the conditions in South Africa for collusion are good which could be potentially very damaging to the economy.

Roberts said the repercussions of such a situation – with specific reference to the steel industry – are well known and relate to issues such as local steel users getting no cost advantage from local steel supply because Iscor steel is sold cheaper on the export market than the local market.

Price setting and regulation

As the role of key services and utilities in manufacturing success becomes apparent, the focus increasingly turns to the role of regulators in setting prices for these industries. Independent consultant Ethèl Teljeur provided an overview of the research being done in this area. Research focused on reviewing the effectiveness of regulatory frameworks for the electricity, telecommunications and transport sectors. Within this context attempts were made to explore the nature and extent of oversight of the regulators as well as the need for closer cooperation between various departments and with the Competition Commission.

David Storer of the Adam Smith Institute and Teljeur reviewed the effectiveness of price regulation in key sectors such as electricity, telecommunications, water, transport, education and health. They found that in many cases there is a strongly input-driven approach, a lack of price and efficiency focus and ultimately inefficient prices.

Grove Steyn of the HSRC argued that the electricity supply industry remains organised along the lines of the traditional public monopoly model while the National Electricity Regulator (NER) has not shown a robust approach to regulating Eskom prices. The best and only sustainable way of limiting inflationary pressures is to accelerate institutional reforms aimed at increasing cost efficiency and service delivery levels, Steyn argued.

Teljeur, exploring pricing issues in transport, said the sector – although largely corporatised and commercialised – remained largely unregulated in the economic sense.

Alison Gillwald from the LINK Centre analysed the telecommunications sector and argued that the weakness of price regulation in this sector is a direct result of an ineffective regulator with inadequate resources and a lack of enforcement power. LB