

# **FROM ISOLATION TO INTEGRATION?**

## **The South African Economy in the 1990s**



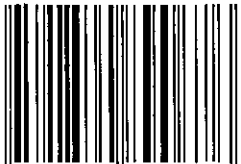
**edited by: Antoinette Handley and Greg Mills**



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Antoinette Handley & Greg Mills

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## Introduction and Acknowledgments

*Greg Mills*

*The primary motivation of the ANC's foreign economic policies as a whole will be to place South Africa on the path of rapid economic development with a view to addressing three key problem areas: slow growth, severe poverty, and extreme inequalities in living standards. The South African economy has grown very slowly since the early 1970s, with the exception of short periods of gold market booms. Annual GDP growth declined from almost six percent in the 1960s to less than four percent the following decade and to barely one percent during the 1980s. The economy contracted sharply during the recession-bound 1990s, and in 11 of the past 12 years, per capita income declined.*

Nelson Mandela, 1993<sup>1</sup>

Given the dramatic changes in South Africa's international position over the past five years and far-reaching developments in the nature of global politics and economics, the South African Institute of International Affairs (SAIIA) considered it timely to stage a major international conference on *South Africa in the Global Economy* from 11-12 July 1996. This event was designed to help locate and understand South Africa's position in the context of the continent's developmental problems and the evolving global economic system of the late 1990s.

What is the state of the global economy today? How does South Africa adapt to it? These questions are on the minds of many as South Africa, with its own unique mix of development and underdevelopment - of First and Third Worlds - is faced with meeting high expectations, not only of its own citizens, but of those in Southern Africa and further afield. The international community nevertheless has great hopes of what South Africa could contribute to Africa's economic regeneration and to the global economic environment in general. It is therefore crucial that South Africa balance its domestic needs while nevertheless playing a positive developmental role on the African continent.

Critical to the South African government's macro-economic strategy is the imperative to attract and reassure both the national and international investor by creating a friendly climate. In this, the need to ensure fiscal and monetary discipline and provide incentives through the privatisation of state assets, is coupled with a seemingly more intractable problem - to create a stable socio-political environment. In a complex synergy of relations and perceptions, the

overall view of South Africa is shaped also by its geographic location on a continent crudely characterised by political and economic instability, and a region staggering forward from the effects of 30-something years of civil conflict. An understanding of the idiosyncrasies of the global economy and of South Africa's place in this 'village' is of paramount importance, and one which many South Africans have been slow (or unwilling) to recognise.

## **The Conference Sessions**

The conference was structured mindful of this backdrop of global, regional and national demands. The presenters were followed immediately by respondents selected largely on account of their opposing views. The sessions focused on: an evaluation of the South African economy; trends in the global economy; the contemporary debate around the role of free markets and central planning; Africa's place in the global economy; the role of the World Bank in Africa; regional integration and the multilateral system; Africa in the context of the developing world; lessons from both the Asia-Pacific and Latin America; and, future paths and trends for the South African economy. Where no written papers were provided, an edited transcription of the conference presentation is published here.

## **Evaluating the South African Economy**

The Governor of the Reserve Bank of South Africa, Dr. Chris Stals, provides an overview of the South African economy in a global context. Within all the structural limitations outlined, as Dr. Villa Pillay of the National Institute for Economic Policy (NIEP) reminds, there are challenging socio-economic inequalities and problems.

In South Africa, nominally 32.6% of the population is unemployed, though this figure could be as high as 45-50% if the figures for the informal sector are included. It is forecast that, at current rates of growth (the population is predicted to rise to 58 million in 2010 and 73 million in 2025), jobs will be found for only 7% of new entrants into the labour market, compared to an absorption rate of 80-85% between 1965-70. Almost half the unemployed people are younger than 30, and almost 90% of them do not possess any skills or training for any kind of job. Some 12.5 million of the population (30%) of the population are said to be illiterate. The country displays extreme inequalities in the distribution of wealth, where the per capita income of whites is around 12 times that of blacks, and the income of the richest 20% of households is some 45 times that of the poorest 20%. About 45% of all dwellings (85% in the rural areas) do not have access to electricity.<sup>2</sup>

South Africa	
Population (m.)	42,3
Population Growth, 1985-94 (per annum average %)	2.4
GNP US\$m, 1994	117,200
GNP/per capita US\$, 1994	2,771
Real Growth (average annual), % 1985-94	-1.4
Inflation (average annual), % 1985-94	14.2
Foreign Debt US\$bn	30.8
Defence Spending, US\$bn	2.3
Sources: <i>The World Bank Atlas, 1996; South Africa in Figures 1996.</i>	

### Trends in the Global Economy

Robert McKinlay frames the terms of reference for the emergent forces of globalism and integration - which have progressed to the point where today, we can speak of a 'globalisation' of business and markets. The global economy has evolved along with the massive expansion in world trade and developments in international investment and banking which, together, have created high levels of interdependence. In 1963 total world exports stood at US\$154 billion. This increased to US\$1 trillion in 1977, and to over US\$2.5 trillion today. Key here is the rate of increase of merchandise exports as a share of GDP: in East Asia this annually averages over 11%, in Latin America around 5%, but in South Africa only 1.4%. From 1983-93, the South African manufacturing sector's share of world markets actually dropped from 0.46% to 0.34%.

In 1994, the share of exports to Gross Domestic Product (GDP) in South Africa was 20.87% - with exports mainly in mining (56.6%), agriculture (5.6%), and iron and steel manufacturing (9.0%). In 1995, 4.7% of exports (worth around US\$25 billion in 1995) flowed to the United States (US), but 25.3% to the European Union (EU), while Japan took 5% of exports (see the table below).<sup>3</sup>

National boundaries have become increasingly meaningless in an age where not only exports, but capital too, can move around the globe and from currency to currency at the touch of a keyboard, while these improvements in mass communications have also served to disseminate information and stigmatise the politics (and economics) of 'pariah' states, something which South Africa knows only too well from recent experience. And whereas the basis of wealth was in past centuries linked to the control of natural resources and trade routes, this

has shifted to the control of capital and to the accumulation of knowledge, human competence and technological progress. Industrial expansion is now fuelled by the expansion of knowledge, where skills are essential for survival yet easily transferable in the global economy.

South Africa's Top Ten Trade Partners, 1995 (Rmillion)					
Country	Position		Total	Imports	SA Exports
	1994	1995			
Germany	2	1	20583.6	16029.9	4553.7
UK	3	2	19042.3	10755.4	8286.9
USA	1	3	16337.0	11511.5	4825.5
Japan	4	4	14990.5	9880.1	5110.4
China/Hong Kong	6	5	6478.8	3472.5	3006.3
Italy	7	6	6415.6	4005.9	2409.7
Switzerland	5	7	6040.9	2382.1	3658.8
Taiwan	8	8	5774.0	3220.2	2545.8
Zimbabwe	-	9	5507.0	964.1	4542.9
Belgium	9	10	5365.4	2129.0	3236.4
<i>The grand total for South African trade in 1995 was (1994 figures in brackets): imports, R97,285 billion (R75,601); exports, R102,323 billion (R90,133). The current (September 1996) US\$-R rate-of-exchange is: R4.50-US\$1.00, though this has depreciated in value considerably from around R3.80-US\$1.00 at the end of 1995.</i>					

In the sphere of external relations, it is critical that emerging nations appreciate fully the nature of this changed world outside. Clearly, as stressed above, the most important global trend is that of political and economic liberalisation, in which a body of *Eurocentric* ideas around free trade and democratic governance are today taking root beyond just 'the West'. In South Africa's case, this much has been impressed on President Mandela, his Deputy Thabo Mbeki, and Finance Minister Trevor Manuel by the local business community, and clearly also by international players when the South Africans make their frequent trips abroad.

As the macro-economic growth strategy proposes, the central objective of Pretoria's foreign economic policy must remain the attraction of foreign savings (investment). To do so, its foreign financial and trade policies are crucial. A combination of a free-market economy and political stability without domestic

violence - criminal or otherwise - would be ideal. Freedom of movement of capital and currency is also required, hence the need for the removal of exchange controls.

It is therefore clear that South Africa has to strive to 'hook' into the global political-economy in order to secure the most favourable conditions for domestic economic growth which, notably, depend on large foreign investment flows. Only through growth, as conventional wisdom would have it, will extreme socio-economic disparities disappear.

In this, South Africa - not unlike the states of Latin America - will have to distance itself from continuing, negative and stereotypical assumptions and perceptions of Africa. It will also have to recognise an evolving global context in which the relative locus of economic power is continuing to shift eastward. Analysts predict an increase in East Asia's share of total global production from 20% to 40% and a relative decline in North American Free Trade Agreement (NAFTA) area's share from 30% to 25%, and that of the EU from 34% to 25%.<sup>4</sup> This, in turn, will potentially exacerbate the marginalisation of most sub-Saharan countries from the economic and political mainstream. At the same time, there looks set to be a continuation in the movement of total aid flows, which could potentially be greatly stepped up, subject to a decline in isolationist tendencies in the United States. Increasingly, aid might well be guided by the need to arrest humanitarian catastrophes (where the 'CNN factor' will undoubtedly play a major part in highlighting these emergencies) rather than to long-term development programmes. Already in 1994 sub-Saharan Africa received only 9.7% (US\$20,136 million) of the US\$207,402 million of long term resource flows to developing countries; just 6.1% (US\$2,987 million) of the US\$48,614 billion of Foreign Direct Investment (FDI); but a relatively high percentage, 32.7% (US\$15,482 million), of the US\$47,416 million of Official Development Assistance (ODA), indicating thus the vulnerability to changes in the extent of aid flows.<sup>5</sup>

What does this mean for South Africa's foreign policy, and the allocation of its resources?

Though the foreign policy aspirations of South Africa may be hazily cloaked in the rhetoric, *inter alia*, of the 'North-South' divide and in reconstituting the world order, essentially the challenge is to try to develop its domestic economy in a manner consonant with international consensus. This involves the acceptance of a 'package' of liberal-democratic reforms, which in the economic realm includes accession, internationally, to the World Trade Organisation (WTO) as part of a structured, though voluntary attempt to legislate for free-markets and world trade. At home, the range of macro-economic reforms must

include deregulation, privatisation and the careful management of fiscal deficits which will open the country up to foreign investment.

### **Free Markets, Central Planning, and Africa's Place in the Global Economy**

Chester Crocker outlines what is expected of South Africa's interdependent world, where the post-apartheid nation - unfairly or not - has not only to contend with the internal challenges of poverty but also with a negative geographic association with and perception of Africa. As Jeffrey Herbst soberly reminds us, Africa has probably some way to go before it is back to even the same position that many states found themselves in at independence.

Despite their allegedly 'amorphous' qualities, the global markets clearly dictate and are the final arbiter of the value of government - of the personalities as well as policy direction. This is a lesson that South Africa's new elite has had to learn quickly and painfully, though South Africa's trade unions still apparently are holding out against the international consensus on policy, especially regarding privatisation, a point that is explained by Jeremy Cronin. Another fundamental point of disagreement persists between pundits who argue the need for social equity (through redistribution) first, and those who maintain the need for growth as a prerequisite for wealth distribution. Many on the side of South Africa's trade unions maintain that by comparable international standards of export-GDP ratios, the economy is relatively open already and attack the free-trade dogma, instead arguing that the government should aim to stimulate local consumption of domestically-produced goods. This group would also favour the maintenance of exchange controls fearing that any relaxation will lead to an outflow of domestic savings - an opposite advocacy to the current consensus on the phasing-out of such controls as a spur to investment.

South Africa's organised labour groups are also among those who generally see privatisation as a threat. In the future, the trade unions could potentially come into conflict with black business over this issue, particularly if the latter come to view privatisation as a quick and easy route to empowerment.

### **The Role of the World Bank**

It is clear that while the South African government's new macro-economic growth strategy marks a significant recognition of the benefits of greater integration with the world economy, South Africa's relatively low level of integration into this global village would appear to be a key constraint on the country's economic growth rate. Yet the concomitant (from a conference perspective) and sharp fall in the value of the Rand fully illustrates the risks of

heavy reliance on short-term capital flows and an inability to attract sizable long-term investment. 'There is a danger of further capital outflow and balance of payments crisis' warns the macro-economic strategy document. Should this occur, 'growth would be abruptly curtailed and structural adjustment under terms set by international agencies (such as the IMF and World Bank) would be unavoidable'. Kim Jaycox explains the World Bank's programme for Africa, a role that South Africa's Director-General of the Department of Finance, Maria Ramos, contends it is probably better placed to serve in a demand-driven environment than a needs-based situation.

The inability to sustain current account surpluses during cyclical upswings and to attract long-term capital flows has for years restricted South Africa's growth. The strategy document points to the balance of payments as a 'structural barrier to accelerated growth'. Although capital flows have, since 1994, eased this constraint, these have been largely short-term and speculative in nature (as opposed to the desirable FDI), which has contributed to the Rand's plunge. The short-term nature of these flows has, in turn, forced a reliance on high interest rates to attract capital, at the cost of restricting domestic output and growth.

### **Regional Integration and the Multilateral System**

The global environment is torn between the sometimes contradictory *push-and-pull* of globalism, regionalism and nationalism. The first-named is apparent in increased acceptance of a global economic consensus regarding policy: to re-emphasise, a cocktail of free-market reforms including privatisation, and the reduction of protectionism under the General Agreement on Tariffs and Trade (GATT) and its successor, the World Trade Organisation. Gilles Gauthier's analysis of Canada's role in the NAFTA and the WTO points to certain lessons about the ease whereby countries of similar economic standing can integrate their economies.

Viewed globally, regionalism has taken on a variety of forms and with differing intensity: from development and political co-ordination under the likes of the Southern African Development Community (SADC) and the Asia-Pacific Economic Co-operation forum (APEC), to integration through NAFTA and, in its purest-yet form, the European Union. These trends have, at times, been offset by national demands - topically, the recent furor that has resulted between the United Kingdom (UK) and the EU over the ban on British beef; or in another way through the problems that the United States (US) has with the flow of illegal Mexican migrants.

South Africa is clearly the giant of Southern Africa, and what happens to its domestic circumstances will inevitably affect its regional environment. As

President Mandela stated in the UN General Assembly in October 1994:

We are a part of the region of Southern Africa and of the continent of Africa. As members of the Southern African Development Community and the OAU [Organisation of African Unity], and an equal partner with other member states, we will play our role in the struggle of these organisations to build a continent and a region that will help to create for themselves and all humanity a common world of peace and prosperity.

Yet, in doing so, South Africa will have to balance the need for domestic development and its leadership of Southern Africa, especially given regional political sensitivities around South Africa's role. The table below gives some indication of its regional dominance.

Southern African Regional Perspective (1993)				
	Area (sqkm)	Population (m)	GDP (US\$m)	GDP/head
Botswana	600,400	1.2	3,740	2,670
Lesotho	30,400	1.7	510	408
Swaziland	17,400	0.7	950	1,174
Namibia	823,100	1.3	2,508	1,716
Zimbabwe	390,600	9.6	4,514	420
Zambia	752,600	7.9	3,995	352
Mozambique	801,600	14.0	1,467	97
Angola	1,25m	8.9	6,179	601
Malawi	118,500	8.9	2,019	192
South Africa ('94)	1,22m	42.3	117,200	2,771

Source: The Standard Bank, *South Africa in Figures, 1996*.

Put another way, South Africa's economy is nearly four times as big as the other 11 members of the SADC combined, or nearly twenty times the size of the next largest. Though Pretoria has, since 1994, tried to avoid the old apartheid government's stress on South Africa's regional dominance (and, thus, indispensability), the fact cannot be ignored. In 1994, South Africa exported nearly R20 billion worth of goods to its SADC neighbours, but imported only R4.8 billion from them; it has 23,000 of Southern Africa's 42,000 kms of railway lines; 58,000 of 87,000 kms of paved roads, and over 5.1 million of the region's 6 million motor-vehicles; it handled nearly 16 times more tonnage of goods through its harbours than those of the region; and it creates nearly 75%



of sub-Equatorial Africa's total installed electricity capacity.<sup>6</sup>

Willem Bosman, the Director of Regional Economic Organisations in the Department of Foreign Affairs (DFA) illustrates South Africa's many 'complexities' in co-operation with Southern Africa, let alone integration, and in Pretoria's relations with the EU over the proposed Free Trade Agreement. The former problem areas relate, firstly, to the restructuring of the Southern African Customs Union (SACU) agreement which is already being fundamentally altered by trade liberalisation. Secondly, in dealing with SADC, the problems around integration, including the definition of the parameters of co-operation, so-called 'two-speed' integration with countries such as Mozambique and Angola, and the SADC-Common Market for Eastern and Southern Africa (COMESA) membership dichotomy need to be determined. Thirdly, SADC is not yet recognised by the Abuja Treaty establishing the Pan-African Economic Community (AEC). Fourth, it is unclear whether regional integration can occur without the presence of good governance and democratisation, yet without which region-wide investment prospects could be adversely affected. Fifth, 'South-South' co-operation remains a South African government priority, and it is felt that a bilateral focus on regions elsewhere could detract from a concentration on Southern Africa. Finally, it is at this stage unclear what South Africa's bilateral relationships with, for example, the EU and the WTO will mean for South Africa-Southern Africa integration.

In June 1994, South Africa was offered a Free Trade Agreement by the European Union's Council of Ministers. In spite of support from SADC and the African, Caribbean and Pacific (ACP) countries that South Africa be accorded instead full Lomé status, the Council also decided to exclude South Africa from the trade preferences enjoyed by the ACP nations and grant only qualified accession to the Lomé Agreement. The effects of the proposed FTA will be debated for some time to come. It will mean, for example, that EU states will have more preferential access to the South African market than its SADC neighbours. At best, SADC member-states will have to compete on an equal basis against those in the EU which possess a comparative advantage in many areas. Furthermore, the EU agreement could be a precursor to similar arrangements being struck at the insistence of trading partners in North America (NAFTA) and in the East. At this stage it is thus not clear how South Africa's bilateral trade relations might, in short, impact on the potential route for South African-SADC integration.<sup>7</sup>

Global capital will, of course, seek out only the most viable opportunities for a return on investment. It is attracted to countries which do not impose restrictions on investment flows, maintain a good balance between productivity

and labour costs on the one hand and between investment and consumption expenditure on the other, run small and efficient bureaucracies, and have a good record against corruption and monopolies.

## **Africa and the Developing World**

Nelson Mandela has noted that South Africa 'cannot escape its African destiny'. Of course, its African location does present certain trading advantages, and as the over 30% increase in South African-African trade from 1994-95 indicates, these have been quickly seized upon. Unfortunately, African states do not have a good track-record, which inevitably, if unfairly, influences perceptions of South Africa. Papers by Chris Heymans, the manager in charge of policy co-ordination at the Development Bank of Southern Africa (DBSA) and Tom Lodge of the University of the Witwatersrand help to place Africa in the context of the world economy. According to the World Bank, Africa managed a reduction in real GDP per capita income of -1.4% for 1994, compared to +2.2% for the G-7, +6.9% for Asia, and +2.9% in Latin America. This picture is more rosy when viewed against the Middle East (-0.3%) and the Russian Federation (-12%), but these are not areas with which South Africa would necessarily want to compare itself.<sup>8</sup>

Any comparative assessment must incorporate today an examination of the relevance of Asia and Latin America's economic transformations - their so-called 'success stories' - to South Africa. Why is it that Asia's economies were able to grow at rates surpassing 10% annually in the 1980s and 1990s? How have the popularly (mis)portrayed 'ramshackle' economies of Latin America managed to usher in reforms that have helped to turn them around from models of import-substitution with large foreign deficits, overworked currency printing-presses and telephone-number inflation figures, to today's improved examples of economic growth and stability? How have these nations managed to maintain democracy and commitment to reforms in the face of rising (if short-term) unemployment and social hardship?

## **Lessons from the Asia-Pacific and Latin America**

Perhaps the first lesson to note is that Asia and Latin America were only one generation ago in a similar, if not worse, economic situation than Africa. Thirty years ago, with the exception of Japan, most of Asia, and Southeast Asia in particular, appeared to be caught up in an endless cycle of misery, war and suffering. Yet South Korea, Taiwan, Hong Kong and Singapore all followed

Japan's move in the 1950s, by focusing their growth efforts on manufacturing industry and exports. Malaysia, Thailand, Indonesia and China have followed in the 1990s, while Vietnam and India are not far behind. A number of factors are common to the Asian performers of the past two decades: the effective use of human resources, the ability to combine these effectively with capital, political security, outward orientation, and macro-economic stability. A sufficient quantity of labour (expert) combined with investment in primary and secondary/technical education is another important ingredient in this 'cocktail' for success. A 'bulge' of skilled, young people entering the economy at the same time, a high saving rate (around 35% of GDP in the 1990s), and a highly motivated workforce (for which read high productivity) make, as P.J. Botha points out, these economies both attractive for and receptive to foreign investment.

But can South Africa replicate East Asia, with its largely authoritarian governments and apparently 'different' work ethic? Maybe not, but other states in Latin America and those such as New Zealand, where there are arguably more easily identifiable social parallels with South Africa, also provide lessons and examples to follow. In Latin America, lest one forget, the average annual per capita real growth rate in the 1980s was only 0.4%, whereas by 1994 this had improved dramatically to 2.9%.

Antoinette Handley, Jorge Heine and Cassio Luiselli provide an insight into the nature of Latin America's economic reform programme, illustrating especially the importance of the 'sequencing' of the package of liberalisation - including the removal of exchange controls, privatisation and deregulation. However, as Brian Absolum argues, if the New Zealand example is anything to go by, sequencing may be less important than getting the reform process underway immediately - by the so-called 'big-bang' approach to economic liberalisation which has seen a impressive economic turnaround.

In the 1980s, a combination of heavy regulation, high tariffs, bloated government payrolls and inefficient parastatals meant that the New Zealand economy grew at only one percent per annum. As a result, in 1984 the government initiated reforms which included the overhaul of the civil service and slashing of public payrolls, privatisation, as well as the scrapping of tariffs and exchange controls. New Zealand may appear to be an unlikely Asian tiger perhaps, but since reform GDP growth has topped the 6% mark, while inflation has remained below 2%. Unemployment has dropped from a peak of 11% in 1992 to around 6.2% today.

Aside from subjective assessments of their efficacy, there are at least three

important reasons in favour of South Africa pursuing such a package of liberal economic reforms: *first*, it will place the South African economy within a band of consensus where the international community expects it to be, and without which South Africa will find it difficult to attract inward foreign capital flows. *Second*, privatisation offers black business a quick and easy route to empowerment, thereby placating an important government constituency. *Third*, regional prosperity through integration - dependent as it is on the investment opportunities created by privatisation - rests, too, on the pace and extent of deregulation in South Africa itself. Without this, the failure of complete government withdrawal in South Africa will hinder open, market-driven competition in Southern Africa.

At the regional level, also, the success of Latin America's R3.5 billion, 200 million person Mercosur (Mercado Común de Sur - or Southern Cone Common Market) could contain lessons for the SADC region.<sup>9</sup> For *one*, the combined weight of Brazil, Argentina, Uruguay, Paraguay and now Chile (and potentially Bolivia as well) gives the Mercosur region much greater economic clout. *Second*, although Mercosur's broader remit includes the coordination of, for example, fiscal and monetary policies, industrial and technical policy, agricultural policy and macro-economic policy, essentially its immediate function has been carefully (at least to the outsider) focused so as 'to enhance its members' competitiveness in the face of increasing internationalisation of economic and trade flows'. Hence its first priority was to introduce a customs union on 1 January 1995.

*Third*, in the past, there was a confusing overlap of regional clusters - so-called 'multiple linkages' - which are now being streamlined through attrition: hence the previous operation of the Group of Three, Andean Pact, Central American Common Market (CACM), the Caribbean Community and Common Market (CAMCOM), and Mercosur. In this, there has been the tension of attraction between the North-based groupings and elsewhere - put another way, between linkages with NAFTA, and those with the EU. Despite the calls for the creation of a South American Free Trade Area (SAFTA), this tension would appear to have been resolved, with sub-regionalism being seen as a means to an end - such as *global integration - rather than as an end in itself*.

*Fourth*, Mercosur (like NAFTA which operates only a small secretariat/registry) has no overarching, bureaucratic structure as does SADC; instead it is simply a functional organisation which has tremendous success in boosting regional trade without being side-tracked by security and other issues. Mercosur has resulted in an increase in cross-border trade and investment). The progressive decrease in tariff protection has meant that the value of intra-

regional (Mercosur) trade doubled from US\$4.1 billion to US\$10 billion between 1990 and 1993.

*Finally*, greater regional co-operation has led to, on the one hand, an improved intra-Mercosur trade relationship; and on the other, to co-operation in a range of multi- and trans-national infrastructure projects, such as the plan to pipe natural gas, due to start operating by 1999, from Bolivia to central Brazil.

### **Future Paths and Trends for the South African Economy**

South Africa's attraction as a destination for FDI goes beyond just ensuring that the necessary macro-economic framework is in place. The latter strategy has also to be implemented, no matter how painful that process might be in the short-term. Additionally, the overall social environment has to be favourable, including the factors of domestic political stability and the crime rate. A recent study of the relationship between crime, violence and investment showed that more than 45% of people polled named crime as South Africa's biggest problem. Unemployment, affecting over 32% of the population, was a distant second. According to the study, the cost of all forms of crime in 1995 was over R30 billion, or 18% of the 1996 national budget.<sup>10</sup> In September 1996, President Mandela admitted for the first time that 'crime was out of control' but that 'although we are using short-term tactics to deal with crime, we must address poverty. The government's macro-economic plan is an important document in this regard'. This statement came in the face of threats by major corporations to reconsider investments if violent crime did not begin to abate and *without improvements in labour discipline*.<sup>11</sup> Increases in criminal behaviour are linked, ironically, to the end of isolation, as South Africa has been opened up not only to international markets, but also to organised crime syndicates.

South African industry will also need to improve on its current productivity levels if it is to attract foreign savings. According to a 1996 survey by the International Institute for Management Development, the country ranks only 44th out of 46 in terms of competitiveness; or 43rd out of 49 on the World Economic Forum (WEF) listings.<sup>12</sup> Not only will improved skills and management techniques have to be implemented, but also, in effect, pay rises will have to stay below average rates of productivity growth. The latter condition will be difficult, if not impossible, to achieve if there is an adversarial relationship in the labour-government-business nexus.

The final conference session with Philip Spies and Gavin Keeton showed that, given its broad if cohesive framework, the macro-economic growth plan is no

quick-fix guarantee to the hoped-for 6% growth and 400,000 jobs annually by the year 2000. Without details of the mechanics of growth and, importantly, the acceptance of this strategic vision not just by government and business but by labour as well, it is little more than an ambitious 'wish-list'. Our future economic prosperity hinges now on improving productivity ratios, and striking and maintaining a favourable, even if politically costly, balance between consumption and investment. Given its location on a continent until now largely characterised by poor economic performance and instability, South Africa will not get too many chances in the global economy.

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### **Endnotes**

*Please note that abbreviations will normally only be explained once as they appear in the text.*

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## 2.1

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# The South African Economy: An Evaluation

*Chris Stals*

### **Recent Developments in the South African Economy**

#### ***Real Economic Activity***

After a period of economic stagnation running from approximately 1982 to 1992, the South African economic performance has improved gradually over the past three years. Six out of the eleven years preceding 1993 produced declines in total gross domestic production, and the few outshoots during this period, for example in 1984 and 1988, were short-lived because of balance of payments constraints at that time. South Africa could not afford any strong upsurge in imports in reaction to increases in domestic expenditure at a time when it was committed and forced by the international community to repay substantial amounts of foreign debt.

This situation changed dramatically over the past three years. The political and social reforms in South Africa brought with them the termination of international sanctions and trade boycotts, the cessation of the disinvestment campaign and pressure for the withdrawal of foreign loans. South Africa, of course, welcomed the opportunity of being reintegrated in the world economy.

In this new environment, economic growth gradually rose to a higher level. The rate of change in gross domestic product switched from -2.2% in 1992 to +1.3% in 1993, before increasing to 2.7% in 1994 and 3.3% in 1995. Were it not for adverse climatic conditions and a substantial decline in gold mining production in 1995, the growth rate would have been even better - growth in the secondary sectors of the economy last year exceeded 7%, with a particularly strong contribution emanating from private sector manufacturing.

The expenditure or demand side of the economy showed even more resilience, and the rate of change in total gross domestic expenditure switched from -1.5% in 1992 to +1.3% in 1993, before accelerating to 6.7% in 1994 and 5.6% in 1995. It is clear that the South African economy at this stage needs but little demand stimulation - the challenge remains to raise the production capacity to a higher level in order to meet the growing demand for goods and services.



It is therefore good to note that, on the demand side, a particularly strong increase in private sector fixed investment provided the main stimulus to the expansion. In 1994, total gross domestic fixed investment in real terms rose by almost 9%, and in 1995 by a further 10%. On the other hand, consumption expenditure by general government increased only modestly, with steady growth of between 3 and 5% for private consumption expenditure.

It remains a major deficiency of the South African economy that not enough jobs are being created to provide employment for the growing labour force. Last year was the first since 1989 that total employment increased, albeit by only 0.6% compared with the level of employment in 1994. Despite the turn-around in the employment cycle during the course of 1995, it is estimated that nearly 280,000 people joined the ranks of the unemployed in the 18 months up to the end of December 1995.

It is also encouraging to note that the rate of increase in the average nominal remuneration per worker in the non-agricultural sectors of the economy tapered off from 12.0% in 1994 to 9.6% in 1995. Adjusted for inflation, the average rate of increase in the real remuneration per worker last year was only 1.0%. Because of the relatively good growth, particularly in manufacturing production in 1995, the average productivity per worker increased by 3.2%, with the result that there was an actual decline of 2.1% in the unit labour costs per unit of production in the South African economy last year.

These important developments in the labour market deserve credit, not only because of the contribution they must make to enhance South Africa's competitiveness in the international markets, but also for the assistance they lend to the fight against inflation. If the unit labour cost per unit of production will continue to decline as it did last year, economic growth and total employment will be stimulated in the longer term. It will obviously also reduce the burden of monetary policy to maintain financial stability at all times.

One further aspect of real economic activity that continues to give reason for concern is the low level of saving in the national economy. The ratio of gross domestic saving to gross domestic product in 1995 was equal to only 16.5%. In view of the much needed increase in gross domestic fixed investment, the country has had to rely to an increasing extent on foreign funds to finance the widening gap between domestic saving and investment.

It is not always understood that the economists' call for more saving is indeed a call for less consumption. In the national accounts analyses saving is but the difference between total production and total consumption. One of the reasons

for the low rate of saving in South Africa is the excessive use of credit that enables the population to absorb tomorrow's production already in today's consumption. One of the many adverse macro-economic results of over-consumption financed with credit creation is high interest rates, or alternatively, excessive money creation with an eventual higher inflation rate.

### ***Balance of Payments Developments***

As could have been predicted in the environment of large increases in domestic expenditure, and particularly in gross domestic fixed investment, South Africa's imports rose quite sharply over the past three years. The level of imports, measured in nominal values, almost doubled from 1992 to 1995. Total exports of merchandise also performed remarkably well, but could not match the rise in imports and, with but a small increase in the value of the net gold production over this period, the current account of the balance of payments switched from surpluses of about R5 billion in each of the years 1992 and 1993, to a deficit of R2.2 billion in 1994, and R12.7 billion in 1995. The deficit in 1995 was equal to 2.6% of gross domestic product.

On this occasion, the growing current account deficit provided no serious funding problem, and placed no instant constraint on the expansion of domestic expenditure. This was, of course, thanks to the substantial inflow of capital from the rest of the world. After regular net outflows of capital of about R5 billion per annum from 1985 onwards, the capital account of the balance of payments showed a dramatic turn-around in the second half of 1994. Over the eighteen months from July 1994 to December 1995 a net amount of more than R30 billion flowed into the country from the rest of the world. This exceeded even the most optimistic expectations at the time of the election of the Government of National Unity (GNU) in April 1994.

It is true that a substantial part of the net capital inflow over the past two years was either in the form of short-term funds, or portfolio investments entering the country through the Johannesburg Stock Exchange. A not insignificant amount of medium and longer term money was, however, also raised through international public issues by the South African government and the parastatals, whilst South African private sector institutions made a number of international equity issues, particularly for the funding of their offshore operations. A smaller amount of direct investment also flowed in.

The capital inflows in excess of the current account deficit enabled the Reserve Bank to replenish its foreign reserves. At the time of the election in April 1994,

the Reserve Bank held, on a net basis, almost zero foreign reserves. By the end of 1995, the Bank's net foreign reserves holdings had risen to about R16 billion.

The overall favourable balance of payments situation also enabled the South African authorities to relax exchange controls. Over the past three years:

- \* the debt standstill arrangements were terminated;
- \* the financial Rand system was abolished;
- \* many South African corporations were enabled to acquire or establish international subsidiaries, branches or production units;
- \* a programme for the gradual removal of restrictions on institutional investors to accomplish prudent international diversification of trust funds managed on behalf of the public was commenced with; and,
- \* some important liberalisation was introduced in the spot and forward foreign exchange markets.

Finally, as far as international financial relations are concerned, the exchange rate of the Rand remained remarkably stable for a six-year period from 1990 to 1995. Over this period, the average weighted value of the Rand against a basket of the currencies of South Africa's major trading partners depreciated by 7% per annum. In real terms, that is after adjustment for the inflation differential between South Africa and its major trading partners, the exchange rate of the Rand depreciated by only 0.5% per annum.

### ***Domestic Financial Developments***

Over the past few years, the Reserve Bank achieved mixed success in its efforts to keep the rate of growth in the money supply in check. After having risen by only 8% in 1992 and 7% in 1993, the M3 money supply increased at rates of 16% and 15% respectively, in 1994 and 1995. Excessive increases in the money supply may not be the only cause of inflation in the country, but remain an important precondition for sustainable inflation in the longer term. Although *the influence on the money supply of the major social and political transformations in South Africa in recent years, and also the major technological advances in the financial sector with the introduction of electronic data processing and transfer systems, must be taken into account, the Reserve*

Bank remains concerned about the excessive rates of increase in the total, and in the various components, of the money supply. Recent rates of increases exceeded not only the real rate of growth in the economy, but also the nominal rate of growth in gross domestic production.

It is a matter of concern also that the major cause for the acceleration in the rate of increase in the money supply is an excessive rate of increase in bank lending to the private sector. Total bank credit extended to the private sector rose by 17% during each of the past two years, compared with increases of only about 9% per year in the preceding two years. Such increases not only raise the burden of debt servicing for the household sector, but can easily also lead to a deterioration of the quality of the loan book of banking institutions. It also, of course, exerts increasing upward pressure on the level of interest rates.

Against this background, and taking account of the low level of savings in the country, interest rates moved up quite strongly over the past three years. Short-term interest rates already started rising during the second quarter of 1994. The rate on 91-day Treasury bills, for example, was just over 10% in early 1994, but then rose to 12.7% at the end of 1994 and 14.2% at the end of 1995. The Reserve Bank's discount rate rose from 12% early in 1994 to its present level of 16%.

Financial markets in South Africa in general almost exploded over the past few years. In 1992, the total value of shares traded on the Johannesburg Stock Exchange, for example, amounted to R22 billion, but increased to R63 billion in 1995. The increase in the turnover in the bond market was even more spectacular, having risen from R496 billion in 1992 to R2,006 billion in 1995. The average price of all classes of shares listed on the Stock Exchange increased by 18.2% per annum from 1992 to 1995. In the market for foreign exchange, the average daily turnover in the first five months of 1996 amounted to US\$6.8 billion.

The rate of inflation in South Africa was gradually reduced from 15.3% in 1991 to 8.7% in 1995. After double-digit inflation from 1974 up until 1992, that is for a period of 19 years, the rate of change in the consumer price index finally broke through the magical 10% barrier in 1993, and has now been in the single digit range for more than three years.

### ***The Budget of the Central Government***

Government made an important contribution towards the encouragement of economic development within the private sector by constraining the rate of increase in total government expenditure, and reducing the deficit on the budget as a percentage of gross domestic product.

Over the past three fiscal years ending on 31 March 1996, total government expenditure as a percentage of gross domestic product stayed at the level of 31.5%, but with rising government revenue, the deficit before borrowing declined from 8.5% of gross domestic product in 1993 to 6.2% in 1996. For the current fiscal year, government has budgeted for a deficit of only 5.5%. Government has succeeded in meeting short-term demands for increased social and other essential economic upliftment expenditures mainly by reprioritising existing expenditure, and by rationalising in many government departments.

The deficit on the budget is, however, still large enough to exert undue upward pressure on total government debt which has risen from 44.5% of gross domestic product in 1993 to 56% in 1996. The growing amount of government debt, which will be inherited by the next generation, is still a worrying aspect of government finances and part of the reason why government regards the reduction of the deficit as a percentage of gross domestic product even further as essential during the next few years.

### ***Prospects for 1996***

The momentum of economic recovery was almost derailed in the first half of 1996 when a sudden outflow of foreign capital during the period February to April threatened financial stability. Following the large net inflows of capital since the middle of 1994, the inflow for a number of reasons suddenly petered out in the middle of February 1996. As a result of a large outflow of short-term funds and some disinvestment through Stock Exchange transactions, particularly during April, the Rand came under tremendous pressure and the Reserve Bank's net foreign reserves declined by R6.6 billion from the end of January to the end of April 1996.

In the process, the exchange rate of the Rand, which appreciated by 5.5% from the end of May 1995 up to the middle of February 1996, depreciated by more than 15% in the subsequent 2½ months. The outflow of capital also drained liquidity from the domestic banking system and exerted substantial upward pressure on interest rates. The yield on long-term government stock, for

example, rose from 13.77% in January 1996 to 16.84% on 9 May 1996. Short-term interest rates also moved up strongly. The rate on bankers' acceptances with a maturity of three months rose from 14.05% at the end of February 1996 to 16.40% at the end of April 1996. The Reserve Bank raised its discount rate from 15 to 16% on 29 April 1996.

The events of February to April 1996 created major disruption in the South African financial markets and served to create undue pessimism about South Africa's economic potential, both within the local business community and amongst foreign investors. The situation, however, returned to more stable conditions towards the end of April, and the financial markets have been remarkably stable during May and June. After a net outflow of R1.9 billion through the Stock Exchange in April, there was a surprisingly large net inflow of funds of R2.6 billion in June. The Reserve Bank's net foreign reserves showed small increases in May and June, money market liquidity eased again, and some market interest rates declined.

The events did, however, leave one important scar, and that is an exchange rate that has depreciated by 15% in nominal terms, partly to correct the fundamentals, and partly as an over-reaction to the market developments of the February/April period. In retrospect, although not everybody may agree, South Africa has weathered the storm reasonably well, has hopefully passed its first major test as a member of the volatile global financial market community, and is now proceeding again with its longer term programme of gradually raising the growth potential of the South African economy on a permanent basis to a higher level. The first challenge now is to ensure that the South African economy will indeed benefit from the depreciation of the Rand, and that the potential advantages in depreciation will not be eroded by escalating inflation.

It is encouraging to see confidence returning again to the South African business community. Despite the slippage of the past few months, the country can still look for economic growth in the region of 3% in 1996; the chances have improved now of reducing the deficit on the current account of the balance of payments to below last year's level of about R12 billion; prospects are good that the exchange rate will for some time remain relatively stable at its new-found level; and the rate of inflation should remain below the 10% level.

## **The Macro-economic Strategy for Growth, Employment and Redistribution**

No survey of the current economic situation in South Africa can be complete without reference to the government's strategy for *Growth, Employment and Redistribution*. I have for some time been pleading for a marriage of the Reconstruction and Development Programme (RDP) with a macro-economic strategy that will provide a consistent programme for the elevation of the South African economic growth potential to a sustainable higher level. Without such a programme it would not have been possible to reach the laudable objectives of the RDP. The Strategy Document presented to Parliament by the Minister of Finance on 14 June 1996 goes a long way towards meeting this request.

In the announced strategy, the government included for South Africa the following macro-economic goals that, I believe, provide distinct guidance for the implementation of monetary policy over the next five years:

- \* an acceleration of the fiscal reform process, including a tighter short-term fiscal stance to counter inflation;
- \* an appropriate medium-term deficit target to eliminate government dissaving;
- \* a further step in the gradual relaxation of exchange controls;
- \* the maintenance of monetary policies consistent with inflation reduction;
- \* exchange rate management to stabilise the real effective exchange rate at a competitive level;
- \* a further lowering of tariffs to compensate for the real depreciation of the Rand;
- \* the implementation of the public sector asset restructuring programme;
- \* a structured flexibility within the collective bargaining system to support a competitive and more labour-intensive growth path; and,
- \* a social agreement to facilitate wage and price moderation, underpin accelerated investment and employment, and enhance public service delivery.

On inflation, one of the most important threats to the achievement of social and economic objectives in any developing or emerging economy, government is equally unambiguous:

To contain inflationary pressures requires concerted implementation of complementary stabilisation measures: accelerated tariff liberalisation, sharper deficit reduction, tight monetary policy, and above all, productivity-linked wage increases.

The government also instructs the Reserve Bank as follows:

The main objective of monetary policy will continue to be the maintenance of financial stability and the reduction of the inflation rate. Positive real interest rates are a minimum condition for overall financial stability. Low inflation is an important requirement for higher economic growth, the creation of employment opportunities, and a more equitable distribution of income.

No central bank governor can ask for a more clear and unequivocal mandate from his government. The role of monetary policy within the overall economic strategy of government must be to lend support to the objectives set for the year 2000, and to do so as instructed:

Responsible monetary policies anchor the competitiveness and stability of the economy in regard to both the domestic value of the Rand and its foreign purchasing power and encourage domestic saving and investment. Finally, the fiscal containment in the package reduces the burden placed on monetary policy.

In answer to the many questions recently directed to the Reserve Bank, I would like to give an unmistakable reply:

- \* Yes, if this strategy is diligently implemented, it will be possible to have a real Bank rate of not more than 3% in the year 2000.
- \* Yes, it is consistent within the strategy to assume that the annual rate of inflation will remain below 10% and may even be lower than the 7.6% envisaged for 2000.
- \* Yes, economic growth at a rate of 6% per annum can be reached, provided we all work together in implementing the *Strategy for Growth, Employment and Redistribution*.

Needless to say, we in the Reserve Bank are enthusiastic about this programme and can only encourage all sectors of the economy to lend their full support to the realisation of the goals set by the government for the future economic development of South Africa.



## 2.2

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### Response

*Vella Pillay*

I first met Dr. Stals in New York in 1981 around the time of the annual meeting of the International Monetary Fund and the World Bank, and just before the outbreak of the international debt crisis. Our meeting took place at a symposium convened by the American bullion traders, J. Aron & Sons, where Dr. Stals made his familiar pitch in favour of the restoration of the gold standard while I, in more sombre mood, was claiming that the mountain of internationalised credit generated by the regime of floating exchange rates since 1971 was certain to threaten the stability of the international financial system, and reproduce the crisis conditions of the 1930s.

We were both proved wrong. We simply underestimated the enormous capacity of the United States to organise and manage the international trading and financial system in terms of its hegemonic aspirations and establish the US dollar as the undisputed reserve asset and settlement currency for international transactions, irrespective of movements in the American balance of payments.

We have also met on subsequent occasions, though more as adversaries on critical issues of monetary policy since 1992 and in particular on the seeming divorce of monetary policy from the broader macro-economic objectives of the South African state. That debate remains unresolved and in March last year Chris Stals and I once again crossed swords, though I must say we did this, as at all times, in the best of spirits. And here, in that same spirit, I shall try to advance my side of that debate.

Put in summary form, my evaluation of the state of the South African economy is as follows:

1. Unemployment has markedly worsened in the period since 1994, reaching anything between 30% to 60% of the active working population, and threatening to rise to even higher levels with less than 2% of each year's 400,000 new entrants in the labour force finding employment. I see nothing in the government's economic policies which can remotely be described as being directed towards the alleviation of this problem. On the contrary, with economic policy largely dominated by a stringent fiscal and monetary stance, it can be said that economic policy itself has significantly contributed to the aggravation of this problem.

2. This problem has been accompanied by a further redistribution of income and wealth in favour of the highest income brackets - a fact reflected in the difficulties of delivering what was promised under the RDP. The country thus continues to be confronted by the legacy of a vast social dysfunction, by grotesque under-education, and by armed anger with some seven million of our people living out their lives in squatter camps. The need for a convincing policy, let alone a vision (and a sense of determination with which it will be implemented) has yet to be established - this notwithstanding the government's latest *Growth, Employment and Redistribution* strategy. The latter, I suggest, advances policies which possess a heavy deflationary bias, marked by a rapidly falling fiscal deficit in conditions of a relative wage freeze, lowering of import tariffs, tax breaks for the corporate sector, the elimination of exchange controls and positive real interest rates supported by generally tight credit conditions.
3. The country's industrial policy - a key to employment creation and the generation of a wider domestic market on the basis of which export competitiveness can be won over time - is being steadily undermined by the country's lurch into a programme of tariff cuts and the weakening of other protective devices for our nascent industries. My own long experience in these matters suggests it is the combination of tariff protection, state support for technological upgrading and extensive foreign borrowing by the state on international capital markets which have been and continue to remain the key ingredients of the early and middle stages of economic development. This important lesson, I believe, has been neglected in South Africa's current approach to industrial policy.
4. Our fiscal policy has been allowed to be trapped by both an unrelieved legacy of massive national debt coupled with the virtual bankruptcy of the state sector pension funds. This is made all the more unmanageable by a monetary policy which imposes vast obligations on the fiscus in the form of high interest servicing of that debt, which now approaches some 25% of government expenditure. This problem is now being compounded by what my friend Edward Osborne calls the 'fiscal trap', namely the *inability of the government to deploy the budget in support of a range of macro-economic objectives, including employment creation and economic growth*. That fiscal trap could be largely eliminated by ending the Reserve Bank's concern to maintain a regime of high real rates of interest.

5. Our currency is confronted by an unrelieved crisis - its depreciation resulting not from some carefully calculated and managed set of considerations to improve the competitiveness of the country's exports and stimulate economic activity. Rather it flows from what I consider to be the mismanagement of our country's foreign exchange policy. The present system of exchange control, especially over capital flows, is racked with inefficiencies and by policy changes designed to satisfy the major insurance and other corporations in using part of the nation's savings and their own resources in acquiring foreign assets. I find it utterly incomprehensible that, given the present size of our reserves and deficits in our balance of payments, consideration is being given to the liquidation of all exchange controls. The evidence available to me suggests that the spot sales of the Rand which provoked its recent sharp fall were largely made by domestic commercial and industrial companies and banks rather than by global funds. You will perhaps recall that a similar flight of local rather than global funds was responsible for the crash of the Mexican peso and the Mexican securities market at the end of the 1994. A report from the Reserve Bank this month suggests that outstanding short-term debts in dollar terms now amount to over R10 billion compared to reserves of no more than R2.5 billion. This indicates that this country could well be going back to the 1980s when the country's foreign short-term debt and its rupture caused a meltdown of dramatic proportions and the consequent unravelling of the apartheid regime. Managing a nation's currency in this manner hardly suggests the presence of a sense of concern for the longer-term stability and growth of the economy.

The battle of ideas and policies concerning the economy has now been formally linked with the resurrected South Africa Foundation, in the name of big business, joining with the trade unions and the government in advancing each of their programmatic positions for economic policy. However, in terms of what I have related so far on the state of the economy, these programmatic positions, especially those of the South African Foundation and the government, suffer from a seeming indifference to the need for early measures to tackle the grim conditions in which the vast majority of our people are living out their lives.

Perhaps, I should try here to indicate the basis of my critique of present trends in economic policy. I believe that business is as much a social as a business organisation, and that it requires committed owners; that social and industrial peace requires a set of understandings on the sharing of rewards between labour, management and shareholders, and for investment in new productive

capacity. Also, property rights are not absolute but come from parallel obligations. While we accept that large parts of the public sector are sclerotic, the solution is not to abandon the public domain and off-load the duty for producing public goods to a private sector that is ill-equipped to do the job. Moreover a significant public sector remains crucial for macro-economic stability, namely, managing the flow of investment and hence the business cycle without producing costly fluctuations in the level of income and employment.

I have been concerned by the tendency for our leaders in government to surrender critical areas of economic policy to the seeming expertise of the Reserve Bank and economic officials. They also appear to have accepted the fatalistic arguments on the size and unpredictability of international capital flows and the infallibility of the markets, to the extent that their power to govern the country's economy has been irrecoverably eroded.

It is in this context that the concept of globalisation appears to have mesmerised and further befuddled the thinking of some of our leaders and the business community. I fear that this concept, being something in the nature of a necessary myth, serves to impose further constraints on our freedom to manage our affairs in the interests of our own people.

I do not believe there exists such a reality as a globalised economy. Rather what we have are three major trading blocs functioning in a world of fluctuating prices and exchange rates, and of wide variations in the level of risk in the market for securities.

In my view our economy needs more political direction if we are to move towards the resolution of the historic legacies of inequality, racism and capital concentration and into an era of steady growth and rising living standards.

These then are the considerations which stand at the centre of the argument for a continuing, if not enhanced role, of the nation-state in the management of the economy. This flows, not from any centralist approach to economic organisation, but from the fact that our country requires the highest level and most detailed co-ordination of economic policy - covering fiscal, monetary, industrial, labour markets, and much else to serve a common set of objectives focused on employment creation and the reduction of poverty. It goes without saying that the latter is now the key to our country's longer-term social and political stability - an issue which I hope brooks no argument or dissent among us here.

## 3.1

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# 'Globalisation': Integration and Control in the World Economy

Robert McKinlay

### 'Globalisation'

The terms 'global', 'globalised' and 'globalisation' have become a very common currency. What in part is particularly striking is the variety of different areas which seem to have adopted globalisation so firmly. From cultural and media studies, for example, it is pointed out that personalities such as Michael Jackson or Michael Jordan have become global household names; the films of Spielberg are shown to a global audience; Coca-Cola and Levi jeans are consumed globally; or the Internet has created a global multi-media store-cum-library. Environmental studies point *inter alia* to damage to the ozone layer and to changes in global weather patterns. More prosaically, economists cite one trillion dollars of a foreign exchange being traded daily on the global financial markets which never close. The list goes on and on.

This kind of evidence is so varied and so extensive that globalisation has come to be seen as constituting some form of revolution. In essence this revolution is one whereby the global level is increasingly taking priority over national or local levels. The increasing priority of the global level is caught in the communications-media-cultural area with the analogy of the 'global village', in the environmental area with 'spaceship earth', and in the economic area with the 'global market place'.

In the politico-economic area, globalisation has come to have two very important and related connotations (though these connotations can be generalised to other areas). The first of these is *integration*. By virtue of supplanting the local with the global and of breaking down segmentation, globalisation is held to bring increasing integration. A shared fate and high levels of interaction and interdependence underpin not only the global market place but also the global village and spaceship earth. A second important connotation is that a major structural change is taking place as *control* passes from what has been held to be the most important macro unit of politico-economic organisation, namely the nation-state. As segmentation of the local breaks down under the inexorable drive of integration, the nation-state is seen as being increasingly unable to control either its domestic or external environments. National governments are seen as becoming not only increasingly

powerless but also increasingly anachronistic in the 'world without borders' or in the 'post-international relations world'. For some commentators this increasingly anachronistic nature of the nation-state is posing an ever more severe problem for global governance. If, for example, pollution or the destruction of the ozone layer or climatic changes do not respect national borders, and therefore national jurisdiction and control, then who or what is going to respond to these problems?

Much of the evidence for globalisation is, however, somewhat anecdotal. Unsurprisingly it is not difficult to come up with counter-examples. At the more trivial level, Michael Jordan is better known in Chicago than in any other city of the world. At a rather more significant level, nation-states do not seem to be going out of vogue. Indeed recent developments in the former Soviet Union and Eastern Europe seem to point not only to the popularity of the nation-state but also to a world in which there will be more rather than fewer nation-states.

The main focus of this chapter falls on an examination of the phenomenon of globalisation, as applied to the world economy, examining in particular the issues of integration and control.

Before turning to each of these issues, it is necessary to pause on the term 'globalisation'. Globalisation is currently so fashionable that the literature on it is growing exponentially. The exponential growth in quantity does not however seem to be matched by insights. One of several reasons for this is that the term globalisation is often ill-defined and colossally overworked, to the point where analytically the form, causes and consequences of globalisation become hopelessly intertwined. The way through the confusion is to define globalisation in much more restricted - and therefore less overworked - terms. Globalisation is more usefully conceptualised as 'global diffusion'. In and of itself, globalisation says nothing about the content or form of what is being diffused - globalisation itself is nothing other than a transmission process. Consequently to try to analyse the causes or consequences of globalisation makes no sense until we know exactly what is being globalised.

Within the frame of reference of this paper, it is argued that there has been a substantial degree of politico-economic globalisation and that has come from liberalisation. Liberalism - or liberalisation as the movement toward liberalism - is not synonymous with globalisation. Indeed liberalisation is neither cause, consequence nor prerequisite of globalisation but is quite independent of it. Liberalism has however become diffused globally to a very significant degree. Indeed the principal politico-economic content of what is commonly taken to be globalisation is liberalism. It is however more accurate and less confusing to talk of the global diffusion of liberalism.

The objectives of this chapter are to consider the issues of integration and control in the light of the global diffusion of liberalism and in the context of the world economy.

## **Liberalism**

Presenting any even moderately sophisticated outline of liberalism is well beyond the scope of this chapter. However, the broad outlines of liberalism are relatively uncontentious. Liberalism is conventionally taken to be a macro politico-economic ideology. As such it profiles a set of core values, essentially a commitment to individual or negative freedom, and a set of politico-economic structures and institutions deemed necessary to promote and protect these values. Liberal thought has developed and changed over time and is conventionally regarded as a tradition, within which there can be some marked controversies, rather than a precisely stipulated and agreed orthodoxy.

Several aspects of liberalism should perhaps be highlighted for the particular subject matter of this paper. *First*, liberalism is not and never has been coterminous with the market. As a politico-economic arrangement liberalism is much more extensive, including in its long list of negative freedoms, the freedom, for example, of choice, of representation, of association, or of the press. The market is simply one of the mechanisms, albeit an extremely important one, whereby decisions on the production, distribution and consumption of goods and services are made in consonance with the requirements of negative freedom. The market is justified and rationalised in terms of its capacity to maximise individual choice. By dint of fostering choice the market provides additional benefits such as efficiency, innovation and growth.

A *second*, liberalism does not offer a stark choice between the market and the state. Indeed far from precluding the state, liberalism unequivocally requires the state to protect and preserve not only the market but also other central institutions deemed essential for the promotion of negative freedom.

*Third*, there has been substantial debate and controversy within the liberal tradition as to the role and significance of the state. That there needs to be a minimal constitutional state is beyond dispute. In the context of the market the necessity for legislation and intervention in the guise, for example, of contract law or anti-trust legislation is taken for granted. However, beyond minimal monitoring or policing activities, there has been substantial controversy over how active the state should be. Again illustrating in the context of the market, there has been serious disagreement for example on the degree of state

intervention to correct market imperfections (regional aid being a good example), on how much competition needs to be preserved in order to sustain a market, or on what role the state should play in providing an economic infrastructure - which also begs another source of dispute, viz. how extensively the infrastructure should be defined. Even more troublesome for liberals have been questions of how much intervention, which may even be explicitly illiberal, can be justified either to develop liberalism from an illiberal base or to protect liberalism from external threats. In the latter context both neo-mercantilist protectionist measures or the development of national military forces have figured prominently.

*Fourth*, though liberalism is popularly twinned with democracy, democracy has a very different pedigree and indeed, since it can take several different forms, need not be compatible with liberalism. Certainly popular representation is consonant with and even integral to liberalism - representation being one of the core freedoms. Furthermore the vote to some extent can be seen as the equivalent of purchasing power in the market, in this way 'spending' votes determines outcomes. As in the case of the market, however, representation has to accord with certain rules, central among which are competition and representation geared to ensuring the protection of negative freedom. The most preferred form of representation is that in which a multiplicity of parties compete in open elections based on universal suffrage. This leads liberals, despite their seeming commitment to toleration, to be opposed for example to monolithic or dominant parties (for much the same reason that they support anti-trust legislation) or to parties based on ethnic, religious or linguistic identities (all of which lead to the mobilisation of communities, which does not accord with liberal ideas of community).

*Finally*, it might be noted that liberalism is a universalising ideology. One of the most powerful ways of understanding its universalising nature is to consider what constitutes a liberal community and where its borders lie. A liberal community consists quite simply of like-minded liberal individuals. Identities drawn, for example, in terms of ethnicity or class or language or religion or previous history are of necessity antithetical to liberalism. For the purpose of this chapter, one identity which can be strongly opposed by liberalism is the nation-state. While liberalism requires a constituency, which in turn requires a sphere of jurisdiction, liberalism ultimately is incompatible with national territorial jurisdiction if the national unit comes to act as the basic constituent unit from which policy is devised and evaluated. Precisely because the basic constituent unit of liberalism is the individual rather than the nation-state, liberalism becomes a strong candidate for globalisation.



## **Globalisation, Liberalisation and Integration**

Though there are numerous definitions of integration, in general they add up to much the same. While terminology may vary, it is relatively uncontentious to define integration as the process whereby units move toward collective action based on consensual values for the achievement of common goals. Integration is not synonymous with interaction. It certainly presupposes interaction but critically requires that interaction be based on consensual values for the achievement of common goals. It is this crucial latter requirement which explains why the question of whether one is in favour of integration makes little sense until such time as the content or form of integration - that is, the values and goals of collective action - are specified. It is entirely appropriate to investigate the extent of liberal integration precisely because liberalism specifies both the values and goals within which collective action can be pursued. In looking for any corroboration of integration in the context of the globalisation of liberalism, we are required to search for evidence both of the reinforcement and of the extension of liberalism.

One strand of evidence that points to the reinforcement of liberalism comes from the privatisation and deregulation programmes of the Organisation for Economic Co-operation and Development (OECD) countries. Over the course of the 20th Century, and particularly after 1945, many of the Western European countries under the influence of corporatism, of Social-Democratic parties or of left-oriented Christian Democratic parties developed significant public sectors. This was reflected in the growth of central government budgets which as percentages of the GDP grew to around 40-45% for many countries and reached levels of over 60% for some of the more strongly social democratic countries of Scandinavia. From the early 1980s when the trend began to reverse, there has been a substantial degree of privatisation. Nationalisation or even re-nationalisation of newly privatised industries is now off the agenda for the majority of the electorate in the European OECD countries. Privatisation has been accompanied by so-called deregulation. Deregulation, which arguably ought to be called re-regulation, refers in essence to the removal of certain governmental restrictions. Both in the public and private sectors governments, often under pressure from special interest groups, had protected many industries often to the point of creating public or private monopolies. Deregulation, which has focused in particular on the removal of regulations restricting competition, has swept through a huge number of industries ranging from banking to transport to communications to health care to education.

Privatisation and deregulation are explicitly liberal in content. Not only have privatisation and deregulation drives been extensive but they have also been adopted by most political parties - the electorates of the OECD countries have

become faced with a choice between parties which for the most part have economic policies which show relatively little variation and which have become significantly liberalised. Finally it might be noted that privatisation and deregulation have had explicit international ramifications. Not only have they been demonstrated quite rapidly internationally but also they have removed many of the barriers that either precluded or complicated foreign participation in a domestic economy.

While the privatisation and deregulation programmes have principally manifested a *reinforcement* of liberalism, the changes in the command economies of the former Soviet Union and Eastern Europe have reflected mainly *extensions* of liberalism.

The significance of the changes can be appreciated by recognising the obstacles posed until comparatively recently by the command economies to any *globalisation of liberalism*. *First*, a large and significant area of the world, made all the more so by the size of the nuclear arsenal, was the very antithesis of liberalism. *Second*, such was the size and significance of the former Soviet Union that it could influence developments outside its borders. It could do so by acting as a role model, by influencing developments through its arms sales programmes (though its capacity for so doing was rather dwarfed by the much more extensive aid, trade and investment arsenals of the West), or by using direct intervention (which it did only rarely). *Third*, it could influence the West's interaction with the third world. Particularly in the case of the US it can be argued that while Washington could have used its aid, trade or investment policies to promote liberalism within the Third World it devoted its attention to vetoing what it took to be Soviet moves and often pursued policies explicitly detrimental to liberalism. *Finally*, though trade and investment exchanges could and did take place between the command economies of the East and the mixed market economies of the West, many obstacles existed to the development of high levels of exchange. Putting aside the substantial foreign policy obstacles, illustrated by the activities of the Western Committee on Trade with Communist Nations (COCOM) which was used by the US to pressurise members to deny the export of technology to the Soviet Union, there were many economic difficulties. For example, it is hard to have high levels of economic intercourse with an economy in which market price has no meaning or with which there is no convertible currency.

Though the post-1989 changes in the former Soviet Union and Eastern Europe have their roots, particularly in cases such as Poland or Romania, prior to that year, these changes by any measure have been dramatic. The change has unquestionably been in the direction of a very significant degree of political and economic liberalisation. There are of course some serious cautions that must be

noted. For example, in some countries Communist Parties quickly reconstituted themselves or in others after a temporary hiatus had a rebirth; or again, the *possibility of the development of some variant of national socialism cannot be ruled out*; or again, the redrawing of boundaries and reconstruction of new regimes has led in some cases to serious civil strife. Equally, the economic strategies that have been followed are quite varied: the attempted degrees of economic liberalisation have also varied, and the transitions have often been accompanied by chronic problems (particularly unemployment, inflation and devaluation). Though it would be quite wrong to assert that the former Soviet Union and Eastern Europe have now become stable mixed market economies and foolhardy even to suggest that they will of necessity become so in the near future, the direction of change is very significantly in line with political and economic liberalisation and the transitions appear to be going increasingly successfully for these countries (such as the Visegrad states) which have been most ambitious in their liberalisation.

The impact of the transitional economies on levels of world trade and investment is unlikely to be pronounced in the near future - not least because these countries are relatively poor. However, this would be to ignore the much more important consequences for the globalisation of liberalism which come from the removal of the obstacles noted above.

Of the variety of changes in the Third World that are consonant with the diffusion of liberal integration, arguably the most important concerns China. The significance of China rests quite simply with its population size (some 1.2 billion) and the fact that, at least in purchasing power terms, its economy is the third or fourth largest in the world. In a much less dramatic manner than the old Soviet Union, China for a longer period has been pursuing a sustained, quite highly controlled, and well integrated programme of economic liberalisation. The agricultural reforms introduced by Deng Xiaoping from 1978 successfully raised agricultural output and productivity and were succeeded by industrial changes. Though many state controls still remain, the market increasingly sets prices. Furthermore trade has been liberalised (for example, the currency has been devalued or trading companies can retain and exchange large portions of foreign exchange earnings), there is an emerging stock market, and the trajectory of FDI is upwards.

The discussion thus far has focused on liberalisation initiatives pursued for the most part within nation-states. A related but rather different development is that several opportunities have emerged for the progressive development of a number of non-state actors to further and foster liberal integration. Curiously enough many of these opportunities have been created by national governments.

The first of three illustrations that can be cited in this area concern multinational corporations (MNCs). Though figures oscillate from year to year there has been a general and marked increase in the volume of FDI particularly since the late 1970s.

There is no *a priori* reason to suppose that the growth of MNCs should *ipso facto* enhance liberalism. MNCs have the capacity through a variety of mechanisms, including sheer size or vertical integration or cartel formation, to act as illiberal agencies using their monopoly power to distort markets. Furthermore, they can use, or be used by, the foreign policy arsenals of their governments of origin to promote the interests of either in a manner antithetical to market principles. Though there have been plenty of examples of such behaviour, the examples are reducing mainly because the conditions for this type of action are declining. Other things being equal, illiberal action is easiest in extractive production (but this as a proportion of foreign direct investment is reducing) and when MNCs establish themselves in puppet or satellite regimes (which are also declining in number). In the post-1945 period some of the best examples both of illiberal behaviour and of changes in such behaviour come from the oil industry.

Without pretending that MNCs are complete paragons of liberal virtue, the weight of evidence is increasingly in the direction of seeing them as vehicles for liberal integration. For example, multinationals have had a major impact on trade, where their impact is much greater than that recorded in standard trade figures, which do not include sales of MNCs abroad or sales by domestic firms to foreign MNCs. Or again, MNCs will, all things being equal, move capital to its most productive location. In so doing they will stimulate employment. In addition to carrying investment, multinationals can provide a number of externalities, such as control of superior technology or management methods. Or again, by seeking out the comparative advantage of different locations and by being able to sell in larger markets, these corporations benefit from specialisation and increasing returns to scale which can result in lower prices as well as greater consumer choice. Moreover, though the ownership of most multinationals can be traced to one country of origin, the territorial borders of the nation-state are of no concern to the MNC. Though MNCs do pay great attention to 'things national' - especially tax regimes, exchange rates, as well as national interest rates and legislation - they do not make their calculations in terms of national interest. In this respect they are supra-national agencies, which explains for example domestic trade union protests about the export of jobs by MNCs - something held to be contrary to the national interest.

A second example comes from international banking. If liberalised globalisation is taken to mean in part the development of integrated markets, then the

changes in the international financial markets over the last 25 years must constitute a resounding success for liberalisation. Though high levels of international financial flows are not novel, it is difficult to see how the changes from the emergence of the 'Euro-dollar' market have not constituted something of a revolution.

Part of the evidence for this radical change comes from the financial agencies and the way they work. National governments through their deregulation programmes have contributed significantly to this change. Many of the legislated distinctions between different types of banks have been struck down as have many of the limitations on the spheres of activity of banks. Furthermore many agencies which traditionally have been billed as 'near banks', such as building societies, have become banks. Or again, there has been a growth in institutional investors, such as pension funds and insurance companies. There has been a proliferation of financial instruments - most notably in derivatives. These developments have been facilitated in part by a number of developments in technology and communications, particularly in the area of computing. Finally it might be noted that the growth in international banking has both facilitated and been stimulated by the growth of MNCs. The twin developments of international banks and MNCs constitute a formidable combination.

Perhaps the most dramatic evidence for the radical change in the international financial markets comes from the sheer volume of funds which now flow rapidly across borders in the endless and relentless search for the highest return. The stock of international bank lending has grown sixteen-fold over the 20 years up to 1994 to stand at US\$4,200 billion. Outstanding international bonds have grown to over US\$2,000 billion. In the most global of all markets, average daily turnover in foreign exchange trading now exceeds US\$1,000 billion.

Finally, the role of the principal 'Bretton Woods' institutions of the International Monetary Fund (IMF), the World Bank and the GATT, now WTO, should be considered. Again the changes and developments in the roles of these organisations are generally reflective and supportive of an enhanced degree of liberal integration.

The twin institutions of the IMF and World Bank were created primarily by and in the interests of what were to become the OECD countries (indeed they were designed principally by the USA and UK). For a variety of reasons under the 'Bretton Woods period' itself, both organisations were relatively quiescent. In the post-1973 period their attention has turned almost exclusively to less developed countries, in which context two points are of particular relevance.

Firstly, these two organisations, whose roles now overlap to such a degree that they could well be merged, have become unequivocally liberal. What is sometimes referred to as the 'Washington consensus' is little other than a prescription of textbook liberal orthodoxy. At the level of micro-economic policy they emphasise, for example, free prices, deregulated markets, free entry and exit of businesses, and the dismantling of industrial licencing systems. At the level of macro-economic policy they emphasise, for example, the moderation of government spending, the raising of adequate revenue, and keeping close control of public borrowing and the money supply. At the international level they seek to promote inward foreign direct investment, the removal of export subsidies and government licencing of trade, and the devaluation of over-valued exchange rates.

Secondly, the IMF and the World Bank have become more active. Each has created a multiplicity of special funds - including for example the External Fund Facility, the Trust Fund, the Structural Adjustment Facility, the Enhanced Structural Adjustment Facility, Sectoral Adjustment Loans, and Structural Adjustment Loans. Particularly with the opening created by debt problems, both organisations, increasingly in alliance, have progressively used their powerful funding capabilities against a backdrop of explicit conditionality where the conditions have been the textbook liberal orthodoxy outlined above. Though there continues to be debate over how successful the IMF and World Bank programmes have been, what is beyond dispute is that both organisations have been extremely intrusive and that intrusion has been predicated explicitly on liberal values and goals.

The final Bretton Woods institution of the GATT did not get off to an auspicious start, beginning life as a series of agreements rather than a permanent organisation. Once again its development has not only reflected but also promoted liberal integration. GATT membership has expanded over time. Successive GATT Rounds, none of which was obligatory, have generally become more ambitious. The Uruguay Round did finally succeed in transforming GATT into a permanent organisation, the WTO. Though unilateral threats and actions have been taken by states, GATT has provided a forum in which trade disputes could be discussed without automatic recourse to neo-mercantilist conflict. Though the GATT had more success in reducing tariffs than non-tariff barriers to trade, the agenda of the Uruguay Round and of the WTO not only has very explicitly incorporated the subject area of non-tariff barriers but also a number of areas of trade, such as agriculture or services, which had been rather overlooked in the GATT period.

In sum, though the definition of integration is clear, it cannot be pretended that integration can be easily or uncontentiously measured. However, there has been

an explicit focus on a rather stringent and demanding requirement which is to search for evidence of integration by focusing on goals and values. Though the evidence cited above is neither exhaustive nor easy to cumulate, it does point to a significant degree of reinforcement and extension of liberalism.

### **Globalisation, Liberalisation and Control**

If the analysis of integration is not exactly straight-forward, that of control is substantially less so. Before indicating the means of procedure it is important to distinguish between relational and structural control. Many analysts focus purely on relational control and would look in general for the capacity of one actor to get another to do something it may otherwise not have done. Other analysts argue that this focus is too limited and that it is also necessary to examine structural control on the grounds that compliant behaviour may take place on the part of one actor, not because it is being directly coerced by another, but because it finds itself in a structural setting such that compliant behaviour, even if not obligatory, is expressly encouraged.

Following the format of the discussion of integration we can again enquire: if liberalism were being diffused what kind of changes in control would we expect to find? In a highly developed liberal system, control is highly pluralistic. Indeed at the idealised extreme, under perfect competition, control would be so pluralistic or diffused that it would be impossible to find relational control. There would however be structural control set by the rules of perfect competition. An obverse of this design is the traditional Realist model of the international system in which power accrues principally to national governments albeit in a clear hierarchy, and therefore relational inequality, of states. If liberalism is being diffused we would expect to find a diffusion of control or more precisely greater pluralism with less dominant relational patterns.

At the relational level, the first of two arguments that can be considered is that there has been some redressing of the imbalances across states. One of the striking changes has been the relative decline in the so-called hegemonic position of the United States. It matters little which economic aggregate is examined - whether it be the position of the dollar in international reserves, the contribution to world trade, the contribution to the stock of international investment or the contribution to world GDP - the relative dominance of the US has reduced.

Since such measures of relative dominance are zero-sum, others must have made up the difference. The first group of states to do this was the OECD countries, of which Germany and Japan have proved to be the most successful

cases. For the most part, however, this change was simply a delayed response to the relatively greater problems of reconstruction following the Second World War.

Arguably the change in the Third World is more striking. In the majority of years since 1945, Third World countries as a whole have had higher rates of growth of GDP than the OECD states. Even more significantly, there is some evidence from the late 1980s that the pattern whereby the level of output in the Third World follows the up- and down-turns of output in the OECD has been broken. In this report one particular form of dependence has changed. Another way of viewing changes in the Third World is to note that, in terms of per capita income, the largely bimodal distribution of First and Third World states has disappeared to be replaced by a much more graduated progression approximating to a normal distribution.

The second argument is that there has been some decline in the relative salience of national governments. The general case rests on the argument that there has been a growth in the salience of international intergovernmental and non-governmental actors. The patterns however are rather complex.

In general, international trade law and practice, as enshrined in GATT, has acted as a constraint on trade policies. Even though its formal powers, especially sanctions, are very weak compared to domestic legislation, GATT has proved sufficiently robust at least to set the latitudes or parameters, which are explicitly liberal in content, within which trade policies can be pursued. The effects however have been uneven. In keeping with selective control, the US government has been prone to unilateral action, notably under Section 301 of the US Trade Law (which in 1988 was extended to 'Super 301' to cover not only specific goods but also particular countries). GATT however has proved sufficiently strong that only a state like the US could contemplate unilateral action. Other states have been obliged to form coalitions. Very significantly, and this testifies to the dominance of liberalism, such groups have made some progress only when they have identified themselves clearly with free trade - the Cairns Group is an example. Where groups have attempted to pursue policies at odds with free trade - as have a number of Third World countries using the United Nations Council on Trade and Development (UNCTAD) to try to establish a comprehensive set of commodity agreements - they have been defeated.

The IMF and World Bank have not only, as has been noted, become very active but also have come to enjoy a substantial degree of autonomy. The funds of the IMF and World Bank are of little consequence for the OECD countries and



these bodies are of importance mainly as forums for the discussion and debate over policy co-ordination - though in this context the Group of Seven is more significant. Though the OECD countries do have some controls, it is wrong to see the IMF and World Bank as foreign economic tools of the OECD countries. This autonomy, and hence greater pluralism, has however had a very different relational impact on Third World countries. For those countries, which have found themselves relatively dependent on IMF or World Bank funds, there has been a substantial loss in their autonomy particularly as the IMF and World Bank have moved to stringent conditionality demands.

MNCs have also come to enjoy some autonomy, again introducing a further element of pluralism. Furthermore this autonomy combined with the capabilities of MNCs can be used in defiance of government policy. For example, attempts by governments to dampen output by (say) raising interest rates can be circumvented by external borrowing; or attempts by governments to change trade balances through currency changes can be circumvented by MNCs increasing or decreasing their home or overseas production; or tariff and some non-tariff barriers to trade can be overcome by multinationals establishing production inside the country trying to exclude the imports.

While MNCs unquestionably enjoy some autonomy and can be at odds with government policy, this does not mean that MNCs and nation-states are inexorably at logger-heads. These corporations are subject to national legislation, in which context formal legal sovereignty is not threatened. Increasingly there is competition across MNCs which constrains their leverage. Multinationals do not of necessity have an identity of interests - a policy change that may adversely affect one may benefit another. Once again however the uneven impact of MNCs needs to be noted. Other things being equal, the leverage of MNCs in poorer countries is greater, though this needs to be offset against the fact that the bulk of MNC investment is in the OECD countries.

Arguably, the greatest impact on national government autonomy has come from the development of international financial markets. Like MNCs, the financial markets are not respecters of national borders and (probably more so than MNCs) have little commitment to any nation-state or national interest. Financial markets direct funds quite simply to where there are the most productive investments. Though having few commitments to national governments, financial markets do play close attention to government policy where their greatest inroads into government autonomy are in monetary and fiscal areas.

In the monetary context the main influence of the financial markets is the limiting effect on the power of governments to set interest rates. The activities

of Central Banks have become more complicated. The role of banks, control of whose reserves is a critical form of Central Bank control, in providing credit has shrunk; savings can be moved very easily across national borders; bond yields can be pushed up if investors expect inflation or do not like cuts in interest rates; official reserves are completely dwarfed by financial market transactions. The idea however that monetary policy is sacrificed to the whim of financial traders is inaccurate. Even if there has been some loss of control, governments have not always had monetary control - they did not under the gold standard or under fixed exchange rate systems. Central Banks do still have influence over the setting of interest rates (though under floating systems and capital mobility this is at the expense of control over exchange rates).

International financial markets can also influence fiscal policy. If governments want to raise taxes then MNCs can move; if deficits become too large investors can transfer to another currency. On the other hand, governments never had a completely free hand. In a completely closed system, for example, a government could only increase its deficit by paying higher interest rates. Furthermore, under capital mobility, governments themselves can borrow (governments are a major actor in the bond market). Or again it should be emphasised that the financial markets are more interested in the fiscal balance than the composition of expenditure.

Three general points that bear on the issue of control in monetary and fiscal areas can be emphasised. *First*, it is not the case that in general government fiscal and monetary policies are powerless before the international financial markets. However, markets do set latitudes or parameters within which governments can move. Though these parameters are not codified in any way, they are in effect the IMF and World Bank orthodoxy. *Second*, liberals in general applaud this development. Governments are not *ipso facto* paragons of virtue. Governments can and do behave in profligate and irresponsible manners in which event they will, rightly according to liberals, be penalised. *Third*, market discipline can be unequally applied as is illustrated well by the different cases of the USA and Mexico. Since the early 1980s, the US government has financed deficits from foreign savings, transforming itself into the world's largest debtor. It has been able to do this in part because the US economy is still *primus inter pares* and in part because the rest of the world still holds a large number of dollars. Mexico on the other hand was penalised for its current account deficits by a sudden and massive outflow of funds.

Turning finally to the issue of structural control, several important points may be noted. *First*, the rules of the world economy are increasingly strongly liberal. Since these rules are not neutral as far as control is concerned, this

represents an important structural shift. *Second*, the diffusion of liberalism reflects an extension of values and goals which unequivocally have their origin in the West. The structural shift as such represents a global expansion of the West. *Third*, while liberals would not accept the left-wing charge that these rules are exclusively to the benefit of the West, not only has there been unequal contribution to the production of the rules but also accommodation to these rules has proved much easier for the originators. *Fourth*, though the extension of these rules has been accepted with some degree of spontaneity, the capabilities of the originators have been such that any contest was very uneven. *Finally*, as the momentum of liberalism has increased the price of failure to accommodate is getting greater. The international system is sufficiently decentralised that no formal sanction would be taken against a dissenting state. However, any government choosing a set of economic policies deviating significantly from the 'Washington consensus' will find itself being penalised and will risk exclusion from the club which though admittedly not truly global is nonetheless the largest one in the world.

## Conclusion

'Globalisation' has become a very fashionable term, arguably to the point of losing all meaning. It can however be usefully salvaged by being restricted to meaning global diffusion - an important phenomenon in its own right. This requires that we specify separately the form and content of whatever allegedly is being globalised. Following this procedure it has been argued that liberalism is being progressively diffused throughout the world economy.

Three words of caution are however necessary. *First*, to argue that there has been a globalisation of liberalism does not imply that the process has been neutral or even. Nor does it imply that the process may not be changed or reversed. Nor does it imply any inevitability about the process. *Second*, it must be emphasised that liberalism is a broad tradition and does contain some pronounced conflicts and controversies. *Third*, the process, arguably more so politically rather than economically, still has a long way to go.

Nonetheless the magnitude and momentum of the global diffusion of liberalism is impressive. In global terms we are living through an unprecedented combination of diffusion of control and integration.

## 3.2

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### Response

*Rob Davies*

There were a number of things in Bob McKinlay's paper with which one could readily agree. In particular, I very much agreed with his insistence on the need to define globalisation in a more vigorous way than it is in much everyday discourse - where it often tends to be seen as little more than the spread of Hollywood culture and the Internet. I also agreed with the emphasis placed, at least in the first part of the paper, on integration as an element. Globalisation, I believe, has to be understood as a process aiming at integrating national commodity, capital and financial markets into a single global market operating according to a universal set of rules. I would stress the words 'process' and 'aiming', because I believe that it is important to take note that globalisation has emerged at a particular conjuncture in the development of the world economy - the period of diminishing US hegemony, as noted by McKinlay, and also at the end of a long wave of contraction in the global economy. Whether or not globalisation will be a permanent, irreversible feature, or how much integration it has actually produced, are fundamental questions to which I do not believe any substantial answers have yet been given.

Globalisation is, however, clearly a process that is having profound effects on present reality, particularly when looked at from the point of view of peoples in peripheral and semi-peripheral countries. It is a major element shaping contemporary economic and political life.

Globalisation is clearly also linked to liberalisation. I would, however, argue that there is a need to make a distinction, and perhaps a sharper distinction than made by McKinlay, between liberalisation and liberalism. Liberalisation, as I understand it, is essentially a process of deregulation. Liberalisation at national level is, it seems to me, somewhat inherent in the integrative nature of the process of globalisation. It should be no surprise that those forces pushing for globalisation - amongst them, transnational corporations - would want to remove barriers at national levels to the free movement of commodities, capital, financial instruments and also to the location of production processes in any part of the world. These basically are real pressures inherent in the integrative character of globalisation.

The paper referred to liberalisation as a process of deregulation or re-regulation. The deregulation element, it seems to me, operates essentially at national level, while re-regulation occurs at a global level with the establishment

of global rules and norms. While a major power like the US may to some extent, as McKinlay describes, be able to stand aloof from this process, looking at it from the point of view of peripheral and semi-peripheral countries, the impact of global re-regulation does indeed have to be recognised as a significant aspect of the reality of the current period.

Liberalism on the other hand is, as was pointed out, a political and economic philosophy. The liberalism that is being diffused in the era of globalisation is not quite classical liberalism. It is variously referred to as the 'Washington Consensus' (the term used by McKinlay) and 'neo-liberalism'.

This distinction between liberalisation as a process and liberalism or neo-liberalism as a philosophy or ideology is, I believe, an important one, not least because it assists in identifying a number of contradictions in and implications of, the dominance of an ideology of neo-liberalism in a globalising world, or at least in one in which less developed countries are under severe pressures to liberalise.

*First of all*, this points to a glaring contradiction between the ideology of neo-liberalism and the actual patterns of liberalisation. Neo-liberalism holds that liberalisation is a good thing not just for the trading partners undertaking the process (who obviously stand to benefit from increased access to a market) but also for the country that is liberalising. We can see an example of this ideology in our own case in some of the debates about a proposed Free Trade Agreement with the EU. In response to the point made by a number of observers that the current proposal from the EU would require us to liberalise over 40% of our imports from the EU, but require the EU to open up its markets to only about 7% additional duty-free imports from South Africa, it has been argued that what is in fact being offered to South Africa is some additional duty-free access to the EU plus the benefit of making credible the adjustment of its economy to a globalising world. In other words, reciprocal obligations are presented as benefits within the framework of neo-liberal ideology.

Also, of course, it is important to note that we are dealing here with what is essentially a northern hemisphere ideology. It is after all known as the 'Washington Consensus', and yet the actual patterns of liberalisation have been highly uneven with peripheral and semi-peripheral countries having undergone much more profound liberalisations than many developed countries. The United Nations Development Programme (UNDP), *Human Development Report* for 1992 pointed out that whilst developing countries had undergone very substantial tariff reductions partly under the pressures of structural adjustment programmes in the decade 1982 to 1992, tariff and non-tariff barriers actually

became more restrictive in developed countries. According to the UNDP these 'global market restrictions and unequal partnerships' were costing developing countries about US\$500 billion in 1992 - an amount equivalent to about 20% of their combined Gross National Product (GNP).

*Although the Uruguay Round will remove some of these non-tariff barriers (and replace others with tariffs), its effects, too, will be uneven. A study by the OECD, for example, suggested that the major beneficiaries of the Uruguay Round would be North America and Europe, and that Africa, including South Africa, would be likely to be net losers - at least in the short-run. This represents a major disjuncture between the way in which neo-liberalism attempts to describe the reality, and the reality itself.*

*Secondly, the ideology of neo-liberalism has informed policies on liberalisation and responses to globalisation that have been far from optimum for developing countries. In a paper presented to the North-South Forum meeting held in Johannesburg in October 1995, Sanjaya Lall and Francis Stewart argued that whereas protectionist policies emphasised capacity development at the expense of efficiency, liberalisation emphasised efficiency at the expense of capacity development. Lall and Stewart went on to refer to the policies which a number of African countries had implemented in the 1980s (often as part of structural adjustment programmes) and said that these had 'focused almost exclusively on efficiency and paid no attention to capability building thus effectively killing the goose that could lay the golden egg of efficient African industrialisation'. They suggested that the appropriate response of developing countries to globalisation would be to liberalise on the basis of the prior development of capacity and that liberalisation without this capacity development was a recipe for de-industrialisation. A fundamental question that arises in this connection is whether the rules of the international trading system, informed as they are by neo-liberalism, really allow developing countries to follow this path? Or do they impose an appropriate response? And what about countries with very little capacity? Those of us who were at the UNCTAD IX heard President Benjamin Mkapa of Tanzania argue that whilst he supported many of the elements of structural adjustment in relation to macro-economic policies domestically, pressures for liberalisation would basically threaten his country with what he described as suicide.*

*Thirdly, it is important to draw attention to the impact of neo-liberal policies on the global economy in general, and here I want to refer to a recently published international journal which commented on the development of the global economy as follows. It said: "The global economy is leaving millions of disaffected workers in its train. Inequality, unemployment and endemic poverty*

have become its handmaiden'. Lest anyone thinks that this is an article published in some radical journal, let me hasten to add that it is a quotation from an article published in the May/June edition of *Foreign Affairs* by Ethan Kapstein, who is the director of the US Council on Foreign Relations. Kapstein is basically arguing that the policies which are being pursued at the global level are contractionary and are having negative effects on working people - not only in developing countries, but also in developed countries. He then goes on to say, 'The current obsession with balanced budgets in the United States and the Maastricht criteria in Europe must be replaced by an equally vigilant focus on growth and equity. National responses to this global problem are likely to fail as any state that deviates from 'responsible economic policies' will be punished by currency markets and bond holders. States must now re-orientate their economic policies towards growth but it should be done as part of a co-ordinated international effort'. This quote raises a point that McKinlay made, which highlights one of the very important realities of the current world, namely that globalisation and the attendant pressures of deregulation nationally and re-regulation internationally, have reduced the scope for, and raised the price of, non-conformity by individual states from global norms. Conformity is now being imposed - as McKinlay also shows - in a variety of ways: most directly through conditionalities, structural adjustment programmes and the like, but now increasingly also through the actions of increasingly globalised financial markets.

Although liberalism - or neo-liberalism - is clearly still the dominant ideology informing globalisation, it is important to note that it is perhaps not so uncontested as it appeared to be a few years ago. Under pressure, perhaps, of increasing competition between the major trading blocs, and certainly in a context where such policies have delivered neither growth nor development to many, we have some signs of a break in the apparent consensus. The issue of development, the distinction between growth and development, and the need for development-oriented growth is now being posed much more sharply on the international agenda with organisations like the UNDP, UNCTAD and others attempting to claw back some of the ground which they had definitely lost in the 1980s. Also significant is the Japanese critique of the 'Washington Consensus' for not having taken on board the experiences of East Asian countries, and particularly the important role of the state in East Asian economies. We are now seeing some marginal shifts at least in the policies of the World Bank under the leadership of James Wolfensohn. This leads, finally, to the following conclusions:

As I have tried to indicate, we need to recognise globalisation and liberalisation as having created significant new realities. From the point of view of individual

peripheral and semi-peripheral countries, at least, these have decisively altered the convention boundaries between domestic and foreign policy. What may have been attempted domestically in a number of spheres that were previously relatively isolated from foreign policy concerns is now crucially dependent on developments in the international domain. For a country like South Africa, this means continuing to struggle to maintain the maximum degree of integrity of domestic decision-making over economic policy questions. It also demands finding new ways to engage with a broadening range of international issues on a terrain in which the balance of forces is not always favourable.



## 4.1

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### Free Markets or Central Planning?

*Chester Crocker*

This will not be an economics lecture. I am not an economist and there are many others in these proceedings who are professional economists, equipped to deal with these issues in a professional manner and to raise your confusion to a higher level in a professional way. In addition, it is not my intention to preach or prescribe for South Africans. I underscore that it is not my intention to do so, but being an American I will no doubt fall across the line from time-to-time.

Now, a word about the title: it is interesting and provocative. It is the kind of title that is mediagenic and gets people stimulated, but it can be an obstacle to communication. It may generate ink but I am not sure that it advances anyone's real agenda. Why do I say that? Well I say it because I do not know if 'central planning' is a current phenomenon - it is more of a historic phenomenon. The only place where it is really practised still is in North Korea, but it has been jettisoned in Albania, and Havana and by the British Labour Party, the Italian Communist Party and others.

Can I share with you a brief anecdote about central planning? As a young student in 1963 I took my first visit into Eastern Europe. When I arrived at the Metropole Hotel in Prague and asked for a map of the city, I was told that I should go to the Intourist Office because the hotel had run out of maps. So we went down to the Intourist Office and asked for maps of Prague and of Czechoslovakia. We were told that the 18,000 maps printed in 1962 - which was the previous year - had run out and that there would not be any more maps printed until 1964. The result of central planning in that particular instance is that I was arrested four times in three days for wandering in my automobile through arms depots in the outskirts of Bratislava and for falling into a petrochemical complex that was highly strategic in Eastern Bohemia - I think that you get my drift.

On the other hand, the pure version of a free market is a very rare beast. I do not know where it really exists. I am quite confident that South Africa has never had a free market - in the pure academic sense of the model. One should thus start by stating the obvious - that absolutely free markets and completely controlled central planning are not really on the agenda. These things can become slogans, but there is a need to watch out for verbal minefields.

I have had a few experiences with verbal minefields and will share one with you that might be illustrative: when we were trying to achieve independence for Namibia we decided to link it to the issue of Cuban troop withdrawal from Angola and of course, as a result, were accused of all manner of war crimes. It was not until we got the job done that people recognised the essential sanity of it. But initially the reaction went something like this: the Frontline States and South West African People's Organisation (SWAPO), then in exile, said, 'We'll do Namibia first - implement Resolution 435 and then we can talk about Cuban troop withdrawal'. The South African government - it will not surprise you - had a somewhat different version: they said, 'let's get all the Cubans out of Angola first - and we want their names, ranks and serial numbers - and then we will consider going forward with the independence plan for Namibia'. At one stage, I had to report this news back to Secretary of State Alexander Haig, who was my first boss in the Reagan years; I asked for some guidance given these different positions and Haig said to me: 'Chet, why do not you just go out and just tell them that what we need really' - and these were his exact words - 'is a greater degree of empirical simultaneity' - in other words, a 'package'. If Haig's obfuscation is translated into the current dialogues of South Africa's economic policy, it would come out something like this: what South Africa needs is a market friendly, globally competitive, social-democratic capitalism defined on a sectoral basis after due consultation with all relevant stakeholders. I did not make that up. I am quoting almost verbatim from a distinguished South African trade unionist - I would not mention her or his name. I want to emphasise that this is an important topic but let us not be distracted by the verbal minefield.

I will now move on to pose some questions because I do not want to preach. Rather, there some questions which only South Africans can resolve and which presumably they are or will be doing.

Question number one: will South Africa's quest for a consensus economic strategy be consistent with a dynamic changing world, with the world economy, world technologies, world trends in terms of employment and income and inflation and so forth. In other words, will it be possible to devise a consensus here which is compatible with the need to be adaptable and flexible *vis-à-vis* the external world? And will it be possible to do so in a manner consistent with the maintenance of democratic pluralism, an open society, and a free debate? In other words, will it be possible for South Africans to do this in a way that permits them the continuing openness which will lead to success? Will you create a closed, inward-looking straightjacket *or* a shared, open, inclusive orientation, and an adaptable culture? Is this to be a doctrinal framework laid down from on high or a culture of learning and changing and adapting that

comes from beneath? That is the kind of question I would ask and I am not going to prescribe the answers. That is for you all to do.

Secondly, is it possible for South Africans, as they come up with an economic strategy, to create a win-win game so that everybody is seen to be owning that strategy or will the country be so immersed in struggle talk that this will not be possible? I might put it a different way - can the shared patriotism that you have so brilliantly displayed in the constitutional political and sports arenas, move into the economic arena? I say that because outsiders and external audiences - and I hear a lot from them - are quite liable to misread your debates. We are as good at misreading your debates as you have been at misreading ours over the years. Some observers overseas will look at your partisan polemics and will say, 'well, that just shows that they cannot make it work - that just shows that they cannot pull it together'. There are all sorts of reasons why that might happen - in some quarters perhaps because outsiders have not learnt to cope with the issues of race as successfully as you have in this country. Will you be able to show that you can pull it together, rather than pull yourselves apart?

*Another relevant question is whether this 'rainbow nation' can really live up to that goal - in its governance, in its acceptance of dissent and criticism from all quarters, in the composition and leadership of its vital civil society institutions across the spectrum, in its corporate boardrooms and management teams, and in its delivery to all segments of society. It is an obvious point - clearly you are much pre-occupied with it, but it is necessary to mention it.*

A fourth question is whether South Africans will come to grips with some of the most insidious threats to civil society in the world today? These threats are also visible beyond South Africa: this is not something specific to your country. Those threats are the two linked evils of corruption and criminal business enterprise. *My country, the US, has not solved this problem, but we are working on it.* I am not sure that anybody can solve it permanently. These forces of corruption linked to criminal business enterprise have weakened civil order and economic vitality in my country, in Latin America, in South and East Asia and in the former Soviet Union, and are capable of destroying your new society too. So the question is: will you go after these linked forms of societal cancer, or will you tolerate them and in the process legitimise them, thereby permitting the forces of coercion and greed ultimately to triumph in this country and in the region?

A fifth and last question is: will South Africa decide to have a foreign policy? Or, perhaps, to put it more diplomatically (and SAIIA is a great foreign policy institution) will it be possible to move beyond important, but symbolic

celebrations and solidarity rallies, investor road shows and pilgrimages to places of power and glory, and now start conducting serious evaluations of the national interest? What is meant by that? Let me provide a few illustrations:

- \* Engaging in a serious, high-level professional discussion of South Africa's options in trade policy with the EU: I do not profess to have the answers or to even know what the right questions are, but I do not sense much discussion about something that is awfully important. The economic relationships between Europe and Africa are the closest set of relations the African region has with any other part of the world. So, get it right, whatever the right answer is. Do not assume that you have the rest of time to think about it.
- \* Resolving important bilateral disputes with partners around the world: one case close to home is the Armscor issue with the US. It is surely incumbent on people on this side to do what can be done to try and get that issue of historical origins behind you.
- \* Building regional peace and security: without regional peace and security there will be little economic growth here or in the region. So the question is, should this be a primary and important continuing focus of South African foreign policy? There are many other issues that I could cite as examples - building regional and sub-regional economic institutions; economic, financial and monetary linkages; trade co-operation linkages - all of these things are important and serious. But I am not just going to confine it to Africa. What about Asia? What about South and East Asia? What about linkages in the Middle East? Where are the niches that give you comparative advantage in the global economy? People are thinking about this in different sectors of your economy, but I hope that somehow the gear-shift and transmission between business and government get linked to each other, so that eventually there is a possibility of systematically exploring opportunities in the interests of your country.

There you have five questions; I could continue with more, but I promised not to sermonise. I will move on now to some other remarks and, briefly, a few predictions. These are not predictions about South Africa, but about the way the external world will interpret your progress and your efforts over the next year or two.

*First prediction:* the outside world will continue to swing back and forth erratically in response to events, decisions and pronouncements from here. That is the way the world works. On the outside, there is no sustained attention span focused on your daily politics and economic decision-making. We tune in and out - we are selective. But it does matter what the outside world thinks, and

how it responds. It matters to you.

On the positive side, the behaviour of world currency and bond markets, for example, serve as a kind of reminder and external constraint - a rather cold discipline if you like - reminding people here that there is no free lunch and that South Africa will obtain the investment, capital flows, and credit ratings which it earns. This is a plus. The world economy is not a singles bar: there are some constraints. The world economy will scrutinise South Africa and say: the South Africans are *saying* the right things, but are they *doing* the right things and how does what they are doing compare to what others are doing? That is common sense, which you have heard a hundred times.

The negative side of this erratic attention span from outside, is that foreigners will often misinterpret you. They will misconstrue you, they will listen to your 'struggle' talk as though that meant that you are incapable of reconciling. They will fail to see how much you have already accomplished in building a culture of tolerance and pragmatism. They will fail to appreciate that there is more to South Africa's soft landing than President Mandela and his special genius. And so, they will over-simplify things - you are familiar with what I am talking about. *At times, they will behave as if they doubt that you can succeed. Why?* Because you are African - and Africa, sadly, remains in many quarters of the outside world a metaphor for failure. It is not an accurate metaphor, but it is a clearly perceived metaphor. So, that is the down side. The implication for you all is to create your own facts, not to wait for the right moment of external perceptions, but to create your own facts - to show them that there is the will to act and to govern and to convert your society from a society of protestors and negotiators into a nation of builders, creators and innovators. Show them. That is the first prediction.

The *second prediction* is that outsiders will be less focused on the precise blend of policies you adopt than on the degree of confidence and coherence and conviction with which you carry out those policies. They are looking for predictability. They are looking for a sense that you know what you are doing, *that you are capable of carrying out what you say you are going to carry out.* Of course they care about some of the policies substantively: the outside perception is so far there has been a lot of talk, but delivery and performance have been a little slower. This is now beginning to happen. A most recent development which received a lot of attention overseas is the macro-economic strategy pronouncements of your government. There are people attending and participating in this conference who played a role in that. That kind of thing is being positively received and will be even more so as words and concepts are translated into action.

The kind of policies which are most impressive to outsiders depends - and this I want to underline - on which outsiders you are talking to. There are some areas of external consensus about what makes for economic success and you are familiar with those: the rule of law, domestic law and order, a focused programme for training people and fast-tracking them into the next century, high domestic savings rates, market efficiencies that avoid market distortions and corruption and so forth. There are also areas where foreigners, outsiders like me, are unsure about what the formula is for success. We debate each other, though we do not know the answers and have contending views. For example, a lot of people are still debating what Asia's secret for becoming a region of tigers is. There are no final answers and I am certainly not here to pronounce upon the debate. You will have to draw your own conclusions. It must be emphasised that while there are some areas of consensus, there are also others where you will have your confusion raised to a much higher level if all you do is listen to what the outsiders are saying. Ultimately you must make your own choices and decisions.

*My third prediction* is that outsiders - like myself - will likely act on what we see and hear from the networks that we are part of. So, I hope that South Africans as they make their choices are aware of the fact that Europeans, Asians, other Africans, and Americans for that matter get their information from the networks in which they live - friends and contacts within the world of business, the media, the university world - and they will draw conclusions, not from what you say publicly and officially, but from what they hear. If we start to hear that public officials in South Africa are lining their pockets and that there is a trend in that direction here, people will draw their own conclusions. If people begin to get the impression that there is really no South African response to the crisis of violent crime, they will wonder about your competence and your maturity (because the first task of any government is law and order). Obviously, I am not the first person to say all this but I am underlining the point that we get our news from networks we are part of, not from reading your parliamentary debates or memorising the pages of *Business Day*. If they begin to hear in the outside that there are stable industrial relations emerging, that there is a degree of social compact coming together on aspects of industrial relations and on various market-friendly attitudes, this will speak eloquently in the networks that I am talking about.

*A fourth prediction* is that a special sense of South Africa's uniqueness will wear off quite soon. The outside world is not going to continue much longer to treat this country with the special support and unusual indulgence of the past few years. The implication is clearly one of pulling up one's socks and taking advantage of opportunities while they are there. The rather drawn out and

technocratic discussions in the European Union about trade relationships is a very concrete example. How many friends - really intimate and committed friends - do you have in Europe today? Think about it - and think about whose side is time on.

Finally, let me offer a few predictions about the kinds of things that will most impress external audiences, bearing in mind that internal audiences come first. You are a democracy and all of us on the outside have an obligation to recognise that you cannot have policies that only sell in London, Wall Street or on the Tokyo Stock Exchange - they have to sell in South Africa. Indeed the primary call on the attention of decision-makers is to be saleable here.

With that in mind, the following will impress audiences abroad, however:

- \* Domestic law and order: recent trends towards a more peaceful climate or environment in KwaZulu-Natal are very encouraging in this respect;
- \* The capacity to govern and to implement policies: governing is a lot harder than negotiating or protesting. Governing is actually about the most difficult thing I have ever experienced, and I have been on both sides of the equation. Governing is about making sure that the steering wheel, gear-shift, transmission and brakes are all linked together somehow. Governing is about allocating pain and sacrifice which will be essential as you restructure and accommodate yourselves to a globally dynamic environment. It means deciding on priorities and then sticking with them - relentlessly, with a kind of determined intensity so that people cannot blow you off course after a bad day on the London bond market.

For example (to get away from Southern Africa for a moment), I was recently at a graduation ceremony at Stanford University, California. While looking across the cohort of graduates in different disciplines, I noted that over 60% of the graduates - in the sciences, technology, engineering, computer science and information technology - were not American. They were overwhelmingly from Asia. I posed the question to some people in the Stanford Admission Office: 'What is the ratio of Asians, let's say, to Russians attending university?' My respondent said, 'Never mind about Asians, I will tell you about Taiwan. Taiwan has 10 times the number of students studying in the US as the entire former Soviet Union does. That is just Taiwan, a country of 20 million people'. Now that is what I mean about pursuing priorities with a relentless intensity and getting the job done. Taiwan transformed itself in thirty

years - it is a remarkable performance - education was a major part of that transformation.

- \* Finally, avoid doing business as usual. It will impress people outside if you keep on innovating, if you keep on fooling us, if you keep on surprising us by creating your own facts. Innovate. There are thousands of ways to innovate in the financial world that relate directly to your lift-off. To paraphrase Margaret Thatcher (who had a more blunt use of language than I): 'Do not mess with the market', rather help it along. This does not mean that the government should just stand by and wait to be told by some folks in the private sector or from overseas what to do.

There are roles for government. My basic point is that all of God's children understand incentives about bettering their lives. Create the incentive structure and climate for everybody. That is where the innovation has to come from, along with other things that I have touched upon: rule of law, transparency, vigorous fiscal discipline, high growth targets. Set targets that are too high. The most successful companies in the US are companies that just amaze the analysts, because they are always setting targets that are impossibly high, and then beating them. This reminds me of a conversation I had last night with some friends here in South Africa who said: 'Well Chet, what do you think about the 40-hour work week as opposed to the 35-hour work week in Germany'. I said that I do not know anybody in Washington who works a 40 hours a week. Most of my friends work 60 hours a week.



## 4.2

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### Response

*Jeremy Cronin*

I find myself in a great deal of agreement with many of the points Chester Crocker has made. First of all, as we South Africans look outwards from this new South Africa, we should ask whether it is so new? How new is it? Where on earth is it going? In this, the debate is clouded by a number of illusions. The first illusion is a profound amnesia which is often induced from the outside about the role of governments in the critical take-off period of developing countries. I do not think that in the 20th Century there is a single example of a society emerging - either from wartime ruin, from economic crisis, or from Third World backwardness (and we probably suffer from a combination of all three of the above) - in which planning (by the government) has not had a very critical role. This is an important point. Therefore some formula provided to us from outside - such as the 'Washington Consensus' - is a consensus which induces a profound amnesia about, for example, the 'New Deal' in the United States; about Japan twice over - when it first launched itself into modernisation and then post-war; about Western Europe post-1945; about the Asian Tigers; and indeed, about the failed, but important examples of the Soviet Union and Eastern Europe. In all of those cases, government played a very central role in the critical take-off period. That is not to say that any of those examples are appropriate to our situation or even remotely applicable in the world of the 1990s, let us not forget those realities.

The second illusion - it is linked to the first - which we often suffer from, is the notion that we in South Africa have now 'joined the Family of Nations'. As Dr. Crocker knows, South Africa has been deeply implicated in Cold War divisions and in the global situation, for better and for worse. It is not as if we have now suddenly returned from outer space. But perhaps the gravest illusion out there is this notion of some 'happy family of nations', and it gives rise to the roadshows he referred to. There is indeed an absence of a foreign policy in South Africa. Who needs a foreign policy, when out there is this well-meaning world that loves us, because it has a happy feeling about what we have achieved here in South Africa? It is an advantage which we should not throw away, but is also greatly exaggerated. So, we see often - in foreign, trade policy as well as economic policies in South Africa - what anthropologists would call 'a cargo cult': the expectation of Marshall Aid arriving in some aeroplane. Yet, it does not seem to be arriving and therefore, as a sort of adjunct to this 'cargo cult', we see, a pseudo-science of normative semiology. The cargo is about to arrive,

but what is the science of the right and wrong signals? What do we have to say to the outside world - regardless of what we intend doing - so that the 'cargo' will eventually arrive? A great deal of debate and pre-occupation seems to be centred around these assumptions.

Of course, I am bending the stick a great deal here; I am not suggesting that what we say is insignificant in many aspects and that the messages we send out are irrelevant. They are very important for the reasons that Dr. Crocker has underlined, but we should not simply get into that kind of normative semiology mode and imagine that we do not have to deal with the domestic audience - which I agree completely with Dr. Crocker is the most important audience. If what they are looking for 'outside' in the 'Family of Nations' is not so much the right signals but evidence of commitment to clear policies and to some degree of predictability, then we are doing the right thing by starting on that footing.

The third point I was going to develop, anticipated a rugged defence of free markets from Dr. Crocker, which did not come, so I can safely restrict some of my comments. I must say though that clearly many questions need to be asked in that regard around how free 'free markets' are? Many assumptions again are made in our country that out there is a single globalised free market. That is a grave distortion of realities in many respects. First of all, a great deal of trade is not in fact on the market. It is bilateral trade, it is trade within multinationals, and a component of it is market trade. There are huge trading blocs which distort the free market and that is where I would have a slight disagreement with Dr. Crocker. I am not sure that there *is* a window of opportunity we should seize while Europe still has a happy feeling about the 'South African miracle'. My view - and I think that it is shared by many in government - is that the offer on the table from the European Union demonstrates that the honeymoon is no longer. We need not dive in on the assumption that it is the best offer that we are going to get. It may well be an indication that the honeymoon, certainly on the trade front, has disappeared.

It is important not to duck the issue economic planning. I am not going to plunge into a mindless defence of Leonid Brezhnev and I doubt whether I will be disappointing any supporters, though I might be disappointing some opponents! What emerged as central planning in the Soviet Union and Eastern Europe had more to do in its initial period with the admiration that certain Bolshevik leaders had for the German war economy of the First World War than anything you might find in Marx and Engels - but that is a whole separate academic discussion. What then is the relationship between the new global challenges and the issue of planning? This, of course, dramatically raises the

issue of national governments, although it is important to underline immediately that planning is not the monopoly of national governments. Multinational institutions, provincial governments, local governments and a host of other 'realities' and institutions are also involved in planning - although they would often deny that they are doing that. If one tried to review - and it is a schematic review as it can only be in a brief space of time - the evolving approaches to planning since the Second World War, it is possible to distinguish three distinct phases. The first, through the 1950s and into the mid-1970s, was a very state-centred approach to economic planning. It was regime-driven national development planning and it had two major faces: the one in Western Europe, Southern Europe and to a lesser degree in the United States was essentially a Keynesian approach. The other one was of course in Eastern Europe - the Soviet bloc central planning approach. In most or many developing countries a variety of hybrids drew heavily on these assumptions.

The 1980s - Reaganomics, Thatcherism - right into the early-1990s, saw a massive anti-planning reaction to what was a global consensus within a Cold War situation. This 1980s phenomenon, referred to this morning as the 'Washington Consensus', counterposes growth and development on the one hand, with state intervention on the other. State intervention is seen as a negative: it damages the capacities of economies and societies to grow and develop. In Africa this particular policy has been achieved dramatically via, in particular, the IMF and World Bank Structural Adjustment Programmes (SAPs). Needless to say, despite the anti-planning rhetoric, even SAPs have to be planned. The rhetoric often disguises the fact that planning is done elsewhere - extra-territorially, undemocratically and usually highly schematically. There is a global blueprint which then gets imposed regardless of the specifics of different societies.

There is an emerging complex, confusing attempt to shift paradigms when it comes to planning and the role of government in economies. South Africans are trying to grapple - we are not alone in this, but I think that we are among the pioneers - *first*, with the new global realities; and *second* with the question of how we unlock our country out of wartime ruin or quasi-wartime ruin, and out of a huge economic and social crisis and the backwardness of a semi-peripheral country? In trying to grapple with answers to those two questions, we are moving away - unevenly - from both the state-centred assumptions of the first model towards planning and the anti-planning rugged free market approach that has characterised the 1980s and the first half of the 1990s.

I do not want to overplay the clarity with which we are doing this, either as South Africans or as the ANC government, but this is what we are engaged in.

What does this mean? It means, first, a shift away in terms of emphasis from government towards governance. Government remains important, critically important, but it is not the 'be-all' of planning. It results also in a shift away from structure towards relationships which are often *negotiated* relationships. Therefore, government engages and negotiates with the private sector, and also with the broad social movements. As a government that also has to take into account international and regional Southern African dimensions, as well as provincial and local level governments, this process occurs as much in government departments as it does in the National Economic Development and Labour Council (NEDLAC), in legislatures and at all other levels. This is a different approach which we hope will succeed. Put it another way: we are moving away from blueprint planning and much more towards the notion of government as critical within the economy, but less as 'big brother' - capable of giving strategic leverage to critical processes of development and capacity building.

There are two examples to illustrate this: the 'Washington Consensus' tells us that you cannot survive in the modern world unless you have flexible labour markets. This is probably true. But we have a choice before us, and the ANC government is trying to move - in collaboration and in negotiation - towards flexibility of labour markets. This is a negotiated flexibility which would both be sectoral as well as regional. This is distinct from a market-driven flexibility where you would say, 'no regulation, the unions are in the way, they are too strong, they must get the hell out the picture, government must clear out, and let investors come in and pay the going price'. What the latter neglects is the huge under-development in our country; the huge contradictions, and the massive lack of skills. What we would have as a consequence, in my view, is cherry-picking. The option that we have selected is different. In fact, greater regulation of the labour market could be introduced to try and empower the negotiating possibilities of unions, for instance. So regulation is extended into new areas, but within the framework of that regulation the notion of negotiations is introduced. This is not some kind of blockbuster five-year social accord negotiated between trade unions and business and that is it. This demands a much more flexible approach in many areas, including that of the labour market.

A second example would be (and it is probably risky to stray into areas of hot debate), the approach to Telkom that is being developed. Far from being an old debate between privatisation versus nationalisation, the approach with Telkom is to search for a strategic equity partner which would bring in 'high-tech' and capital and would therefore expose the company more effectively to global realities. At the same time this would maintain a Telkom monopoly over voice

telephones. This is not designed to extend the *status quo* for all time, but to prevent competition coming in and cherry-picking - in other words, providing cheaper voice telephones to the corporate sector, which is where the money is to be made, and undermining Telkom's other capacities entirely. The approach that the Minister in this particular portfolio is adopting is to say that we will introduce liberalisation and competition into voice telephones, but after a window of four, five or six years, so that Telkom's profits - of which 80% comes from the corporate sector - can be used to cross-subsidise and develop a universal supply of telephones in a country which has been badly affected by huge inequalities.

This is liberalisation - yes - but *planned* liberalisation. We agree with the need for integration into the global economy - yes - but *planned* globalisation on the basis of the country's developmental priorities.

In conclusion, we cannot introduce a Berlin Wall. It would be undesirable and it would not work. However, as South Africans engage with global realities, we have to build some kind of wall - not a Berlin Wall, but perhaps a breakwater. Breakwaters are designed not to seal a country off from the outside world, but to create the conditions in which it is possible, mindful of national domestic priorities, to engage effectively with the outside world. Building this breakwater involves many things. It involves a regional perspective, and the public sector - not as some blockbuster do-all big brother - but as a strategic, critical leverage in setting the developmental challenges for ourselves. It also demands building the capacity of social movements including trade unions, and a democratic involvement of the broad citizenry. It involves planning too - as strategic intervention, not as a big five-year plan. Finally, the problem - and that is why there are so many confusing signals coming out of South Africa - is that often our debates are locked in old dualisms. We have a silly argument around 'Free Market versus Central Planning'. We need to throw that debate away because it does not correspond to current global reality and understand what it is we are trying to do. It is not privatisation for its own sake, and it is not nationalisation. There is also a need to move away from the globalisation versus protectionism debate. Unfortunately much of the debate in South Africa is still locked in old dualisms which produces only a dialogue of the deaf.

South Africans need to find a way forward. These dualisms can only lead to misunderstanding of each other. Responsibility here lies on all sides: trade union movements, the ANC and the private sector are all guilty of returning to the shelter of these familiar dichotomies. This is, however, unhelpful in finding a way forward, and does not reflect the realities of what is being attempted in the country at present.

## Africa and the International Economy

*Jeffrey Herbst*

The relationship between the countries of sub-Saharan Africa and the international economy is of critical importance to the development prospects of millions of people over the next decade. The creation of the World Trade Organisation (WTO), dramatic changes in the nature of global markets, and the adoption of new policies by developed countries have heightened both the risks and the rewards of participating in the global economy. Given Africa's unhappy experience with the slave trade, colonisation, fluctuating commodity markets and foreign debt, it is only natural that many on the continent have come to stress the negatives of becoming more engaged in the international economy. However, despite the real risks, further engagement in all aspects of the international economy is the only avenue out of Africa's current economic morass. At the same time, there are new threats posed by the developing international political economy to the African state system that may, in the end, be a much more dangerous and important phenomenon than the more studied trends in trade and finance.

This chapter deliberately paints a broad canvas because the relationship between Africa and the international economy is complex and there are several different sets of issues involved. Any one of these issues (for example, Africa and the Uruguay Round) could justify a paper. However, it is only by examining the cumulative impact of the different issues that the truly important implications of globalisation on African countries become clear.

### **Africa's Ambiguous Relationship with the International Economy**

By almost any measure, Africa has performed poorly relative to other regions of the world. After controlling for initial conditions and external shocks, Patrick Conway and Joshua Greene concluded for the period 1976-1986,<sup>1</sup>

the macro-economic performance and policies of African countries differed significantly from those of non-African developing countries in many respects. ... African countries had lower investment and inflation rates. In addition, they exhibited lower rates of real economic growth even after adjustment for external and developmental factors.

African economic activity now accounts for only 5.6% of world economic activity although 10% of the world's population lives in Africa. Overall, Africa's growth rate between 1980 and 1993 was only 1.6% compared to the world's growth rates of 2.9% and, also, 2.9% for low- and middle-income countries. While total African economic activity accounted for 36% of economic activity in East Asia and the Pacific in 1970, by 1993 it amounted to only 21% of total activity in that increasingly prosperous region.<sup>2</sup> As a result, Africa is the only region where the absolute number of poor people will increase significantly in the next few years.<sup>3</sup>

To address this poor performance, dozens of African countries have adopted stabilisation and structural reform programs championed by the IMF and the World Bank. These programs usually involve some combination of exchange rate devaluation (to make exports more competitive), trade liberalisation (to make imports cheaper and promote efficiency in business) and pro-market reforms that, cumulatively, seek to make the country more open to the international economy. Proponents of these policies argue that domestic reform is necessary if Africa is to take advantage of the changing global environment. Thus, the World Bank states that globalisation will 'affect the growth prospects of developing countries by expanding opportunities and intensifying competition in international markets. Globalisation, consequently, places a high premium on sound policies'.<sup>4</sup> Globalisation actually broadens the agenda for reform because, the Bank argues, 'to be fully effective, measures that liberalise trade need to be accompanied by complementary policies on foreign direct investment'.<sup>5</sup>

Indeed, it is now clear that to grow quickly, countries must be open to the international economy. Worldwide trade grew at an annual average of 6.1% between 1991 and 1994, three times the growth in world output.<sup>6</sup> Indeed, the statistical evidence now seems clear that openness promotes growth.<sup>7</sup> Given the success of the Uruguay Round, there is every reason to believe that international trade will continue to outpace domestic growth. Countries that are relatively closed to the international economy thereby shut themselves off from the primary source of global economic dynamism.

However, the African embrace of globalisation, despite the advice of the international institutions and the example of the East Asian countries, has been restrained. Certainly, there is a long history of African countries actively advocating *not* participating in the international economy that reached its apex during the debates over the New International Economic Order (NIEO) in the 1970s. However, even in the 1990s, when the 'Washington Consensus' is often thought to be universal, the African response has been ambiguous at best. For instance, the official African contribution to the UNCTAD IX conference held

in Midrand in 1996, the Addis Ababa Declaration, while a seachange from the rhetoric of the 1970s, sounded a more cautionary note than is commonly heard in Washington:<sup>8</sup>

The Ministers acknowledge that economic liberalisation and the ensuing globalisation of investment and production have been the hallmark of economic policy throughout the world. However, because of sluggish growth in the enterprise sector, lack of success in the acquisition of new technology, insufficient aid flows, poor infrastructural facilities and weak national institutional capacities, domestic enterprises of African countries have not been able to participate to any significant extent in the globalisation of production of goods and services.

Indeed, while fully recognising the need for domestic reform and for taking responsibility for their own economies (both enormous changes from the 1970s), the African ministers also have a different agenda for the international financial institutions:<sup>9</sup>

*the multilateral financial institutions, notably the IMF should oversee the coordination of macro-economic policies and the regulation of monetary and financial markets of industrialised countries in order to reduce exchange and interest rate instability, while also promoting growth and full employment. Thus, there is a crucial need for coordination of global economic policy ...*

It is therefore not surprising that the recent World Bank study on global integration found that twenty-four African countries could be considered 'weak' or 'slow' integrators into the international economy while ten could be considered 'moderate' and only two (Ghana and Mauritius) 'fast' integrators.<sup>10</sup>

The domestic response by African elites to the international economy has been, at best, tepid. For while many African countries have, finally, adopted structural reform programmes and made significant changes, especially in regard to pricing, in their economies, they have not developed new domestic ideologies and programmes necessary to actually encourage their fellow citizens to participate in the global economy and to explain both the benefits and risks of that participation. There are undoubtedly several reasons for this hesitation including the unhappy history with the global economy noted above, pessimism about the ability of the world to absorb more exports, the inability to espouse 'capitalism' as an ideology because of the baggage left over from colonialism, weak adoption of overall reform programmes, and the very real trauma that globalisation will entail for many economies. In addition, the fact that no African country has yet become an obvious success via globalisation (or any other way, for that matter) has meant that the demonstration effect so powerful in East Asia and Latin America has been largely absent in Africa.



Indeed, there has been little debate about any aspect of economic policy in many African countries and little effort to build a constituency for globalisation even in the context of political liberalisation. Observers of elections in Ethiopia (1992), Ghana (1992), and Madagascar (1993), among others, have noted that there was no real debate over economic issues. For example, the National Democratic Institute noted that in the Niger elections, 'support for political parties, in general, depended more on geographic location and ethnic affinity than on political platforms'.<sup>11</sup> The African National Congress (ANC), one of the very few African political parties to even have a view of the international economy during an election, was actually very pessimistic: 'We believe that Africa is once again the victim of a new and grossly unjust global system'.<sup>12</sup> Few, if any, African leaders yet say 'export or die'.

At the same time, many groups in Africa outside of government have been outspoken in their antagonism to calls for greater globalisation. For instance, the parallel of the Non-Governmental Organisation (NGO) conference to UNCTAD IX declared:<sup>13</sup>

The current system of globalisation and liberalisation has had devastating effects upon African economies. Our countries have been pushed backwards into increasing debt, structural decline, and environmental degradation, poverty and deepening inequality. Those worst affected, such as children, youth and women, are already at the margins of society.

Similarly, there is widespread public opposition to globalisation in African societies. For instance, researchers at the Zimbabwe Institute of Public Administration noted that in their country it was widely held that privatisation should, 'solely benefit the indigenous population'. Similarly, researchers from Tanzania's Institute of Development Management warn that the public fears that 'if due care is not taken to maintain a balance, the trend will reflect wholesale foreign ownership of the privatised enterprises'.<sup>14</sup> Further, there are few, if any, African political parties that are running on an explicit campaign of increased liberalisation and embracing globalisation. Whatever their other problems, African governments face no enemies on the right.

Given the profound disagreements between the international financial institutions and many in African civil societies, and the obvious ambivalence of African governments literally caught in between, there is an urgent need to understand the precise opportunities and dangers posed by current trends in the international political economy to African countries. The following sections will examine first global trade and then financial developments, and how they affect African countries. The chapter will continue with an examination of how the developing international political economy will affect the African state system.

## **The Emerging International Trade Regime and Africa**

Recent dramatic changes in the international trade regime have raised considerable concerns that Africa will be further marginalised. It is widely felt in Africa that the adoption of the Uruguay Round and the increasing importance of regional trade blocs may cause Africa to continue its relatively disappointing trade performance. Indeed, across Africa, the perception that industrialised markets are closed and will remain protected is often cited as one of the main reasons for the relative lack of enthusiasm for embracing liberalisation and globalisation.<sup>15</sup> As a result of these fears, the prospect of regional integration has again been suggested as a potential answer to the problems Africa supposedly faces in world trading markets. The following sections analyse each of these issues and suggest that, in fact, the Uruguay Round will not harm Africa and may offer substantial, if yet unrealised, benefits. Further, it appears that the fear surrounding the emergence of regional trading blocs is not warranted. At the same time, regional integration holds out only extremely limited benefits for Africa.

### *The Uruguay Round*

The completion of the Uruguay Round in 1995 was greeted by, at most, a muted response by African countries and a significant amount of pessimism. The Midrand Declaration adopted at the end of the UNCTAD IX Conference was typical in stating, 'The least developed countries, particularly those in Africa, and other developing countries remained constrained by weak supply capabilities and are unable to benefit from trade'.<sup>16</sup> However, the effects of the Uruguay Round have probably been over-hyped in Africa. The increase in the price of some food imports has been the major concern because food deficit countries have benefitted from the EU and American policies of subsidising domestic producers and then dumping the excess supply on the world market. However, the aggregate net deficit across the African continent for the food crops affected by changes in the Uruguay Round is relatively small, approximately US\$1.5 billion, and even the gross deficit is only US\$2.6 billion. The expected 5% increase in the price of food (8% for sugar) would only increase the import bill by, net, US\$100 million and only, gross, US\$200 million if the two winners (Ghana and Côte d'Ivoire) were excluded.<sup>17</sup> Moreover, given that imported food tends to be consumed by the relatively wealthy in the cities, the higher price for foreign grains and other products will have a positive effect on rural-urban terms of trade as peasant producers will be able to sell more of their crops at a higher price if they no longer have to face competition subsidised by European and American taxpayers.

Another fear has been the relative loss of preferences previously granted African countries because the Uruguay Round will reduce global tariff levels. Most African exports have long been tariff free because they were either raw materials or because many African countries received tariff concessions under the Lomé Convention. However, in part due to previous global rounds of tariff reductions, it is not commonly understood how little these preferences now matter. In the EU, Africa's biggest market, the overall preferences for most African countries is three percentage points or less compared to other developing countries. In the US market, African tariffs are higher and the preferences are lower. As a result, all African countries have a tariff advantage over other developing countries of 3% or less.<sup>13</sup>

In a static situation, the Uruguay Round has almost no overall effect on African countries. The losses noted above are largely eliminated, on balance, by gains, especially in the elimination or 'tariffication' of non-tariff barriers which affect some African manufactured exports, notably textiles. Rather, the real question is whether African countries will take advantage of the new opportunities available because of the expected increase in global trade. For instance, the net loss to Africa from price increases elsewhere is eliminated and the Uruguay Round actually will cause a substantial net gain for Africa if liberalisation is pursued aggressively.<sup>19</sup>

*The argument that Africa has weak supply capabilities and poor infrastructure and therefore cannot benefit from trade is a self-fulfilling prophecy but not a guide to policy action. Certainly, the immediate economic gains for African country of any policy initiative will be limited because of bottlenecks in the economy. However, a start has to be made somewhere and African countries will simply have to address the distortions in their economies if they are to develop. East and Southeast Asian countries which faced many severe bottlenecks in the 1950s and 1960s could also have argued that they would never benefit from trade but chose, instead, to address their domestic problems and managed to profit immensely from globalisation. Globalisation is, in fact, particularly important to Africa because, given the already high rate of growth in international trade, any significant increase in openness by an African country will be a significant prompt to overall performance.*

*Unfortunately, African countries, reflecting the ambiguities noted above, appear unwilling to take full advantage of the Uruguay Round. In particular, the Round allows developing countries a large amount of leeway in making binding international commitments to trade liberalisation that reinforce domestic, unilateral efforts at reform. Binding is a potentially useful instrument because it ostentatiously commits African countries to trade liberalisation and allows the*

WTO the ability to monitor how the reforms are progressing. However, overall, very few African countries bound tariffs at a level which will amount to any significant trade liberalisation in agriculture, trade or services.<sup>20</sup> The failure to use the Uruguay Round to make trade reform more credible is especially unfortunate, because it is now increasingly being recognised that to stabilise an economy and, eventually, to garner new investment, getting prices 'right' and even making fundamental reforms of institutions is not enough.<sup>21</sup> Entrepreneurs simply will not invest in response to price changes or tariff reductions done reluctantly on a one time basis because they often do not believe that the government is credibly committed to the reforms over the long-term so that they can recoup their investment. Rather, trade reform lacking credibility is particularly dangerous because there is the possibility that importers will use the trade liberalisation to make a quick profit by bringing in a large volume of relatively inexpensive imports quickly while entrepreneurs may not make the reforms necessary to export more because they do not believe the trade reform will last. As a result, incredible trade reform may bring about a balance of payment crisis and end the experiment in liberalisation.<sup>22</sup> The NGOs at the UNCTAD IX conference complained that the Uruguay Round was a 'legal device [to give] force on the international plane to the trade liberalisation programmes already adopted within the countries of Africa'.<sup>23</sup> However, far from this international reinforcement being a dangerous feature of the Uruguay Round for Africa, it was, in fact, an opportunity missed.

The long-term effect of the Uruguay Round on African countries will depend largely on the success of domestic reform. A robust international economy governed by increasingly transparent rules will be of tremendous benefit to developing countries in Africa, and elsewhere, that embrace globalisation and reform their economies accordingly. The new international trade regime will be possibly harmful, and, more probably, simply irrelevant, to those countries that do not reform. African NGOs apparently believe that it is impossible for their countries to change and have therefore opted for alarmist rhetoric. However, the reality is simply more nuanced and variable depending on the choices each country makes.

### *The Myth of Regional Trade Blocs*

A related fear of many in Africa is that the world is dividing into trade blocs - the EU, NAFTA, Asia - and that Africa will be further marginalised because it does not belong to any of these groupings. Indeed, regional trade has been growing quickly and the NAFTA and EU have received a significant amount of publicity. However, Africa probably has little to fear from these blocs. First,

the recent surge in regional trade can be misinterpreted. Much of it simply amounts to catch-up as the countries of Central Europe and Latin America begin to trade more with what should always been their natural trading partners (Western Europe and the United States, respectively), except their trade patterns were altered by the imposition of communism in Central Europe and decades of distorted economic policies in Latin America.

Indeed, even a superficial examination of the three trading blocs suggests that their immediate importance is overblown. The EU is by far the most advanced of all trade groupings. However, the pressure on the exchange rate mechanism that led to the devaluation of the pound and lira as well as the failure of almost all of the Community's members to come close to the Maastricht macro-economic targets suggests that the EU is much further away from integrating the twelve national economies than previously thought.

There are a host of indications that the EU economies will not be integrated soon. European managers have found that they cannot even institute continental information systems because national managers are unwilling to submit to regional control. In many cases, their subsidiaries will not provide them with data on customers, pricing, and product specifications, precisely the information needed to take advantage of economies of scale.<sup>24</sup> Similarly, much of the debate over Maastricht revolves around the fact that many Europeans do not want their economies and nations to become fully integrated in a regional bloc, much less under a stultifying bureaucracy based in Brussels. Finally, and most importantly, the divergence in interests among countries limits the degree to which Fortress Europe can be created. For instance, the tension between France and Germany over the Uruguay Round treaty came about because German industrialists, a dominant group in Bonn, did not have the same interests as French farmers.

Over the long-term, pressure on the part of the Central European countries for increasing rights to EU trade and perhaps, eventually, for membership will force the Union to become broader at the expense of depth. As the EU's numbers increase, it will have ever more difficulty devising a common strategy that might significantly isolate it from international trade.

The NAFTA is not the beginning of a regional trade bloc. The agreement signed by the US, Canada, and Mexico does not allow a common currency or the free movement of people, steps seemingly integral to a true trading bloc. Further, parts of the NAFTA, especially the clauses on 'import surges' during the long transition, look suspiciously like managed trade. The steps taken by Mexico during the 1980s to reform its own economy probably will be more

consequential than NAFTA in determining how much it actually exports to the US, although the trade agreement can play an important role in helping institutionalise the reforms. Also, Canada's and Mexico's share of the US market, at 19% and 7% respectively, are simply too small to impinge on imports from other countries in any meaningful manner.<sup>25</sup>

Former President George Bush's fleetingly stated view that NAFTA should serve as a building block for a hemispheric regional trade bloc has been *consigned to oblivion*. Indeed, the political capital that Canadian and US leaders had to expend just to get the current accord ratified suggests that prospects for including Chile or Argentina in an expanded regional grouping are limited for the time being. Further, the mechanism by which additional countries would be included in NAFTA is not detailed and their inclusion will undoubtedly prompt a long debate in the United States. The Clinton Administration does not appear to have the temperament or the ability to devote significant resources to the design of a much larger trade grouping.

Finally, there is no such thing as an Asian trading bloc. Asian countries are not geographically close enough for a trading bloc to make much sense. Nor do they have the security imperative (in the case of the Bonn-Paris axis) or sense of common destiny fostered by shared borders (US-Canada-Mexico) that prompt leaders to develop and adhere to regional agreements. While Asian countries will naturally trade more with each other as their economies continue to grow and old enmities break down, there is simply no evidence to date that they have either the desire or the ability to form a regional trade grouping. Indeed, the slow movement of China into the world trade agreement is probably the most significant institutionalised *opening* to world trade in the last decade or more.

This not to argue that African countries do not face significant barriers when trying to penetrate international markets. Protection at both the national level (notably non-tariff barriers) and increasing international collusion (symbolised by the US-Japan semiconductor agreement) is significant and there is certainly much greater competition than was faced by South Korea or Taiwan when they started their export drives in the 1960s. However, those Third World countries which get their domestic economies in order still can rely on export-led growth. Indonesia (166%), Malaysia (258%), and Thailand (180%), for example, all managed to increase their exports between 1988 and 1994 considerably faster than total world export growth (57%) because their domestic economies were sound and they aggressively sought out markets throughout the world.<sup>26</sup>

Indeed, for perspective, it is useful to compare the current dynamic international economy, even with the EU and NAFTA, to the Sterling area

established in Ottawa in 1932. Commonwealth countries had a common currency and collaborated closely by pooling dollars, gold and foreign exchange. They co-operated in discriminating against dollar products. Great Britain was seen as the most important source of development capital and London understood its obligation to provide such funds. Indeed, in the 1952 Commons debate on the Sterling area, many members of parliament advocated abrogating GATT because the trade agreement hindered closer co-operation among Commonwealth countries.<sup>27</sup> There is no chance of any of the current regional groupings ever becoming as cohesive and protectionist as the Sterling area because of the lucrative markets worldwide and the impossibility of ever duplicating that degree of monetary co-operation. In this context, the importance of today's regional trade blocs should once again be questioned.

### *Limited Promise of African Regional Integration*

Just as regional blocs pose little danger to Africa, regional integration within Africa will do little to help the continent in the short-term. Regional integration in most of Africa is not progressing because of domestic and regional instability or a lack of political will. However, the outbreak of peace in Southern Africa has caused many to be more optimistic about that subregion's economic prospects. Of course, the great hope of many is that South Africa, given its relatively large and sophisticated economy, will now become an economic catalyst for Southern Africa and perhaps the entire continent. President Nelson Mandela has encouraged this optimism. Writing in *Foreign Affairs* he argued that:<sup>28</sup>

Southern Africa commands a special priority in our foreign policy. We are inextricably part of southern Africa and our destiny is linked to that of a region, which is much more than a mere geographical concept. ... I share the view of many that the forging of closer economic relations can potentially be of great benefit both to a democratic South Africa and the rest of Southern Africa.

However, an examination of the Southern African political economy suggests that the transition in South Africa, through the medium-term, may have less of a positive impact than is commonly suggested even in that now peaceful and relatively cohesive region. The fundamental problem confronting Southern Africa at this time is that the regional economy is simply so small that South Africa in particular will benefit little from regional trade and the prospects for greater inter-regional trade is extremely limited. Over the last 25 years, the region as a whole performed poorly, with its share of the global economy decreasing from 0.76% in 1970 to 0.58% in 1993.<sup>29</sup> Southern African countries

will be far better served by reforming their economies to take advantage of the roughly 99.4% of the world economy that is outside their region. Indeed, there is so little economic activity in Southern Africa that significant efforts to promote trade within the region could quickly become counterproductive. It is true that there are approximately one hundred million people in the Southern African region, however, their extraordinarily low per capita income means that the effective market they represent is minuscule.

The value of greater regional trade is especially limited to South Africa. The region's total economic product without South Africa amounted to only 0.13% of the global economy in 1993.<sup>30</sup> The absolute size of the regional economy without South Africa is roughly equivalent to the economy of the Czech Republic or Romania. Hong Kong's economy alone is approximately three times *larger* than the regional economy excluding South Africa.<sup>31</sup> Indeed, the regional economy is even less attractive to South Africa than if it bordered Romania or the Czech Republic because the market, such that it is, is divided among ten countries.

Further, as in the rest of Africa, the nature of the region's economies limits the degree of regional integration. South Africa already accounts for between 33.3% and 40% of total imports in Malawi, Zambia and Zimbabwe and this figure is probably higher in neighbouring countries.<sup>32</sup> It is hard to believe that South Africa will be able to increase these market shares significantly, especially given that in all of the countries in the region imports of fuel, which South Africa cannot meet, probably account for a substantial portion of the import profile.

On the other hand, Malawi, Zambia, and Zimbabwe send a relatively low percentage of their exports (13%, 2%, and 17% respectively) to South Africa and figures are likely to be similar for other countries. The countries in the region have not been able to export more to South Africa because of a fundamental mismatch in their development profiles. As is typical for middle income countries, South Africa imports mainly capital goods and manufactured products. In 1992, machinery and transport equipment alone accounted for 40% of total imports while chemicals, manufactured goods, and miscellaneous manufactured goods accounted for another 22% of the total import bill.<sup>33</sup> On the other hand, the countries of the region are mainly exporting a few raw materials. South Africa simply does not need that much of Zambia's copper (79% of total exports), Malawi's tobacco (67% of total exports), or Zimbabwe's tobacco, gold, or ferro-alloys (48% of total exports).<sup>34</sup> What it does need in terms of basic raw materials it probably buys already, suggesting that the immediate scope for increased regional exports to South Africa will be mainly a function of economic growth rather than increasing market share.



Indeed, given the fundamental mismatch between South Africa's import profile and what the region is currently exporting, the critical question becomes whether Southern African countries, and those elsewhere on the continent, can transform their economies so that they are more than mere raw material producers and can actually make products that their neighbours will buy. Thus, prospects for increased inter-African trade, which would be a useful important component of any regional economic resurgence, hinge far less on regional integration *per se* than on the fate of domestic economic reform and the overall embrace of globalisation. Regional integration is not a substitute for globalisation but a logical complementary activity.

### ***Africa and Global Capital Markets***

Of the changes in the international political economy, none have been more revolutionary than the transformation of global capital markets. Certainly, the most dramatic illustration of the revolution in global finance has been the explosion in the worldwide foreign exchange market. It is estimated that turnover in the three largest markets (London, New York and Tokyo) increased three-fold just between 1987 and 1993, and now amounts to an astounding one trillion dollars a day. As a result, currency traders are now able to mobilise 'runs' on currencies of perhaps one hundred billion to two hundred billion dollars in a week, far more capital than any central bank has access to.<sup>35</sup>

The explosion in the foreign exchange markets is just the tip of the global financial revolution. Perhaps even more important are the huge increases in international portfolio investment due to financial liberalisation in a host of countries, the revolution in computer technology, and the concentration of savings in the hands of institutional investors (notably mutual funds and pension funds) in Europe and the United States. It is estimated that total gross cross-border equity holdings in the US, Europe, and Japan increased from US\$800 billion in 1986 to US\$1.3 trillion in 1991. Total cross-border ownership of tradeable securities is estimated to have risen to US\$2.5 trillion.<sup>36</sup> This figure will only increase in the future as stock markets, especially in developing countries, allow foreign participation and institutional investors in the industrialised world seek to further internationalise their portfolios in order to escape low domestic yields. For instance, the assets of the Fidelity Emerging Markets Fund increased from US\$15 million in February 1993 to US\$3.6 billion spread over three funds nine months later.<sup>37</sup>

Indeed, after the long capital drought caused by the debt crisis, more loans and equity investment are flowing back to the Third World. External bond offerings

for developing countries and Eastern Europe increased to US\$426.9 billion in 1994 from US\$229.9 billion in 1990 while syndicated credits increased from US\$124.5 billion to US\$202.8 billion.<sup>38</sup> A significant percentage of the total inflows from the international economy are going to a few developing countries such as South Korea, Indonesia, and Malaysia, that have managed their economies well and now offer lucrative opportunities to investors.<sup>39</sup>

The result of these changes in global financial markets has been a significant, and probably irreversible, change in the balance of power between markets and states worldwide. Some countries will benefit greatly from the opportunity to attract unprecedented inflows of portfolio and equity investment. However, those countries that are not performing well, much less their governments, will be ignored by international markets. It is therefore not surprising that Sub-Saharan Africa, the region with the poorest growth record, is now a net exporter of capital.<sup>40</sup> Further, it is increasingly easy for capital to flee countries perceived as not providing competitive opportunities for investment. The total stock of capital that has fled developing countries is roughly US\$700 billion. Latin America alone lost the equivalent of 30% of total GDP during the 1980s and the amount of African flight capital is estimated to be equivalent to 95% of continental GDP.<sup>41</sup> That money may return, as has happened in post-reform Argentina and Mexico, if countries adopt sensible economic policies, but will otherwise stay berthed in safe havens.

Even in the countries that have received record amounts of foreign investment, the nature of the flows has changed to make capital much more mobile at the expense of the state. First, more money is going directly to the private sector. Firms and individuals in developing countries received just 16% of external finance at the height of the debt crisis in the mid-1980s. The figure has now increased to 30% due, in part, to the wave of privatisation. The private sector's share of bond finance alone increased from 4% in 1989 to 47% in 1992.<sup>42</sup>

Also, the nature of FDI has changed. While countries always competed for foreign investment, it used to be that once the decision was made to invest, a government gained considerable leverage over the foreign firm. The classic case was mining where a company had to devote a tremendous amount of capital to (quite literally) sunk costs and therefore had no choice but to stay with that investment for decades, no matter what the policy of the government. Further, investors just had to go to certain countries where the minerals were. Now, proportionally, far less money is invested in fixed projects like mines and much more in services which can be rapidly moved to any country with an expanding economy. For instance, in 1975, petroleum and mining accounted for 31% of total US foreign investment while finance and insurance received only 12%. By

1992, petroleum (mining was no longer desegregated) accounted for only 11% of total foreign investment while insurance, banking, real estate and services broadly defined accounted for 35%.<sup>43</sup>

The political implications of the global financial revolution and its consequent shift in the power balance between investors and governments are manifold and will only be slowly understood. Certainly, the first is that the shift to greater export orientation, freer markets, privatisation, concern with government deficits and the general scepticism regarding the state as an economic actor that began with the election of Margaret Thatcher in 1979, is not simply an extreme movement of the pendulum but a more or less permanent fact of life. The international environment has simply become much more averse to countries that do not foster competitive economies. For instance, when Nelson Mandela stated, shortly after he was released from prison in February 1990, that he was still in favour of nationalisation of the banks and mines in South Africa, De Beers announced that it was moving part of its operations to Geneva. This dramatic example, and the gradual realisation that capital was under no obligation to stay in South Africa, has greatly contributed to the evolution of thinking in the ANC away from nationalisation and in favour of a dynamic private sector and fiscal discipline. However, the more generally ambiguous embrace of globalisation by African countries in the face of these profound changes means that Africa is increasingly behind the curve.

Another result of the financial revolution is what can be termed the global search for credibility. As with trade reform, it is not enough for a government to announce that it is going to liberalise policies, favour the private sector, or adopt conservative macro-economic policies. If investors and owners of firms do not believe that the government has made a credible commitment, they will not invest and will simply move their money to a more inviting climate. As a result, governments have sought to convince the private sector that they are serious about enacting good policies by stripping power from politicians who are potentially susceptible to populist pressures. The most widespread attempt at gaining credibility has been what Paul Volcker, in his Per Jacobsson lecture, has tentatively called 'the triumph of central banking'.<sup>44</sup> For instance, then Chancellor of the Exchequer Nigel Lawson, in his minute to then Prime Minister Margaret Thatcher arguing for an independent Bank of England, suggested that such a reform would 'enhance the market credibility of our anti-inflationary stance, both nationally and internationally'.<sup>45</sup> Similarly, countries as disparate as France, Chile and New Zealand are attempting to devolve more power to their central banks to convince markets that their future monetary policy will be based largely on a desire to preserve the value of the currency. Even the ANC, not noted for its previous allegiance to neo-classical precepts,

says that it is committed to the independence of the South African Reserve Bank.

However, relatively few other African countries have made notable changes in the relationship between their central banks and governments. Indeed, reforms such as central bank independence have not been high on the agenda of African countries or donors because immediate redress of macro-economic imbalances was an immediate priority followed by the requirement to begin institutional reform in areas such as health, education and industry given the pressing human needs. As a result, even the agenda in Africa is different to that in Latin America, where making countries attractive to international capital markets is at the top of the agenda.<sup>46</sup> Thus, once again, Africa has not made the domestic institutional changes necessary to take advantage, or even participate, in the global financial revolution.

Similarly, the IMF and the World Bank have signed restrictive conditionality agreements with poor countries, especially in Africa, for whom they are essentially lenders of last resort. These conditionality agreements, which on paper are more restrictive than those for loans given out by the Fund in earlier decades,<sup>47</sup> reflect the fact that poor countries have fewer and fewer options in the face of the increasing mobility of capital and that it is desirable for them to be able to show investors that they have a real incentive to follow pro-private sector policies. However, again, the conditionality agreements, in general, have not been embraced by African countries as a means of signalling their commitment to reform but are generally resented as infringements of sovereignty that have to be accepted grudgingly because the countries have no other choice. Indeed, African countries have, at the very best, a mixed record in meeting even the goals of price reform included in the conditionality agreements. As the World Bank concluded after reviewing Africa's reform experience:<sup>48</sup>

None of the countries in the region, however, has yet achieved a *good* macro-economic stance with a four-star rating across the board in fiscal, monetary, and exchange policies. ... Even in countries that have gone the furthest, the fiscal balance is fragile, inflation is above international levels, and the parallel market premium for foreign exchange has not been eliminated. . . It is worrisome that even the best performers do not come close to achieving the good macro-economic policies typified by Chile, Malaysia, Mexico and Thailand ...

While there have been some significant price reforms, institutional reforms (for example, privatisation and financial sector reform) in Africa have lagged behind because these changes, unlike devaluation, cannot simply be instituted by

administrative fiat overnight. Rather, institutional reform is often technically difficult, takes years, and requires the development of a pro-reform constituency to overcome the vested interests within and without government that benefit from the old way of doing business.

In addition, there has been relatively little work in Africa on developing a societal consensus on mechanisms (such as independent central banks or conditionality agreements) which seek to take power away from politicians because, unless there is a political culture that supports these institutional innovations, they will not be effective. For instance, Dr. Chris Stals, the Governor of the South African Reserve Bank, suggested to me that the debate over whether or not that central bank's independence should be enshrined in the new constitution was not that important because, 'A central bank can only be as independent as the government wants it to be'.<sup>49</sup> The Bundesbank's success over the last forty years is due not only to its statutory independence but also to the political culture in a Germany which, scarred by the hyperinflation of the 1920s, does not provide support for politicians who advocate a cheap money policy. Only when African countries have developed similar political climates will the work of reform be accomplished.

*A priori*, the global financial revolution is neither positive nor negative for Africa. The question, as with the Uruguay Round, is whether African countries can make the institutional reforms necessary to take advantage of the profound changes in capital markets. To date, the evidence suggests that African countries have been unable and unwilling to make the domestic institutional reforms necessary or even, in many cases, to engage in domestic debates that might result in profound changes in their political cultures. As a result, the global financial changes are likely to hurt Africa relatively because other countries in the developing world will make the necessary reforms (for example, with regard to central bank independence) that are necessary to benefit from the changes in capital markets. Indeed, those African countries that continue to perform poorly are likely to continue experience high rates of capital flight and a continued failure to attract new inflows.

### **International Challenges to the African State System**

An overly economic analysis of the relationship between Africa and the international political and economic system should be avoided. Indeed, recent changes in the global political economy have important implications for the continued viability of some African states. Of course, the notion that Africa was ever composed of sovereign states (classically defined as having a monopoly on

force in the territory within their boundaries) is false. Most colonial states had not made an effort to extend the administrative apparatus of government much beyond the capital city. As Robert H. Jackson has noted, 'In most cases they [the colonial governments] were little more than elementary bureaucracies with limited personnel and finances and were more comparable to rural country governments in Europe than to modern independent states'.<sup>50</sup> After independence, African countries did try to extend the administrative reach of the state but were always more focused on the urban populations. However, the effort to expand the state faltered due to the severe economic crisis that began in the late 1970s. As a result of the profound erosion of many governments' revenue bases, even the most basic agents of the state - agricultural extension agents, tax collectors, census takers - are no longer to be found in many rural areas. Even more importantly for discussions of sovereignty, some states are increasingly unable to exercise physical control over their countries.

However, despite the weakness of many African states' claims to sovereignty, the international community has supported the African state system since the continent was formally demarcated at the turn of the 20th Century. Indeed, even after their colonial empires expired, the great powers continued to uphold the African state system. The international community, encouraged by the large number of newly independent African countries in the UN General Assembly, elevated the norm of sovereignty to the extent that all boundaries, no matter how irrational they were in practice, were viewed as sacrosanct. In a revolutionary change, the international community granted sovereignty to a large number of countries emerging from colonialism despite the fact that as they were weak and it was unclear whether they could demonstrate control over their own territory.<sup>51</sup>

Also, the Cold War tended to uphold the African state system as even countries that were dysfunctional managed to receive large amounts of aid. From 1966 to 1988, Ethiopia, Kenya, Liberia, Somalia, Sudan, and Zaire, received the largest share of US aid to Africa.<sup>52</sup> Of the six countries, only Kenya cannot be considered an unmitigated disaster. The US continued to provide aid to Numeiri in Sudan, Doe in Liberia, Siad Barre in Somalia, and Mobutu in Zaire, among others, although it was obvious that none of these leaders were serious about reform because of security concerns. Indeed, in their review of aid allocation patterns, Ravi Gulhati and Raj Nallari found that political events had a major effect on US aid allocations in Eastern and Southern Africa in the 1970s and 1980s. Developments related to the Cold War, such as the 1980 Base Rights agreement with Kenya and the Somali switch out of the Soviet camp, greatly affected aid allocations. As a result, not surprisingly, US aid allocations were far less oriented towards development than those of West Germany or the

United Kingdom (although more development-oriented than French or Japanese aid).<sup>53</sup>

The end of the Cold War has enabled aid donors to reorient their assistance away from countries with some claims to strategic importance and towards those that are actually performing well.<sup>54</sup> Indeed, the *mantra* among aid donors with declining budgets is to be more selective and assist only those African countries that are serious about reform. At the same time, developed countries are most likely to engage in serious debt relief if an African country has demonstrated significant commitment to economic reform.<sup>55</sup> Otherwise, it is feared, the moral hazard problem is simply too great.

It is therefore not surprising that as donors redirect their aid from Cold War proxies to countries that are achieving some successes with their economic and political reform, those countries that are failing have experienced accelerated decline. Somalia entered its particularly sharp downward trajectory in part because it could no longer play the US off against the Soviet Union in order to receive more aid. Nor is it surprising that Africa's failed states include Liberia and Zaire who were Cold War favourites. William C. Thom, the US Defence Intelligence Officer for Africa, has summarised the cumulative effect of domestic and international changes on the forces of order in African countries:<sup>56</sup>

Most African state armies are in decline, beset by a combination of shrinking budgets, international pressures to downsize and demobilise, and the lack of the freely accessible military assistance that characterised the Cold War period. With few exceptions, heavy weapons lie dormant, equipment is in disrepair, and training is almost nonexistent. ... In short, the principal forces of order are in disorder in many countries at a time when the legitimacy of central governments (and indeed sometimes the state) is in doubt.

The decline in aid is not only a short-term problem. It represents a fundamental break with the practice of the last one hundred years which saw international actors offer support to the African state system, first through the creation of colonies, then by the enshrinement of sovereignty, and finally by the provision of financial resources without regard to domestic economic or political performance. In Charles Gesheker's words, the intravenous tube that has been vital to so many African countries is finally being removed. It is thus hardly surprising that so many African states have failed since the Berlin Wall fell.

Indeed, it should be clear that the trade and financial pressures generated by changes in the global economy reinforce the changes in aid donor policies. The Uruguay Round, the global capital markets, and now donor policy all favour those countries that are successful in making significant domestic reform.

Indeed, successful implementation of reform allows a country to enter a virtuous circle whereby significant trade liberalisation can be institutionalised by the Uruguay Round, monetary reform is rewarded by increased capital flows, and the country becomes a favourite of the donor community and thereby benefits from increased concessional aid flows and more debt relief. Those countries that are viewed as failing are irrelevant to the Uruguay Round, see even more of their capital flee, are cut off from international assistance and do not benefit from debt relief.

## **Conclusion**

One of the major trends in Africa over the first 35 years of independence has been the increasing heterogeneity of the continent. Countries that once had fairly similar economies have now diverged considerably.<sup>57</sup> The force of the economic and political changes noted in this chapter will be to further increase the diversity of Africa's economic experience. Some African countries will probably be able to institute the necessary domestic reforms so that they will be able to take advantage of new trade opportunities and the global premium placed on success by international capital markets and donors. Those countries that fail in making such reforms will probably see accelerated decline as inflows diminish and they are abandoned by donors. Thus, the effect of the new international political economy on Africa may be the same as it has been on many industrialised societies: the gap between the relatively affluent and the relatively poor will widen as those who can participate in the international economy are able to reap significant rewards.

However, Africa's increasing heterogeneity may, in the end, have a negative effect, even on the success stories. Poor performance in Africa is seldom contained within borders. Failure, as in the Horn of Africa, Central Africa or Mozambique, often causes hundreds of thousands of refugees to cross borders and destabilise neighbouring countries. In addition, political instability can spread like a contagion across a region in Africa. For instance, the coups in The Gambia and Sierra Leone were directly related to the war in Liberia and that conflict has also caused some instability in Côte d'Ivoire. Indeed, one of the lesser noted facts about the East Asian miracle is that so many of the successful countries were islands which were at least somewhat insulated from the ramifications of domestic failure elsewhere in the region (although their neighbourhoods were dangerous in other ways). Similarly, Mauritius has not had to worry about the failure of neighbours in its, to date, successful attempt at development. If aiding the poor performers is beyond the ability of the international community, helping contain the failure may be imperative if Africa's successes are to flourish.



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### The Role of the World Bank in Africa

*Edward Jaycox*

I would like to thank the organisers of this conference for the opportunity to exchange some views with you here in South Africa. I know that the World Bank shares with you the common overarching goal of improving people's quality of life and eliminating poverty. Our interaction, then, can only further our mutual understanding of the development problems facing Africa - which, as we all know, are many and complex. I myself hope to gain from it new insights into your government's efforts to deal with these problems, and I do not need to emphasise to you how crucial collaboration and co-ordination are for the success of such work.

In my remarks, I propose to discuss:

- \* The mission of the World Bank in Africa;
- \* The development opportunities and challenges Africa poses;
- \* The Bank's partnership with Africa; and,
- \* A development agenda for Africa as it prepares to enter the 21st Century.

#### **The World Bank's Mission in Africa**

The World Bank's overriding mission throughout the world is to reduce the incidence of poverty and alleviate its effects. Almost everything the Bank does in Africa is related to this mission - including its lending in support of structural and sectoral adjustment. For, difficult as it is to institute macro-economic policies that promote market activity, it is an absolute prerequisite for economic growth - and economic growth is the only known way to provide jobs and income for the poor on a scale sufficient to reduce poverty in a lasting way.

A growing economy, then, is necessary for poverty reduction. But high rates of growth alone are not enough. The kind of economic activities engaged in are as important as the rate of growth they bring, since to reduce poverty, rising productivity must be accompanied by the equitable distribution of resources. The Bank's strategy is therefore to promote activities that are efficient but also appropriately labour-intensive and which therefore generate jobs that provide revenue to the continent's least-advantaged citizens.

Examples of this strategy in action include:

- \* The Bank's attempts to boost the productivity of smallholder farmers, the largest segment of the African poor;
- \* The Bank's stress on the need for countries to establish a policy environment conducive to market activity and on such other economic boosters as technology creation and transfer, rural infrastructure, and natural resource management - all of which have a decisive impact on the productivity of the rural poor;
- \* The Bank's direct investment in people - such as its lending for education, health care, family planning and nutrition supplements - all aimed at improving living standards and increasing the poor's capacity to take advantage of new income opportunities in a growing economy;
- \* The Bank's efforts to support only such development as is environmentally sustainable and to help break the nexus of poverty, overpopulation, and overuse of the land that is threatening Africa's natural resource legacy; and,
- \* Finally, the Bank's strategy calls for targeting women and other groups that are particularly vulnerable, in order to enhance their role in Africa's economic development.

### **Development Opportunities and Challenges**

How do I, from my perspective as the former head of Bank operations in Sub-Saharan Africa, see Africa's development future?

I have been with Africa a long time, and before venturing to answer that question, would like to give you a brief summary of what I have seen and learned here - much of which will be more than familiar to you, but which is necessary to understand how my own ideas have evolved from there to here.

At independence, Africa's history looked a lot brighter than one could imagine given its subsequent history. Its mineral and agricultural resources were rich and in high demand throughout the world. It had virtually cornered the world market in cocoa, palm oil, coffee and tea. Its population was large and growing and seemed primed to become highly productive.

During the first decade of African independence, economic growth rates across the continent justified this early optimism. A number of economies grew at rates of 5-10%, out-performing those East Asian countries that would later become the so-called 'miracle' economies. Ghana's per capita income, for instance,

exceeded that of both South Korea and Portugal.

And Africa's leaders had plans. Seeking to industrialise their countries fast but lacking indigenous entrepreneurs, they formed state enterprises to bring in the new age and brought in foreign experts to run them. At the time all but a few in Western countries applauded this approach, which was then generally accepted as the best way to get the developmental ball rolling. In fact the guiding development theory of the day was that all Africa needed was an injection of resources to produce a momentum toward sustained growth that would be unstoppable. Africa enjoyed considerable confidence and goodwill around the world, and plenty of donors were willing to help.

But this was also a time when Sub-Saharan countries faced equally as many challenges as opportunities, many of which the development community chose to ignore. These challenges included:

- \* *Lack of infrastructure.* Africa's infrastructure at independence still reflected the needs of colonial economies. Road and rail systems were rudimentary, telecommunications were primitive, energy resources had not begun to be developed;
- \* *Lack of technology.* Africa lacked the plant, equipment, and technical know-how needed to run a modern economy;
- \* *Lack of trained workers.* The colonial powers had invested little in education. What education there was, moreover, tended to be unsuitable for an independent country, which needs to be able to train its own engineers, technicians, accountants, doctors, managers and skilled workers;
- \* *Lack of economic diversity.* As single crop (or single mineral) economies, African countries were particularly vulnerable to international price swings;
- \* *Lack of integration into the world market.* The international connections of newly independent countries were typically dominated by trade and other dealings with their former colonial rulers; and,
- \* *Lack of institutions.* Africa lacked the institutions needed to promote economic development. The educational system was particularly inadequate, but it also lacked qualified agencies to build roads and other infrastructure, provide effective agricultural extension, and so forth. Perhaps even more importantly, the citizenry mistrusted institutions run on the colonialist model, and a vicious circle of civic disillusionment arose. As state institutions showed little civic responsibility toward

citizens, citizens increasingly mistrusted, side-stepped or ignored the state.

The question at independence was whether or not African countries could overcome these tremendous problems to seize the opportunities so nearly in their grasp. It was a hopeful time, but I need not tell you - who have lived it - that they did not. Most of Africa fell into a ruinous pattern familiar to us all.

This pattern was not fore-ordained, however. What, then, were the choices and events that led to Africa's later economic woes? As I see it, the mistakes Africa made during the post-independence years went something like this:

- \* *Almost every country in Africa adopted economic policies that later proved disastrous.* Governments set up protectionist policies and other barriers to trade, overvalued exchange rates, spent far in excess of the revenues they took in, and nationalised and over-regulated private enterprises. Not surprisingly, trade took a dive - and with it, the income trade brings declined. (To give you some idea of what that has meant, the decline in Africa's share of total global exports from 3.1% in the mid-1950s to 1.2% in 1990 implies a loss of roughly US\$65 billion for the continent in 1990 alone.) Foreign investment also dried up, and with it, the transfer of capital, ideas, and technology - dooming Africa to the perpetuation of the single-product economy;
- \* *Africa's leaders discouraged the private sector,* both for ideological reasons and because they feared the opposition of a flourishing business community. In this repressive environment, few chose to take risks. Entrepreneurship died in the formal economy, and the government bureaucracy running and regulating state-owned businesses became increasingly inefficient;
- \* *Centralised governments created bloated state sectors,* vastly expanding the government apparatus and entering fields of production they had no idea how to manage. African countries began to spend half of their public revenues or more on the public wage bill for bureaucracies that are over-staffed and under-productive. Even today, quite a few African countries spend more shoring up failing state-run industries than on education and health combined.
- \* *As their economies began to slide into decline, Africa's governments took on huge amounts of debt.* At the end of 1995 - after three-and-a-half decades of irresponsible government borrowing - Africa's total debt was US\$223 billion, more than 80% of its 1994 GDP;



- \* *Lacking legitimacy, these governments slid into habits of poor governance - operating for self-interest and without such essentials as accountability, openness and transparency, predictability, tolerance for dissent and respect for the rule of law. Single-party states typically engaged in clientelism, cronyism and graft. Patronage and nepotism have produced a civil service that is inept and inefficient, with the net result that the public cannot respect the state, feels no call to pay its taxes and frequently does not obey its laws; and,*
- \* *Perhaps most damaging of all was the failure of Africa's governments to invest in building the capacity of its people and institutions. Investments in education were insufficient and not well targeted, so that the quality of primary and secondary schooling has consistently declined and access has become less equitable. As patronage replaced merit as the basis for advancement, Africa's institutional efficacy also declined, so that what we see today is a chronic dependence on foreigners, who are called in to do the jobs Africans should be doing themselves.*

I do not have to dwell on the result. By the late 1970s, many African economies were in a tailspin. And that is when the World Bank stepped in.

### **The World Bank's Partnership with Africa**

At about this time, the Bank launched its well-known early assessment of Africa's economic situation, *Accelerated Development in Sub-Saharan Africa* (1982, commonly known as the Berg Report), which identified many of the impediments to economic prosperity outlined above. Based on this analysis, the Bank began urging countries to reverse policies that were strangling competition in Africa and hastening its economic decline. To make the adjustment process less painful, the Bank also provided quick-disbursing balance of payments credits and loans.

Help was at hand, but it was not until the mid-1980s that African leaders finally began to admit that macro-economic reform was the only answer to their problems and turned to the World Bank. By that time economies throughout the continent were in an economic free-fall such as the Bank and the IMF had never seen. Whole countries had no goods on the shelves, no drugs in the clinics, and no chalk in the schools. Equipment lay idle for lack of spare parts. Consumption was at a virtual stand-still. Infrastructure was falling apart, and professionals were leaving in droves.

Based on its experience from around the world, the Bank urged countries that wanted to break out of this cycle to open their economies up to the free play of market forces, to work their comparative advantages, and to invest in ways that would increase productivity and exports. Countries also had to face the fact that to get the balances they needed to dampen inflation, they would have to cut government expenditures and put deflationary policies in place.

This - as you all know far better than I do - was a hard time. But the World Bank worked with Africa. Bank staff helped countries conduct economic research and analysis and drew on their 50 years of experience with development to offer advice. In addition, the Bank tried to make sure the reforms it promoted would be constructive by restricting its lending and making disbursement contingent upon the fulfilment of certain conditions.

During this transition period, then, the World Bank fulfilled three major roles:

- \* As a funding institution, the Bank began to increase its own lending for structural adjustment, which went from some US\$163 million in 1985 to a high of nearly US\$2 billion in 1992;
- \* As a development institution, it helped African countries to devise national policy strategies and programmes of institutional reform; and,
- \* As a leader within the international development community, it helped mobilise US\$69 billion in new money and debt relief to help Africa through the adjustment process.

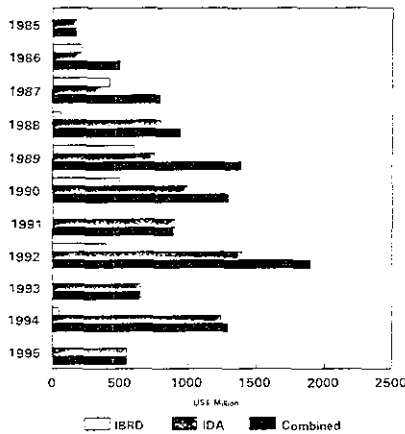
In the late 1980s the Bank collaborated with African nations, in consultation with donors, to define a strategic agenda for the continent's economic future as a whole. The results of these efforts were published in *Long Term Perspective Study of Sub-Saharan Africa* (1990), according to which, economic growth in Africa could best be spurred on by:

- \* Intensifying macro-economic policy reforms to maintain and strengthen the economic momentum they had already generated (See Figure 1);
- \* Increasing investment in human resource development (that is, in the areas of education, health, family planning, and bringing women fully into the development process) (See Figure 2);
- \* Boosting agricultural productivity by introducing technological innovation, reducing population growth, and protecting the environment - a strategy designed to reverse the cycle of increasing demand and stagnating productivity in agriculture that has led to severe environmental degradation (See Figure 3);

- \* Catalysing private sector activity in Africa, in part by mobilising investment support and, in part, by increasing lending in the areas of industry and finance (See Figure 4) and infrastructure and urban development (See Figure 5);
- \* Facilitating economic co-operation and integration within Africa to enlarge markets, achieve economies of scale, and improve efficiency as a first step toward integration into the world economy; and,
- \* Promoting debt relief and co-ordinating aid from the donor community.

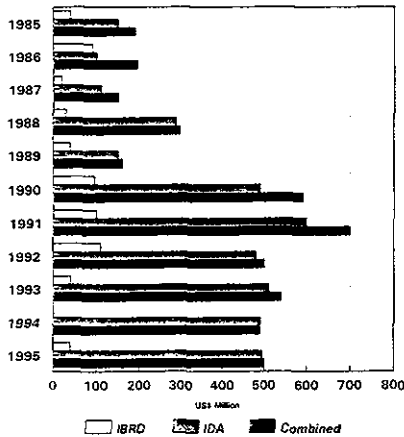
All of these are priority concerns, and we could discuss each one at length. But African countries have now recognised that to achieve economic development, their government institutions must operate openly and responsibly and be capable of carrying out reforms. *The strategic agenda therefore identified good governance and capacity building as the two main pillars of African development.*

**Figure 1: World Bank Adjustment Lending, 1985-95**



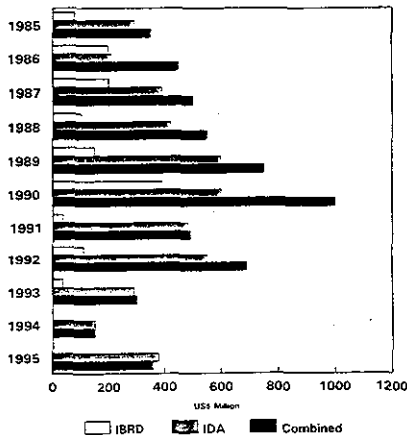
Source : World Bank Database

**Figure 2: World Bank Lending for Human Resources, 1985-95**



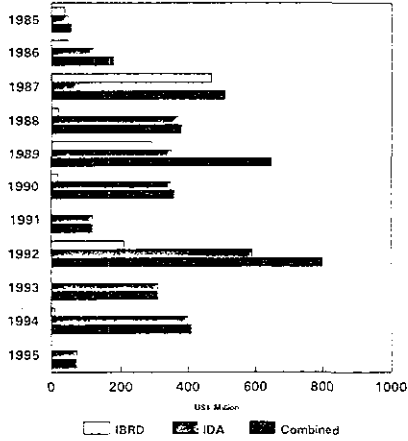
Note : Lending totals include adjustment and investment lending.  
 Source : World Bank Database

**Figure 3: World Bank Lending for Agriculture, 1985-95**



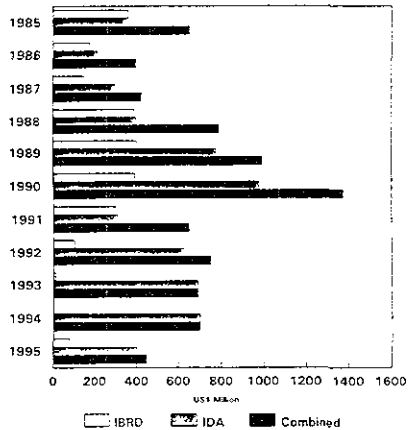
Note : Lending totals include adjustment and investment lending.  
 Source : World Bank Database

**Figure 4: World Bank Lending for Industry & Finance, 1985-95**



Note : Lending totals include adjustment and investment lending.  
 Source : World Bank Database

**Figure 5: World Bank Lending for Infrastructure and Urban Development, 1985-95**



Note : Lending totals include adjustment and investment lending.  
 Source : World Bank Database

## ***Good Governance***

The World Bank defines *good governance* as 'the exercise of political authority and control over a society and the efficient management of its resources for development'. As used here, governance refers to the proper exercise of political power free of self-interest and corruption - which the Bank considers to be essential for development.

The main elements of good governance are:

- \* *Accountability*. Holding government officials, both political leaders and civil servants, accountable for the disposition of public funds, providing a safe and secure environment, and pursuing the economic well-being of society with equity and disinterest;
- \* *Transparency*. Keeping government procedures, processes, investment decisions, contracts, and appointments open to public scrutiny;
- \* *Predictability*. Requiring government agents to follow the law rather than to act according to political or personal whim, particularly with regard to economic and investment transactions;
- \* *Openness*. Requiring government to supply the public with reliable economic and social data. The press, for example, needs full access to social and economic data pertaining to the well-being of society, and the business community needs to know national economic strategies and regulations; and,
- \* *Rule of law*. Making sure that rules and regulations are broadly understood and enforcing the law's sovereignty over both government officials and the general public.

It is critical to development that governments go beyond rhetoric and apply the principles of good governance. As it stands in Africa today, public scepticism about government intentions is a major impediment to policy reform. Only governments that act openly and responsibly can regain the confidence of the African people, whose co-operation with reforms is essential to their success.

## ***Capacity Building***

'Capacity' is the combination of human and institutional resources that permits countries to achieve their development goals and individuals to achieve the objectives they set for themselves. East Asia's 'miracle' economies, for instance, were built with heavy investment in human capital and the

development of a competent and highly motivated civil service. By contrast, countries lacking in capacity must rely on foreign expertise and resources to perform development tasks.

For these reasons, building capacity should be a core goal of any development strategy. In Africa, both governments and donors must make sure that the course of action they recommend leads to an increase in the continent's store of capacity. Working together, Africa and the World Bank have lately given a great deal of thought to the question of how this can best be done.

*One habit that has to be broken is African governments' reliance on expatriate technical advisers to analyse budgets and policy and to plan and implement economic activities. The Bank can help bring this about by not providing technical assistance to governments at no charge and by providing incentives to use local personnel.*

One of the Bank's first independent efforts to address this problem was its creation of the *African Capacity Building Foundation* based in Harare, Zimbabwe, to help African countries identify their individual capacity needs and improve the quality of their policy analysis and development management. But given the Foundation's narrow focus and the poor track record of the few efforts to build capacity in Africa sponsored by the Bank in the past, clearly more had to be done.

For this reason, when a delegation of African Finance Ministers approached the President of the Bank, Mr. James D. Wolfensohn, last Fall with a proposal to establish a *Partnership for Capacity Building in Africa*, he jumped at the chance. As of February 1996, the Bank and Africa have been engaged in a joint effort to devise national capacity building plans, which will delimit each country's capacity deficit and set in motion measures needed to address it.

For its part, the development community has pledged to reduce its own use of technical assistance in Africa and to gear its projects to train African nationals - particularly in management positions - both in the classroom and on the job. Donors and the Bank are also striving to think not only in terms of supply - that is, of what they can contribute - but also in terms of demand - that is, of how they can use (and encourage African governments to use) the indigenous capabilities at hand.

## ***Economic Reforms and the Poor***

Today, the policy reform effort first suggested for Africa by the World Bank in the late 1970s has gained widespread acceptance. Of sub-Saharan Africa's 48 countries, 28 have policy adjustment programmes in place. And the net result of these reforms can already be seen in the continent's revitalised economies - 30 of which achieved more than 3% GDP growth in 1995.

By this time everyone knows that policy adjustment is necessary and that it entails a certain amount of hardship. Some absolutely essential but difficult measures - such as reducing subsidies on food - almost inevitably produce heated opposition throughout the population, making it difficult for politicians to continue with their reform plans.

But there is also now no doubt that such reforms, if well implemented, stimulate economic growth and eventually benefit the poor. Even in the short-run the rural poor - who account for 80-90% of Africa's least well-off segment - have already benefitted from reforms. Freeing food prices, for instance, led to higher rural employment and greater food production in Burkina Faso, Ghana, Guinea, Mali and (before recent events) Nigeria. And because farmers tend to consume their own produce rather than to buy food, the higher prices did not unduly affect them. Then in the fiscal year of 1995, when prices for African agricultural exports reached record highs on the world market, per capita GDP in Africa rose - for the first time in many years - nearly 1%.

This is not to forget those poor Africans who live in cities - the 4-20% of the continent's poor who suffered badly from the rise in food prices. Yet even in urban areas, adjustment does not appear to have been the major culprit fuelling this rise. Studies show that even *before adjustment* food prices had already risen to higher prices on the parallel market, so that in fact food was available at the official, subsidised price only to such privileged groups as the civil service and army. In the medium to long term, moreover, the accelerated growth sparked by adjustment will benefit the urban poor - it is no accident that in Ghana, which has stuck to a strict reform schedule, urban wages have begun to recover.

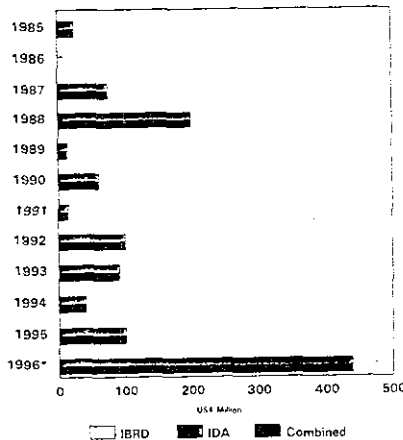
Today, with many of the worst policy-induced distortions corrected, a number of African countries are now able to turn their attention to the second stage of adjustment - sector reform and the mobilisation of investment for the private sector. In these countries the focus of reform has shifted away from liberalising exchange rates, prices and trade policy to:

\* reforming budgetary spending and revenue collection;



- \* privatising publicly owned and run services where it is possible, improving their management where it is not (See Figure 6);
- \* transforming the incentive and regulatory regimes affecting private economic activity; and,
- \* establishing solid social services, particularly in education and health, to build human capital.

**Figure 6: World Bank Lending for Public Sector Management 1985-95**



Note : Lending totals include adjustment and investment lending.

Source : World Bank Database

Would Africa have been better off without adjustment? Look at Ghana, Tanzania and Uganda - countries that, ten years ago, showed just how bad things could get where exports and food production for market are discouraged, and imports are rationed, and the poor must suffer through years of economic decline. Yet today just a few years after adjustment - the economies of all three countries, despite high population growth rates, are on the rise (See Figure 7 below).

Figure 7: Selected Economic Indicators\*

	GDP Growth (%)			Export Growth (%)			Import Growth (%)		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Benin	4.0	6.1	4.9	15.6	0.1	13.1	8.9	38.9	2.8
Burkina Faso	3.9	4.5	3.6	0.7	8.6	10.0	-0.9	15.7	7.9
Burundi	0.6	-3.7	-2.3	1.0	2.2	-3.4	11.5	-8.9	-1.9
Cameroon	-4.6	3.3	0.9	-2.9	3.0	4.7	-4.1	10.2	2.8
Central African Republic	-2.1	2.9	5.0	0.6	-2.0	9.8	-13.1	12.5	6.3
Chad	-0.5	5.5	5.3	-0.2	26.2	8.7	-4.3	25.5	2.8
Comoros	1.7	0.6	0.8	25.5	1.0	3.4	-2.1	10.0	0.2
Congo	1.2	0.9	0.1	2.0	22.4	11.3	5.4	-13.2	-17.4
Côte d'Ivoire	-0.1	7.1	5.1	-6.2	12.2	7.9	1.8	29.6	9.3
Equatorial Guinea	6.3	11.2	11.2	18.5	...	...	6.7	...	...
Eritrea	-2.5	6.0	7.3	...	...	...	...	...	...
Ethiopia	0.7	4.9	4.3	4.4	10.4	20.4	4.5	11.3	2.5
Ghana	4.7	4.5	4.4	9.7	3.4	7.0	11.2	1.3	1.4
Guinea	3.4	4.6	4.4	2.7	7.8	3.4	1.3	7.2	1.0
Guinea-Bissau	2.8	4.3	4.4	-1.2	-23.2	38.3	-3.6	-2.3	-3.2
Kenya	0.3	5.0	4.6	0.7	8.9	3.3	-5.7	7.5	11.3
Madagascar	-1.0	2.0	1.5	3.5	6.8	6.1	0.2	6.5	4.5
Malawi	2.8	9.9	3.4	-0.9	7.1	9.8	1.6	-7.8	-10.5
Mali	1.7	6.0	4.1	6.2	19.8	6.5	0.6	16.1	2.3

**Figure 7: Selected Economic Indicators (continued)**

	GDP Growth (%)			Export Growth (%)			Import Growth (%)		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Mauritania	3.3	4.6	4.6	-1.2	25.7	3.3	-3.5	2.7	-3.1
Mozambique	7.8	3.0	4.0	9.9	16.0	11.3	1.5	-18.1	-6.2
Niger	-0.9	3.2	3.8	-5.3	3.0	0.7	-6.1	5.0	1.2
Rwanda	-1.9	25.0	-4.7	-5.9	96.5	30.8	3.8	17.6	48.0
São Tomé & Príncipe	1.5	2.0	2.1	6.6	-33.1	-18.9	-1.0	2.5	6.7
Senegal	0.0	4.5	3.6	-2.9	9.1	5.6	-0.8	7.1	1.0
Sierra Leone	-0.3	-2.6	-2.3	9.5	-37.7	-20.6	6.3	-13.0	-1.1
Tanzania	3.0	4.0	3.9	4.9	5.2	7.7	-0.3	-0.8	7.3
Togo	-7.6	8.3	9.7	-13.6	4.9	1.7	-16.4	22.7	5.2
Uganda	6.3	10.6	7.8	1.7	19.9	9.9	-3.1	42.8	23.1
Zambia	1.3	-3.9	0.4	16.9	-6.2	1.4	3.0	16.1	5.3
Average (weighted)	2.8	7.0	5.1	-1.5	12.1	6.8	-1.8	24.5	12.5
Average (unweighted)	1.2	4.8	3.5	3.5	7.8	6.9	0.1	8.7	3.9
Median	1.3	4.5	4.1	1.7	7.0	6.7	0.2	7.4	2.6

Note: Weighted averages are obtained by converting the individual country constant local currency series into US dollars at 1987 average exchange rates and then taking the percent change of the resulting aggregate total.

Figure 7: Selected Economic Indicators (continued)

	Savings Rate (as % of GDP)			Investment Rate (as % of GDP)			Private Investment (as % of GDP)		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Benin	5.1	11.3	11.2	14.4	21.6	18.3	9.1	6.7	7.3
Burkina Faso	6.4	6.9	7.1	20.5	22.8	22.9	12.4	16.0	15.5
Burundi	-3.2	-7.1	-8.5	16.6	11.0	11.0	2.9	1.3	1.5
Cameroon	16.0	22.0	20.9	15.3	15.5	15.3	12.4	14.5	14.0
Central African Republic	1.8	7.6	8.4	10.8	14.6	14.2	2.8	6.8	6.6
Chad	-11.1	-3.4	-3.9	8.9	15.4	15.5	0.6	1.4	1.7
Comoros	-0.7	3.3	4.5	16.4	21.5	21.6	8.0	13.7	12.5
Congo	20.1	30.0	27.9	20.4	29.3	35.9	18.2	26.2	32.9
Côte d'Ivoire	9.7	23.1	22.9	8.3	12.5	12.8	4.7	7.7	8.3
Equatorial Guinea	-1.4	...	...	30.9	...	...	...	...	...
Eritrea	-5.9	-16.4	-15.1	11.8	20.5	20.0	1.0	8.6	8.9
Ethiopia	2.2	6.6	6.3	9.7	15.6	16.5	5.1	8.7	8.8
Ghana	2.9	10.1	7.0	14.5	18.6	17.1	5.8	5.4	5.3
Guinea	5.9	6.2	6.1	16.4	14.8	14.6	8.9	8.3	8.0
Guinea-Bissau	-6.4	1.1	2.0	29.6	24.9	23.2	2.9	7.1	6.0
Kenya	19.7	21.7	23.1	19.0	22.9	22.2	10.1	14.5	13.1
Madagascar	1.4	3.2	3.2	10.3	11.6	11.7	4.0	5.5	4.9
Malawi	2.1	4.1	4.2	17.0	15.8	15.0	12.1	9.4	8.7

**Figure 7: Selected Economic Indicators (continued)**

	Savings Rate (as % of GDP)			Investment Rate (as % of GDP)			Private Investment (as % of GDP)		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Mali	6.1	8.2	8.2	22.2	26.0	26.2	11.9	13.5	13.7
Mauritania	9.0	11.1	11.6	20.6	14.5	16.3	15.5	9.1	10.7
Mozambique	2.9	17.5	14.2	53.8	53.9	54.4	32.2	32.7	32.8
Niger	3.3	2.1	2.3	6.8	7.5	10.1	1.9	1.8	3.0
Rwanda	-6.5	-1.0	0.3	13.9	15.0	12.9	7.7	8.0	5.3
São Tomé & Príncipe	-16.4	-24.0	-22.5	41.7	53.1	52.8	16.7	16.9	17.5
Senegal	7.7	11.0	10.7	13.2	15.6	15.4	8.9	10.8	10.6
Sierra Leone	9.1	-0.7	-0.9	10.9	7.2	7.9	5.8	3.6	4.2
Tanzania	4.7	4.7	4.5	32.8	31.0	31.1	20.1	22.9	21.8
Togo	2.5	8.5	8.8	10.9	13.6	13.6	10.4	7.8	7.7
Uganda	0.3	6.5	4.3	15.3	14.0	15.2	8.6	8.8	9.9
Zambia	10.1	2.9	2.9	11.1	11.7	10.2	5.1	8.2	6.5
Average	3.2	6.1	5.9	18.1	19.7	19.8	9.2	10.6	10.6
Median	2.9	6.5	6.1	15.3	15.6	15.5	8.6	8.6	8.7

Figure 7: Selected Economic Indicators (continued)

	Agriculture Value Added Growth (%)			Consumption Per Capita Growth (%)			Government Revenue, excl Grants (as % of GDP)			Reserves (in months of imports)*		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Benin	4.6	8.0	6.9	...	...	...	12.2	13.8	13.0	4.0	6.4	7.1
Burkina Faso	7.7	4.1	2.9	1.2	3.0	-0.3	12.5	11.6	11.6	4.9	7.6	6.8
Burundi	-0.7	-5.2	-2.6	-1.4	-10.8	-2.7	22.8	22.1	19.2	6.0	7.9	7.5
Cameroon	-0.8	4.0	1.7	-7.3	1.4	-4.0	15.3	11.9	12.0	0.2	0.1	0.3
Central African Republic	0.2	0.9	2.9	-6.7	-1.4	-0.4	9.3	9.2	8.7	3.7	7.2	7.8
Chad	9.1	5.7	7.9	-1.6	4.9	0.5	9.2	9.0	8.7	2.1	2.7	3.0
Comoros	0.5	1.5	1.7	-3.2	-5.4	-5.7	15.2	12.5	12.8	4.3	5.4	6.0
Congo	-3.5	2.3	2.4	-1.2	41.3	-9.6	24.0	24.8	25.5	0.1	0.2	0.4
Côte d'Ivoire	-1.8	5.5	4.4	-3.2	3.9	-0.3	17.1	22.3	21.7	0.1	1.4	1.3
Equatorial Guinea	-3.5	...	...	-0.5	...	...	20.9	...	...	0.8	2.7	3.1
Eritrea	...	...	...	...	...	...	30.0	32.2	32.6	1.8	5.5	5.3
Ethiopia	1.5	4.0	0.7	-5.0	1.0	2.1	12.1	18.4	16.2	2.4	5.7	5.6
Ghana	2.3	4.2	3.5	2.4	-0.7	0.7	13.8	-3.6	5.6	3.2	4.1	3.8
Guinea	4.1	5.0	5.0	0.7	-0.3	0.3	13.2	11.0	11.4	1.9	2.2	2.1
Guinea-Bissau	4.2	7.4	5.8	-0.8	0.3	2.5	11.9	12.5	12.7	1.5	2.1	2.3
Kenya	-2.4	5.9	4.3	-2.9	0.0	2.7	28.6	35.7	33.7	1.3	1.6	2.1
Madagascar	1.8	2.7	1.5	-2.5	-1.2	-1.3	9.3	8.3	8.3	1.2	1.6	1.2

**Figure 7: Selected Economic Indicators (continued)**

	Agriculture Value Added Growth (%)			Consumption Per Capita Growth (%)			Government Revenue, excl. Grants (as % of GDP)			Reserves (in months of imports)*		
	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96	1991-93	1995	1994-96
Malawi	13.6	28.3	6.4	2.7	3.3	-5.2	18.5	18.1	17.0	2.3	2.0	1.9
Mali	0.5	8.5	5.4	-2.2	3.9	-1.7	14.4	14.4	13.9	4.4	3.8	3.9
Mauritania	5.2	5.0	4.4	-2.2	-5.2	1.5	22.5	24.0	24.1	1.1	1.7	1.9
Mozambique	2.0	5.4	...	-1.2	-7.3	-2.2	40.0	33.3	34.4	3.3	4.8	4.7
Niger	-3.4	1.7	5.2	-2.1	0.9	-1.1	8.0	7.5	7.4	5.7	5.6	5.5
Rwanda	-1.7	17.9	-6.3	-4.3	32.8	16.2	12.6	5.9	6.1	2.5	3.5	2.4
São Tomé & Príncipe	...	...	...	-3.0	35.4	11.6	18.5	16.5	15.1	3.6	2.3	2.4
Senegal	-2.1	1.8	6.5	-1.8	-2.9	-1.7	17.9	15.3	14.9	0.1	0.4	0.6
Sierra Leone	-1.2	...	...	-2.2	0.3	-1.4	12.7	11.1	11.9	0.5	1.1	1.1
Tanzania	6.6	4.0	3.8	...	...	...	15.2	14.5	14.0	1.9	1.4	1.4
Togo	3.3	5.5	-1.1	-2.6	6.2	0.5	15.0	14.7	14.6	5.1	4.4	4.6
Uganda	3.7	6.0	4.0	1.3	10.9	7.3	7.2	9.9	9.6	1.3	3.2	3.4
Zambia	17.2	-13.2	-6.0	-1.0	-3.0	-0.1	17.2	16.9	16.7	1.5	1.3	1.8
Average	2.4	4.9	2.9	-1.9	4.3	0.3	16.6	15.6	15.6	2.4	3.3	3.4
Median	1.7	4.6	3.8	-2.1	0.6	-0.3	15.1	14.4	13.9	2.0	2.7	2.7

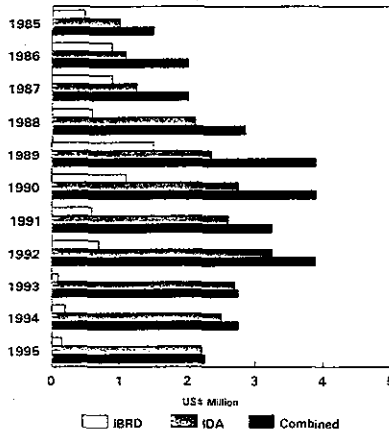
\* Import of goods and services

Note: Ethiopia, Malawi and Zambia were affected by drought in 1994, and Rwanda was affected by civil war in 1994.

### Resource Mobilisation and Aid Co-ordination

In addition to its own lending (See Figure 8), the World Bank has been instrumental in making sure that a good portion of the world's development resources are directed toward Africa. But in order to attract more aid and investment from abroad, the continent must be able to demonstrate that it knows how to use it efficiently to produce tangible results. To enhance their performance, Africa's countries must deepen their policy reforms, build capacity within the civil service, and operate according to the principles of good governance. The Bank's initiatives to help African countries help themselves therefore also serve the dual purpose of helping them to attract external aid.

Figure 8: Total World Bank Lending to Africa, 1985-95



Source: World Bank Database

What else has the Bank done to help Africa get the resources it needs?

In 1987 - coming to the aid of highly indebted countries undertaking structural reform - the World Bank and 18 donor agencies came up with the *Special Programme of Assistance for Africa (SPA)*. In its nine years of existence, the SPA has helped many African countries to weather the adjustment process by providing a mixture of debt service relief, low-interest loans and grants for balance of payments support. *By the end of 1996, the SPA will have mobilised*



*more than US\$69 billion in quick-disbursing new money and debt relief* for this purpose. The Bank also sought to promote greater spending on programmes that directly benefited the poor and those hurt by the adjustment programme by making disbursement of a third of its 1989-90 adjustment lending conditional on social sector spending. This percentage was up sharply from the 7% made contingent in the early 1980s, showing the Bank's new emphasis on establishing basic services and a social safety net to help the poor (See Figure 8).

In addition to the regular aid co-ordination work of its Resident Missions in Africa and the ongoing dialogue promoted in its Consultative Groups, the Bank has also been a catalyst and supporter of such international efforts as the successful fight to eradicate onchocerciasis.

Finally, Mr. Wolfensohn has initiated negotiations with the IMF and the donor community regarding debt relief for Africa.

### **Development Agenda for Africa in the 21st Century**

Much of the Bank's activity in Africa will continue in the future. But having been through these exacting experiences with our African partners, the Bank has internalised the hard lessons we all have learned together and is determined to conduct its operations differently in light of these lessons.

Poverty reduction remains the overarching goal, but to achieve this, the Bank will increase its efforts to:

- \* *Make its projects client-centred.* The Bank will emphasise its funding projects generated by the client country but will continue to assist with the identification, preparation, design, monitoring and evaluation of projects as requested. The Bank will promote the increasing involvement in development projects of civil society, beneficiaries, donors and other stakeholders outside the circle of traditional government contacts;
- \* *Be selective.* With less money available for development aid and evidence that certain projects have been less than beneficial, the Bank will be increasingly selective in choosing projects to support (See Figure 8). It will not fund projects where government commitment is thin and will weigh proposed projects against the country's demonstrated ability to use aid resources to good effect;
- \* *Encourage the establishment of a market-friendly environment.* In addition to supporting direct efforts to encourage private sector development, the Bank will seek to establish the economic stability, liberal policies and good governance practices that make up a market-friendly environment;

- \* *Build African capacity.* Recognising that Africans need both individuals and institutions competent to run the country and carry out development programmes, the Bank will no longer use foreign technical assistance to do work Africans can do. The Bank has also entered into a partnership with African countries to mount a massive international effort to identify Africa's capacity resources and needs and what has to be done to shrink the capacity deficit. For its part, the World Bank will include measures *to utilise existing capacity and to build capacity in every study it conducts and every project it funds;*
- \* *Promote the principles of good governance.* While the Bank cannot ensure that governments will respect rule of law and act responsibly, it can refuse to lend to those that don't. The sincere attempt to operate according to the principles of good governance should therefore be a prerequisite for future Bank lending;
- \* *Co-ordinate donor efforts.* One of the Bank's most effective roles in the past has been as a co-ordinator of international development efforts and a mobiliser of funds. To avoid scattershot funding and duplication of effort, the Bank should help countries to develop strategic national development plans and to involve a variety of stakeholders at all stages of the development process;
- \* *Invest in human capital.* The Bank recognises that human capital is needed to make economies productive and that an investment in people is likely to earn high returns. The Bank favours an integrated approach to human resource development, which will include slowing population growth; increasing investment in and reforming primary health care, nutrition, and education services; and better management of social programmes; and,
- \* *Protect the environment and promote development that is environmentally sustainable.* The Bank should not support development which local conditions cannot sustain and should work to break the fatal chain of events where rapidly increasing populations put pressure on weak agricultural production or inadequate city services, so that populations are forced to ravage the environment to live.

## **Conclusion**

For all the very real crises in African development, there are considerable grounds for hope:

- \* There has been a marked shift in the ideological climate since the 1970s

and 1980s, and particularly since the end of the Cold War. There is very little left of the old ideological disputes that prevented international collaboration for development.

- \* Also in connection with the end of the Cold War, it is no longer possible for corrupt or ineffective leaders to hide behind the protection of one or another world power. The African people are taking charge of their governments. Fed up with past failures in leadership, they are demanding change. A full-fledged political transition is underway. It may proceed in fits and starts, but is, however, irreversible.
- \* A new generation of leaders is emerging in Africa that is committed to the practice of good governance, and is dedicated to achieving substantive economic reform.
- \* African countries that have undertaken reforms and stayed with them are showing clear signs of improvement. This is indisputable and encouraging. Progress is real, but fragile and much more must be done. That is why the fourth phase of SPA has been unanimously supported by the donor community and African leaders.
- \* The World Bank is a genuine partner in Africa's development effort. The Bank:
  - \* has increasingly promoted social investments to create a safety net and increase opportunities for the poor;
  - \* has helped turn the spotlight on good governance and the building of human and institutional capacity as the bedrock essentials required for economic growth; and,
  - \* is even now in the process of discussing with donor agencies the problem of Africa's massive debt.

*The new challenge for Africa is to build its own economic capacities and become fully integrated into the world market. The World Bank, too, is revamping its own practice in Africa to enable it to respond effectively to Africa's needs defined by its own people.*

Today, perhaps for the first time in history, your economic future is wide-open, and the World Bank is ready to help with advice, lending, and co-ordination. Starting from so far behind, Africa's task is not easy. But I am convinced that *Africa will make it.*

## 6.2

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### Response

*Maria Ramos*

Mr. Jaycox has set out the issues very comprehensively. It occurred to me when I read the paper that the one theme that comes across time and time again, is the issue of *capacity*. Whether we are talking about the time just after liberation and independence in many of the African countries; whether we are talking about the period in the 1970s; whether we are talking about the period in the 1980s; or even the current period as African countries, and particularly countries in Southern Africa, grapple with the challenges that lie ahead - the one issue that we are always confronted with is the issue of capacity. It is an issue which exists at a multiplicity of levels, but it seems to me that the one area of capacity that is either misinterpreted or not taken into consideration in the policy packages that have been advocated over time for so many countries who have had to approach either the IMF or the World Bank during crises, is the issue of *institutional capacity*.

I will deal with the issue of institutional capacity first, because policies have sometimes failed for this reason. Countries which have adopted a specific stance to a set of needs have not taken into consideration their own institutional frameworks and arrangements. Also the World Bank's and the IMF's - the Bretton Woods institutions - policy responses have not taken on board the institutional capacities and configurations of the individual countries concerned. So many policy prescriptions, where the issues of liberalisation - whether of the exchange rate, or the exchange control, of markets - have been part-and-parcel of the policy prescription, or the medication that the patient has to take (I know that Mr. Jaycox does not like the idea of a generic policy response or medicine). And sometimes, even in the 1990s, some of the difficulties faced by many of the countries that have to deal with social adjustment programmes, are rooted in the fact that there is no point - to my mind at least - of advocating liberalisation of markets if those markets do not even exist. You need to have something that you are going to liberalise first. The fact that market liberalisation is prescribed, means that the sustainability of the treatment then comes into question. The history and, certainly, the challenges that we face demonstrate that some of those issues still need to be tackled. It does concern me that in some cases where Structural Adjustment Programmes seem to be yielding results, that we may forget to ask how sustainable those results are and, at the same time as the medicine is being taken, whether or not we are building sufficient institutional capacity to ensure that the problems that we have had to deal with in the past do not recur in a few years time.

I think the countries themselves see - and certainly what we see in SADC and what we see when we attend African Development Bank meetings - is the recognition by countries in Africa, by ourselves, that a lot of the responsibility for what has gone wrong and for the challenges that lie ahead, needs to reside with the countries concerned. It needs to reside with *us*. Governments need to take responsibility for their own destinies. That is the difference - there has been a shift in emphasis. That shift in emphasis is reflected in more careful attention being paid to the importance of macro balances, to the understanding that sometimes what seems to be the correct policy response is simply not sustainable - and lack of sustainability is what has driven many countries to approach Bretton Woods institutions at the time when there is no possibility of a real partnership. I do not think that you go to the World Bank or the IMF, and negotiate from a position of power when you are in desperate need for foreign exchange or financial support. If you are the patient, you are automatically in a position where there is no equivalent power. That lack of equivalence of power has resulted in policies and sometimes policy prescriptions on the part of the World Bank which have not been suited for the conditions and for the problems that the patient was facing.

That is, for me, an important point to note as the World Bank reviews its own position and looks for a partnership with Africa. That partnership has to come out of a mutual respect and an understanding that both partners should make an equal or equivalent contribution to and sets of demands from, the partnership that is being considered. What we also need to see is countries moving away from the position where they are the patient, to the position where they are the customer. In this regard, it is quite refreshing to see that the World Bank, particularly, has started to look at countries it deals with as customers. Its responses are becoming much more tailored to the customer, much more customer-, demand- and needs-driven than has been the case in the past.

In many respects, South Africa finds itself in the fortunate position that it has a government which is taking responsibility, is looking forward and is accepting the very significant challenges faced. The response to some of these challenges are incorporated in the macro-economic framework that the government announced on the 14 June 1996. The reason why our relationship, with the World Bank has been a positive and mutually rewarding relationship is precisely because we are a customer. We have taken control of our own destiny. We have engaged with the World Bank from a position of equivalence - there is a true partnership in the relationship between South Africa and the World Bank. South Africa is also one of two African countries - the other being Botswana - which make contributions to the World Bank's International Development Association (IDA), and has been instrumental in trying to overcome the

problems of the replenishment of IDA with positive solutions which have taken us some way forward.

In our relationship with the World Bank we are looking for a whole range of things. We have used services of the World Bank and will continue to use and engage with the Bank at a technical level. The support that they have provided to the government and to a whole range of parties before the elections has been useful and has made a very positive contribution to policy development. When South Africa engages with the World Bank in a lending relationship it will be driven by the needs and demands of its own programmes. If there is going to be a lending relationship with the World Bank, it will be a project-based lending relationship. It will be a matter of identifying projects, of looking at the sources of finance and understanding whether the Bank will provide a better alternative as a source of finance to other sources of finance that are available elsewhere in the market place. But we are able to do that precisely because we have taken into consideration what it required to ensure the maintenance of a set of macro-balances - sound and sustainable economic policies to generate jobs and the growth essential down the line. This set of economic policies will allow us to become fully integrated into the world economy. I am never sure what the word 'globalisation' really means, but there is a very definite need for economies and African economies to become fully integrated into that world economy. South Africa is in the process of doing that, but to do so, it needs a set of policies which will stand the test of time.

The importance of integration into the world economy cannot and should not be underestimated in terms of growth and job creation in developing countries such as ours. Access to international savings is an important part of the equation in this regard.

There is no substitute for sound and sustainable economic policies. Part of that sustainability is an adjustment programme, a transition that builds capacity at an institutional level. But it is also a transition that builds capacity at the human resource level. The fact that the World Bank and other donors often come in with their own consultants, that so much aid is tied in this way, constrains the ability of countries to build capacity. This is an important issue that, as developing economies, we need to deal with. There is no point in saying 'here is an aid package' or 'here is a set of concessionary finance measures that you can access' when, at the same time, you tie the capacity - the human resource development component - to the country providing the assistance or providing the aid. If we are serious about human resource development and capacity-building in Africa, there must be a greater sensitivity and need to invest in local economists - people who actually ultimately are going to be charged with the responsibility of implementation.

In addition, the issues relating to good governance also need to be considered, including greater accountability, transparency and the rule of law. These issues now permeate into the language of government and into policy developments in sub-Saharan Africa, and we need to make that part-and-parcel of our own priorities. We also have a responsibility to ensure that our engagement with the Bretton Woods institutions shifts further and further away from being the patient to an engagement which says: 'We are the client. These are our needs. How are our needs being addressed? Are the products that you are supplying to us, are the instruments that you have available for us, instruments that can actually get further along the line of where we want to be?' We also, coming back to my first point, need to ensure that what we are experiencing are not short-term gains that come from shock therapy. It is very easy to put a patient into shock therapy, and to see results. Sometimes those results are sustainable for a period, but you have to ensure that you are actually dealing with the problem.

Mr. Jaycox's paper raises many interesting questions. In many circumstances (and I think the Bank itself has acknowledged this), its policies have actually exacerbated rather than advanced those problems. It is sometimes necessary to step back as the Bank is doing now and ask: 'how do we make this partnership work and how do we make this a real partnership?'. There is a lot to be built on in that new approach, in that new engagement. As African countries we also have a responsibility to respond in a manner that ensures that we take control of our own destinies so that in the future we would not be hostage to a set of policy prescriptions not always in our long-term interests.

# Regional Integration and the Multilateral System

*Gilles Gauthier*

Trade policy has been front and centre in Canada's economic history. The birth of the Canadian Confederation in 1867 followed the termination of a 'Reciprocity Treaty' with the United States - the first example in contemporary economic history of a regional free trade agreement. Through the years, international trade has always been Canada's bread-and-butter. This is even more the case now with exports accounting for over one-third of Canada's GDP, compared to around 20% in the 1970s and 25% in the 1980s.

Canada's trade policy has followed a two-track strategy - regional and multilateral liberalisation. The two are closely intertwined. This chapter explores some of the underlying fundamentals of this inter-relationship, *first* in terms of the economics of Canada's trade performance, *second* by reviewing how trade rules-making (the bread-and-butter of trade policy officials) of the North American Free Trade Agreement (NAFTA) and the World Trade Organisation (WTO) interact, and *finally* to offer a Geneva-based perspective on developments in the world trading system, particularly in light of the proliferation and broader scope of regional trade agreements.

### The Economics of Canada's trade policy

While the exposure to trade of the Canadian economy is one of the highest among OECD countries, its degree of concentration on one market (the US) is also one of the highest among developed countries. In fact, Canada-US trade is the biggest bilateral trade relationship in the world. One billion dollars of trade crosses our borders on a daily basis. In relative terms, however, our bilateral trade does not carry the same significance. The US market absorbs more than three-quarters of Canada's exports while Canada accounts for merely 20% of US trade, although Canada is still America's largest trading partner. When adjustment is made to reflect the difference in the degree of openness of our respective economies, it is clear that the Canadian economy is far more dependent on its access to the US market, than *vice versa*. This, compounded by the fact that Canada has generally enjoyed a trade surplus with the US, leaves no doubts as to the significance of the Canada-US Free Trade Agreement (FTA) for the Canadian economy.



The investment dimension should not be neglected either. Canada has always been relatively dependent on foreign capital simply because of the huge capital needs for the development of its resources, the transport network and infrastructure. Canada is the primary destination of US FDI and *vice versa*. The high degree of US FDI in Canada has also been associated with one of the structural characteristics of the Canadian economy, that is the importance of branch plant operations of US firms often established for servicing the Canadian market.

At the time of the negotiation of the FTA, a number of studies were carried out in an attempt to measure its overall impact on the Canadian economy. All have concluded that positive gains would emerge in the magnitude of 2-3% of GDP. Similarly, estimates of trade creation and trade diversion effects clearly suggested much higher numbers for the former than the latter. These results did not come as a surprise. When two economies are already so closely integrated, the removal of artificial barriers at the border can only be beneficial: it allows firms to specialise and broadens consumer access to lower-priced goods; it exposes firms to greater international opportunities and competition, thus encouraging flexibility and faster response to market changes; and finally, it reduces uncertainty by securing access to larger markets.

This is now the seventh year of implementation of the Canada-US FTA and the third year of its successor agreement, the NAFTA. The impact on the Canadian economy has been as significant, if not more, than anticipated. Trade has soared. From 1989 to 1995, Canada's exports to the US grew by 90%, and by 80% with the rest of the world. As a percentage of GDP, exports are up more than 10% over this period. From a macro-economic standpoint, there is no doubt that foreign trade has been the primary engine of growth in the Canadian economy in recent years.

At the micro-economic level, the impact has been equally noticeable. In fact, for a very large number of businesses, the FTA and NAFTA have been a major cultural shock. Many had to do away with the branch plant mentality - which resulted in some plant closures with the US parent firm deciding to service the Canadian market directly from US production - and many others had to respond quickly to new opportunities. Examples are numerous of deeper integration, sometimes at the firm level (for example, IBM plants being specialised, Canadian banks expanding in the US, US giant distribution firms establishing in Canada) or at the regional level, where North-South links have expanded for all Canadian regions. In short, regional trade liberalisation has triggered a significant structural adjustment process of the Canadian economy, making it more internationally competitive and thus more enthusiastic about further liberalisation.

Indeed, the Canadian experience can give credence to the 'bicycle theory' of trade liberalisation. In this, trade liberalisation generates its own momentum simply because once firms have adjusted to competition from this principal source of foreign competition, the potential gains from greater access to other markets will necessarily be greater than the incremental adjustment cost necessary to stay competitive. In other words, the Canada-US FTA and NAFTA have made Canada more prepared and enthusiastic about further trade liberalisation, whether this be at broader regional level (FTA Agreements, Asia-Pacific Economic Co-operation) and/or at the multilateral level.

A few examples illustrate the situation well. Soon after the entry into force of the FTA, a very large number of requests were received from firms seeking a *faster elimination of trade barriers*. Two additional rounds of negotiations were then conducted, resulting in the acceleration of tariff cuts for several thousand tariff lines. A second example is the Canadian beer industry which had been protected to the point where even inter-provincial trade was prohibited. At the time of the FTA, the industry was clearly not competitive and totally incapable of sustaining US competition. The sector was excluded from the agreement but the message certainly got through. Certain restrictive practices were successfully challenged in the GATT which prompted further regulatory changes. Five years later, Canada agreed, in the Uruguay Round, to eliminate all its tariffs in this sector by the end of the decade.

Securing access to an importing market the size of the United States was viewed as a crucial marketing tool with which to attract new investments. The response from investors, domestic and foreign alike, has been generally positive although in some ways tempered by the economic downturn of the early 1990s. Net inflow of foreign capital increased by 11% during 1990-93 and the stock of FDI also rose in the same proportion. Interestingly, Canadian investment abroad has grown faster than foreign investment in Canada, suggesting a redeployment of Canadian firms towards greater international operations.

At the time of the negotiation of the NAFTA, there were some fears amongst the general public that Canada was bound to lose in any competition with a country - Mexico - that has wages, on average, seven times lower than those in Canada. Of course, this was a gross misconception of economics. It is clear that trade is not dictated by wage differentials but rather by comparative advantages and that both countries could be better off by specialising in what they produce best. Moreover, any measurement of competitiveness requires taking into consideration all elements of costs and not just labour costs, including labour productivity, the cost of capital, capital productivity and other factors (such as technology and the general policy environment).

Canada's trade with Mexico has historically been quite modest, less than one percent of total exports. Despite Mexico's economic difficulties of recent years, two-way trade has expanded considerably under the NAFTA - by more than 40% since 1993, roughly in the same proportion of Canada's total trade. More importantly, perhaps, the NAFTA has heightened interest on the part of the Canadian business community to look beyond the US market and explore new opportunities in Latin America. This interest was further amplified by (and to some extent behind) the Free Trade Agreement of the Americas (FTAA) initiatives.

Canada's experience with regional integration has been positive for our trading partners and increased our interest in pursuing further liberalisation.

### **Trade Rules under GATT/WTO and NAFTA**

Canada has always been an active player in trade rules making. It was a founding member of the GATT in 1947 and was involved in all rounds of multilateral liberalisation. It was at Canada's instigation that the idea of creating the WTO emerged in 1990. Regional integration in North America also has a long history. As mentioned above, it started in the mid-19th Century with the Reciprocity Treaty, and surfaced from time-to-time - on approximately a 40 year cycle - to the conclusion of the Canada-US FTA in 1989 and NAFTA in 1992. When GATT was being developed, the possibility of a Canada-US free trade agreement was being explored and exerted some influence on the drafters of GATT Article XXIV pertaining to free trade areas and customs unions.

Beyond these historical anecdotes, the interplay between trade rules developed at the regional level and those of the multilateral system can be quite complex and not necessarily fixed in time. It is often asked whether these rules are 'complementary' or 'substitute'. However, this characterisation does not seem to be appropriate in describing Canada's perspective of NAFTA and the WTO. 'Complementary' would suggest that the two sets of rules do not deal with the same issues, whereas 'substitute' would suggest that one set can live without the other. A better and more accurate representation is two sets of rules juxtaposed, with an area of overlap at the centre.

The area of overlap is of fundamental importance since it relates to the basic concepts of non-discrimination, national treatment, transparency and the rule of law, including dispute settlement. It is clear that the GATT and now the WTO remain the core framework for regulating international trade. It is almost certain that NAFTA would have been impossible to negotiate if Mexico had not joined

the GATT beforehand in 1986. A common basis would simply not have existed.

In terms of the mechanics of the NAFTA, when a matter pertains to obligations of both the NAFTA and the WTO, *dispute settlement procedures can be initiated in either forum, but not both, at the choice of the complaining party.* The mutually exclusive process prevents procedural harassment and conflicting interpretations. There have been examples on both Canada and US sides where the complaint was brought to the WTO instead of the NAFTA, or *vice versa*, following, no doubt, a careful analysis of the most likely chance of success. For example, the US has recently file a complaint in the WTO against Canadian measures pertaining to certain type of periodicals; Canada is considering *challenging certain aspects of the US Helms-Burton laws before NAFTA.* In both cases, the complaint could have been brought before the other body.

It is clear, however, that even a cursory review of NAFTA would conclude that its provisions contain a level of obligations that far exceed the GATT and the WTO (even though it was concluded before the Uruguay Round). There are essentially two explanations. One is that it is often much easier to resolve issues in a regional context, where there is a greater commonality of interests. A second reason is that the higher degree of economic integration and interdependence at a regional level simply warrants broader and deeper rules to govern the relationship between the parties.

In the area of trade in goods, NAFTA significantly expands the scope and coverage of obligations. Of course, all tariffs are to be eliminated on virtually all goods under a schedule which contains elimination in four different stages: immediate, five, ten or (for very few cases) 15 years. NAFTA also prohibits *export taxes and duty drawbacks; it imposes additional obligations regarding various regulatory measures pertaining to standards, customs administration and the administration of some sectoral policies, notably autos, energy, textiles and agriculture.* As such, NAFTA significantly goes beyond the removal of border measures and imposes disciplines on domestic policies which have implication for market integration.

For trade in goods, rules of origin are fundamental since they determine which goods receive *preferential tariff treatment under NAFTA.* As such, rules of origin are an essential component of any preferential agreement. It is not sufficient that a product moves across the Canada-US border to receive preferential treatment. In fact, there are still around 10-15% of Canada's imports from the US that remain dutiable. There are basically three scenarios:

- \* goods wholly produced in North America;

- \* goods incorporating imports from outside the region provided that they are sufficiently transformed in North America (the NAFTA provides a simple way to make this determination by using a shift in tariff classification: the import undergoes sufficient transformation if the good exported has changed to another specified section/chapter in the tariff nomenclature; this facilitates administration at the border since the exporter only has to document tariff classification of the imported inputs); and,
- \* the goods transformed to a certain level of North American content. This is used mainly for autos and textiles.

Trade in services is another area where NAFTA goes significantly beyond the General Agreement on Trade in Services (GATS). The greatest difference between the two agreements lies in the overall architecture and framework. While the GATS obligations apply to specifically listed sectors and on the basis of specific modes of delivery of the service (positive list of commitments), the NAFTA basically covers everything except those measures or sectors expressly exempt (negative list). The NAFTA details for each member the list of non-conforming measures that are preserved. These measures cannot be made more restrictive, sometimes they must be eliminated by a certain date, and no new restriction can be introduced. There are few sectors which remain 'unbound', that is without obligation pertaining to existing and future measures that may be inconsistent with the obligations of the Agreement. Most notably, the list includes basic social services (education, health, correctional services), minority affairs, and certain particularly sensitive sectors such as maritime transport and basic telecommunications.

Under the NAFTA, the obligations on trade in services go hand-in-hand with the obligations pertaining to investment. The NAFTA investment provisions are probably at the present time the most sophisticated set of treaty obligations in this area. They provide for comprehensive coverage - both FDI and portfolio investment - and rules designed to ensure protection of investment and investors (non-discrimination, expropriation, transfer of funds), and to prevent the introduction of trade distorting investment measures. The Investment Chapter also provides direct access to international arbitration for investors seeking monetary compensation for an alleged breach of the NAFTA obligation. In addition, the NAFTA also contains rules pertaining to government procurement, competition policy, monopolies and state enterprises, and extensive rules on intellectual property. The inclusion of disciplines in these areas into a free trade agreement is designed to reflect the broad nature of the process of economic integration which now goes much beyond the simple consideration of barriers at the border, but must also reflect the complementarity between trade and

investment and the need to provide for general convergence of economic framework policies affecting market structure, conduct and performance.

At the institutional level, the NAFTA remains quite lean. There is a small secretariat which essentially fulfils the function of registry. There are, however, *fifteen committees and working groups which meet on a regular basis to monitor the implementation of the agreement and to explore further liberalisation initiatives where needed.* The NAFTA Commission, composed of representatives at the ministerial level, meets at least once a year to supervise the implementation of the Agreement.

Despite the breadth of NAFTA, it does not deal with all issues. Some have essentially been left to the WTO, in part because the nature of the problem is such that it requires a global solution, and/or because the negotiating dynamics in the regional context have yet to be conducive to developing mutually acceptable solutions. The two most prominent examples are agriculture and trade remedy rules (that is, anti-dumping and subsidies and countervailing duties), although other examples exist in the services sectors - basic telecommunications and maritime transport.

In agriculture, the negotiation of the NAFTA coincided with the crux of the negotiations of the Uruguay Round where the same issues were being debated. Issues such as trade distorting subsidies and the elimination of non-tariff barriers and tariffication not only had ramifications far beyond regional trade but also required solutions at the multilateral level to be effective and defensible to domestic interests at play.

In the case of trade remedy rules, this has always been at the heart of Canada's preoccupation with securing market access to the US market. Canada's exports have been regular targets of US trade laws, causing uncertainty and, at times, serious impediments to trade. With respect to anti-dumping, Canada has always argued that as markets further integrate with the elimination of border barriers, pricing practices across borders should be disciplined the same way as if they were occurring in the domestic market. Concrete suggestions to do away with anti-dumping laws have resulted, with a reliance rather on domestic competition laws to deal with truly anti-competitive transborder pricing practices. We are still trying to persuade our partners of the merits of this approach in the context of working group discussions in the NAFTA. In the meantime, WTO rules governing anti-dumping continue to apply to bilateral trade.

Similarly, disciplines on subsidies and countervailing duty laws have also proved up to now to be impossible to negotiate in the regional context. One of

the major difficulties in this area is to agree on a definition of subsidy, especially given the structure of governments (to be truly effective it would have to apply at all levels) and the various means by which assistance to a particular sector can be provided (for example, direct payments, infrastructure, defence procurement and regulatory relaxation). Another problem is that any solution would require a careful balance between the 'sovereign right' of a government to subsidise and the right of the importing country to protect its producers injured by foreign subsidisation. This balancing act is the cornerstone of the WTO Agreement on Subsidies and Countervailing Measures, which remains applicable in NAFTA trade.

While the WTO still governs the substantive anti-dumping and countervailing duty laws of NAFTA parties, the NAFTA and before it the Canada-US FTA, provide for dispute settlement procedures to seek judicial review of the application of domestic laws. This novel and quite unique feature provides assurance to exporters facing anti-dumping or countervailing duty orders that the action against them can be independently and expeditiously reviewed by a binational panel, composed of non-government trade experts selected by the parties. The panel is empowered to verify whether domestic laws have been properly applied and can order that a determination be set aside and be re-done properly. This system has been used extensively by exporters of Canada and the US and now Mexico and has proved very effective in ensuring consistency, due process and administrative rigour in the application of domestic legislations. For many Canadian businesses, this system has been considered one of the most important achievements of the agreement for improving security of access to the US market.

In short, it should be apparent to everyone that the NAFTA and the WTO support each other. The NAFTA, by including additional obligations in a number of areas, has pushed forward the frontier of trade rules making. This has already spurred efforts to achieve further liberalisation at the multilateral level during the Uruguay Round, for example for trade in services, and is being used now as a reference point for efforts to bring new issues such as investment and competition policy to the multilateral agenda.

### **Regionalism and the Multilateral System**

It is often suggested that the creation of the Canada-US FTA, then NAFTA, has been instrumental in providing strong impetus to regional integration initiatives. Indeed, since 1990 more than 40 agreements have been notified to the WTO and a dozen more notifications are pending. This proliferation means that there

is now a greater proportion of world trade taking place under preferential rules than under the general 'most favoured nation' principle of the GATT. In addition, broader regional initiatives are underway in the FTAAs, APEC, the Trans-Atlantic discussion and European association initiatives. Clearly, however, this trend also responds to a change in economic fundamentals: the push toward market reforms in a number of countries, and the globalisation of markets applying more pressure to liberalise.

This development has prompted some concerns that the WTO may not be adequately equipped to deal with this new world trading environment. Article XXIV of the GATT spells out the guiding principles for examining the consistency of regional preferential agreements with the WTO. Namely, these must facilitate trade between the parties and not raise barriers to the trade of other Members; and, customs duties and other restrictive regulations of commerce are to be eliminated with respect to substantially all trade between the parties. These tests have proved difficult to apply - examinations are generally inconclusive - and were drafted in the context where tariff issues were the determining factor. This is no longer the case in today's major regional integration initiatives.

Earlier this year, the WTO established a new structure to look at the issue of regionalism, viz. the Committee on Regional Trade Agreements, chaired by Ambassador Weekes of Canada. The Committee has been given the mandate, not only to the examination of notified agreements, but also to initiate a broader reflection on the 'systemic implications' of regional agreements and initiatives for the multilateral system. There is a widely-held view that the WTO must cope with developments taking place at the regional level to avoid the fragmentation of the world trading system and the consequent marginalisation of the institution as it loses its influence over trade policy making.

It has been Canada's view that the consideration of these 'systemic implications' should be forward-looking and directed toward building a consensus on creative ways to multilateralise the liberalisation achieved at the regional level. As mentioned before, regional agreements have often led the way for multilateral negotiations. We believe the same holds true today in a number of areas, notably investment and competition policy where significant developments have taken place at the regional level.

At the same time, the multilateral system must be vigilant in ensuring that initiatives at the regional levels do not erect obstacles to further multilateral liberalisation. Concerns have been expressed, for instance, regarding the implementation of different sets of preferential rules of origin - NAFTA, the



EU and Mercosur do not have the same rules - which not only seriously complicates the life of businesses operating in more than one region, but also may attempt to tilt trade patterns in such a way to hinder further multilateral liberalisation. Another example is standards. Many discussions are underway in regional agreements to further harmonise standards, develop mechanisms for the mutual recognition of domestic standards and streamline certification procedures for parties to regional agreements. From a multilateral standpoint, it is important that these developments do not work at cross-purposes with efforts to ensure an effective, non-discriminatory multilateral trade system.

## **Conclusion**

Canada's trade policy has always been one of the pillars and determining factors of the country's economic performance. NAFTA has not only codified the world's largest bilateral trade relationship, it has also fostered greater and deeper market integration. As a result, Canada is now much better prepared to respond to globalisation forces and to promote further multilateral liberalisation. Regional integration must not be an end in itself; it must be a means to promote economic development and improve standards of living. Trade agreements are important because they provide assurance that trade relations between countries will be governed by the rule of law and not by power. NAFTA has made new and important contribution in this domain and, hopefully, has opened new opportunities for the WTO to pursue further multilateral liberalisation.

## 7.2

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### Response

*Willem Bosman*

Regional integration between partners that enjoy parity with regard to their levels of economic development will naturally lead to wide benefits for all. Free trade within such a region appears to be logical, even enticing. Taking the differences between the Southern African region and the North American region into account, one's first reaction is to wonder how much of the Canadian-US-Mexican experience could be applied directly to the Southern African paradigm.

The following may illustrate some of the complexities with which South Africa is dealing at this moment. Nothing I say now must be construed as being an indication of the South Africa negotiating team's position with regard to the European Union. The position has still not been decided, so please do not jump to conclusions.

#### **South Africa and the Customs Union**

At the lowest level of regional co-operation, the democratisation of the Customs Union agreement is important. We are in effect structuring a more formal regional body. We also are aware of the global economic tendencies which will soon begin to erode the most important reason for having a Customs Union - notably its monetary aspects. So, we are working to establish something, knowing at the same time that the erosion of the Customs Union pool would change its structures radically.

South Africa, for instance, will find it hard to live with a notion of free movement of labour in this region, which could flow from the new Customs Union agreement. So if we have trade liberalisation, particularly with regard to movement of capital, the natural outcome would also be free movement of people. This could become a problem. Labour relations would possibly have to be organised in a regional dimension which could have a positive effect on employment, productivity and investment for the region. But this will also demand a clear rethink by the South African Trade Unions. With the diminishing Customs Union pool, new dynamics for economic self-sustainability will have to be found and generated in the Botswana, Lesotho, Namibia and Swaziland (BLNS) countries. We will have to do it ourselves. We would not be able to do it with aid money - that is also drying up. Nor do I think that

trade liberalisation is going to be the complete answer. How do we create self-sustainable economies in Lesotho or in Swaziland? Investment in South Africa could spill-over into BLNS countries after a while. But the opposite could also happen, because as we heard, for example, Canadian companies (or American companies in Canada) closed and are now serving Canada from US territory. The same could happen here.

### South Africa, the EU and SADC/COMESA

Let us go one step further by looking at South Africa's relations with the EU and SADC, and also at the problem created by the membership of most SADC countries of COMESA. The EU conference with SADC countries in 1994 in Berlin promised assistance for regional integration between South Africa, SADC and the EU. The apparent parameters for this form of co-operation still need fine tuning and obstacles need to be removed: for instance, the *ad hoc* clause in the mid-term review of Lomé. I would like to refer you to the rules of origin cumulation mentioned by the previous speaker. The European Union is, in terms of the Lomé rules of origin, making it possible for countries in the Caribbean to cumulate, with a country like Venezuela. (Please note that Venezuela is not a member of the Lomé or ACP). Southern African Lomé members asked for a similar agreement between them and South Africa. They wish to have the right to have South African parts, for example, exported to Botswana or to Namibia for the assembly of the final product and then exported from there to the EU at a zero tariff. Southern Africa was excluded from this benefit. Every single case of cumulation in Southern Africa is subject to *ad hoc* rulings. The bureaucrats in Brussels will have to give their permission for cumulation. This is no way in which short-term regional co-operation can be assisted or in which investment in the region can be encouraged.

Within the SADC there is also a need for the introduction of two-speed considerations for regional integration. We do have some economies in the region that move faster than others. For example one would have to apply different rules to Angola, Malawi, Lesotho and Swaziland because it will be very difficult to include them in an open and fully liberated economy.

The SADC/COMESA dichotomy is something that has to be resolved soon, because SADC does not enjoy representation in the Organisation of African Unity (OAU), although it is the best example in Africa of regional co-operation.

## **South Africa and the Abuja Treaty**

The Abuja Treaty envisages that, by the year 2034, the African continent will be managed in the same way as the EU. That is the ideal. The Treaty has been signed by most of the African countries and the ideal is that the respective regions will form separate building blocks towards economic unity in Africa. The building blocks include Southern Africa, East Africa, West Africa, and the Central African region.

A question which arises, however, is whether full economic integration can be achieved without the presence of solid and democratic governments across the whole continent? Which comes first? The economic or the political thrust? Do we need a strong economy to maintain good governance and democratic government, or do we need that type of government to ensure a strong economy and encourage investments? I think the latter. Discussion of Africa's economic woes potentially neglects the political dimensions, thereby putting the cart in front of the horse.

Good governance and democratisation still serve as the best attractions for investment and other forms of support. Should one or two countries in a region become politically destabilised, the whole region could be affected.

## **South Africa in the South-South Perspective**

South Africa has made a policy statement that South-South co-operation should be a priority. As a result, South Africa is approaching co-operation within the South Atlantic area with the trade dimension as the major thrust. Closer links in the future between Southern Africa or South Africa and Mercosur or the Association of South East Asian Nations (ASEAN) or NAFTA should not be ruled out, perhaps as observers or perhaps more directly. South Africa's possible qualified membership of the Lomé Convention is another matter which is receiving attention. This will be a qualified political membership given that South Africa has only limited trade access to the EU. They say that we can be a political member, but without trade. Trade will have to be arranged bilaterally. It does suit us to some extent, given Lomé's limited lifespan. The EU has already announced that the Lomé Convention with its present aid dimension (its present aid is given to the 70 members of the Lomé Convention) will have to be altered radically. They will be encouraging trade liberalisation in all of those countries instead. It is going to be quite a difficult challenge for ACP countries - the developing countries - to enter into this global economic dimension which is in fashion, just as the mini-skirt was once upon a time.

South Africa's potential choice between free trade or the Generalised System of Preferences (GSP) must be examined. Both have specific pros and cons. South Africa, in its relations with the EU, has to choose. Free trade seems to be very enticing. It offers possibilities for South Africa. But remember that South Africa is still a member of SACU. We do have a responsibility as a member of that club to take care of their interests. Or are we going to be selfish and tell them 'be damned, we are going our own way'? We cannot do that.

The obstacles in the way of free trade between South Africa and the EU become quite obvious when they are compared with the Canada-US FTA and NAFTA. The EU is geographically on the other side of the globe and they want a free trade agreement with us. Canada, the US and Mexico, are on the same continent and almost share the same borders. It looks easier there. South Africa's regional responsibilities - not only with the Customs Union, but also within SADC and even further under the Abuja Treaty - deserve careful consideration. There is reasonable parity in the relative size of the American economies, although Mexico has encountered a little set-back. Between Canada and the US there was sufficient parity to establish free trade at an early stage. Compare this to the South African position. We export, like any ex-colony, mostly raw materials and not many capital goods. But the EU is exporting to us. While it seems enticing to go for a free trade agreement with the EU, there is a lot of work still to be done before we come to a conclusion.

## 8.1

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# Is Africa Atypical in the Developing World?

*Chris Heymans*

### **Introduction**

Success stories in the globalised world economy of the late 20th Century have become associated with the industrialised world, the Asia-Pacific region and parts of Latin America. In contrast, African regions, countries, cities, districts and companies struggle to attract the highly mobile investors in the new world. Somehow, these investors do not find Africa sufficiently stable, serviced and flexible to direct their resources towards it. This naturally limits the prospects for Africans themselves, both within their own continent and the wider world. Even the most economically dynamic African countries fall significantly short of the increased average growth rates which have marked the economies of low and middle-income countries across the world.

These observations suggest that socio-economic development in Africa compares unfavourably with that elsewhere in the world. But are these differences merely of a symptomatic nature or are they more fundamental? This chapter approaches this question about Africa's presumed uniqueness from two angles. It asks first whether the African experience is different and, second, whether Africa requires different strategies and approaches to overcome its development challenges.

### **African Development in Perspective**

It has become conventional wisdom to argue that Africa's woes can best be reversed through political democratisation and administrative restructuring, coupled with economic and trade liberalisation and fiscal reform. While such initiatives would be in step with the approaches followed in many other parts of the developing world, their relevance to Africa warrants some scrutiny. The challenge - which has not yet been met - is to analyse development issues in Africa and introduce such reforms with the commitment which has marked successes elsewhere in the world, while also attending to the nuances required in an African context.

Three general points should be made to place African development in perspective:

### ***The Universal 'African Condition'?***

While there are indeed similarities between many African countries, they are offset by a sufficient range of differences between and within nation-states and between groups of countries to render many such generalisations inappropriate. One simply cannot discuss in the same breath areas as diverse as North and Sub-Saharan Africa or East and West Africa. There are also vast differences between Anglophone, Francophone and Lusophone countries and regions and among parts of the continent dominated by different religious traditions. Furthermore, although many African countries fit into comparable levels on the global economic hierarchy, their sectoral and other economic features vary considerably. The continent is also marked by disparities in terms of policy approaches, markets, natural resources, institutional capacities and political systems and conditions, infrastructure and service provision and levels of economic performance. A recent World Bank report, for example, highlights marked differences between countries applying far-reaching structural adjustment programmes and recovering from the economic declines which affected them in the 1980s (for example, Ghana, Tanzania and Uganda), those continuing historic strong performance (like Botswana) and those locked in civil strife and economic contraction (for example, Liberia, Rwanda, Somalia and Zaire). It is therefore not appropriate to treat the entire continent as if it constitutes one uniform political and economic entity.<sup>1</sup>

### ***Is Africa Poorer?***

Development literature is fairly unambiguous about Africa being the most troubled part of the developing world. Not only are 32 of the 47 countries classified by the United Nations as 'least developed' African,<sup>2</sup> but any analysis beyond regional and continental averages highlights significant manifestations of poverty, little or negative growth, social and political instability and institutional weaknesses.

Population trends and nutrition and food scenarios illustrate sub-Saharan Africa's predicament rather pointedly.<sup>3</sup> The absolute increase in population numbers is highest in Asia, but the African population growth rate is higher, especially in sub-Saharan Africa. While a faster than expected drop in fertility rates and the impact of AIDS could slow it down, Africa's population growth rate in the immediate future is expected to be twice that of the rest of the world. This means that the population could double to 1.2 billion by 2020.

Furthermore, the number of hungry people is rapidly declining in East Asia,

persisting in South Asia and Latin America, but accelerating substantially in sub-Saharan Africa. It is estimated that the number of food insecure people in Africa has increased by 46% since 1970, to a current level of 175 million. Recent analyses show that while the global malnutrition rate among children is expected to decline from 34% in 1990 to 26% in 2020, the number of malnourished children in Africa will increase by more than 50% to reach 43 million in 2020 if current trends continue. In contrast, rates are improving in the near East and North Africa, as well as in South and Central America and the Caribbean. While there are some differences between individual countries, the prevalence of malnutrition in these regions is expected to be similar to the situation in developed countries by 2000. Southeast Asian countries show rapid improvements. The majority of underweight children live in South Asia, where malnutrition levels seem to be holding steady or declining slowly.

Such indicators underscore the problems of African countries, relative to other parts of the developing world. But perhaps more significant from a policy perspective are structural issues like strongly resource-based economies which leave little room for diversification, a high dependence on external aid, weak trade and other linkages, a lack of local-level capacities and institutional shortcomings. Even some of the more successful African countries continue to experience such structural problems. Africa's ability to address its problems and to manage itself first towards sustainable recovery and ultimately towards greater prosperity, is inextricably tied to policy-makers and their partners coming to terms with these fundamental matters.

### ***Do African Countries Require Different Policy Responses?***

Sound policy is mostly tailored to particular conditions, even if it is based on more universal experience. Different situations often call for different policy responses. This requires that single-minded notions of socio-economic causes and effects simply cannot be applied in the real world. One cannot glibly assume that all developing countries should expect similar results from the same policy approaches. There is, for example, nothing inevitable about poorer countries growing faster than richer ones and them being destined to find their income levels converging with that of the latter. Policy choices and institutional arrangements have to accommodate situational variables like educational levels, rates of investment and the regional contexts within which developing countries function. Economic development requires careful strategic thinking and planning, enabling - within the confines of the public good - different roleplayers to contribute their parts in ways which reflect the realities of their environments and their interests.<sup>4</sup>



However, one also cannot ignore some global trends. Significant patterns have emerged around the relationships between the economic prospects of regions, countries and sub-national entities and their policies and approaches towards some key issues. The market orientation of such roleplayers, their attitudes towards domestic and international trade liberalisation, institutional, macro economic and fiscal reform and the judicious management of resources, seem particularly important. There are, therefore, a number of useful policy lessons which African and other less developed countries (LDCs) can benefit from, provided that they apply them sensitively with due regard for their own circumstances. In a globalised environment, this could become very difficult as the trend would increasingly tend towards common approaches and because such LDCs are often so weak that they are unable to withstand pressures for policies which may not be appropriate to their countries. Anyone with a genuine interest in the development of such countries therefore faces the challenge of balancing, very carefully, local realities with global lessons of experience. Doing so in reality is often rather difficult.

### **The Political Economy of Space and Location**

The globalisation of the world economy places new demands on actors at different levels of the international society. Nation-states find themselves in a particularly interesting position. On the one hand, they have to come to terms with a world beyond their own borders, investors who move swiftly across national boundaries and global technology which renders parochial interests and approaches obsolete. Ironically, the new global investor is also often more interested in opportunities at levels below the national state. It is often the markets, stability, administrative flexibility, infrastructure and services in cities, districts and sub-national regions which shape investment decisions. All they require from national governments is to ensure stable investment environments. Beyond that, they want lower tier authorities and service agencies that shape those environments in practice and consumers, workers and technology that enable them to either produce or sell their goods and services.

Success in the modern global economy therefore mostly revolves around networking and integration across national boundaries, national policies which facilitate access to resources and markets and locally-focused institutions and facilities geared towards securing investment. A growing number of African governments have - with mixed success - introduced national policy reforms quite similar to those which seemed to underpin successes in other developing countries. However, the continent has been markedly less successful than other parts of the world in increasing and institutionalising both regional integration and locally-based development strategies.

### ***Regional Development and Integration***<sup>5</sup>

The benefits of regional co-operation or integration are widely acknowledged and have motivated governments and private sector stakeholders to actively pursue such integration. In the industrialised countries, much political debate and economic bargaining have characterised these processes, but over the past few decades a number of significant initiatives achieved at least some success. The EU is arguably the best known, but NAFTA has captured the imagination because it links industrialised countries with developing ones, opening possibilities for unprecedented joint ventures and trade across national boundaries. Developing countries participate in many other regional initiatives and the Asia-Pacific economic surge revolves around quite a number of such efforts, some of which have now come to bring Australia into the fold. On the other hand, the Asian experience also illustrates that institutional form does not necessarily precede regional trade and co-operation. Strong economic and trade links often developed among Asian countries in the absence of formal institutional mechanisms for co-operation and integration. This contrasts sharply with the African situation where such functional links remain either fragile or absent despite a wide number of institutional arrangements aimed at forging them.<sup>6</sup>

The continent's colonial legacy has perhaps made the need for regional integration even more pertinent in Africa than elsewhere. The former colonial powers divided Africa in an arbitrary manner with little regard for indigenous economic, political and social factors. Modern Africa continues to carry the burden of this legacy with sparsely populated states, small internal markets, economies vulnerable to fluctuating world commodity prices and politically separated from adjacent economies and many fragile and controversial borders. African countries have therefore engaged in several regional initiatives in order to enhance economic co-operation, trade and alignment and to overcome many of the factors which divide the continent in so many important areas.<sup>7</sup>

The track record of these initiatives has, however, been ambiguous. They show little progress in the promotion of intra- and inter-regional trade and the development of markets across national boundaries and have not really forged economic unity between states. Problems, debates and conflicts around issues of regional integration are not uniquely African phenomena, but the progress in Africa seems to have been slower than elsewhere. Trade remains limited because production structures are weak and often inward-focused, inter-sectoral and inter-country economic and infrastructure links are underdeveloped and markets are small or often not in need of the commodities which form the bases of many countries' exports. Many such realities also curtail wider economic

integration, but their impact is compounded by artificial government-driven initiatives, poorly developed private sectors and contradictory policies. Percy Mistry argues convincingly that the 'different and conflicting economic and social objectives of nation-states and the chronic dependency ... of the fiscus in developing countries on trade taxes are major reasons for the problematic movement towards greater economic integration'.<sup>8</sup> He also contends that national governments and international organisations alike often profess commitment to regional integration, but fail in practice to uphold that commitment (for example, by funding development mainly on a country, and rarely on a regional basis).<sup>9</sup>

### *The Economic Role of Cities*

One of the most distinct differences between Africa and other developing areas, especially the Asia-Pacific region, revolves around the role of local units, especially cities, in the national and global economies.

The economic fortunes of many developing countries in Asia and Latin America are closely intertwined with the development of their cities. Cities provide infrastructure and services, house financial institutions and employees and often shape the regulatory environment which is of immediate relevance to a company's activities. If local and metropolitan governments manage their cities and towns poorly, the conditions for investors decline accordingly. For this reason, the governments of many developing countries, especially in Asia, have focused considerable development energy on urban areas, assisting local governments in the provision of infrastructure and creating an environment which involves the private sector in basic and economic services. While rural development is not necessarily neglected, cities are seen as the engines of growth which most effectively lead economic progress. The cities of the Asia-Pacific may not necessarily be models of prosperity and social equity, but many perform a considerable role in their countries' pursuit of development and growth. When the OECD organised a conference on the role of cities in the global economy in 1994, Asian analysts, policy-makers and city managers took a front seat in articulating the city-focused perspective on economic growth and development.<sup>10</sup>

In sharp contrast, African cities are in search of a new identity as they struggle to cope with rapidly expanding populations, decaying inner cities, continuing sprawl, a collapse in services and weak administrations often imposing rigid regulations. Not unlike Asian cities, these issues require of the African city managers and central governments drastic action to turn sites of decay into engines of growth. However, they are far behind their Asian counterparts.

Centralised political styles, incoherent economic policies and poorly developed domestic private sectors constrain the ability of African cities to overcome poverty and attain economic competitiveness. Whereas more Asian-Pacific cities are becoming dynamic participants in a global economy of 'competition, corporations, capital and communication', most African cities battle with 'poverty, pollution, politics and population growth'.<sup>11</sup>

### **Trade, Investment and Financial Flows**

The external exposure of African economies is high. They rely on exports of primary commodities and on imports of basic inputs and capital to support their own production processes. Their vulnerability was particularly evident in the 1980s as revenues from exports declined in a volatile primary commodity market and the costs of imports increased. While the early 1990s saw an improvement, the economies of most African countries have found it difficult to cope without foreign support or involvement. Nonetheless, distinctly varied patterns are emerging and generalisations about the fate of less developed (and specifically African) countries seem increasingly inappropriate. Some appear to be falling further behind in a rapidly integrating global economy. Others have - with varying success - taken bold policy initiatives to improve their competitiveness in that economy. The predicament of LDCs, most of which are in Africa, is well illustrated, first, through their limited trade and their inability to attract substantial FDI and, second, through the squeeze imposed by a decline in ODA, coupled with external debt. The trends are, however, not only negative. There are a notable range of brighter prospects and actual positive developments in quite a few African countries.<sup>12</sup>

### ***Trade***<sup>13</sup>

The global trade regime has become increasingly flexible, opening new opportunities not only for the economically established nations of the world, but also for developing countries. The countries of East Asia and Latin America have taken advantage of many aspects of the new dispensation. This positive environment is likely to prevail amid continued liberalisation, regional trade agreements and arrangements, trade-orientated initiatives on the part of developing countries, declining communications costs and increased private capital flows.

In this environment, the newly industrialising economies of East Asia have flourished and have even proved able to overcome the impact of periodic slow-downs in international trade. Their strengths lie, essentially, in their diversified

export sectors and their low reliance on exports of primary commodities as well as their flexible import structures. Through exports of manufactures they benefited from improved terms of trade in the 1980s. As a result, these economies have not had to make the same structural adjustments which have become conditions for overseas aid to many African countries. They managed, instead, to continue their successful industrialisation policies and maintain or even expand their investment levels.

While many African countries have experienced growing benefits from and participation in the expanded trade environment, they - and their less fortunate continental partners - continue to face some very real constraints. Two types of constraints warrant specific mention:

- \* *Supply-side constraints.* As African countries often depend on exports of primary commodities and imports of manufactures, the external trading environment is generally more unfavourable towards them. Many of these countries find diversification rather difficult as they lack investment funds, producer services, infrastructure and services, marketing systems, technological capacity and entrepreneurs. Because increased commodity exports often depress prices as a result of low price elasticity of demand, the success of aggressive exchange rate policies and trade strategies cannot be guaranteed. Expensive trade-credit, inadequate access to finance and non-transparent legal and regulatory frameworks further inhibit their ability to take advantage of the new global trade regime.

Net-food importing countries experience these problems in a particularly pronounced way, particularly over the short-term. They are trapped in a cycle of poverty with little diversification, export growth and new investment. They generally require substantial imports and foreign exchange; a need compounded by the loss of purchasing power through exports not being compensated for in the prices of imports.

- \* *Trade inefficiencies.* Inefficient and costly business practices, customs procedures and flows of business information also hamper trade by several African countries. This problem is compounded by underdeveloped transport links and communication technologies.

These problems underscore the need for assistance to improve the competitiveness of Africa's commodity exports, to enhance diversification, to improve the management of natural resources, and to develop coherent risk management strategies. The art of balancing these requirements with maintaining and promoting growing trade liberalisation, poses one of the

significant challenges to African policy-makers and their partners.

### ***Foreign Direct Investment***

One cannot generalise about the ability of African countries to attract FDI, but as a group they tend to be less successful than other parts of the developing world. It is noteworthy that while foreign investment dropped across the developing world in the mid-1980s, subsequent recoveries benefited mainly newly industrialising economies in Asia and a few cases in Latin America where debt-equity swap schemes were introduced. Africa's track record during these periods has been more ambiguous,<sup>14</sup> albeit not only negative.<sup>15</sup> Some major trends are:

- \* *FDI in Africa remains directed mainly - and more than in other parts of the developing world - towards the primary sector and resource-based manufacturing.*

In the *primary sector*, the oil reserves of Nigeria and Angola have retained a remarkable ability to attract FDI, even amid political conflict. Their potential remains high. Minerals like gold, diamonds and uranium are available in significant quantities and countries like South Africa and Namibia remain well-placed to benefit from these natural resources.

In *manufacturing*, relatively cheap labour and preferential access for some African countries to the European market, leaves some potential for higher FDI. At this stage, however, African countries lag behind their counterparts elsewhere in the developing world as locations for non-resource based industries.

The *service sector* is weak. Lacking duly trained professionals and intensive capital investments, African regions, countries and localities are nowhere near the levels of service achieved in East Asia and parts of Latin America. Telecommunications, transport and modern tourist facilities are inadequate and although some progress has occurred in the latter sector, the backlogs are severe.

- \* *The FDI picture varies between regions and countries.* Some are in dire straits and largely unable to attract FDI of any significance while others have already been more successful or show considerable potential to improve their situations. Resource-based economies like Angola and Nigeria fit both these descriptions and now face the challenge of

addressing the factors which inhibit them from reaching their full potential. Others like Botswana have maintained a reasonable growth rate and proved capable of attracting FDI. Resurgent economies in Uganda, Tanzania and Ghana are showing progress, albeit not remotely on the scale which has marked Asian and Latin American recoveries over the past few years. Compared to East Asian and Latin American countries, FDI in African countries remains too resource-focused, underscoring the need for initiatives which would enhance the capacity of nations and local populations to access opportunities in the service sector. In short, the economic case for far-reaching investment in human resources, and especially in the development of professional skills, is overwhelming. The backlogs in this regard clearly set Africa apart from countries like Malaysia, Korea and Singapore.<sup>16</sup>

- \* *Rates of return in Africa have often been higher than in many other developing countries.* This raises serious questions not only about the commonly held perceptions that investments in African locations are intrinsically unprofitable, but also necessitates a very careful analysis of the reasons for investors' reluctance to come to the continent. The US Department of Commerce figures indicate, for example, that rates of return on American investments in Africa between 1980 and 1993 were second only to those in the Asia-Pacific region and distinctly higher than those in Latin America. In the 1990s, the rates of return on FDI in Africa would appear to be even higher than that of the Asia-Pacific (See table below).
  
- \* *Compared to developing countries in the Asia-Pacific, intra-regional investments in African countries are limited.* In other world regions, Newly Industrialised Countries (NICs) have emerged as significant sources of FDI to follow developing countries. The lack of such investment trends in Africa is probably due mainly to the relatively underdeveloped private sector and markets and the considerable problems encountered in the quest for regional integration.<sup>17</sup>

Rates of Return on United States FDI, by region, 1980 - 1993 (Per cent)														
Region/country and sector	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993
<b>Developing Countries</b>	24.4	22.5	16.7	14.5	17.0	14.1	11.9	13.8	14.2	18.3	17.1	15.8	16.8	16.6
Africa	41.3	26.9	11.2	19.2	25.4	19.5	2.9	16.2	19.2	15.3	24.1	30.6	28.5	25.5
West Asia	4.4	85.4	67.2	16.1	19.4	9.2	11.8	8.1	19.0	17.3	31.8	23.5	19.2	13.1
Other Asia	44.4	40.0	30.3	28.3	29.6	21.4	16.9	22.6	24.9	24.3	26.5	23.8	22.5	20.4
Latin America	18.8	15.0	10.5	6.8	7.9	9.9	10.8	10.0	9.3	16.4	13.0	12.0	14.1	15.0
Canada	13.7	8.8	6.0	11.8	13.1	8.7	10.0	13.1	12.2	10.0	7.2	4.5	3.6	5.7
Europe	17.8	12.0	10.2	12.8	14.3	20.6	14.6	22.7	17.9	16.5	16.1	12.4	8.7	9.4
Other Dev. Countries	17.0	15.8	7.9	9.2	4.2	10.8	21.1	21.5	16.4	8.6	9.9	7.8	10.0	8.8
<b>All Countries</b>	<b>18.4</b>	<b>14.4</b>	<b>11.0</b>	<b>12.9</b>	<b>14.3</b>	<b>15.4</b>	<b>12.6</b>	<b>18.4</b>	<b>15.7</b>	<b>15.2</b>	<b>14.3</b>	<b>11.6</b>	<b>10.1</b>	<b>10.8</b>

Source: United States, Department of Commerce, *Survey of Current Business, various issues, 1979 - 1993* (Washington, D.C., Government Printing Office) as quoted in UNCTAD, 1995, *Foreign Direct Investment in Africa*, United Nation, New York and Geneva.



### ***Official Development Assistance***<sup>18</sup>

Faced by insufficient FDI and some continuing trade weaknesses, many African countries have come to depend heavily on ODA for the financing of development. In 1994, ODA constituted up to one-third of the net resource flows to middle-income and least developed countries and African countries have experienced this pattern in a particularly pronounced manner. In Mozambique, for example, ODA represented two-thirds of GDP in the early 1990s.<sup>19</sup>

However, such assistance has also been on the decline since the early 1990s and the prospects for significant increases in the near future are not positive. Donors have been seeking firmer commitments on the part of recipient countries to introduce institutional and policy reforms. Disillusionment with the impact of aid programmes, budgetary pressures at home, competing claims and strategic shifts have caused donors to cut aid or re-orientate it towards more 'successful' developing regions and countries.

In the absence of strong institutions and firm policy frameworks, African governments have often been unable to direct ODA towards their own distinct sets of objectives. Other developing countries and regions also experienced such problems, but the particular policy and institutional shortcomings of a great number of African countries have made the co-ordination of donor activity particularly difficult. Many African governments, supported by investors and their own private sectors, have initiated reform processes to address the symptoms and causes of their countries' problems. However, having lagged behind other parts of the developing world, their efforts are not received with the enthusiasm many of them might have expected.

### ***External Debt***<sup>20</sup>

The debt crisis currently poses less of a threat to the international financial system than in the 1980s. However, it affects mainly low-income countries, which means that its overall impact on Africa is greater than anywhere else. Numerous debt initiatives have not removed the debt burden on these countries, although there has been a shift away from private towards multi-lateral debt. Recent reschedulings still stretch debtors' capacity to pay. The institutional framework for dealing with the debt, still places considerable transaction and adjustment costs on debtor countries.

Even with more accommodating repayment schedules, many heavily indebted

low-income countries still face unsustainable debt burdens. This intensifies the need for policy and institutional reforms aimed at long-term growth and poverty reduction while special steps are taken to relieve the short-term problems.<sup>21</sup>

## **Institutional Issues**

Amid several variations, both between African experiences and in terms of their similarity to developments elsewhere in the developing world, the following institutional themes warrant brief comment:

### ***Governance***<sup>22</sup>

The quest for appropriate systems of government (including an ongoing debate about democracy and governance), the interface between government and civil society, institutions for regional co-operation and continuing conflicts which impede development in some areas, feature on the contemporary African political landscape.

- \* *As has often been the case elsewhere in the developing world, democracy has had a rollercoaster experience in many African countries. The withdrawal of the colonial powers was followed by a range of systems, from democratic arrangements based on Western models to one-party governments, often involved in violent conflict with their rivals. The fortunes of democracy were influenced by various factors: debates about the applicability of Western notions of multiparty democracy in African situations; fears that conflicts about resources and between ethnic and other groups would threaten the nation-state; disillusionment with corruption and inefficient governments; the perceived (and at times, fabricated) trade-offs between rapid development and participatory processes; and, more recently, the global trend towards democratisation and decentralisation, coupled with donor pressure on African leaderships to move in that direction.<sup>23</sup> In general, the patterns of political rule, which saw a less than smooth democratic experience, have not been entirely dissimilar to those in other parts of the developing world; democracy struggled to take root amid power struggles, questionable governance and often a philosophical discomfort about Western models.*
  
- \* *Against this background, the political and developmental roles of civil society assume significance. Politically, it concerns the participation of interest groups in decision-making. As in the Asian developing countries,*

the tradition of trade unions and lobby groups is not particularly strong. South Africa is somewhat of an exception, in part resembling Latin American cases where trade unions and grassroots organisations have either been powerful within a formal relationship with the state or through their activities at different levels and in different sectors. On the whole, the political impact of non-state actors remains limited in most African countries - a tendency which many international agencies have raised as a concern in the planning of development initiatives and for the functioning of democracy in general.

Civil society's *role in development* is also an important issue. Indigenous NGOs have - with the exception mainly of South Africa - not been particularly prolific in African societies' development efforts. Most NGOs active in Africa are of international origin. At the height of the authoritarian age of African politics in the 1970s, the scope for voluntary organisations was simply too limited for many of them to really take root. This remains a constraint on the implementation of development projects, and has particularly important consequences in the light of the capacity limitations of most governments.

- \* *Regional institutions exist, but have had mixed success.* This is due mainly to the lack of demand for imports from other African countries, continued distrust and many of the other structural economic issues raised in this paper. In the absence of the necessary economic activities, and perhaps most importantly, the lack of vibrant private sector agencies, institutional arrangements often take shape in a vacuum. There is, nonetheless, a need for action and innovation in this regard.
  
- \* *The conflictual nature of African politics is not unlike that in other parts of the developing world, but has made investors uneasy about coming to African locations, perhaps more so than in other parts of the developing world.* Violent conflicts within and between nation-states, and an ongoing inability to forge sustainable alliances have marked many parts of the continent. Recent development indicators suggest definite correlations between such conflicts and the economic fortunes of the countries and regions involved, although it would be unduly simplistic to argue that this is the sole cause of the woes of such areas. There are, as pointed out earlier, distinct structural causes which continue to shape the patterns of development and underdevelopment, especially in sub-Saharan Africa. However, it is noteworthy that conflict-ridden Liberia, Rwanda, Somalia and Ethiopia are often singled out as particularly poor areas, suffering contraction even when others make progress.<sup>24</sup>

### *Administrative Weaknesses*<sup>25</sup>

The problem of weak public administration manifests itself in three distinct forms. The first concerns the lack of proper policy and planning capacity; the second is about the high levels of centralisation and expenditure in the public service; and the third centres around the poor quality of services and the service sector in many African countries.

- \* *Faced by so many development challenges and resource constraints, many African governments have simply not managed to establish sound information bases, analytical capacities and policy-making and planning mechanisms to mould the type of policy environment fundamental reforms require.* Critical public policy issues are mostly inadequately analysed; little relevant and timely research is done; data sources are generally inadequate or unreliable; and high-level officials in key economic ministries are sometimes poorly trained and equipped. This has increased the dependence on expatriate advisors, but failed to resolve the problem in a sustainable manner. This will likely only happen if indigenous capacity is created. Until this switch, African governments are unlikely to take full ownership of the policies required to overcome the structural problems their countries face. This appears to be a major difference between the African experience and that of countries like Malaysia and Indonesia where considerable investment in capacity-building occurred and where governments now have access to structured policy and planning expertise in their own ranks.
  
- \* *The centralising and statist tendencies in most developing countries are often rooted in their economic circumstances.* Many lacked a domestic entrepreneurial class that could mobilise capital and develop the economy; hence governments often felt compelled to do everything themselves. The result has been extensive intervention and direct participation in productive activities. While this has not been unlike many of the experiences in the developing world, African countries have not yet entered a phase of private sector engagement and the selling of public sector assets comparable to the Asian and some Latin American experiences.<sup>26</sup>
  
- \* *Centralist tendencies have also prevailed in the public sector.* Sub-national governments either do not exist at all or are inadequately staffed, financed and managed. Within national departments, the emphasis has been on control, rather than facilitation of activities at all levels and in the broader environment. This is, of course, closely related to the

shortcomings in policy analysis and management, as the absence of coherent frameworks and mechanisms to direct their application, leads senior and central bureaucracies to feel the need for detailed control. This has not only had an impact on the nature of routine administrative management, but weakened the checks and balances required to ensure good governance.

### ***Limited or No Private Sector Activity***<sup>27</sup>

The governments in most developing countries have played - at least at some stage - a significant role in their economies. This resulted often from the lack of private sector capacity, sometimes because governments wanted to pursue goals which they felt required them to control the policy agenda tightly, and at times because they wanted to counteract the influence of external economic forces and agents.

In recent years, the private sector has increasingly become engaged in financing and service delivery and the generation of economic activities in Asian and some Latin American societies. As trade and economic liberalisation, public sector reform (especially the sale of state assets) and the worldwide sentiment towards joint public/private sector ventures took hold, the governments in these societies removed many controls on foreign investment and actively encouraged their own private sectors to expand. A few African states, like Ghana, Uganda and Tanzania have begun to move in this direction and those engaged in structural adjustment programmes have been compelled to do so. However, institutional capacities in the private sector are lacking and are often entirely non-existent. Without clear and flexible regulatory environments, and faced with limited opportunities outside the resource-based extraction export sectors, private enterprises have found it difficult to get established and expand their roles. The ambiguous ideological approaches towards greater private sector involvement have also inhibited the expansion of private sector activities. This remains one of the distinguishing institutional features in Africa.

### **Into the Global Economy**

Amid many variances, the generic issues facing Africans are:

- \* deep-rooted poverty;
- \* inadequate trade and foreign investment;

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- \* ongoing external debt and a decline in foreign aid flows;
- \* resource-based and undiversified economies devoid of significant private sector participation;
- \* a lack of progress towards regional trade and economic integration and co-operation;
- \* poorly serviced cities failing to lead economic growth as cities in many other parts of the world have done; and,
- \* unsettled, yet often centralised political and administrative institutions operating amid political tension and uncertainty.

Africa is, however, not a homogeneous entity and the prospects for different regions, states, cities and districts to overcome these problems are likely to vary. In fact, some actors have already made some progress, while others seem to face growing difficulties. The realities and challenges facing Africans are also in some ways distinct from those that confronted or still confront the rest of the developing world. However, other developing countries offer important pointers towards the approaches and shifts in mindsets that African decision-makers should consider. The challenge is to balance the lessons learnt from other experiences with the particular conditions in Africa.

In this regard, the agenda for the future revolves around:

- \* Dramatic investment in the development of skills and capacities to manage, research and implement policies, strategies, development initiatives and new technologies;
- \* Economic policy and management changes directed at trade liberalisation and attracting foreign investment, but balanced with concerted efforts to diversify economies beyond their current narrow bases;
- \* Steps to strengthen and broaden regional trade and investment between African countries and to encourage African and other institutions to apply their commitments to regionalism more vigorously;
- \* Concerted efforts to establish lead cities and innovative urban management systems that would attract foreign and domestic investors; and,
- \* Institutional changes to facilitate good governance and effective service delivery at the different tiers of government and between governments and other roleplayers.

Many aspects of such an agenda resemble the recent growth paths of the developing countries in other parts of the world. They could obviously not be rigidly applied in Africa. However, with the necessary nuance, they provide the parameters for a way out of the predicament so many African countries face.

## Endnotes

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## 8.2

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### Response

*Tom Lodge*

Four characteristics of African states invite generalisation:

- \* their roots in colonialism;
- \* their uncertain territorial jurisdiction;
- \* their early and extensive involvement in economic activity; and,
- \* their dependency.<sup>1</sup>

Each of these features can be traced to their evolution during the colonial period. All of them have resulted in polities with unusually weak developmental capacities. These general observations do not have a uniform applicability throughout sub-Saharan Africa: in particular, in Southern Africa settler colonialism and industrialisation resulted in comparatively stronger states presiding over relatively better integrated political economies.

#### Colonial Roots

In most cases, African state formation was by colonial administrators. Liberia and Ethiopia represent exceptions. Some African states were built upon the foundations laid by pre-colonial indigenous state formations, Lesotho and Swaziland for example, and others, especially in the case of British colonies, ruled along indirect rule principles used localised pre-colonial political structures as the essential units in local and regional administration. Even so, the modern notion of a state as a bureaucracy standing apart from society and coordinating and controlling its various components and activities was generally an exotic import. Colonial states were distinctive in several ways. *First*, and most obviously, they lacked sovereignty - indeed in some cases colonial territories were treated administratively as extensions of the metropolitan country: in the case of French Africa, for example, qualified Africans helped to elect members of the French parliament. *Second*, they depended very little upon instruments of legitimation: their power, such as it was, rested upon coercive capacity, especially at the beginning, though 'welfare colonialism' became more important from the mid-1930s. Political forms of legitimation were very rare until after the Second World War. *Third*, their power to transform society was quite limited - partly because colonial states had such

limited hegemony. In Africa they were created very swiftly, mainly from the beginning of the 20th Century by powers which were already beginning to experience political and economic decline: there was no strong economic compulsion behind their creation (contrary to the expectations and predictions in Leninist or Hobsonite explanations of colonialism and imperialism there was to be comparatively little imperial investment in sub-Saharan Africa - not outside Southern Africa). So colonial states had to be self-sufficient fiscally, for the most part of their history - they had to 'pay their way'. Colonial powers rarely supplied them with the military means to totally dominate society. The numbers of expatriate administrators - especially in British colonies - were always small - 5,000 in Nigeria at most. Their internal taxation capacity was very limited - more in the South than in the West - but generally, most colonial revenues came not from personal taxation but from customs dues and, from the 1940s, from marketing boards. Colonial states had a strong propensity to intervene in the economy; this was driven partly by fiscal needs. However they were administratively weak. Colonial states often incorporated local political systems, patterns of justice and social relationships. Because they depended upon these systems for their effective authority, colonial administrators tended to be socially conservative - in the sense that they were hostile to transformations of social structure.

### **Uncertain Territorial Jurisdiction**

States have a second dimension: the term 'state' means both an institutional apparatus and a geographically defined territorial unit. In this second sense, African states are external creations. Because of this they are often seen as 'artificial'.<sup>2</sup> Of course, all states are artificial, except perhaps for islands - most are the result of conquest, war, imperialism, and so forth. The argument about African state 'artificiality', though, implies something more than this: that the state boundaries created at the 1885 Congress of Berlin were peculiarly inappropriate, that they overlaid and cut across a pattern of territorial state formation which if it had been allowed to persist would have produced states which in a territorial sense would have been more 'natural' or logical. Colonisers, it is sometimes said 'balkanised' Africa. This view is tendentious. Colonial partition tended to bring together smaller units rather than splitting up larger ones - and, indeed, colonial powers tended to try and create still larger units after partition. True, not all boundaries followed geographical features - for example, watersheds and mountains - but this is not a general characteristic of territories elsewhere. True, some communities were split between different territories - but on the whole it was unusual that this would affect communities which if left intact would themselves have formed a political unit large enough

to become, for practical purposes, a nation-state. The real problem was that colonial states paid so little attention to the business of national integration - that task was left to their post-colonial successors. Indeed, within the frontiers they created some colonial powers tended to accentuate regional distinctions - and these could become ethnic ones as well. Secondly, colonial power rarely extended to frontiers, and the notion of the frontier was for most colonial history, fairly abstract. It is only quite recently that African states have had the capacity to control and regulate movement across their boundaries.

### **Involvement in Economic Activity**

In developed industrial economies the formation of the modern bureaucratic state tended to follow rather than precede the modernisation and commercialisation of their economies. In Britain, for example, the mid-Victorian civil service, notwithstanding the size of the military apparatus (chiefly naval), was quite a modest affair until the establishment of compulsory schooling in the 1870s - half a century after Britain had become an industrialised society. In Africa the development of a relatively sophisticated state apparatus has tended to *precede* modern economic development and, indeed, be chiefly responsible for it. In other words the state has performed the accumulating and investing and exploitative functions that elsewhere has been played by entrepreneurial groups in society at large. Notwithstanding the limits to its administrative capacity some analysts have called African states, for this reason, 'overdeveloped'.<sup>3</sup> On the whole, both during the colonial period and in the post colonial aftermath to it, the state has been the main actor in the modern sector - has often been the chief employer, and has often been the nexus of class formation - the axis around which the development of propertied classes has taken place. Hence, political control of the state has a peculiar significance and importance in an African context. At their moment of entry, colonial powers confronted societies which were relatively undifferentiated - compared with colonised societies elsewhere - in South and Southeast Asia. Of course, there were exceptions, particularly in those African societies which had developed relatively large and hierarchical political structures, but very few of these had developed to the point of initiating large scale production beyond the household unit. Only in exceptional cases did the colonial power invest sufficient resources in society to profoundly alter its structure and its accompanying value and belief system - and these exceptions tended to be in the south where the presence of large settler populations and the existence of mineral deposits were powerful compulsions in favour of large scale proletarianisation. Some theorists have argued that rather than penetrating society African states have been penetrated socially, that at their base they are

very permeable, that the distinction between state and society is very unclear and that state formations become dominated by the dominant social relations, those of lineage systems, kinship and clientelism. Jean Bayart contends that in Africa colonisers simply imposed a superficial modern administrative web upon indigenous social structures which remained unchanged and which today exercises the most powerful influence upon African bureaucracies. Hence the widespread privatisation or personalisation of notionally public resources - corruption.<sup>4</sup> Such 'informal state society linkages' are one reason why African states are widely perceived as 'soft'.<sup>5</sup>

## **Dependency**

Colonial states were by definition dependent. Whatever legitimacy colonial state authority possessed tended to rest upon the coercive power which could be mustered and despatched by metropolitan countries. In the 1940s and 1950s, France and Britain abandoned the notion of colonial financial self-sufficiency. By the end of the 1950s, colonial government was heavily subsidised by metropolitan exchequers - though metropolitan currencies benefitted from the savings made by colonial marketing authorities in metropolitan banks. So new post-colonial governments were rarely in a position in which they had the internal resources to govern effectively. They had tiny armies and police forces, they depended upon external trade for most of their revenues, and at best local level administration was quite rudimentary. Often the power of the state apparatus was organisationally less impressive than the administrative capacity of the nationalist movement which had developed in opposition to it. Indeed, the incorporation of the party apparatus into the state apparatus was a very common experience in post-colonial African political history. The expansion of welfare services to meet popular expectations or the expansion of the coercive apparatus to contain them - both necessary tasks for states which were inadequately prepared for carrying out the normal obligations of modern government - had normally to be accomplished through taxing trade, usually at the expense of rural producers (who because they were dispersed were less threatening to the state's authority than those who lived in towns). State revenues therefore drew upon and tried to maximise earnings generated by commodity exports and were heavily dependent on world prices. As these declined, states became increasingly dependent upon other forms of externally derived income, such as aid and loans. Fiscally, African states have been externally oriented to an unusual degree, no more so than today.

Certain former colonial territories have succeeded in overcoming these weaknesses. Adrian Leftwich has identified six features which characterise

'developmental states' which had prevailed over rapidly growing and in other senses developing economies. These features are:<sup>6</sup>

- \* A determined developmental elite;
- \* Relative autonomy;
- \* Insulated economic bureaucracy;
- \* Weak and subordinated civil society;
- \* Effective management of non-state economic interests; and,
- \* Combination of repression, legitimacy and performance.

Most modern African states fall short of this ideal type. African states may or may not be managed or led by a developmental elite - but they have a strong propensity to consume rather than invest. Their internal and external autonomy is quite limited; they are penetrated by society and dependent upon externally derived resources. Their ability to socially insulate their bureaucracies is questionable. Civil society may be weak but the state often finds it difficult to subordinate civil society - except at the cost of destroying it. There are few economic interests which are not already state directed, at least in the modern sector. The state's relationship to the economy tends to be parasitical rather than managerial, especially in national context in which gross capital formation declines. African states are indeed repressive but their legitimacy is at best questionable and for broad swathes of society performance is non-existent.

### **Southern Africa**

Southern African states may constitute partial exceptions to these generalisations. No Southern African state is free of the shortcomings which characterise African bureaucracies, but these affect the functioning of government less in this region than elsewhere in Africa. Southern African states differ characteristically from most African post-colonial states in having stronger or at least longer established traditions of legitimation and political continuity. In several countries the formation of the modern state has been facilitated by the congruence of frontiers with pre-colonial political boundaries: Lesotho, Botswana, Swaziland, Zimbabwe and, in certain respects, South Africa, have benefitted from this. In the cases of South Africa and Zimbabwe especially, complete sovereignty or at least considerable national political autonomy for most of the century has enabled their administrations to develop a degree of social impermeability. State autonomy is also facilitated by what are in African terms quite well-developed capitalist class structures in relatively

diversified economies; in especially South Africa, Zimbabwe, Botswana and Swaziland, the state is less significant than elsewhere upon the continent as a nexus of class formation and hence can function more independently of specific social forces. These qualities reflect the comparatively sophisticated bureaucratic development required to administer a labour repressive mining economy which evolved at the turn of the century, fairly extensive secondary industrialisation in South Africa and Zimbabwe, and sharply differentiated social structures which include large and well-organised working classes and correspondingly vigorous industrial, commercial and agricultural bourgeoisies. The remainder of this paper pursues this argument in more detail.

Until recently, racial exclusiveness helped to reinforce the state's autonomy in South Africa as did a degree of social and cultural distance between political and economic elites. Independence from these elites is partly attributable to the relative strength of what David Yudelman has termed a 'legitimation imperative' arising from the institution of democratic politics (for whites) before the creation of an industrial society.<sup>7</sup> This helped to explain the state's attentiveness to the needs of farmers despite the competing labour claims of business.<sup>8</sup> In relatively economically diversified Zimbabwe, the state has also been able to maintain a balance between the interests of different sectors of capital, notwithstanding the powerful influence exercised by settler agriculture; in certain respects the ascendancy of a African nationalist governing class in 1980 has strengthened state autonomy. The government has been able to resist urban pressures for cheap food and maintain pricing policies which are generally favourable to rural producers and to small-holder peasants especially. Crop marketing boards remain exceptionally efficient and, in contrast to the experience north of the Zambezi, continue to invest their surpluses in the countryside.<sup>9</sup> Sophisticated financial regulatory institutions developed during the UDI period had been by 1990 rather successful in directing foreign investment to promote a more competitive domestic industry<sup>10</sup>; these gains have since been largely dissipated by over-hasty tariff reductions. Relatively early representative politics for Namibian settlers also helped to advance the fortunes of a commercial farming class but until independence state policies remained subordinate to South African economic priorities and this ruled out any local manufacturing or processing. Democratic politics under a government of former guerillas has accelerated a growing Africanisation of the ranching class. This together with the purchase of equity shareholding in the diamond industry (which supplies about half of public revenues) helps to keep government policies business-friendly and keeps social reform gradual.<sup>11</sup> With respect to Botswana, the social connections of a landowning rancher class and the political elite are very intimate; here the state's measure of social insulation is a reflection of the idiosyncratic preferences of an aristocratic ruling group whose

economic base was well established before decolonisation.<sup>12</sup> Retaining the services of a large group of expatriate technocrats helped to protect the bureaucracy from social pressure.<sup>13</sup>

Several of the structural predeterminants of Botswana state autonomy were present in early post-colonial Malawi and Swaziland, notably the existence of a landowning class: the possibility of capital accumulation outside the state already existed. In the case of colonial Malawi, estate agriculture was foreign owned and the creation of an indigenous group of commercial farmers depended upon public finance. Much of the sector was to be owned by President Banda's personal parastatal, Press Holdings.<sup>14</sup> In Swaziland, plantation revenues from multinational corporations supplied the capital of a royal holding company, the Tibiyo Taka Ngwane.<sup>15</sup> In these two countries, in contrast to Botswana, state power was employed to create huge patrimonial estates in which the distinction between the private and public domain became very blurred indeed. In Lesotho an extreme degree of external fiscal dependence places severe constraints on state autonomy; for over two decades after independence a government representing junior chiefs consolidated the fortunes of this group through adroit exploitation of donor agencies' susceptibilities to accord Lesotho a special position in their priorities.<sup>16</sup> Of all the Southern African countries though, Zambia resembles the most stereotypical 'economy of affection'.<sup>17</sup> In this country, the state served as the main motor of indigenous class formation and a swiftly expanding public sector supplied a generous field of political patronage. Notwithstanding the presence of an expanding entrepreneurial class within the bureaucracy, state activity was mainly geared to consumption rather than accumulation, much of it in the form of generous subsidies to strategically placed political constituencies.<sup>18</sup>

In Angola and Mozambique violent decolonisations allowed insurgent elites to capture political power. In Angola, three separate liberation struggles left state power in the hands of an *évolué* grouping already well represented in the colonial civil service and largely drawn from a creole elite in Luanda.<sup>19</sup> In Mozambique the victorious guerilla leadership embraced rather a wider social range but FRELIMO's urban leadership's antipathy to the chiefly colonial collaborators ensured hostility to its policies in many parts of the countryside.<sup>20</sup> In both cases the ruling groups were ideologically and culturally distinctive and their initial policies suggested a freedom from the communal and moral restraints which bound other African states to prevalent social conventions. Even without the force of external military aggression, though, the frail and permeable foundations of state power in these two territories would have made the 'revolutions from above' contemplated by their governments impossibly ambitious. In each of the four territories in which the state's internal freedom



of manoeuvre was quite limited, Lesotho, Zambia, Mozambique and Angola, their governments developed extreme degrees of external fiscal dependency and foreign indebtedness which today detract significantly from their sovereignty.

With the exception of the former Portuguese territories, state reach in Southern African countries is extensive either because it reflects substantial bureaucratic systems of repression and control developed during the colonial period in quite diversified modern economies (as in Rhodesia, Namibia and South Africa) or because of the very small size of the territories (Swaziland and Lesotho) or the relative density or concentration of population and social networks (Malawi and Zambia). Until the mid-1980s, South Africa maintained an extensive apparatus to control the geographical movement of black workers, in this process arresting 300,000 'pass offenders' every year.<sup>21</sup> The degree of administrative social penetration deepened in the 1960s with the institution of almost universal primary education and the provision of (very meagre and racially inequitable) pensions to all adults. To maintain these services an enormous bureaucracy developed, employing 1,081,000 people in 1994.<sup>22</sup> In the cases of Lesotho and Malawi state penetration was chiefly manifest in the power of repressive agencies which were built along earlier networks of pervasive nationalist mobilisation which themselves reflected the depth of proletarianisation through migrant labour. State access to mineral wealth permitted the expansion of subsidies, welfare services, and social security on a considerable scale in Zambia during the 1960s and early seventies and, more recently, in Botswana. Relatively efficient state distributive networks in Botswana dated from an unusually effective colonial famine relief system, an institutional response to an especially harsh climatic environment.<sup>23</sup> In Zambia, Lesotho and Malawi, shrinking resources and foreign indebtedness has led to a geographical contraction of the state and its effective disappearance from remoter rural areas. Counter-insurgency campaigns in Rhodesia and Namibia during the 1970s and 1980s encouraged colonial states to reorganise settlement and expand welfare services to an extent well beyond the normal reach of colonial states elsewhere in Africa. Counter-insurgency in Mozambique and Angola also strengthened state capacity and supplied some of the impetus for post-colonial social engineering efforts in former 'protected villages'. Civil wars and South African 'destabilisation' put paid to any efforts to expand the scope of state institutions in Mozambique and Angola and in contemporary peacetime Mozambique the state's fiscal dependency has led to a direct usurpation of its functions by foreign NGOs.<sup>24</sup>

Obviously state authority is closely tied to the effectiveness of its repressive and welfare components. To be sure, that authority can be considered legitimate simply if the majority of a repressive state's subjects perceive no conceivable alternative to its rule; outside of South Africa before 1976 and Rhodesia before the inception of peasant-based guerilla warfare, no Southern African state has

possessed coercive power on a sufficient scale to rule without ideological forms of legitimisation. Even in South Africa, racially limited representative democracy and accompanying liberal institutions was a significant component of state rule and probably affected values and expectations amongst a large section of the disenfranchised. Liberal democracy has shaped the post-colonial histories of Botswana, Namibia and Zimbabwe. In the case of Zambia, the existence of a strategically placed and very well-organised labour movement quite independent from the control of the ruling party, compelled the state to invest heavily in ideological activity and to allow measures of freedom and choice within the constraints of one party politics. In Swaziland traditional patrimonialism and in Lesotho and Malawi neo-traditionalist discourses help to sustain the state's authority, but in these cases ideology probably has had less to do with the long survival of autocratic government than the relative ease of governing geographically small countries and, in the case of Swaziland, the state's relative wealth. In Angola the state's ideological legitimacy was contested from its inception and it has yet to obtain territorial hegemony: this reflects an especially fragmented expansion of colonial society in three distinctive regions within the country. In Mozambique the post-colonial state might have fared better had it not adopted ideologies and programmes so much at odds with the beliefs and aspirations of most rural people.

To what extent has post-colonial Southern Africa been administered by effective and rule regulated bureaucracies geared to developmental ethics? South Africa, Namibia, settler Rhodesia,<sup>25</sup> and modern Botswana evolved professionalised and technically competent bureaucracies, and direct political interference remains in each quite limited. Arguably, in the case of South Africa, socially exclusive recruitment detracted from efficiency but a Public Service Commission generally succeeded in curbing personalised forms of patronage by politicians.<sup>26</sup> In Malawi, as in Botswana, the long period during which expatriate experts were retained helped to socially insulate the civil service. Compared to many African countries, relatively slow rates of bureaucratic expansion have helped to maintain bureaucratic quality. In the cases of Zambia and Lesotho, bureaucratic growth was from very modest starting points for in both these countries colonial governments delegated administrative and welfare functions to private agencies to an unusual extent. Zimbabwe's administration expanded swiftly after 1980, matching the proliferation of services, but this growth merely maintained the momentum of the counter-insurgency period and included a significant demilitarisation. After South Africa, the largest public service is Zambia's but its 180,000 workforce of 1995<sup>27</sup> remains smaller than the Ghanaian bureaucracy in 1960. Civil services have been least effective where their functions have been replicated by party or parastatal structures and where political leaders have prevailed in recruitment and promotion: Zambia, Lesotho,

Mozambique and Angola are all cases in point. In South Africa, Zimbabwe, Botswana, Swaziland and, more arguably, Malawi and Namibia, the state has been rather successful in promoting local accumulation of capital both within and outside the public sector; in Lesotho, Mozambique, Zambia and Angola the state's deployment of resources has tended to be more wasteful, geared either towards consumption or to warfare. In all these territories the factors which are generally held to cause political corruption - the persistence of pre-colonial tributary obligations, the status insecurity of emergent as opposed to established elites, institutional expansion and proliferation, and comparatively undifferentiated social formations<sup>28</sup> - have been less of a feature of the political system than elsewhere in Africa and hence bureaucratic venality has generally been less pervasive.<sup>29</sup>

As noted above the historical roots of modern states are deeper in this region than elsewhere in Africa; also, the existence in the region of diversified and complex capitalist economies as well as the bureaucratic requirements of large scale labour mobilisation help to explain the evolution of comparatively resilient and effective state structures in Southern Africa. To this might be added, notwithstanding its damaging effect on the former Portuguese territories, the impact on state formation of militarisation and warfare, as well the integrative role played by fairly vigorous working class mobilisation, and relatively early development of state programmes of legitimisation arising from the presence of enfranchised settler minorities. Finally, the existence of developmentally effective states in the region seems to more or less coincide with those societies in which early modern state formation was closely linked to the consolidation of a local agricultural bourgeoisie. Southern African state hardness is derived from structural features of the region's political economy and historical characteristics which distinguish it quite sharply from the rest of post-colonial Africa.

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## 9.1

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### Lessons from the Asia-Pacific

*Brian Absolum*

I am always a bit nervous about any suggestion that other people have something to learn from us, in New Zealand. It makes us sound a bit patronising, a bit pleased with ourselves. On the other hand South Africans are always telling me that they are going to teach us how to play rugby. They even say they are going to provide an intensive course of tuition over the next series of Test Matches, so I suppose it all evens out.

It is a fact, however, that New Zealand has done some things in the last ten years or so that have radically changed the way we manage our economy and have attracted the interest of other countries. By the end of the 1970s and the beginning of the 1980s, our economic performance was one of the worst in the Western world. All kinds of things were wrong:

- \* For a start we were over-regulated. Business was stifled by a bewildering range of directions and injunctions about what it could and could not do. In a misguided attempt to control inflation we even imposed a freeze on wages, prices and interest rates;
- \* We were over-taxed. Our highest marginal income tax rate was a crippling 66 cents in the Dollar. That was something that people on modest incomes had to face. Indirect taxes were inconsistent and lacked transparency;
- \* We were over-protected. Our tariff and other barriers were very high. We paid our farmers and our manufacturers significant subsidies and gave them export incentives;
- \* Our expenditure on social welfare was well beyond what we could afford. In 1977, the Government introduced what must have been the most generous public superannuation scheme in the world, giving everybody who attained the age of 60, regardless of what they earned or what they owned, a pension equivalent to three-quarters of the average wage;
- \* We were heavily in debt. Years of borrowing to bridge both large budget and balance of payment deficits had put us in an untenable position; and,
- \* Finally, although the government was involved in just about every kind of trading activity you could think of, it was often unsure of what it was trying to achieve and ill-equipped to operate efficiently or profitably.

The consequence of all this was high inflation, minimal growth, expanding unemployment, a misallocation of resources, an unsustainable national debt and a structural balance of payments deficit. Apart from that, things were pretty good!

The truth was that we had just about come to the end of the road and that if we were going to get out of the hole we had dug for ourselves we were going to have to do things differently. The government that came to power in 1984 realised this and adopted what you would now describe as a 'big bang' approach. Reforms were introduced at high speed. A measure would be talked about one day and in place the next. Roger Douglas, the architect of many of those reforms, reasoned that if you moved quickly and widely enough, the cost of reforming one sector of the economy would be met from the benefits of reforming others, that you would retain the initiative and not allow special interests to coalesce and put obstacles in your path and that the burden of the reforms would be shared equitably. Let us look at some of the things we did:

- \* We undertook a sweeping deregulation of financial markets, floated the exchange rate, removed restrictions on bank competition and abolished all controls on capital movements;
- \* We unilaterally removed all quantitative controls on imports and slashed tariff levels. By the year 2000, all but a handful of tariffs will be at either zero or 5%. People said that that would cripple our industries and cost jobs. It did not. It made us more competitive and focus more closely on the things we were good at;
- \* We comprehensively restructured the tax system, introducing a value added tax, cutting direct tax rates and phasing out others. We now have only two income tax rates: 33% and 21.5% and the lower rate will be cut to 19.5% in a year's time;
- \* We undertook one of the largest privatisation programmes in the world (measured as a percentage of our GDP), selling state agencies worth over R35 billion. And in so doing we did two things that other countries did not. First, we tried to get the best possible price by neither favouring nor excluding any particular bidders, including foreign bidders. And, second, we elected to privatise only those government-owned corporations that were operating in a contestable market at the time of privatisation. Thus our national airline was not sold until the domestic skies had been deregulated;
- \* Partly flowing from the privatisation programme - but also reflecting a fundamental downsizing and restructuring - we reduced the number of people employed in the public service by 59% in the decade after 1984;

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- \* We abolished all subsidies to the farming sector so that our farmers now get only what they earn in the international market place. After the initial pain New Zealand farmers adjusted rapidly and constructively. They became more innovative and responsive to markets. They allocated their *resources more efficiently and developed new international customers for competitive new products*;
- \* Importantly and perhaps uniquely among the advanced economies we abolished the old system of compulsory union membership and replaced it with a more flexible labour relations framework. The results were significant. In 1990, the last full year before the change, 331,000 working days were lost through work stoppages, whereas in 1994 (the last full year for which data is available and a year in which the economy was growing strongly) there were only 38,000 days lost; and,
- \* Finally, we sought to consolidate and lock in the macro-economic policies underlining these reforms through some important pieces of legislation. One is the Fiscal Responsibility Act which requires the government to report to Parliament on the extent to which the government's fiscal policies are generally consistent with accepted business practices and to justify any departure from those principles, including, importantly, before an election. Specifically, the Act requires the government to reduce public debt to 'prudent levels' and to maintain them by ensuring that total operating expenditure does not exceed total operating revenue. In other words the Act outlaws budget deficits unless the government can find a convincing justification for them. Another piece of legislation is the Reserve Bank Act which allows the government to set targets for inflation, but gives the Reserve Bank sole responsibility for implementing the policies necessary to meet those targets - without interference from Ministers, the Treasury or anyone else. The Governor of the Reserve Bank is currently on a contract which requires him to maintain price stability within the range of zero to 2%.

So those were the problems we faced and our solutions to them. What about the outcomes?

- \* Our real GDP growth over recent years has reached levels of between 5% and 6% and, although it has slackened off in the last year, is forecast to remain at between 3% and 5% on a sustainable basis;
- \* Despite this strong growth, underlying inflation has stayed around 2% or below since 1991 and is expected to remain at these levels;
- \* Unemployment has fallen from 11% of the work force a few years ago to 6.2% today. New jobs are being created at a rate of 5% a year;



- \* The government's accounts are now in surplus and are expected to remain so indefinitely. Indeed the surplus is forecast to grow to 8% of GDP by 1997-98;
- \* These surpluses have given the government the capacity to do three very important things: *first* to reduce public debt from what was a high of 52% of GDP in 1992 to below 30% this year; *second*, to cut corporate and personal tax rates; and *third* to put more money into priority social areas like health and education;
- \* Moody's international credit rating agency a few months ago emulated Standard and Poors in upgrading New Zealand's credit worthiness. We have nudged ahead of Australia for the first time since these ratings were established, to just one notch below the world's most secure economies. This move reflected the rating agency's judgment that a strong majority of New Zealanders support the thrust of the economic reforms of the last decade;
- \* For the last three years the World Competitiveness Report has rated New Zealand the top country for government policies most supportive of business, and for the long term competitiveness of domestic economic policies. We are now rated eighth overall and sixth in the OECD; and,
- \* Foreign investment has flowed into New Zealand at record levels, reaching almost 6% of GDP in 1993.

So what lessons can South Africa draw from our recent experience? Well I realise that here I am getting into dangerous territory. Whatever I might say, there is a risk that I will be accused of teaching my grandmother to suck eggs, of stating the obvious, of misunderstanding South Africa. All I will say is that our experience suggests that governments will *not* succeed if they:

- \* *Spend money they do not have and run up a crippling national debt.* Our objective in the 1970s was to maintain living standards even though our income was static at best and our cost of living was rising. By borrowing massively we managed to do it for a few years but the day of reckoning eventually came. Even in the late 1980s, we were spending one out of every five dollars of public revenue on debt servicing;
- \* *Protect industries that are inefficient or lack comparative advantage.* Our experience with agricultural subsidies is illuminating. Although New Zealand has significant natural advantages in pastoral farming, subsidies became part of the culture from the early 1960s until they were totally abolished in 1987. They were said to be necessary to create employment, to maintain levels of output, to protect the social environment, to give the

farmers a fair go and so on. We found that that was not so. On the contrary the evidence suggested that the subsidies' major contribution was in the field of inefficiency. The only real hope for most economies is to become internationally competitive and to dispense with props and fences;

- \* *Get involved in areas of business where the private sector can do a better job.* We now take the view that the government should get out of individual businesses unless there is a compelling social policy reason to stay there. The privatisation process in New Zealand was initially launched as a way of raising the money with which to reduce our debt. But further down the track it became apparent that the gains in efficiency and productivity were compelling and were in themselves a justification for the change. To give you just one example: Telecom, since it was privatised in 1990, has increased after tax profits from NZ\$257 million to NZ\$717 million, reduced the real prices of telephone services to households by an average of more than 21% (and to businesses by 28%), and has hugely improved the range and quality of its service to customers. Indeed it now has a higher proportion of digital quality lines than any comparable system in the world except Hong Kong; and,
- \* *Do not look after the people at the bottom of the scale as best they can.* The capitalist system is possibly the most efficient yet devised. Its major flaw is, however, that it creates major disparities in wealth and income which can lead to social and political disruption unless they are reduced. New Zealand has had and retains a comprehensive social welfare system. As part of a significant effort to reduce expenditure the government cut some benefits in 1991. Even so it still spends 11.5% of GDP on social welfare.

So there it is. I would not dare to suggest that what we have done in New Zealand will work in South Africa. Your background and your environment are different. And there are plenty of New Zealanders who will insist that what we have done has not worked in New Zealand either. But there may be some things you will want to look at. And we are certainly worth trading with. We have purchasing power. Our economy is half as big as yours and only slightly smaller than Malaysia's. We are efficient. And we have been judged to be the least corrupt country in the world.

## 9.2

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### Response

*Peter Botha*

There is very little in the High Commissioner's paper with which I can actually disagree or find fault. But I will try and draw the circle a little broader than New Zealand. The paper is 'Lessons from Asia-Pacific'. What he has set out is now a well tried and tested formula in the Asia-Pacific. If the successful economies in the Asia-Pacific region are scrutinised, it is possible to identify certain policy threads running through all of them.

The region's countries differ greatly in terms of race, culture, language and religion but they all have certain basic fundamentals in place. These have been clearly set out in the High Commissioner's paper. He has also pointed out New Zealand's mistakes in the past. I might add that most of these mistakes exist in South Africa and are the issues that confront government today:

- \* Over-regulated business and government sector: one just has to think of the control boards for example;
- \* Over-taxed (both business and individuals);
- \* Over-protected industries;
- \* Expenditure on social welfare above what can be afforded; and,
- \* Heavily in debt.

The consequences are also well spelled out by the High Commissioner:

- \* High inflation;
- \* Minimal growth;
- \* Expanding unemployment;
- \* Misallocation of resources;
- \* Unsustainable national debt; and,
- \* Structured balance of payments deficit.

All these problems to some degree manifest themselves in the South African economy today. Mr. Absolum has provided an indication of what a country must do and what it must not do to be economically successful. If it is so

simple, however, why is it that there are still governments who do not follow these guidelines for success?

Discarding the intricacies of constituency politics for a moment, which is of course something one cannot ignore, I will suggest that in this post-Cold War environment one of the main reasons why certain countries have lagged behind is because of ideology. It is my contention that ideology plays a very small role in the success of the Asia-Pacific economies, where governments emphasised that the type of political system is not that important. It is the betterment of a country's people that counts. For instance, countries like New Zealand and Singapore have socialist elements in their policies which are less evident in countries like Thailand and Korea.

As the paper pointed out, a major flaw in the capitalist system is that the disparity of wealth and income to which it lends itself can result in social and political disruption. New Zealand therefore has had, and retains, a comprehensive social welfare system. Singapore on the other hand, has travelled a different route. Singapore, for instance, has heavily subsidised social infrastructure - education, housing and basic health care - but has refrained from spending on social welfare. Prime Minister Goh Chok Tong of Singapore explains their approach by saying: 'their efforts to *level up* society has always been motivated by the principle of equality of opportunity as opposed to equality of outcome'.

If the fundamentals are in place, different ideologies can be catered for and are not material to the success of the country. Unfortunately, it would seem that ideology still clouds some of the decision-making about fundamental policy in Southern Africa. A closer look at the Asia-Pacific will show that ideology is less of a factor. For example, some governments have communist policies, for example, China and Vietnam. Some have capitalist policies, notably, Thailand and Malaysia. Some are more democratic than others, but this has not effected the economic policies they have implemented. Dr. Lee Tsao Yuan, Deputy-Director of the Institute for Policy Studies in Singapore pointed this out in an interview with *Asia Week* on Singapore's system and its success: 'If anything, it's the ideology of pragmatism and efficiency, of getting things done'.

The paper suggests that the best way to get things done is to have business-friendly policies. Mr. Absolum referred to the World Competitiveness Report which rates New Zealand the top country for the last three years in terms of government policies most supportive of business.

The paper also points out that it is not a blueprint for South Africa.

Nonetheless, reading between the lines, his message for success is obvious:

- \* Deregulate the financial markets;
- \* Lift import controls and tariff barriers;
- \* Cut direct taxes, emphasise indirect or consumption tax;
- \* Privatisise state assets, using the proceeds to reduce debt;
- \* Reduce the public service;
- \* Abolish subsidies, both in industry and agriculture; and,
- \* Reach an arrangement with the unions.

All the above have been vigorously debated in South Africa but, some will contend, have not been tackled with the necessary conviction. Not all the successful Asia-Pacific economies have followed the 'Big Bang' approach of New Zealand, but they have all made similar decisions and been persistent in their application through long-term planning.

The results have been phenomenal. I remember the New Zealand of the 1970s as a country with no hope. Heavily dependent on agricultural exports, their traditional European markets were becoming less accessible (as we in South Africa are experiencing now). With severe recession, no natural resources of consequence or industrial base of consequence and crippling debt, the future was indeed bleak. In fact the whole region, with a few exceptions, was regarded with scepticism. Yet they performed a so-called economic miracle. You may say that New Zealand and Singapore are less relevant for South Africa because of their small size and population, but Indonesia with 190 million people and China with 1.2 billion people, are on the same growth track. Even the other slumbering giant, India, with its population of 900 million, is showing positive results with its open economic policies.

At the recent launch of the African-Asian Society in Johannesburg the key-note speaker, Mr. Ronnie Chan, a prominent businessman and chairman of the Hong Kong Asian Society emphasised two crucial elements in the Asian economic success.

The first is the role of government, which forms the thrust of the High Commissioner's argument. The second is the role of the people themselves. This element was addressed indirectly in the paper but should be mentioned again. It is necessary to inculcate a belief in hard work, thriftiness and, more importantly, a measure of self-sacrifice. Hard work and productivity are not related to ethnicity but are a factor of education and good management. There

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is no instant gratification. New Zealand started its policy change over one-and-a-half decades ago and only now is starting to really reap the benefits.

In conclusion, many of the aforementioned success factors are now accepted as conventional wisdom. Hopefully we, and Southern Africa, will also take them to heart.

### Lessons from Latin America

*Antoinette Handley*

The debate about economic policy and reforms is, in many senses, a debate about the state: what the state is and what its role in the economy should be. Since the 1960s and 1970s, we have seen a fundamental shift in this discourse and seen, in the 1990s, a realignment of arguments around neo-liberalism, and even, in some countries, the emergence of a new neo-liberal fundamentalism.

Any consideration of the lessons which South Africa can learn from Latin America, takes us to the heart of this debate and to the paradox of neo-liberal reforms *viz.* that the very reforms which set out to reduce the scope and role of the state, require the services of efficient and competent state structures for their implementation. If one is to consolidate economic reform in newly democratised emerging markets, it is necessary not simply to introduce new incentives and efficiencies into previously state-owned sectors of the economy (through privatising and restructuring), but to do this to the state itself too. The debate is not simply one about what the state should *not* be doing, and how to facilitate the involvement of the private sector in these areas, but also about what it is that the state *should* be doing, and how to strengthen its capacity in this regard. What is required then, is a state which is competent, not only in its immediate technocratic capacity but also in its ability to consolidate and institutionalise the process. Beyond the starting point and the fundamentals of stabilisation and liberalisation of the economy, Latin America can teach us much also about the dangers of substituting an 'amputation' of state capacity for a more judicious pruning and restructuring process. To a large extent, reforms in Latin America have been most successful and most sustainable where there has been effective guidance from the state, and where the state has also turned its reforming eye inward to embark on a process of internal restructuring.

We might begin therefore, by asking why Latin America is important as a source of lessons for South Africa. A number of reasons spring to mind.

The first is that the political economies of Latin America, and that of South Africa, share many similarities. We share a history of policies of Import Substitution Industrialisation (ISI) and a legacy of manufacturing sectors which were, for long periods of time, protected from international competition. In addition, the structures of our political economies all display, to varying degrees, reasonably high levels of poverty and socio-economic inequality.

Politically, South Africa shares with much of Latin America a history of authoritarianism (albeit of a very different sort) and, again like much of Latin America, has also embarked on the long and difficult path of democratic transition and consolidation.

Beyond the similarities however, the successes (and difficulties) of the Latin American region during the 1990s are an important indicator of both the potential offered to and the limitations which are imposed on developing countries like our own. In Brazil, inflation fell from 2,500% in 1993 to monthly rates in single digits. In the last eight years, the Chilean economy expanded by 75% and a growth of 5% was expected last year. Peru experienced an average of 8.9% growth over the last three years. The region's remarkable emergence from the economic chaos of the 1980s, the strong recovery evident in a number of states, and the sometimes astonishing rates of growth are elements that South Africa would very much like to emulate. Where these are accomplished alongside an uneven but nonetheless important consolidation of democracy, it appears that there is much that the region can teach us. This is precisely what I hope to examine a little more closely in this chapter.

In considering the policy lessons from Latin America, Haggard and Kaufman suggest three important areas:<sup>1</sup>

- \* The initiation of policy reform and what makes this possible;
- \* The substantive nature of that policy reform including both the scope and content of the reforms; and,
- \* Whether the reforms are consolidated - that is, to what degree they persist and are institutionalised.

### **The Initiation of Economic Reform Processes**

There is much debate about the precise combination of factors that make economic reform possible in any given society. In Latin America, a mix of factors appeared to be at work.

In the international arena, the economic collapse of the Soviet Union and the devastating impact of the debt crisis of the 1980s, led to an emerging convergence of views, first within international financial institutions, and later within a growing circle of policy makers and academics on the fundamentals of neo-liberal policies. The emergence of the 'Washington consensus',<sup>2</sup> as it has come to be known, marked an important shift in the international policy agenda and swiftly rendered any attempt at heterodoxy a dangerous and costly exercise



for developing countries.

Within Latin America more specifically, the debt crisis of the 1980s, the hyperinflation and reversals in economic development which accompanied this, were all important and motivated a radical rethink of policy options. The immediate and frequently devastating fiscal crises experienced, forced policy makers and newly elected leaders to cast about for new ways of making the state work and for improving its income. Neo-liberalism frequently proved one of the few options which would facilitate access to renewed international finance.

While it is clear however, that the international and regional political economy does constrain policy choices and sets important limits for emerging markets, the 'Washington consensus' - pressure from outside - is not in itself a *sufficient* explanation. It does not explain the precise timing of the onset of the reform process, nor does it explain variations in policy scope and content within the countries of Latin America.

An explanation for these differences must be sought in the particularities of the state and its political and institutional setting in each case. Despite many differences between the various Latin American states, two broad commonalities are evident. The first is the leadership provided by a powerful central figure in government, usually the President and/or the Finance Minister. Cardoso, Fujimori, Salinas, Menem and Cavallo immediately spring to mind. While some of these were elected on blatantly populist tickets, they all, on their accession to power, embarked on far-reaching and rigorous reform programmes. Central to the implementation of these programmes were 'change teams'; small, technically expert and frequently trained at top rate overseas institutions, these teams were generally appointed directly by the President and enjoyed his support and political protection. Pinochet's 'Chicago boys' are among the best known of these, but they have their counterparts in other countries.

The second explanation concerns the exact relationship between the state and key sectors of the society. What is striking in this regard, is that the particular relationship which best facilitates the *initiation* of reform can differ markedly from that required at a later stage to *consolidate* those reforms. In order to successfully initiate reforms, it seems that politicians and their technocratic allies must be insulated from particular interest group constraints. In his discussion on the importance of political institutions, Peter Evans<sup>3</sup> argues that the initiation of policy reform appears more likely when technocratic decision makers enjoy some degree of independence from particularistic interests. However, he goes on to argue that no reform process can be sustained in the long-run unless it appeals to or creates a new coalition of beneficiaries. In order

to consolidate reform then, it is important to stabilise expectations around a new set of incentives. This is most likely where the government concerned has constructed relatively stable coalitions of political support.

## **The Substance of Policy Reform**

In terms of the broad outlines of economic policy, there is a surprising amount of convergence in Latin America. Few people quibble with 'the basics' - the need to stabilise, liberalise and privatise the economy. There is also a fair amount of consensus that economic policy is a package deal which requires the consistent implementation of all three these components, and that the credibility of the reform process and precise sequencing of the implementation are crucial to their success.

### ***Stabilisation***

For many Latin American states, the reform process began with a realisation of the importance of getting the macro-economic fundamentals in place. Such reform was often a prerequisite for debt rescheduling which provided these states with renewed access to international finance institutions and capital. The priority was, most commonly, to reduce inflation through cutting state spending and moving towards fiscal equilibrium. Tax reform, and attempts to stimulate domestic savings and investment, as well as measures to strengthen flows of FDI, frequently accompanied this. Debt, of course, continues to be an ongoing problem for many of the countries of Latin America, one which we in South Africa face to a far lesser extent, but stabilisation has, for them, at least succeeding in re-igniting the legendary light at the end of the tunnel.

Economic recovery in Latin America facilitated a growth in imports which has led, in almost every case, to a negative trade balance. In the early 1990s, this deficit in balance of payments in the current account was compensated for by fairly substantial flows of foreign capital which allowed some states in the region to accumulate significant volumes of international reserves. The crucial question to ask in this regard of course, concerns the nature of these flows: were they short-term and easily reversible, and were they being invested in increasing the productive capacity of the country? (South Africans would be well advised to ask the same question of our capital inflows.) Latin America did not always provide the right answers to these questions, and the crash of the Mexican peso indicated most dramatically that the restructuring process was far from complete, despite the good rates of growth.

At the end of 1993 and the beginning of 1994, political instability in Mexico led to the withdrawal of a large number of local investors. They were swiftly followed by international investors, withdrawing from the short-term portfolio investments that they had made. A bungled devaluation of the Peso compounded the crisis. By January 10, prices in Mexico's stock market had fallen by almost 50% in dollar terms. The 'tequila effect', as it came to be called, spread throughout the region as 'hungover' investors withdrew from many of the region's markets, resulting in a sharp contraction of economic growth. In Argentina for example, the World Bank and IMF negotiated a loan package of more than US\$3.9 billion to see Argentina through the crisis. (Chile, where the reforms were most advanced, was probably least affected.) However, after the initial panic, most of the regional stock-markets have regained at least some of their upward momentum, even if at a lower rate than previously. In this sense, the Mexican crisis of the 1990s was very different to that of the 1980s. Although concerns persist, the reform project remains largely in place. In fact a number of states, undeterred, have intensified their processes of economic reform.

### ***Liberalisation***

Liberalisation has involved a fundamental restructuring of the state's role in the economy. This has most characteristically involved the elimination of wage and price controls, subsidies and incentive schemes, the streamlining of customs procedures and the slashing of tariffs. It has also, in some cases, involved regional integration initiatives and the formation of regional trade blocs like Mercosur and NAFTA. Average tariffs under Mercosur, for example, have fallen to 12% and a common external tariff agreed for about 90% of products. The fundamental restructuring of the economy and the competition which has resulted has undoubtedly been tough for previously protected sectors. Large businesses have had to restructure themselves in order to be better able to compete internationally and a large number of small- and medium-sized businesses have folded, with important consequences for unemployment rates.

### ***Privatisation***

Latin American states previously exercised a high level of participation in the economy, not only in terms of incentives and subsidies but also more directly, as an employer and as the owner of large chunks of the economy. The range of enterprises owned by the state was, in some instances, extraordinary, including hotels, mines, banks and fish-meal production. Provincial

governments in the most economically depressed areas of Argentina addressed the problem of unemployment by themselves employing over 50% of the workforce. The costs of this were correspondingly high, in addition to the deficits frequently accumulated by state-run enterprises. Faced with unsustainable fiscal deficits, the states of Latin America have turned their attention to cutting their bureaucracies and divesting themselves of many of their assets.

The role of labour in the privatisation process was informed, in places like Peru, by the weakness of the union movement and in Mexico, by its close alliance with the ruling party. The restructuring of these economies has critically affected the unions, in many instances weakening them substantially. Changes in labour relations regimes, exposure to international competition and subsequent restructuring of companies, and the growth of informal sector activities have all contributed to undermine the bargaining power of organised labour and to reduce the effectiveness of their opposition to the process. By 1991, in Peru for example, the level of unionization had dropped by one-third to 12% of the workforce, while over 50% of the workforce in the capital city Lima were engaged in informal activities and 49% of salaried workers in the private sector had temporary contracts.<sup>4</sup> In addition, the speed with which many of the governments of the region moved to privatise, and the political will with which they undertook the process, meant that in many countries, the unions simply did not have the capacity to organise successfully in opposition to the process. As the problem of unemployment persists, and as retrenched state employees continue to find it difficult to find new jobs and maintain their living standards, opposition to privatisation is evident, but thus far it has not been sufficient to significantly disrupt the reforms.

Unlike in South Africa, there appears to be little debate about whether or not to privatise; rather the debate concerns the precise modalities of the process. There is almost universal approval of the improvement in services that have followed the privatisation of state-run utilities, and, although the price increases which generally accompanied this have been less warmly welcomed, there is a wide-spread recognition of the importance of the process. Privatisation is, in many respects, non-negotiable and is seen as central to both the international and the domestic credibility of a government's commitment to reform. In privatisation, as in so many other fields, the devil is in the detail, and it is precisely here that some interesting possibilities arise for South Africa.

Throughout much of Latin America, privatisation has been extensive and has even included the privatisation of frequently bankrupt pension systems. The success of the Chilean model in this regard, and the spectacular increase in

domestic savings, now at around 26%, which has accompanied this process, has led to many attempts to duplicate the model.

In some instances however, the privatisation process has been conducted in too hasty and ill-considered a manner and has resulted in *state-owned* monopolies being replaced by poorly regulated *private* monopolies. There have, however, also been attempts to broaden the ownership of assets and capital in various countries. For example, the privatisation of Banco de Chile, one of the country's major commercial banks, took place through the sale of shares to small investors, while the privatisation of *Ecom*, the state-owned computer firm, occurred through the sale of shares to employees. In Peru, 10% of the shares of every privatisation sale are made available to workers. Such options might prove attractive to unions in South Africa too. In addition, Peru recently launched the start of the Citizen's Participation programme, aiming to turn 400,000 lower and middle-class Peruvians into share holders. The programme hopes to do this by making a portion of the shares being sold available at slightly lower prices than the market rate and by offering credit schemes for purchase. By this means, the government hopes to deepen the process of privatisation, further develop the capital market and offer new mechanisms for public saving.

Again in Peru, a pilot project has just been launched, funded in part by some of the proceeds of privatisation, to retrain workers retrenched from state enterprises, either to begin their own businesses or to seek new jobs in the formal market. Thus far, the project has encountered many difficulties and is proving expensive to administer, even within a growing economy. However, it is an example of some of the creative thinking which is going on in that country about ways in which the harsher affects of privatisation can be mediated - and how the political opposition to the process can potentially be softened.

While it is early days yet for many of the privatisation programmes, it seems clear that the process has indeed begun to successfully restructure incentives within the economy. The inflow of capital and the increase in productivity have contributed in large share to improved economic growth.

### ***The Sequencing of Economic Reform***

Our own Governor of the Reserve Bank, Dr. Chris Stals, has frequently argued that the liberalisation of capital controls should not precede domestic financial market reform. The experience of Latin America would appear to prove him right. In the inflationary economies of this region, the liberalisation of the

domestic financial market was only successfully undertaken in the context of broader reforms and once the fiscal deficit was under tight control.

There remains much debate and controversy about the finer points of sequencing, a debate which there is no room to enter into here. However, as Sebastian Edwards<sup>5</sup> points out, the first (and perhaps only) generally accepted principle of reform sequencing is that international capital controls should be lifted after the domestic financial market has been reformed and domestic interest rates have been raised. In turn, interest rates should be liberalised only after the fiscal deficit is under control. In this sense too then, it is the *entire* package of reforms that is important.

Edwards argues convincingly that the sequencing and speed of reforms influenced the outcomes. In Chile, for example, the financial sector was reformed first, with the domestic financial sector and goods market (external trade) following. Capital controls were maintained until 1979, when a slow liberalisation process was started, and it was not until 1982 that capital flows were allowed to move more freely.

In terms of sequencing, one of the most important points regarding Chile's reform process was that the government retained capital controls until the domestic financial reform and trade liberalisation had been accomplished. However, the relaxation of capital controls was not (in Edward's opinion) delayed sufficiently, and the massive inflow of capital that started in 1979 strongly impacted on the real exchange rate. The most important consequences of the real appreciation of the domestic currency generated by the relaxation of capital controls was that the tradable goods sector suffered an important loss of competitiveness and that a large number of firms ran into serious financial trouble. Similar problems have been evident in Peru, Argentina and Brazil, if for somewhat different reasons.

### *Credibility*

Even if a government gets the content and the sequencing of its reforms right however, these will be undermined if the reform process does not enjoy *widespread credibility*. If there is no such credibility and the public expects the liberalisation measures to be reversed, it will actually take steps that will undermine the effectiveness of the reform programme.

A fundamental aspect of establishing credibility is related to the perception that the public has of the internal consistency of the policies being pursued. This

perception will in turn be affected by the sequencing of reform. An inconsistent fiscal policy (for example, the maintenance of a large deficit) with a freed domestic financial market will send the wrong signals and undermine the reform effort.

Unfortunately, credibility is frequently something that takes time to establish, and it arrives only after the consistent application of policy and its institutionalisation over a number of years. For this reason, it is important that reform be regarded as a long-run process and one which will take some time to deliver the hoped for results.

## **The Consolidation of the Reform Process**

### ***Poverty and Political Sustainability***

The question of what happens to poverty under a neo-liberal regime is an important one, if only for the problem of the political sustainability of the process. In terms of targeted and effective poverty alleviation programmes, it may be that Latin America has less to teach us than in other areas - except, perhaps, about the ease with which high-profile poverty alleviation programmes can turn into vote-getters and election winners. In Mexico, the work of the social agency *Solidaridad* is hampered by its reputation as the populist arm of the ruling Institutional Revolutionary Party (PRI), and in Peru, President Fujimori's neo-liberal credentials were dented by the spending sprees he embarked on just prior to last year's election.

While the end of hyper-inflation and the onset of renewed growth has contributed to an overall (if uneven and slow) reduction of poverty in the region, analysts are talking of the 'new poor', a politically important constituency comprising, in part at least, those retrenched as a result of privatisation and restructuring processes. In Argentina, for example, between 1990 and 1993, over 85,000 employees at state-owned enterprises lost their jobs due to privatisation, and retrenchments from the national state administration numbered 103,000.<sup>6</sup> On its own, the growth that has resulted from the reforms has not been sufficient to satisfactorily resolve the problem of unemployment and in Latin America, as in South Africa, one hears much talk of jobless growth. Increasingly, there are calls on the state to 'do something'.

It is important at this point to say something about the centrality of education and training, of investing in human capital. Various statistical analyses have shown that countries with a lot of human capital relative to their physical capital

are likely to grow faster. The critical question is how a state continues to invest in human capital when social budgets are being cut as part of the package of neo-liberal reforms. This is a painful dilemma and the difficulties should not be underestimated: when are you cutting fat from state spending and when are you cutting into the heart and bone, possibly crippling prospects for future growth?

Until recently, real spending per student in Peru was just one-fifth of what it was in 1970, and 93% of Peruvian students did not have school books. Yet, today, Peru is one country where social spending under a neo-liberal reform programme has actually increased. This has been made possible, we are told, by cuts elsewhere in government spending and by utilising some of the proceeds of privatisation. The dangers of spending privatisation proceeds are obvious: social spending is an ongoing expense and the proceeds of privatisation are a one off. Such difficulties should not be glossed over.

It is in the area of the changing face of poverty and the state's response to this that the question of state capacity becomes absolutely central. It is no easy thing to put in place effective poverty alleviation programmes, as South Africa has learned with the RDP, and to do so in a neo-liberal context where state spending is being shrunk is even more so. If the task is to be successfully undertaken, it requires a second generation of reforms, reform of the state itself. The new neo-liberal governments have discovered, as the Marxists did, that the state does not simply wither away, and neither does the need for the state disappear. Rather, what is required is a re-examination of the way in which the state operates in order to enable it to do more about poverty, with less money. This is part of the neo-liberal paradox referred to earlier: in order to reduce the size of the state, one needs a strong, efficient state.

Before concluding, it is important to consider what kind of state it is that best undertakes such a difficult and fraught process. This takes us straight into the heart of the contentious debate about democracy, authoritarianism and development.

### *Democracy and Development*

To some extent, Haggard and Kaufman<sup>7</sup> are correct when they argue that the political effects of the reforms are contingent on the sequencing of political and economic liberalisation. This does not address the social costs of the reform process and the political difficulties of dealing with these in a democracy.

Much of the literature about neo-liberal reforms is concerned with how best to



tackle political resistance to reforms: Anne Krueger,<sup>8</sup> for example, argues that the most serious problem with any liberalisation programme is the political resistance that it generates. While economic agents can generally recognise the short-run adjustment costs associated with reforms, they frequently have difficulty perceiving their long-run benefits.

This, along with the example of such countries as Chile under Pinochet and Singapore, has fuelled the debate about authoritarian development. There are many who argue that it is only in an authoritarian state that the government enjoys sufficient insulation from popular protest to persist with reforms. Apart from Chile, however, it is notable that many of the reforms in Latin America have been undertaken by democratically elected governments, and these governments have, until now, remained committed to the reform process despite significant social pressures. What may have generated this commitment to reform is the region's history of hyperinflation and the economic devastation of the 1980s. There is a very real sense of the extent to which the decade of economic crisis in Latin America has made the taking of tough decisions possible for democratically elected governments. This sense of urgent and immediate crisis is not evident to the same extent in South Africa and this could raise problems for any government intent on wide-ranging reforms here. However, our need for reforms may be as urgent, because South Africa's economy is undoubtedly in a crisis. Unemployment in South Africa is estimated to be the highest of that of any country in the world for which there are figures available. It is almost impossible to overstate the seriousness of the problem - and it is a problem that will not be addressed by growth of 3%, however marvellous that rate may seem after years of economic stagnation.

At any rate, the debate about authoritarian models of development is, for South Africa, to some extent, moot: we have already embarked on the transition to democracy, and few people would argue that a return to authoritarianism is desirable. What we should rather be concerned with, therefore, is how best to consolidate our fledgling democracy while at the same time moving successfully to reform the economy. It is evident from the example of Latin America that, in the end, what may be more important than the precise nature of a regime, is the extent to which it provides a stable policy setting for the institutionalisation of expectations.

## **Conclusion**

In the end, the biggest question mark hanging over Latin America's reforms may be the question of their sustainability and ultimately, of economic

recovery. Latin America has seen booms and busts before and it would be tragic if the current recovery turns out to be illusory. The extent to which the reforms are maintained and institutionalised over the long-term may be a critical factor here. Undoubtedly, it will take some time before decisive results are evident. It seems then that persistence over time may be one of the requirements for successful reform.

Chile is now widely regarded as *the* Latin American success story - but even that country's recovery was not without 'teething' problems. The early years of the reforms, launched in the first half of the 1970s, were difficult, with unemployment surpassing 20% and with inflation stubbornly remaining at extremely high levels. After an initial period of recovery and fast growth in the late 1970s, Chile experienced a tremendous setback between 1982 to 1985, when a combination of external and internal events resulted in a deep recession. Only after 1985 was the country able to move once again towards rapid growth and recovery. Reform takes time to deliver solid results and the process is not one of immediate and irreversible gratification. Nonetheless, the experience of Latin America has much to teach us.

It seems clear that consistent, decisive and broad ranging reforms are necessary in South Africa if we are to lift the economy to higher growth rates. The economy must be restructured in fundamental ways, along the lines of the transformation wrought in Latin America, in order for us to compete along with the Latins, in what is a very harsh global economy. The rules of the global economy may be unfair and unequal for different players, but for emerging markets such as Latin America and South Africa, they are at least clear:

*The reforms come as a package; timing and sequencing are important as is the credibility and sustainability of the reform process. There is no escape from the basics - but within the consensus over the fundamentals of economic reform, there remains room for manoeuvre. In the initial stages of reform, autonomy from particularistic interests is important - but responsiveness to developments within society are important for the subsequent consolidation of reforms. Finally, in the end, what may be more important than the particular form of government, may be the capacity of the state, and its ability to institutionalise the reforms and stabilise expectations.*

Of course, there are no guarantees that if a country adopts the correct policies, growth and recovery will automatically result. The fates of emerging markets are frequently bound together and developments in one economy are likely to impact on others. In addition, perceptions are sometimes more important than realities. However, in order to equip South Africa to compete in this global

economy, there appear to be few alternatives to getting the (macro-economic) basics right. This does not mean that there is no room for graduated policy making; on the contrary, there are good reasons to consider carefully the precise modalities of the transition. Latin America illustrates the need to balance the potential of an open, export oriented economy with some sustainable attempt to address social equity. That continent's experiences suggest that the best course may not be the left-wing radicalism of Peru's Garcia or the neo-liberal fundamentalism of the same country's Boloña, but rather the sensible, decisive moderation of Frei's Chile. I would argue the need for determined and efficient implementation of reforms in South Africa, alongside a programme to strengthen the capacity and streamline the role of the state. Our government must consider carefully the lessons of other emerging markets - then it must move, unequivocally and with deliberation, to reform.

## Endnotes

1. Haggard S & RR Kaufman (eds), *The Politics of Economic Adjustment*. New Jersey: Princeton University Press, 1992.
2. I have used 'Washington consensus' and 'neo-liberal project' as near-synonyms in this paper. I acknowledge that both terms are imprecise and imperfect. I use them, however, as they are widely employed and understood in both academic circles and in the press to indicate a particular set of policies which include the following: reducing fiscal deficits; shifting expenditure priorities; tax reform; interest rate reform; exchange rate adjustment; trade liberalisation; liberalisation of the rules governing FDI; privatisation; deregulation; and, protection of property rights. Cf. Williamson J (ed.), *Latin American Adjustment: How Much Has Happened?*. Washington DC: Institute for International Economics, 1990.
3. Evans P, 'The State as Problem and Solution' in *The Politics of Economic Adjustment*, *op.cit.*.
4. Samain SD, 'Ajuste sin Reestructuración' in *Cuadernos Laborales*, 100, May 1994, p.11; and *Foreign Labour Trends: Peru*. Washington DC: US Department of Labour, 1991, p.7. Both quoted in Roberts KM, 'Neo-Liberalism and the Transformation of Populism in Latin America', *World Politics*, 48, October 1995, pp.82-116.
5. Edwards S, 'The Sequencing of Economic Reform' in *World Economy*, 3, 1, March 1990.
6. World Bank, *Argentina: From Insolvency to Growth*. Washington DC: The World Bank, 1993.
7. Haggard & Kaufman, 'Economic Adjustment in New Democracies' in Nelson JM and contributors, *Fragile Coalitions: The Politics of Economic Adjustment*. Oxford, UK: Transaction Books, 1989.
8. Kreuger A, 'Problems of Liberalisation', in Chiksi A & D Papageorgiou (eds.), *Economic Liberalisation in Developing Countries*. Oxford: Blackwell, 1986.

## 10.2

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### Response

*Cassio Luiselli*

I wish to add two general observations:

- \* *First*, the comparison of the Latin American and South African economies is both very convincing and compelling and furthermore, extremely relevant. In both cases, Import Substitution Industrialisation has played a very important role. Equally significant is the necessity to address socio-economic disparities. Both are also in transition from authoritarian regimes to full-fledged democracies.
- \* *Second*, Ms. Handley has (rightly in my view) put the state and its role at the centre of the economic debate. There is a need for a strong, decentralised role for the state in this new stage of economic development. The experience of East Asia bears this out.

I shall endeavour to elaborate upon and also to emphasise and illuminate Ms. Handley's basic framework and perhaps add a point or two to some of her comments:

#### **On the Initiation of Economic Reform Processes**

My own view is that the drastic reforms applied to Latin American economies were triggered by two powerful forces:

- \* *First*, by the debt crisis that simultaneously hit most Latin American countries in 1982 and forced very harsh adjustment policies: this controversial adjustment was imposed in general by the conditionality of the International Monetary Fund, the World Bank and other governmental financial institutions.

This was followed by the whole process of deregulation, liberalisation and privatisation, and was subsequently crystallised in the so-called 'Washington consensus'.

- \* More generally, but equally important in the Latin American context, was the kind of paradigm shift towards what is now loosely termed the 'neo-liberal shift'. This has at least three main components:
  - (a) The dismissal of socialism as a practical and viable alternative to market-oriented economies.

- (b) The 'selling' of the Asia-Pacific (better known as the 'East Asian Tigers') as a bloc of export-oriented, free market champions. This was, of course, fairly biased, especially in regard to state powers of intervention and its role as a great facilitator. Throughout, it was a market-friendly or market-conforming type of intervention.
- (c) The notion of the unavoidable globalisation of the world economy, although a little premature, which has changed the inward-looking policies of the past and, furthermore, reluctantly or not, the way in which the Latin American countries have embraced this paradigm shift.

Ms. Handley also mentioned the crucial role of the strong leader as a precedent for initiating the Latin American reforms and cites some key figures such as Salinas and Menem. This is the case in many countries, but we can mention equally relevant examples of countries that even without one central figure have achieved major reforms: among them, Bolivia, Ecuador and Costa Rica.

### **The Substance of Policy Reforms**

On the section regarding the *Substance of Policy Reforms*, there is a basic concurrence on the main content and sequencing of the reform package, viz. *stabilisation first, followed by liberalisation and privatisation*.

*Stabilisation* was successfully accomplished in most cases. Despite the Mexican crisis of 1994-95, we have gradually managed to stabilise the economy.

With regard to *liberalisation*, external trade liberalisation should be stressed as one of the key components of liberalisation. In most of the major countries (including Mexico), the economies were opened up unilaterally and well beyond immediate regional commitments. Today Latin America is probably one of the most open economic regions of the world, unlike South Africa which has so far been quite cautious in its approach.

Trade liberalisation has forced massive industrial and economic restructuring which led to painful losses of both industries and jobs. But liberalisation also fuelled a remarkable export boom which has been the case in Chile, Argentina (in spite of an over-valued currency) and Mexico (whose exports for just 1995 totalled US\$80 billion).

There is a great deal of consensus in Latin America on the issue of *privatisation*. In part, this is due to the traumatic memories of mismanagement,

waste and corruption of many state-owned enterprises, but there still exists a very large state-owned sector in Latin America: copper in Chile; oil in Mexico; as well as large mines and other concerns in Brazil. There is also consensus about the convenience of retaining in the public sector (in most countries) a large presence of the state in natural monopolies, or public resources such as oil and copper (although Argentina may be an exception to this).

There are also useful comparisons with South Africa of successful privatisation programmes in Latin America. One example is the telecommunications sector in Mexico: the successful privatisation of TELMEX, which retained monopoly power for a brief transitional period, could be quite instructive for South Africa.

With regard to the *sequencing of economic reforms*, it is now widely recognised, for instance, that Mexico's sudden devaluation and financial collapse in 1994-95 had to do with ill-conceived sequencing, a weak financial sector and huge short-term debt exposure denominated in US dollars. As Sebastian Edwards states, the Mexican crisis in 1994-95 looks very much like Chile in 1982-83.

### **The Consolidation of Reforms**

I believe that Latin America *does* have some useful examples to offer concerning Poverty Alleviation programmes.

For instance, the Solidarity Programme in Mexico (PRONASOL) was much more than a political scheme to win votes. It was decentralised, involved grassroots groups and relied on local initiatives, which mobilised financial and human resources.

Spending on social programmes now involves close to 50% of the government budget. It is important to separate *poverty alleviation programmes* from *employment creation* efforts given the need to consider a role for the so-called informal sector.

### **Democracy and Development**

This is a *controversial issue*. In Asia, not only Singapore but also in Korea, Taiwan, Thailand, Malaysia and Indonesia authoritarian governments have influenced economic development patterns. But in the case of Chile, after

Pinochet, the economy has actually accelerated its specific growth and most Latin American countries have better performing economies within the framework of advancing democracy. Perhaps what works best is a strong and active state with a clear democratic mandate as a superior alternative to an authoritarian market-friendly government. This could pose an open-ended question for an ongoing debate.

Finally, I would like to mention three additional points:

- \* We would benefit from more '*cross-country comparisons*'. After all, and in spite of many commonalities, Latin America is not only huge, but also very diverse. Brazil is significant because of both its sheer size and importance, and given that it also follows a more cautious or perhaps ambiguous path with regard to privatisation.
- \* The very powerful trend of *economic integration* throughout Latin America needs to be stressed. The examples are very relevant, such as: NAFTA, Mercosur, G-3 (Mexico, Colombia, Venezuela), CARICOM, CACM, and a real plethora of bilateral Free Trade Agreements. This is, to my understanding, unlike the timid economic integration amongst the SADC countries.
- \* Thirdly and finally, it is important to stress that democracy is still gaining ground in Latin America, and that the commitment towards democracy has not weakened. I believe that democracy, plus an active, albeit pro-market state will offer the best source of hope and optimism for continuing long-term growth in Latin America.

## 10.3

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### Response

*Jorge Heine*

Latin America is seen as a very distant and remote region by most South Africans; many of them only think of visiting South America if they are going to the United States, and refuse to believe that we are in fact much closer to you: it is seven hours from Cape Town to Buenos Aires versus 18 hours to New York.

Needless to say, any effort to derive any 'lessons from history' is a tricky one - at least one observer is on record as saying that the only lesson from history is that no lessons can be drawn from it. Having said that, it should also be obvious that there are many parallels between the situation in which South Africa finds herself now and what Latin American countries have gone through.

I would like to share some general propositions emerging from the Latin American experience in general, and from Chile in particular. Before doing that, though, it is important to put this in the proper context.

The extent and scope of the Latin American turnaround is really quite remarkable, and sometimes not fully appreciated. Ten years ago, a panel such as this one would either have been unthinkable, or largely of a negative sort - that is, it would examine what the Latin American countries had done so as not to repeat it. For anybody who looks back at 1989, when the Berlin Wall fell, and the end of what came to be known as 'the lost decade' in Latin America and remembers how bleak the prospects were, what has occurred since is nothing short of miraculous.

From 1980-81 to 1990-91, Latin America's GDP grew at an annual average of only 1.3%. With a population growth of 2.1% a year, this resulted in a fall of per capita GDP of 9% during the decade, with per capita consumption falling much the same. Not surprisingly, the number of people falling under the poverty line increased from 113 million in 1980 to 184 million in 1990.

In 1989, Latin America was the most heavily indebted region in the world in per capita terms. The adjustment programmes initiated to pay off that debt led the region to become a net capital exporter, exporting hundreds of billions of dollars without making any appreciable dent in the total amount of extant debt. These adjustment programmes demanded heavy sacrifices, not only for



individuals, whose incomes fell drastically, but also for future growth, as investment rates were curtailed across the board to meet foreign obligations.

This rather bleak picture was compounded by developments in Eastern and Central Europe. With the fall of the Wall, Eastern Europe became a powerful competitor to Latin America in the world's capital markets and one with seemingly big advantages over the latter. In turn, the single European Market and Maastricht, then only a few months ahead of us, seemed to indicate that the protectionist tendencies in Northern markets would continue unabated, making it even more difficult for Latin America to raise, via exports, the necessary hard currency to pay its half trillion dollar debt.

In short, the prospects for Latin America in 1989 were hardly encouraging. Yet, seven years later, it is difficult to escape the conclusion that Latin America finds itself on very solid footing and, generally speaking, is doing very well. The average growth rate of 3% during 1991-93, jumped to 4.6% in 1994, and, if we exclude Mexico and Argentina which were especially affected by the tequila effect, the region grew between 4-4.5% in 1995. During this period, the average inflation rate (excluding Brazil, about which more later) continued its steady decline, from 49% in 1991, 22% in 1992, 19% in 1993 to 16% in 1994, the lowest in many decades.

Chile grew 8% in 1995, achieving a true breakthrough in Latin American economic history, with a growth rate higher than its inflation rate, an unemployment rate of 6% and an investment rate of 27%. Mexico has managed to recover quite swiftly from the events of December 1994, as has Argentina. Brazil and Peru have also rebounded with a vengeance.

The so-called 'Real plan' finally got Brazilian inflation under control (in a few months lowering the monthly inflation rate from 50% to 3%) and the election of President Fernando Henrique Cardoso has led some to predict the country may well enter an upswing period like those it saw in the 1960s and 1970s. Peru, in turn, was the fastest growing Latin American economy in 1994 with 11%, and expanded again growing by 7% in 1995.

This positive situation is not confined to the economic sphere. With the exception of Haiti and Suriname, very special cases for a variety of reasons, there has not been a successful military *coup d'état* in Latin America since 1982, when that in El Salvador occurred. Needless to say, there is much that is fragile about re-emerging democratic regimes, but the overall picture of democratisation looks a lot better than most observers would have thought only a few years ago.

## **What Lessons?**

In a 15-minute commentary there is hardly the time to engage in an extensive analysis of the policies that have led to this turnaround, many of them embodied in what has been termed the 'Washington consensus'. Antoinette Handley has already mentioned many of these factors in underscoring stabilisation, liberalisation and privatisation as their key building blocks.

Drawing largely on the Chilean experience, but also on the wider evidence available, I would therefore like to summarise in a few key propositions what I consider to be if not necessarily the lessons, at least the underlying policy trends that have made this turnaround possible.

### *Open your Economy as Much as Possible*

In the late 1960s, at one point Chile had 26 car assembly plants (this in a country with 11 million people), most of them located in Arica, on Chile's northern border, 2,000km away from the main car market, in Santiago. We even produced our own whisky, if you can believe that there could be such a thing as Chilean whisky. It was an abominable concoction called Old Gold, but with Johnny Walker Red Label priced at US\$30 dollars a bottle because of our high tariffs, it made business sense and people actually drank it.

This was, of course, protectionism with a vengeance. Today, there are two car assembly plants left in Chile, and we are driving better and cheaper cars - in fact, so many of them, that Santiago and other major cities are facing major traffic congestion problems.

Our uniform external tariff of 15% was slashed to 11% in 1991, and may be cut again soon. Exports have been one of the driving forces behind Chile's 6% average growth rate for the past twelve years, as has the inflow of foreign investment and the outflow of Chilean capital abroad. The latter amounted to as much as US\$9 billion as of last reckoning, largely to Latin America, but also to Europe and the US.

And far from increasing the vulnerability of our economy, this has diminished it. One reason we are doing so well is because our exports go to so many different markets - one-third to Asia, one-quarter to the EU, some 20% to North America and another 20% to Latin America. As a result, even when there is a recession in the world economy, as there was in 1991 when world output fell by 1%, we grew by 6%.

What does a commitment to an open economy mean? I will tell you what it means. In 1991, the Ministry of Health opened a tender for linen goods for all of Chile's public hospitals - a major contract, worth in the region of US\$50 million. There were 11 bids, 10 from Chilean companies, one from a foreign one. Guess which one had the lowest bid and was awarded the contract? The one foreign company, which was Chinese.

And here I must express my disagreement with my good friend Jeremy Cronin. Again and again, the many competitiveness studies done by Swiss outfits like the World Economic Forum, which give Chile high ratings, identify what they call (for want of a better word) its 'internationalisation' as one of its key comparative advantages.

We are a small country, located at the end of the world, a 'a dagger pointing straight at the heart of Antarctica' as Henry Kissinger once mockingly said, for long quite isolated from the main centres of commerce and industry. Nowadays, our ability to tap instantly into those centres, the ease with which one can bring in or take out of Chile capital, goods or services has become one of our biggest assets. To create those breakwater walls that Jeremy Cronin alluded to, would, to my mind, put an obstacle in the way of South Africa's greatest advantages - its highly sophisticated science and technology, on the one hand, and its private sector on the other.

### *Promote Investment, Not Consumption*

A key factor behind Chile's success - it has had for some time now the fastest growing economy in the West - has been its high savings and investment rate, in the vicinity of 26-27%, both in the public and the private sector. The government consistently runs a budget surplus - as high as 2% of GDP.

One reason this takes place is because of its tax structure (and I realise that what I am going to say is terribly politically incorrect) in which the VAT rate is higher than the corporate tax rate - 18% versus 15%, and there is no zero rating. Nothing is VAT exempt - even books, much to my chagrin. The point is, the bulk of taxes collected come from VAT, a tax that is easy to collect and difficult to evade, where the entrepreneurial spirit is not penalised by high taxation.

### ***Regulate, Do Not Manage the Economy***

It is one thing to stabilise, liberalise and privatise. It is quite another to abdicate the state's responsibility for effective public policies. In this new policy environment, state and market are part of the new institutional framework, and the state is the main agent responsible for this institutional development. The key challenge is how to build an institutional framework that is conducive to competitive growth.

Let me give two examples in this regard, often cited as especially successful in the Chilean experience. One of them is the private pensions scheme, which has been instrumental in raising the savings rate to around 25% of GDP; the other is the telecommunications policy, which has allowed us to treble our telephone lines over the past ten years and to have the first fully digitalized telephone system in the world. To succeed, both cases demanded extremely fine-tuned regulatory public policies, whose thrust was to make room for private entrepreneurs to thrive.

Chile has by no means a monopoly of highly imaginative policy solutions to its problems. Bolivia has now come up with a quite extraordinary privatisation scheme, whereby once a public sector company is sold, the proceeds from that sale do not go into the Treasury, but are capitalised by the company, and shares from it are assigned to individual retirement accounts for the Bolivian population. According to some estimates, in 20 years, they might provide for a decent pension for every Bolivian in retirement age, many of whom have no prospects whatsoever for a pension now.

On the negative side, before privatising, a regulatory framework must be in place to ensure free and fair competition. In Chile, in at least three sectors a lack of proper regulation led to debacles of various sorts: one of them was the banking sector in the late 1970s and early 1980s, for which we are still paying the bill; another was the public transport system in Santiago, and the third that of public utilities, especially in electricity.

### ***Foster Growth, But Growth With Equity***

In her paper Antoinette makes the remark, and I quote, 'in terms of targeted and effective poverty alleviation programmes, it may be that Latin America has less to teach us than in other areas'. I would not necessarily disagree - indeed, our wide income disparities are quite comparable with South Africa's - the Gini indices give South Africa 0.61 and Chile 0.59 - but there are certain

conclusions that we have drawn from our own efforts at poverty eradication.

First, the sort of targeted social programmes required cannot depend solely on the public sector budget. Only an association between the state and civil society will allow for a genuine breakthrough in this matter.

Second, the integration of marginalised social sectors into the economy depends heavily on increased access by the former to productive employment. Chile has managed to reduce the number of people under the poverty line from 5 million in 1990 to 3.7 million in 1995.

Given the dualism extant in many societies in the South - that is, the coexistence of a modern sector with an informal, more traditional one - this implies creating jobs in both. Nonetheless, the requirements of doing so in the modern sector are often extremely costly. Due to the significance of the informal sector, creating jobs means, above all, expanding the entrepreneurial base of society and thus reducing the gap between the modern and the informal sectors of the economy. This will not happen simply through 'getting prices right' and the free hand of the market, but will require very deliberate public policies and programmes.

### ***Rely on Regional Integration***

I belong to a generation, the one that came of age in the 1960s, that placed much hope in Latin American regional integration, only to see our hopes quashed over and over again, be it because of the failures of the Latin American Free Trade Association, or of sub-regional schemes like the Andean Pact.

Yet, one of the most exciting developments in Latin America in the 1990s, and one much under reported elsewhere, has been the renewed impetus of regional integration. Mercosur, joining Argentina, Brazil, Paraguay and Uruguay has made enormous strides since its formal launching in 1991. The long-standing rivalry between Brazil and Argentina has been replaced by increased economic complementarity, and cross-border trade between the two South American giants has grown exponentially. Many people consider this a decisive turnaround in the geopolitics and geo-economics of Latin America, equivalent to the decision made in the 1950s by France and Germany to bury their differences that led them to war every 30 years-or-so and start building together a united Europe.

During the 1990-94 period, intra-regional trade in Latin America doubled, from US\$16 billion to US\$32 billion, and from 13% of exports to 21%. Within Mercosur, it has almost tripled in four years. Chile also joined Mercosur in 1996, thus becoming part of what is now a 200 million people market.

Other sub-regional integration schemes, like the Andean Pact, CACM and CARICOM have also made much progress. The point is, though, that the sort of regional integration that is being promoted is very different from that of the 1960s. Rather than the inward-looking approaches typical of the import-substituting '*desarrollo hacia adentro*' economic development strategies favoured in those days, this is much more flexible, 'open regionalism' concept.

Instead of using the regional market as a buffer against foreign competition, creating all sorts of barriers against the entrance of foreign products, the driving force behind these schemes is to develop regional and sub-regional markets as extensions of the national market, providing local producers with 'trial run' experiences in competing abroad, thus preparing themselves for the even tougher world market.

And thus Chilean business, for long very sceptical of Latin American integration - the argument was often made that a fully open economy does not need regional integration as it is 'integrated to the world' - has been investing heavily in Argentina, in Peru, Bolivia and now also in Brazil.

## **Conclusion**

There are obviously considerable differences among Latin American countries, and some have been more successful than others in their policy reforms. But many of the larger Latin American countries whose economies and societies are in many ways comparable to South Africa, have made enormous progress.

This progress has, by and large, been made under democratic regimes in countries with often strong trade union movements and a thriving free press. If we can rearrange our mental maps, and realise that we are much closer than we tend to think on both sides of the Atlantic, there is much South Africans and Latin Americans can do together.

## 11.1

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### Future Paths and Trends for the South African Economy

*Philip Spies*

The mathematician Richard Bellman tells the story of Gertude Stein who, on her deathbed, was confronted by a close friend, Alice B. Toklas: 'Gertude, Gertude, what is the answer?', she asked, hoping that as she lay dying Gertude would see even further into the future. Gertude then apparently opened her eyes for the last time and said: 'What is the question?'.<sup>1</sup>

Our perspectives about the future are clouded by three kinds of difficulties which form the backdrop to this paper, *viz.*

- \* Asking the right questions about the future;
- \* Identifying the appropriate frameworks and parameters needed to answer these questions; and,
- \* Engaging in conjecture about the nature of change in these frameworks and parameters, and the future landscapes change may produce.

#### What Questions Should We Ask About the South African Economy?

Concerns about the future of the South African economy tend to focus on various aspects relating to the rate of growth, and on ways of achieving this. Recently released documents on economic strategy are cases in point. In February 1996, the South African Foundation published its version of a 5% economic growth strategy<sup>2</sup> which is based on five policy pillars; *viz.* improving the country's legal framework, sound macro-economic policy, efficient government, supporting competitive markets and developing an outward (global) orientation. The government released its macro-economic strategy in June 1996, and again the emphasis was on growth - on attaining economic growth rates of at least 6% per year by the year 2000.<sup>3</sup> In both of these reports, economic growth is perceived to be the key to long-term welfare and job creation.

Some other very important dimensions of economic development (as opposed to mere growth) in South Africa were highlighted in the policy proposals of COSATU.<sup>4</sup> The emphasis of their report is not so much on economic growth, but on social justice, redistribution, equity and finding safeguards for jobs. This

serves as a reminder that the economy of a country only has meaning within the context of the aspirations of its dominant stakeholders - and that these aspirations may differ considerably in their primary focus, if not in ultimate purpose. The investor's primary interest - that which affects them most directly and immediately - is in long-term earnings and capital growth. For labour it is job security and wages. Society's interest may be in measures that can improve general living standards.

These differences in primary focus could explain the varied positions of different stakeholders even if there is an implicit agreement between them on what is required to make the economy work. Differences in the primary positions of stakeholders illustrate some of the relevant dimensions of 'the economy' of a country which should be considered in a foresight exercise. Thus, questions about the future of the South African economy could include a combination of the following considerations.

- \* What rates of economic growth are possible in South Africa?
- \* What rates of economic growth are likely in South Africa?
- \* What type of economic growth path can produce social equity and political stability in South Africa, and what actions are needed to accomplish it?
- \* Is it possible for the South African economy to provide employment for the growing labour force over the long-term?
- \* Is it possible to have growth with equity in South Africa?
- \* What is the real basis for economic growth in South Africa?

### **A Framework for Conjecture**

The above-mentioned six questions can only be answered once we have an understanding of the forces driving a modern economy. The economy of a country can best be defined as a purposeful social system consisting of functionally related economic actors who collectively and individually strive, by means of production and exchange, to fulfil their needs and aspirations within the limits of resource constraints. Economic power means the ability to control the original enabling factors that sustain the functioning and development of the economic system.

Over the past four centuries, the bases of economic power have shifted continuously as a consequence of scientific and industrial progress, with important implications for the management of human affairs. During pre-

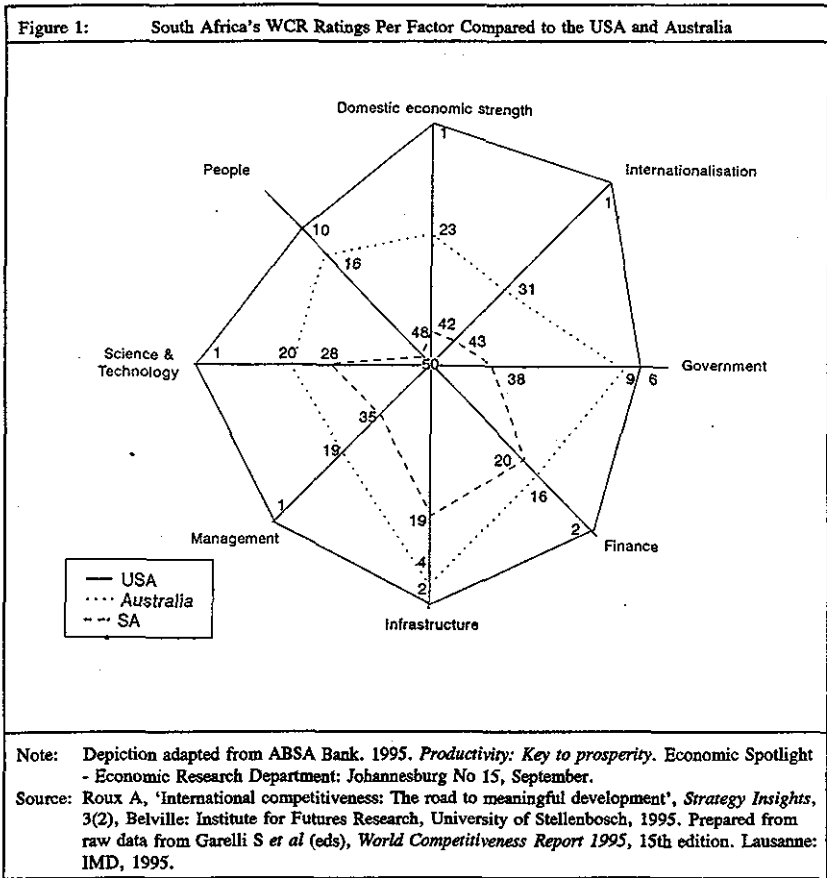


industrial times power was vested in the control of land resources, which resulted in an agrarian oligarchy gaining the control over large regions of the pre-industrial world. The scientific and industrial revolution caused a shift in the economic power base from control over land towards control over capital, including control over mineral resources. This was a mechanistic world with a dominant belief in the sanctity of conquest, profit, economic growth and capitalisation. Moreover, industrialising nations had the ability to produce the results to that effect. The 19th Century scramble for colonies and the empire building process, which, *inter alia*, spawned the First World War, were typical strategies of the 19th Century and early 20th Century industrial age.

The scientific revolution and industrialisation produced the environment for the serious ideological conflicts of the 20th Century. Capital-based industrialism is essentially centralist (or 'mechanistic') in orientation. It is therefore not surprising that the ideological conflict between capitalism and Marxist-Leninist communism in the last half of the 20th Century, and the threat of fascism in the first half of the century, played such a dominating and conflictual role in international relations. Whether it was capitalism, fascism or Marxist-Leninism, all of these ideologies agreed that the real basis of economic and political power in the world was to have control over capital, land and minerals.

However, after the Second World War, and especially over the past 25 years, the economic power base of nations experienced another groundshift; a shift as significant as that of the industrial revolution. A new kind of social order emerged which Daniel Bell<sup>5</sup> called the post-industrial society and Kostopoulos<sup>6</sup> the emerging 'nomocratic society'. This new world order is fuelled by a powerful enabling factor, that is by 'embodied capital': knowledge and information are resource flows which are embodied in human potential. This created powerful regenerative capacities within society. A continuous stream of technological innovations is now rewriting the rules of profitability and international competitiveness and those who want to play this game cannot ignore the recreative power of international knowledge and information flows. Whereas in the past people became the servants of capital in the industrial society, they are, according to Kostopoulos, now the servants of knowledge and information systems.

It is therefore not surprising that a former executive of Royal Dutch Shell in London, Arie de Geus,<sup>7</sup> noted that in today's dynamic business environment the only competitive advantage is in the ability to learn (and apply your knowledge) faster than your competitors. His comment highlights the implications of running a business in a post-industrial nomocratic world, which is a world of an achieved competitive advantage rather than a 'given' comparative advantage.



The implications of the new world order for governments are even more significant. The rules of managing and applying knowledge and information resources are based on global entrepreneurship and economic freedom. Within this new economic game, national borders are obstructions to progress and long-term economic growth. Thus, we observe how the sovereignty of the nation-state is corrupted by the very competitive processes which are needed to strengthen the economies of the nation-state.<sup>8</sup> What Ohmae calls the four 'T's' - that is, transborder investment flows, transborder industrial development, transborder information flows and individual consumers with a global lifestyle - are slowly but persistently erasing the economic boundaries that are set by the nation-state. According to Ohmae, governments are progressively losing some

of their power to control the shape, content and intensity of economic policy and development in their countries. Today, few countries can withstand the pressures set by the international rules of the politico-economic game; rules that are shaped less by governmental decree than by the imperatives of a nomocratic world.

Our framework for conjecture about the economic future should therefore be based on the requirements set by this new world order, because these will determine whether South Africa can survive economically over the next 25 years. In this respect one can do worse than apply some of the key indicators of international global competitiveness studies<sup>9</sup> which pinpoint problems with human development and governance as being the most serious obstructions to South Africa's competitiveness, and thus long-term development (Figure 1). I will therefore start formulating the answer to the six questions posed here by presenting a brief overview of the country's current economic situation, its causes and possible consequences.

### **South Africa's Enabling Factors of Production**

The most salient characteristic of the South African economy is that within a global context it is relatively small, but within a regional context a giant (see Table 1 below), and with foreign trade amounting to more than 40% of GDP, its economy is very open to global developments. Moreover, because it is a developing society, South Africa's economy is very vulnerable to international turbulence. This is especially applicable to South Africa's global competitiveness which is seen to be the most important factor in shaping the pattern of this country's long-term economic development.

Three types of enabling factors of production are applicable. These factors tend to display different qualities as far as South Africa's long-term development is concerned, namely:

- \* 'Embodied capital' (or human resources) which is considered to be potentially the main recreative force behind South Africa's long-term competitiveness and development;
- \* Natural resources, considered to be 'given' physical resources which display the qualities of limits of exploitation (for specific technologies) and renewability in some instances; and,
- \* Capital resources, including infrastructure, which are 'created' physical resources with the qualities of depreciation, obsolescence and recapitalisation through investment flows.

Table 1: Selected Economic Indicators and Trends, South Africa and the Rest of the World						
Region or Country	1993 GDP '000 million US\$	1993 GDP per capita US\$	1980-1993 Average annual rate of GDP growth %	1980-1993 Average annual rate of per capita GNP growth %	1980-1993 Average annual rate of inflation %	1980-1993 Average annual real growth in exports %
Global						
Low-income	990.3	380	5.7	3.7	14.1	6.4
High income	18,247.5	23,090	2.9	2.2	4.3	5.1
Sub-Saharan Africa	269.4	520	1.6	-0.8	16.1	2.5
Selected OECD countries						
United States	6,259.0	24,740	2.7	1.7	3.8	5.1
Japan	4,214.2	31,490	24.0	3.4	1.5	4.2
Germany	1,910.8	23,560	2.6 <sup>1</sup>	2.1 <sup>1</sup>	2.8 <sup>1</sup>	4.2 <sup>1</sup>
France	1,251.7	22,490	2.1	1.6	5.1	4.5
Italy	991.4	19,840	2.2	2.1	8.8	4.3
United Kingdom	819.0	18,060	2.5	2.3	5.6	4.0
Selected Commonwealth countries						
Canada	477.5	19,970	2.6	1.4	3.9	5.6
Australia	289.4	17,500	3.1	1.6	6.1	6.2
New Zealand	43.7	12,600	1.5	0.7	8.5	4.0
Selected African countries						
Nigeria	31.3	300	2.7	-0.1	20.6	-0.6
Zimbabwe	5.0	520	2.7	-0.3	14.4	-1.1
Botswana	3.8	2,790	9.6	6.2	12.3	6.7
South Africa	105.6	2,980	0.9	-0.2	14.7	5.4
Note : 1 - Data refer to the Federal Republic of Germany before unification.						
Source : World Bank, <i>World Development Report 1995</i> . New York: Oxford University Press, 1995.						

### South Africa's Embodied Capital: The State of Human Development

South Africa is one of more than 70% of countries worldwide that are classified by the World Bank as having 'developing economies'. Although this country enjoys a higher development status than 80 of the lower-middle-income and low-income countries of the world,<sup>10</sup> it shows a decidedly inferior development status when it is compared with other middle-income countries. The United Nations ranks the level of South Africa's human development at 93 out of 173

countries, with Canada being ranked at number one and Guinea at 173 (see Table 2).

Associated with South Africa's poor human development ranking are the also great disparities in wealth within the country. A *Human Development Report*<sup>11</sup> case study on South Africa, for example, revealed that the disparity in human development between whites and blacks is four times larger than in the US. The United Nations calculate the overall Human Development Index (HDI) for South Africa at 0.650, for whites at 0.878 and for blacks at 0.462. Another indicator of inequality is the Gini coefficient which measures complete inequality at 1.0 and complete equality at zero.

These inequalities are also evident from the study report on poverty by Whiteford *et al*<sup>12</sup> (see Table 3). According to this report, approximately 46% of all South Africans live in income poverty; 57% of blacks and 2% of whites. Poverty does not only mean having insufficient income to subsist on. It is a particular societal condition; one where people, under the persistence of deprivation, become alienated from the economy and where they create a survival culture which functions according to its own rules. In such a society children are often physically and mentally stunted by malnutrition - thus transforming the endemic deprivations of the present into the societal incompetencies of the future: malnourished children are precursors of poor productivity and creativity in the future workplace. A malnourished child is, by the age of five, stunted for life.<sup>13</sup>

The social, political and economic implications of inequality, poor human development, poverty and malnutrition do not augur well for the long-term growth potential of the South African economy. Apart from the inherent political instability of a situation where the politically powerful are economically weak, there is also the prognosis of pathological instabilities in townships and squatter camps. This must have a detrimental effect on productivity in the workplace. The situation displays all the characteristics of what the French call a *problematique*; a system of interrelated problems which cannot be solved separately. For example, income redistribution strategies could produce lower productivity and even result in the emigration of scarce human resources, whereas official strategies to attract expertise and investment (such as tax holidays and subsidies) may be discounted by a poor assessment of South Africa's long-term economic prospects (as recent reports on South Africa's competitiveness in fact did).

Suffice it to say that South Africa's long-term economic prospects in a post-industrial nomocratic world are decidedly bleak unless the vexing problem of

its poor status of human development can be solved sufficiently. What is needed is an increased consciousness of the scope of this very human problem, and a true appreciation of its long-term implications - by especially the economically powerful in this country. Unless it is solved, the politically powerful and economically weak, who *live* the problem, may react instinctively in ways that may destroy any hope of long-term economic growth; despite the very sound approach followed in the recent announced macro-economic strategy of the government.

Dimension	South Africa	Canada	Guinea
HDI ranking	93.00	1.000	173.00
Life expectancy at birth (years) (1992)	62.2	77.200	43.90
Adult literacy rate (%) (1992)	80.00 <sup>1</sup>	99.000 <sup>1</sup>	26.90
Mean years of schooling (1992)	3.90	12.200	0.90
Literacy index	0.80	0.990	0.27
Schooling index	0.26	0.820	0.06
Educational attainment (1992)	1.86	2.800	0.06
Real GDP per capita (PPS\$) (1992)	3,885.00	19,320.000	500.00 <sup>1</sup>
Adjusted real GDP per capita	3,885.00	5,347.000	500.00 <sup>1</sup>
HDI (1992)	0.65	0.932	0.191
GNP per capita rank minus HDI rank	-33.00 <sup>2</sup>	10.000 <sup>2</sup>	-44.000 <sup>2</sup>
<p>Notes : 1 - Figures are UNDP estimates                  2 - A positive figure shows that the HDI rank is better than the GNP per capita rank, a negative the opposite.                  Countries with an HDI below 0.5 are considered to have a low level of human development, those between 0.5 and 0.8 a medium level, and those above 0.8, a high level.</p> <p>Source : United Nations. United Nations Development Programme, <i>Human Development Report 1994</i>. New York: Oxford University Press, 1994.</p>			

South Africa	0.65	Korea	0.36
Brazil	0.61	United Kingdom	0.32
Malaysia	0.48	Former West Germany	0.30
India	0.42	Japan	0.28
Australia	0.40	Taiwan	0.27
United States	0.38		
Source : Whiteford A, Posel D & T Kelatwang, <i>A Profile of Poverty, Inequality and Human Development in South Africa</i> . Pretoria: HSRC, 1995, p.21			

### The Natural Resource Base of South Africa

The natural resource base is defined as consisting of the productive land, water, ocean and mineral resources, that underpins the primary activities of South Africa's economy. We could consider these resources to be 'disembodied'. However, the productivity and development of the natural resource base are closely aligned to the quality and development of the human resource base. It is, for example, possible to have an abundance of natural resources but still to suffer from poverty and hunger due to poor organisation, poor public management practices (including corruption, poor administration, war and criminality) and poor human development. Conversely, the productive capacities of a weak natural resource base can be enhanced through human development, good organisation and sound governance.

### *Population Pressure on Natural Resources*

Land, water and ocean resources are primary, life-sustaining resources which served as the basis for civilization in pre-industrial times. The relation between population growth and natural resource availability has, since the beginning of history, been one of the crucial determinants for the survival of mankind. Table 4 (above) presents forecasts of population growth in Africa, Southern Africa and South Africa. The population of Africa is expected to increase by approximately 100% over the next 20 years, that of Southern Africa by 106% and of South Africa by 55%.

Table 4: Population Size of Africa, Southern Africa and South Africa, 1950-2050  
(Population in '000)

Year	Africa	Southern Africa <sup>1</sup>	South Africa <sup>2,3</sup>
1950	223,967	46,145	13,683
1955	250,360	51,429	15,385
1960	282,136	57,790	17,396
1965	320,485	65,545	19,832
1970	364,206	74,591	22,458
1975	413,988	85,084	25,669
1980	475,664	98,149	29,170
1985	548,800	113,229	33,043
1990	632,669	130,464	37,944
1995	728,074	150,219	41,970
2000	831,596	171,617	46,136
2005	945,044	194,877	50,282
2010	1,069,378	220,584	54,289
2015	1,203,919	248,841	58,111
2020	1,347,789	279,125	61,625
2025	1,495,772	310,305	64,648

- Notes : 1 - Southern African countries are defined here as countries that broadly share the same physical infrastructure.  
 2 - South African statistics and forecasts from 1990 exclude estimates for illegal immigrants which vary from figures of 3 million to 8 million in 1996.  
 3 - South African population statistics and forecasts from 1990 are for the following year, eg, 1990 statistics are for 1991 and 2025 forecasts are for 2026.

Sources : Haldenwang B, *Migration Processes, Systems and Policies - With Special Emphasis on South African International Migration*. Belville: Institute for Futures Research, University of Stellenbosch. Occasional Paper No 25, 1996.

Haldenwang BB & SC Boshoff, *Forecasts of the South African population, 1991-2026*. Belville: Institute for Futures Research, University of Stellenbosch. Occasional Paper, 1996.  
 United Nations. Department for Economic and Social Information and Policy Analysis. *World Population Prospects: The 1994 Revision*. New York: United Nations, 1995, pp.222, 226, 227.

South Africa's population forecasts exclude estimates for a downward migration of large numbers of people from the rest of Africa into South Africa. The present situation in this respect is unclear, but reports on the number of illegals in the country suggests figures of between 3 million and 8 million people which should be added to the 1995-96 forecasts in Table 4. Therefore, although the forecasts for South Africa's natural population growth compare very favourably



with the rest of Africa, the prognosis for increased population pressure on resources may be much bleaker than Table 4 suggests. Unless the economies of countries north of our border improve over the coming decades at rates that are significantly better than that of South Africa (because of the present regional economic disparities), the inevitability of millions of destitute and hopeful Africans crossing the border illegally to settle in this country will have to be accepted. The forecasts of South Africa's population in Table 4 are therefore on the conservative side.

### ***Land, Water and Ocean Resources***

We now turn to the natural resources that must sustain this growing population. Tables 5 and 7 provide some comparative statistics on the availability of land and water. They indicate that South Africa's population density is higher than the average for Africa, and almost twice the average for North and South America. The available cropland per capita is currently approximately 0.31 hectares (compared to 0.8 in the US) and with *natural* population growth it is set to decline to 0.2 hectares per capita by 2025. Thus, in order for South Africa to sustain its current per capita levels of agricultural production, multifactor productivity will have to increase by at least 50% over the next 20 years, and this will have to be done with less than half the per capita cropland that is available to the US. The pressure on South Africa is clear from Table 6 and Figure 2 (see below) which indicate a sharp decline in South Africa's per capita food production since 1980, with the likelihood of deficits in food production towards 2010. In other words, whereas in the past South African agriculture was perceived to be the bread-basket of Africa, the prognosis now is that it could become a basket-case in the next century - unless this challenge is taken up with realistic (non-ideological) strategies to support agricultural development in Southern Africa.

South Africa is a water-scarce country, with population growth and industrialisation putting increasing pressure on the amount of water that is available for irrigation - thus adding to the country's existing land constraint problems. Table 7 indicates that South Africa currently has approximately 1,260 cubic metres of water available per capita compared to the world average of 7,420 cubic metres per capita and an African average of 6 140 cubic metres per capita. South Africa is therefore a very dry country where extreme fluctuations in rainfall may result in the production of a major crop such as maize fluctuating by as much as 100% from one year to the other.

Region	Population Density	Crop Land <sup>1</sup>	Permanent Pasture <sup>2</sup>	Forest and Woodland <sup>3</sup>	Other Land Use <sup>4</sup>	Total Land Area
	(per 1000 ha)					
World	427	1,441	3,357	3,898	4,345	13,041
Africa	237	181	900	685	1,198	2964
Northern & Central America	190	272	362	710	794	2,138
South America	177	114	494	829	316	1,753
Asia	1,229	457	759	532	931	2,679
Europe	1,086	139	83	157	94	473
Oceania	33	50	431	157	207	845
Former USSR	131	229	327	828	806	2,190
South Africa	334	13	81	5	23	122

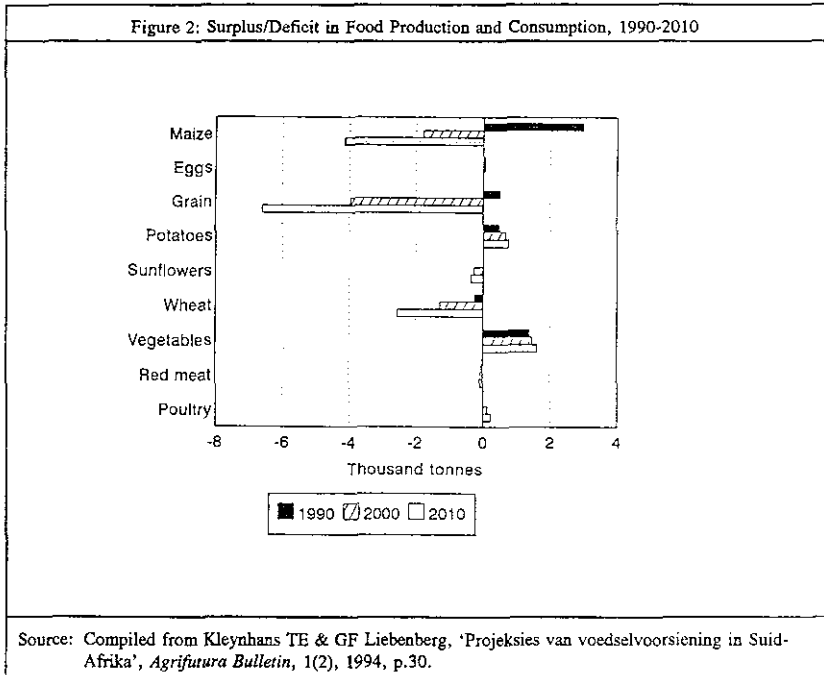
Notes : 1 - Cropland includes land under temporary and permanent crops, temporary meadows, market and kitchen gardens and temporarily fallow land.  
 2 - Permanent pasture includes land used for five or more years for forage, including natural crops and cultivated crops.  
 3 - Forest and woodland include land under natural or planted stands of trees, as well as logged-over areas that will be reforested in the near future.  
 4 - Other land uses include uncultivated land, grassland not used for pasture, built-up areas, wetlands, wastelands and roads.

Source : *World Resources 1994-95*. New York: Oxford University Press, 1994, pp.284-285.

Region	Total Production		Per Capita Production	
	1980-1982	1990-1992	1980-1982	1990-92
World	103	127	101	105
Africa	102	129	99	94
Northern & Central America	102	112	101	96
South America	104	134	102	108
Asia	104	148	102	121
Europe	102	107	101	104
Oceania	97	112	96	95
Former USSR	100	110	99	101
South Africa	101	97	98	74

Note : 1 - The food production index covers all edible agricultural products which contain nutrients. Coffee and tea have virtually no nutritive value and are thus excluded.

Source : *World Resources 1994-95*. New York: Oxford University Press, 1994, pp.292-293.



One would expect that the oceans around South Africa's vast coastline could provide an alternative source of protein for South Africa's growing population, and that this to some extent could compensate for the food production problems associated with the land and water constraints. However, Tables 8 and 9 indicate that the total demersal and purse-seine catches have stabilised around 580,000 tonnes per year (14 kg per capita per year) in recent years, with some indications of a declining trend. According to a report of the World Resource Institute there seems to be little hope of this situation improving.<sup>14</sup> The result is that the per capita availability of coastal fish in South Africa is set to decline to a maximum of 9 kg per capita per year by 2025.

Region	Annual Internal Renewable Water Resources <sup>1</sup>		
	Total (cubic km)	Percentage of world	Per capita supply ('000 cubic metres)
World	40,673.0	100.0	7.42
Africa	4,184.0	10.3	6.14
North & Central America	6,945.0	17.1	17.31
South America	10,377.0	25.5	34.08
Asia	10,485.0	25.8	3.24
Europe	2,321.0	5.7	4.53
Former USSR	4,413.1	10.8	15.51
Oceania	2,011.0	4.9	73.05
South Africa	50.0	0.1	1.26
Note : 1 - Refers to the average annual flow of rivers and groundwater generated from endogenous precipitation. Source : <i>World Resources 1994-95</i> . New York: Oxford University Press, 1994, pp.346-347.			

The overall conclusion that can be drawn from these statistics on life-giving natural resources is that South Africa's *natural* capacity for food and fibre production has already reached a ceiling, while the population of the country is set to continue on a high growth path, due to natural increases as well as expected north-south migration towards South Africa. There is, therefore, a need for a food policy that can address this emerging crisis, including innovative survival strategies for food production in poor communities. Food plots and vegetable gardens in townships, are two examples of strategies that are already operative. However, South Africa can only avert longer-term (or 'structural') food shortages through the rapid development of its economy, as well as the economies of the resource-rich countries north of its borders. The operating environment that is created by a developed economy is a necessary condition for sustained improvements in agricultural technology and thus also for technology-based increases in agricultural production. With high rates of economic growth it is also more likely that a country can afford to import agricultural production factors and agricultural products.

Table 8: Trends in Annual Demersal or Bottom-Trawl Fishery Catches in South African Coastal Waters, 1965-1994 <sup>1</sup>						
Year	Cape Hake	Maas-Banker	Snoek	Kingklip	Other	Total
Thousand Tonnes						
1965	68.6	2.3	12.9	1.8	29.2	114.8
1970	64.5	7.2	5.4	2.5	27.8	107.4
1975	77.4	9.1	6.2	2.5	25.1	120.3
1980	143.6	15.8	8.1	3.1	21.1	191.7
1985	121.0	11.7	8.1	7.1	44.1	192.0
1986	97.1	14.0	8.0	7.5	46.1	172.7
1987	96.4	21.6	12.5	5.8	44.1	180.4
1988	103.2	22.2	18.4	5.1	39.9	188.8
1989	133.6	26.8	14.8	1.6	39.0 <sup>2</sup>	215.8
1990	132.8	66.3	21.1	1.3	39.0 <sup>2</sup>	260.5
1991	136.5	35.0	21.9	2.0	39.0 <sup>2</sup>	234.4
1992	135.4	32.0	13.6	2.2	39.0 <sup>2</sup>	222.2
1993	141.2	24.3	12.5	2.7	31.2	211.9
1994	136.6	19.7	6.0	2.7	19.9	184.9

Notes : 1 - The statistics in respect of Namibia are included up to and including 1979. Statistics from 1980 include landings at Walvis Bay.  
2 - Estimate based on catches of the last 8 years.

Source : Du Plessis S, Sea Fisheries Research Unit, Department of Environment Affairs. Cape Town. Personal communication, June 1995.

Table 9: Trends in Annual Purse-Seine or Pelagic Fishery Catches in South African Coastal Waters, 1965-1994 <sup>1</sup>							
Year	Pilchards	Anchovy	Small Maas-Becker	Mackerel	Red Eye	Other	Total
Thousand Tonnes							
1965	204.5	171.0	65.0	41.4	8.2	-	490.1
1970	61.8	169.3	7.9	77.9	23.7	18.2	358.0
1975	89.2	223.6	1.6	69.3	23.6	0.1	407.4
1980	50.4	315.5	0.4	0.2	14.1	0.1	380.5
1985	29.6	277.0	0.7	0.1	37.7	37.1	382.2
1986	35.4	303.8	0.5	0.1	52.3	1.1	393.2
1987	33.1	596.0	2.8	0.8	33.3	0.1	668.0
1988	32.3	569.9	6.3	0.3	62.4	1.1	672.3
1989 <sup>2</sup>	39.0	291.0	21.6	0.4	46.0	5.2	403.2
1990 <sup>2</sup>	52.6	149.9	7.2	-	44.1	5.1	259.4
1991	52.0	150.5	0.5	9.4	33.5	2.1	248.4
1992	53.4	347.5	2.0	0.3	47.4	0.7 <sup>3</sup>	451.3
1993	50.7	235.8	11.6	0.3	56.3	1.1 <sup>3</sup>	355.8
1994	93.4	155.6	8.2	2.0	54.1	1.7	315.0

Notes : 1 - The statistics for pelagic fish exclude Namibian catches and landings at Walvis Bay.  
 2 - 1989 and 1990 figures for pilchard and anchovy were subject to government quotas.  
 3 - Lantern fish only.

Source : Du Plessis S, Sea Fisheries Research Unit, Department of Environment Affairs. Cape Town. Personal communication, June 1995.

### *South Africa's Mineral Wealth*

The South African mining industry is recognized as a world leader both in the value of mineral commodities produced and also its innovating mining technology and equipment (Table 10). The vast mineral wealth, quality of its management systems and a policy of non-intervention by the state, have all contributed to the industry's expansion over the past century.<sup>15</sup> For more than a century, South Africa's mineral industry, with gold, coal, diamonds and platinum in the forefront, has made an important contribution to the national economy. Not only has it been instrumental in the development of an extensive and well-organised physical infrastructure (such as the railroad and road system), but it has also contributed greatly to the establishment of secondary industries.

The industry is resourceful, being underpinned by a high degree of technical expertise as well as being able to mobilise capital for new developments. It is recognized world-wide as a leading and reliable supplier of a large variety of minerals and mineral products of a consistently high quality. The industry produced more than 60 different minerals from some 896 mines and quarries, of which 66 were for gold, 65 for coal, and 68 for diamonds. Mineral commodities are exported to 81 countries, the major customers being in Europe and the Far East.<sup>16</sup>

Although mining's value-added contribution to South Africa's economy has declined from approximately 23% at the beginning of this century to its current level of less than 10% of GDP, it remains an important base for much of South Africa's economic activity. Through its backward and forward linkages with other sectors of the economy, it has helped to create clusters of economic activity which spearhead a causal chain of further initiatives. The broad-based economic power of Gauteng, for example, rests on a history of mining and miners.

Nevertheless, current trends in global technological development are creating a much different mining environment than the one which prevailed even as recently as 25 years ago. Developments in materials technology impact directly on minerals such as copper and iron ore, with the value added from mining-based materials in manufacturing being substituted by value-added from technology and knowledge resources.

Countering these trends is the increased importance of the economies of the Far East. Woodall<sup>17</sup> expects a major shift in global economic power towards the East over the next 25 years. Today seven of the ten largest economies in the world are in the West, but according to Woodall, by 2020, this situation could be reversed and he expects seven of the ten largest economies by then to be in the East. However, not everybody agrees with Woodall regarding the explosive economic prospects of an 'Eastern Millennium'. Segal,<sup>18</sup> argues that the East's economic successes should be seen within the historical context of development patterns with its precedence in the Atlantic world. McRae<sup>19</sup> is of opinion that rapid economic development in the Pacific region is highly dependent on having ready access to markets in the Atlantic region, as well as a steady flow of minerals and commodities from the South. This suggests that South African mineral exports could experience a new growth phase if the Asian economies should indeed follow the growth pattern which Woodall expects. Apart from the possibility of new markets in the East, there is also the industrialising strategy of beneficiation which could strengthen long-term mining development.

The outlook for South African minerals remains positive, despite global

technological developments, with one important proviso: mineral exports are operating in a highly competitive international environment. Inefficiencies and poor productivity will kill the industry just as effectively as technological obsolescence. It is therefore again clear that the long-term viability of mining in this country will be dependent on the development and general competitiveness of the South African economy. Mining can no longer be (as was the case in the past) the 'Lone Ranger' who potentially could save the South African economy through windfall gains; it can only function as an efficient interdependent element of the country's economic cavalry.

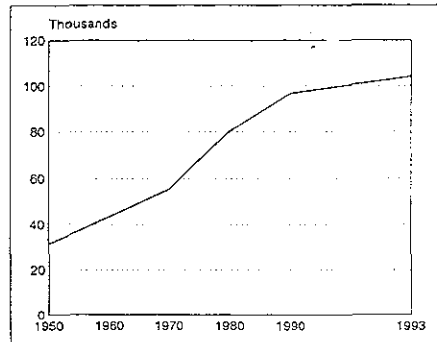
Table 10: South Africa's Mineral Production and Reserves as Percentage of World Reserves, 1993			
Mineral Commodity	Production	Reserves	As Percentage of World Reserves
Alumino-Silicates (in situ)	231kt	50,800kt	37
Antimony (Metal-in-concentrates)	4,111t	250kt	5
Asbestos	104kt	8,200kt	n/a
Chrome Ore	2,827kt	3,200Mt	72
Coal (largely bituminous)	182,226kt	55,300Mt	11
Diamonds	10,324.025car	n/a	n/a
Fluorspar	218kt	36,000kt	12
Gold	619t	18kt	39
Iron Ore	29,385kt	5,900Mt	6
Lead (Metal-in-concentrate)	100kt	5,000kt	4
Manganese Ore	2,507kt	3,992Mt	83
Nickel (Metal-in-concentrate)	30kt	11,800kt	10
Phosphate (Contained concentrate)	2,466kt	2,310Mt	7
Platinum-group Metals	176,167kg	59kt	88
Titanium (Metal)	758kt	45,000kt	11
Uranium Oxide	2,008t	179kt	14
Vanadium (Metal, 30m depth)	27kt	12,500kt	45
Vermiculite	211kt	80,000kt	40
Zinc (Metal-in-concentrate)	77kt	15,000kt	5
Zirconium minerals	230kt	15,300kt	26
Source: South Africa. Minerals Bureau, Department of Mineral and Energy Affairs. <i>South Africa's mineral industry 1993/94</i> . Braamfontein: Minerals Bureau, 1994.			



### Capital Resources: A Close Companion for Growth and Development

One of the key characteristics of the South African economy in the post-Second World War period is that its development was accompanied by a systematic process of capital deepening; a process which slowed down somewhat in recent years due to the recession in the economy (Figure 3). In constant 1990 Rand, R31,400 of capital stock per employee was required in 1950, whereas this figure was more than three times higher in 1993 (R104,200). This means that comparatively less labour is required today to keep the economy growing than 50 years ago. Research into long-term growth trends at the Institute for Futures Research has revealed that the ratio between job creation and economic growth is still showing a declining trend from current ratio of 0.4:1. This means that at current levels 0.4% growth in employment in the formal economy is associated with 1.0% growth in the economy.

Figure 3: Average Capital Stock (in 1990 Rand) per Employee in South Africa, 1950-1993



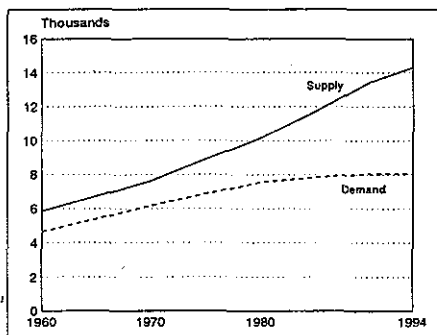
Source: Roukens de Lange A & PH Van Eeghen, 'Standardised Employment Series for South Africa's Formal Economy', *Studies in Economics and Econometrics*, 14, 2. South African Reserve Bank, *South Africa's National Accounts, 1946-1993*. Supplement to *Quarterly Bulletin*. Pretoria: SA Reserve Bank, June 1994. National Productivity Institute, *Productivity Statistics 1995*. Pretoria: NPI, 1995.

It is therefore not surprising that South Africa's formal economy has lost its ability to create jobs over the past 15 years (Figure 4), and that the few new

employment opportunities have been largely reserved for those with sought-after skills. Thus, the original income poverty of the vast majority of unskilled people in the country is now being reinforced by an economic growth pattern which, in line with all industrialising nations in the world, is becoming ever more demanding with respect to human competencies and skills (Figure 5).

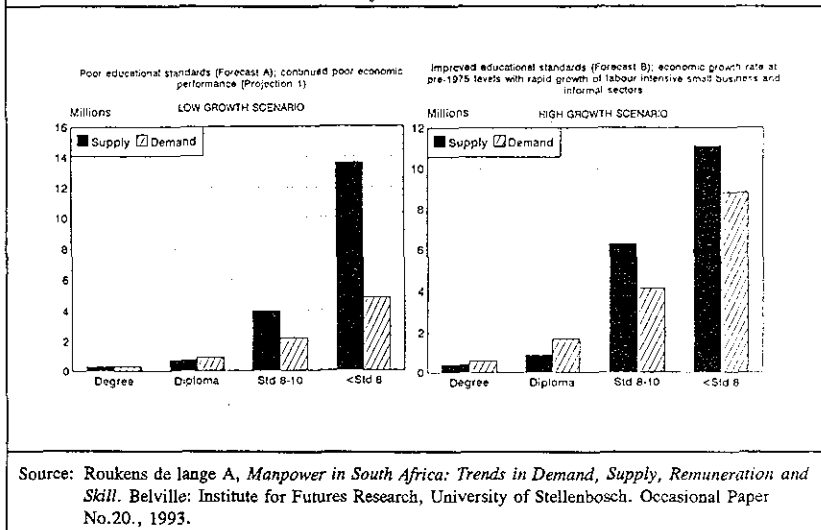
At present, the South African labour force is growing at a rate of 2.7% per annum, which means that with a job creation:economic growth ratio of 0.4:1, the economy will have to grow at a rate of at least 6.8% per year over the next decade in order to absorb new labour entrants. However, given the constraints in the labour market (a serious shortage of skills), and also in other parts of the economy, such a growth rate carries with it the real danger of overheating the economy. It is for this reason that a public works programme and a more flexible labour market are preconditions in a macro-economic strategy for South Africa.<sup>20</sup>

Figure 4: Labour Supply and Formal Sector Demand, 1960-1994



Source: South Africa. Central Statistical Service, *October Household Survey 1994*. Pretoria: Government Printer, 1995c, pp.3-10. Statistical Release P0317.  
Spies PH (ed), *Business Futures 1994*. Belville: Institute for Futures Research, University of Stellenbosch, 1994, Table 2.84, p.2-135.

Figure 5: Comparison of Labour Supply and Demand for Various Education (Skill) Levels and Projections for the Year 2000



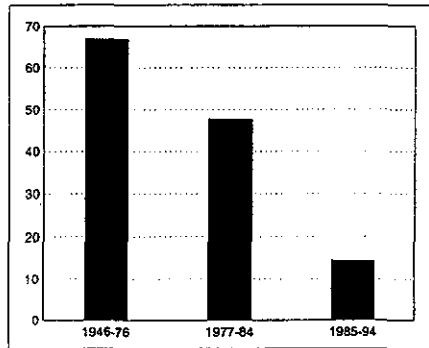
While the pattern of South Africa's economic development is making the country progressively more dependent on capital equipment, the levels of net domestic investment have decreased dramatically over the past 25 years (Figure 6). Prior to 1976 South Africa was regularly able to use foreign capital to finance gross domestic investment (GDI), but following the debt crisis of 1985 South Africa became a net exporter of capital - put another way, domestic savings (and export revenue) have had to be used to finance debt repayments. In recent years, foreign investors remained reluctant to return to South Africa at a level that could significantly effect the country's economic growth prospects. This reluctance is a cause for concern.

The investment challenge that South Africa is facing is formidable, and it is most unlikely that the country will succeed by going it alone. Given that the capital stock per employee now approaches R150,000 and with 400,000 new entrants into the job market per year, South Africa needs net investments of R60 billion annually to finance economic growth of more than 6% a year. Currently, provision for depreciation allowances approximates R60 billion a year. In other words, South Africa requires a gross investment level of R120 billion a year, which is almost double the current level of approximately R70 billion. In order to reach this level of investment, investor *perceptions* of the

prospects for stable long-term economic growth must at the very least match the growth that this level of investment could produce. In other words, the economic development and investment challenges that we are facing present a chicken-and-egg dilemma to policy-makers. To solve this dilemma will require innovative actions, socio-political stability and great statesmanship in order to cut the Gordian knot. Problems of low economic growth, low investment levels, unemployment, poverty, criminality and poor human development are mutually reinforcing dimensions of one South African *problematique*.

Another important facet of South Africa's capital resource base is the country's economic infrastructure. Figure 1 indicates that this is perceived to be one of the most important competitive strengths of the country. Within the context of Africa, and especially Southern Africa, South Africa is an infrastructure giant (see Table 11). It produces 50% of Africa's and 87,2% of Southern Africa's electricity. Whether it is railways, paved roads or telephones, South Africa stands out within the African context in terms of infrastructure development.

Figure 6: Net Domestic Investment as % of GDP for 1946-1976; 1977-1984 and 1985-1994



Source: South African Reserve Bank, *South Africa's National Accounts, 1946-1993*. Supplement to *Quarterly Bulletin*. Pretoria: SA Reserve Bank, June 1994.  
South African Reserve Bank. *Quarterly Bulletin* (various issues).

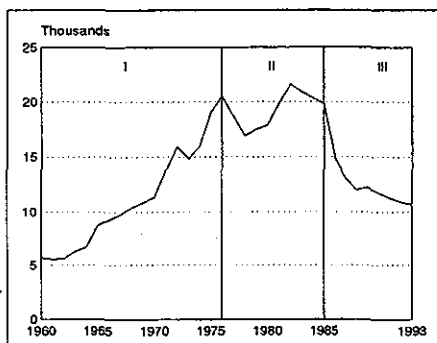
Infrastructure	South Africa As A Percentage Of:	
	Africa	Southern Africa
Electricity Output	50.0	87.2
Railways	25.6	58.0
Paved Roads	47.8	62.5
Motor Vehicles	33.0	85.0
Telephones	40.0	88.3

Source: Own computations from: ABSA Bank. 1995. *The Structure of the South African Economy*. RSA: Southern Book Publishers.

However, what we are now observing is the infrastructural fruits of past investment practices. During the past twenty years, gross domestic fixed investment (GDFI) in economic infrastructure at first levelled out (between 1975 and 1989) and then went into an absolute decline in real terms (see Figure 7 and Table 12). This decline in infrastructure investment represents a trend which, if sustained, could have serious implications for long-term economic growth; especially because it is likely that a large share of the existing infrastructure investment is targeted at replacing or maintaining aging capital equipment.

The most immediate infrastructure challenge facing South Africa is the threat to South Africa's transport infrastructure. The country's rail system is faced with a need for restructuring in order to make it more competitive and the road system is faced with the prospect of rapid deterioration in quality, because of the growth in road freight traffic. Problems with maintaining and expanding South Africa's road system could obstruct the government's long-term growth strategy. There seems to be a bias in land freight policy in this country that favours road transport - while the country's railway lines are underutilised. The recent increases in the legal limits on axle weight, and poor enforcement of the road traffic quality system are additional factors that could see the standards of South Africa's roads continuing a declining trend.

Figure 7: Real GDFI in Economic Infrastructure



Source: South African Reserve Bank, *South Africa's National Accounts, 1946-1993*. Supplement to *Quarterly Bulletin*. Pretoria: SA Reserve Bank, June 1994.

Table 12: Real Growth in GDFI in Economic Infrastructure and GDP, 1960-1993

Period	Annual Average Percentage Change	
	GDFI in Economic Infrastructure	GDP
1960-1976	8.3	4.8
1976-1985	-0.4	2.2
1986-1993	-7.4	0.8

Source: South African Reserve Bank, *South Africa's National Accounts, 1946-1993*. Supplement to *Quarterly Bulletin*. Pretoria: SA Reserve Bank, June 1994.

To conclude, the real decline in expenditure in economic infrastructure does not augur well for South Africa's long-term potential for sustained economic development. It is nevertheless important to note that there are special circumstances in two particular areas of infrastructure investment, *viz.* electricity generation and water infrastructure. In the area of electricity generation, South Africa is currently favoured with surplus capacity. However, this situation may rapidly change under a high economic growth scenario which could see the current growth in electricity demand of around 3.2% per annum returning to the pre-1980s growth of over 7% per annum.<sup>21</sup> This would be even more true if the Southern African region in general should experience improved economic growth over the coming decades.

With respect to water infrastructure, it is well-known that large dam building schemes absorbed vast amounts of capital up to the early 1980s, and currently also including the Lesotho Highlands Scheme. However, the scope for expansion is, in this case, limited by the availability of the resource, notably, water and suitable dam building sites. Water is nevertheless one of South Africa's scarcest natural resources and one can foresee the need for significant infrastructure investments to build installations for water recycling and for the desalination of sea water.

There is a need for a continuing (and even increasing) investment in South Africa's telecommunication infrastructure. The rapid rate of innovation in *telematique* and the fact that information and communication are key factors of global competitiveness, make this a *sine qua non*. Currently, South Africa is well serviced by world class telecommunication services, but it will require constant renewal and investment to keep it on par with world standards.

### **The Current Future of the South African Economy**

With the 'current future' is meant that future where we assume that the trends of the past and present will continue into the future. This is a 'surprise free' forecast of how events could evolve if we continue riding the waves of change without breaking out of the mould, and trying to recreate the world we are living in.

### ***The Conditions Dictating Our Current Future***

At the beginning of this paper, I posed a number of questions about the future of the South African economy. From the previous overview of the constraints and capacities of the economy, we are now in a better position to formulate answers to all of them.

We now know, for example, that a long-term economic growth path of between 6% to 7% is required for social equity and political stability. This much is also abundantly clear from the government's macro-economic strategy. We also know that, given the present structure of, and constraints on, the economy (as was discussed), we cannot expect long-term rates of economic growth that are significantly better than those South Africa has experienced over the past twenty years (see Tables 13 and 14). This is because the economy went into a structural decline in the mid-1970s due to a number of factors, including a warped manpower structure, warped investment strategies, changes in the country's demographics, and economic development patterns which ignored the major thrusts of international industrial development.

True, other legacies of the country's apartheid policies also contributed to this decline. South Africa's military activities in the sub-continent consumed a growing share of the budget - and even swallowed the road fund by the end of the 1980s. The debt moratorium and sanctions also had a serious (if not crippling) effect on the economy. However, underlying all of these factors are a number of enduring structural deficiencies which cannot be wished away or resolved by simply removing the reasons for sanctions, for example, by improving the political situation in the country. The fact that investors are not rushing back to South Africa despite the global acceptance of the new government is a case in point.

Apart from the particular situation in South Africa, we also come to understand from the previous discussions the particular rules of international economics that could make or break the South African economy - depending on how well we can adapt and play according to these rules. We know that the successful economies of the world will be those:

- \* With competitive (largely created) rather than comparative (largely given) advantages;
- \* Where the human resource base is well-developed, managerial processes (public and private) effective and technological innovation institutionalised within the education and research systems, within business and within society in general (that is, the 'nomocratic world');
- \* Where economic freedom (and therefore also political freedom) is respected; and,
- \* Where particular economies can align themselves with global practices and principles, which will allow the creative influences of Ohmae's four 'I's (international investment flows, industry co-operation, information/technology flows, consumer individualism) into the domestic economy.

Within this context, there is a likelihood of a shift in the centre of economic gravity towards the East, which could benefit especially mineral exports. The growing importance of international institutions such as the WTO has been identified also, which could, *inter alia*, affect domestic policy-making in the mould of Ohmae's borderless world (the other influence being multinational businesses). Underlying these are trends in technological innovation which double the productivity of some technologies every three years - with potentially dire consequences for the poorly-trained and unskilled workers of South Africa.



Table 13: Trends in South Africa's GDP <sup>1</sup> (at market prices) and Relationship to GDE, 1946-1994						
Year	GDP (Rm)		Real GDP Relative to 1990	GDP Per Capita R (1990)	GDP Per Capita Relative to 1990	GDE/GDP
	Current Prices	Real (1990) Prices				
1946	1,704	53,650	0.194	4,483	0.603	1.048
1950	2,587	63,016	0.228	4,936	0.664	0.966
1955	3,883	80,012	0.290	5,464	0.735	0.984
1960	5,141	97,883	0.355	5,717	0.769	0.943
1965	7,682	132,744	0.481	6,770	0.911	1.008
1970	12,473	170,592	0.618	7,587	1.021	1.035
1975	26,646	204,061	0.739	7,969	1.072	1.024
1980	61,328	237,636	0.861	8,163	1.098	0.918
1981	71,080	250,375	0.907	8,380	1.127	1.017
1982	80,531	249,415	0.903	8,138	1.095	1.001
1983	91,457	244,809	0.887	7,790	1.048	0.963
1984	107,221	257,292	0.932	7,987	1.074	0.981
1985	123,126	254,175	0.921	7,700	1.036	0.909
1986	143,255	254,221	0.921	7,517	1.011	0.907
1987	167,098	259,561	0.940	7,495	1.008	0.920
1988	200,448	270,463	0.980	7,631	1.026	0.946
1989	240,639	276,940	1.003	7,633	1.027	0.948
1990	276,060	276,060	1.000	7,434	1.000	0.940
1991	310,074	273,249	0.900	7,192	0.967	0.950
1992	340,963	267,257	0.968	6,879	0.925	0.963
1993	383,071	270,181	0.979	6,803	0.917	0.961
1994	432,753	276,464	1.002	6,813	0.917	0.983

Note : 1 - Provision for the contribution of the informal sector has been included in the estimates for GDP from 1987 onwards.

Sources : South African Reserve Bank, *Quarterly Bulletin* (various issues).  
South African Reserve Bank, *South Africa's National Accounts, 1946-1993*. Supplement to *Quarterly Bulletin*. Pretoria: SA Reserve Bank, June 1994.

Table 14: Average Annual growth Rates of Real South African GDP<sup>1</sup>  
Over Five-Year Periods, 1946-1990, and for 1991-1994

Period	GDP	GDP per Capita
	Percent change per annum	
1946-1950	4.10	2.44
1950-1955	4.89	2.05
1955-1960	4.11	0.91
1960-1965	6.28	3.44
1965-1970	5.14	2.30
1970-1975	3.65	0.99
1975-1980	3.09	0.48
1980-1985	1.35	-1.16
1985-1990	1.67	-0.70
1991	-1.0	-3.26
1992	-2.2	-4.37
1993	1.1	-1.1
1994	2.3	0.15

Note : 1 - An additional 5.5% value added was, as from 1994, phased into the official GDP figures with the phasing-in back dated to approximately 1987. This additional value added is to accommodate for that part of the informal sector activities which is not normally included in official GDP calculations.

Source : Calculated from Table 12.

### **The Current Future: A Muddle Along Economy**

The 'muddle along economy' is perhaps the most likely scenario for South Africa if the current climate of group conflict, criminality and the apparent inability to act decisively on important matters - such as labour relations, education and reconstruction and development - continues. The new politics of South Africa have created great scope for development by releasing South Africans from the shackles of apartheid, and by creating an inviting international climate for the economy. But, alas! The dynamics of poverty, low-level conflict and criminality in South Africa seem to have forced presentism and survivalism to the fore. There is a lack of collective vision: an absence of belief in South Africa's future as an achievable exciting prospect. Therefore, actions are dominated by two overbearing concerns, namely:

- \* To win the fight against our countrymen in the shape of a class struggle and through official sanction for the emerging neo-apartheid and racist

patterns of social behaviour; and,

- \* To survive, and grab as much as possible where the politically powerful and economically weak confronts the economically powerful and politically weak.

Within this context and with our understanding of the constraints on the enabling factors of the past, our economic future will simply be the extrapolative shadow of past trends.

This means that the economy will grow at below a ceiling of around 3.5% per annum, in other words, a long-term growth trend of around 2% per annum. This growth scenario is especially likely if investor confidence in the country is not restored due to a worsening in the social, political and business environment in the country; which will, of course, confirm their worst fears, because this low-growth scenario will be dynamically self-reinforced by a vicious cycle of decline.

At 3% growth,

- \* Less than half the annual new entrants of approximately 400,000 to the labour force will be able to find jobs;
- \* Government will not be able to support infrastructure investment, and its RDP promises for social upliftment will go wanting which will inevitably increase political instability;
- \* Pressure for redistribution, restitution and affirmative action will increase, which could lead to an increased emigration of qualified people, lower productivity, lower domestic investment and a slow but certain increase in tax levels; and,
- \* In order to contain the consequences of endemic societal conflict, and to strengthen its power base, government will be tempted to become more centralistic which will erode economic freedom, innovation, and thus ultimately global competitiveness.

This future path spells the end of South Africa as a viable country. Its demise is unlikely to happen suddenly. Ten years from today we will still be able to enjoy the beauty and pleasures of the land. But gradually, like a frog being cooked on a slow fire, while adapting to the heat, the marrow will be sucked from the economic bone while we adapt to worsening conditions - while the young and enterprising are leaving our shores. Like an untended garden, the country will slowly revert back to the bush, with a growing number of people opting out of formal economic activity into the 'dark' (or 'black') economy in

an effort to avoid taxes, and the informal sector in order to survive. The share of the labour force in the formal economy will drop from its current level of 55% to 47% by 2005, while there is a continuing influx of illegal job seekers who are compounding this problem.

## **Conclusion: Is There A Road Map for Another Economic Destination?**

### ***On Foresight***

Foresight is often just personal reflections between the shadows of the past and the light of the future: The former representing extrapolative thinking and the other hope, creativity and action. Sir Geoffrey Vickers<sup>22</sup> describes human history as a two-stranded rope. The one strand is the history of events; the trends that we observe and the perspectives, experiences, fears and hopes that we carry within us. The other strand is the history of ideas through which we forever search to find new solutions to our problems. These two strands develop an intimate relation with one another in the design of history. Each strand follows its own logic in its own timescale; conditioning both its own future and the future of the other in the process.

Perspectives on the future of the South African economy can similarly be expressed in terms of history, events, trends, hope, ideals and intent. There is no 'truth' in this kind of future or any other future for that matter, because it does not yet exist; only our images and ideals are there to be displayed. Even so, we all live the future. It is our world of practice, our world of action: our *real* world which guides our behaviour and, through that, creates our future. Therefore, how we perceive South Africa's economic future and how we think about it, will have major implications for what *will* happen. Nietzsche<sup>23</sup> said: 'I ask whether we know of any other method of acting well than always thinking well; the latter is an action, and the former presupposes thought'.

### ***On Extrapolation***

Years ago there was a Calypso song which shouted the refrain: 'How low can you go?' Indeed, how low can an economy go? The recent drop in the rand exchange rate prompted one delegate at a meeting to ask my colleague, Willie Esterhuysen: 'What is your view of the future exchange rate?' Now, Willie is a professor of philosophy who specialises in business ethics. His understanding of the moral dimensions of money is much better than his understanding of economics. His reply should therefore be appreciated within this context, which

was something to this effect: 'Well, I think the exchange rate will drop to zero, and then we will be rid of that problem!'

The problem is that negative economic growth is a real possibility (as recent events in Russia show), when the socio-economic fabric of a society becomes unstuck. The muddling through economy assumes that this will not happen in South Africa, only that a lack of vision combined with a strong sense of survival will slowly erode the capacity of the country. In such an economy we will only lose our humanity, not our life.

### *A New Road Map For a Road to be Constructed*

The alternative route is a visionary route, best summarised by the following quote from the Spanish philosopher, Ortega:<sup>23</sup>

Man has been able to grow enthusiastic over his vision of unconvincing enterprises. He has put himself to work for the sake of an ideal, seeking by magnificent exertions to arrive at the incredible. And in the end he has arrived there. Beyond all doubt it is one of the vital sources of man's power to be thus able to kindle enthusiasm from the mere glimmer of something improbable, difficult, remote.

Therefore, my argument is that South Africa's economic future is largely a function of choice and action. The preconditions were established in this paper:

- \* We know that we must be competitive and productive, and that also requires us to be technologically minded;
- \* We know that the country cannot develop if current levels of inequality and poverty are not rectified;
- \* We know that South Africa cannot develop in isolation from its neighbours lest it is flooded by 'illegal' immigrants;
- \* We know that we cannot resolve the problems of the short-term unless we have a *clear practical* vision of the long-term; and without an improving short-term (even in our perception) there is not a worthwhile long-term;
- \* We know that bad management, poor organisation, a poor work ethic and intergroup conflict will destroy the country;
- \* We now clearly understand the standards of governance that will allow South Africa to become competitive; and,
- \* We understand the constraints on our enabling resources.

What we *think* we do not know is whether we can succeed. But that is a question for the mind of the individual, and for leadership of the community. Russell Ackoff, the systems thinker, expressed the problem in this way: 'The principle obstruction between man and his desired future is man himself. We do *not* know we cannot change the world; we have not tried ... Trying is a word whose time has come'.<sup>24</sup>

The ground work for an active future has already been prepared. We have a constitutional democracy. The country weathered the recent political and monetary storms well. We have frameworks for economic strategy that should satisfy most domestic and foreign investors. For South Africa the world is an oyster.

What we apparently do not have is a keen appreciation by business of the *central* importance of human development for the future of the country; by the political establishment that political posturing is a serious obstruction to the future of the country; by labour that their elitist stance is an obstruction to employment; and by the new governing establishment that centralism and the emerging pattern of restitution and affirmative action are developing into a neo-apartheid ideology.

The key to a high growth economic future lies in a compelling vision, a community spirit, entrepreneurship and hard work. The future is for our making (not our taking).

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## Response

Gavin Keeton

In recent months South Africa has witnessed an unprecedented focus on the macro-economic policies necessary to grow the economy sufficiently rapidly to ensure a better quality of life for all its citizens. While concerns about the lack of a credible medium-term growth strategy were already evident for some time in the writings of many of the more serious commentators on this country, it was the release of the South Africa Foundation document *Growth for All*<sup>1</sup> in February 1996 that brought these issues into the domestic spotlight. The vigorous debate generated by this document was subsequently further fuelled by the sharp decline in the Rand exchange rate and increases in domestic interest rates in April and May which were the consequence of significant foreign capital outflows. A great deal of public finger pointing was indulged in by certain groups, and written policy alternatives were produced by, amongst others, organised labour<sup>2</sup> and the National African Chamber of Commerce (NAFCOC).<sup>3</sup> Most recently, in June 1996, government released its own macro-economic strategy for South Africa entitled *Growth, Employment and Redistribution*.<sup>4</sup>

### The 'Muddle Along' Economy

Against this background, the paper delivered today by Professor Philip Spies<sup>5</sup> is an important one. It is important not just for its detailed statistical analysis of the current characteristics and trends within the South African economy, for which the Institute for Futures Research is well known. Rather, its importance lies in the fact that the principal conclusion of the paper is that the current debate about macro-economic policy is essentially futile. The view is advanced that despite changes in macro-economic policy, South Africa's most likely future scenario is a 'muddle along' economy in which economic growth will average about 3% per annum and unemployment will grow: this, ultimately, 'spells the end of South Africa as a viable country'.<sup>6</sup> Fortunately, Professor Spies does also offer an alternative scenario which, to be realised, requires a change of vision by all interest groups in South Africa, a community spirit, entrepreneurship and hard work.

It is important to note that the 'muddle along' scenario presented by Spies is little different from the type of scenario that was being put forward by most



economic commentators prior to the announcement of the government's *Growth, Employment and Redistribution Strategy*. Indeed, the starting points of both *Growth for All* and the *Growth, Employment and Redistribution Strategy* are an economy that will grow at about 3% per annum under current policies. This means one of three things: either Professor Spies does not believe that government will actually implement the strategy to which it has committed itself; or he believes that the contents of this strategy are inappropriate or inadequate; or, alternatively, he accords little importance to even appropriate macro-economic policy as a determinant of a country's economic growth success.

There are plenty of reasons for being concerned about whether government will indeed achieve the policy ideals set out in *Growth, Employment and Redistribution*. These include the considerable difficulty in actually achieving the expenditure reorientation and deficit reduction targets that government has set itself at a time of slowing economic growth; continued hostility to privatisation on a meaningful scale by government's alliance partners; and concerns that the envisaged 'regulated flexibility' in the labour market will be insufficient to generate the numbers of jobs necessary to reduce unemployment. Other concerns include the fact that South Africa at present seems to lack a politically popular individual, strongly committed to policy reform, to 'champion' the reforms through political difficulties - a factor that was often so important in successful economic policy adjustments internationally. Likewise, greatest success appears to have been achieved internationally only after a significant economic crisis (such as hyper-inflation): it is not clear that South Africa's political, business and labour leadership yet sufficiently appreciates the magnitude of the employment crisis which this country faces.<sup>7</sup>

Yet these, it seems to me, are not Professor Spies' concerns. Indeed he appears to take the successful implementation of government's new macro-economic strategy as a given.<sup>8</sup> Rather, he seems to believe that even appropriate changes in macro-economic policy are on their own insufficient to raise economic growth rates in a 'nomocratic' world - a world in which competitive advantage is achieved through acquired knowledge rather than given; a world in which South Africa's low skills base and the conflict between the 'politically powerful and economically weak' and the 'economically powerful and politically weak' are debilitating constraints on our ability to compete internationally and therefore to grow.

## **Does Macro-Economic Policy Matter?**

This conclusion is a bitter blow for economists striving to improve the lot of fellow South Africans. But is macro-economic policy in fact as impotent as Professor Spies' conclusion appears to suggest?

Fortunately not. There is a wealth of evidence from around the world that indicates that good economic policy results in improved economic performance.<sup>9</sup> To take a current domestic example: we know that (subject to statistical revisions) the South African economy grew by 3.3% in 1995 and that much of this growth was the result of an increase in gross fixed investment to a level equal to 19.3% of GDP. It is a matter of national accounting that the difference between what an economy saves and invests is equal to the deficit on the current account of the balance of payments: as domestic savings equalled only 16.7% of GDP in 1995, South Africa accordingly experienced a current account deficit equal to 2.6% of GDP, or R12.7 billion. This deficit was funded by foreign capital inflows, largely of a short-term nature, and it was the outflow of large amounts of this short-term capital that caused such turbulence in the foreign exchange market earlier this year.

We also know, however, that domestic savings in 1995 were reduced by government dissaving (borrowing to fund consumption) of R19.2 billion, or 4% of GDP. In other words, had there been no government dissaving, South Africa would, *ceteris paribus*, have run a surplus on the current account of the balance of payments. Foreign capital inflows could then have been used to build up the foreign exchange reserves and to accumulate foreign assets.<sup>10</sup> The vulnerability of the Rand exchange rate to a sudden reversal of foreign capital inflows would thereby have been significantly reduced.<sup>11</sup> Clearly macro-economic management did matter and better policy would have resulted in a more favourable outcome.

Longer-term evidence is available from around the world of the importance of macro-economic policy for economic growth. Most recently, Professor Mancur Olson has shown why it is that the most rapidly growing countries in the world are never the poorest countries (as is predicted by neo-classical growth theory), nor the richest countries (as is predicted by endogenous or new growth theories), but rather a subset of the poorest countries. The reason, he shows, is because the poorest countries usually have inefficient economic policies and institutions.<sup>12</sup> As a result, poorest countries are usually not operating on their production function frontiers as is assumed in neo-classical and new growth theories. Consequently, future economic growth is not dependent just upon improving and increasing the availability of inputs into these economies, but also on utilising existing resources more efficiently. Olson concludes:<sup>13</sup>

(A)ny poorer countries that adopt relatively good economic policies and institutions enjoy rapid catch-up growth: since they are far short of their potential, their per capita incomes can increase not only because of the technological and other advances that simultaneously bring growth to the richest countries, but also by narrowing the huge gap between their actual and potential income.

Moreover, the widening gap between poor and rich countries over time demonstrates that poor countries have fallen even further below their potential income. Consequently, the possibility for poor countries to experience extremely rapid rates of per capita income growth has risen over time. This is demonstrated by the fact that, whereas it took 50 years between 1820 and 1870 for per capita income in the UK to double, and another 80 years between 1870 and 1950 for it to double again, per capita income in the East Asian tigers now doubles in less than ten years. Put differently, whereas the average person in the world in 1990 had a per capita income some 72% higher than their parents had in 1960, the comparable increase for the average Korean was some 600%.

With South Africa's unemployment rate currently around 30% and its underemployment rate perhaps another 10-15%, this country is clearly also operating well within its production frontier. The opportunities for catch up from appropriate policy change are therefore correspondingly high. Given the magnitude of unemployment, a movement of the currently unemployed even into low skilled, low productivity jobs would add significantly to average labour productivity. In the process absolute poverty and income inequality would be dramatically reduced.<sup>14</sup>

In a similar vein, Paul Krugman has argued that the secret behind the East and South Asian 'miracle' economies lies precisely in their massively increased use of the vast quantity of production inputs at their disposal rather than from increased skills or technological progress. These economies are, in fact, not miracles at all.<sup>15</sup>

### **Education and Training**

Professor Krugman notwithstanding, the importance given in this response to 'getting macro-economic policies right' does not mean that micro-economic policies such as education and training and workplace organisation are not important. Professor Spies is correct in pointing to South Africa's deficiencies in these areas. However, even in a 'nomocratic' world these deficiencies need not be a cause of despair. For the modern global economy means not just that goods and services are traded internationally, but also that the stock of global knowledge is easily available and at little cost. Knowledge of technology or

organisational practice is easily transferred from rich to poor countries - either directly through foreign direct investment, or indirectly through licensing or by simple copying - and at little cost. So rapid are such flows of knowledge that Royal Dutch Shell in their latest global scenarios<sup>16</sup> talk of 'bubbles of value', referring to the brief period of perhaps only six months in which firms can make high profits from new discoveries before these new products and methodologies are duplicated around a 'copycat' world.

The ability to make use of global technology and experience was a key factor in the growth experience of the Asian tigers and the cost of this knowledge was very small. In Korea, for example, it is calculated that the cost of acquiring foreign knowledge amounted to less than one-fiftieth of the rapid economic growth which this knowledge helped generate.<sup>17</sup> There is no reason why South Africa cannot benefit similarly from flows of knowledge.

While an improvement in South Africa's overall education system is clearly critical to long term skills enhancement, it is also important to note that the gains to be made from quite modest improvements in skills are quite large and immediate. The World Bank, for example, in developing a series of economic scenarios for South Africa, found that the long term growth rate of the economy could more than double (from 2.4% to 5.9% per annum) mainly as a result of skills upgrading at a 'high, but feasible rate'.<sup>18</sup> At a firm level, Samcor - the South African manufacturer of Ford and Mazda vehicles - in 1995 increased its production of motor vehicles per employee by a factor of 50%, from 10 to 15 cars per annum. This compares with an industry average in 1994 of nine cars per employee. This was achieved not by cutting staff, but by increasing the average number of hours of training per employee from 14 hours in 1994 to 54 hours in 1995. A further factor was the introduction of best international practices brought to it by the return of Ford as a joint equity partner with Anglo American Industrial Corporation. Training will be increased further in 1996, which means that the bill will rise to 7% or 8% of the payroll - five times the industry average. The scope for further improvements is illustrated by the fact that in 1994 Ford's plant in Valencia, Spain produced 65 cars per employee.<sup>19</sup>

### **Is the 'Current Future' for South Africa a Continuation of the Past?**

Professor Spies' generally gloomy prognosis for South Africa is the result of not just (in his eyes) the impotence of macro-economic policy, but also his acceptance that the 'current future' or 'surprise free' forecast of the South African economy is the continuation into the future of the trends of the past and the present. Thus he notes:<sup>20</sup>

We (also) know that, given the present structure of, and constraints on, the economy ... we cannot expect long-term rates of economic growth that are significantly better than those South Africa has experienced over the past twenty years.

My contention is, however, that the future constraints on the economy will not be the same as those of the past or even of the present. To give one example, capital outflows from South Africa over the period 1985-93, largely to repay foreign debt, amounted on average to some 2.5% of GDP per annum. This enormous drain on domestic savings limited the possibility of increases in domestic investment and macro-economic policy, especially monetary policy, adjusted to ensure that this was the case. The result was dismal growth of around 1% per annum. Even if we make the relatively pessimistic assumption that South Africa's future net capital flows will be neutral, a substantially better growth performance than the past decade will be possible. With only modest net inflows the country's growth performance will be substantially enhanced.<sup>21</sup>

## **Conclusion**

Professor Spies' 'muddle along' scenario is clearly a possible future for South Africa, but I am not convinced it is the most likely scenario. With better economic policies South Africa's growth rate is likely to be better than he envisages: with good policies it will be much higher.

What is the likelihood that policies will indeed be better or even very good? To return to Spies' struggle between the 'politically powerful and economically weak' and 'politically weak and economically powerful', I would suggest that this is only important if it results in bad policies. Bad policies are not inevitable: indeed it is the high growth that results from good policies that is the rational choice for a government many of whose supporters are already amongst the ranks of the unemployed.

Politicians do not, of course, always make decisions that are rational in the long term. But here we have the power of international capital markets to ensure that government does not stray. After a similar experience in 1993-94 when the capital markets in the United States forced the Federal Reserve to raise interest rates to offset what the market believed was the threat of higher inflation, James Carville, an election adviser to President Clinton, commented:<sup>22</sup>

I used to think if there was reincarnation, I wanted to come back as the President or the Pope. But now I want to come back as the bond market. You can intimidate everybody.

In the first half of 1996, South Africa received a similar lesson of the power of the markets and any future perceptions that government is straying from sound

economic policies will no doubt have similar consequences. Because economic policy *does* matter in determining the growth performance of nations, this discipline, together with what I believe are genuine commitments on the part of government to implementing appropriate policies, and on the part of business to responding to the investment and productivity challenges which these offer to them, makes me hopeful that South Africa's future will be a brighter one that Professor Spies envisages.

## Endnotes

1. South Africa Foundation, *Growth for All: An Economic Strategy for South Africa*. Johannesburg: South Africa Foundation, February 1996.
2. Cosatu, Nactu and Fedstal, *Social Equity and Job Creation, The Key to a Sustainable Future*, Johannesburg, April 1996.
3. Nafcoc, *Growth and Development with Equity Strategy*. Johannesburg: Nafcoc, April 1996.
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5. Spies P, 'Future Paths and Trends for the South African Economy'. Paper delivered at the South African Institute of International Affairs Conference, *South Africa in the Global Economy*, 11-12 July 1996.
6. Spies P, *ibid.*, p.18.
7. For a discussion of the conditions necessary for successful policy reform see Williamson J (ed.), *The Political Economy of Policy Reform*. Washington DC: Institute for International Economics, 1994.
8. Spies P, *op.cit.*, p.19.
9. See, for example, World Bank, *The East Asian Miracle*. New York: OUP, 1993; Easterly W & Pritchett L, 'The Determinants of Economic Success: Luck and Policy', *Finance and Development*, December 1993, pp.38-41; as well as 'Survey of the Third World', *The Economist*, 23 September 1989.
10. The problem for macro-economic stability would have been the need to neutralise the impact on domestic liquidity of foreign capital inflows and prevent an even more rapid appreciation of the exchange rate than actually occurred. Government's new macro-economic strategy commits it to avoiding either possibility: these goals could have been met in 1995 by partly lifting exchange controls.
11. Of course, international experience shows that no exchange rate is immune in the event of sustained attack.
12. Olson M, 'Big Bills Left on the Sidewalk: Why Some Nations are Rich, and Others Poor', *Journal of Economic Perspectives*, 10, 2, Spring 1996, pp.3-24.

13. *Ibid.*, p.20.
14. Professor Spies rightly points to South Africa's highly unequal income distribution. One-third of this inequality is, however, due to South Africa's abnormally high unemployment rate. A significant reduction in unemployment would dramatically reduce income inequality to a level that would be considered 'normal' by comparison with other countries at a similar level of economic development (South African Foundation, *op.cit.*, pp.92-93).
15. Krugman P, 'The Myth of Asia's Miracle', *Foreign Affairs*, November/December 1994, pp.62-78.
16. Royal Dutch Shell, *Global Scenarios, 1995-2020*, unpublished, 1996.
17. Olson, *op.cit.*, p.8.
18. Fallon P & LA Pereira de Silva, 'South Africa: Economic Performance and Policies', *Informal Discussion Papers on Aspects of the Economy of South Africa: Discussion Paper 7*, Washington DC: World Bank, 1994.
19. Anglo American Corporation of South Africa, *Chairman's Statement*, 1996.
20. Spies P, *op.cit.*, p.15.
21. Professor Spies suggests that fixed investment will have to double (to almost 30% of GDP) for 6% GDP growth to be achieved. Even with the most optimistic forecasts of domestic savings this will be possible only if government dissaving is completely eliminated: indeed it may be necessary for government to become a net saver. Foreign capital inflows (of perhaps 3% of GDP) will also be crucial at such a level of investment, but this is not unsustainable in an appropriate environment of growth and macro-economic stability.
22. Cited in *The Economist*, 18 June 1994, p.19.

## 12.1

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### Summary and Conclusions

*Robert McKinlay*

As far as the global economy is concerned, I have two comments: one has to do with history and one has to do with ideas. Many social scientists have a habit of regarding 1945 as being Year Zero; many politicians have the habit of regarding yesterday as being Year Zero. In fact, there is much to be said for looking back over history - not of necessity to find out what is going to happen tomorrow of course, but to put things into perspective.

On the subject of ideas, I might be at variance with Jeffrey Herbst. Ideas can be used as *post hoc* rationalisations for events that have taken place. I think that they are also - thank goodness - critically important in the things that human beings get up to and indeed, were ideas not to influence what human beings get up to, we would never have raised ourselves above the level of worms.

If we look back over history, in particular, over the history of the 20th Century, we have been extraordinarily influenced by ideas that are firmly rooted, interestingly enough, in the 19th Century and largely came to fruition at the beginning of the next century. The winning ideas of the 20th Century - next to the fascisms and atavistic nationalisms that would otherwise have appeared - have been liberalism and socialism.

It was quite clear that by the turn of the century some fusion was possible between these two apparent poles of liberalism and socialism. And these have become fused into what I would prefer to call compensatory liberalism and what other people call social democracy.

Much of the success and progress of the 20th Century has been in the living out of these ideas, that is in putting these ideas into practice. These have taken the form, of course, of the development of the mixed market economy and what many people regard as liberal democratic political systems. This would help to put into perspective the 'red herring' that somehow governments are going out of vogue.

Two quite different things have been happening in the global context. First, there has been a true global diffusion of the ideas and forms of compensatory, liberal democracy. This has unquestionably become the dominant form of political economic organisation. If you look at the international level - and the



very fact that compensatory, liberal democracy is rooted in the nation-state, means we must continue to talk about interstate relations - this level is rather more purely liberal. So the hallmark of interstate relations is, for the most part, the kind of minimal constitutionalism which we classically see in bodies like the WTO. These two rather different developments are certainly not fully globalised although, as far as I can see, there is no clear rival to the continuing globalisation of these ideas. The only thing, sitting on the sidelines fortunately, are a pile of very different authoritarian regimes - or the prospects of the so-called economic war of the regional worlds. Quite why NAFTA and the EU should ever go to war is, however, entirely inconsistent with the principles on which they are based.

As these ideas and forms have become globalised and as we look towards the turn of the century, we could look forward to the world becoming an increasingly happier place, which is not to pretend, of course, that there are not all sorts of conflicts and disharmonies around at the moment.

South Africa, like anywhere else, has choices before it. Two little things I would say in the context of choice: first, whenever you presented with options, it is well to remember that there are such things as over-determined equations, that is, cases where you have too many variables and too few equations. You could also express it as they do in Yorkshire: 'you cannot have your cake and eat it', you cannot have all your choices all at the same time. The second thing to remember, is that choices always entail values. Some people will try and sell you choices as though they are somehow value-free. The classic illustration of this at the moment being the so-called neo-liberalism (which incidentally is not new and certainly is not neo) but they will try and pretend to you that it is somehow value-free. But it is parading an explicit set of values.

Given the choices before South Africa and as they have been discussed in this setting, it seems to me that some of the extreme choices have been discarded: those of isolation, 'regional interaction' (and I use the term 'interaction' deliberately rather than the term 'integration'), 'South-South' and neo-mercantilism. Which leaves us then with the choice of integration. South Africa seems ideally suited to take this route, although it is certainly the case that the parameters within which integration within the global economy could take place are relatively fixed and set. And these will to some extent lie beyond the control of the South African government, although no doubt many South African politicians would have you believe otherwise. There is no formula and no express sequence that needs to be followed at all, and this is entirely up for internal debate. There are understandably varying degrees of freedom that would accrue to interested groups on the particular form and timing of that integration.

### Summary and Conclusions

*Jonathan Katzenellenbogen*

This summary deals with the South African economic crisis and what we have learnt from this conference. I did not get the sense either from Dr. Stals or any of the other speakers (bar Professor Spies) that we really are in all that serious a crisis - yet we are. Perhaps a Central Banker always gives a slight tone of optimism but the facts are that we are probably in a state of structural decline. We cannot get away from that. We have had 20 years of declining per capita income and declining productivity rates and in contrast to Dr. Stals, I think that the years since 1992 are to some extent an aberration when we faced the full force of the global economy, sanctions ended and our trade took off. I think that many aspects of our re-integration are those from which we are now gaining the benefits - but for how many years will this last? What then of our trade relations with the region? How can our trade with the region be financed?

More generally in terms of economic reform, what I have learnt from this conference is that basically you cannot afford to mess around and talk to all the vested interest groups - whether they be business or trade unions - however much you depend on that support. You are elected by the electorate to govern. You are not elected by business and trade unions, which are very small groups numerically which diminish the determination to continue on the path of economic reform. What we have seen from this government over the last two years - and I think this has been brought out in the discussions on Latin America and New Zealand - is that one has got to go ahead with the 'big bang': Having been elected for five years in most countries, you do not have to face the electorate again for five years and the benefits of economic reform are usually there within about two years, according to most IMF programmes. At the same time, one cannot afford to start any economic programme some three years into your term, when you face an electorate two years on. The New Zealand programme - as the High Commissioner noted - adopted a 'big bang' approach, rather than what is known as the 'salami slice' tactic. The latter, as most incremental reforms show, is too exposed to reversal and political opposition at various stages.

There was great discussion at this conference on capacity and its lack of definition. Certainly the experience of the East Asian tigers shows that institutional capacity and the capacity of the population for development, through a combination of education and health-care, is absolutely essential.

Capacity in terms of policy-formulation and project appraisal is relevant. However, this poses the question of what type of education system is most appropriate. More appropriate educational systems are paramount. Some of the richest men in South Africa and the most successful entrepreneurs failed matric and we need more of them than bureaucrats. Definitely there should be less emphasis on university education and more on vocational training.

Some aspects of globalisation and the (unfortunately termed) 'Washington Consensus' require discussion. Its real origin lay in the Latin American debt crisis in the mid-1980s when a number of Washington economists were asked 'what must Brazil do to come right', and their answer was - as most economists would have it - 'cut deficits, raise interest rates, de-regulate', and so forth. This really does not say much about timing and sequencing, which is very often vital to the debate, particularly over trade policy, especially bearing in mind some of the harsh effects of adjustment to globalisation by tariff reduction, for instance. The 'Washington Consensus' simplifies what is basically a technocratic solution which you cannot get around.

I would also like just briefly, to touch on another aspect of this conference: the role of the state. I was struck by the degree of consensus - call it the 'Johannesburg Consensus' - between Dr. Crocker and Jeremy Cronin on the role of government. What was missed in the discussion was the primacy of the role of prices, and this factor has been indicated in development almost universally. If you are going to subsidise something, recognise this in your economic policy and only do it for a short while. Do not subsidise vested interests. The debate today concerns more the degree to which prices should reflect market reality rather than official edict.

Another aspect is that the role of the state has definitely declined. While the Central Bank is not strictly part of the state - as we all know, it is independent - the role of the state has definitely declined for a number of reasons. It is the information age: the role of technology, business corporations and cross-border flows are all very important. What is the impact on economic policy? It first points to the fact that the state, however much it tries and whatever fiscal deficits it faces, cannot really engineer economic growth for very long. And, secondly, that the bond markets will not wreak their vengeance, because bond markets want to have a state borrowing all the time - it is a place for savings to go and for profits to be made. What is interesting from Dr. Stals' remarks is that the state does not have very precise control over monetary policy. The Reserve Bank has worries about the Euro-Rand market which is concerned essentially with domestic liquidity outside the country which has the potential for rapid monetary expansion - a very serious threat to the economic power of the state.

## 12.3

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### Summary and Conclusions

*Jeffrey Herbst*

There was a slight neo-mercantilist tone to this conference at some points as people seemed to value higher exports much more than cheaper imports - but that is an analytical quirk you will find in most countries. Indeed, the issues identified as important, or as contentious, would be the same if this conference was held in Daros, or Princeton, or Washington or New York. This suggests that the debate has very much been transformed in Africa and many other places from strategies to tactics.

What was particularly important?

First, our predictions have been bad about individual countries over long periods of time. I was struck, for instance, by the number of countries that had been proclaimed 'basket cases' at various points in recent history, only to turn around and have much higher growth rates than the world average. This includes, in no particular order, New Zealand, Korea, Taiwan, Indonesia, Malaysia, Mexico, Chile and Argentina. Although it was not mentioned, a number of countries were at various times reviewed as having very good prospects, but have subsequently declined. This includes the Soviet Union, Sweden and the United Kingdom - although their declines have been in very different trajectories. Over decades the fortunes of countries can change - and change quite dramatically!

The second thread which seemed to be common to the speakers was the tremendous effort which is needed to turn around structural conditions. While these conditions are not necessarily permanent, it requires a seriousness of effort in mobilising an entire society, which should not be underestimated. No issue demonstrates this more than that of South African savings. If you want to raise savings from 16% of GDP to 25% (which is probably what is needed if South Africa is going to have 6% sustainable growth), then you have to find 9% of GDP somewhere. That is equivalent to last year's growth, this year's growth, and next year's growth probably. That is a large part of the economy that has to be redistributed and, more importantly, it is a large part of the economy that is being expended right now, through savings. That is a tremendous sacrifice and it is going to require a huge effort on the part of all concerned.

A number of papers argued that these reforms should be done relatively quickly once they are decided upon. In this, the effort of consultation and the exact decision-making process may vary. Some argued that reforms should be transparent, not underestimating the loss suffered simply by going slowly and allowing distortions and structural conditions to continue; and that while there may be certain benefits to allowing people to adjust slowly, over time, the structural problems continue as long as you go slowly and there is a tremendous loss there.

But how do governments make this tremendous effort to turn around, to increase savings, or to enact these other very difficult reforms? Well, the implication of any number of speakers was: they did not decide, it was forced on them, that it was only consultation with crisis, if you like. That is extraordinarily unfortunate, because if you wait until you hit rock-bottom, as so many countries have found out, or if you wait until you are staring crisis in the face, not only is adjustment that much greater, but inevitably you sacrifice part of your freedom of action to other actors. Here, South Africa's culture of consultation is a double-edged sword. It is potentially of tremendous benefit. Consultation - the almost unprecedented culture of consultation - will enable the understanding of structural problems and potential solutions to them in a way that may be open to few other countries where information between sectors and between populations is not shared as readily.

The problem I see with consultation (and here I disagree with Jonathan) is not with the vested interests around the table, it is with the unvested interests. It is who is *not* at the table. The two groups to be worried about most - who are not vested - are the unemployed and the unborn. Who speaks for the unemployed during debates about industrial policy, during debates about how high your wages should be? The unemployed are affected the most by these debates. But unless they are at the table, unless their interests are taken into account, then full consultation does not occur.

I refer to the 'unborn', because development, they teach us, is in essence no more than an inter-generation transfer. And if that sounds a whole lot like Alexander Haig being quoted by Chester Crocker yesterday, all it really is, is grandparents and parents saving so that their children and grandchildren will be able to spend more, people denying themselves things so that their children and grandchildren will have a lot more. The interest of those future generations has to be taken into account. This is the essence of the government budget debate and other issues.

Now, the final thread that seemed, to me, to be common to many papers is the

role of the state. In the end it seemed that people said the state should do things that make sense:

- \* It should be relatively efficient;
- \* It should act where government has a clear and unambiguous advantage over the private sector. No one suggests, for instance, that the private sector take over primary and secondary education - it is clearly a governmental role;
- \* It should be transparent - one of the things that I find a little jarring about South Africa is that while there is a demand for tremendous transparency on the political side, there is not always a similar demand on the economic side. The cross-subsidisation scheme that was mentioned for Telkom yesterday, is not transparency. It does not say who is paying for who really. The 'Washington Consensus' view of Telkom of course would be that if you want to string lines to Venda or the Transkei or anywhere else, great. But pay for it out of the fiscus and let business phone rates be as inexpensive as possible; and,
- \* There should be an exit strategy. If government is going to intervene and there may be many instances, especially in an economy that has distortions - in my own estimation - when it will intervene, then it must be very sure what it is getting out and what are the criteria. Those criteria should be irrevocable, because inevitably the people who benefit most from government intervention will plead at the very end for just a few more years of protection or subsidy. If a commitment to government intervention is to be made, a commitment to exiting must also be made.

The premium on governments acting well, in the world today, especially South Africa, is exceptionally high. What many other governments did in the past to develop is no longer good enough. The bar has essentially been raised in the international economy. Partially this is because lots of other people are now on the scene. The Koreans and Taiwanese had the international economy to themselves, in a way. They were not facing 40 or 60 or 80 other developing countries who also want to grow through exporting. You are. That is a reality that cannot be changed. It is also a reality that given the structural problems your new South Africa inherits, government policies have to be exceptionally good.

While your endowment in many ways is positive - in the sophisticated industrial and financial sector - in many other ways, your endowment is profoundly worse than the other countries, especially the tremendous inequalities in the society. That means that government intervention and performance cannot be measured

against the norm of the world - or what the developed countries are doing. Those performances may be good enough for the rest of the world or for the developed countries, but they may not be good enough for South Africa, or for other developing countries who also have low per capita incomes and who want to develop. This means that government performance will have to be exceptionally good in the future. It seems to me that a strategy and a set of tactics where every sector of the society is mobilised to the maximum degree to understand the threat (and this is a very real threat), will enable government in conjunction with all the interests - both vested and unvested at the moment - to move forward, with the understanding that absolute performance objectives must be achieved, because the down-side would be quite considerable.

There are tremendous opportunities for the international economy, but they will go to other people unless they are grabbed. It is through discussions like this, where information is shared and where strategies are developed, that South Africa and indeed all other countries can move forward.

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## Glossary

ACP	African, Caribbean and Pacific
AEC	Pan-African Economic Community
AIDS	Auto Immune Deficiency Syndrome
ANC	African National Congress
APEC	Asian-Pacific Economic Co-operation
ASEAN	Association of South-East Asian Nations
BLNS	Botswana, Lesotho, Namibia and Swaziland
CACM	Central American Common Market
CAMCOM	Caribbean Community and Common Market
CARICOM	Caribbean Community
CNN	Cable News Network
COCOM	Western Co-ordinating Committee on Trade with Communist Nations
COMESA	Common Market for Eastern and Southern Africa
COSATU	Congress of South African Trade Unions
DBSA	Development Bank of Southern Africa
DFA	Department of Foreign Affairs
EU	European Union
FDI	Foreign Direct Investment
FRELIMO	Frente de Libertação de Moçambique
FTA	Free Trade Agreement/Area
FTAA	Free Trade Area Agreement (of the Americas)
GATS	General Agreement on Trade in Services
GATT	General Agreement on Tariffs and Trade
GDFI	Gross Domestic Fixed Investment
GDI	Gross Domestic Investment
GDP	Gross Domestic Product
GNP	Gross National Product
GNU	Government of National Unity
GSP	Generalised System of Preferences
HDI	Human Development Index
IDA	International Development Association
IMF	International Monetary Fund
ISI	Import Substitution Industrialisation
LDC	Less Developed Country
Mercosur	Mercado Comúne de Sur



MNC	Multinational Corporation
NAFCOC	National African Chamber of Commerce
NAFTA	North American Free Trade Agreement
NEDLAC	National Economic Development and Labour Council
NGO	Non-Governmental Organisation
NIC	Newly Industrialised Country
NIEO	New International Economic Order
NIEP	National Institute for Economic Policy
OAU	Organisation of African Unity
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
PRI	Institutional Revolutionary Party (of Mexico)
RDP	Reconstruction and Development Programme
SAIIA	South African Institute of International Affairs
SACU	Southern African Customs Union
SADC	Southern African Development Committee
SADCC	Southern African Development Co-ordination Conference
SAFTA	South American Free Trade Area
SAP	Structural Adjustment Programme
SPA	Structural Programme of Assistance
SWAPO	South West African People's Organisation
UDI	Unilateral Declaration of Independence
UK	United Kingdom
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Programme
US	United States
VAT	Value Added Tax
WEF	World Economic Forum
WTO	World Trade Organisation