Alan Hirsch's article on South Africa's poor economic performance since 1994 draws on research condusted with ***Haroon Bhorat*** *and* ***Aalia Cassim****. The following is our summary report of their 2014 paper, "Policy coordination and growth traps in a middle-income country setting: The case of South Africa".*[1]

SOUTH AFRICA'S GROWTH TRAPS

A SUMMARY OF BHORAT, CASSIM & HIRSCH (2014)

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INTRODUCTION

South Africa is currently experiencing grave economic turmoil. The World Bank has cut the country's growth forecast for 2016 to 0.8 percent while the International Monetary Fund's estimate of 0.7 percent is a similarly depressing prediction. This does not bode well for an economy that has failed to realise the ideals of the liberation movement some 22 years into the post-apartheid era.

Current economic statistics paint a grim picture. As of 2014, 47 percent of South Africans remained below the poverty line (US$43 per month). Such poverty exists alongside high inequality, which has been increasing in South African society the post-apartheid era. The country's Gini-coefficient is 0.69, indicating that the local economy generates possibly the most unequal outcomes on the globe. It is now widely accepted that the nature of South Africa's growth path has caused this skewed welfare outcome. In the democratic era, a minority of well-educated and wealthy households have gained relative to the unskilled and uneducated poor majority. Indeed, South Africa's growth path seems to systematically favour the former over the latter as it rewards economic activity that reproduces patterns of inequality inherited from the past.

Haroon Bhorat, Aalia Cassim and Alan Hirsch, in their 2014 study "Policy co-ordination and growth traps in a middle-income country setting: The case of South Africa", attempt to explain South Africa's limp economic performance since 1994, while offering concrete policy solutions for the future. They argue that South Africa exhibits traits of a middle-income growth trap. These include "an over-dependence on natural resource-based foreign exchange for export revenues and short-term growth; a capital intensive path of industrialisation; a consumption- rather than investment-driven growth trajectory; reliance on state infrastructure for domestic growth, or simply a growth path built on sectors that are not employment intensive" (p. 4). The persistence of these leads to a low cycle of growth that many other middle-income countries have found it difficult to escape.

Some key points of the paper are summarised below. These should form the basis on which policymakers engage the urgent task of removing the structural barriers to realising an inclusive, pro-poor economic trajectory in South Africa.

THE STRUCTURE OF THE ECONOMY

Since 1994, South Africa's economic character has been defined by an eroding primary sector and an undiversified, uncompetitive and undynamic manufacturing sector. The country's post-apartheid growth path has been driven by its relatively sophisticated finance sector and

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consumer demand. Between 1994 and 2012, the financial sectors contribution to GDP was some 5 percentage points higher than manufacturing. In the same period, growth was negative for mining (-0.3 percent) and a low 2.2 percent in agriculture.

Ultimately, the ability to achieve an inclusive growth trajectory and raise the living standards of the majority is undermined by the weakness of mining, agriculture and, particularly, manufacturing.

These weaknesses are exacerbated by a relatively low fixed investment and savings rate: sitting at 20 percent, they are significantly lower than other emerging markets. Low investment rates persist despite relatively high real returns to capital (averaging around 15 percent between 1994 and 2008 and the same as China), suggesting that investment aversion is principally due to perceived political risks, structural impediments and low national savings rates. Though it is appropriate to characterise South Africa as a mixed economy, in which both the state and private sector leave significant footprints, investment growth has been driven by the private sector. Private investment has contributed between 65 and 75 percent of total investment while government and public enterprise expenditure has been fairly low since the transition.

Low savings rates have ensured that investment has been financed by running a significant current account deficit of nearly 6 percent. This deficit has been financed, moreover, through unstable and inconsistent portfolio investment. Portfolio investment has averaged close to double the portion of foreign direct investment (FDI) annually in the post-apartheid era. Dependence on such short- to medium-term capital inflows has perpetuated reliance on the resource sector and powerful, publically quoted oligopolies in the services sector; the market power of these companies produces the margins that portfolio investors seek.

GROWTH PATH AND EMPLOYMENT

The structure of the South African economy produces worrying outcomes in growth and employment. Since the transition, employment growth has been less responsive to changes in GDP: a 1 percent increase in GDP has resulted in a 0.69 percent increase in employment. Sectors such as agriculture, manufacturing and transport have indicated a lower capacity to create employment compared to retail, finance and business, and community services. Moreover, because growth has been concentrated in the latter, the economy is structurally biased towards skilled labour. Low-skilled workers, making up the large majority of the unemployed, are not accommodated by patterns of economic growth which reproduce inequality.

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The nature of investment has contributed to the disparities between growth and employment. Between 1990 and 2012, capital investment into labour intensive sectors – such as clothing, electrical machinery and apparatus, textiles, footwear, wood and wood products, television, radio and communication equipment, and furniture – experienced annual decline. By contrast, sectors that experienced increasing annual capital investment within the period include medical and dental services, communication, civil engineering and construction, coal mining and motor vehicles. At the industry level, investment growth in manufacturing and light manufacturing was outweighed by annual growth in community services and finance and business services.

Bhorat et al found that capital-intensive industries attracted far more investment in the period in question. Citing Rodrick (2006), the authors claim that deepening capital results in increased demand for skilled workers, further contributing to the South African economy's structural bias towards the relatively well-off and educated minority. This dynamic is apparent in sectors such as construction, manufacturing, mining and electricity that have increased capital intensity at a rate greater than employment. In the manufacturing sector, annual capital formation was 3.15 percent in the period between 1990 and 2012, while employment growth was less than 1 percent. This points to the increasing mechanisation in sectors that have traditionally been more labour intensive as well the increased investment in heavy manufacturing.

By contrast, employment exceeded growth in capital in finance (6.36 compared to 2.05 percent), community services (3.15 compared to 2.44 percent) and wholesale and retail (3.28 compared to 2.74 percent). Sectors that yield the lowest levels of capital accumulation, such as agriculture, » increased employment by 1 percent annually. Agriculture has the potential to absorb skilled labour, yet it is in decline.

Since the transition, capital investment has not yielded high returns for employment. Sectors which have gained employment on the back of capital investment have either been in the public sector, reinforced the consumption-based growth trajectory of the economy (wholesale and retail trade), or indeed have been labour-outsourcing sectors. Most concerning, manufacturing, which has been the growth engine of many rapidly growing emerging markets, remains unable to convert capital expenditure into high levels of employment.

OBSTACLES TO TRANSFORMATION

It is clear that South African policymakers should prioritise initiatives that would release the economy from the dynamics of a middle-income growth trap. In particular, these initiatives must be targeted to redirect the economy away from a growth trajectory that reproduces inherited patterns of inequality. However, poor policy coordination and rent-seeking remain major obstacles to realising this urgent objective.

Policy coordination

Bhorat et al note that a lack of policy coordination has been a constant feature of the post-apartheid era. Indeed, three different and conflicting economic policy frameworks were by published by different parts of government just two years after the democratic transition: the Reconstruction and Development Plan (RDP) office in the Presidency produced the National Growth Path Framework; the Labour Department's Presidential Labour Marker Commission produced an approach towards a social plan; and the Treasury produced the influential and controversial Growth, Employment and Redistribution strategy (GEAR). From this contradictory and uncertain point of departure, coordination on economic matters deteriorated even further in the years that followed.

Lack of policy coordination has resulted in uneven policy outcomes. For example, the WTO-linked trade liberalisation programme advocated by GEAR forged ahead on the principle of reducing oligopoly power and encouraging diversified investment, while the policy around network industries moved in the opposite direction. Today, electricity provision remains a monopoly of Eskom, a state-owned corporation. Telecommunications provider Telkom, although partially privatised, has had its monopoly over fixed line provision was extended by the state to a five-year period and beyond. This was done on the basis of what Bhorat et al call a "misguided belief that Telkom would follow through on its commitment to the extension of services to unserved customers in poor rural areas, as well as to raise the privatisation sale value of the company" (p. 15).

In terms of industrial policy, the relationship between the department of trade and industry (DTI) and the National Treasury has been defined by unease and distrust. The DTI attempted to push a sector or cluster-based development strategy that would combine various incentives. The Treasury opposed this on the basis that the DTI would be "picking winners" and blocked programme implementation, weakening the relationship between domestic producers and government. Although several studies have shown that the industrial incentives introduced by the DTI in the post-apartheid period had reasonably positive impact, the 1994–2005/6 period saw a steady decline in the overall value of the budget for DTI programmes. The Treasury is renowned for its narrow focus on managing the country's debt. While this is important in its own right, a failure to balance priorities will leave an untransformed economy intact.

Having said this, research into the DTI's impact also points to a lack of coordination between it and other influential government departments. As noted by Bhorat et al, DTI incentives for small businesses have been rendered relatively impotent by a failure to improve the regulatory environment for small businesses. The authors cite a series of reports for the Presidency in 2005 which demonstrated how municipal, labour and other regulations undermined the capacity for growth in the small business sector (p. 15).

Bhorat et al claim that fragmentation is the overriding characteristic of government in South Africa today (p. 17). This is particularly so in economic policy formulation and implementation. For example, even with strong political support for industrialisation, the DTI's annually revised Industrial Policy Action Plan is not received as a strategy to be followed by all arms of government. At the level of policy and rhetoric, calls for industrialisation seem urgent, but the government's ability to implement and monitor programmes is systematically limited. This lack of policy coordination will not make a dent on the skewed structure of South Africa's economy.

Curse of "rent-seeking"

Overall, the authors note that the performance of government has deteriorated quite sharply in recent years. The World Bank governance indicators indeed show a clear decline in the quality of governance in South Africa since 1996. Perhaps the most unfortunate reason for the government's implementation weakness involves the capture of parts of government by special interests. This capture is deeply embedded in structural features of the South African economy that continue to facilitate rent-seeking between key players. Historically, economic policy interests have long been aligned to the mineral-energy complex (MEC), beginning with the cheap labour policies of colonialism and apartheid to today's bias toward ensuring suitable exchange rates for commodity exports such as gold and minerals. Capital within the MEC has historically been highly concentrated and strongly linked to the financial sector, and MEC owners and managers have had a significant influence in economic policy, an influence that they are still able to wield today.

A primary objective of the first democratic government was to reconfigure the economy to deal with this historical legacy. One of the first acts passed was the National Economic Development and Labour (NEDLAC) Act of 1994. It constituted a tri-partite council of government, business and labour to negotiate labour laws, and required potentially binding consultations for economic and social legislation. Policy coordination would, in theory, be pursued through this structure, tasked with providing the necessary checks and balances to prevent the continued domination of the economy by narrow interests.

However, trust between the three social partners collapsed with the introduction of GEAR in 1996 and the failure of the Jobs Summit in 1998. After the weakening of NEDLAC, the corporate sector, government and trade unions settled into an uneasy but relatively stable political economy equilibrium, defined by distribution of high margins, or rents, between them.

This tripartite relationship is constrained within the bounds of labour regulation, competition policy, tax policy and equity considerations. These have not always served to enhance productivity. New firms,


Source: Eric Miller/REUTERS

which could create a more competitive environment and normalise returns, still face high barriers to entry, and serious efforts to engage in thinking through and implementing labour market reform have not been undertaken. Black economic empowerment (BEE) measures have had little redistributive impact, and their emphasis on transferring ownership and control to the political elite has largely excluded low-skilled labour, the unemployed, and those in the informal sector. BEE seems to be the outcome of a pact between the ANC government and previously white-owned firms that were concerned about securing their property rights and influencing economic policy. Indeed, the authors note that 56 ANC officials and politicians can be found on the boards of directors of JSE-listed firms (p. 27). The persistence of rent-seeking and the failure of NEDLAC to achieve its stated objectives have disappointed the prospects of the unemployed and the hopes of those who would like to see rents transferred into higher-productivity and higher-investment growth enhancing actions.

A STRONG STATE BASED ON TRUST

In order to transform its economy to meet the needs and aspirations of its people, Bhorat et al argue, South Africa needs a strong and effective state to lead a process of breaking away from the path-dependant pattern of low value-added exports and oligopolistic market structures with high margins. Such a strong, efficient state is also essential to manage a transition away from a growth trajectory financed by short-term capital flows and dependant on domestic consumption. Finally, the rent-seeking in the South African political economy needs to be eradicated. This can only be achieved if trust is built between business, government and labour. The basis for this trust can only be secured by an efficient, programmatically consistent and coordinated state apparatus. NA

NOTE

1. For citations, please consult the original paper. Bhorat, H, A Cassim and A Hirsch. 2014. Policy co-ordination and growth traps in a middle-income country setting: The case of South Africa. WIDER Working Paper 155/2014. Helsinki: UNU-WIDER. Available at https://www.wider.unu.edu/sites/default/files/wp2014-155.pdf