

## Growth: Can It Be Sustained?

The South African economy appears to have turned the corner with most commentators predicting GDP growth of between 3 % and 3,5 % this year. With headline inflation expected to continue its downward path, averaging around 5 % for the year, the current account deficit ranging between 1 % and 1,5 % of GDP, and the fiscal deficit as low as 2,4 %, South Africans have reason to enter this year with renewed confidence.

Finance Minister Trevor Manuel expects growth of 3,5 % this year – to be followed by 3,4 % next year and 3,2 % in 2002. The latter predictions have no doubt been made on the basis of the Reserve Bank's tried and tested forecasting model. But mathematical models are only as good as the assumptions on which they are based – which are by definition fixed and one-dimensional. It seems therefore worth using the written word to speculate about the conditions necessary to extend the current upswing and enter the "high road" of sustainable economic growth.

The conditions for sustainable growth are many and varied, covering both the global and domestic economies, macroeconomic and structural policy issues, and the broader social environment. We focus here on a few of the more important macroeconomic and structural policy issues.

### Macroeconomic Issues

The first and overriding condition is a *growing world economy* and increased global demand for our exports – one of the critical assumptions in the government's GEAR strategy. The current upswing is largely export-driven with the growth in domestic demand being largely a derivative of the growth in exports. Increased exports give rise to a multiplied increase in domestic incomes, especially wages and profits, which in turn lead to an expansion in both domestic demand and capital investment, i.e. an increase in both demand and supply.

A second condition refers to the *capital account of our balance of payments*. An economic upswing usually goes hand in hand with a growing current account deficit, as imports and net service payments abroad tend to outstrip exports. It is therefore critically important that the latter deficit be offset by a net inflow of capital, including foreign direct investment (FDI). This is indeed what is happening currently. The healthy state of our capital account, albeit due to short term capital inflows, has eased the pressure on the rand and has enabled the Reserve Bank to lower interest rates and improve its net oversold position in the forward market – an important consideration for foreign portfolio investors.

A third and related condition concerns the need for *higher levels of FDI* – not only to close the import-export gap but also – and especially – to help close the investment-savings gap. Domestic savings (comprising personal and company savings net of government dissaving) currently stands at about 15 % of GDP, which is well below the investment ratio required to sustain GDP growth in excess of 3,0 %. The latter growth requires a gross investment ratio of about 20 % of GDP – a ratio which will depend on the quality and composition of that investment, but which is still well below the ratio of 26 % envisaged in the original GEAR programme.

The fact is that we do not save enough to finance the capital investments – new factories, expanded capacity, new machines and equipment – needed to underpin sustained growth. It is largely for this reason that the country needs to supplement its own savings with higher levels of FDI.

Fourthly, higher levels of investment also call for a continuation of the *current macroeconomic policy stance*. Stable economic growth requires a market-oriented monetary and exchange rate

policy – or as Reserve Bank Governor Tito Mboweni recently put it, “...a neutral (policy stance) with a tightening bias”.

Moreover, as the recent Asian crisis clearly demonstrated, financial stability requires an effective and transparent system of bank supervision aimed at instilling confidence among the investor community. South Africa is well advanced along this track with local banking institutions having to adhere to certain predetermined capital adequacy ratios and publicising them on a regular basis.

On the fiscal policy front too, it remains necessary for government to curb and effectively restructure its own spending, reduce the fiscal deficit, and continue with its tax-cutting initiatives of the past few years. Many commentators would agree that fiscal policy has played an important role in helping us to weather the financial storms of 1997 and 1998, and in setting the conditions for the recent economic upswing.

## **Structural Policy Issues**

Turning now to structural policy issues, the present government appears to recognise the need for an *intensified privatisation drive* – not only to boost FDI and improve efficiency, but also to reinforce government’s fiscal policy initiatives. Public Enterprises Minister Jeff Radebe’s promise to accelerate the restructuring and privatisation of the big four parastatals – Telkom, Transnet, Eskom and Denel – will help government to lower the public debt : GDP ratio, cut the cost of debt servicing and the fiscal deficit, and eliminate government dissaving.

Gensec economist Jac Laubscher estimates that if R 100 billion could be raised through privatisation and used to retire government debt, the cost of debt servicing would be cut by R 15 billion – a windfall which could be used either to fight crime and provide additional social services, or to lower the fiscal deficit by a similar amount.

A further structural policy condition refers to our *current trade policy*, in particular the need to continue liberalising our trade relations with the rest of the world. The recently concluded SA-EU Free Trade Agreement – frustrating delays and huge transactions costs notwithstanding – will give local exporters greater access to European markets, lower the costs of imported capital and consumer goods, and make local industries globally more competitive.

Much the same can be said of the proposed SADC Free Trade Agreement, scheduled to kick in by mid-year. According to a recent SA Foundation report, the Agreement is likely to encourage South Africans to import greater quantities from several SADC countries, at least during the first few years of the deal. But this will at least improve what is now a very lop-sided trade balance between the two sub-regions. More importantly, the resultant growth in our neighbouring countries, coupled with higher levels of fixed investment in them, should also increase *their* capacity to import manufactured goods from South Africa.

Yet another structural condition refers to the perennial issue of *labour market flexibility*, or rather the *lack* of it. Although the government has agreed to review certain aspects of the Labour Relations and Basic Conditions of Employment Acts – primarily to remove unintended cost-raising effects on small and medium-sized enterprises – a more fundamental review may well be called for.

At the risk of flogging what seems a local dead horse, it is as well to remind ourselves of the views taken by several international rating agencies. Standard & Poor is yet to grant us an investment rating, while Moody’s has kept us at their lowest investment rating (of BAA3) for some time now, both quoting the inflexible nature of our labour market as one of the primary reasons. As they see it, legal difficulties in the way of hiring and firing workers are partly responsible for our high unemployment rate, which may in turn tempt government to abandon its GEAR programme and adopt a more populist macroeconomic policy stance.

A related structural issue concerns our ability to overcome a serious *skills shortage* – caused by inadequate education and health systems and reinforced by the “drain” of local skills and administrative obstacles in the way of acquiring foreign skills. It takes time to develop an appropriate skills base, and if this is further threatened by a loss of skills to other countries, every effort should be made to facilitate importation of the requisite skills, e.g. by streamlining the current work permit system. It makes no sense to accept foreign capital but not foreign skills, especially when the latter are needed quickly – often instantaneously – during economic upswings.

Ultimately, of course, the solution lies in a better functioning education system, as new Education Minister Kader Asmal fully realises – witness his attempts to tighten discipline at schools and rationalise higher education. Business too is doing its share. The recently launched Business Trust has devoted a large part of its activities to building capacity and improving efficiency at the school and technical college level.

A final (and sufficient) condition refers to the need for an investor-friendly *social environment* – entailing a stable political system and a high degree of personal safety. Our high levels of crime and corruption constitute something of a Catch 22 situation: they tend to scare off investors and tourists and thus undermine our ability to achieve sustainable growth – which is itself a necessary condition for coming to grips with the crime problem. Nonetheless, the recent establishment of a new FBI-style super police unit, together with increased powers given to the Asset Forfeiture Unit in the Investigative Directorate for Serious Economic Offences, would seem to be steps in the right direction.

## **Conclusion**

On the whole, it seems fair to say that many of the conditions for sustainable growth are either already in place – macroeconomic fundamentals, trade liberalisation and an anti-crime strategy – or have at least been recognised by government and become official policy – re-structuring and privatisation of state assets. The present government can take much credit for these achievements, as too can other major stakeholders, including the business community.

But it is important that the momentum thus gained should not be lost – not when the rest of the world is growing rapidly and world investors are showing renewed confidence in the local economy: no one needs reminding that you’re only as good as your last innings – ask the South African cricket captain!

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